

**SAUK RIVER WATERSHED DISTRICT
Stearns County, Minnesota**

MANAGEMENT LETTER

For the Year Ended December 31, 2010

SAUK RIVER WATERSHED DISTRICT

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**REPORT ON MATTERS IDENTIFIED AS A RESULT OF THE
AUDIT OF THE FINANCIAL STATEMENTS**

Board of Managers
Sauk River Watershed District
Sauk Centre, Minnesota

In planning and performing our audit of the financial statements of the Sauk River Watershed District, Sauk Centre, Minnesota, as of and for the year ended December 31, 2010, in accordance with U.S. generally accepted auditing standards and *Government Auditing Standards*, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. Material weaknesses and significant deficiencies identified, if any, are stated within this letter.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

The accompanying memorandum includes recommendations for improvement of accounting procedures and internal control measures that came to our attention as a result of our audit of the financial statements of the District for the year ended December 31, 2010. The matters discussed herein were considered by us during our audit and they do not modify the opinion expressed in our Independent Auditor's Report dated June 9, 2011, on such statements.



This communication is intended solely for the information and use of management and the Board of Managers, others within the District and state oversight agencies and is not intended to be and should not be used by anyone other than these specified parties.

Kern, DeWenter, Viere, Ltd.
KERN, DEWENTER, VIERE, LTD.
St. Cloud, Minnesota
June 9, 2011

SAUK RIVER WATERSHED DISTRICT

MATERIAL WEAKNESSES December 31, 2010

LACK OF SEGREGATION OF ACCOUNTING DUTIES

During the period ended December 31, 2010, the District had a lack of segregation of accounting duties due to a limited number of office employees. In order to have appropriate segregation of accounting duties, the performance of the following duties would need to be completed by a different employee: initiation and authorization of transactions, recording and processing of transactions, reconciliation and reporting of transactions and financial information and custody of assets. This lack of segregation can be demonstrated in the following areas, which is not intended to be an all inclusive list:

- The Office/Finance Manager receipts goods, posts amounts into the finance system, prints and mails the checks and prepares the bank reconciliation. In addition, the Office/Finance Manager is an authorized signer on the District's accounts.
- The Office/Finance Manager handles the cash receipts, posts amounts into the finance system, prepares the deposits, makes the deposits and prepares the bank reconciliation.
- The Office/Finance Manager is responsible for all functions of the payroll process.
- The Office/Finance Manager has access to all areas of the accounting system.
- The Office/Finance Manager prepares and enters journal entries, no supporting documentation is kept and the entries are not reviewed until year-end.

Management is aware of this condition and will take certain steps to compensate for the lack of segregation. However, due to the small accounting staff needed to handle all of the accounting duties, the cost of obtaining desirable segregation of accounting duties can often exceed benefits which could be derived. Due to this reason, management has determined a complete segregation of accounting duties is impractical to correct.

We recommend management, along with the Board of Managers, remain aware of this situation and continually monitor the accounting system including changes that occur.

ENSURE JOURNAL ENTRIES ARE CORRECT

Numerous journal entries that were entered during the year needed to be reversed out at year-end and corrected to ensure that the financial statements were free of misstatement. The District requires documentation be attached to each entry and that each entry is approved; however, a step needs to be taken to ensure that entries are correct. If entries are not correct, this can result in inadequate financial information used in decision making.

We recommend training is done to ensure personnel have adequate knowledge for creating journal entries.

SAUK RIVER WATERSHED DISTRICT

MATERIAL WEAKNESSES

December 31, 2010

PREPARATION OF FINANCIAL STATEMENTS

As a function of the audit process, auditors are required to gain an understanding of the District's internal control, including the financial reporting process.

The District does not have an internal control system designed to provide for the preparation of the financial statements being audited. As auditors, we were requested to draft the financial statements and accompanying Notes to the Financial Statements. This circumstance is not unusual in an organization of your size.

Even though all management decisions related to financial reporting are made by the District's management and approval of the financial statements lies with management, it is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

MATERIAL AUDIT ADJUSTMENTS

During the course of our engagement, we proposed material audit adjustments that would not have been identified as a result of the District's existing internal controls and, therefore, could have resulted in a material misstatement of the District's financial statements.

In order to ensure financial statements were free from material misstatement, an audit adjustment was required in the following area:

- Deferred Revenue and Receivables

RECONCILING SPECIAL ASSESSMENTS

The District currently does not have adequate training for the reconciling of their special assessments. Additionally, some individual land owners were assessed twice for the same project. This resulted in the District either paying those individuals back, or reducing future assessment payments on those properties.

BALANCE CASH TIMELY

During our audit, we noted the District's bank accounts for the year had not been reconciled to the general ledger until November 2010 and were not reviewed until December.

We consider the fact that cash was not reconciled throughout the year to be a material weakness in internal control as the failure to do so can generate incorrect postings and inaccurate accounting records and does not provide current, reliable cash balance information for management and the Board of Managers to base decisions. We recommend cash balances be reconciled to the general ledger on a monthly basis and all variances be investigated.

SAUK RIVER WATERSHED DISTRICT

DEFICIENCIES December 31, 2010

RECONCILE WITHHOLDING ACCOUNTS

During our audit, we noted the payroll withholding accounts on the District's financial records are not reconciled. All payroll withholding accounts should be reconciled on a regular basis to ensure proper withholding amounts are posted to the general ledger and paid.

We recommend the Office/Finance Manager reconcile the payroll withholding accounts monthly to ensure the proper balances are recorded. The monthly reconciliations should be reviewed for accuracy by the District Administrator. The reconciliations should include signature blocks for the preparer and the reviewer.

ESTABLISH A FORMAL CAPITAL ASSET POLICY

During our audit, we noted the District does not have a formal capital asset policy. The purpose of a capital asset policy is for the governing body to give direction to management with respect to recording and depreciating the District's capital assets.

A formal capital asset policy should include:

- The definition or criteria of a capital asset (tangible in nature, extended useful life, cost greater than capitalization threshold).
- A capitalization threshold (includes new purchases and repairs and betterments).
- Clarification on what amounts account for the initial cost of an asset (purchase price, interest capitalized during construction and other).
- What depreciation method to use (straight-line, accelerated or other).
- The depreciable lives for each class of capital assets.
- Procedures to follow for the disposition of capital assets (sales of assets, identifying obsolete and/or idle assets or other).

We recommend the District consider adopting a formal capital asset policy. A formal capital asset policy consistently applied will provide the District with financial statements that are consistent and comparable for future operating periods.

CONSIDER FORMAL DEPOSIT AND INVESTMENT POLICY

The District currently does not have a formal deposit and investment policy in place. Disclosure of the lack of policies was made in the District's financial statements, as required by Governmental Accounting Standards Board (GASB) Statement No. 40.

We recommend the District consider adopting a formal deposit and investment policy to establish guidelines for investing the District's funds. It is also recommended the policy address the risks outlined in GASB Statement No. 40. Those risks include custodial credit risk for deposits, credit risk, concentration of credit risk, interest rate risk, foreign currency risk and custodial credit risk for investments

SAUK RIVER WATERSHED DISTRICT

DEFICIENCIES December 31, 2010

UPDATE THE DISTRICT'S PERSONNEL POLICY

During our audit, we noted the District's personnel policy is outdated.

We recommend the District update its policy to align with current District philosophy. The policy should address whether or not employees are eligible to receive payment for vacation and sick days accrued during their employment if the employment is terminated. It should also clarify the rate at which an employee earns vacation and sick time.

ENSURE APPROVED BUDGETS MATCH THE FINANCIAL SYSTEM

During our review of the budget process, we noted the budgets approved by the Board of Managers did not match the budgets in the system for expenditures. It was further noted, the revenue budget was not entered into the financial system at all.

We recommend revenue and expenditure amounts are included in the minute's documentation and are reflected in the City's software system. This will ensure accurate and timely data is available for decision making.

SAUK RIVER WATERSHED DISTRICT
RECOMMENDATION FOR MANAGEMENT
December 31, 2010

CONSIDER THE IMPLICATIONS OF GASB STATEMENT NO. 54, *FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS*

GASB Statement No. 54 was enacted to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. The initial distinction that is made in reporting fund balance information is identifying amounts that are considered nonspendable, such as fund balance associated with inventories or prepaid expenses. This Statement also provides for additional classification as restricted, committed, assigned and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The restricted fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers or through enabling legislation. The committed fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the assigned fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed, unless that is a negative balance. Unassigned fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts have been restricted, committed or assigned.

Governments are allowed to have stabilization amounts which are formally set aside for use in emergency situations or when revenue shortages or budgetary imbalances arise. These funds must be restricted or committed for a specific purpose and cannot occur routinely.

Governments are required to have a fund balance policy which addresses a reasonable minimum level of unassigned fund balance to be maintained, how the unassigned fund balance can be used or spent down and how that fund balance will be replenished if it falls below the minimum level.

Elimination of the reserved component of fund balance in favor of a restricted classification will enhance the consistency between information reported in the government-wide statements and information in the government fund financial statements and avoid confusion about the relationship between the reserved fund balance and restricted net assets. The Statement is also designed to enhance the usefulness of fund balance information by clarifying the definitions of governmental fund types. For example, special revenue funds are created only to report a revenue source that is restricted or committed to a specified purpose and that revenue source should constitute a substantial portion of the resources reported in the fund. In addition, the definition of the capital project fund type has been clarified to focus on the broader, more consistent understanding of capital outlays and capital activities in today's environment.

This Statement is effective for the year ending December 31, 2011. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented.

SAUK RIVER WATERSHED DISTRICT

REQUIRED COMMUNICATION

December 31, 2010

We have audited the financial statements of the District for the year ended December 31, 2010, and have issued our report dated June 9, 2011. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITY UNDER U.S. GENERALLY ACCEPTED AUDITING STANDARDS, GOVERNMENT AUDITING STANDARDS AND OMB CIRCULAR A-133

As stated in our engagement letter, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit.

We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with U.S. Office of Management and Budget (OMB) *Circular A-133*.

Also, in accordance with OMB *Circular A-133*, we examined, on a test basis, evidence about the District's compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* applicable to its major federal program for the purpose of expressing an opinion on the District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the District's compliance with those requirements.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously communicated to you.

SAUK RIVER WATERSHED DISTRICT

REQUIRED COMMUNICATION

December 31, 2010

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2010. We noted no transactions entered into during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the financial statements was:

Depreciation – The District is currently depreciating its capital assets over their estimated useful lives, as determined by management, using the straight-line method.

We evaluated the key factors and assumptions used to develop the above estimate in determining it is reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no difficulties in dealing with management in performing and completing our audit.

CORRECTED AND UNCORRECTED MISSTATEMENTS

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management did not identify and we did not notify them of any uncorrected financial statement misstatements. A material misstatement relating to deferred revenue and receivables was detected as a result of audit procedures and was corrected by management.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting or auditing matter, whether or not resolved to our satisfaction that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

SAUK RIVER WATERSHED DISTRICT

REQUIRED COMMUNICATION December 31, 2010

MANAGEMENT REPRESENTATIONS

We requested certain representations from management which were provided to us in the management representation letter.

MANAGEMENT CONSULTATIONS WITH OTHER INDEPENDENT ACCOUNTANTS

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. We are not aware of any consultations by the District's management with other accountants during the course of our audit.

OTHER ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

We have not reviewed, and it is our understanding, that no other published documents exist that contain audited financial statement information, for which we are currently auditing. As stated in our engagement letter, if you publish or reproduce the financial statements or make reference to our Firm name in relation to such documents, you agree to provide us with a copy of the final reproduced material for our approval before it is distributed.