

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

MANAGEMENT AND COMPLIANCE REPORT OF THE

CITY OF DULUTH
DULUTH, MINNESOTA

YEAR ENDED DECEMBER 31, 2010

Description of the Office of the State Auditor

The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for approximately 730 public pension funds; and

Tax Increment Financing - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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**CITY OF DULUTH
DULUTH, MINNESOTA**

Year Ended December 31, 2010



Management and Compliance Report

**Audit Practice Division
Office of the State Auditor
State of Minnesota**

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**CITY OF DULUTH
DULUTH, MINNESOTA**

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**CITY OF DULUTH
DULUTH, MINNESOTA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2010**

I. SUMMARY OF AUDITOR'S RESULTS

- A. Our report expresses unqualified opinions on the basic financial statements of the City of Duluth.
- B. Significant deficiencies in internal control were disclosed by the audit of financial statements of the City of Duluth and are reported in the "Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*." None were material weaknesses.
- C. No instances of noncompliance material to the financial statements of the City of Duluth were disclosed during the audit.
- D. A significant deficiency relating to the audit of major federal award programs is reported in the "Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133." It is not a material weakness.
- E. The Auditor's Report on Compliance for the major federal award programs for the City of Duluth expresses an unqualified opinion.
- F. A finding relative to major federal programs for the City of Duluth was reported as required by Section 510(a) of OMB Circular A-133.
- G. The major programs are:
 - Northeastern Minnesota Environmental Infrastructure
Section 569 Program - ARRA CFDA #12.120
 - Homelessness Prevention and Rapid Re-Housing
Program - ARRA CFDA #14.257
 - Edward Byrne Memorial Justice Assistance Grant (JAG)
Program/Grants to States and Territories - ARRA CFDA #16.803

Workforce Investment Act (WIA) Cluster	
WIA Adult Program	CFDA #17.258
WIA Adult Program - ARRA	CFDA #17.258
WIA Youth Activities	CFDA #17.259
WIA Youth Activities - ARRA	CFDA #17.259
WIA Dislocated Workers	CFDA #17.260
WIA Dislocated Workers - ARRA	CFDA #17.260
Highway Planning and Construction Cluster	
Highway Planning and Construction	CFDA #20.205
Highway Planning and Construction - ARRA	CFDA #20.205
Capitalization Grants for Clean Water State Revolving Funds Cluster	
Capitalization Grants for Clean Water State Revolving Funds	CFDA #66.458
Capitalization Grants for Clean Water State Revolving Funds - ARRA	CFDA #66.458
Energy Efficiency and Conservation Block Grant Program (EECBG) - ARRA	CFDA #81.128

H. The threshold for distinguishing between Types A and B programs was \$622,096.

I. The City of Duluth was determined to be a low-risk auditee.

II. FINDINGS RELATED TO FINANCIAL STATEMENTS AUDITED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-5 Departmental Internal Control

The limited number of office personnel within various City departments prevents a proper segregation of the revenue accounting functions necessary to ensure adequate internal accounting control. The revenue accounting functions consist of collecting and recording fines, permits, licenses, utility billings, tourism taxes, and miscellaneous revenues.

Such a situation is not unusual in small departmental operations or where cash collection is decentralized. However, the City's management should constantly be aware that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an accounting point of view.

We recommend that the City administration be aware of the lack of segregation of the accounting functions within City departments and, if possible, implement oversight procedures to ensure that the internal control policies and procedures are being performed by staff. The City should consider centralizing the cash collection functions under the City Treasurer and recording functions under the City Auditor in order to strengthen the internal control over revenue accounting.

Client's Response:

The City is aware that, in some departments, staffing levels prevent an ideal segregation of duties. Mitigating controls are implemented when possible. In addition, the City is reviewing the feasibility of centralizing cash collections and is investigating additional internal controls that can be implemented on a departmental level over revenue accounting functions.

96-10 Accounting Policies and Procedures Manual

The City does not have a current and comprehensive accounting policies and procedures manual. All governments should document their accounting policies and procedures. Although other methods might suffice, this documentation is traditionally in the form of an accounting policies and procedures manual. This manual should document the accounting policies and procedures which make up the City's internal control system.

An accounting policies and procedures manual will enhance employees' understanding of their role and function in the internal control system, establish responsibilities, provide guidance for employees, improve efficiency and consistency of transaction processing, and improve compliance with established policies. It can also help to prevent deterioration of key elements in the City's internal control system and can help to avoid circumvention of City policies.

We recommend the City's Chief Financial Officer update the accounting policies and procedures manual. The accounting policies and procedures manual should be prepared by appropriate levels of management and be approved by the City administration to emphasize its importance and authority. The documentation should describe procedures as they are intended to be performed, indicate which employees are to perform which procedures, and explain the design and purpose of control-related procedures to increase employee understanding and support of controls.

Client's Response:

The Finance Department will develop a policy manual that addresses accounting-related items. Accounting policy and procedures that are incorporated into the City-wide policy and procedure manual will be updated with these new accounting policies.

06-2 Computer Risk Management

The City has internal controls in place for its computer system. However, the City has not developed a formal plan to identify and manage risks associated with its computer system.

Risk management begins with a risk assessment of the City's computer system to identify those risks that could negatively influence computer operations. Internal controls should be implemented to reduce the identified risks. Internal controls implemented should be documented in a well-maintained policies and procedures manual, which should be communicated to the City's staff. Staff adherence to these policies and procedures should be monitored. Because computer systems are ever changing, the City should include in its plan periodic reassessment of risk to ensure existing internal controls are still effective.

We recommend the City administration develop a plan to ensure that internal controls are in place to reduce the risk associated with the City's computer systems.

Client's Response:

The City's MIS staff routinely evaluates risk factors and implements safety features to protect the City's technology systems. In addition, the City is hiring a new CIO. One of his/her first responsibilities will be to formalize additional policies and procedures in accordance with the State of MN OET Enterprise Vulnerability Management Security Standard to ensure internal controls are in place to reduce risk associated with the City's technology systems.

ITEM ARISING THIS YEAR

10-1 Preparation of the Schedule of Expenditures of Federal Awards

The City of Duluth does not prepare a Schedule of Expenditures of Federal Awards (SEFA), nor does it adequately identify federal programs by amount received and expended, federal grantor agency, pass-through agency, and Catalog of Federal Domestic Assistance (CFDA) title and number as required under Office of Management and Budget (OMB) Circular A-133.

This condition results in a weakness in internal control over financial statement preparation and the reporting of federal financial assistance by the City. Because the City has not developed an adequate system for properly identifying all federal financial assistance, the City relies on its auditors for assistance with preparing the SEFA. Independent auditors cannot be considered part of the City's internal control over financial reporting.

The OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations, Auditee Responsibilities*, subpart C § .300, requires, “The auditee shall: (a) identify, in its accounts, all Federal awards received and expended and the Federal programs under which they were received. Federal program and award identification shall include, as applicable, the CFDA title and number, award number and year, name of the Federal agency, and name of the pass-through entity; (d) prepare appropriate financial statements, including the schedule of expenditures of federal awards in accordance with § .310.”

We recommend that City management develop a system and written procedures that will allow staff to adequately accumulate all information needed to be included in the SEFA. This should include, for each federal award, determination of the correct program CFDA title and number, award number and year, federal grantor agency, pass-through agency, amount received and expended, and whether American Recovery and Reinvestment Act funding is involved. The federal CFDA website is available to assist in the process. The City should also reconcile the SEFA amounts to the general ledger and financial statements.

Client’s Response:

The City implemented a Grants Application/Identification Policy in August 2010 that will assist in the preparation of the SEFA. The new policy addresses federal program award identification requirements. Additionally, the City will review its procedures for accumulating information required to be included in the SEFA and will prepare the SEFA for the 2011 audit.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

ITEM ARISING THIS YEAR

10-2 Identification of Federal Awards - Coastal Zone Management Administration Awards (CFDA No. 11.419), Highway Planning and Construction (CFDA No. 20.205), Capitalization Grants for Clean Water State Revolving Funds (CFDA No. 66.458), and Great Lakes Program (CFDA No. 66.469)

The City did not adequately identify amounts received and expended for various federal and state programs in its general ledger. The following errors due to improper classification and identification of federal awards were noted:

- The City classified \$4,561,903 as federal Capitalization Grants for Clean Water State Revolving Funds (CFDA No. 66.458) when it was actually a state grant--Wastewater Infrastructure Funds.

- The City misclassified \$45,000 of federal Coastal Zone Management Administration Awards (CFDA No. 11.419) and \$6,000 of the federal Great Lakes Program (CFDA No. 66.469) as state grants.
- The City received and recognized in 2010 federal Highway Planning and Construction (CFDA No. 20.205) revenue of \$400,000 for project work completed in 2009. The City had not set up a federal receivable at December 31, 2009, nor identified these federal expenditures on the SEFA for 2009.

If the SEFA preparation had been based only on the descriptions provided in the general ledger, the awards and expenditures reported would have been misstated.

OMB Circular A-133, Subpart C, § .300, indicates auditee responsibilities include identification of all federal awards received and expended and the federal programs under which they were received and preparation of the SEFA.

We recommend City management develop a system and written procedures that will allow staff to correctly identify and classify all federal financial assistance received and expended. Procedures should include determination of the correct program CFDA number, revenue source, and program name.

Corrective Action Plan:

Contact Person Responsible for Corrective Action:

Wayne Parson - City Auditor

Action Planned:

The City implemented a Grant Application/Identification Policy in August 2010 that will improve the identification and classification of federal revenues. The new policy includes a required form that identifies program name, funding source, grant contract number, CFDA number, and grant program administrator.

Completion Date:

December 31, 2011

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Late Payment of Claims (08-3)

We recommended the City review the payment process and establish procedures to comply with Minn. Stat. § 471.425. A municipality is required to make payment to a vendor according to terms of contract, or within 35 days of receipt of the invoice or the delivery of the goods or services, whichever is later. The statute also requires a municipality to pay interest on the outstanding balance of a late payment at the rate of 1.5 percent per month or part of a month.

Resolution

We did not note any late payments that violated Minn. Stat. § 471.425 in the current year review of disbursements.

B. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

03-2 Uncollectible Receivables Policy

The City does not have a formal policy addressing the proper procedures and authorization needed to write off uncollectible miscellaneous and billed receivables from the City's accounting records. Uncollectible accounts should be written off only in accordance with applicable legal and policy requirements and be approved by a responsible official who is not associated with the detailed receivable and cash functions.

We recommend the City administration adopt a policy outlining the proper procedures to follow and authorization needed to write off uncollectible accounts.

Client's Response:

The majority of account receivable adjustments occur in our utility billing system which does have formal procedures for write-offs incorporated into the City Code. A policy covering other miscellaneous accounts receivable procedures, including the write-off of uncollectible accounts, will be developed while updating the accounting policies and procedures manual reported as finding 96-10.

Contracts

The City enters into a large number of contracts each year; however, the City does not have formal contract policies and procedures in place. Contract policies provide guidelines for consistency and efficiency in the contracting process as well as requirements for monitoring terms specified in the contracts. Contract policies address when written contracts are needed and the form or content of contracts. A signed contract indicates a mutual agreement of the terms between the parties involved and can serve as an important tool in resolving contract disputes.

We recommend the City Attorney, City Purchasing Agent, and City Auditor work together to develop a formal contract policy. The policy should address when written contracts are required, the form and content of the terms of the agreement, and responsibilities for monitoring contract requirements. The City Purchasing Department and the City Auditor's Office should ensure that, when required, signed contracts are in place before disbursements are made. We recommend all contract noncompliance be reported to the Mayor and City Council.

Client's Response:

The City does have some contract requirements detailed in the City Charter, City Code and in the City Policy & Procedure Manual. Complete written contracting procedures will be developed while updating the accounting policies and procedures manual reported as finding 96-10. In addition, the City has hired a Contract Management and Compliance Administrator who will be responsible for refining the contract process and monitoring compliance with policy.

C. OTHER ITEM FOR CONSIDERATIONGASB Statement 54

The Governmental Accounting Standards Board's (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, is effective for the City of Duluth for the year ending December 31, 2011. The standard's objectives are to enhance the usefulness of fund balance information included in the financial report through clearer fund balance classifications that can be consistently applied and to clarify existing governmental fund type definitions.

Fund Balance Reporting

Statement 54 establishes new fund balance classifications based on constraints imposed on how resources can be spent. The existing components of fund balance are reserved, unreserved-designated, and unreserved-undesignated. Statement 54 replaces these components with nonspendable, restricted, committed, assigned, and unassigned as defined below:

- *Nonspendable* - amounts that cannot be spent because they are either not in spendable form (for example, inventory or prepaid items) or legally or contractually required to be maintained intact (such as the corpus of a permanent fund).
- *Restricted* - amounts that can be spent only for specific purposes stipulated by constitution, external resource providers, or through enabling legislation.
- *Committed* - amounts that can be used only for specific purposes determined by a formal action of a government's highest level of decision-making authority.
- *Assigned* - amounts a government intends to use for a specific purpose that do not meet the criteria to be classified as restricted or committed.
- *Unassigned* - spendable amounts not contained in the other classifications.

The City of Duluth should begin the process for implementing the new fund balance classifications. A key step in successfully implementing the new fund balance requirements is to plan ahead. The City can start with the following steps:

- review the requirements of GASB Statement 54;
- review current fund balances and compare to the new classifications;
- reclassify January 1, 2011, fund balance using the new classifications;
- review/update/prepare a comprehensive fund balance policy;
- prepare appropriate Board resolutions to commit fund balance; and
- if the Mayor and Members of the City Council intend to delegate authority to assign fund balance, prepare the resolutions delegating that authority.

Governmental Fund Type Definitions

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified in the new standard. The new definition for a special revenue fund could have significant impact on the City's current fund classifications.

GASB Statement 54 provides a new and clearer description of when it is appropriate to account for an activity using a special revenue fund. Special revenue funds are used to report specific revenue sources restricted or committed to specified purposes other than debt service and capital projects where the restricted or committed revenue sources comprise a substantial portion of the fund's resources and are expected to continue to do so in the future. The standard does not define substantial portion; however, most recommendations are generally that the restricted or committed revenues should comprise at least 35 to 50 percent of total fund revenues. Under this definition, it is possible that some current special revenue funds will no longer meet the requirements for special revenue fund treatment. The City of Duluth's management should review the City's special revenue funds to ensure these funds continue to warrant treatment as special revenue funds.

The City's management should perform the following steps prior to December 31, 2011:

- prepare a list of the City's special revenue funds;
- determine the sources of revenues for each of those funds;
- identify whether any of those revenues are restricted or committed;
- determine if these restricted or committed revenues represent a substantial portion of the fund's revenues and are expected to continue to be a substantial source of revenues;
 - if yes, the fund may continue to be classified as a special revenue fund;
 - if not, determine whether the City will combine that fund with the general fund or with a similar purpose special revenue fund that meets the new definition;

- code revenues in the general ledger by source constraints--restricted, committed, assigned, or unassigned; and
- determine if there needs to be a restatement of beginning fund balances.

Additional implementation steps could include: informing any component units that they also will need to meet the requirements; deciding on how fund balance will be presented in the financials, for example, detailed vs. aggregate methods; and developing the potential note disclosures. Additional guidance on GASB Statement 54 can be found on the Office of the State Auditor's website at:

http://www.auditor.state.mn.us/other/Statements/fundbalances_postGASB54_1012_statement.pdf.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Honorable Don Ness, Mayor,
and Members of the City Council
City of Duluth, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Duluth as of and for the year ended December 31, 2010, which collectively comprise the City's basic financial statements, and have issued our report thereon dated June 24, 2011. These financial statements include the Spirit Mountain Recreation Area Authority activities for the year ended April 30, 2010. We issue separate management and compliance letters for the Duluth Airport Authority, Duluth Entertainment and Convention Center Authority, Duluth Transit Authority, and Spirit Mountain Recreation Area Authority. The letters for the Duluth Airport Authority and the Duluth Transit Authority include the reports required for a single audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Duluth's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

A deficiency in internal control over financial reporting 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 over financial reporting such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the Schedule of Findings and Questioned Costs as items 96-5, 96-10, 06-2, and 10-1, that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Duluth'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 and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions* contains seven categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our study included all of the listed categories.

The results of our tests indicate that, for the items tested, the City of Duluth complied with the material terms and conditions of applicable legal provisions.

Also included in the Schedule of Findings and Questioned Costs are management practices comments and an other item for consideration. We believe these recommendations and information to be of benefit to the City, and they are reported for that purpose.

The City of Duluth's written responses to the internal control and management practices findings identified in our audit have been included in the Schedule of Findings and Questioned Costs. We did not audit the City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Mayor, the City Council, management, others within the City of Duluth, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

/s/Greg Hierlinger

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STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

June 24, 2011

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REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

The Honorable Don Ness, Mayor,
and Members of the City Council
City of Duluth, Minnesota

Compliance

We have audited the City of Duluth's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010. The City of Duluth's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the City's management. Our responsibility is to express an opinion on the City's compliance based on our audit.

The City of Duluth's basic financial statements include the operations of the Duluth Airport Authority and the Duluth Transit Authority component units, which expended \$6,803,173 and \$5,413,321, respectively, in federal awards during the year ended December 31, 2010, which are not included in the Schedule of Expenditures of Federal Awards. Our audit, described below, did not include the operations of the Duluth Airport Authority and the Duluth Transit Authority because they had separate single audits in accordance with OMB Circular A-133.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Duluth's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City's compliance with those requirements.

In our opinion, the City of Duluth complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2010.

Internal Control Over Compliance

Management of the City of Duluth is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the City's internal control over compliance with requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying Schedule of Findings and Questioned Costs as item 10-2. A significant deficiency in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Duluth as of and for the year ended December 31, 2010, and have issued our report thereon dated June 24, 2011. Our audit was performed for the purpose of forming opinions on the City of Duluth's financial statements that collectively comprise the City's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (SEFA) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. The SEFA is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The SEFA has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the SEFA is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The City of Duluth's corrective action plan to the federal award findings identified in our audit is included in the accompanying Schedule of Findings and Questioned Costs. We did not audit the City's corrective action plan and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Mayor, the City Council, management, and others within the City, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

June 24, 2011

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**CITY OF DULUTH
DULUTH, MINNESOTA**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 2010**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Expenditures
U.S. Department of Agriculture		
Direct		
Cooperative Forestry Assistance	10.664	<u>\$ 8,607</u>
U.S. Department of Commerce		
Passed Through Minnesota Department of Natural Resources		
Coastal Zone Management Administration Awards	11.419	<u>\$ 45,000</u>
U.S. Department of Defense - Army Engineers		
Direct		
Northeastern Minnesota Environmental Infrastructure Section 569 Program - ARRA	12.120	<u>\$ 1,862,892</u>
U.S. Department of Housing and Urban Development		
Direct		
Community Development Block Grants/Entitlement Grants Cluster		
Community Development Block Grants/Entitlement Grants	14.218	\$ 3,944,971
Community Development Block Grants/Entitlement Grants - ARRA	14.253	381,624
Emergency Shelter Grants Program	14.231	131,070
Home Investment Partnerships Program	14.239	747,359
Homelessness Prevention and Rapid Re-Housing Program - ARRA	14.257	527,512
Fair Housing Assistance Program - States and Local	14.401	<u>19,380</u>
Total U.S. Department of Housing and Urban Development		<u>\$ 5,751,916</u>
U.S. Department of Justice		
Direct		
Alcohol, Tobacco, and Firearms Training Assistance	16.012	\$ 19,788
Grants to Encourage Arrest Policies and Enforcement of Protection Orders Program	16.590	218,794
Local Law Enforcement Block Grant	16.592	17,847
Bulletproof Vest Partnership Program	16.607	19,206
Edward Byrne Memorial Justice Assistance Grant Program	16.738	76,403
Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to Units of Local Government - ARRA	16.804	132,534
Edward Byrne Memorial Competitive Grant Program - ARRA	16.808	76,507
Passed Through the City of Chisholm		
Public Safety Partnership and Community Policing Grants	16.710	59,633
Passed Through the City of Virginia		
Public Safety Partnership and Community Policing Grants	16.710	16,708

**CITY OF DULUTH
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**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 2010
(Continued)**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Expenditures
U.S. Department of Justice (Continued)		
Passed Through Minnesota Department of Public Safety Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to States and Territories - ARRA	16.803	157,473
Total U.S. Department of Justice		\$ 794,893
U.S. Department of Labor		
Passed Through Senior Service America, Inc. Senior Community Service Employment Program Cluster Senior Community Service Employment Program	17.235	\$ 319,254
Senior Community Service Employment Program - ARRA	17.235	72,558
Passed Through Minnesota Department of Employment and Economic Development Unemployment Insurance - ARRA	17.225	3,075
Senior Community Service Employment Program Cluster Senior Community Service Employment Program	17.235	113,763
Senior Community Service Employment Program - ARRA	17.235	32,382
Workforce Investment Act (WIA) Cluster WIA Adult Program	17.258	337,561
WIA Adult Program - ARRA	17.258	143,084
WIA Youth Activities	17.259	566,622
WIA Youth Activities - ARRA	17.259	44,372
WIA Dislocated Workers	17.260	279,217
WIA Dislocated Workers - ARRA	17.260	111,812
Total U.S. Department of Labor		\$ 2,023,700
U.S. Department of Transportation		
Passed Through Minnesota Department of Transportation Highway Planning and Construction Cluster Highway Planning and Construction	20.205	\$ 3,125,483
Highway Planning and Construction - ARRA	20.205	4,056,420
Total U.S. Department of Transportation		\$ 7,181,903

**CITY OF DULUTH
DULUTH, MINNESOTA**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 2010
(Continued)**

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number	Expenditures
U.S. Environmental Protection Agency		
Passed Through Minnesota Department of Employment and Economic Development		
Capitalization Grants for Clean Water State Revolving Funds Cluster		
Capitalization Grants for Clean Water State Revolving Funds	66.458	\$ 2,563,100
Capitalization Grants for Clean Water State Revolving Funds - ARRA	66.458	2,667,442
Capitalization Grants for Drinking Water State Revolving Funds	66.468	2,428,858
Passed Through Minnesota Pollution Control Agency		
Nonpoint Source Implementation Grants	66.460	24,829
Great Lakes Program	66.469	<u>6,000</u>
Total U.S. Environmental Protection Agency		\$ <u>7,690,229</u>
U.S. Department of Energy		
Direct		
Energy Efficiency and Conservation Block Grant Program (EECBG) - ARRA	81.128	\$ 267,568
Passed Through Minnesota Department of Commerce		
State Energy Program - ARRA	81.041	<u>75,021</u>
Total U.S. Department of Energy		\$ <u>342,589</u>
U.S. Department of Health and Human Services		
Passed Through Minnesota Department of Employment and Economic Development		
Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Programs - ARRA	93.714	\$ <u>122,507</u>
U.S. Department of Homeland Security		
Direct		
Assistance to Firefighters Grant	97.044	\$ 33,218
Port Security Grant Programs	97.056	170,209
Passed Through Minnesota Department of Public Safety		
Homeland Security Grant Program	97.067	93,838
Passed Through St. Louis County		
Homeland Security Grant Program	97.067	<u>104,300</u>
Total U.S. Department of Homeland Security		\$ <u>401,565</u>
Total Federal Awards		\$ <u>26,225,801</u>

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**CITY OF DULUTH
DULUTH, MINNESOTA**

**NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2010**

1. Reporting Entity

The Schedule of Expenditures of Federal Awards presents the activities of federal award programs expended by the City of Duluth. It does not include \$6,803,173 and \$5,413,321 in federal awards expended by the Duluth Airport Authority and Duluth Transit Authority, respectively, component units of the City, which had separate single audits. The City's reporting entity is defined in Note 1 to the financial statements.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the City of Duluth under programs of the federal government for the year ended December 31, 2010. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of the City of Duluth, it is not intended to and does not present the financial position, changes in net assets, or cash flows of the City of Duluth.

3. Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through grant numbers were not assigned by the pass-through agencies.

**CITY OF DULUTH
DULUTH, MINNESOTA**

4. Reconciliation to Schedule of Intergovernmental Revenue

Federal grant revenue per Schedule of Intergovernmental Revenue	\$	15,396,179
Grants received more than 60 days after year-end, deferred in 2009		
Community Development Block Grants/Entitlement Grants		52,364
Workforce Investment Act - Adult Program		62,160
Workforce Investment Act - Youth Activities		31,427
Highway Planning and Construction		1,563,997
State Energy Program - ARRA		1,063
Port Security Grant Programs		170,209
Deferred in 2009, recognized as revenue in 2010		
Highway Planning and Construction		(551,518)
Nonpoint Source Implementation Grants		(2,210)
Homeland Security Grant Program		(20,162)
Capital grants received in enterprise funds		
Northeastern Minnesota Environmental Infrastructure Section 569 Program - ARRA		1,862,892
Capitalization Grants for Clean Water State Revolving Funds		2,563,100
Capitalization Grants for Clean Water State Revolving Funds - ARRA		2,667,442
Capitalization Grants for Drinking Water State Revolving Funds		2,428,858
		2,428,858
Expenditures Per Schedule of Expenditures of Federal Awards	\$	26,225,801

5. Subrecipients

Of the expenditures presented in the schedule, the City of Duluth provided federal awards to subrecipients as follows:

CFDA Number	Program Name	Amount Provided to Subrecipients
14.218	Community Development Block Grants/Entitlement Grants	\$ 3,291,787
14.253	Community Development Block Grants/Entitlement Grants - ARRA	34,123
14.231	Emergency Shelter Grants Program	127,337
14.239	Home Investment Partnerships Program	696,526
14.257	Homelessness Prevention and Rapid Re-housing Program - ARRA	503,960
16.804	Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to Units of Local Government - ARRA	30,592
81.041	State Energy Program - ARRA	75,021
	Total	\$ 4,759,346

6. American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act of 2009 (ARRA) requires recipients to clearly distinguish ARRA funds from non-ARRA funding. In the schedule, ARRA funds are denoted by the addition of ARRA to the program name.