

June 28, 2013

Honorable Mayor and Members of the City Council  
**City of Lake Elmo, Minnesota**

In planning and performing our audit of the financial statements of the governmental activities and each major fund of the City of Lake Elmo, Minnesota as and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the City of Lake Elmo, Minnesota's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

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. We consider the following deficiencies in the City of Lake Elmo, Minnesota's internal control to be significant deficiencies:

### **Accounting and Financial Reporting**

A City of this size has an inherent limitation in its ability to effectively segregate its accounting duties and to prepare annual full disclosure financial statements in accordance with generally accepted accounting principles. It would not be practical for the City to devote the resources required to overcome this limitation. Management should attempt to segregate duties, however, that are incompatible from an internal control standpoint (e.g. cash receipts, posting to receivables, preparation of deposits, depositing cash to bank, receiving bank statements, reconciling bank accounts, reviewing reconciliations, disbursing cash, etc.) whenever possible. This will prevent any single individual access to control the entire cash process and help reduce the risk of fraud or embezzlement.

### Reconciliations

During our audit, it was noted that the City's investment accounts are not reconciled to the general ledger trial balances. The City pools its cash and investments for all funds and personnel reconcile cash balances in the City's checking account on a monthly basis. The investments held with various financial institutions are not included in this reconciliation, however, which led to differences between the amounts reported by those financial institutions and the amount recorded on the City's trial balances. This condition, if not corrected, could also cause other errors or fraud to go undetected for extended periods of time. We understand management has subsequently implemented a monthly reconciliation procedure to ensure investment accounts are included in the reconciliation of cash and investments reported by the City's custodial financial institutions to the City's trial balances.

In addition to the matters described above and on the previous page, we identified certain opportunities for the City to strengthen internal controls and operating efficiency:

### Utility Billing Software

During the performance of our audit procedures, it was noted that the City's utility billing software currently is not integrated with the City's overall general ledger accounting software. This creates additional work for City staff in that information is required to be manually entered in the general ledger accounting software, requires reconciliation between the two systems and creates duplicate information. Additionally, it increases the possibility that errors will occur and be more difficult to prevent and detect. Management should consider purchasing a utility billing software package that integrates with the City's current accounting software or purchase an accounting software package that incorporates utility billing.

This communication is intended solely for the information and use of management, the City Council, and others within the City, and is not intended to be and should not be used by anyone other than these specified parties.

If we can assist you in addressing these matters please contact us. We acknowledge and appreciate all of the assistance extended to us during our audit.

*Smith, Schafn and Associates, Ltd.*

Maplewood, Minnesota  
June 28, 2013