

MINNESOTA OFFICE OF THE STATE AUDITOR

**MANAGEMENT AND COMPLIANCE
REPORT OF THE
CITY OF DULUTH
DULUTH, MINNESOTA
YEAR ENDED DECEMBER 31, 1997**

**JUDITH H. DUTCHER
STATE AUDITOR**

**CITY OF DULUTH
DULUTH, MINNESOTA**

MANAGEMENT AND COMPLIANCE REPORT

YEAR ENDED DECEMBER 31, 1997

**CITY OF DULUTH
DULUTH, MINNESOTA**

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**CITY OF DULUTH
DULUTH, MINNESOTA**

Schedule 1

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 1997

I. SUMMARY OF AUDITOR'S RESULTS

- A. Our report expresses an unqualified opinion on the general purpose financial statements of the City of Duluth.
- B. Reportable conditions in internal control were disclosed by the audit of financial statements of the City of Duluth and are reported in the "Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*." None are material weaknesses.
- C. No instances of noncompliance material to the financial statements of the City of Duluth were disclosed during the audit.
- D. No matters involving internal control over compliance relating to the audit of the major federal award programs were reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133."
- E. The Auditor's Report on Compliance for the major federal award programs for the City of Duluth expresses an unqualified opinion.
- F. No findings relative to the major federal award programs for the City of Duluth were disclosed during the audit.
- G. The major programs are:
 - Public Safety and Community Policing Grants CFDA #16.710
 - Senior Aids/Senior Employment CFDA #17.235
 - STRIDE CFDA #93.561
 - Airport Improvement Program CFDA #20.106
 - Federal Transit Administration - Section 9 CFDA #20.507

- H. The threshold for distinguishing between Types A and B programs was \$318,743.
- I. The City of Duluth was determined to be a low-risk auditee.

II. FINANCIAL STATEMENT AUDIT--INTERNAL CONTROLS

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-5 Departmental Internal Controls

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 receipting fines, permits, licenses, utility billings, 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's management 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 implemented by staff. The City should consider centralizing the cash collection functions under the City Treasurer in order to strengthen the internal controls over cash receipting.

Client's Response:

The City is aware of the lack of segregation of duties within certain operations due to limited staff and cost benefit considerations.

The City Treasurer's office is in the process of evaluating various internal controls regarding cash collection functions in other areas of the City and may make appropriate changes to address those concerns depending on the results of its review.

96-6 Control Over Library Fines

Inadequate documentation and control over book fines due, billed, waived, and collected at the Duluth Public Library results in poor internal control over cash collections.

We recommend the City Auditor review the controls over collections made at the Duluth Public Library. The City Auditor should establish procedures to ensure that all fines and fees are adequately documented and can be reconciled to appropriate records.

Client's Response:

In 1997, the Library implemented a new computer system that oversees the entire Library automated functions. Included in this system is a financial cash collection module which accounts for library fines by card holders. This new module is in the process of being installed and will be evaluated as far as its ability to address your concerns during 1998.

96-7 Special Assessments

During our review of the special assessment and garbage assessment process, we noted the following internal control weaknesses:

- No reconciliations are performed on garbage assessments between the "Garbage Collection Assessment Forms" reported by haulers, notices to delinquent customers processed by the City Assessor's Office, "Requests for Cancellation of Assessment" collections reported by haulers, and billings processed by the City Assessor's Office.
- City Treasurer's Office personnel collect payments for special assessments and garbage assessments. Several of the same personnel who collect money also have computer access to the assessment records and may make adjustments to these records.
- City Treasurer's Office monthly reconciliations of special assessments and garbage assessments are prepared by an employee who is able to adjust the assessment records. Also, the reconciliations are not independently reviewed by someone else.

With this system and lack of oversight, it is possible for payments to be taken or unauthorized cancellations/abatements to be made with an adjustment to the appropriate assessment record to cover the shortage.

We recommend that:

- Reconciliations be prepared between garbage hauler forms and computer records. These reconciliations should be reviewed and approved by a responsible official or designated employee.
- Monthly assessment reconciliations be reviewed and approved by a responsible official or designated employee.

Client's Response:

We concur with your recommendations and the City Treasurer's office and the City Assessor's office will take appropriate steps necessary to address your concerns prior to next year.

96-8 Sales and Use Tax Collections

The City Treasurer's Office audits, collects, and accounts for sales and use tax. The individual tax accounts are not reviewed by an independent party outside the City Treasurer's Office. The tax collection function should be separate from the auditing and accounting functions.

We recommend the City review the internal controls over the collection of sales and use taxes.

Client's Response:

In conjunction with the previous internal control comment, we will review the internal controls over the collections of sales and use taxes in the Treasurer's office. Although the sales tax collection function is contained within the City Treasurer's office, there are several individuals, as opposed to one individual, who monitor and oversee the operations of that function. As such, there is a limited segregation of duties to this point.

PREVIOUSLY REPORTED ITEM RESOLVED

Fixed Asset Inventory (96-9)

The Water and Gas Department has not performed a physical inventory of its fixed assets.

Resolution

A physical inventory of fixed assets was performed and compared with fixed asset records in the Water and Gas Department in 1997.

III. MAJOR FEDERAL AWARD PROGRAMS--COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Civil Rights (96-4)

The City had a civil rights case filed against it with the U.S. Equal Employment Opportunity Commission. This case involved federal funds and was reported to comply with federal grant requirements.

Resolution

New single audit requirements no longer require this to be reported in the management letter.

OTHER FINDINGS AND RECOMMENDATIONS

IV. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-1 Donations/Gifts

The Mayor and City Council continue to "gift" public funds to various charities and civic organizations even though such expenditures are not permitted by law. During 1997, the City of Duluth donated public funds and sponsored programs totaling approximately \$18,000.

Schedule 1
(Continued)

The Minnesota Attorney General has consistently held that public funds cannot be "gifted" away by public officials. In Op. Atty. Gen. 59-a-3, July 26, 1946, the Attorney General held that the City of Owatonna could not donate funds to the Owatonna Chamber of Commerce. In Op. Atty. Gen. September 28, 1933, the Attorney General held that the City of Anoka could not give public funds to the Boy Scouts. In Op. Atty. Gen. 442a-17, January 17, 1938, it was held that the City of Hutchinson could not donate tax money to the Red Cross. The Cities of Owatonna, Anoka, and Hutchinson, like Duluth, are home rule charter cities.

The Minnesota Attorney General's opinions have been totally consistent with law across this country. In *McQuillin Municipal Corporations*, Section 39.19, the law is stated as follows:

A fortiori, a municipality has no power, unless expressly conferred by constitutional provision, charter or statute, to donate municipal moneys for private uses to any individual or company, not under the control of the city and having no connection with it. . . .

In Op. Atty. Gen. 159b-10, March 1, 1966, the Attorney General held that a school district may contract and pay for the services rendered by a nonprofit corporation, but may not, in the absence of statutory authority, become a member thereof and obligate itself to pay annual dues.

We noted payments to organizations which may, in fact, represent situations in which the City is receiving consideration in exchange for the funds it pays to the organizations involved. However, no written contracts exist indicating that the involved organizations are performing specific services for, or on behalf of, the City, nor are there any reports as to the use of these funds made to the City by these organizations.

We again recommend that the City of Duluth stop donating public funds or seek express authority to make such expenditures by amending its Charter. With regard to donations to organizations which provide City services, we recommend that the City enter into written contracts with the involved entities documenting what services these entities are performing for the City and providing for accountability to the City for funds received.

Client's Response:

Although not specific, the City believes that the "all powers" provision of the Charter authorizes it and the Council to gift certain groups where a governmental purpose may be served. The City uses a test such that the gift serves a legitimate civic objective, and by that gift no private party or individual benefits or profits and finally that the purpose is for the good of the City and its programs as a whole. The City Attorney's Office now uses a contract to provide accountability for services as appropriate.

Auditor's Reply:

The City's reliance on the "all powers" clause of the Duluth City Charter as authority to make gifts of tax money to private entities is misplaced. The charters of the Cities of Anoka, Hutchinson, and Owatonna all contain "all powers" clauses which are at least as broad as the language found in the Duluth Charter. Yet, despite this, in each of the Opinions cited in this comment, the Attorney General found that no authority existed for these cities to "gift" tax money to private persons or entities.

96-2 City Council Proceedings

The August 1997 City Council proceedings were given to the State Auditor's Office on March 17, 1998. The latest proceedings approved by the City Council as of that date were for the February 1997 meetings. Minn. Stat. § 471.705 requires that the proceedings contain a record of how the City Council voted on any action taken. Because of the lateness in preparing and approving the proceedings, it is questionable whether the proceedings are receiving a proper review and approval for accuracy by the City Council.

We recommend the City Council proceedings be prepared and presented to the City Council for approval on a more timely basis.

Client's Response:

The City finds no violation of any statute relating to a time limit on published minutes of the City Council proceedings. However, the City is interested in reducing the time period between council action and minute approval, and will work towards that goal. As you are aware, we have made recent progress in this area.

96-3 Service Club Memberships

The City has a policy which encourages management team members to belong to service clubs in an effort to communicate to service club members the activities, positions, and programs of the City. The City pays the employees' membership dues and related expenses.

Minn. Stat. § 471.96 states, in part, that the governing bodies of cities are authorized to appropriate necessary funds to provide membership of their respective municipality in county, regional, state, and national associations of a civic, educational, or governmental nature which have as their purpose the betterment and improvement of municipal governmental operations. Cities are also authorized to participate through duly designated representatives.

Without a specific authority from state law or charter provisions, memberships to associations which do not have as their purpose the betterment and improvement of municipal governmental operations are not allowed.

We recommend the City discontinue these memberships or pursue special legislation to provide authority for the memberships.

Client's Response:

With emphasis on its service club membership policy, the City feels that by supporting its management teams membership in these civic organizations, it has a unique mechanism to communicate its activities, positions, and programs to members of Duluth's business community which it feels provides an improved municipal governmental operation and believes that by doing so, meets the intent of existing laws.

V. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

96-10 Policies and Procedures Manual

The City should update the accounting policies and procedures manual to cover current financial operations. Existing policies and procedures should be updated and new policies and procedures written for current accounting systems.

A manual helps to prevent the deterioration of key elements in the City's internal control structure. A manual can often help to avoid circumvention of City policy. It provides assistance in training new personnel and provides a source of reference for current personnel.

We recommend the City update the accounting policies and procedures manual covering the current financial operations.

Client's Response:

The City Auditor's office is working, as time permits, to update the accounting Policies and Procedures Manual to address current financial operations as they change.

96-12 Group Health Internal Service Fund

The Group Health Internal Service Fund had deficit retained earnings of \$452,205, \$1,408,567, and \$866,579 for the years ended December 31, 1995, 1996, and 1997, respectively. Governmental Accounting Standards Board Statement 10 provides the accounting standards for employee health benefits paid from an internal service fund. Paragraph 67 of the statement states that deficits do not need to be charged back to other funds in any one year, as long as adjustments are made over a reasonable period of time. The City's plan is to reduce the deficit with an increase in premiums as provided by the employee bargaining agreements.

We recommend the City closely monitor the Group Health Internal Service Fund to ensure that the deficit retained earnings keep being reduced.

Client's Response:

In accordance with the formula found in all City employee labor agreements, the Group Health Fund deficits for the previous year are incorporated into the premium rate calculation for the subsequent year. For the deficit retained earnings in question for the years 1995 and 1996, those were incorporated in to the premium rate adjustments, as will be the \$866,579 deficit for 1997, which will be calculated in to the rates for 1998. Currently, this is the only way that the Group Health Fund deficit can be incorporated into the premium rates. By this methodology, the deficit decreased by \$541,988 during the year ended 1997.

The City, and its various labor unions, have incorporated a Labor Management Insurance Committee which oversees the Group Health Fund. This committee meets on a monthly basis to monitor the results and claims activity of the fund to determine what actions or steps can be taken to improve its financial condition. The committee is aware of the increasing deficit condition.

ITEMS ARISING THIS YEAR

97-1 Grant Receivables

A \$50,000 Mighty Ducks ice arena grant receivable from the state has been reported in the Special Projects Special Revenue Fund for over a year. The City has not filed the necessary grant paperwork in order to receive the grant funds.

At December 31, 1997, the Community Development Special Revenue Fund had borrowed \$429,311 from the General Fund for cash flow purposes. The need to borrow the cash was caused in part by 1996 expenditures of \$243,933 and 1997 expenditures of \$101,690 not being submitted for federal grant reimbursement on a timely basis. Failure to draw down funds in a timely manner requires the City to use its own funds for a longer period. This results in less City funds available to invest.

We recommend the City seek grant reimbursement as quickly as possible to maximize positive cash flow and increase earnings on City investments.

Client's Response:

With regard to the \$50,000 Mighty Ducks grant, paperwork has been filed with the state and we are awaiting reimbursement. With regard to the Community Development Special Revenue Fund cash flow problems, the City draws down the cash reimbursement for this fund via HUD IDIS system. Conversion to the HUD IDIS system of drawing funds took a tremendous amount of time and effort in 1997.

HUD brought the system on line before it was ready. It had, and continues to have, a significant amount of problems. The amount of work associated with the conversion, as well as HUD's conversion method for pre-1997 items, made it very difficult to access funds from previous years. IDIS continues to be revised and these revisions have made it easier to use, in fact all of the receivables mentioned in the comment have been drawn.

97-2 Zoo Operations

The City has accounted for the zoo's operation as an enterprise fund since 1993. Enterprise funds, by definition, are operations where the governing body intends for the costs (expenses, including depreciation) to be financed or recovered primarily through user charges.

With the new zoo facilities, it was anticipated that the zoo's revenues would be sufficient to cover its operating costs. Therefore, accounting for the zoo as an enterprise fund seemed proper. However, zoo revenues have not covered costs, requiring the City to contribute over \$800,000 per year towards its operation. Also, approximately \$300,000 of the City's cost allocation plan was not recovered by the zoo operation. The City has not funded the zoo's depreciation causing its retained earnings deficit to increase each year.

The zoo operation is not currently meeting the enterprise fund definition as costs are not recovered primarily through user charges.

We recommend the City review the operation to determine if the zoo should be self-supporting and how that would happen. If the City decides the zoo should continue to operate mainly from City support, the operation should be accounted for in some other manner such as a special revenue fund.

Client's Response:

We agree with your recommendations regarding the Zoo's operations and will be transferring the accounting function for the Zoo to a special revenue fund sometime in 1998.

97-3 Duluth Transit Authority Tax Levy

The City levies a tax for the Duluth Transit Authority's operation, promotion, maintenance, or betterment as authorized by Minn. Stat. § 458A.31. The tax levy is deposited into the City's Transit Support Special Revenue Fund. The City makes operating transfers from this fund to the Authority. An additional amount is transferred to fund the debt service requirements of City-issued transit bonds. Transit bond proceeds were used to finance local match requirements of transit capital grants.

The Authority's 1997 budget, as approved by City Council resolution, authorized a transfer of \$108,000 to the City's Transit Bond Debt Service Fund. However, the actual transfer made by the City to the Transit Bond Debt Service Fund was \$201,200. The \$201,200 transfer was based on the amount reported for the Transit Support Special Revenue Fund in the City's 1997 annual budget book. The City Council ordinance establishing the City's 1997 budget does not address the Transit Support Special Revenue Fund.

We recommend the City review the use of the tax levy with the Authority as authorized by Minn. Stat. § 458A.31. The City's budget and the Authority's budget should agree as to the amount of the annual transfer to the Transit Bond Debt Service Fund as authorized by the City Council.

Client's Response:

The City and the DTA have initiated a procedure whereby each of their budgets will be reconciled so as to agree to the amount of the annual transfer of the Transit Bond Debt Service Fund, as authorized by the City Council.

Problems which resulted from the previous transfer shortfall will be addressed in the near future, so as not to disrupt the Transit Authority's operations.

PREVIOUSLY REPORTED ITEMS RESOLVED

Community Investment Trust Fund (96-11)

We recommended the City reimburse the General Fund for actual administrative costs incurred in administering the agreement.

Resolution

The General Fund was reimbursed only for actual administrative costs.

Duluth Convention and Visitors Bureau (96-13)

We recommended the City develop procedures to ensure that the Bureau is reimbursed only for costs according to the City-approved marketing plan.

Resolution

The City approved Resolution 97-0544R which provided the Bureau with additional funding for cash flow purposes. It appeared that the Bureau's financial condition improved during 1997. However, the City should continue to monitor the Bureau's financial condition.

VI. OTHER ITEMS FOR CONSIDERATION

Post-Employment Health Care Benefits

The City provides post-employment health care benefits to retirees in accordance with the various union contracts. Expenses for health care benefits are recognized as reported claims when paid and include a provision for estimated claims incurred but not yet reported to the City. The City does not report, nor do generally accepted accounting principles require the reporting of, a liability when the benefit is earned.

During the year, expenses of \$1,961,197 for these health care benefits were recognized. This is a 241 percent increase from the 1989 expenses of \$574,578 and a \$71,421 increase from the 1996 expenses. We believe the City's expense will continue to increase rapidly because of an increasing number of retirees using this benefit, increasing medical costs, and possible decreasing Medicare coverage.

We recommend the City obtain the services of an actuarial firm to determine the long-term obligation for future retirees' health benefits. We believe this unrecorded liability to be material to the City's financial statements. In addition to the present method of recognizing expenses, the City should monitor this unrecognized liability when the benefits are earned by employees.

Recording Investments and Related Gains and Losses

The Governmental Accounting Standards Board has issued Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This statement requires governmental entities to report investments at fair value in their balance sheet. Fair value is the amount at which an investment could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Fair value is readily determinable if prices or quotations are available on an exchange registered with the U.S. Securities and Exchange Commission or are publicly reported over-the-counter market prices.

All investment income, including changes in the fair value of investments, should be recorded as revenue in the operating statements. Investment income assigned to another fund for other than legal or contractual provisions, for example, management decision, should be recognized in the fund that reports the investments. The transfer of that income to the recipient fund should be reported as an operating transfer.

The notes to the financial statements should disclose: (a) the methods and significant assumptions used to estimate the fair value of investments if that fair value is based on other than quoted market prices, and (b) the policy for determining which investments are reported at amortized cost. This statement is effective for the year ended December 31, 1998.



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

Mayor and City Council
City of Duluth

We have audited the financial statements of the City of Duluth as of and for the year ended December 31, 1997, and have issued our report thereon dated May 15, 1998. These financial statements include the Spirit Mountain Recreation Area Authority activities for the year ended April 30, 1997. We did not audit the financial statements of Steam District #2 Public Utility Enterprise Fund, which statements represent 17 percent of the assets and 17 percent of operating revenues of the enterprise fund type. Those financial statements were audited by other auditors. Separate management and compliance letters have been issued for the Duluth Airport Authority, the Duluth Economic Development Authority, the Duluth State Convention Center Administrative Board, the Duluth Steam District #2, the Duluth Transit Authority, and the Spirit Mountain Recreation Area Authority. The letters for the Duluth Airport Authority and the Duluth Transit Authority included the reports required for a single audit.

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

Compliance

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 grants, noncompliance with which could have a direct and material effect on the

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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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items 96-5, 96-6, 96-7, and 96-8.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions indicated above is a material weakness.

We also noted other matters involving the internal control over financial reporting that we have reported to management of the City of Duluth in a separate letter dated May 15, 1998.

Minnesota Legal Compliance

We conducted our audit in accordance with generally accepted auditing standards and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the Legal Compliance Task Force 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 Local Government* contains five main categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, and claims and disbursements. Our study did not include the claims and disbursements section because it is not applicable to cities of the first class.

The results of our tests indicate that for the items tested, the City complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Questioned Costs as items 96-1, 96-2, and 96-3. Further, for the items not tested, based on our audit and the procedures referred to above, nothing came to our attention to indicate that the City had not complied with such legal provisions.

This report is intended for the information of the City's management, the Mayor, the City Council, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



JUDITH H. DUTCHER
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GREG HIERLINGER, CPA
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May 15, 1998



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JUDITH H. DUTCHER
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**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Mayor and City Council
City of Duluth

Compliance

We have audited the compliance of the City of Duluth with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended December 31, 1997. The City'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.

We conducted our audit of compliance in accordance with generally accepted auditing standards; 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 audits 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'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 on the City's compliance with those requirements.



The City's general purpose financial statements include the operations of the Duluth Transit Authority and the Duluth Airport Authority, both component units of the City of Duluth. The federal awards received by these two component units are included in the City's Schedule of Expenditures of Federal Awards for the year ended December 31, 1997. Our Schedule of Findings and Questioned Costs, however, did not include findings or questioned costs from these two component units because they had separate reports for their single audits.

In our opinion, the City of Duluth complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 1997.

Internal Control Over Compliance

The 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 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 OMB Circular A-133.

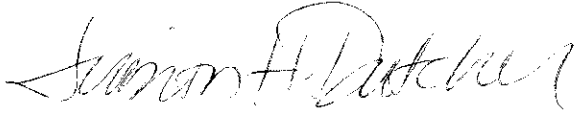
Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the general purpose financial statements of the City of Duluth as of and for the year ended December 31, 1997, and have issued our report thereon dated May 15, 1998. Our audit was performed for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the general

purpose financial statements. Such information has been subjected to the auditing procedures applied in the audit of the general purpose financial statements and, in our opinion, is fairly stated in all material respects in relation to the general purpose financial statements taken as whole.

This report is intended for the information of the City's management, the Mayor, the City Council, and federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.



JUDITH H. DUTCHER
STATE AUDITOR



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DEPUTY STATE AUDITOR

May 15, 1998

**CITY OF DULUTH
DULUTH, MINNESOTA**

**Schedule 2
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 1997**

Federal Grantor Pass Through Agency Grant Program Title	Federal CFDA Number	Expenditures	Passed Through to Subrecipients
Department of Agriculture			
Passed Through St. Louis County Food Stamp Employment and Training Services	10.561	\$ 103,550	\$ -
Department of Commerce			
Direct Economic Development Grant - Airbus Facility	11.300	\$ 37,076	\$ -
Department of Housing and Urban Development			
Direct			
Community Development Block Grant 1992	14.218	\$ 32,924	\$ 23,344
1996	14.218	1,858,286	1,317,547
1997	14.218	1,452,472	1,029,820
Passed Through St. Louis County			
Community Development Block Grant 1993	14.218	77,286	54,797
1994	14.218	402,840	285,618
1995	14.218	212,647	150,769
Direct			
Emergency Shelter Grant 1997	14.231	38,437	38,437
Passed Through St. Louis County			
Emergency Shelter Grant 1996	14.231	41,359	41,359
Direct			
Home Investment Partnerships Program 1993	14.239	9,566	7,783
1996	14.239	351,980	286,383
1997	14.239	139,547	113,540
Passed Through St. Louis County			
Home Investment Partnerships Program 1994	14.239	42,094	34,249
1995	14.239	72,646	59,107
Passed Through Minnesota Housing Finance Agency			
Lead Based Paint Abatement	14.900	15,371	15,371
Total Department of Housing and Urban Development		\$ 4,747,455	\$ 3,458,124

**CITY OF DULUTH
DULUTH, MINNESOTA**

**Schedule 2
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 1997**

Federal Grantor Pass Through Agency Grant Program Title	Federal CFDA Number	Expenditures	Passed Through to Subrecipients
Department of Justice			
Passed Through Minnesota Department of Public Safety			
Narcotics Control Assistance Grants			
Greater Minnesota Triad Grant	16.579	\$ 19,826	\$ -
Middle School Liaison Grant	16.579	31,971	-
Passed Through Minnesota Department of Corrections			
Violence Against Women Act	16.588	27,134	-
Direct			
Public Safety and Community Policing Grants			
Equipment Block Grant	16.592	78,373	-
Weed and Seed Grant	16.595	40,590	-
COPS Ahead Grant	16.710	212,500	-
Community Policing to Combat Domestic Violence Grant	16.710	<u>124,615</u>	<u>-</u>
Total Department of Justice		\$ 535,009	\$ -
Department of Labor			
Direct			
Senior Aides Program	17.235	\$ 223,053	\$ -
Passed Through Minnesota Department of Economic Security			
State Senior Employment Program			
5% Incentive Grant	17.250	95,544	-
Title IIA Grant	17.250	4,179	-
Title IIB Grant	17.250	188,513	-
Title IIB Grant	17.250	246,617	-
Title IIC Grant	17.250	18,057	-
5% Older Worker	17.250	8,466	-
5% Capacity Building	17.250	6,936	-
Passed Through Minnesota Department of Children, Families and Learning			
8% Education Coordination	17.250	5,560	-
Passed Through Minnesota Department of Economic Security			
Women's Special Employment Assistance	17.700	<u>6,231</u>	<u>-</u>
Total Department of Labor		\$ 803,156	\$ -

**CITY OF DULUTH
DULUTH, MINNESOTA**

**Schedule 2
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 1997**

Federal Grantor Pass Through Agency Grant Program Title	Federal CFDA Number	Expenditures	Passed Through to Subrecipients
Federal Aviation Administration			
Passed Through Minnesota Department of Transportation - Aeronautics Division Airport Improvement Program	20.106	\$ 526,471	\$ -
Department of Transportation			
Passed Through Minnesota Department of Transportation Highway Planning and Construction 69-634-11	20.205	\$ 71,648	\$ -
Highway Planning and Construction 118-142-06	20.205	6,542	-
Highway Planning and Construction 118-142-07	20.205	18,742	-
Highway Planning and Construction 118-151-09	20.205	403,991	-
Highway Planning and Construction 118-152-11	20.205	26,291	-
Highway Planning and Construction 118-157-18	20.205	74,055	-
Highway Planning and Construction 118-160-14	20.205	16,137	-
Highway Planning and Construction 118-179-01	20.205	234,716	-
Direct			
Federal Transit Capital and Operating Assistance	20.507	2,408,039	-
Passed Through Minnesota Department of Transportation Federal Transit Administration - Section 9	20.509	1,853	-
Total Department of Transportation		\$ 3,262,014	\$ -
Federal Emergency Management Agency			
Passed Through Minnesota Department of Public Safety Flood Disaster Assistance	83.516	\$ 10,525	\$ -
Passed Through St. Louis County Emergency Management Assistance	80.534	8,054	-
Total Federal Emergency Management Agency		\$ 18,579	\$ -
Department of Health and Human Services			
Passed Through Arrowhead Regional Development Commission Senior Nutrition Program	93.045	\$ 189,637	\$ -
Passed Through St. Louis County Success Through Reaching Individual Development and Employment (STRIDE) Grant	93.561	358,819	-
Total Department of Health and Human Services		\$ 548,456	\$ -

**CITY OF DULUTH
DULUTH, MINNESOTA**

**Schedule 2
(Continued)**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 1997**

Federal Grantor Pass Through Agency Grant Program Title	Federal CFDA Number	Expenditures	Passed Through to Subrecipients
Corporation for National and Community Service			
Passed Through Minnesota Department of Economic Security Americorps	94.006	<u>\$ 23,094</u>	<u>\$ -</u>
Department of Defense - National Guard Bureau			
Cooperative Agreement	Unknown	<u>\$ 19,912</u>	<u>\$ -</u>
Total Federal Awards		<u><u>\$ 10,624,772</u></u>	<u><u>\$ 3,458,124</u></u>

Notes to the Schedule of Expenditures of Federal Awards

1. The Schedule of Expenditures of Federal Awards presents the activity of federal award programs expended by the City of Duluth. The City's reporting entity is defined in Note 1 to the general purpose financial statements.
2. The expenditures on this schedule are on the accrual and modified accrual bases of accounting, which are described in Note 1 to the general purpose financial statements.