

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, 2006

Description of the Office of the State Auditor

The mission of the State Auditor's Office 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, 2006



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 1

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2006**

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*." One of the significant deficiencies is a material weakness.
- 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 were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.
- G. The major programs are:
- | | |
|-----------------------------------|--------------|
| Community Development Block Grant | CFDA #14.218 |
| Highway Planning and Construction | CFDA #20.205 |
- H. The threshold for distinguishing between Types A and B programs was \$300,000.
- 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 may prevent an ideal segregation of duties. Mitigating controls are implemented when feasible. The City is planning on implementing a new software module that will allow us to integrate departmental cash collection reporting with the City Treasurer's Office and the general ledger.

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 Finance Director 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 City has a formal policy and procedure manual that encompasses accounting related items. The City Auditor's Office will work, as time permits, on updating accounting related items within the existing manual.

ITEMS ARISING THIS YEAR

06-1 Audit Adjustments

A control deficiency 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 misstatements of the financial statements on a timely basis. Statement on Auditing Standards (SAS) 112 states that deficiencies in controls over the period-end financial reporting process, including controls over procedures used to enter transactions and journal entries into the general ledger and to record recurring and

nonrecurring adjustments to the financial statements, are ordinarily at least significant deficiencies. SAS 112 also states that one control deficiency that should be regarded as at least a significant deficiency, and a strong indicator of a material weakness in internal control, is identification by the auditor of a material misstatement in the financial statements that was not initially identified by the entity's internal controls even if management subsequently corrects the misstatement.

During our audit, we identified material adjustments to the City's financial statements. The City made the adjustments which resulted from the need to recognize revenues, establish loans receivables, and reclassify revenues.

We recommend the City Auditor review the internal controls over financial reporting to improve the detection of misstatements in the financial statements. The controls should include a thorough review of the financial statements prior to the statements being audited.

Client's Response:

The procedures for financial statement preparation will be reviewed. Current staffing levels, together with a six-month deadline for financial statement submission, impacts the time available for final review prior to submitting the financial statements for audit. The timeline for financial statement preparation has not changed over the past 30 years even though GASB has issued a multitude of new accounting standards that have significantly increased both the complexity of, and the time required to prepare, financial statements. Due to these constraints, a limited number of audit adjustments may be unavoidable.

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. Staffs' 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 computerized systems. A formal plan will be developed, as time permits, addressing risks that could impact the City's computer system and operations.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Section 108 Loan Guarantees - Cash Management (CFDA #14.248) (05-1)

The City Treasurer did not establish a separate bank account and invest funds as required by HUD.

Resolution

Funds were properly accounted for and invested during the current audit.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM RESOLVED

Collateral Pledged to Secure Deposits (05-2)

Deposits at one bank exceeded collateral by \$74,637 at December 31, 2005.

Resolution

Collateral exceeded deposits at December 31, 2006.

B. MANAGEMENT PRACTICES

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

01-6 Premium Hours

Our review of the premium hours report for the year ended December 31, 2006, indicates that City employees accrued a total of 125,211 overtime and compensatory time hours worth approximately \$3,306,000. This is an increase of 2,297 hours from the prior year. Seventy-three employees earned in excess of 400 premium hours; four of these employees earned in excess of 1,000 premium hours.

Following is a breakdown by department of the 73 employees:

Public Works and Utilities	44 employees
Fire Department	21 employees
Police Department	7 employees
Administrative Services	1 employee

The City limits the number of full-time employees for each department during the budget process. Department managers may be using premium hours in order to stay within these authorized limits. In addition, the City has limited the hiring of new staff. The City relies on the employees' supervisors to determine that hours compensated were necessary and were actually worked.

We recommend the City Administration and City Council carefully review the necessity of the premium hours compensated and consider the cost of premium hours versus additional staffing.

Client's Response:

The City continues to monitor the use of premium hours in all City Departments. Premium hours are often the result of having to fill shifts to meet minimum staffing requirements. The Administration believes the use of premium hours is less expensive than hiring additional employees, especially after considering the liability incurred for other post-employment benefits. The City Auditor will investigate the circumstances regarding employees earning in excess of 1000 premium hours.

01-7 Special Assessment Debt Service Fund

The Special Assessment Debt Service Fund had a negative cash balance of \$1,163,781 after the February 1, 2006, principal and interest payments and remained negative through much of the year. The negative balance is caused by abatements, certification withdrawals, and bond costs not being funded by the City.

An analysis of future collections based on the December 31, 2006, outstanding assessment balance and projects yet to be assessed estimated a shortfall of approximately \$1,700,000 when compared to future debt service requirements. The analysis indicated that parcel owners prepay a substantial amount of assessments. The prepayment of assessments lowers the interest earnings on future assessment collections. Prepayment does allow the City to invest the collections and earn interest that offsets the loss of future assessment interest earnings. However, the interest earnings are not allocated specifically to the Special Assessment Debt Service Fund. Interest earnings are allocated among City funds based on each fund's cash balance. Because the Special Assessment Debt Service Fund had a negative cash balance for the majority of 2006, it was only allocated \$89 in interest earnings.

We recommend the City Administration estimate the unfunded amount each year and develop a plan to fund these amounts.

Client's Response:

On December 7, 2006, the City applied \$750,000 towards the projected special assessment debt service shortfall. A plan will be developed that addresses funding mechanisms for the Special Assessment Debt Service Fund including potential unfunded balances.

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 vast majority of account receivable adjustments occur in our utility billing system which does have formal procedures for write-offs incorporated into the City Code. All other miscellaneous billing adjustments are approved informally by management, after consultation with legal staff. A miscellaneous billing policy will be developed, as time permits, together with the accounting policies and procedures manual reported as finding 96-10.

05-7

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 formal contract requirements detailed in the City Charter and City Code. Written contracting procedures will be developed, as time permits, together with the accounting policies and procedures manual reported as finding 96-10.

PREVIOUSLY REPORTED ITEMS RESOLVED

Untimely Grant Reimbursement Requests (05-3)

The City did not seek a grant reimbursement on a timely basis.

Resolution

Based on reimbursements tested, the City obtained grant reimbursements on a timely basis in 2006.

Engineering Overhead Charges (05-4)

The City had not updated its engineering overhead charges.

Resolution

The engineering overhead charge will remain at 60 percent.

Zoological Society Fundraiser (05-5)

The contract with the Zoological Society Fundraiser did not allow them to keep the gate receipts during their fundraisers.

Resolution

The contract was amended to allow the Society to retain gate receipts from two special events held during the course of a calendar year.

Fuel Contract (05-6)

The City did not have procedures in place to properly monitor fuel pricing.

Resolution

The City entered into a new fuel agreement effective March 1, 2007. It began new monitoring procedures at that time.

Direct Deposit (05-8)

The City did not require all employees to be paid by direct deposit.

Resolution

The City does not intend to change its practice for paying employees.

B. OTHER ITEM FOR CONSIDERATION

Other Postemployment Benefits (OPEB)

The City provides postemployment health care benefits to retirees in accordance with various labor agreements. During 2006, retirees' health care claims of \$7,371,178 were paid, which is a \$1,191,355 increase (19 percent) from the 2005 claims. We believe the City's expenses will continue to increase dramatically because of increasing numbers of retirees receiving this benefit, longer life spans, ever increasing medical costs, and possible decreasing Medicare coverage. However, recent labor agreements will have an effect on the amount of future claims paid. An actuary calculated the City's unfunded post-retirement benefit obligation for health care benefits as of December 31, 2004, to be \$279,934,736.

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 currently require the reporting of, a liability when the benefit is earned.

Governmental Accounting Standards Board (GASB) Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes financial reporting for OPEB plans, and Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which governs employer accounting and financial reporting for OPEB, provide the accounting and reporting standards for the various other postemployment benefits many local governments offer to their employees. GASB Statements 43 and 45 are effective for the years ended December 31, 2006 and 2007, respectively for the City.

Statement 43 was not applicable in 2006 because the City was not legally able to establish an OPEB trust. In 2007, legislation was passed allowing the City to establish an OPEB trust fund and invest the fund's assets with the Minnesota State Board of Investments. The City has begun earmarking dedicated monies to fund the OPEB obligation. The City is in the process of negotiating future OPEB with its employees. An actuarial study will need to be completed in 2007 that will reflect these changes.

We recommend the City continue seeking methods of controlling and funding this rising employee benefit.

Client's Response:

The City will continue to seek ways to further control OPEB costs and investigate potential funding options.

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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*

Mayor and City Council
City of Duluth

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, 2006, and have issued our report thereon dated June 21, 2007. These financial statements include the Spirit Mountain Recreation Area Authority activities for the year ended April 30, 2006. We did not audit the financial statements of the Steam District #2 Enterprise Fund, which statements represent 5.6 percent, 7.9 percent, and 9.3 percent, respectively, of the assets, net assets, and revenues of the business-type activities; and 10.8 percent, 17.6 percent, and 11.8 percent, respectively, of the assets, net assets, and revenues of the aggregate remaining fund information. Those financial statements were audited by other auditors. Separate management and compliance letters have been issued for the Duluth Airport Authority, Duluth Entertainment and Convention Center Authority, Steam District #2 Enterprise Fund, Duluth Transit Authority, and 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 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. The financial statements of the Steam District #2 Enterprise Fund were not audited in accordance with *Government Auditing Standards*.

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 audit 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. We considered the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 96-5, 96-10, 06-1, and 06-2 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies listed above, we consider item 06-1 to be a material weakness.

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 Local Government*, 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 Local Government* 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 of Duluth, 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 as well as the other item for consideration have not been subjected to any auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the City's management, the Mayor, the City Council, 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 21, 2007

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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, 2006. 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.

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 \$12,199,085 and \$4,013,405, respectively, in federal awards during the year ended December 31, 2006, 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 on 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 are applicable to each of its major federal programs for the year ended December 31, 2006.

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, 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 control deficiency in internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the City's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

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, 2006, and have issued our report thereon dated June 21, 2007. We did not audit the financial statements of the Steam District #2 Enterprise Fund. Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City of Duluth's basic financial statements. 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 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the City's management, the Mayor, the City Council, 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
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/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

June 21, 2007

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**CITY OF DULUTH
DULUTH, MINNESOTA**

Schedule 2

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 2006**

<u>Federal Grantor Pass-Through Agency Grant Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Passed Through to Subrecipients</u>
U.S. Department of Agriculture			
Passed Through Great Lakes Commission Soil and Water Conservation	10.902	\$ 8,885	\$ -
U.S. Department of Commerce			
Passed Through Minnesota Department of Natural Resources Coastal Zone Management Administration Awards	11.419	\$ 153,520	\$ -
U.S. Department of Defense - Army Engineers			
Direct Environmental Assistance Grant Program	12.106	\$ 137,222	\$ -
U.S. Department of Housing and Urban Development			
Direct Community Development Block Grant	14.218	\$ 2,919,034	\$ 1,508,190
Emergency Shelter	14.231	145,162	138,173
Home Investment Partnerships Program	14.239	1,030,437	950,597
Total U.S. Department of Housing and Urban Development		\$ 4,094,633	\$ 2,596,960
U.S. Department of Interior			
Passed Through Minnesota Historical Society Historic Preservation Fund	15.904	\$ 625	\$ -
U.S. Department of Justice			
Direct Grants to Encourage Arrest Policies and Enforcement of Protection Orders Program	16.590	\$ 175,313	\$ -
Local Law Enforcement Block Grant	16.592	16,906	-
Bulletproof Vest Partnership Program	16.607	14,189	-
Public Safety and Community Policing Grant	16.710	6,599	-
Passed Through Minnesota Department of Public Safety Edward Byrne Memorial Formula Grant Program	16.579	212,463	-
Enforcing Underage Drinking Laws Program	16.727	10,178	-
Total U.S. Department of Justice		\$ 435,648	\$ -
U.S. Department of Labor			
Passed Through Senior Service America, Inc. Senior Community Service Employment Program	17.235	\$ 296,956	\$ -
Passed Through Minnesota Department of Employment and Economic Development Employment Service/Wagner-Peysar Funded Activities	17.207	1,729	-
Workforce Investment Act - Adult Program	17.258	418,531	-
Workforce Investment Act - Youth Activities	17.259	1,573	-
Dislocated Worker	17.260	214,222	-
Special Allotment	17.260	8,085	-
Total U.S. Department of Labor		\$ 941,096	\$ -

**CITY OF DULUTH
DULUTH, MINNESOTA**

*Schedule 2
(Continued)*

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDING DECEMBER 31, 2006**

<u>Federal Grantor Pass-Through Agency Grant Program Title</u>	<u>Federal CFDA Number</u>	<u>Expenditures</u>	<u>Passed Through to Subrecipients</u>
U.S. Department of Transportation			
Passed Through Minnesota Department of Transportation Highway Planning and Construction	20.205	\$ 2,628,404	\$ -
Passed Through Minnesota Department of Natural Resources Recreational Trails Program	20.219	14,455	-
Passed Through Minnesota Department of Public Safety State and Community Highway Safety	20.600	4,873	-
Alcohol Traffic Safety and Drunken Driving Prevention Incentive Grants	20.601	<u>42,074</u>	<u>-</u>
Total U.S. Department of Transportation		<u>\$ 2,689,806</u>	<u>\$ -</u>
U.S. Environmental Protection Agency			
Direct			
Great Lakes Program	66.469	\$ 168,611	\$ -
Brownfield Assessment and Cleanup Cooperative Agreements	66.818	<u>48,504</u>	<u>-</u>
Total U.S. Environmental Protection Agency		<u>\$ 217,115</u>	<u>\$ -</u>
U.S. Department of Health and Human Services			
Passed Through Arrowhead Regional Development Commission Senior Nutrition Program	93.045	<u>\$ 201,578</u>	<u>\$ -</u>
U.S. Department of Homeland Security			
Passed Through Minnesota Department of Public Safety State Domestic Preparedness Equipment Support Program	97.004	\$ 271,258	\$ -
Homeland Security Grant Program	97.067	<u>275,628</u>	<u>-</u>
Total U.S. Department of Homeland Security		<u>\$ 546,886</u>	<u>\$ -</u>
Total Federal Awards		<u>\$ 9,427,014</u>	<u>\$ 2,596,960</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 and does not include activities of its component units. The City's reporting entity is defined in Note 1 to the basic financial statements.
2. The expenditures on this schedule are on the basis of accounting used by the individual funds of the City. Governmental funds use the modified accrual basis, and proprietary funds use the accrual basis. CFDA Nos. 11.419 and 66.469 are on the accrual basis.
3. Pass-through grant numbers were not assigned by the pass-through agencies.