

Members of the City Council
City of Paynesville
Paynesville, Minnesota

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Paynesville as of and for the year ended December 31, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered City of Paynesville's internal control over financial reporting (internal control) 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. 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 significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 a 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 consider the following deficiencies in City of Paynesville's internal control to be material weaknesses:

Internal Control over the Financial Reporting Process

Management is responsible for establishing and maintaining internal controls, including monitoring, and for the fair presentation in the financial statements in accordance with U.S. generally accepted accounting principles.

At times, management may choose to outsource certain accounting functions (in this case, financial statement preparation) due to cost or training considerations. Such accounting functions and service providers must be governed by the control policies and procedures of the City. Management is as responsible for outsourced functions performed by a service provider as it is for its own personnel.

Management is also responsible for management decisions and functions; for designating an individual with suitable skill, knowledge, or experience to oversee any outsourced services; and for evaluating the adequacy and results of those services and accepting responsibility for them.

As part of the audit, management requested us to prepare a draft of your financial statements, including the related notes to financial statements. Management reviewed, approved, and accepted responsibility for those financial statements prior to their issuance; however, management did not perform a detailed review of the financial statements.

We understand that this material weakness is already known to management and represents a conscious decision by management and the City Council to accept that degree of risk because of cost or other considerations. We acknowledge the fact that management is responsible for making decisions concerning costs and the related benefits. We are responsible to communicate material weaknesses in accordance with professional standards regardless of management's decisions to ensure that the City Council is aware of this situation.

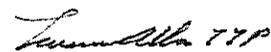
Limited Segregation of Duties

The City has a limited number of office personnel that perform accounting and financial duties. As a result, many of those aspects of internal accounting control which rely upon an adequate segregation of duties are, for all practical purposes, not available in this staffing scenario. We recognize that the City's cost/benefit analysis has concluded the employment of additional persons for the purpose of segregating duties is not practicable from a financial standpoint, but we are required, under our professional responsibilities, to call the situation to your attention. The City should utilize the City Council's oversight of the budgeting, cash reconciling, receipts and disbursements process to the maximum extent possible to mitigate the absence of segregation of duties.

Material Audit Adjustments

As part of the audit, we proposed entries to reclassify revenues and expenditures, record the new bond issuance, and close out funds. These entries relate to internal controls over the year-end close-out process. The absence of a complete control procedure or process in this area is considered a material weakness because the potential exists that a material misstatement of the financial statements could occur and not be prevented or detected by the City's internal control processes.

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



LarsonAllen LLP

Alexandria, Minnesota
March 28, 2011