

**COMMUNICATION TO THOSE CHARGED WITH GOVERNANCE
CITY OF CALISTOGA
For The Fiscal Year Ended June 30, 2011**



Terry E. Krieg, CPA

Certified Public Accountant

March 24, 2012

Honorable Mayor and Members of the City Council
City of Calistoga
Calistoga, California

I have audited the basic financial statements of the governmental-type activities, business-type activities, each major fund and the aggregate remaining fund information of the City of Calistoga for the year ended June 30, 2011, and have issued my report thereon dated March 24, 2012. Professional standards require that I provide you with the following information related to my audit.

1. My Responsibility under U.S. Generally Accepted Auditing Standards

As stated in my engagement letter, my responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material aspects, in conformity with U.S. generally accepted accounting principles. My audit of the financial statements does not relieve you or management of your responsibilities.

As part of my audit, I considered the internal control of the City of Calistoga. Such considerations were solely for the purpose of determining my audit procedures and not to provide assurance concerning such internal control. My responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. I am responsible for communicating significant matters related to the audit that are, in my professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, I am not required to design procedures specifically to identify such matters.

2. Other Information in Documents Containing Audited Financial Statements and Electronic Dissemination of Audited Financial Statements

My responsibility for other information in documents containing the City of Calistoga's financial statements and my auditor's report, such as an official statement for a bond or debt offering, does not extend beyond the financial information identified in the report. I do not have an obligation to perform any procedures to corroborate other information contained in such other documents. To my knowledge, the City of Calistoga's audited financial statements were not incorporated into other documents.

With regard to the electronic dissemination of audited financial statements, including financial statements published electronically on your website, you understand that electronic sites are a means to distribute information and, therefore, I am not required to read the information in any such sites or to consider the consistency of other information in the electronic site with the original documents.

3. Planned Scope and Timing of the Audit

I performed the audit according to the planned scope and timing previously communicated to the City's Administrative Services Director in the audit engagement letter and discussed with the City's Administrative Services Director. My understanding is that the Administrative Services Director has the responsibility for coordinating the audit process with my firm and for communicating to you significant audit matters.

4. Significant Audit Findings

A. Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with my engagement letter, I will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City of Calistoga are described in Note one to the financial statements.

B. Changes in Accounting Policies

No new accounting policies were adopted and the application of existing policies were not changed in the 2011 fiscal year except that the City implemented Governmental Accounting Standards Board Statement Number 54 titled Fund Balance Reporting and Governmental Fund Type Definitions. This new accounting standard provides for reporting fund balances into several new classifications consisting of:

- 1) Nonspendable fund balances for items generally not convertible into cash such as inventories, prepayments and long-term receivables not offset by deferred revenue accounts.
- 2) Restricted fund balances where the use of the underlying resources are restricted by laws, regulations, donors, grantors, or other governments; these fund balances cannot be redeployed for other uses.
- 3) Committed fund balances where the City Council has determined that certain resources are to be used only for specific future purposes. Such fund balance amounts can be redeployed, but only the City Council has authority to make such changes.
- 4) Assigned fund balances which are fund balance amounts where the City has determined that it intends to use those amounts for certain future purposes. These amounts may be redeployed by action of the City Manager or Director of Administrative Services.
- 5) Unassigned fund balance generally limited to the residual balance in the general fund or funds having deficit balances.

C. Significant and Unusual Transactions

There were no significant and unusual transactions reported in fiscal 2011 in the City's statement of net assets and fund statements other than:

1. Reporting in your 2011 financial statements that the water and wastewater funds had minimal cash balances at June 30, 2011 as a result of the current revenue rate structure not generating enough cash to cover operating expenses, debt payments, and capital costs.

2. Reporting in the water and wastewater funds that there was about \$915,000 in cash either transferred into or loaned to the water and wastewater funds in order to cover deficit cash spending in fiscal 2011; these two funds had more cash outflows than inflows in fiscal 2011
3. Reporting in the notes to the financial statements that the water enterprise did not meet any debt service coverage ratios in fiscal 2011 as the water fund had negative net system revenues in fiscal 2011 excluding one- time transfers in and one- time capital connections.
4. Reporting that the wastewater fund had to borrow \$394,408 from other funds in fiscal 2011 in order to have a minimal cash balance at June 30, 2011. The fund reported this \$397,408 as a transfer in because it did not have the resources to make any repayments.
5. Reporting in the Equipment internal service fund a new capital lease for \$248,460 obtained to provide financing primarily for the purchase of a new street sweeper.
6. The City was not subject to federal program compliance audits and reporting requirements in fiscal 2011 because aggregated federal loan and grant expenditures of the City were less than \$500,000 in fiscal 2011
7. Reporting an OPEB liability of about \$288,000 in the government wide financial statements because the City has elected to not prefund its OPEB obligations. Disclosing that the City has a \$963,000 unfunded actuarial accrued liability pertaining to its OPEB Plan.
8. Reporting that in its governmental fund types almost all (about 97 percent) of available cash is restricted either for capital improvements or special purposes leaving relatively little cash in the general fund to begin 2011-2012 fiscal year.
9. Reporting that the general fund expenditures exceeded general fund revenues in fiscal 2011.

D. Transactions Having a Lack of Authoritative Guidance

No significant dollar value transactions came to my attention where there was a lack of authoritative guidance regarding the application of accounting principles to the transactions.

E. Accounting Estimates

Accounting estimates are an integral part of financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most significant estimate affecting the financial statements was management's estimate of depreciation expense which estimates were based upon subsidiary schedules of capital assets and depreciation calculations using the straight-line method of depreciation. Also, the Annual Required Contribution (ARC) to the City's OPEB Plan and the related Unfunded Actuarial Accrued Liability are both estimates based upon assumptions that may vary from actual events.

F. Sensitive Financial Statement Disclosures

The disclosures in the financial statements are to be neutral, consistent and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

The lack of a securities rating and average maturities of the City's investments in the Local Agency investment Fund of the State of California (about \$884,000 combined) and the AAA rating of the \$1.19 million invested in the Goldman Sachs Treasury Obligation money market/mutual funds.

Other disclosures of particular sensitivity may also be the information concerning the pledge of water and wastewater revenues for debt service and the respective coverage ratios in the notes to the financial statements.

The water enterprise fund may not be meeting its debt service coverage ratio requirements because in fiscal 2011 net system revenues (excluding one-time items such as transfers in and capital contributions) were not sufficient to cover the debt service principal and interest payments.

5. Difficulties Encountered in Performing the Audit

I experienced no significant difficulties in dealing with management in performing and completing my audit.

6. Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit other than those that are trivial, and communicate them to the appropriate level of management. There were about 25 correcting and reclassifying journal entries proposed for fiscal 2011; and they were significant and had an aggregated dollar value total of over \$5.7 million.

The proposed adjusting entries, when considered on a collective basis and viewed in the context of the City annual financial statements, were significant and were material in terms of their collective monetary impact on the City's annual financial statements.

The City has reviewed all known mistakes, errors and inaccuracies in the City's general ledger accounting records and in its 2011 financial statements, and the City has, to my knowledge, corrected all known significant errors, mistakes, and inaccuracies.

7. Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to my satisfaction, concerning a financial accounting, reporting or auditing matter that could be significant to the financial statements or the auditor's report.

We are pleased to report that no such disagreements arose during the course of the audit.

8. Management Representations

I have requested certain representations from management that are included in the management representation letter.

9. Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a second opinion on certain situations. If a consultation involves the application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those financial statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts.

To my knowledge, there were no such consultations with other accountants

10. Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to our retention as the City's auditors or prior to commencement of the financial statement audit.

The discussions this year centered on planning, scheduling, and completion of the fiscal 2011 financial statement audit in an environment where the City experienced employee turnover at the management level in its Finance Department. However, these discussions occurred in the normal course of my professional relationship and my responses were not a condition to my retention as the City's independent auditor.

Completion of the financial statement audit for fiscal 2011 was delayed primarily because of employee turnover in the City's Finance Department and the time delays associated with the City's recruitment of temporary and permanent personnel to manage the year end closeout of its financial management system.

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

Sincerely yours


Terry E. Krieg