

**SOUTHWEST TRANSIT
Eden Prairie, Minnesota**

COMMUNICATIONS LETTER

For the Year Ended December 31, 2012

SOUTHWEST TRANSIT

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**REPORT ON MATTERS IDENTIFIED AS A RESULT OF
THE AUDIT OF THE FINANCIAL STATEMENTS**

Board of Commissioners
SouthWest Transit
Eden Prairie, Minnesota

In planning and performing our audit of the financial statements of SouthWest Transit (SWT), Eden Prairie, Minnesota, as of and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, we considered SWT's internal control over financial reporting (internal control) as a basis for designing auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of SWT's internal control. Accordingly, we do not express an opinion on the effectiveness of SWT's internal control.

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements, on a timely basis. A material weakness is a deficiency, or combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of SWT's financial statements will not be prevented or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Significant deficiencies are identified within this letter.

The accompanying memorandum also includes financial analysis provided as a basis for discussion. The matters discussed herein were considered by us during our audit and they do not modify the opinion expressed in our Independent Auditor's Report dated May 8, 2013, on such statements.

During our audit, we also became aware of a matter which we believe represents an opportunity for strengthening internal control and operating efficiently and it is also included within this letter.

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

Kern, DeWenter, Viere, Ltd.
KERN, DEWENTER, VIERE, LTD.
St. Cloud, Minnesota
May 8, 2013

SOUTHWEST TRANSIT
SIGNIFICANT DEFICIENCY
December 31, 2012

LACK OF SEGREGATION OF ACCOUNTING DUTIES

During the year ended December 31, 2012, SWT had a lack of segregation of accounting duties due to a limited number of office employees. The lack of adequate segregation of accounting duties could adversely affect SWT's ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. This lack of segregation of accounting duties can be demonstrated in the following areas, which are not intended to be an all-inclusive list:

- The Administrative Services Director performs various review and backup functions and has access to the accounting general ledger system.
- The Accountant sometimes receives cash and also enters receipt information into the general ledger system.

Management is aware of this condition and has taken certain steps to compensate for the lack of segregation, but due to the small accounting staff needed to handle all of the accounting duties, the cost of obtaining desirable segregation of accounting duties often exceeds the benefits which could be derived. Due to this reason, management has determined a complete segregation of accounting duties is impractical to correct.

We recommend management, along with the Board of Commissioners, remain aware of this situation and continually monitor the accounting system including changes that occur. Although this item is considered to be a significant deficiency, we do not feel it is a material weakness.

SOUTHWEST TRANSIT

REQUIRED COMMUNICATION December 31, 2012

We have audited the financial statements of SWT for the year ended December 31, 2012, and have issued our report dated May 8, 2013. Professional standards require that we provide you with the following information related to our audit.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, GOVERNMENT AUDITING STANDARDS AND OMB CIRCULAR A-133

As stated in our engagement letter, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of SWT. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

As part of obtaining reasonable assurance about whether SWT'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.

We also considered 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 U.S. Office of Management and Budget (OMB) *Circular A-133*.

Also, in accordance with OMB *Circular A-133*, we examined, on a test basis, evidence about SWT's compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* applicable to its major federal program for the purpose of expressing an opinion on SWT's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on SWT's compliance with those requirements.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously communicated to you.

SOUTHWEST TRANSIT
REQUIRED COMMUNICATION
December 31, 2012

QUALITATIVE ASPECTS OF ACCOUNTING PRACTICES

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by SWT are described in Note 1 to the financial statements. We noted no transactions entered into during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the 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 sensitive estimate affecting the financial statement was:

Depreciation – SWT is currently depreciating its capital assets over their estimated useful lives, as determined by management, using the straight-line method.

We evaluated the key factors and assumptions used to develop the above estimate in determining it is reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent and clear.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no difficulties in dealing with management in performing and completing our audit.

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. Management has determined their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting or auditing matter, whether or not resolved to our satisfaction 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 our audit.

MANAGEMENT REPRESENTATIONS

We requested certain representations from management which were provided to us in the management representation letter.

SOUTHWEST TRANSIT
REQUIRED COMMUNICATION
December 31, 2012

MANAGEMENT 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 application of an accounting principle to SWT’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. We are not aware of any consultations by SWT’s management with other accountants during the course of our audit.

OTHER ISSUES

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as SWT’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

We have not reviewed, and it is our understanding, that no other published documents exist that contain audited financial statement information, for which we are currently auditing. As stated in our engagement letter, if you publish or reproduce the financial statements or make reference to our Firm name in relation to such documents, you agree to provide us with a copy of the final reproduced material for our approval before it is distributed.

SOUTHWEST TRANSIT

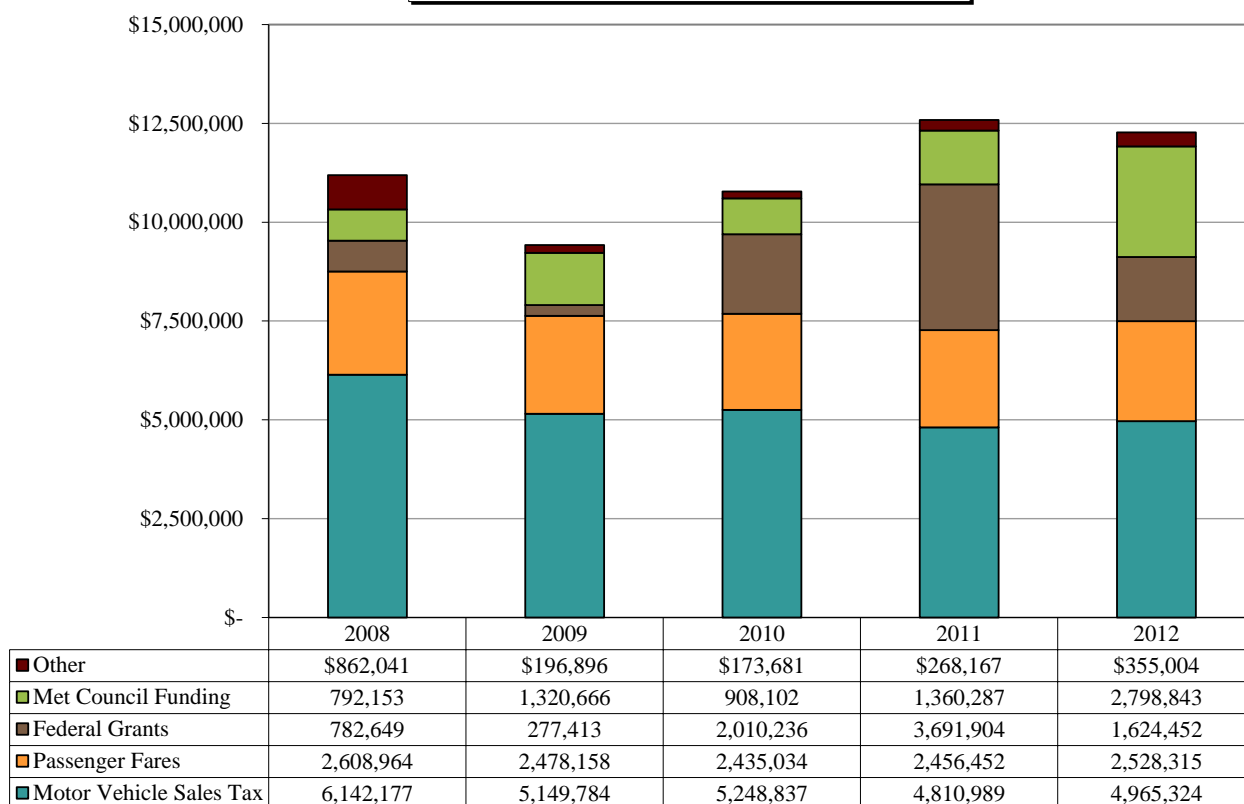
FINANCIAL ANALYSIS

December 31, 2012

The following pages provide graphic representation of select data pertaining to the financial position and operations of SWT for the past five years. Our analysis of each graph is presented to provide a basis for discussion of past performance and how implementing certain changes may enhance future performance. We suggest you view each graph and document if our analysis is consistent with yours. A subsequent discussion of this information should be useful for planning purposes.

The following graphs are included to facilitate discussion of past operating results and related trends for future years' operations of SWT.

Total Revenues by Source - All Funds



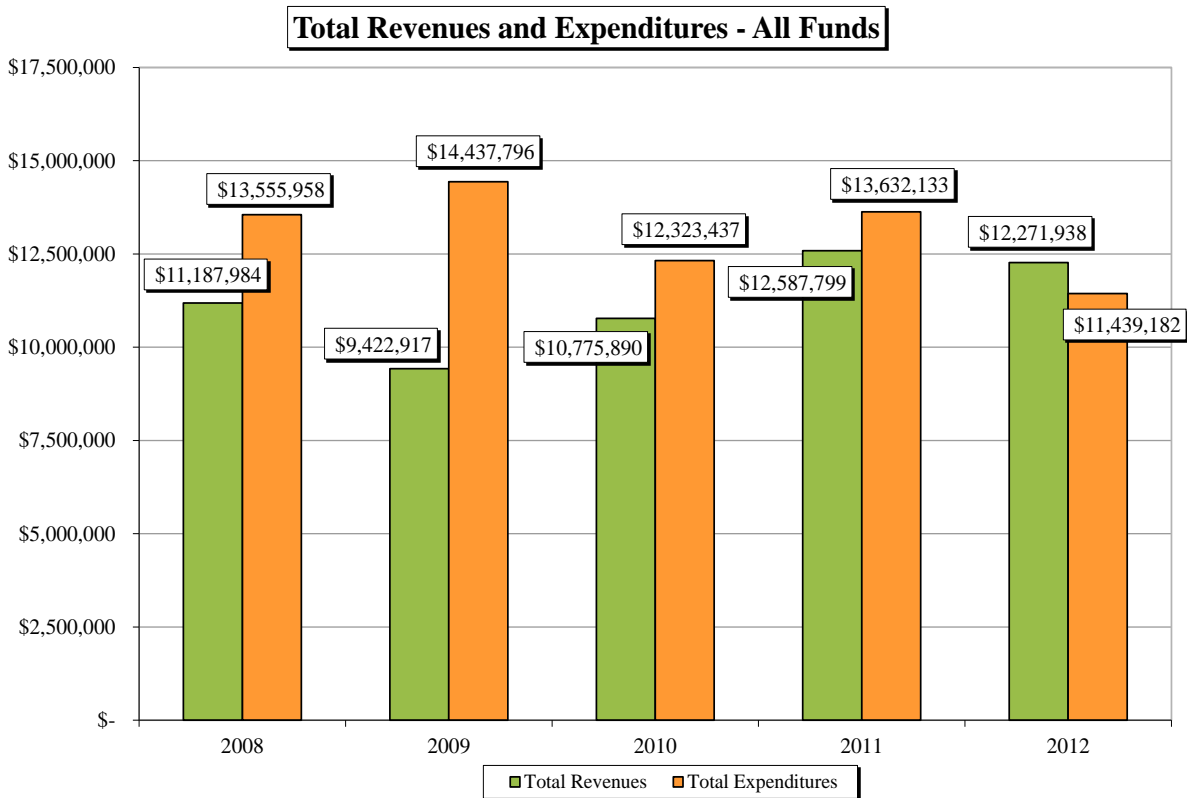
Revenue decreased \$ 315,861 in 2012 compared to 2011. Federal grant revenues decreased \$ 2,067,452 in 2012, from \$ 3,691,904 in 2011 to \$ 1,624,452. This was due to large grants that were received in 2011 for the Chanhassen Transit Station project that was completed in 2011. This decrease in federal funding was partially offset by an increase in funding from Met Council. Met Council funding rose to \$ 2,798,843 in 2012 for an increase of \$ 1,438,556 from 2011 due to reimbursement for expenses for East Creek Station project, a bus rehabilitation grant and a one-time reimbursement of \$ 1,600,000 for past capital expenditures. These increases were offset by decreases in 2011 grants related to the Chanhassen Transit Station and Chaska garage roof repairs. Passenger fare revenues increased \$ 71,863 from 2011 primarily due to a new direct route servicing the new Chanhassen Transit Station. In addition, the state and county also funded two construction routes to test the viability of them and ease construction traffic, which is included in passenger fares.

SOUTHWEST TRANSIT

FINANCIAL ANALYSIS

December 31, 2012

Other changes include an increase in Motor Vehicle Sales Tax (MVST) and other revenues. MVST, which fluctuates each year based on vehicle sales in Minnesota, increased \$ 154,335 from the prior year. MVST revenue was held flat to 2011 levels for the first six months of 2012. However, SWT did receive an increase in the base allocation for the last six months of 2012. Other revenues increased \$ 86,837 from 2011 to 2012 as a result of new Chaska garage lease revenue and a higher property insurance rebate in 2012. SWT participates in the League of Minnesota Cities Insurance Trust (LMCIT) insurance pool and the rebate is a result of the LMCIT pool activity, including SWT experience levels. These increases were offset by a significant decrease in investment income, which decreased \$ 34,630 as a result of continued declines in interest rates as well as lower cash and investments on hand to invest.



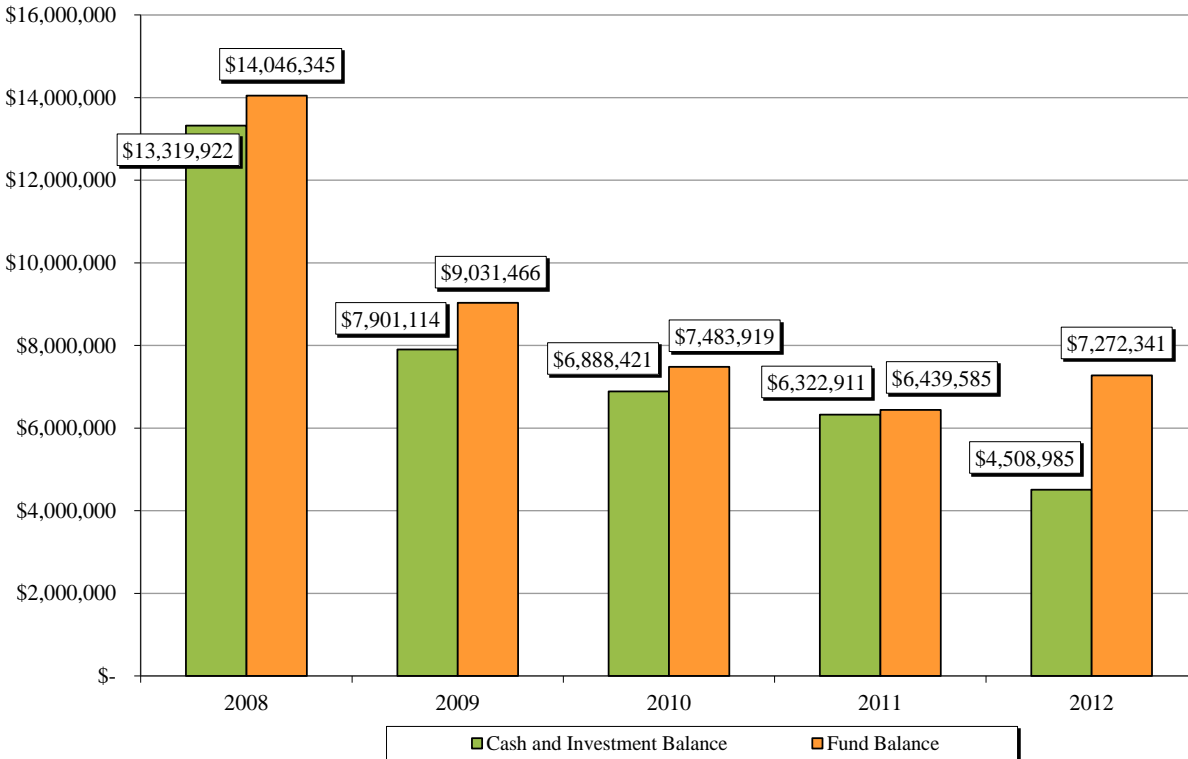
Total revenues exceeded total expenditures for the first time in five years. In 2012, total revenues surpassed expenditures by \$ 832,756. Total revenues decreased \$ 315,861 from 2011, primarily due to a decrease in federal grants received as noted on the previous page. Expenditures also decreased in 2012, from \$ 13,632,133 in 2011 to \$ 11,439,182 in 2012 for a total decrease of \$ 2,192,951. The decrease in expenditures is primarily due to a \$ 2,447,029 decrease in capital expenditures from 2011 as SWT completed its Chanhassen Transit Station project which accounted for \$ 5,376,624 in expenditures in 2011. This was offset by the East Creek Station project, which accounted for \$ 2,510,818 of total 2012 expenditures. Capital outlay for operation and vehicle maintenance also increased \$ 504,662 from the prior year due to a bus rehabilitation grant from Met Council. The decrease in capital expenditures was offset slightly by an increase in current expenditures of \$ 254,077. Current expenditures increased due to new operating costs related to the opening of the Chanhassen Transit Station (approximately \$ 67,000), an increase in fuel as a result of an increase in the average price of \$ 2.98 per gallon in 2011 compared to \$ 3.21 in 2012 (approximately \$ 130,000) and an increase in contracted services for transit drivers as a result of more routes in 2012 (approximately \$ 69,000).

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FINANCIAL ANALYSIS

December 31, 2012

Cash and Fund Balance - All Funds



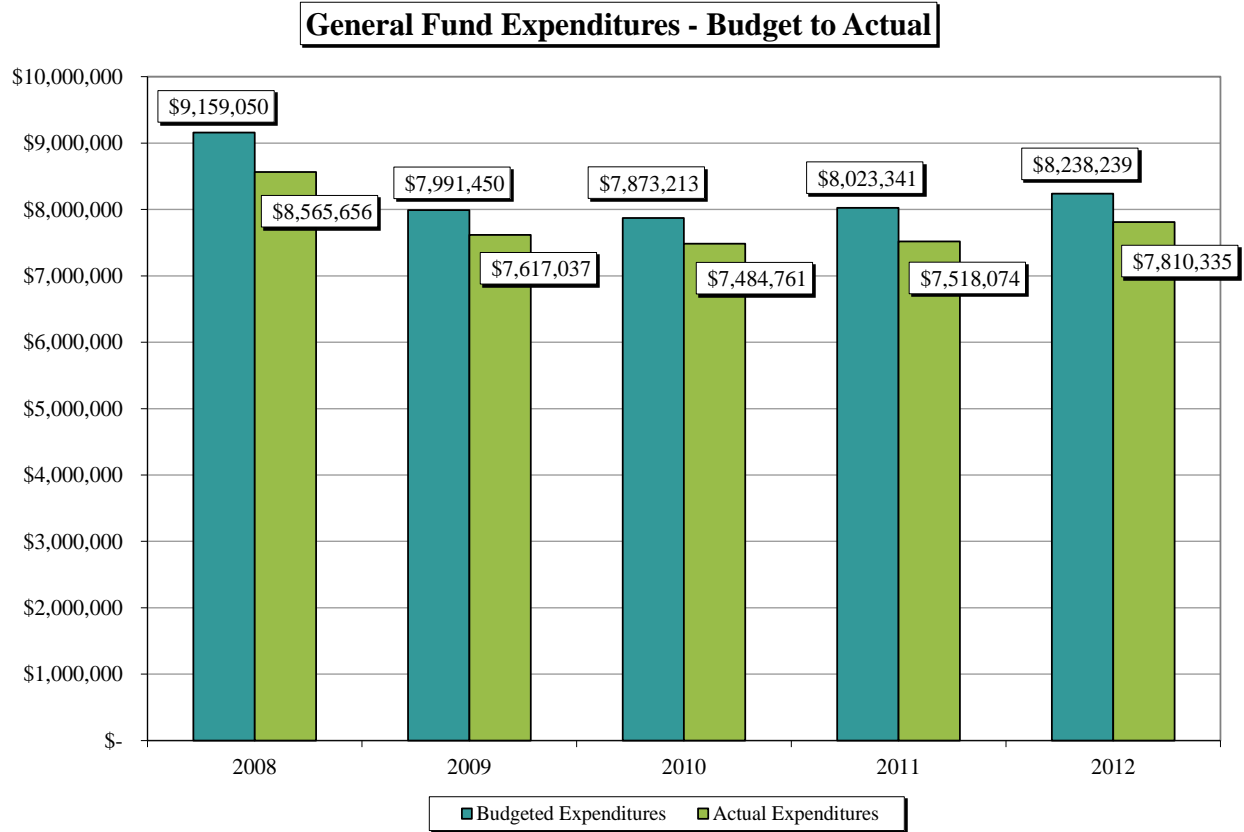
The cash and investment balance was lower than fund balance for the fifth consecutive year in 2012. Cash and investments declined \$ 1,813,926 while fund balance increased \$ 832,756 from 2011 to 2012.

Cash balances decreased and fund balances increased due to a \$ 2,589,591 increase in intergovernmental receivables from the prior year. The increase is due to the reimbursement commitment from Met Council totaling \$ 1,600,000 for prior capital expenditures and the federal and state grant receivable for the East Creek Station project totaling \$ 1,226,963.

The General Fund balance increased \$ 879,598 to \$ 3,290,666 in 2012 primarily due to the reimbursement from Met Council for past capital expenditures, as explained above, of which \$ 1,300,000 went to the General Fund. This increase was offset by a transfer to the East Creek Station Fund for \$ 300,000 and a decrease as a result of operations of \$ 120,402 (when taking out the effect of the one-time \$ 1,300,000 reimbursement from Met Council). The unassigned fund balance in the General Fund as of December 31, 2012 is \$ 2,812,949, which represents approximately 36%, or four months of expenditures, based on 2012 expenditure levels.

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FINANCIAL ANALYSIS December 31, 2012



In 2012, General Fund budgeted expenditures exceeded actual expenditures for the sixth year in a row. Expenditures were under budget by \$ 67,037, \$ 51,095 and \$ 309,772 in general government, buildings and grounds and operations and vehicle maintenance, respectively.

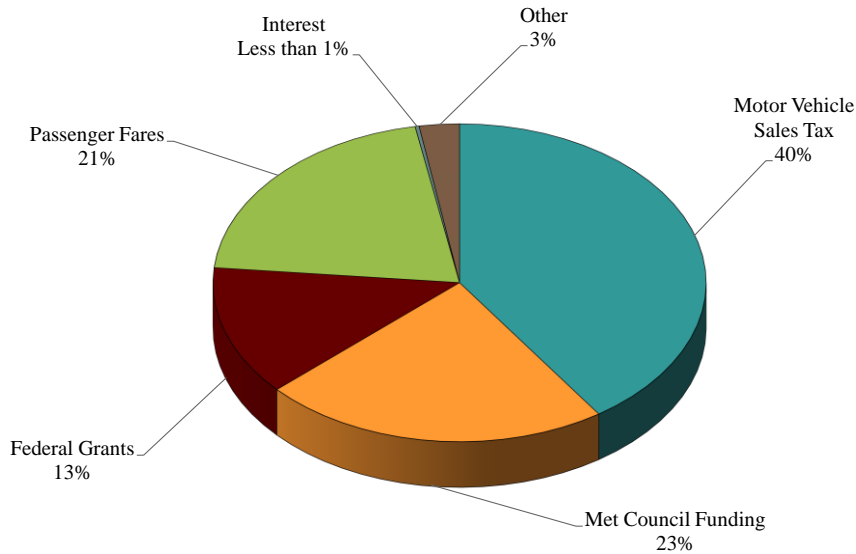
SOUTHWEST TRANSIT

FINANCIAL ANALYSIS

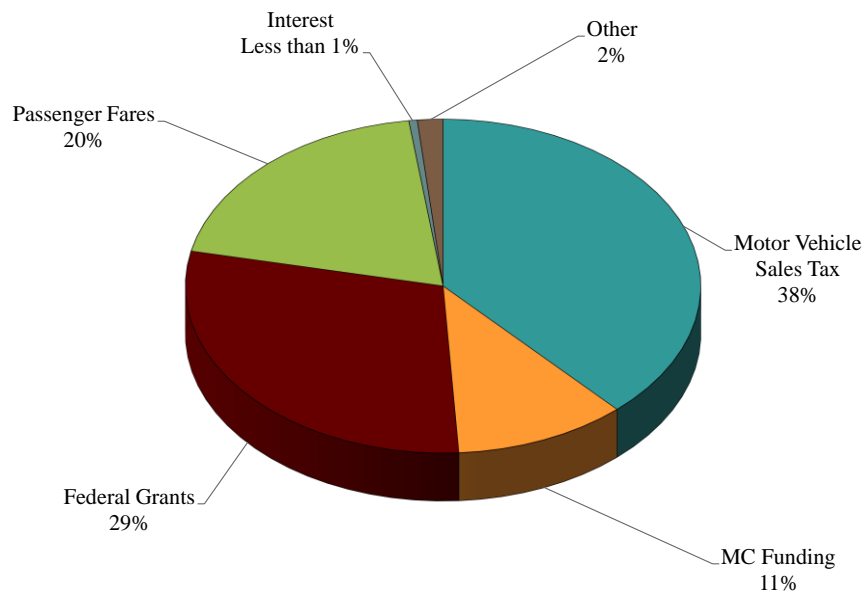
December 31, 2012

The following pie charts show the allocation of revenue by source for all funds in 2012 and 2011. The most noticeable changes were in federal grants and MC funding. Other areas of revenue stayed consistent with the prior years.

Operating Revenues by Source for 2012 - All Funds



Operating Revenues by Source for 2011 - All Funds



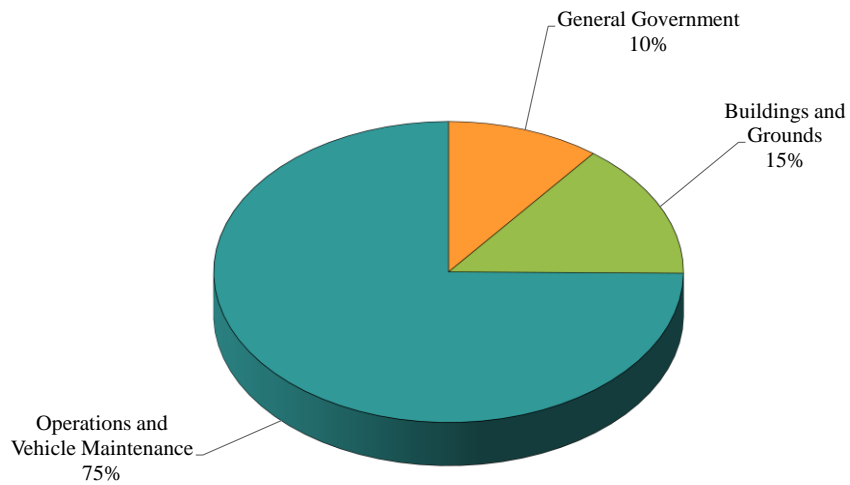
In the General Fund, the regional target for passenger fare revenue in relation to non capital expenditures is 28%. During 2012, SWT's passenger fare revenue as a percentage of non capital expenditures was 32.5%, while it was 32.8% in 2011.

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FINANCIAL ANALYSIS December 31, 2012

The following pie charts show the allocation of expenditures by program for the General Fund in 2012 and 2011. The allocation has been stable with a slight decrease in general government expenditures and a slight increase in building and grounds expenditures in 2012.

**Operating Expenditures by Department for 2012
General Fund**



**Operating Expenditures by Department for 2011
General Fund**

