CITY OF MELROSE
MELROSE, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2008

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

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Certified Public Accountants & Consultants

5201 Eden Avenue
Suite 370
Edina, MN 55436

March 19, 2009

Management, Honorable Mayor and Council
City of Melrose
Melrose, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Melrose, Minnesota (the City), for the year ended December 31, 2008 and have issued our report thereon March 19, 2009. 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 and *Government Auditing Standards*

As stated in our engagement letter, our 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 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 the 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 over financial reporting of the City. 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.

Significant Audit Findings

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control 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 a combination of control deficiencies, that adversely affects the entity'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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies on the following pages to be significant deficiencies in internal control over financial reporting.

952.835.9090 • Fax 952.835.3261
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2008-1: Preparation of Financial Statements (Finding since 2007)

Condition: As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Recent auditing standards require auditors to communicate this situation to the Council as an internal control deficiency. Ultimately, it is management's responsibility to provide for the preparation of your statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. It is our responsibility to inform you that this deficiency could result in a material misstatement to the financial statements that could have been prevented or detected by your management. Essentially, the auditors cannot be part of your internal control process.

Criteria: Internal controls should be in place to provide reasonable assurance over financial reporting.

Cause: From a practical standpoint we do both for you at the same time in connection with our audit. This is not unusual for us to do with an organization of your size.

Effect: The effectiveness of the internal control system relies on enforcement by management. The effect of deficiencies in internal controls can result in undetected errors in financial reporting.

Recommendation: It is your responsibility to make the ultimate decision to accept this degree of risk associated with this condition because of cost or other considerations. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for their accuracy; we have answered any questions they might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosure in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements. While the City is reviewing the financial statements we recommend that a disclosure checklist be utilized to ensure all required disclosures are presented and the City should agree its financial software to the numbers reported in the financial statements.

Management Response: For now, the City's management accepts the degree of risk associated with this condition and thoroughly reviews a draft of the financial statements.

2008-2: Prior Period Adjustment

Condition:	During our audit, a prior period adjustment was needed to correct beginning land capital assets.
Criteria:	The financial statements are the responsibility of the City's management; therefore, the City must be able to prevent or detect a material misstatement in the financial statements including footnote disclosures.
Cause:	Capital assets were incorrectly stated related to governmental activities, due to the City not recording the disposal of land in prior years.
Effect:	The prior period adjustment indicates a misstatement occurred and was not detected by the City's system of internal control. The audit firm cannot serve as a compensating control over this deficiency.
Recommendation:	We recommend that management document and implement procedures that affect capital assets throughout the year to better reduce risk of incomplete accrual accounting.
Management Response:	Management considers this to be an isolated incident of misstatement and has taken adequate steps during 2009 to ensure capital assets are properly reported.

2008-3: MADA Minutes

Condition:	During our audit we noted that minutes for the MADA were not written and approved for meetings held during 2008. Written minutes were provided near the end of our audit field work in February, 2009.
Criteria:	Formal written minutes are necessary to document decisions and activities of the governing body.
Cause:	Omission by management.
Effect:	As a result, MADA is at risk for omission of significant decisions or lack of documentation for the basis of decisions made.
Recommendation:	We recommend that the Board add approval of prior meeting minutes to each meeting.
Management Response:	Management considers this to be an oversight and has taken adequate steps during 2009 to ensure timely minutes are kept and approved.

A material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of compliance with certain provisions of Minnesota statutes. However, the objective of our tests was not to provide an opinion on compliance with such provisions. We noted no instances of non-compliance with Minnesota statutes.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the City 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.

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

Difficulties Encountered in Performing the Audit

We encountered no significant 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 corrected all such misstatements. In addition, two of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole. In total, we prepared 23 journal entries. These entries are necessary to adjust balances to the proper year end amount. It is important that the City understand these entries and prepare to make them in the future. Internal preparation enhances the quality of internal information.

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 have requested certain representations from management that are included in the management representations letter March 19, 2009**.**

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 the City'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. To our knowledge, there were no such consultations with other accountants.

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 retention as the City'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 Matters

The following are items that came to our attention during the audit that we feel should be reviewed.

Financial Position and Results of Operations

General Fund

The General fund is used to account for resources traditionally associated with government, which are not required legally or by sound principal management to be accounted for in another fund. The General fund balance increased $142,092 from 2007. The fund balance of $741,494 is 31 percent of the 2008 expenditures and transfers out. We recommend the fund balance be maintained at a level sufficient to fund operations until the major revenue sources are received in June. We feel a reserve of approximately 40 to 50 percent of planned expenditures and transfers out is adequate to meet working capital and small emergency needs.

The fund balance includes amounts reserved and designated as shown below:

	2004	2005	2006	2007	2008
Reserved for					
Due from other funds	$ 43,182	$ 65,646	$ -	$ -	$ -
Prepaid items	4,541	4,162	3,657	3,501	4,793
Unreserved					
Designated for insurance reserve	4,658	4,892	4,892	4,785	3,571
Designated for vacation and sick leave benefits	37,786	27,381	29,821	30,161	35,951
Designated for working capital	550,000	550,000	550,000	550,000	550,000
Undesignated	155,435	109,756	221,064	363,079	147,179
Total	$ 795,602	$ 761,837	$ 809,434	$ 951,526	$ 741,494
Total expenditures and transfers out	$ 1,657,881	$ 1,657,881	$ 2,066,289	$ 2,084,015	$ 2,402,817
Total fund balance as a percent of expenditures	47.99 %	45.95 %	39.17 %	45.66 %	30.86 %

The Office of the State Auditor (the OSA) has issued a *Statement of Position* relating to fund balance stating "a local government should identify fund balance separately between reserved and unreserved fund balance. The local government may assign and report some or all of the fund balance as designated and undesignated." The OSA also recommends local governments adopt a formal policy on the level of unreserved fund balance that should be maintained in the general and special revenue funds. This helps address citizen concerns as to the use of fund balance and tax levels.

The purposes and benefits of a fund balance are as follows:

- Expenditures are incurred somewhat evenly throughout the year. However, property tax and state aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the governmental fund expenditures.

- The City is vulnerable to legislative actions at the State and Federal level. The State imposed reductions of market value credit aid and local government aid for some cities at the end of 2008 and more reductions are anticipated for 2009. Levy limits have also been implemented for municipalities in past legislative sessions. An adequate fund balance will provide a temporary buffer against those aid adjustments and levy limits.

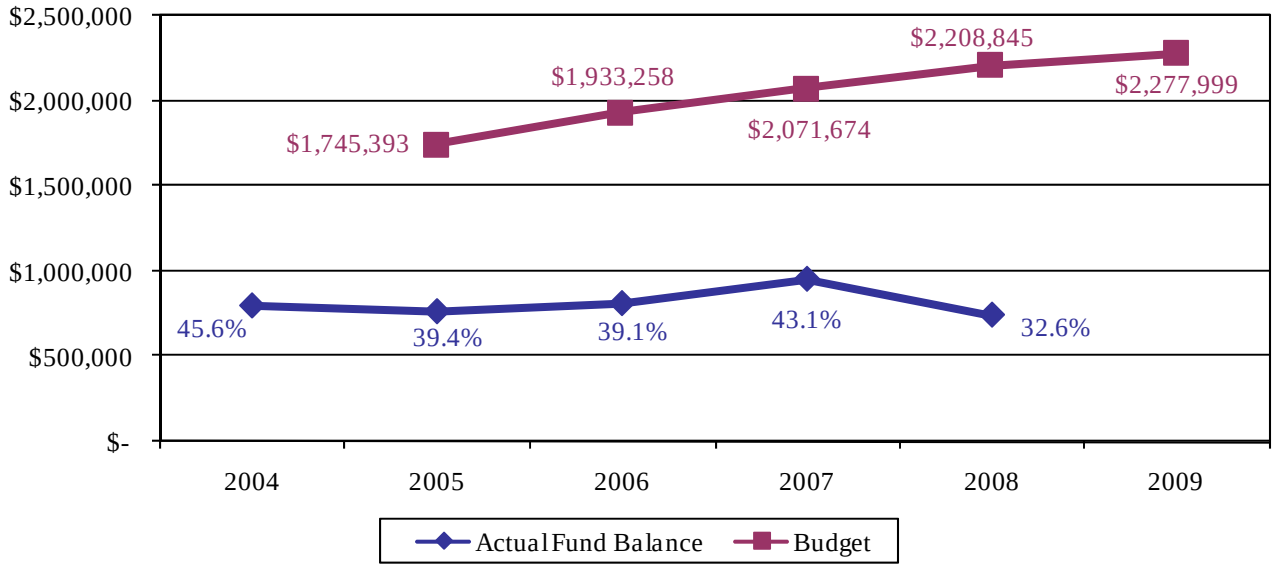
- Expenditures not anticipated at the time the annual budget was adopted may need immediate Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

- A strong fund balance will assist the City in maintaining, improving or obtaining its bond rating. The result will be better interest rates in future bond sales.

The prior five years of fund balance relative to budget are presented below.

Year	Unreserved Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2004	$ 795,601	2005	$ 1,745,393	45.6 %
2005	761,837	2006	1,933,258	39.4
2006	809,434	2007	2,071,674	39.1
2007	951,526	2008	2,208,845	43.1
2008	741,494	2009	2,277,999	32.6

Fund Balance as a Percent of Next Year's Budget



A summary of the 2008 operations are as follows:

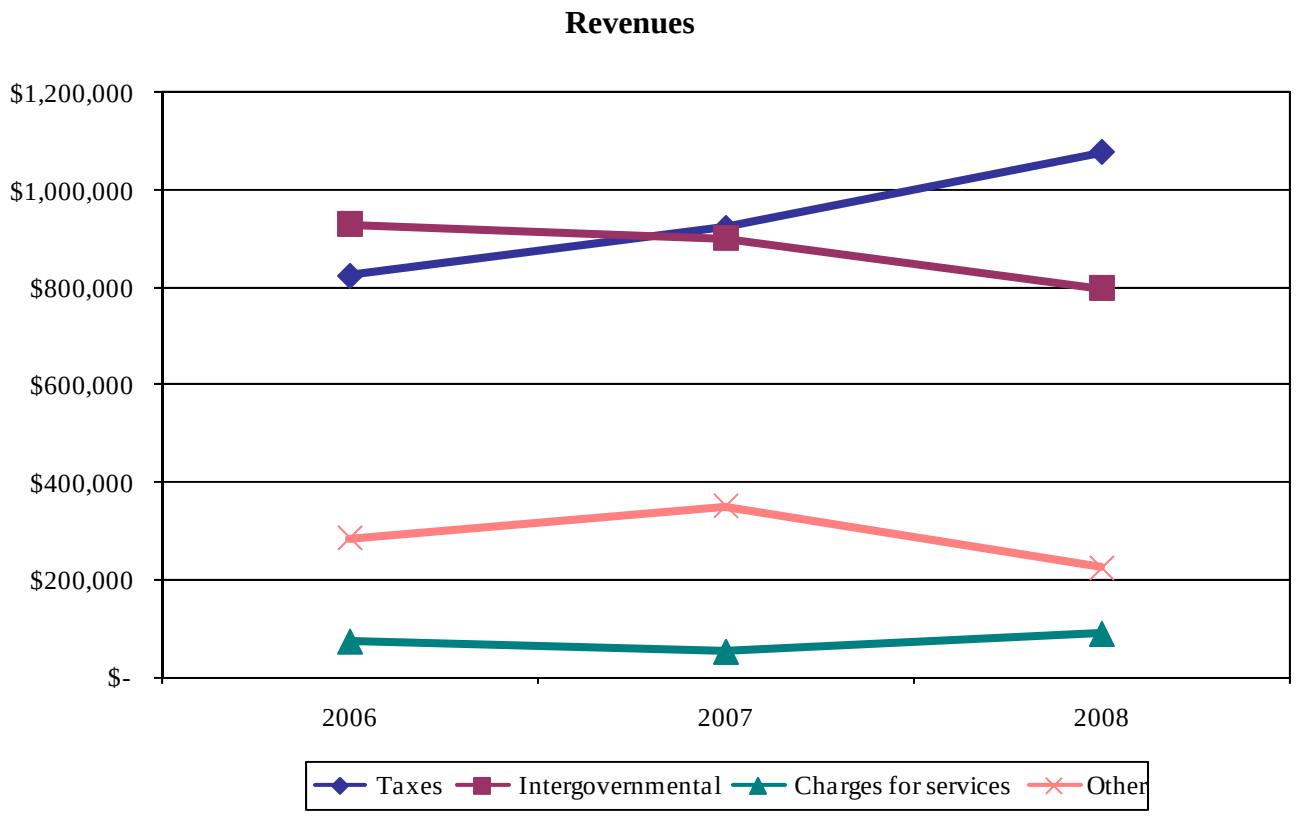
	Final Budget Amounts	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues	$ 2,183,869	$ 2,117,290	$ (66,579)
Expenditures	2,008,097	1,661,799	346,298
Excess of revenues over expenditures	175,772	455,491	279,719
Other financing sources (uses)			
Transfers in	70,000	75,495	5,495
Transfers out	(269,902)	(741,018)	(471,116)
Total other financing sources (uses)	(199,902)	(665,523)	(465,621)
Net change in fund balances	(24,130)	(210,032)	(185,902)
Fund balances, January 1	951,526	951,526	-
Fund balances, December 31	$ 927,396	$ 741,494	$ (185,902)

- Expenditures were under budget in the capital outlay function by $357 thousand. This was because capital outlay transfers were done during the year instead of capital outlay purchases. This also accounted for the majority of the over-expenditure in the transfer out category. The net change in fund balance was primarily due to an unallotment of LGA and a transfer to pay off the SRP loan, which accounted for $79,000 and $145,000, respectively.

A summary and comparison of 2008, 2007, and 2006 General fund revenues and transfers in are as follows:

Revenue Source	2006	2007	2008	Percent of Total
Taxes	$ 824,108	$ 922,549	$ 1,078,599	49.2 %
Licenses and permits	46,325	37,365	64,454	2.9
Intergovernmental	930,144	899,615	798,606	36.4
Charges for services	74,093	53,297	89,975	4.1
Fines and forfeitures	18,669	24,336	18,625	0.9
Interest on investments	43,284	47,783	55,788	2.5
Miscellaneous	29,072	44,476	11,243	0.5
Transfers in	148,191	196,686	75,495	3.4
Total revenues and transfers	$ 2,113,886	$ 2,226,107	$ 2,192,785	100.0 %

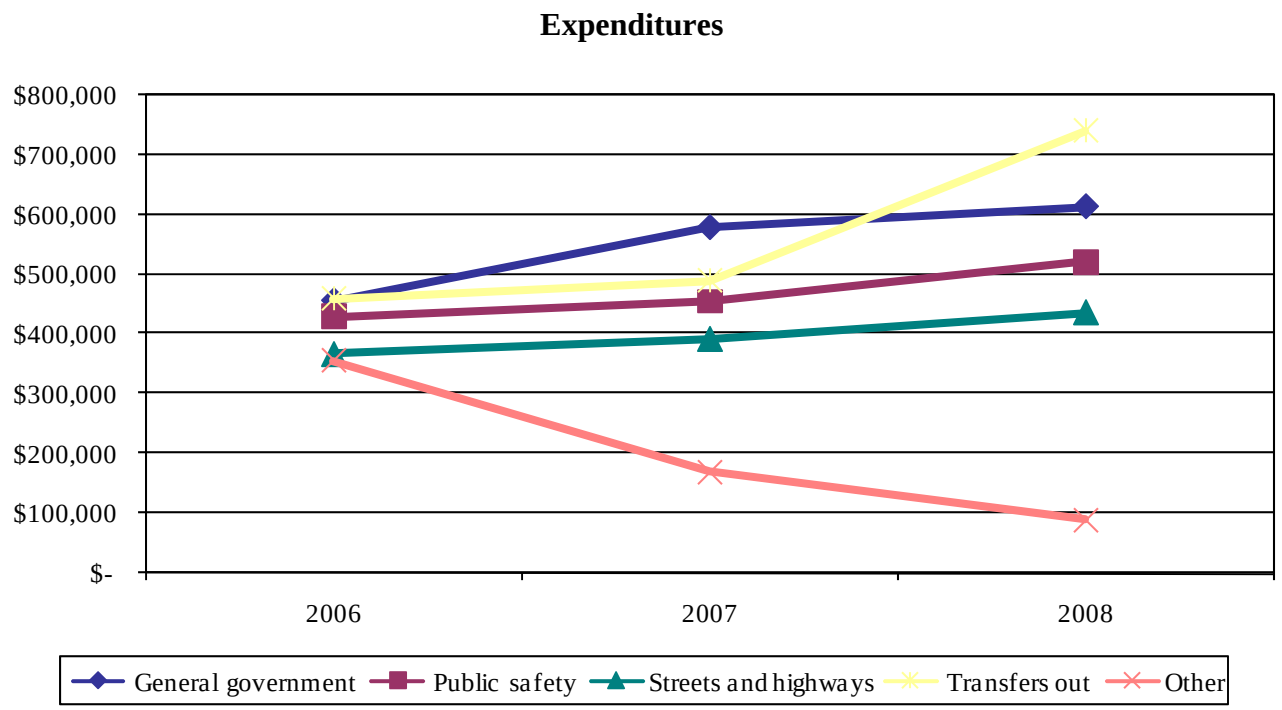
The sources of 2008, 2007, and 2006 revenues and transfers are presented graphically as follows:



A summary and comparison of 2008, 2007, and 2006 General fund expenditures and transfers out are as follows:

Program	2006	2007	2008	Percent of Total
Current				
General government	$ 455,876	$ 578,733	$ 613,840	25.5 %
Public safety	429,248	454,923	522,034	21.7
Streets and highways	366,705	392,042	436,539	18.2
Sanitation	3,984	4,129	5,049	0.3
Economic development	71,124	71,739	76,269	3.2
Total current	1,326,937	1,501,566	1,653,731	68.9
Capital outlay	64,657	84,517	-	-
Debt service	215,794	9,351	8,068	0.3
Transfers out	458,901	488,581	741,018	30.8
Total expenditures and transfers	$ 2,066,289	$ 2,084,015	$ 2,402,817	100.0 %

The 2008, 2007 and 2006 expenditures and transfers are presented graphically as follows:



Major and Nonmajor Special Revenue Funds

The major and nonmajor special revenue funds account for revenue sources that are legally restricted to expenditures for specified purposes. The funds in this account group include:

Fund	Fund Balances (Deficits) December 31, 2008	2007	Increase (Decrease)
Major			
Tax Increment Projects	$ (293,903)	$ (296,498)	$ 2,595
Nonmajor			
Business Improvement Loans	10,882	10,764	118
Melrose Area Development Authority (MADA)	(19,244)	(46,685)	27,441
Parks and Recreation	(63,837)	(387,651)	323,814
MADA Revolving Loan	458,057	411,684	46,373
Soccer League	-	422	(422)
Senior Activity Center	2,611	2,726	(115)
PIA Asset Building	2,025	(520)	2,545
Tri-Cap Bus	678	3,630	(2,952)
Fire Department	81,278	171,425	(90,147)
Total	$ 178,547	$ (130,703)	$ 309,250

All funds should have sufficient resources to provide for their operations but occasionally deficits will occur. Funds with more significant deficits are discussed below.

Melrose Area Development Authority (MADA)

The focus of the fund will be business development. The deficit is being financed by other funds and was a result of planned capital outlay in excess of reserves.

Parks and Recreation

Transfers from the General fund along with contribution commitments from civic organizations provide the funding for the activities of the Parks and Recreation fund. The deficit will be eliminated over time with these transfers and contributions.

TIF Special Revenue Funds

These funds were created in 1997 to account for the City's pay-as-you-go districts. They are also used to account for the amounts due to the General fund and the 1992 Abandoned Railroad Property Project Fund for costs paid in past years. That is the reason for the deficit and future tax increments will be applied against this balance in the future.

Debt Service Funds

Debt service funds are a type of governmental fund to account for the accumulation of resources for the payment of interest and principal on debt (other than enterprise fund debt).

Debt service funds may have one or a combination of the following revenue sources pledged to retire debt as follows:

- Property taxes - Primarily for general City benefit projects such as streets and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.

- Capitalized interest portion of bond proceeds - After the sale of bonds, the project may not produce revenue (tax increments or special assessments) for a period of one to two years. Bonds are issued with this timing difference considered in the form of capitalized interest.

- Special assessments - Charges to benefited properties for various improvements.

In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- Residual project proceeds from the related capital projects fund
- Investment earnings
- State or federal grants
- Transfers from other funds

The following is a recap of the various debt service fund assets and the related bond principal outstanding:

Debt Description	Cash Balance	Total Assets	Bonds Outstanding	Year of Maturity
Improvement Bonds of 2002	$ 59,497	$ 183,877	$ 475,000	12/01/17
Improvement Bonds of 2004	175,235	324,926	985,000	02/01/20
Improvement Bonds of 2005	710,820	1,002,623	2,370,000	02/01/21
Lease Revenue Bonds of 2008	322,611	323,297	2,360,000	02/01/29
Total G.O. and Lease Revenue Bonds	$ 1,268,163	$ 1,834,723	$ 6,190,000	

Capital Projects Funds

The capital projects funds account for the acquisition of capital assets or construction of major capital projects not being financed by proprietary funds. The funds in this group include:

Fund	Fund Balances (Deficits) December 31, 2008	Fund Balances (Deficits) December 31, 2007	Increase (Decrease)
Major			
Capital improvements	$ 2,660,333	$ 2,428,985	$ 231,348
2007 Fire and Ambulance Station	(2,705)	(17,840)	15,135
Total major	2,657,628	2,411,145	246,483
Nonmajor			
1992 Abandoned Railroad Property Project	296,498	298,897	(2,399)
2006 Tri Quality Improvement	273	31,469	(31,196)
Total nonmajor	296,771	330,366	(33,595)
Total	$ 2,954,399	$ 2,741,511	$ 212,888

In 1990, several of the designated funds within the General fund were transferred to establish the Capital Improvement fund. Other revenue sources, which were available, have been transferred to this fund. This fund gives the City the ability to finance its capital improvement projects internally rather than issuing bonds and incurring the related issuance costs. The City has also planned well for its use through a thorough fund balance designation policy

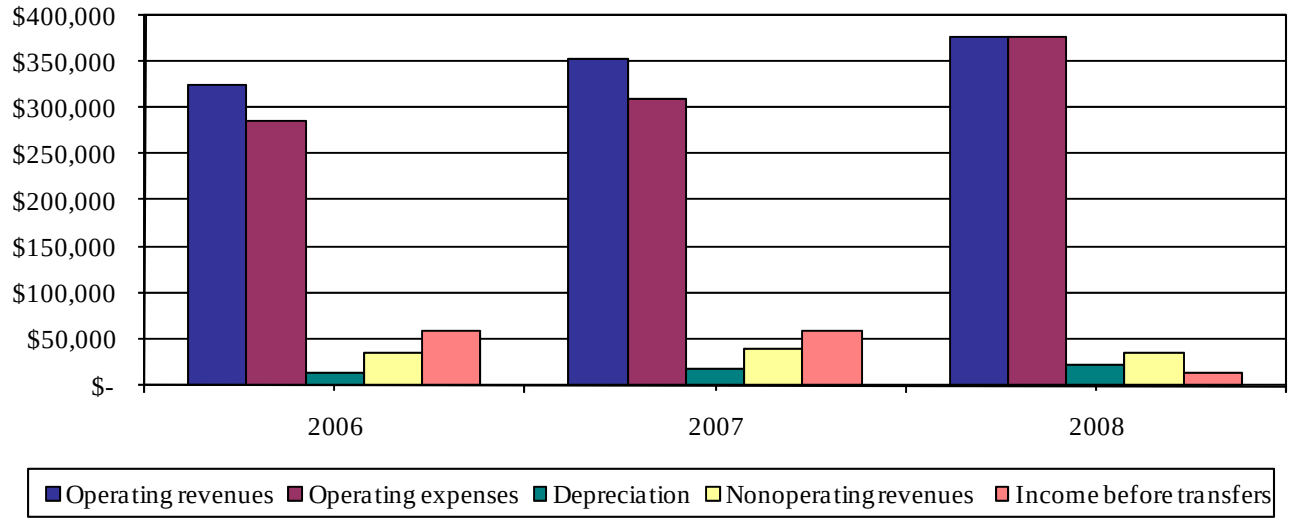
Proprietary Funds

The operations of the Ambulance fund for the past three years are summarized as follows:

Ambulance Fund Operations

	2006		2007		2008	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Amount	Percent of Revenue
Operating revenues	$ 324,116	100.0 %	$ 351,531	100.0 %	$ 376,660	100.0 %
Operating expenses	(285,181)	(88.0)	(310,133)	(88.2)	(376,706)	(100.0)
Depreciation	(13,814)	(4.3)	(16,569)	(4.7)	(21,638)	(5.7)
Operating income (loss)	25,121	7.7	24,829	7.1	(21,684)	(5.7)
Nonoperating revenues	33,547	10.4	39,105	11.1	33,593	8.9
Income before transfers	58,668	18.1	63,934	18.2	11,909	3.2
Operating transfers						
Transfers out	-	-	(5,000)	(1.4)	-	-
Change in net assets	$ 58,668	18.1 %	$ 58,934	16.8 %	$ 11,909	3.2 %
Cash and investments	$ 586,801		$ 537,091		$ 483,181	

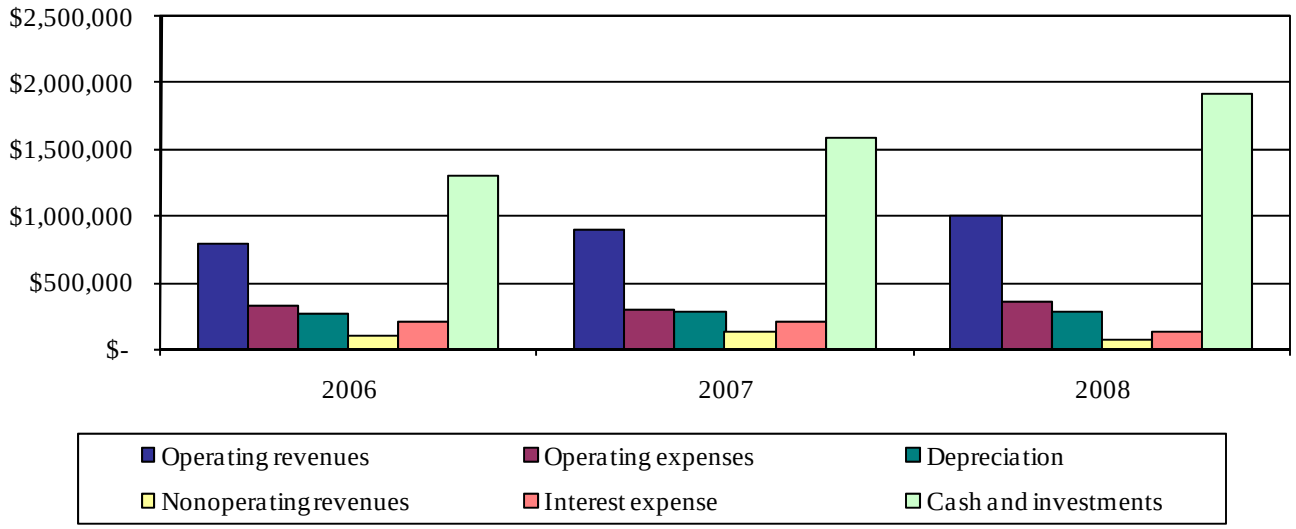
The cash balance is at a level sufficient to provide for working capital and other needs.



The operations of the Water fund for the past three years are summarized as follows:

Water Fund Operations

	2006		2007		2008	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Amount	Percent of Revenue
Operating revenues	$ 786,861	100.0 %	$ 903,510	100.0 %	$ 1,004,684	100.0 %
Operating expenses	(332,559)	(42.3)	(306,757)	(34.0)	(366,616)	(36.5)
Depreciation	(274,657)	(34.9)	(286,637)	(31.7)	(283,403)	(28.2)
Operating income	179,645	22.8	310,116	34.3	354,665	35.3
Nonoperating revenues	104,142	13.2	131,418	14.5	80,469	8.0
Interest expense	(208,691)	(26.5)	(204,652)	(22.7)	(138,710)	(13.8)
Income before transfers	75,096	9.5	236,882	26.1	296,424	29.5
Contributed assets	236,992	30.1	189,986	21.0	71,630	7.1
Change in net assets	$ 312,088	39.6 %	$ 426,868	47.1 %	$ 368,054	36.6 %
Cash and investments	$ 1,295,552		$ 1,581,994		$ 1,912,983	
Loans and bonds payable	$ 5,080,700		$ 4,859,700		$ 3,333,700	

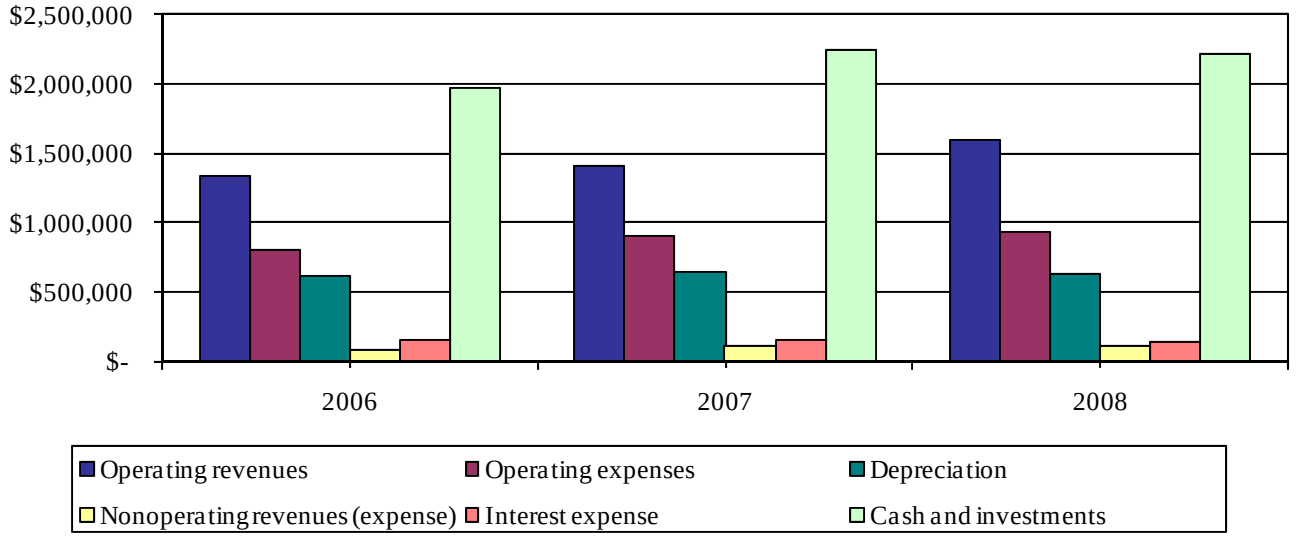


The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations and debt service.

The operations of the Wastewater fund for the past three years are summarized as follows:

Wastewater Fund Operations

	2006		2007		2008	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Amount	Percent of Revenue
Operating revenues	$ 1,331,739	100.0 %	$ 1,409,302	100.0 %	$ 1,599,767	100.0 %
Operating expenses	(797,531)	(59.9)	(910,489)	(64.6)	(936,434)	(58.5)
Depreciation	(616,328)	(46.3)	(643,760)	(45.7)	(634,621)	(39.7)
Operating income (loss)	(82,120)	(6.2)	(144,947)	(10.3)	28,712	1.8
Nonoperating revenues	85,915	6.5	109,476	7.8	115,072	7.2
Interest expense	(162,623)	(12.2)	(155,670)	(11.0)	(147,263)	(9.2)
Loss before transfers	(158,828)	(11.9)	(191,141)	(13.5)	(3,479)	(0.2)
Contributed assets	965,997	72.5	792,785	56.3	121,625	7.6
Change in net assets	$ 807,169	60.6 %	$ 601,644	42.8 %	$ 118,146	7.4 %
Cash and investments	$ 1,962,490		$ 2,237,136		$ 2,218,950	
Loans and bonds payable	$ 3,550,000		$ 3,395,000		$ 3,230,000	

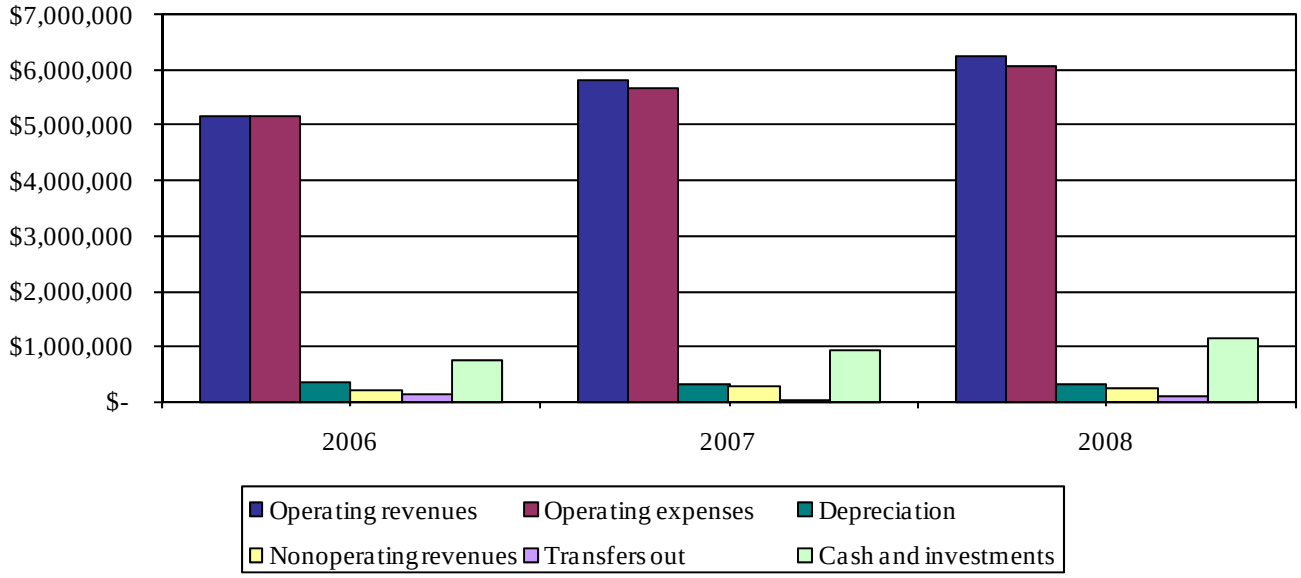


The cash balance remains strong in relation to operations but like the Water fund, it will be important to maintain cash flow to cover future debt service.

The operations of the Electric fund for the past three years are summarized as follows:

Electric Fund Operations

	2006		2007		2008	
	Amount	Percent of Revenues	Amount	Percent of Revenues	Amount	Percent of Revenues
Operating revenues	$ 5,174,467	100.0 %	$ 5,811,579	100.0 %	$ 6,239,696	100.0 %
Operating expenses	(5,145,889)	(99.4)	(5,665,912)	(97.5)	(6,074,445)	(97.4)
Depreciation	(353,713)	(6.8)	(342,560)	(5.9)	(332,737)	(5.3)
Operating loss	(325,135)	(6.2)	(196,893)	(3.4)	(167,486)	(2.7)
Nonoperating revenues	219,503	4.2	285,912	4.9	241,521	3.9
Loss on disposal of fixed assets	(1,850)	-	-	-	-	-
Income (loss) before transfers	(107,482)	(2.0)	89,019	1.5	74,035	1.2
Contributed assets	-	-	34,546	(0.6)	-	-
Transfers out	(126,856)	(2.5)	(40,000)	(0.7)	(103,040)	(1.7)
Change in net assets	$ (234,338)	(4.5) %	$ 83,565	0.2 %	$ (29,005)	(0.5) %
Cash and investments	$ 757,144		$ 925,661		$ 1,164,407	



City Obligation to the Firefighter's Relief Association

The Council approves the Association's per year of service benefit level. The benefit level is currently $1,250 per year of active service. As the Council approves the retirement benefit level, the City is ultimately liable to provide these pension funds if the assets of the Association are not sufficient. In the annual report, the Association's liabilities exceeded their assets as follows:

	Required Supplementary Information				
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Assets in Excess of (Unfunded) Accrued Liability	Funded Rate	Benefit per Year of Service
12/31/08	$ 288,479	$ 362,483	(74,004)	79.6 %	1,250
12/31/07	349,073	341,033	8,040	102.4	1,250
12/31/06	302,251	302,296	(45)	100.0	1,200
12/31/05	293,087	317,757	(24,670)	92.2	1,200
12/31/04	290,245	330,705	(40,460)	87.8	1,200
12/31/03	254,981	276,350	(21,369)	92.3	1,000

Other Matters

Ratio Analysis

The following captures a few ratios from the City's financial statements that give some additional information for trend and peer group analysis. The peer group average is derived from information available on the website of the Office of the State Auditor. The peer group included in the chart below is made up of Cities of the 4th class (under 10,000). The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities regardless of size) ratios are shown below.

Ratio	Calculation	Source	2005	2006	2007	2008
Debt to assets	Total liabilities/total assets	Government-wide	**28%**	**27%**	**26%**	**26%**
			37%	**35%**	**33%**	**N/A**
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	**124%**	**143%**	**160%**	**220%**
			154%	**168%**	**181%**	**N/A**
Debt per capita	Bonded debt/population	Government-wide	**$ 4,073**	**$ 3,923**	**$ 3,744**	**$ 3,863**
			$ 2,662	**$ 2,505**	**$ 2,673**	**N/A**
Taxes per capita	Tax revenues/population	Government-wide	**$ 295**	**$ 366**	**$ 391**	**$ 442**
			$ 330	**$ 346**	**$ 382**	**N/A**
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	**82%**	**80%**	**77%**	**86%**
			71%	**70%**	**70%**	**N/A**
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	**66%**	**64%**	**62%**	**61%**
			72%	**68%**	**68%**	**N/A**

Represents the City of Melrose
Peer Group ratio

Debt-to-Assets Leverage Ratio (Solvency Ratio)

The debt-to-assets leverage ratio is a comparison of a city's total liabilities to its total assets or the percentage of total assets that are provided by creditors. It indicates the degree to which the City's assets are financed through borrowings and other long-term obligations (i.e. a ratio of 50 percent would indicate half of the assets are financing with outstanding debt).

Debt Service Coverage Ratio (Solvency Ratio)

The debt coverage ratio is a comparison of cash generated by operations to total debt service payments (principal and interest) of enterprise funds. This ratio indicates if there are sufficient cash flows from operations to meet debt service obligations. Except in cases where other nonoperating revenues (i.e. taxes, assessments, transfers from other funds, etc.) are used to fund debt service payments, an acceptable ratio would be above 100 percent.

Bonded Debt per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total bonded debt by the population of the city and represents the amount of bonded debt obligation for each citizen of the city at the end of the year. The higher the amount, the more resources are needed in the future to retire these obligations through taxes, assessments or user fees.

Taxes per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total tax revenues by the population of the city and represents the amount of taxes for each citizen of the city for the year. The higher this amount is, the more reliant the city is on taxes to fund its operations.

Capital Assets Percentage (Common-size Ratio)

This percentage represents the percent of governmental or business-type capital assets that are left to be depreciated. The lower this percentage, the older the city's capital assets are and may need major repairs or replacements in the near future. A higher percentage may indicate newer assets being constructed or purchased and may coincide with higher debt ratios or bonded debt per capita.

Future Statute and Accounting Standard Changes

2009 Levy Limits

During the 2008 legislative session, Minnesota legislators amended Statutes section 275.71 to enact levy limits for cities over 2,500 in population. This bill is in effect for taxes levied in 2008 through 2010. Annually the levy limit is multiplied by:

1. One plus the lesser of 3.9 percent or the percentage growth in the implicit price deflator.
2. One plus a percentage equal to 50 percent of the percentage increase in the number of households, if any, for the most recent 12-month period for which data is available, and
3. One plus a percentage equal to 50 percent of the percentage increase in the taxable market value of the jurisdiction due to new construction of class 3 property, as defined in section 273.13, subdivision 4, except for state-assessed utility and railroad property, for the most recent year for which data is available.

In addition there are special levies that are currently allowed outside any levy limit. They are listed below:

- Debt levies – includes bonds, most certificates of indebtedness and levies to pay the local share of bonds issued by another political subdivision
- Voter approved levy increases
- To pay federal or state matching fund requirements for programs instituted after 2001
- For costs to prepare for, or recovery from, natural disasters – upon approval by the commission of revenue
- To pay amounts related to errors in levy certification in the previous year
- To pay for property tax abatements
- To pay increases in the employer share of PERA pension costs since 2001
- To pay operating and maintenance costs of county jails to the extent that the cost is required by the Department of Corrections Rules and Standards.
- To pay for a lake improvement district
- To repay a federal or state loan issued to help a local government pay the required local share of a federal or state transportation or other capital project
- To pay court administration costs during the period in which court costs were being transferred from the counties to the state
- To fund required police and firefighters relief funds, to the extent that the costs exceed costs in 2001
- To fund a storm sewer improvement district
- To fund an animal protection society
- For counties, to pay for the increase in their share of health and human service costs caused by reductions in federal health and human service grants effective after September 30, 2007
- To fund increased costs of securing, maintaining, and demolishing foreclosed and abandoned housing in cities that have a 2007 foreclosure rate over a certain percent
- To lost traffic citation revenue and unreimbursed costs of redeployed traffic control agents due to the collapse of the Interstate 35W bridge
- To fund certain cost increases in police and firefighter costs
- To recoup losses due to any unallotment of city and county general purpose aids and credits

We recommend that the City review all of the options presented when calculating future years levies. There is further guidance provided by League of Minnesota Cities on how to estimate the 2009 levy limit on their website: www.lmc.org

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future City financial statements:

GASB Statement No. 45 - *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*

This statement is effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Governments that were phase 1 governments for the purpose of implementation of Statement No. 34 - those with annual revenues of $100 million or more - are required to implement this Statement in financial statements for periods beginning after December 15, 2006.

- Governments that were phase 2 governments for the purpose of implementation of Statement No. 34 - those with total annual revenues of $10 million or more but less than $100 million - are required to implement this Statement in financial statements for periods beginning after December 15, 2007.

- Governments that were phase 3 governments for the purpose of implementation of Statement No. 34 - those with total annual revenues of less than $10 million - are required to implement this Statement in financial statements for periods beginning after December 15, 2008.

Statement No. 45 gives the following summary, "In addition to pensions, many state and local governmental employers provide other postemployment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes postemployment healthcare, as well as other forms of postemployment benefits (for example, life insurance) when provided separately from a pension plan. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers."

GASB Statement No. 51 - *Accounting and Financial Reporting for Intangible Assets*

This statement was issued in June 2007 and is effective for periods beginning after June 15, 2009.

The new standard characterizes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. Examples of intangible assets include easements, computer software, water rights, timber rights, patents, and trademarks.

This statement requires that intangible assets be classified as capital assets (except for those explicitly excluded from the scope of the new standard, such as capital leases). Relevant authoritative guidance for capital assets should be applied to these intangible assets. The statement provides additional guidance that specifically addresses the unique nature of intangible assets, including:

- Requiring that an intangible asset be recognized in the statement of net assets only if it is considered identifiable

- Establishing a specified-conditions approach to recognizing intangible assets that are internally generated (for example, patents and copyrights)

- Providing guidance on recognizing internally generated computer software

- Establishing specific guidance for the amortization of intangible assets.

GASB Statement No. 54 – *Fund Balance*

This statement was issued in March of 2009 and is effective for periods beginning after June 15, 2010.
This new standard is intended to improve the usefulness of information provided to financial report uses about fund balance by providing clearer, more structured fund balance classifications, and clarifying the definitions of existing governmental fund types.

GASB No. 54 distinguishes fund balance between amounts that are considered non-spendable, such as fund balance associated with inventories, and other amounts that are classified based on the relative strength of the constraints that control the purposes for which specific amounts can be spent. The following classifications and definitions will be used:

- *Restricted* - amounts constrained by external parties, constitutional provision, or enabling legislation
- *Committed*—amounts constrained by a government using its highest level of decision-making authority
- *Assigned*—amounts a government intends to use for a particular purpose
- *Unassigned*—amounts that are not constrained at all will be reported in the general fund.

In addition to the classifications of fund balance, the standard clarified the definitions of individual governmental fund types, for example, special revenue funds, debt service funds, and capital project funds.

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This report is intended solely for the information and use of City, management, others within the City and the Minnesota Office of the State Auditor and is not intended to be and should not be used by anyone other than these specified parties.

Our audit would not necessarily disclose all weaknesses in the system because it was based on selected tests of the accounting records and related data. The comments and recommendations in the report are purely constructive in nature, and should be read in this context.

If you have any questions or wish to discuss any of the items contained in this letter, please feel free to contact us at your convenience. We wish to thank you for the continued opportunity to be of service and for the courtesy and cooperation extended to us by your staff.

Abdo Eick & Meyers, LLP

March 19, 2009
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants