Management Letter

City of Melrose

Melrose, Minnesota

For the Year Ended
December 31, 2014

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

People + Process. Going Beyond the Numbers

ABDO
EICK &
MEYERS LLP
Certified Public Accountants & Consultants

April 6, 2015

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

We have audited the financial statements of the governmental activities, the business-type activities, discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Melrose, Minnesota (the City), for the year ended December 31, 2014. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Audit Standards* as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter dated November 3, 2014. 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

In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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.

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. A *significant deficiency* is a deficiency, or a 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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Compliance

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 laws, regulations, contracts and grants, 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. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or statutes set forth by the State of Minnesota.

Summary of Prior Year Findings

2014-001 Preparation of financial statements

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 City 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.

Current year status:

The client drafted the audited financial statements and related footnote disclosures for the year ended December 31, 2014 and this finding was removed.

2014-002 Reconciliation of investments

Condition: During our audit, we noted that although reconciliations were partially completed for the City's investment accounts, finance system entries are not always completed for each transaction.

Criteria: Timely reconciliations are an important control activity in the City's overall internal control structure.

Current year status:

The investments were properly reconciled during 2014 and this finding was removed.

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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 ended December 31. 2014. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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 significant estimates affecting the financial statements were capital asset basis, depreciation, compensated absences, other postemployment benefits, and allocation of payroll.

- Management's estimate of depreciation is based on estimated useful lives of the assets. Depreciation is calculated using the straight-line method.

- Management's estimate of its OPEB liability is based on several factors including, but not limited to, anticipated retirement age for active employees, life expectancy, turnover, and healthcare cost trend rate.

- Allocations of gross wages and payroll benefits are approved by the City Council within the City's budget and are derived from each employee's estimated time to be spent servicing the respective function of the City. These allocations are also used in allocating accrued compensated absences payable.

We evaluated the key factors and assumptions used to develop these accounting estimates in determining that it is reasonable in relation to the financial statements taken as a whole.

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.

We also assisted in preparing a number of year end accounting entries. These were necessary to adjust the City's records at year end to correct ending balances.

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 April 6, 2015**.**

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

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

Financial Position and Results of Operations

Our principal observations and recommendations are summarized on the following pages. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended December 31, 2014.

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 $206,325 from 2013. The fund balance of $1,567,459 is 66.8 percent of the 2015 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. The City has formally adopted a fund balance policy for the General fund to maintain a minimum unrestricted fund balance of 35-50 percent of the next year's budgeted expenditures. The City's ending fund balance is above this target level.

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.

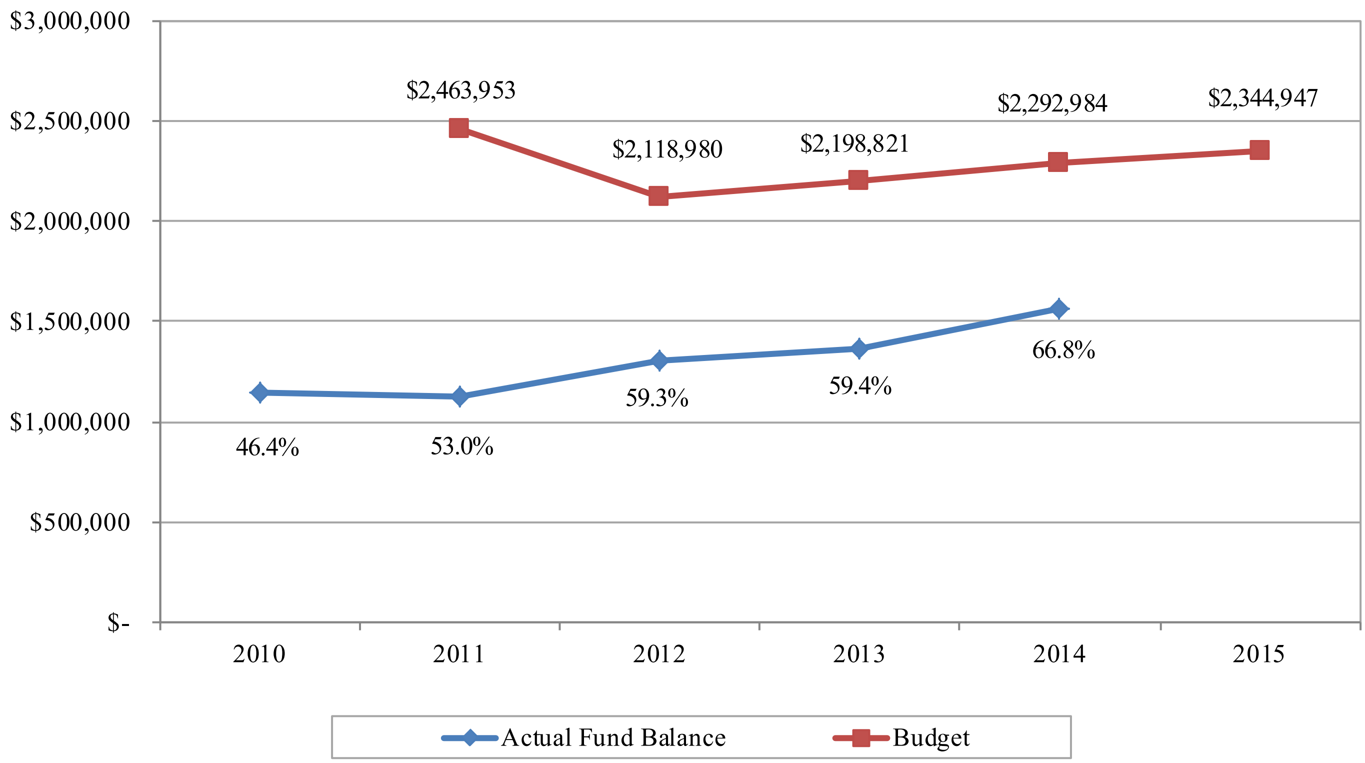
- Expenditures not anticipated at the time the annual budget was adopted may need immediate City Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

- 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.

A table summarizing the General fund balance in relation to the following years' budget follows:

Year	Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2010	$ 1,143,622	2011	$ 2,463,953	46.4 %
2011	1,122,806	2012	2,118,980	53.0
2012	1,304,882	2013	2,198,821	59.3
2013	1,361,134	2014	2,292,984	59.4
2014	1,567,459	2015	2,344,947	66.8

Fund Balance as a Percent of Next Year's Budget



A summary of the 2014 operations are as follows:

	Final Budget Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 2,303,509	$ 2,390,808	$ 87,299
Expenditures	1,723,094	1,589,557	133,537
Excess of revenues over expenditures	580,415	801,251	220,836
Other financing sources (uses)			
Sale of capital assets	-	7,240	7,240
Transfers out	(569,890)	(602,166)	(32,276)
Total other financing sources (uses)	(569,890)	(594,926)	(25,036)
Net change in fund balances	10,525	206,325	195,800
Fund balances, January 1	1,361,134	1,361,134	-
Fund balances, December 31	$ 1,371,659	$ 1,567,459	$ 195,800

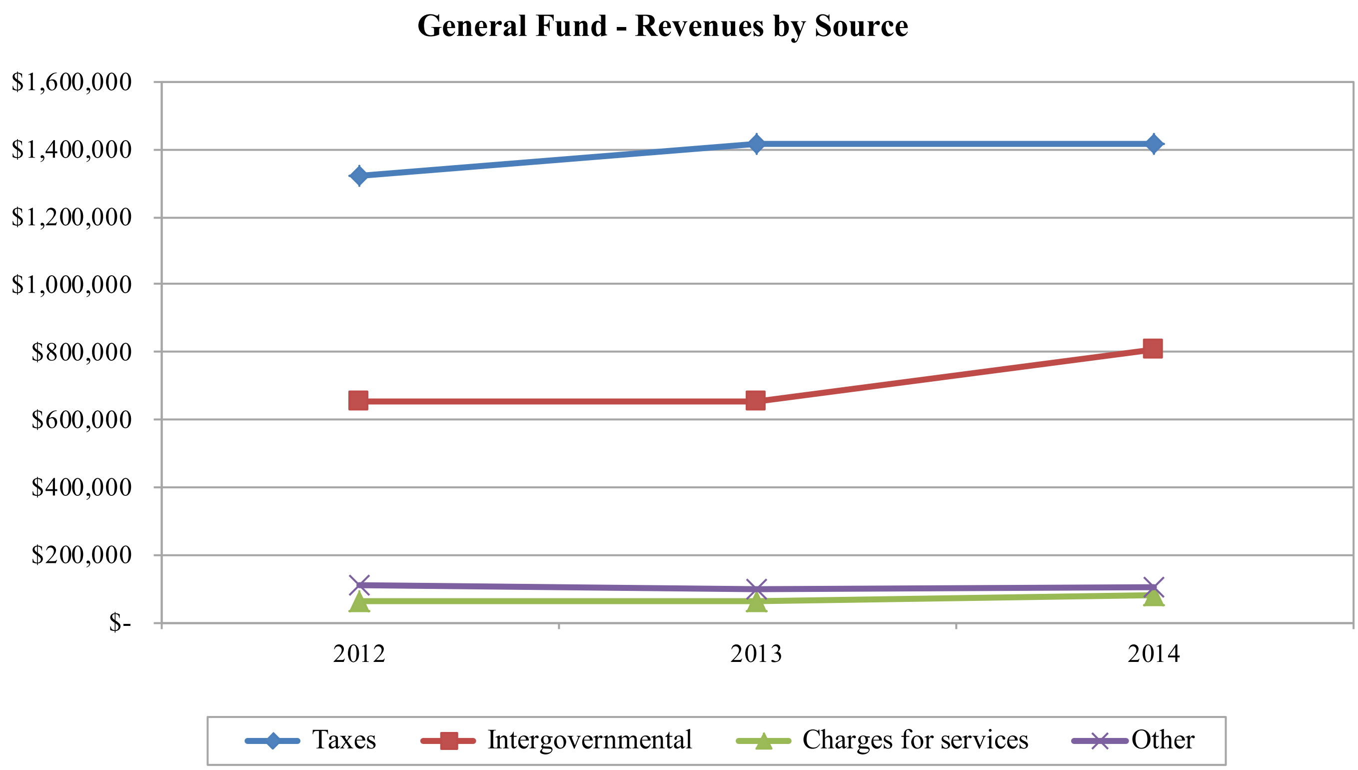
- The most significant revenue variances were in taxes and charges for service which were over budget by $55,364 and $11,339, respectively. The taxes variance was primarily due to franchise fee collections in excess of budget.

- The most significant expenditure variance was in the general government and public safety functions which were under budget by $83,600 and $35,052, respectively. The variance in general government was the result of the vacancy of the finance director position through the first half of 2014.

A comparison between 2012, 2013, and 2014 General fund revenues is presented below:

Revenue Source	2012	2013	2014	Percent of Total	Per Capita
Taxes	$ 1,320,776	$ 1,418,010	$ 1,413,164	58.9 %	$ 389
Licenses and permits	48,217	44,421	49,535	2.1	14
Intergovernmental	655,259	650,769	804,784	33.6	221
Charges for services	63,019	62,244	77,139	3.2	21
Fines and forfeitures	18,825	18,545	15,131	0.6	4
Interest on investments	29,544	19,203	18,543	0.8	5
Miscellaneous	13,253	16,671	19,752	0.8	5
Total revenues	$ 2,148,893	$ 2,229,863	$ 2,398,048	100.0 %	$ 659

A graphical presentation of 2012, 2013, and 2014 revenues follows:



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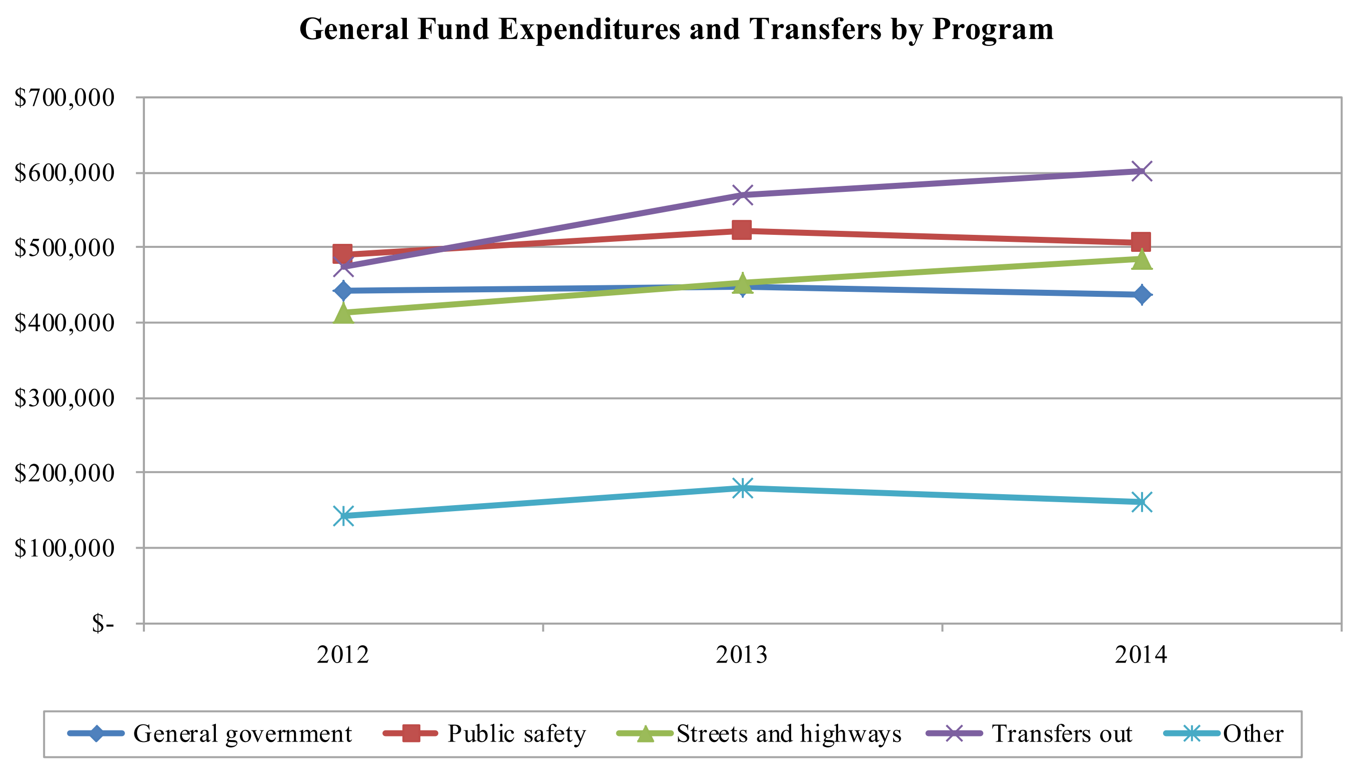
A comparison between 2012, 2013, and 2014 General fund expenditures and transfers is presented below:

Program	2012	2013	2014	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 443,745	$ 448,253	$ 436,645	19.9 %	$ 120	$ 125
Public safety	491,013	522,662	507,440	23.2	140	218
Streets and highways	414,043	453,118	483,943	22.1	133	106
Sanitation	5,255	4,119	3,679	0.2	1	-
Culture and recreation	51,285	59,284	65,961	3.0	18	54
Economic development	84,489	90,654	91,639	4.2	25	4
Total current	1,489,830	1,578,090	1,589,307	72.6	437	507
Capital outlay	-	23,174	-	-	-	34
Debt service	1,468	1,218	250	-	-	-
Transfers out	475,519	571,129	602,166	27.4	166	-
Total expenditures and transfers	$ 1,966,817	$ 2,173,611	$ 2,191,723	100.0 %	$ 603	$ 541

The above chart compares the amount the City spends per capita, in comparison to a peer group. The peer group average is compiled from information we have requested from the Office of the State Auditor of 4th class cities with populations between 2,500-10,000.

A graphical presentation of 2012, 2013, and 2014 expenditures and transfers totals by program follows:



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Special Revenue Funds

The nonmajor special revenue funds account for revenue sources that are restricted or committed to expenditure for specified purposes. The funds in this account group include:

Fund	Fund Balances December 31, 2014	Fund Balances December 31, 2013	Increase (Decrease)
Nonmajor			
Senior Activity Center	$ 2,219	$ 2,875	$ (656)
PIA Asset Building	248	248	-
Tri-Cap Bus	3,490	5,838	(2,348)
Yellow Bike Program	1,686	1,899	(213)
Fire Department	255,041	221,405	33,636
Total	$ 262,684	$ 232,265	$ 30,419

Capital Projects Funds

The capital projects funds account for the financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets not being financed by proprietary funds. The funds in this group include:

Fund	Fund Balances December 31, 2014	Fund Balances December 31, 2013	Increase (Decrease)
Major			
Capital improvements	$ 3,936,376	$ 3,701,460	$ 234,916
Nonmajor			
5th Ave. Bridge Improvements	358,495	-	358,495
Tax increment projects	14,525	-	14,525
Total nonmajor	373,020	-	373,020
Total	$ 4,309,396	$ 3,701,460	$ 607,936

In 1990, several of the designated funds within the General fund were transferred to establish the Capital Improvements 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 policy.

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.

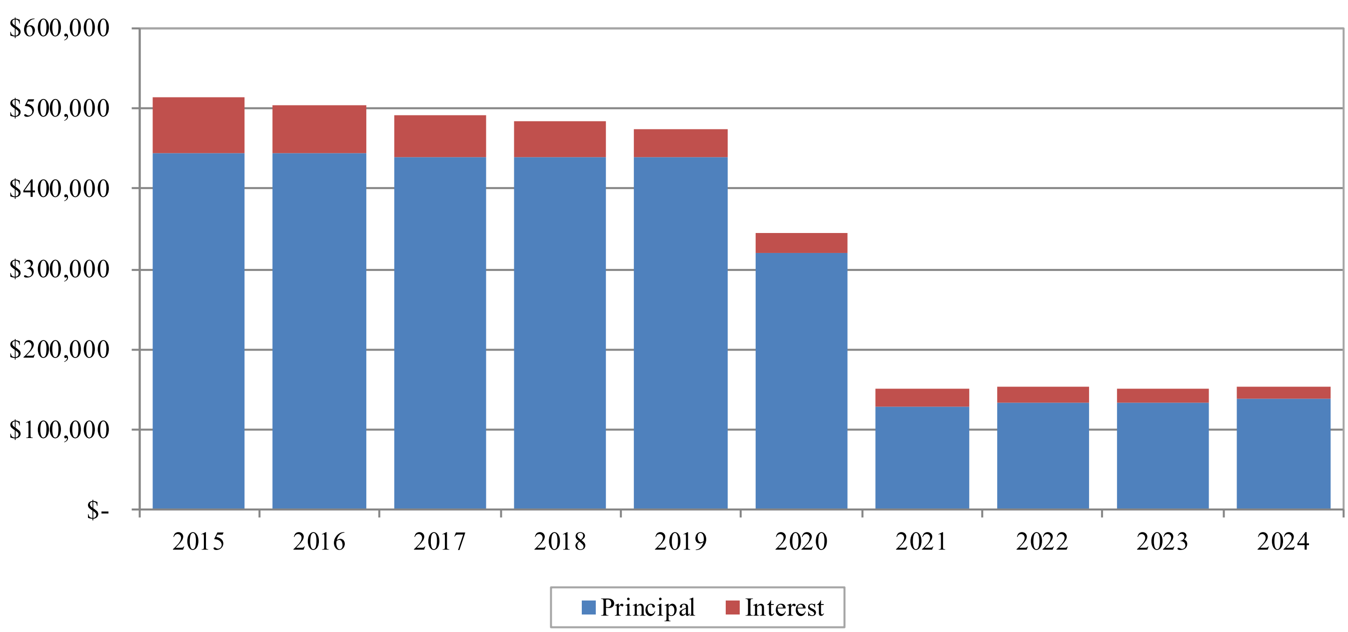
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- Residual project proceeds from the related capital projects fund
- Investment earnings
- 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
G.O. Improvement Refunding Bonds, Series 2011A	$ 315,038	$ 366,102	$ 1,775,000	02/01/20
G.O. Capital Improvement Plan Bonds, Series 2013A	152,625	152,625	1,875,000	02/01/28
Total	$ 467,663	$ 518,727	$ 3,650,000	
Total future scheduled interest payments			$ 379,116	

Debt Service Scheduled Principal and Interest for the Next 10 Years



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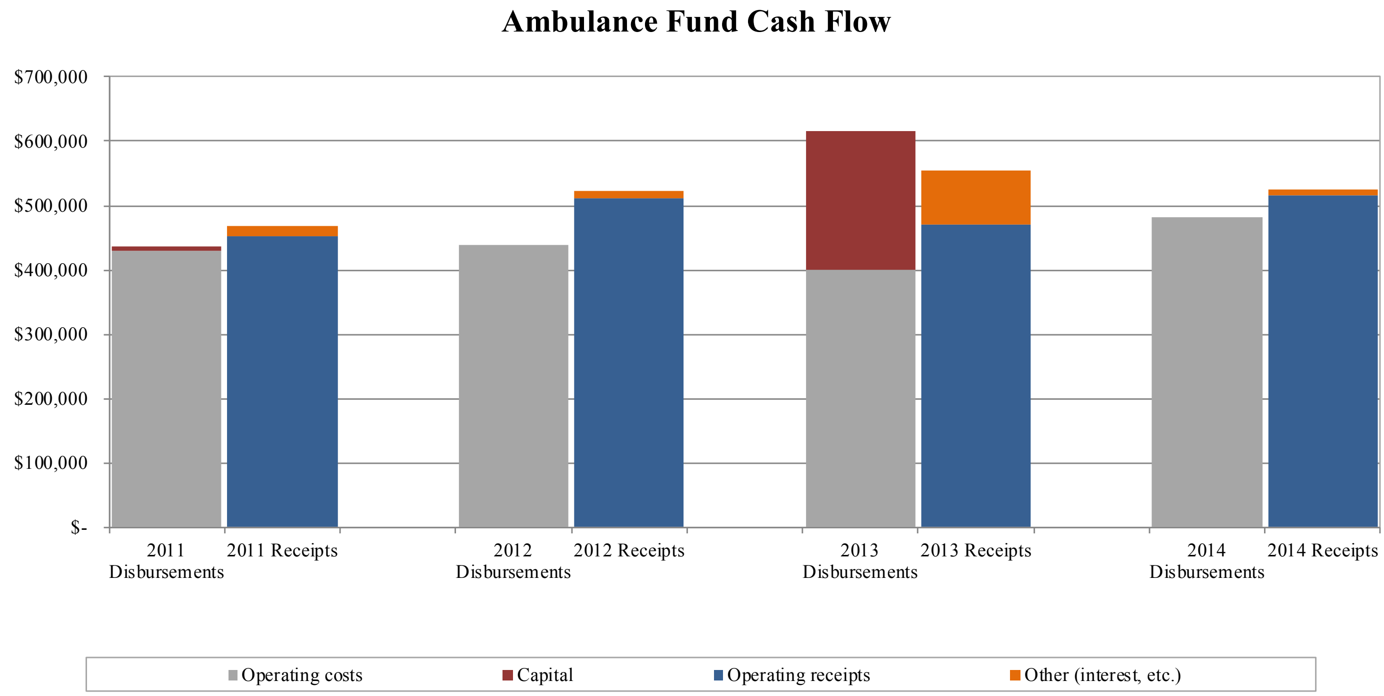
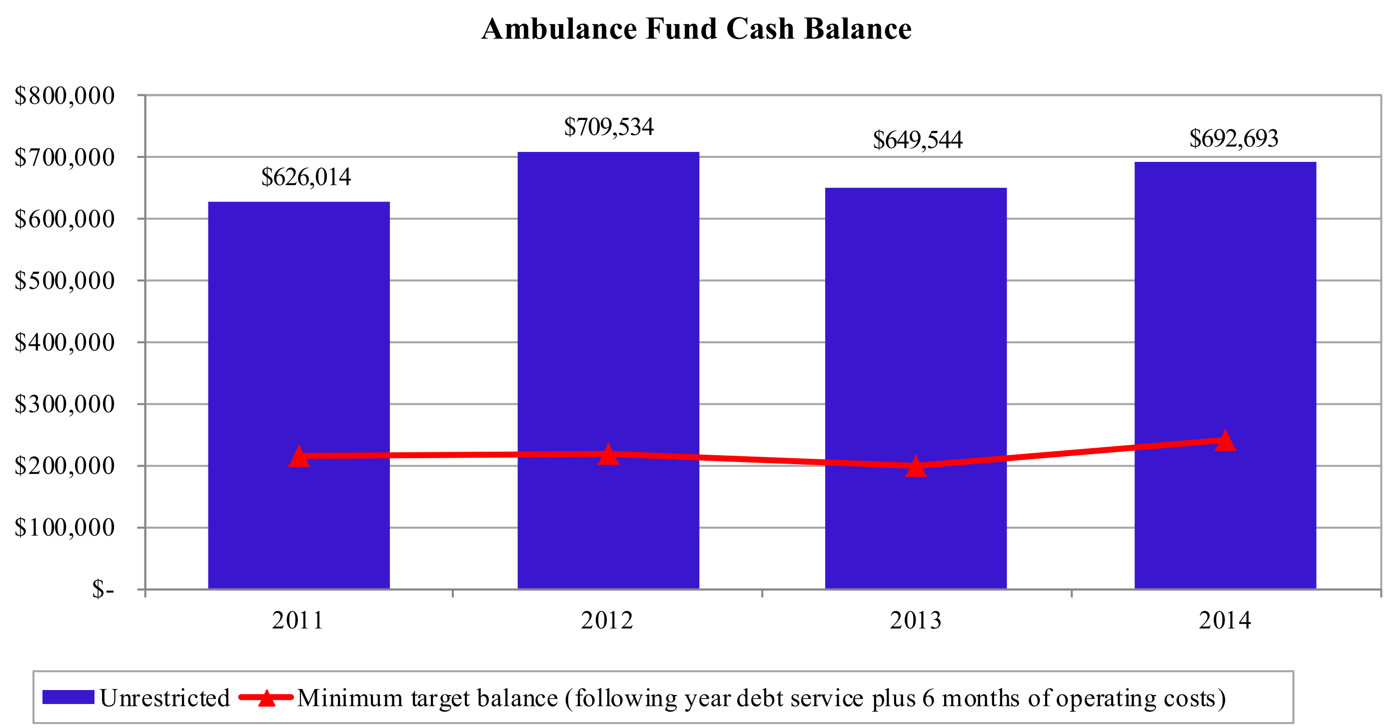
Enterprise Funds

Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. The results of the operations in terms of cash flow and the breakdown of the cash balances for the past four years are as follows:





Some of the items with significant changes are highlighted below:

- Operating receipts (blue) were sufficient to cover operating costs (grey) in each of the prior four years.

The cash balance increased from the prior year as a result of operations and it is at a level sufficient to provide for working capital and other needs. The change in net position was positive and the fund has healthy reserves relative to operations.

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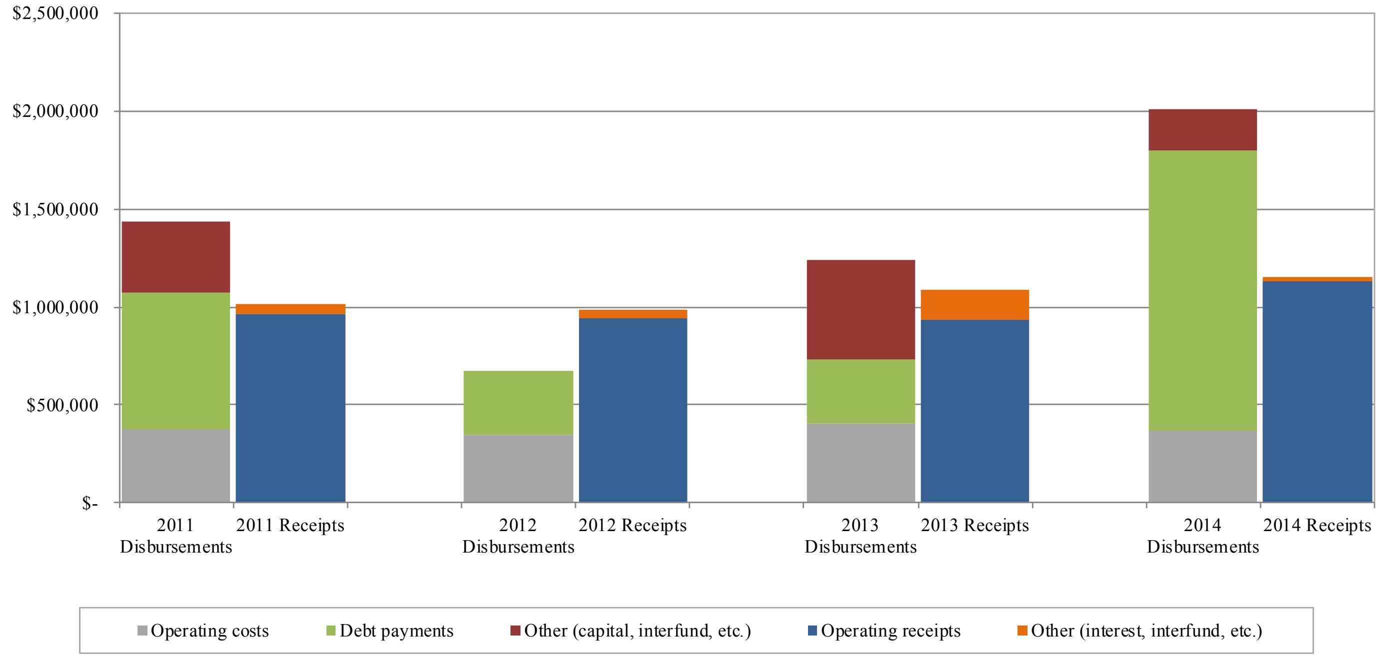
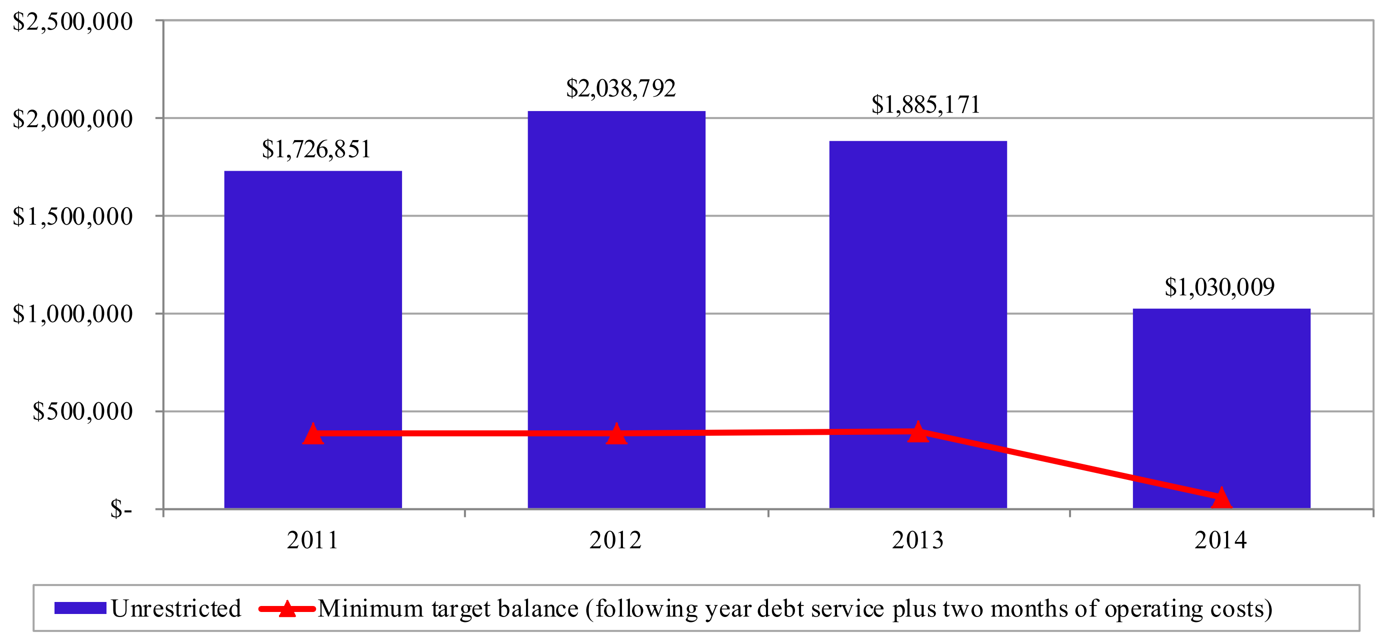
Water Fund Cash Flow



Water Fund Cash Balance

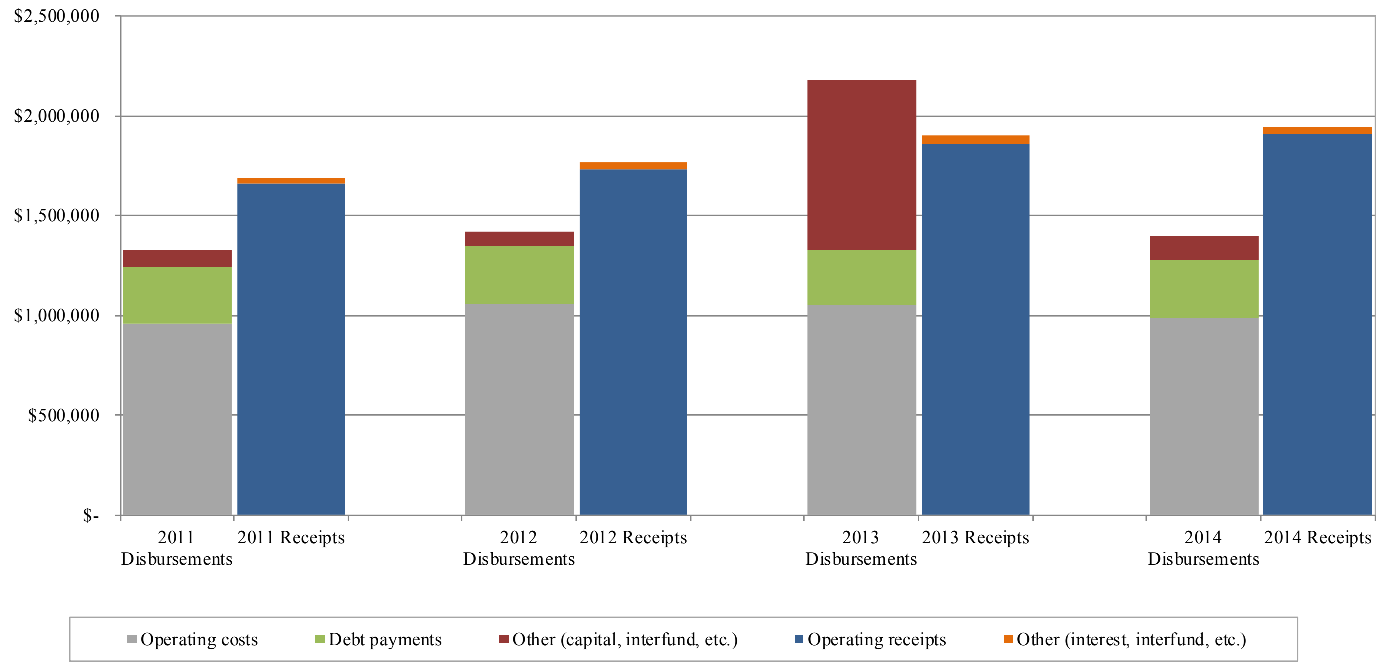


Some of the items with significant changes are highlighted below:

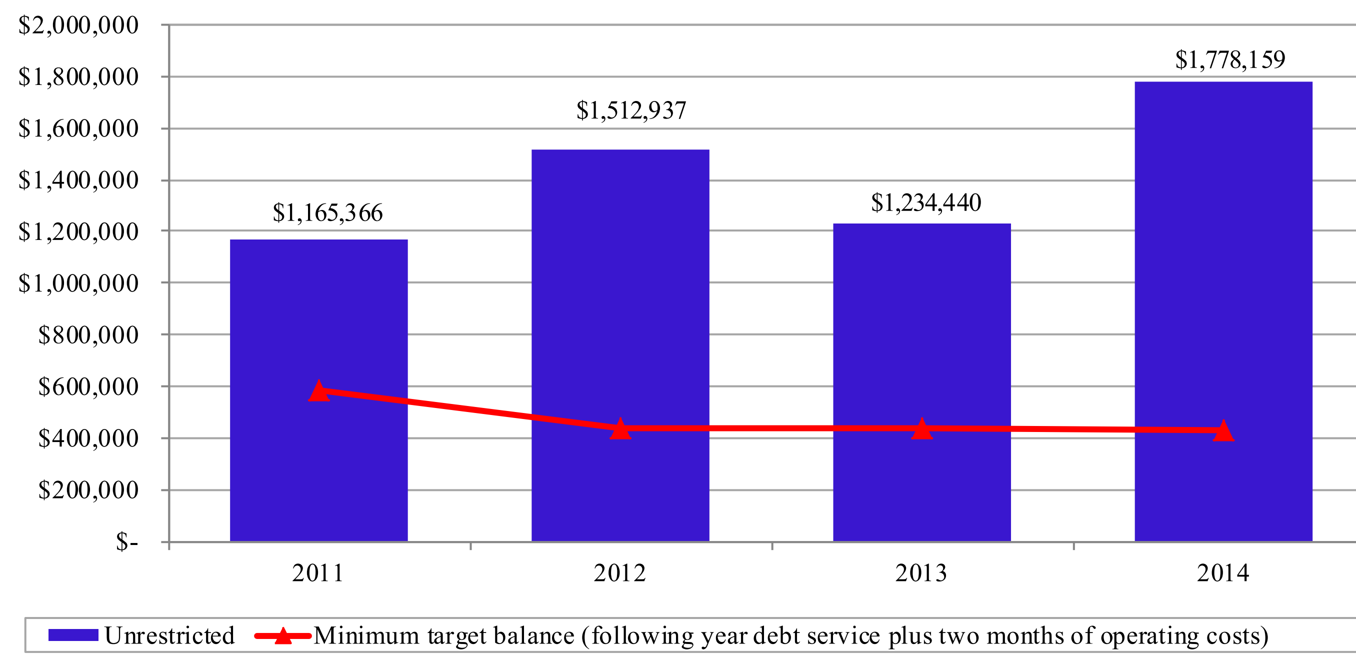
- Operating receipts (blue) were sufficient to cover operating costs (grey) and debt payments (green) in the prior two years.
- The decrease in the cash balance in 2014 was a result of the prepayment of the 1999 G.O. Water Revenue Note ($416,700) and the 2005 G.O. Water Revenue Crossover Refunding bond ($700,000).
- Net cash provided by operations totaled approximately $760,000 in 2014.
- Targeted cash balance in 2014 decreased to approximately $55,000 as a result of the prepayment of the bonds as noted above and currently no future bond payments.

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.

Wastewater Fund Cash Flow



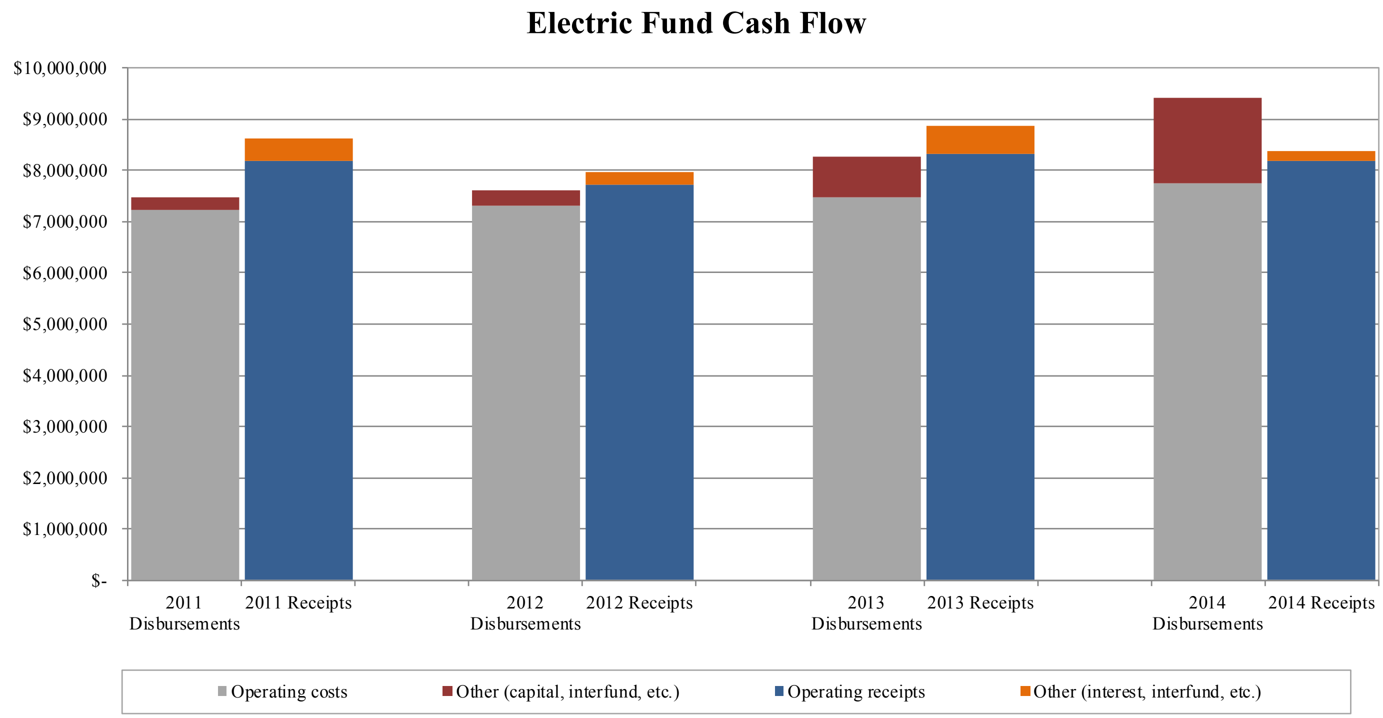
Wastewater Fund Cash Balance

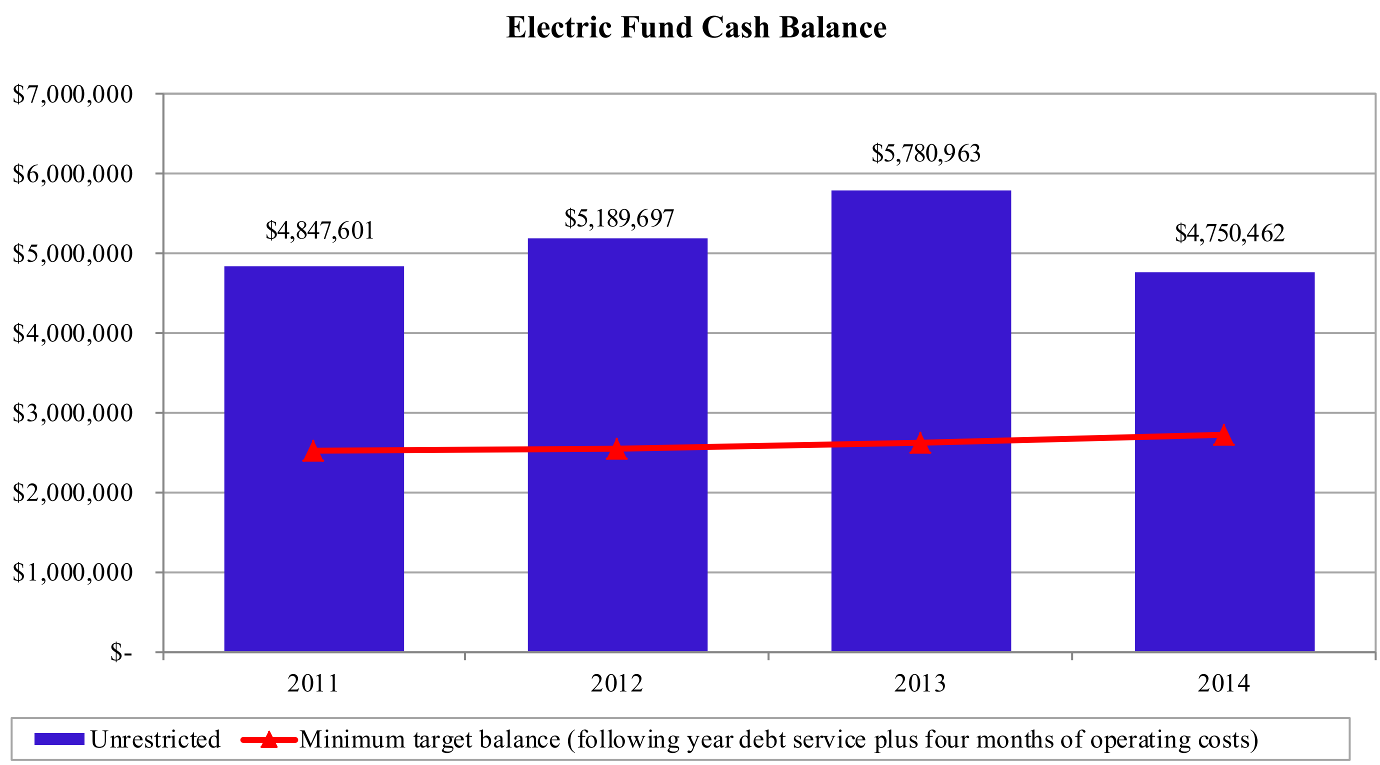


Some of the items with significant changes are highlighted below:

- Operating receipts (blue) were sufficient to cover operating costs (grey) and debt payments (green) in each of the prior four years.
- The increase in the cash balance in 2014 was a result of net cash provided by operations totaling approximately $920,000.
- Operating receipts were higher than expectations related to industrial charges for service revenue and operating costs decreased due to the vacant public works director positon in 2014.

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.





Some of the items with significant changes are highlighted below:

- Operating receipts (blue) were sufficient to cover operating costs (grey) in each of the prior four years.
- The decrease in the cash balance in 2014 was a result of cash used for the acquisition of capital assets of approximately $1,600,000.

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.

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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 for Cities of the 4th class (2,500-10,000). 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) ratios are shown below.

Ratio	Calculation	Source	2011	2012	2013	2014
Debt to assets	Total liabilities/total assets	Government-wide	26% *33%*	20% *33%*	15% *32%*	11% *N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	321% *106%*	206% *106%*	221% *117%*	98% *N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 3,659 *$ 2,826*	$ 2,519 *$ 2,626*	$ 1,814 *$ 2,656*	$ 1,253 *N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 462 *$ 500*	$ 470 *$ 480*	$ 489 *$ 487*	$ 510 *N/A*
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 539 *$ 640*	$ 483 *$ 649*	$ 499 *$ 634*	$ 504 *N/A*
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 44 *$ 229*	$ 175 *$ 298*	$ 200 *$ 294*	$ 82 *N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	71% *64%*	69% *65%*	68% *64%*	65% *N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	56% *65%*	54% *63%*	51% *63%*	49% *N/A*

Represents the City of Melrose
Represents Peer Group Average

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 financed 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.

Current Expenditures per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total current governmental expenditures by the population of the City and represents the amount of governmental expenditure for each citizen of the City during the year. Since this is generally based on ongoing expenditures, we would expect consistent annual per capita results.

Capital Expenditures per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total governmental capital outlay expenditures by the population of the City and represents the amount of capital expenditure for each citizen of the City during the year. Since projects are not always recurring, the per capita amount will fluctuate from year to year.

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.

CITY OF MELROSE, MINNESOTA
MELROSE ELECTRIC UTILITIES
ELECTRIC UTILITY OPERATING STATISTICS (UNAUDITED)
FOR THE YEARS ENDED DECEMBER 31, 2014, 2013, 2012, AND 2011

	2011	2012 Peer Group	2012	2013	2014
Financial Ratios					
Revenue per KWH					
Residential Customers	$ 0.081	$ 0.109	$ 0.082	$ 0.0810	$ 0.0840
Commercial Customers	$ 0.080	$ 0.104	$ 0.079	$ 0.0800	$ 0.0800
Industrial Customers	$ 0.063	$ 0.081	$ 0.063	$ 0.0630	$ 0.0640
Times Interest Earned	N/A	N/A	N/A	N/A	N/A
Debt Service Coverage	N/A	N/A	N/A	N/A	N/A
Uncollectible Accounts per Revenue Dollar	$ 0.0010	$ 0.0008	$ 0.0001	$ 0.0002	$ 0.0010
Operating Ratios					
Total O&M Expense per KWH Sold	$ 0.069	$ 0.083	$ 0.070	$ 0.690	$ 0.070
Total Distribution and O&M Expense (Excluding Power Supply Exp.) per retail customer	$ 397	N/A	$ 375	$ 302	$ 403
Purchased Power per KWH	$ 0.053	$ 0.055	$ 0.058	$ 0.056	$ 0.058
Distribution O&M Expense per Retail Customer	$ 217	$ 306	$ 212	$ 150	$ 235
Distribution O&M Expense per Circuit Mile	$ 7,492 *	$ 14,112	$ 7,319 *	$ 5,175	$ 8,129
Customer Accounting, Service, and Sales, Administrative and General Expense per Retail Customer	$ 206	$ 229	$ 229	$ 224	$ 209
Other Ratios					
Labor Expense per Worker- Hour	$ 27.85	$ 33.26	$ 27.85	$ 27.90	$ 29.35
Energy Loss Percentage	1.90%	N/A	-4.60%	1.70%	2.90%
System Load Factor	75.40%	N/A	75.60%	75.60%	77.00%

Represents the Melrose Electric Utility
APPA peer group ratio

The peer group data was derived from a report issued by the American Public Power Association (APPA) titled, "Selected Financial and Operating Ratios of Public Power Systems, 2012". The report presented data of financial and operating ratios for 157 of the largest publicly owned electric utilities in the United States and averaged the ratios based on number of customers. The ratios presented are those for utilities with 2,000 to 5,000 customers. The ratios can be a useful tool in assessing electric utility performance. However, as it stated in the report , these ratios do not provide definitive information and the level of any indicator should not be taken as the "correct" performance.

* The City of Melrose has a unique situation with a large amount of rural territory which affects their circuit mile cost. Therefore, this could contribute to higher circuit mile costs compared to the peer group.

CITY OF MELROSE, MINNESOTA
MELROSE ELECTRIC UTILITIES
ELECTRIC UTILITY LINE LOSS (UNAUDITED)
FOR THE YEARS ENDED DECEMBER 31, 2014, 2013, AND 2012

Source of Energy, Disposition of Energy and Percentage Relations	2012 KWH	2012 Percent	2013 KWH	2013 Percent	2014 KWH	2014 Percent
Purchased energy	$103,004,346	100.2 %	$115,570,464	100.2 %	$118,514,393	100.2 %
Energy consumed by station	(254,240)	(0.2)	(186,800)	(0.2)	(185,193)	(0.2)
Total net energy outgoing feeders	102,750,106	100.0	115,383,664	100.0	118,329,200	100.0
Net distributed energy	(107,518,002)	(104.6)	(113,383,016)	(98.3)	(114,943,051)	(97.1)
Energy lost in distribution system	$ (4,767,896)	-4.6% *	$ 2,000,648	1.7%	$ 3,386,149	2.9%

* As a result of the timing of meter readings of new and used meters, distributed energy exceeded purchased energy.

CITY OF MELROSE, MINNESOTA
MELROSE WATER UTILITIES
SUMMARY OF OPERATIONS AND UNAUDITED STATISTICS
FOR THE YEARS ENDED DECEMBER 31, 2014, 2013, AND 2012

SUMMARY OF OPERATIONS

	2012	2013	2014
OPERATING REVENUES			
Sales of water	$ 926,071	$ 903,970	$ 966,955
Miscellaneous	23,755	38,383	90,487
TOTAL OPERATING REVENUES	949,826	942,353	1,057,442
OPERATING EXPENSES			
Operating expenses less depreciation	343,325	407,799	372,610
Depreciation	257,976	260,264	284,638
TOTAL OPERATING EXPENSES	601,301	668,063	657,248
TOTAL OPERATING INCOME	$ 348,525	$ 274,290	$ 400,194
PERCENT OF CHANGE			
Sales of water	-2.95%	-2.39%	6.97%

UNAUDITED STATISTICS
MISCELLANEOUS

	2012	2013	2014
WATER PUMPED (gallons)	635,918,999	607,912,000	599,956,000
WATER SOLD (gallons)	610,940,915	590,339,532	587,059,401
Percent of line loss	3.93%	2.89%	2.15%
Revenues per 1,000 gallons pumped	$ 1.50	$ 1.55	$ 1.76
Revenues per 1,000 gallons sold	$ 1.56	$ 1.60	$ 1.80
Labor cost per customer	$ 121.97	$ 120.62	$ 92.29
O&M per customer	$ 180.38	$ 234.25	$ 231.28
Number of customers	1,141	1,148	1,147

Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future City financial statements: [(1)]

GASB Statement No. 68 - *The Accounting and Financial Reporting of Pensions- an Amendment of GASB Statement No. 27*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement.

This Statement is effective for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information.

GASB Statement No. 71 - *Pension Transition for Contributions Made Subsequent to the Measure Date - an Amendment of GASB Statement No. 68*

Summary

The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

Statement No. 68 requires a state or local government employer (or nonemployer contributing entity in a special funding situation) to recognize a net pension liability measured as of a date (the measurement date) no earlier than the end of its prior fiscal year. If a state or local government employer or nonemployer contributing entity makes a contribution to a defined benefit pension plan between the measurement date of the reported net pension liability and the end of the government's reporting period, Statement No. 68 requires that the government recognize its contribution as a deferred outflow of resources. In addition, Statement No. 68 requires recognition of deferred outflows of resources and deferred inflows of resources for changes in the net pension liability of a state or local government employer or nonemployer contributing entity that arise from other types of events. At transition to Statement No. 68, if it is not practical for an employer or nonemployer contributing entity to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, paragraph 137 of Statement No. 68 required that beginning balances for deferred outflows of resources and deferred inflows of resources not be reported.

Consequently, if it is not practical to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, contributions made after the measurement date of the beginning net pension liability could not have been reported as deferred outflows of resources at transition. This could have resulted in a significant understatement of an employer or nonemployer contributing entity's beginning net position and expense in the initial period of implementation.

This Statement amends paragraph 137 of Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement No. 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts.

The provisions of this Statement are required to be applied simultaneously with the provisions of Statement No. 68.

Future Accounting Standard Changes - Continued

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will eliminate the source of a potential significant understatement of restated beginning net position and expense in the first year of implementation of Statement No. 68 in the accrual-basis financial statements of employers and nonemployer contributing entities. This benefit will be achieved without the imposition of significant additional costs.

* * * * *

This communication is intended solely for the information and use of management, City Council, the Minnesota Office of the State Auditor and others within the City 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

ABDO, EICK & MEYERS, LLP
Minneapolis, Minnesota
April 6, 2015

People + Process® Going Beyond the Numbers