CITY OF MELROSE
MELROSE, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2007

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

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April 3, 2008

Grandview Square
5201 Eden Avenue
Suite 370
Edina, MN 55436

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, 2007 and have issued our report thereon April 3, 2008. 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 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 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 deficiency on the following page to be a significant deficiency in internal control.

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2007-1: 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 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 can not 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.

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 previously communicated to you.

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 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.

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 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, none 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.

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 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.

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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 2006. The fund balance of $951,526 is 46 percent of the 2007 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:

	2003	2004	2005	2006	2007
Reserved for					
Due from other funds	$ 69,840	$ 43,182	$ 65,646	$ -	$ -
Prepaid items	4,824	4,541	4,162	3,657	3,501
Unreserved					
Designated for insurance reserve	4,807	4,658	4,892	4,892	4,785
Designated for vacation and sick leave benefits	33,330	37,786	27,381	29,821	30,161
Designated for working capital	531,529	550,000	550,000	550,000	550,000
Undesignated	43,636	155,435	109,756	221,064	363,079
Total	$ 687,966	$ 795,602	$ 761,837	$ 809,434	$ 951,526
Total expenditures and transfers out	$ 1,707,062	$ 1,657,881	$ 1,657,881	$ 2,066,289	$ 2,084,015
Total fund balance as a percent of expenditures	40.30 %	47.99 %	45.95 %	39.17 %	45.66 %

The Minnesota Office of the State Auditor has classified cities' unreserved fund balance levels relative to expenditures as follows:

	Percent of Planned Expenditures	Months Expenditures on hand
Extremely low	Under 20%	Under 2.5
Low	21 - 34	2.5 - 4
Acceptable	35 - 50	4 - 6
Moderately high	51 - 64	6 - 7
High	65 - 100	8 - 12
Very high	100 - 150	12 - 18
Extremely high	Above 150	Above 18

The State Auditor does group all General, special revenue funds of the government when making this calculation where our calculation is based only on the General fund. 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 continually adjusts the local government aid and property tax credit formulas. We also have seen the State mandate levy limits for cities over 2,500 in population. An adequate fund balance will provide a temporary buffer against those aid adjustments or levy limits.

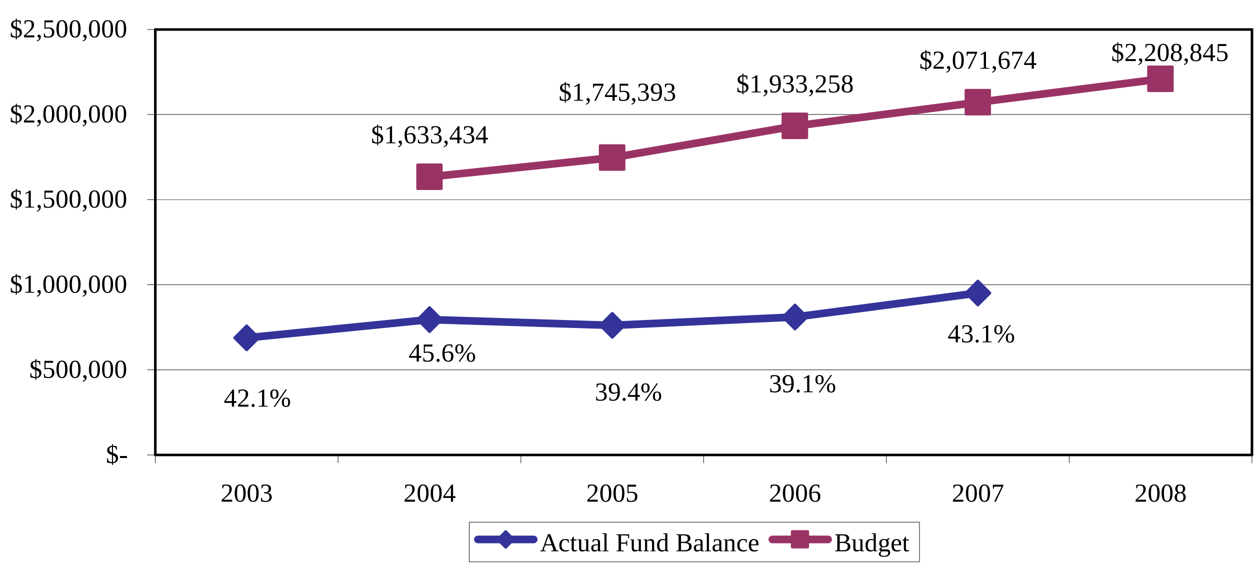
- Expenditures not anticipated at the time the annual budget was adopted may need immediate Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

- 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
2003	$ 687,966	2004	$ 1,633,434	42.1 %
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

Fund Balance as a Percent of Next Year's Budget



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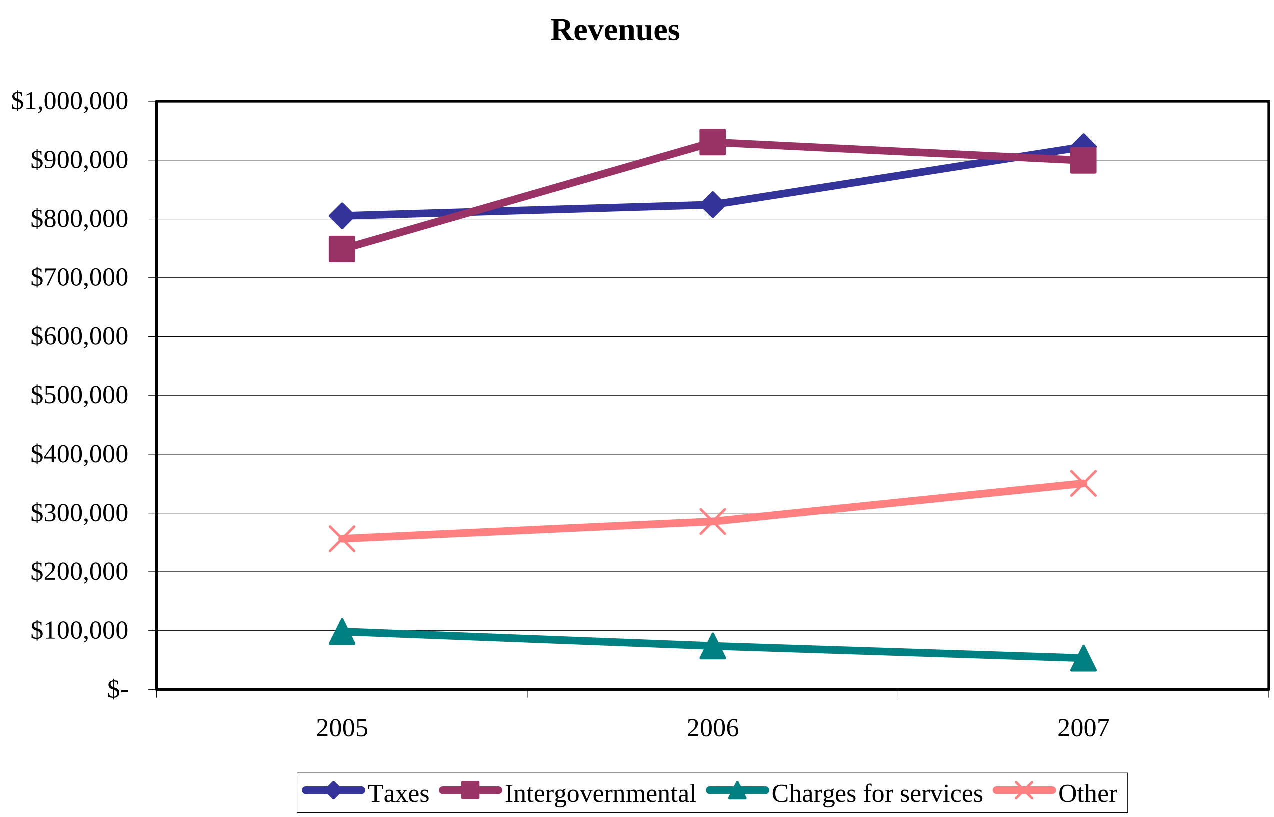
A summary of the 2007 operations are as follows:

	Final Budget Amounts	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues	$ 1,965,804	$ 1,997,521	$ 31,717
Expenditures	1,840,355	1,595,434	244,921
Excess of revenues over expenditures	125,449	402,087	276,638
Other financing sources (uses)			
Land sale	-	31,900	31,900
Transfers in	105,870	196,686	90,816
Transfers out	(231,319)	(488,581)	(257,262)
Total other financing sources (uses)	(125,449)	(259,995)	(134,546)
Net change in fund balances	-	142,092	142,092
Fund balances, January 1	809,434	809,434	-
Fund balances, December 31	$ 809,434	$ 951,526	$ 142,092

A summary and comparison of 2007, 2006, and 2005 General fund revenues and transfers in are as follows:

Revenue Source	2005	2006	2007	Percent of Total
Taxes	$ 805,204	$ 824,108	$ 922,549	41.4 %
Licenses and permits	43,176	46,325	37,365	1.7
Intergovernmental	748,650	930,144	899,615	40.4
Charges for services	98,463	74,093	53,297	2.4
Fines and forfeitures	14,730	18,669	24,336	1.1
Special assessments	45	-	-	-
Interest on investments	20,226	43,284	47,783	2.2
Miscellaneous	46,762	29,072	44,476	2.0
Transfers in	131,549	148,191	196,686	8.8
Total revenues and transfers	$ 1,908,805	$ 2,113,886	$ 2,226,107	100.0 %

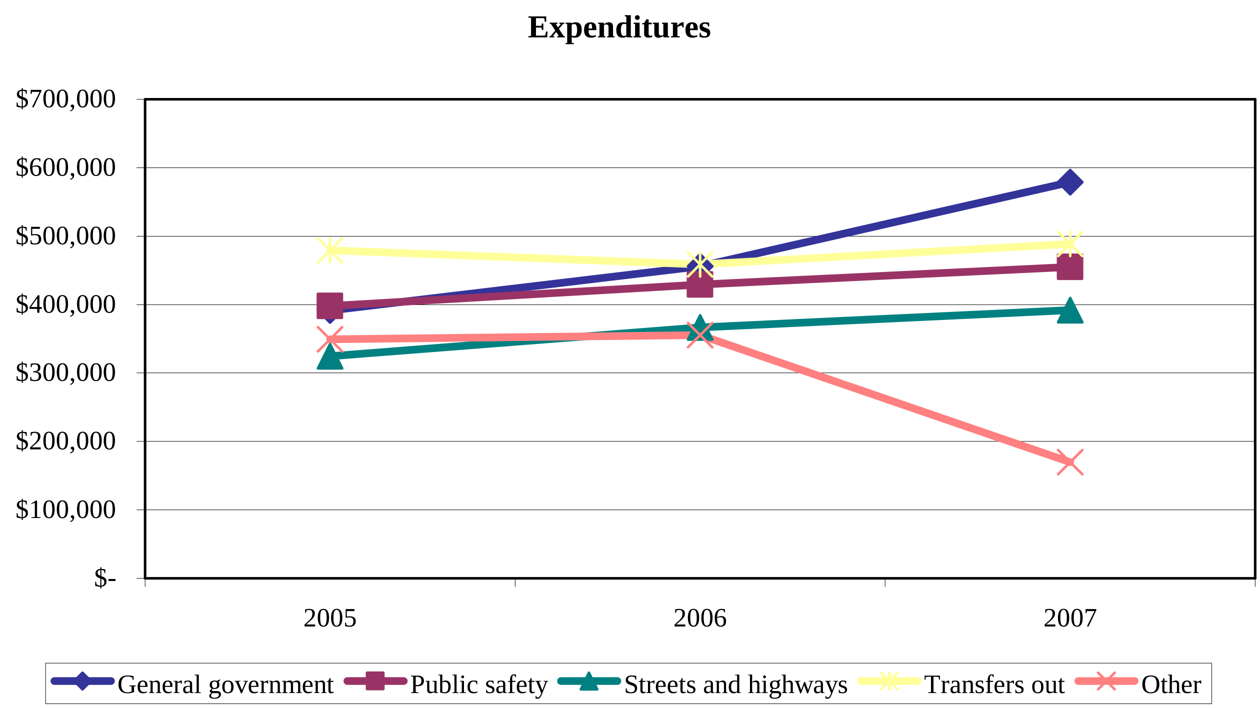
The sources of 2007, 2006 and 2005 revenues are presented graphically as follows:



A summary and comparison of 2007, 2006, and 2005 General fund expenditures and transfers out are as follows:

Program	2005	2006	2007	Percent of Total
Current				
General government	$ 391,538	$ 455,876	$ 578,733	27.8 %
Public safety	397,880	429,248	454,923	21.8
Streets and highways	324,574	366,705	392,042	18.8
Sanitation	3,228	3,984	4,129	0.3
Economic development	66,926	71,124	71,739	3.4
Total current	1,184,146	1,326,937	1,501,566	72.1
Capital outlay	62,932	64,657	84,517	4.1
Debt service	216,251	215,794	9,351	0.4
Transfers out	479,241	458,901	488,581	23.4
Total expenditures and transfers	$ 1,942,570	$ 2,066,289	$ 2,084,015	100.0 %

The 2007, 2006 and 2005 expenditures are presented graphically as follows:



Nonmajor Special Revenue Funds

The nonmajor special revenue funds account for revenue sources that are legally restricted to expenditures for specified purposes (not including major capital projects). The funds in this account group include:

Fund	Fund Balances (Deficits) December 31, 2007	Fund Balances (Deficits) December 31, 2006	Increase (Decrease)
Nonmajor			
Business Improvement Loans	$ 10,764	$ 10,421	$ 343
Melrose Area Development authority (MADA)	(46,685)	(62,589)	15,904
Parks and Recreation	(387,651)	(481,002)	93,351
MADA Revolving Loan	411,684	421,369	(9,685)
Soccer League	422	422	-
Senior Activity Center	2,726	2,552	174
PIA Asset Building	(520)	723	(1,243)
Tri Cap Bus	3,630	7,086	(3,456)
Fire Department	171,425	80,810	90,615
Tax Increment Projects	(296,498)	-	(296,498)
Total	$ (130,703)	$ (20,208)	$ (110,495)

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.

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 account for the servicing of general long-term debt not being financed by proprietary funds. The funds in this group include:

Debt Description	Cash Balance	Total Assets	Bounds Outstanding	Year of Maturity
Improvement Bonds of 2002	$ 68,734	$ 213,395	$ 540,000	12/01/17
Equipment Certificates of 2003	(609)	-	-	
Improvement Bonds of 2004	100,793	262,184	985,000	02/01/20
Improvement Bonds of 2005A	631,249	976,406	2,470,000	02/01/21
Total G.O. Bonds	$ 800,167	$ 1,451,985	$ 3,995,000	

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, 2007	2006	Increase (Decrease)
Major			
Capital improvements	$ 2,428,985	$ 2,084,594	$ 344,391
Nonmajor			
2005 Capital Improvements	-	63,293	(63,293)
2004 I-94 Industrial Park Improvements	-	125,519	(125,519)
1992 Abandoned Railroad Property Project	298,897	771	298,126
2003 Equipment	-	76,714	(76,714)
2006 Kraft Drive Extension	-	206,321	(206,321)
2006 Tri Quality Improvement	31,469	41,261	(9,792)
2006 EBM Improvement	-	(14,402)	14,402
2007 Fire and Ambulance Station	(17,840)	542	(18,382)
Total nonmajor	312,526	500,019	(187,493)
Total	$ 2,741,511	$ 2,584,613	$ 156,898

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

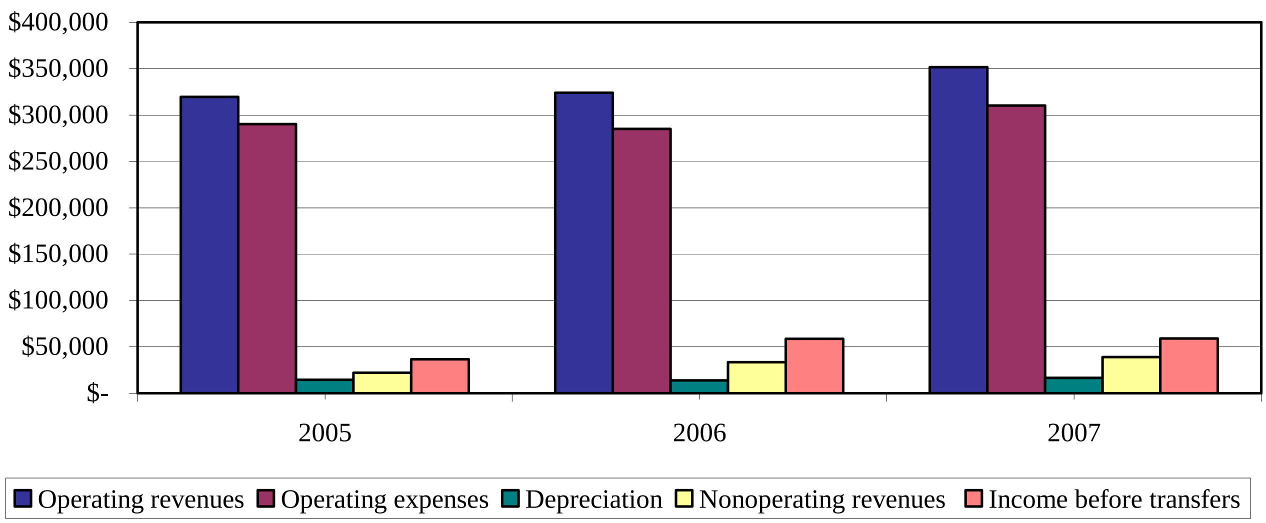
Proprietary Funds

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

Ambulance Fund Operations

	2005		2006		2007	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Amount	Percent of Revenue
Operating revenues	$ 319,632	100.0 %	$ 324,116	100.0 %	$ 351,531	100.0 %
Operating expenses	(290,380)	(90.8)	(285,181)	(88.0)	(310,133)	(88.2)
Depreciation	(14,552)	(4.6)	(13,814)	(4.3)	(16,569)	(4.7)
Operating income	14,700	4.6	25,121	7.7	24,829	7.1
Nonoperating revenues	22,025	6.9	33,547	10.4	39,105	11.1
Income before transfers	36,725	11.5	58,668	18.1	63,934	18.2
Operating transfers						
Transfers out	-	-	-	-	(5,000)	(1.4)
Change in net assets	$ 36,725	11.5 %	$ 58,668	18.1 %	$ 58,934	16.8 %
Cash and investments	$ 521,669		$ 586,801		$ 537,091	

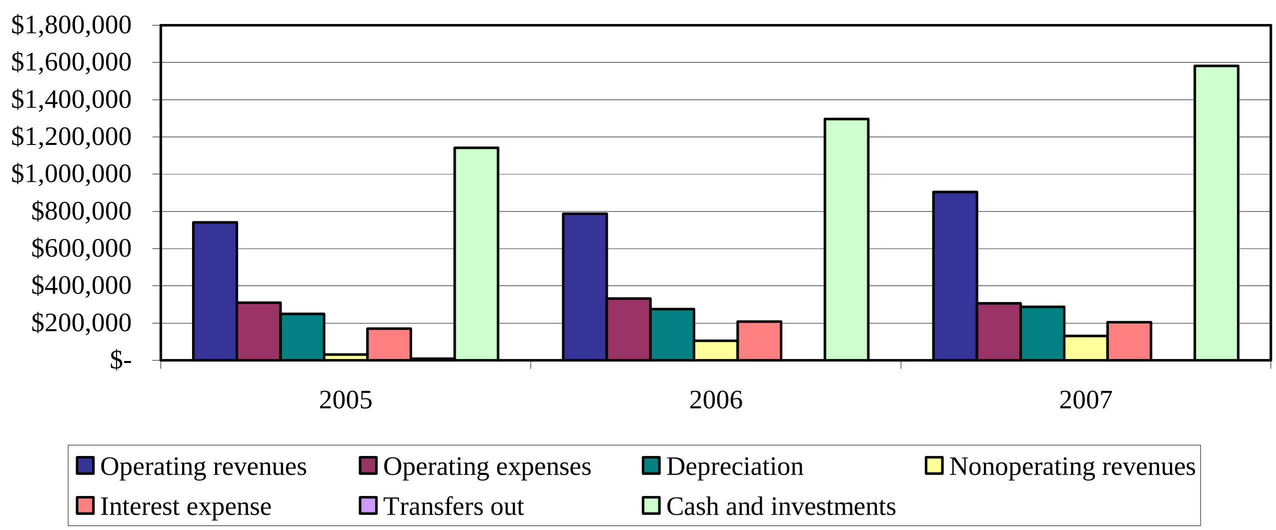
The cash balance is at a level sufficient to provide for working capital and other needs.



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

Water Fund Operations

	2005		2006		2007	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Amount	Percent of Revenue
Operating revenues	$ 740,744	100.0 %	$ 786,861	100.0 %	$ 903,510	100.0 %
Operating expenses	(310,180)	(41.9)	(332,559)	(42.3)	(306,757)	(34.0)
Depreciation	(250,087)	(33.8)	(274,657)	(34.9)	(286,637)	(31.7)
Operating income	180,477	24.3	179,645	22.8	310,116	34.3
Nonoperating revenues	31,097	4.2	104,142	13.2	131,418	14.5
Interest expense	(169,966)	(22.9)	(208,691)	(26.5)	(204,652)	(22.7)
Income before transfers	41,608	5.6	75,096	9.5	236,882	26.1
Contributed assets	101,349	-	236,992	30.1	189,986	21.0
Transfers out	(9,266)	(1.3)	-	-	-	-
Change in net assets	$ 133,691	4.3 %	$ 312,088	39.6 %	$ 426,868	47.1 %
Cash and investments	$ 1,140,805		$ 1,295,552		$ 1,581,994	
Loans and bonds payable	$ 5,291,700		$ 5,080,700		$ 4,859,700	

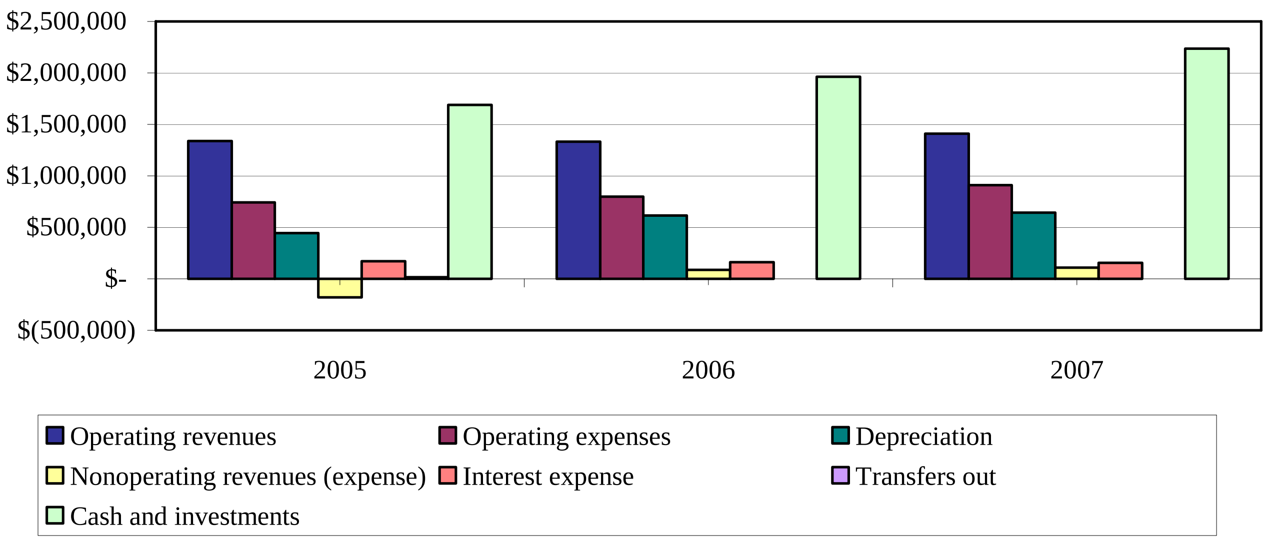


The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations and debt service.

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

Wastewater Fund Operations

	2005		2006		2007	
	Amount	Percent of Revenue	Amount	Percent of Revenue	Amount	Percent of Revenue
Operating revenues	$ 1,339,806	100.0 %	$ 1,331,739	100.0 %	$ 1,409,302	100.0 %
Operating expenses	(743,030)	(55.5)	(797,531)	(59.9)	(910,489)	(64.6)
Depreciation	(443,074)	(33.1)	(616,328)	(46.3)	(643,760)	(45.7)
Operating income	153,702	11.4	(82,120)	(6.2)	(144,947)	(10.3)
Nonoperating revenues (expense)	(181,506)	(13.5)	85,915	6.5	109,476	7.8
Interest expense	(169,272)	(12.6)	(162,623)	(12.2)	(155,670)	(11.0)
Income before transfers	(197,076)	(14.7)	(158,828)	(11.9)	(191,141)	(13.5)
Contributed assets	127,371	-	965,997	72.5	792,785	56.3
Transfers out	(15,117)	(1.1)	-	-	-	-
Change in net assets	$ (84,822)	(15.8) %	$ 807,169	60.6 %	$ 601,644	42.8 %
Cash and investments	$ 1,690,099		$ 1,962,490		$ 2,237,136	
Loans and bonds payable	$ 3,700,000		$ 3,550,000		$ 3,395,000	

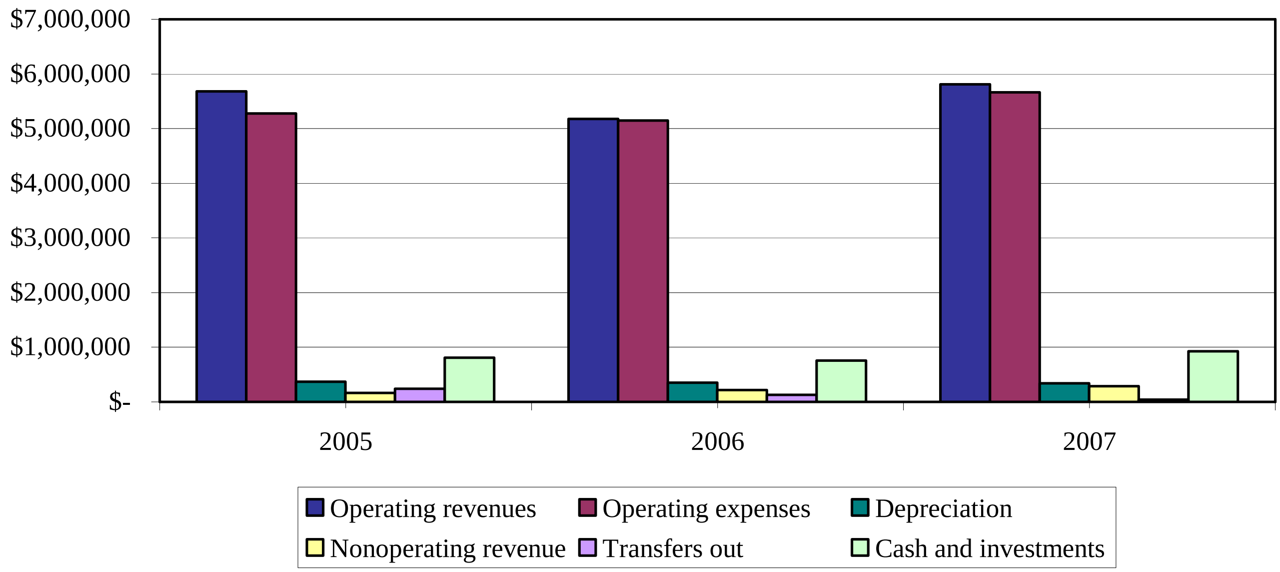


The cash balance remains strong in relation to operations but like the Water fund, it will be important to maintain cash flow to cover future debt service.

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

Electric Fund Operations

	2005		2006		2007	
	Amount	Percent of Revenues	Amount	Percent of Revenues	Amount	Percent of Revenues
Operating revenues	$ 5,680,141	100.0 %	$ 5,174,467	100.0 %	$ 5,811,579	100.0 %
Operating expenses	(5,274,058)	(92.9)	(5,145,889)	(99.5)	(5,665,912)	(97.5)
Depreciation	(368,950)	(6.5)	(353,713)	(6.8)	(342,560)	(5.9)
Operating income (loss)	37,133	0.6	(325,135)	(6.3)	(196,893)	(3.4)
Nonoperating revenue	164,429	2.9	219,503	4.2	285,912	4.9
Loss on disposal of fixed assets	-	-	(1,850)	-	-	-
Income before transfers	201,562	3.5	(107,482)	(2.1)	89,019	1.5
Contributed assets	-	-	-	-	34,546	(0.6)
Transfers out	(241,721)	(4.3)	(126,856)	(2.5)	(40,000)	(0.7)
Change in net assets	$ (40,159)	(0.8) %	$ (234,338)	(4.6) %	$ 83,565	0.2 %
Cash and investments	$ 811,462		$ 757,144		$ 925,661	



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
12/31/07	$ 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
12/31/02	249,123	281,490	(32,367)	88.5	1,000

Other Matters

Ratio Analysis

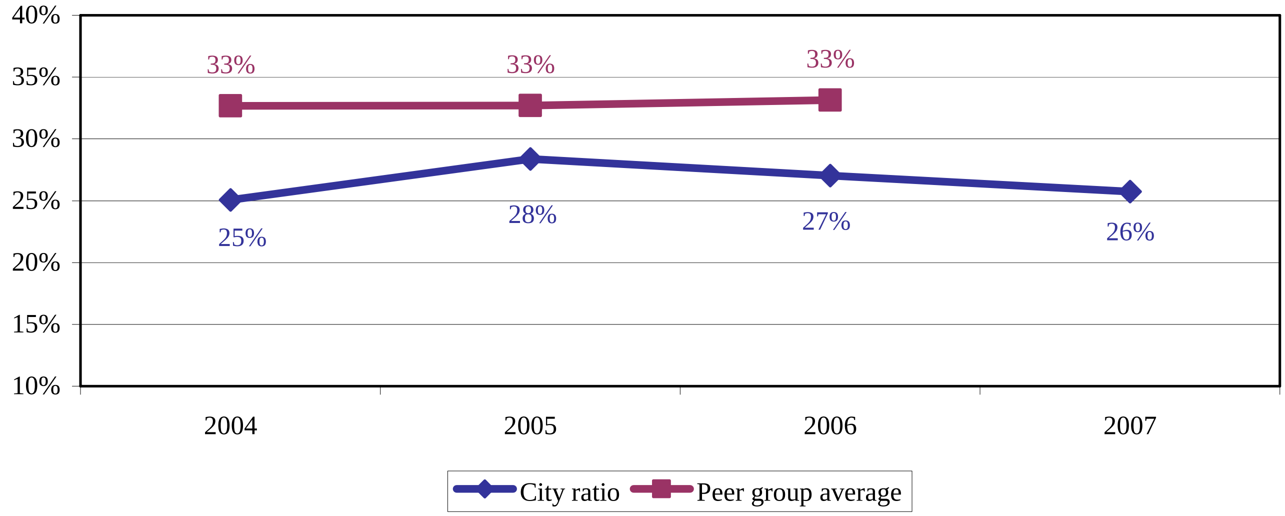
The following captures a few ratios from the City's financial statements that give some additional information for trend and peer group analysis. The peer group average consists of the average of Abdo, Eick & Meyers' client base of approximately 90 cities. The majority of these ratios facilitate the 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	2004	2005	2006	2007
Debt to assets	Total liabilities/total assets	Government-wide	**25%**	**28%**	**27%**	**26%**
			33%	**33%**	**33%**	**N/A**
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	**182%**	**124%**	**143%**	**160%**
			133%	**117%**	**125%**	**N/A**
Debt per capita	Bonded debt/population	Government-wide	**$ 3,052**	**$ 4,073**	**$ 3,923**	**$ 3,744**
			$ 1,670	**$ 1,814**	**$ 2,013**	**N/A**
Taxes per capita	Tax revenues/population	Government-wide	**$ 195**	**$ 295**	**$ 366**	**$ 391**
			$ 337	**$ 368**	**$ 409**	**N/A**
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	**83%**	**82%**	**80%**	**77%**
			75%	**74%**	**76%**	**N/A**
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	**65%**	**66%**	**64%**	**62%**
			72%	**72%**	**73%**	**N/A**

Represents the City of Melrose
Peer Group ratio

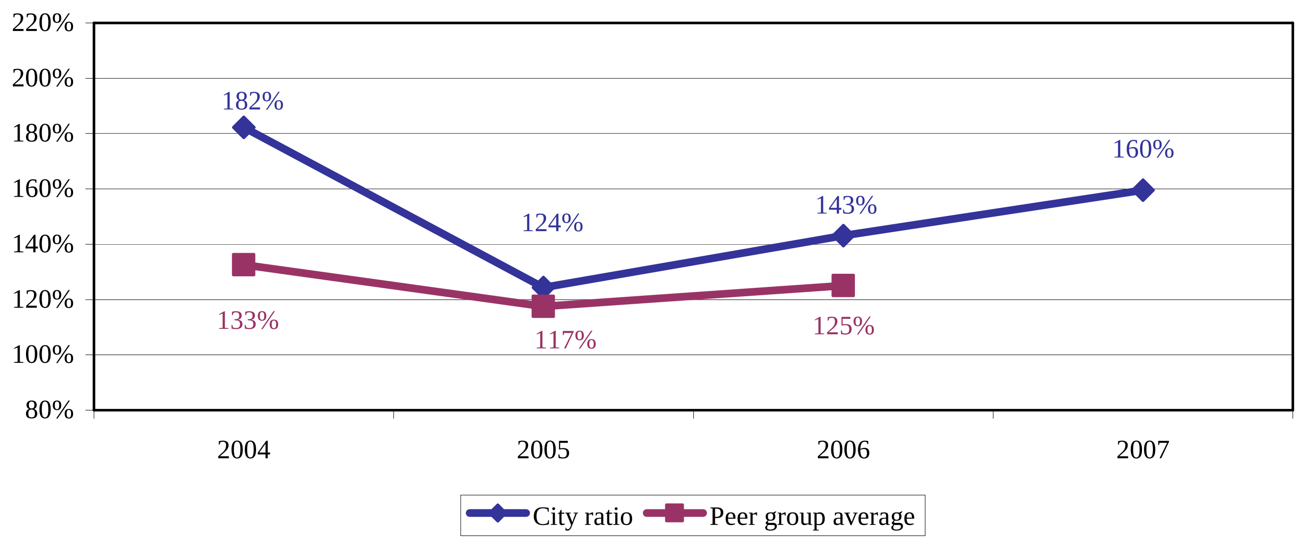
Debt-to-Assets Leverage Ratio (Solvency Ratio)

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).



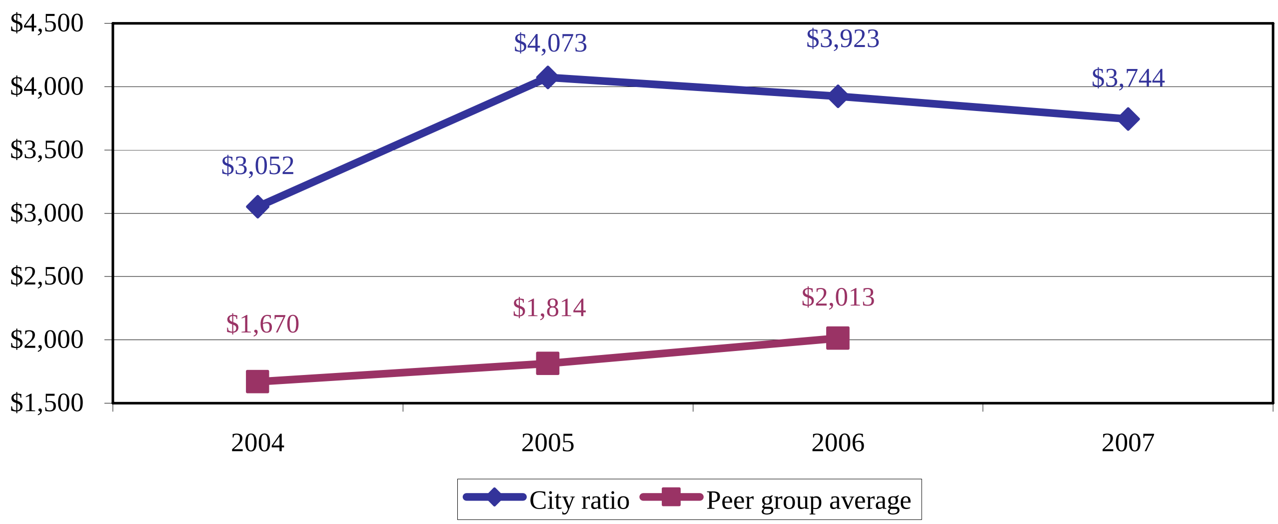
Debt Service Coverage Ratio (Solvency Ratio)

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.



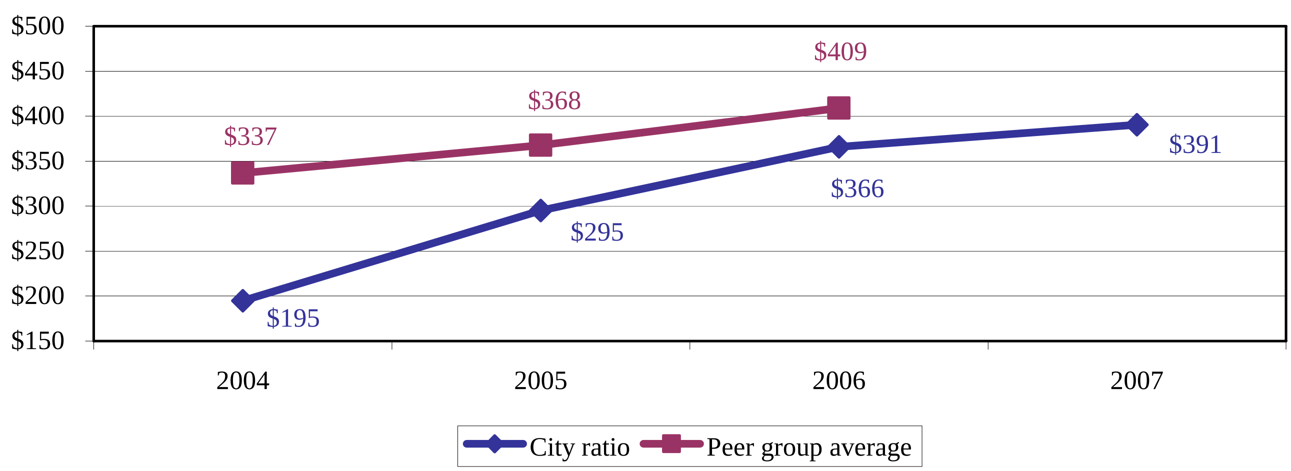
Bonded Debt per Capita (Funding Ratio)

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)

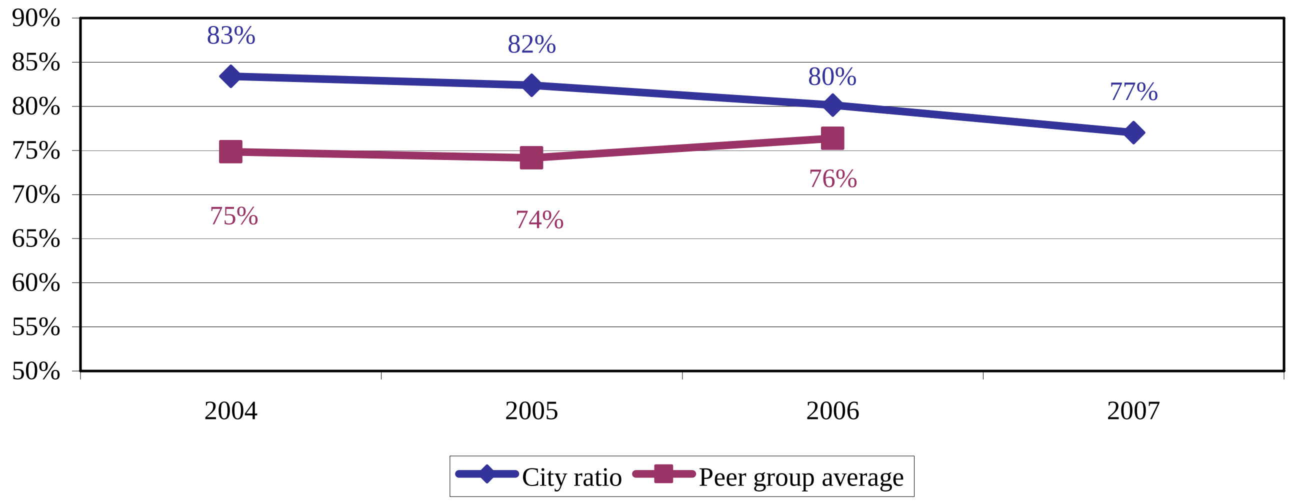
This dollar amount is arrived at by dividing the total tax revenues by the population of the city and represents the amount of taxes for each citizen of the city for the year. The higher this amount is, the more reliant the city is on taxes to fund its operations.



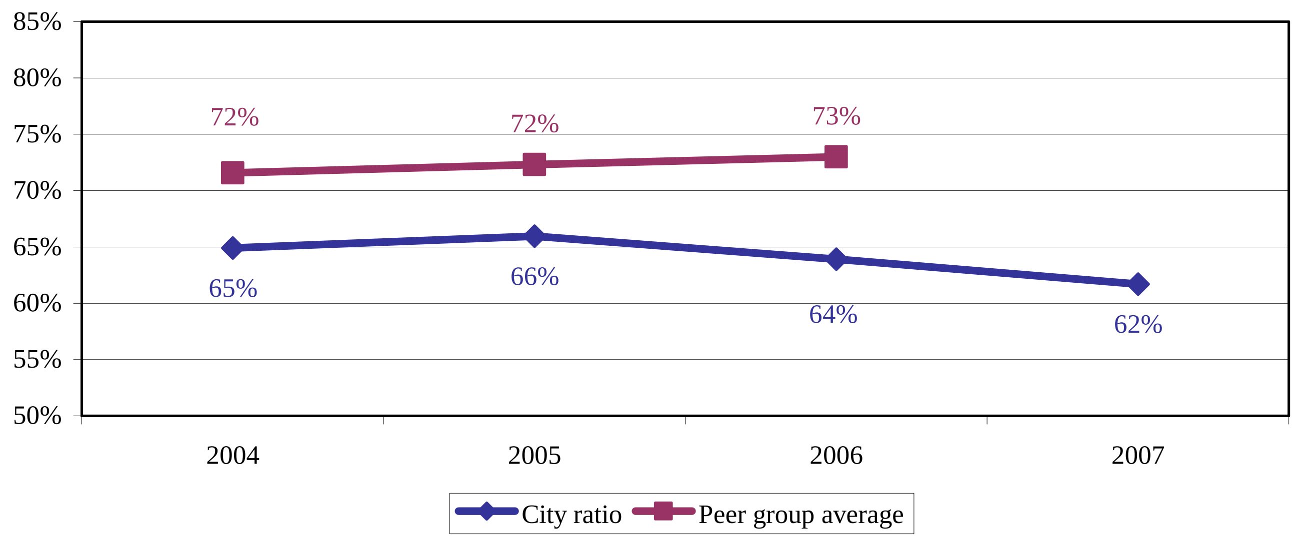
Capital Assets Percentage (Common-size Ratio)

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.

Governmental Activities



Business-type Activities



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:

GASB Statement No. 43 - *Financial Reporting for Postemployment Benefit Plans Other than Pension Plans*

This statement is effective one year prior to the effective date of Statement No. 45 for the employer or largest participating employer in the benefit plan for multiple-employer plans. According to Statement No. 43, “The objective of this Statement is to establish uniform standards of financial reporting by State and local governmental entities for other postemployment benefit plans (OPEB plans). The term other postemployment benefits (OPEB) refers to postemployment benefits other than pension benefits and includes (a) postemployment healthcare benefits and (b) other types of postemployment benefits (for example, life insurance) if provided separately from a pension plan. The term plans, in this context, refers to trust or other funds through which assets are accumulated to finance OPEB, and benefits are paid as they come due. This Statement provides standards for measurement, recognition, and display of the assets, liabilities, and, where applicable, net assets and changes in net assets of such funds and for related disclosures. The requirements of this Statement apply whether an OPEB plan is reported as a trust or agency fund or a fiduciary component unit of a participating employer or plan sponsor, or the plan is separately reported by a public employee retirement system (PERS) or other entity that administers the plan.”

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. 47 - *Accounting for Termination Benefits*

In general, Statement No. 47 is effective for financial statements for periods beginning after June 15, 2005. However, for termination benefits that affect defined benefit postemployment benefits other than pensions, governments should implement Statement 47 simultaneously with Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* The Statement provides accounting and reporting guidance for state and local governments that offer benefits such as early retirement incentives or severance to employees that are involuntarily terminated. The Statement requires that similar forms of termination benefits be accounted for in the same manner and is intended to enhance both the consistency of reporting for termination benefits and the comparability of financial statements.

GASB Statement No. 48 - *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*

This statement was issued September 2006 and is effective for periods beginning after December 15, 2006. Therefore, this statement has been implemented for the current financial statements.

This standard provides accounting guidance for when certain transactions-such as the sale of delinquent taxes, certain mortgages, student loans, or future revenues such as those arising from tobacco settlement agreements-should be regarded as a sale or a collateralized borrowing. The financial reporting question addressed in Statement No. 48 is whether such transactions should be reported as a sale or collateralized borrowing.

In addition to clarifying guidance on accounting for sales and pledges of receivables and future revenues, Statement No. 48 (1) requires enhanced disclosures pertaining to future revenues that have been pledged or sold; (2) provides guidance on the sales of receivables and future revenues within the same financial reporting entity; and (3) provides guidance on recognizing other assets and liabilities arising from the sale of specific receivables or future revenues.

GASB Statement No. 49 - *Accounting and Financial Reporting for Pollution Remediation Obligations*

This statement was issued November 2007 and is effective for periods beginning after December 15, 2007, but liabilities should be measured at the beginning of that period so that beginning net assets can be restated.

This standard is intended to ensure that certain cost and long-term obligations related to pollution clean up not specifically addressed by current governmental accounting standards will be included in financial reports. The standards set forth the key circumstances under which a government would be required to report a liability related to pollution remediation. A government would have to determine whether one or more components of a pollution remediation liability are recognizable if any of the following five obligating events or triggers occurs:

- A government is compelled to take remediation action because pollution creates an imminent endangerment to the public health or welfare or environment, leaving it little or no discretion to avoid remediation action.

- A government is in violation of a pollution prevention-related permit or license.

- The government is named, or evidence indicates it will be named, by a regulator that has identified the government as a responsible party or potentially responsible party for remediation, or as a government responsible for sharing costs.

- A government is named, or evidence indicates that it will be named, in a lawsuit to compel the government to participate in remediation.

- A government commences or legally obligates itself to commence clean up activities or monitoring or operation and maintenance of the remediation effort.

If any of the above bullets are met, the pollution remediation liabilities should be measured at their current value using the expected cash flow technique, which measures the liability as a sum of probability-weighted amounts in a range of possible estimated amounts. Expected recoveries from other responsible parties and from insurers reduce the amount of remediation expense. Statement No. 49 also specifies criteria for capitalization of some pollution remediation outlays.

GASB Statement No. 50 - *Pension Disclosures*

This statement was issued May 2007 and is effective for periods beginning after June 15, 2007, except for requirements related to the use of the entry age actuarial cost method for the purpose of reporting a surrogate funded status and funding progress of plans that use the aggregate actuarial cost method, which are effective for periods for which the financial statements and RSI contain information resulting from actuarial valuations as of June 15, 2007 or later.

This statement more closely aligns the financial reporting requirements for pensions with those for OPEB and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this statement amend applicable note disclosure and RSI requirements of Statement No. 25 , Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and No. 27 , Accounting for Pensions by State and Local Governmental Employers, to conform with requirements of Statement No. 43 , Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, and 45 , Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. This statement requires defined benefit pension plans and sole and agent employers present the following information related to note disclosures:

- Notes to financial statements should disclose the funded status of the plan as of the most recent actuarial valuation date. Defined benefit pension plans also should disclose actuarial methods and significant assumptions used in the most recent actuarial valuation in notes to financial statements instead of in notes to RSI.

- If the aggregate actuarial cost method is used to determine the annual required contribution of the employer (ARC), notes to financial statements should disclose the funded status of the plan, and a schedule of funding progress should be presented as RSI, using the entry age actuarial cost method. Plans and employers also should disclose that the purpose of doing so is to provide information that serves as a surrogate for the funded status and funding progress of the plan.

- Notes to financial statements should include a reference linking the funded status disclosure in the notes to financial statements to the required schedule of funding progress in RSI.

- If applicable, notes to financial statements should disclose legal or contractual maximum contribution rates. In addition, if relevant, they should disclose that the maximum contribution rates have not been explicitly taken into consideration in the projection of pension benefits for financial accounting measurement purposes.

- If an actuarial assumption is different for successive years, notes to financial statements should disclose the initial and ultimate rates.

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.

* * * * *

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

April 3, 2008
Minneapolis, Minnesota

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