CITY OF MELROSE
MELROSE, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2009

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

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MEYERS LLP
Certified Public Accountants & Consultants

5201 Eden Avenue
Suite 370
Edina, MN 55436

March 24, 2010

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, 2009 and have issued our report thereon March 24, 2010. 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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting, described on the following page as finding 2009-1, which we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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2009-1: 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.

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.

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Summary of Prior Year Findings

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.

Current Year Status: The City documented and implemented procedures that affect capital assets throughout the year to better reduce risk of incomplete accrual accounting resulting in the removal of this finding in 2009.

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.

Current Year Status: The Board added the approval of prior meeting minutes to each meeting resulting in resulting in complete formal written minutes and the removal of this finding in 2009.

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. The requirements of GASB Statement No. 45 were adopted for the year ended December 31, 2009. 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 sensitive estimates affecting the financial statements were capital asset basis, depreciation, compensated absences and other postemployment benefits.

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. Management has corrected all such misstatements. We proposed two journal entries that we consider to be audit entries or corrections of management decisions. They related to the following situations:

- Material audit entries were required to:
  - Record retainage payable.
  - Correct beginning fund balances and transfers.
  - Reclass transfers from water and wastewater for construction expenses.
  - Record revenues and expenses the Small Cities Development grant.

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 March 24, 2010**.**

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 $347,864 from 2008. The fund balance of $1,089,358 is 49 percent of the 2009 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:

	2005	2006	2007	2008	2009
Reserved for					
Due from other funds	$ 65,646	$ -	$ -	$ -	$ -
Prepaid items	4,162	3,657	3,501	4,793	8,672
Unreserved					
Designated for insurance reserve	4,892	4,892	4,785	3,571	8,213
Designated for vacation and sick leave benefits	27,381	29,821	30,161	35,951	35,951
Designated for working capital	550,000	550,000	550,000	550,000	550,000
Undesignated	109,756	221,064	363,079	147,179	486,522
Total	$ 761,837	$ 809,434	$ 951,526	$ 741,494	$ 1,089,358
Total expenditures and transfers out	$ 1,657,881	$ 2,066,289	$ 2,084,015	$ 2,402,817	$ 2,240,896
Total fund balance as a percent of expenditures	45.95 %	39.17 %	45.66 %	30.86 %	48.61 %

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.

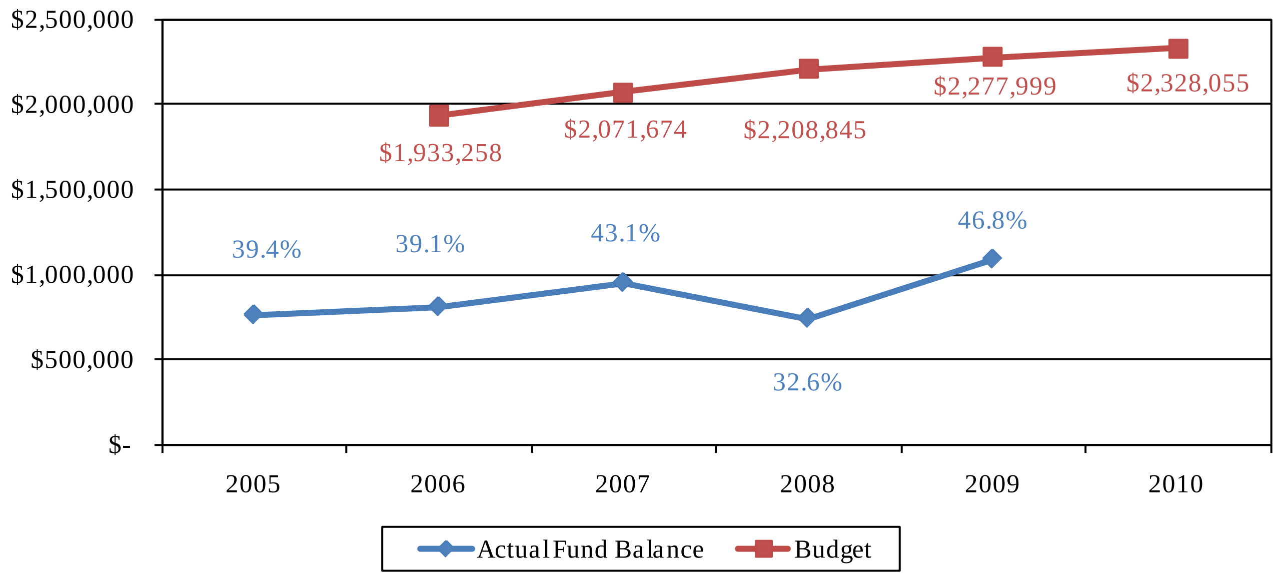
- Expenditures not anticipated at the time the annual budget was adopted may need immediate Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

- 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
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
2009	1,089,358	2010	2,328,055	46.8

Fund Balance as a Percent of Next Year's Budget



We have compiled peer group average fund balance information from reports available on the website of the Office of the State Auditor for Cities of the 4th class (2,500-10,000) and from Abdo, Eick & Meyers' client base of approximately 100 cities. In 2008, the average General fund balance as a percentage of expenditures was 55 percent. Based on comparison to the peer groups, the City's General fund balance is lower than average but improved significantly in 2009.

A summary of the 2009 operations are as follows:

	Final Budget Amounts	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues	$ 2,207,999	$ 2,231,129	$ 23,130
Expenditures	2,008,097	1,520,091	488,006
Excess of revenues over expenditures	199,902	711,038	511,136
Other financing sources (uses)			
Sale of capital assets	-	1,300	1,300
Transfers in	70,000	356,331	286,331
Transfers out	(269,902)	(720,805)	(450,903)
Total other financing sources (uses)	(199,902)	(363,174)	(163,272)
Net change in fund balances	-	347,864	347,864
Fund balances, January 1	741,494	741,494	-
Fund balances, December 31	$ 741,494	$ 1,089,358	$ 347,864

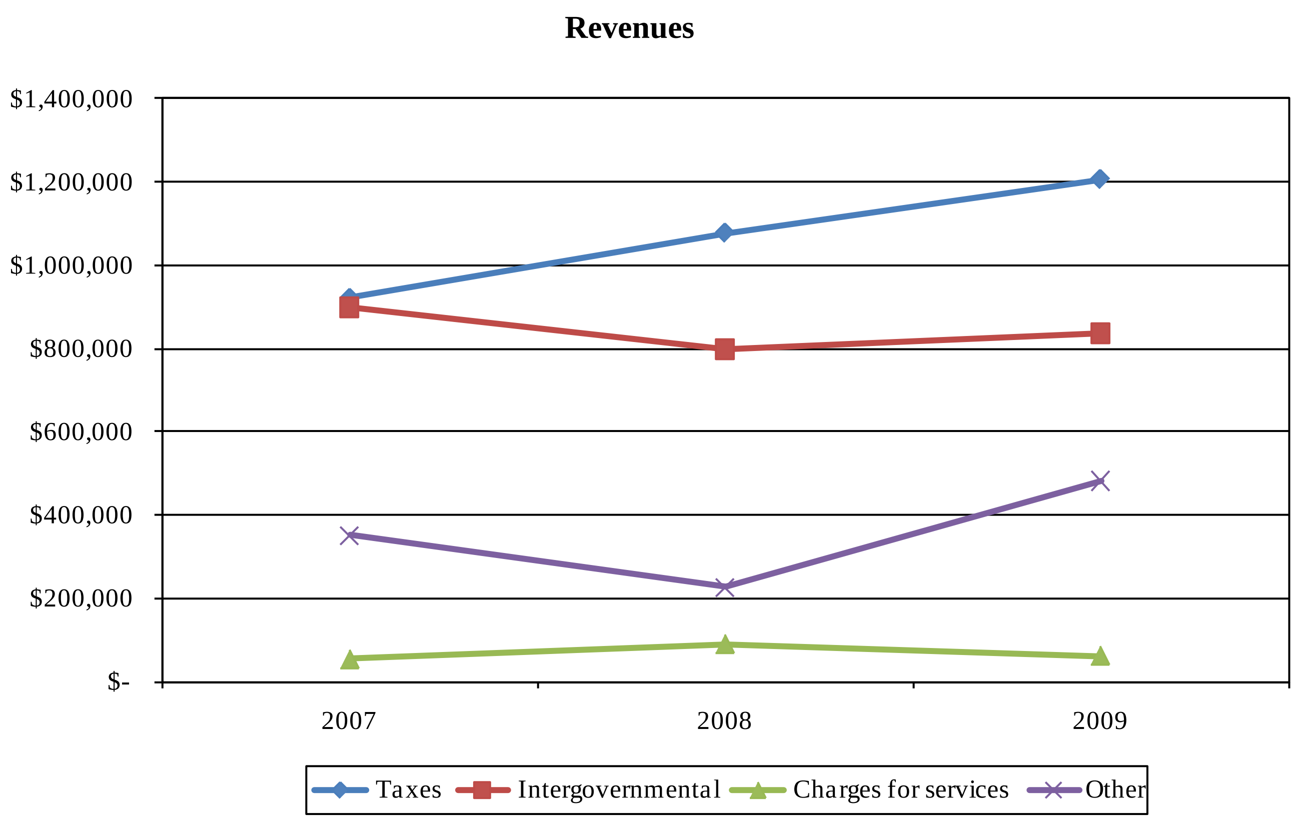
- Expenditures were under budget in the capital outlay function by $357 thousand. This was because capital outlay transfers were done during the year instead of capital outlay purchases. This also accounted for the majority of the over-expenditure in the transfer out category.

- Transfers in exceeded expectations by $286 thousand related to the payoff of a loan by the Capital Improvements fund.

A summary and comparison of 2009, 2008, and 2007 General fund revenues and transfers in are as follows:

Revenue Source	2007	2008	2009	Percent of Total	Per Capita
Taxes	$ 922,549	$ 1,078,599	$ 1,206,790	46.6 %	$ 365
Licenses and permits	37,365	64,454	66,591	2.6	20
Intergovernmental	899,615	798,606	837,404	32.4	253
Charges for services	53,297	89,975	62,047	2.4	19
Fines and forfeitures	24,336	18,625	24,153	0.9	7
Interest on investments	47,783	55,788	23,702	0.9	7
Miscellaneous	44,476	11,243	11,742	0.5	4
Transfers in	196,686	75,495	356,331	13.8	108
Total revenues and transfers	$ 2,226,107	$ 2,192,785	$ 2,588,760	100.0 %	$ 782

The sources of 2009, 2008, and 2007 revenues and transfers are presented graphically as follows:

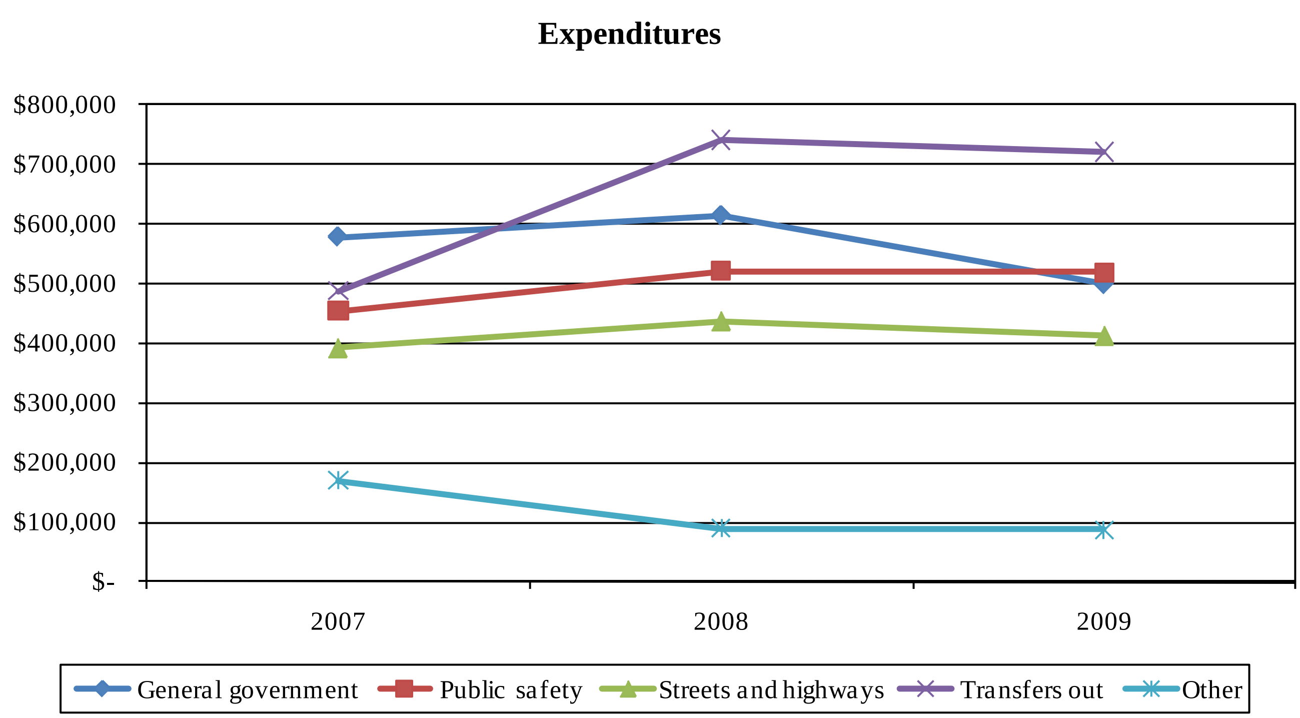


A summary and comparison of 2009, 2008, and 2007 General fund expenditures and transfers out are as follows:

Program	2007	2008	2009	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 578,733	$ 613,840	$ 500,315	22.3 %	$ 151	$ 141
Public safety	454,923	522,034	519,505	23.2	157	205
Streets and highways	392,042	436,539	412,401	18.4	125	115
Sanitation	4,129	5,049	3,818	0.2	1	-
Economic development	71,739	76,269	79,160	3.5	24	8
Total current	1,501,566	1,653,731	1,515,199	67.6	458	469
Capital outlay	84,517	-	-	-	-	25
Debt service	9,351	8,068	4,892	0.2	1	-
Transfers out	488,581	741,018	720,805	32.2	218	-
Total expenditures and transfers	$ 2,084,015	$ 2,402,817	$ 2,240,896	100.0 %	$ 677	$ 494

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 from reports available on the website of the Office of the State Auditor for Cities of the 4th class (2,500-10,000) and from Abdo, Eick & Meyers' client base of approximately 100 cities.

The 2009, 2008 and 2007 expenditures and transfers are presented graphically as follows:



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, 2009	Fund Balances (Deficits) December 31, 2008	Increase (Decrease)
Nonmajor			
Business Improvement Loans	$ 9,092	$ 10,882	$ (1,790)
Melrose Area Development Authority (MADA)	(10,507)	(19,244)	8,737
Parks and Recreation	-	(63,837)	63,837
MADA Revolving Loan	453,990	458,057	(4,067)
Senior Activity Center	2,436	2,611	(175)
PIA Asset Building	3,245	2,025	1,220
Tri-Cap Bus	1,365	678	687
Fire Department	276,253	81,278	194,975
Tax Increment Projects	-	(293,903)	293,903
Total	$ 735,874	$ 178,547	$ 557,327

All funds should have sufficient resources to provide for their operations but occasionally deficits will occur. The larger fund deficits were eliminated in 2009 and the details of the remaining fund deficit are described as follows.

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.

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	$ 51,145	$ 170,351	$ 410,000	12/01/17
Improvement Bonds of 2004	171,958	305,832	915,000	02/01/20
Improvement Bonds of 2005	669,499	963,185	2,255,000	02/01/21
Lease Revenue Bonds of 2008	378,494	378,546	2,360,000	02/01/29
Total G.O. and Lease Revenue Bonds	$ 1,271,096	$ 1,817,914	$ 5,940,000	

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, 2009	Fund Balances (Deficits) December 31, 2008	Increase (Decrease)
Major			
Capital improvements	$ 2,511,005	$ 2,660,333	$ (149,328)
Nonmajor			
2007 Fire and Ambulance Station	-	(2,705)	2,705
1992 Abandoned Railroad Property Project	-	296,498	(296,498)
2006 Tri Quality Improvement	-	273	(273)
2009 Capital Improvements	39,028	-	39,028
Total nonmajor	39,028	294,066	(255,038)
Total	$ 2,550,033	$ 2,954,399	$ (404,366)

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

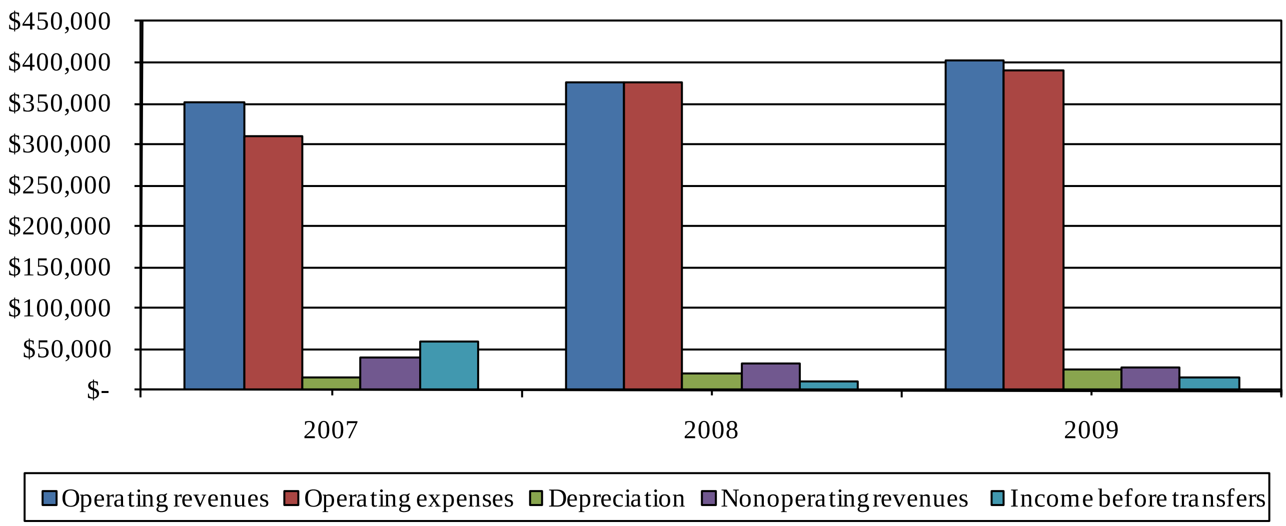
Proprietary Funds

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

Ambulance Fund Operations

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 351,531	100.0 %	$ 376,660	100.0 %	$ 401,789	100.0 %
Operating expenses	(310,133)	(88.2)	(376,706)	(100.0)	(389,574)	(97.0)
Depreciation	(16,569)	(4.7)	(21,638)	(5.7)	(24,551)	(6.1)
Operating income (loss)	24,829	7.1	(21,684)	(5.7)	(12,336)	(3.1)
Nonoperating revenues	39,105	11.1	33,593	8.9	27,581	6.9
Income before transfers	63,934	18.2	11,909	3.2	15,245	3.8
Transfers out	(5,000)	(1.4)	-	-	-	-
Change in net assets	$ 58,934	16.8 %	$ 11,909	3.2 %	$ 15,245	3.8 %
Cash and investments	$ 537,091		$ 483,181		$ 537,694	

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

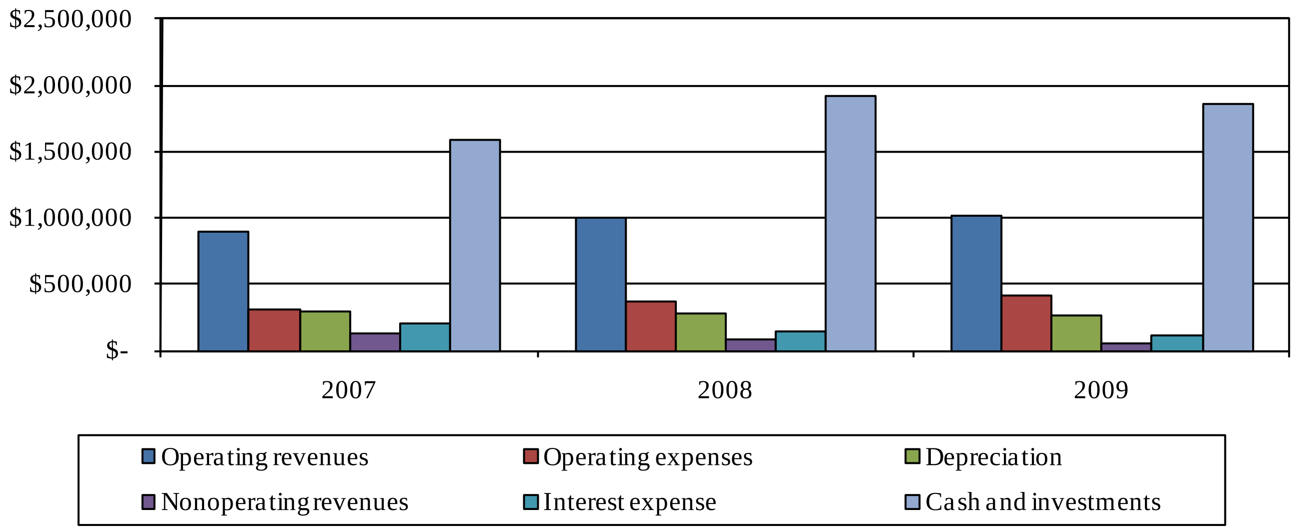


The fund has recorded an operating loss for the second consecutive year as operating expenses continue to increase. The cash balance remains strong in relation to operations; however, it is important to review cash flow each year to determine if rates are adequate to cover operations.

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

Water Fund Operations

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 903,510	100.0 %	$ 1,004,684	100.0 %	$ 1,020,789	100.0 %
Operating expenses	(306,757)	(34.0)	(366,616)	(36.5)	(409,820)	(40.1)
Depreciation	(286,637)	(31.7)	(283,403)	(28.2)	(257,417)	(25.2)
Operating income	310,116	34.3	354,665	35.3	353,552	34.7
Nonoperating revenues	131,418	14.5	80,469	8.0	55,713	5.5
Interest expense	(204,652)	(22.7)	(138,710)	(13.8)	(118,246)	(11.6)
Income before contributions	236,882	26.1	296,424	29.5	291,019	28.6
Contributed assets	189,986	21.0	71,630	7.1	23,208	2.3
Change in net assets	$ 426,868	47.1 %	$ 368,054	36.6 %	$ 300,349	29.5 %
Cash and investments	$ 1,581,994		$ 1,912,983		$ 1,852,839	
Loans and bonds payable	$ 4,859,700		$ 3,333,700		$ 2,749,700	

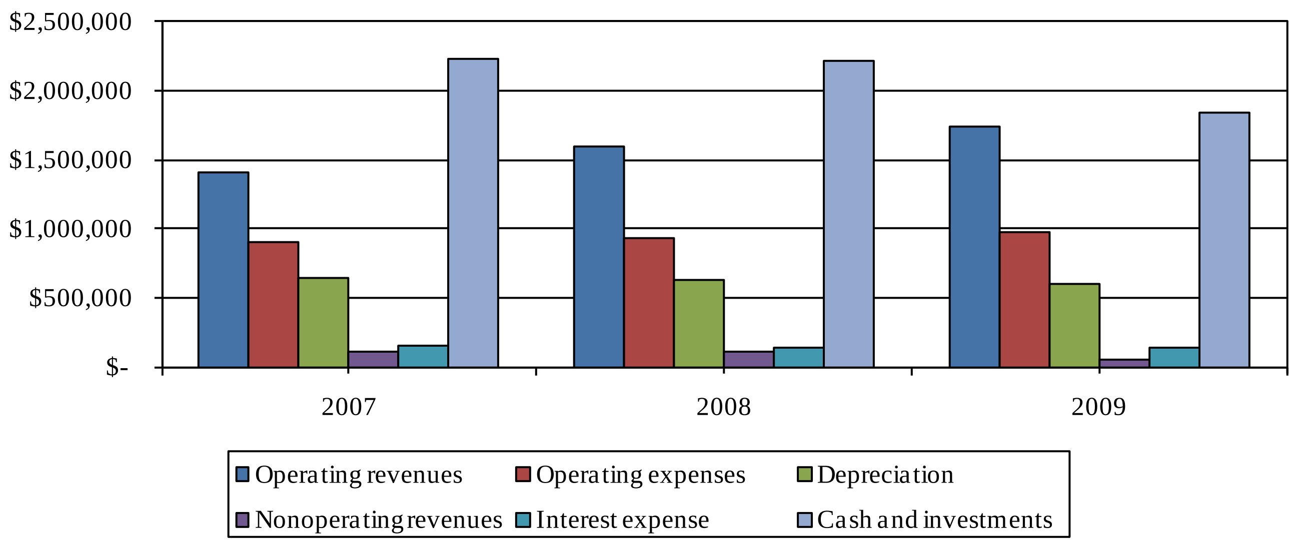


The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations and debt service. The City changed its billing cycle in 2009 which resulted in 12.5 months of revenue for 2009. It is important to consider this change when evaluating 2010 and 2011 results and rates.

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

Wastewater Fund Operations

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 1,409,302	100.0 %	$ 1,599,767	100.0 %	$ 1,746,880	100.0 %
Operating expenses	(910,489)	(64.6)	(936,434)	(58.5)	(971,693)	(55.6)
Depreciation	(643,760)	(45.7)	(634,621)	(39.7)	(600,851)	(34.4)
Operating income (loss)	(144,947)	(10.3)	28,712	1.8	174,336	10.0
Nonoperating revenues	109,476	7.8	115,072	7.2	52,309	3.0
Interest expense	(155,670)	(11.0)	(147,263)	(9.2)	(141,199)	(8.1)
Income (loss) before contributions	(191,141)	(13.5)	(3,479)	(0.2)	85,446	4.9
Contributed assets	792,785	56.3	121,625	7.6	43,439	2.5
Change in net assets	$ 601,644	42.8 %	$ 118,146	7.4 %	$ 92,068	5.3 %
Cash and investments	$ 2,237,136		$ 2,218,950		$ 1,843,840	
Loans and bonds payable	$ 3,395,000		$ 3,230,000		$ 3,080,000	

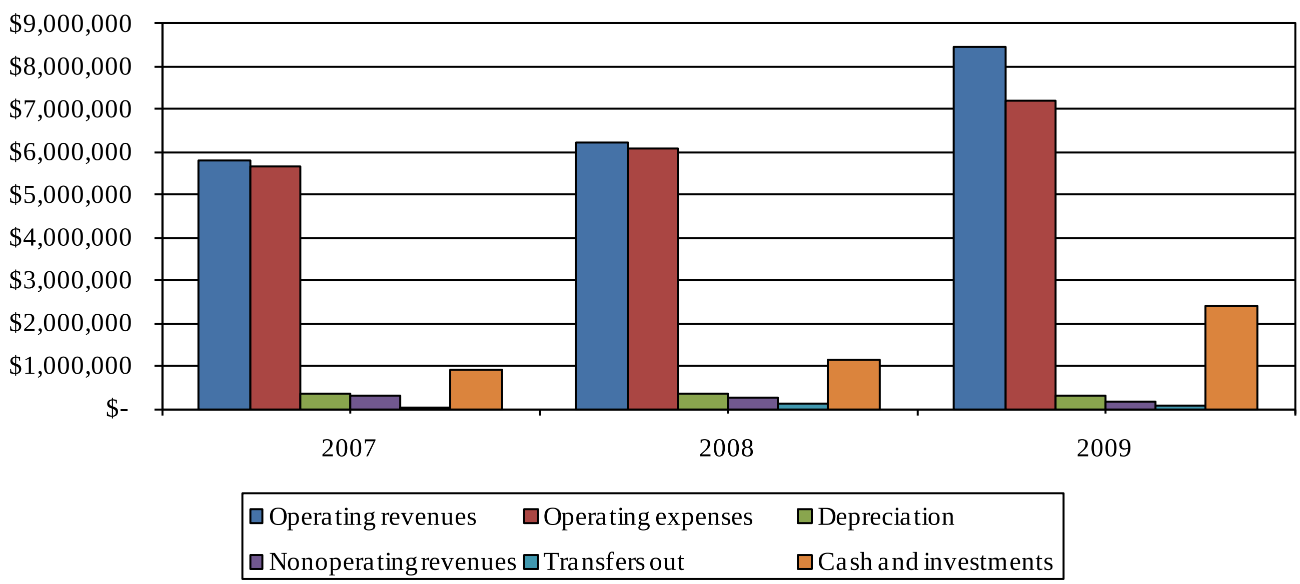


The cash balance remains strong in relation to operations but like the Water fund, it will be important to maintain cash flow to cover future debt service. The City changed its billing cycle in 2009 which resulted in 12.5 months of revenue for 2009. It is important to consider this change when evaluating 2010 and 2011 results and rates.

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

Electric Fund Operations

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 5,811,579	100.0 %	$ 6,239,696	100.0 %	$ 8,460,960	100.0 %
Operating expenses	(5,665,912)	(97.5)	(6,074,445)	(97.4)	(7,216,666)	(85.3)
Depreciation	(342,560)	(5.9)	(332,737)	(5.3)	(313,840)	(3.7)
Operating income (loss)	(196,893)	(3.4)	(167,486)	(2.7)	930,454	11.0
Nonoperating revenues	285,912	4.9	241,521	3.9	173,414	2.0
Income before contributions and transfers	89,019	1.5	74,035	1.2	1,103,868	13.0
Contributed assets	34,546	(0.6)	-	-	-	-
Transfers out	(40,000)	(0.7)	(103,040)	(1.7)	(56,000)	(0.7)
Change in net assets	$ 83,565	0.2 %	$ (29,005)	(0.5) %	$ 1,047,868	12.3 %
Cash and investments	$ 925,661		$ 1,164,407		$ 2,387,152	



The operating income increased significantly from 2008 as a result of an increase in charges for services. The cash balance more than doubled and should assist in covering costs of operation. Like the Water and Wastewater funds, it is always important to review cash flow each year to determine if rates are adequate to cover operations. The City changed its billing cycle in 2009 which resulted in 12.5 months of revenue for 2009. It is important to consider this change when evaluating 2010 and 2011 results and rates.

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
12/31/09	$ 318,898	$ 363,958	$ (45,060)	87.6 %	$ 1,250
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

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) and from Abdo, Eick & Meyers' client base of approximately 100 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	2006	2007	2008	2009
Debt to assets	Total liabilities/total assets	Government-wide	27%	26%	26%	24%
			35%	36%	34%	N/A
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	143%	160%	220%	122%
			168%	181%	163%	N/A
Debt per capita	Bonded debt/population	Government-wide	$ 3,923	$ 3,744	$ 3,863	$ 3,556
			$ 2,505	$ 2,673	$ 2,677	N/A
Taxes per capita	Tax revenues/population	Government-wide	$ 366	$ 391	$ 442	$ 488
			$ 346	$ 381	$ 401	N/A
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 486	$ 526	$ 589	$ 674
			N/A	$ 553	$ 663	N/A
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 440	$ 101	$ 774	$ 147
			N/A	$ 409	$ 323	N/A
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	80%	77%	86%	84%
			70%	70%	70%	N/A
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	64%	62%	61%	61%
			68%	68%	67%	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.

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.

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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. 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 24, 2010
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants