CITY OF MELROSE
MELROSE, MINNESOTA

MANAGEMENT LETTER

FOR THE YEAR ENDED
DECEMBER 31, 2012

ABDO
EICK &
MEYERS LLP
Certified Public Accountants & Consultants

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MELROSE, MINNESOTA

MANAGEMENT LETTER

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ABDO
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April 2, 2013

5201 Eden Avenue
Suite 250
Edina, MN 55436

Management, Honorable Mayor and City Council
City of 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, 2012. 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 19, 2012. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America and *Government Auditing Standards*

As stated in our engagement letter, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control over financial reporting of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Significant Audit Findings

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and 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 such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting 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. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider findings 2012-1 and 2012-2 to be significant deficiencies in internal control over financial reporting.

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2012-1 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 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.

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.

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2012-2 Reconciliation of investments

Condition: During our audit, we noted that reconciliations were not completed for the City's investment accounts and 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.

Cause: An investment report derived from a complex tracking system is prepared monthly and from our review it appears to contain most of the data necessary to agree the investments to the finance system, however, due to staff turnover, it appears that there was not a procedure in place to ensure the report was agreed to the finance system.

Effect: As a result there was unrecorded interest at year end.

Recommendation: We recommend that the City utilize a schedule of investment activity that can be reconciled to transactions in the finance system. Implementing this recommendation will not result in any additional cost and will ensure that finance system data is complete.

Management response:

The City has developed a stream lined tracking and reconciliation procedures and an investment schedule that will allow for complete reconciliation to the finance system.

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.

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 statements No. 63 and 65 were adopted for the year ended December 31, 2012. 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. 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, other postemployment benefits, and allocation of payroll.

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 2, 2013.

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.

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, 2012.

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 $182,076 from 2011. The fund balance of $1,304,882 is 66 percent of the 2012 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 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.

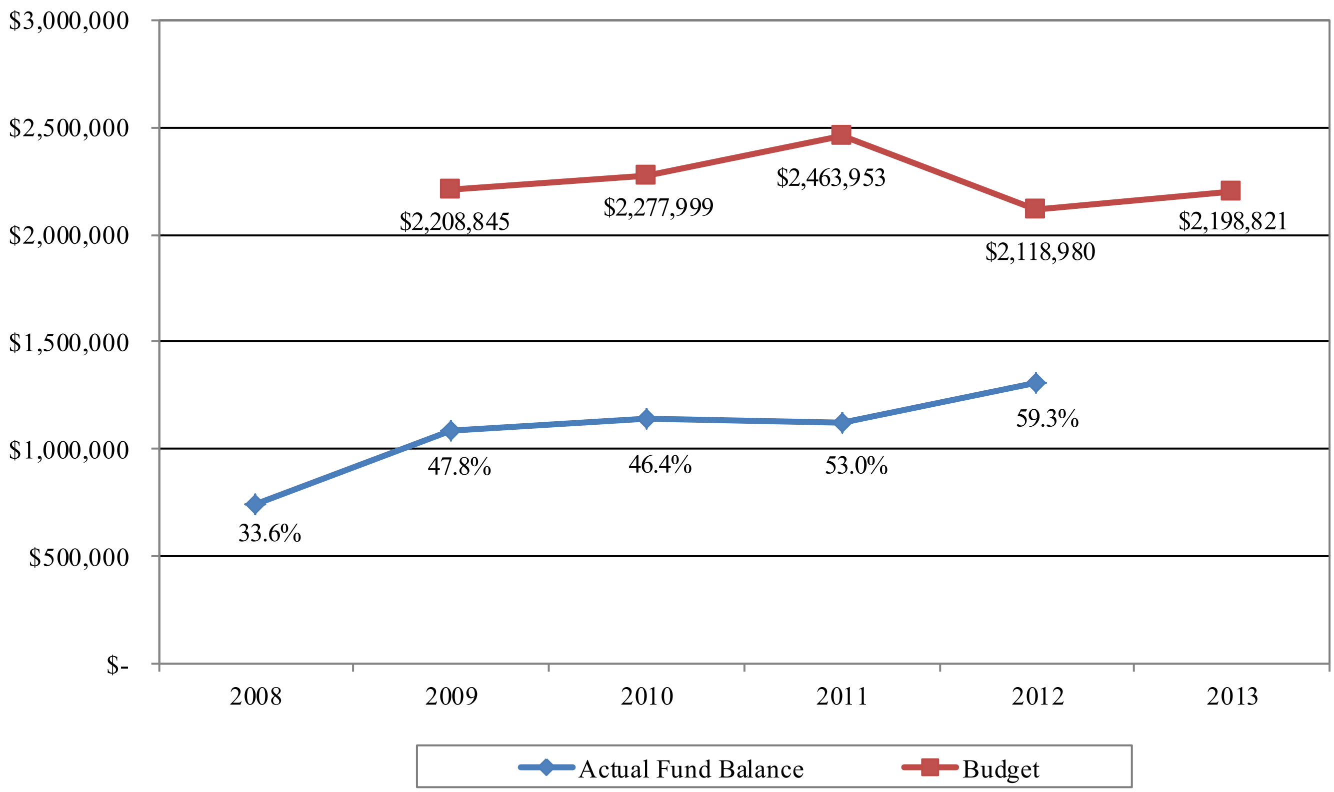
- Expenditures not anticipated at the time the annual budget was adopted may need immediate City Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

- 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
2008	$ 741,494	2009	$ 2,208,845	33.6 %
2009	1,089,358	2010	2,277,999	47.8
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

Fund Balance as a Percent of Next Year's Budget



We have compiled a peer group average derived from information available on the website of the Office of the State Auditor for Cities of the 4th class which have populations of 2,500-10,000. In 2010 and 2011, the average General fund balance as a percentage of expenditures was 67 percent and 69 percent, respectively. Based on comparison to the peer groups, the City's General fund balance is slightly lower than average.

A summary of the 2012 operations are as follows:

	Final Budget Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 2,073,750	$ 2,147,391	$ 73,641
Expenditures	1,652,293	1,491,298	160,995
Excess of revenues over expenditures	421,457	656,093	234,636
Other financing sources (uses)			
Sale of capital assets	-	1,502	1,502
Transfers in	45,000	-	(45,000)
Transfers out	(466,687)	(475,519)	(8,832)
Total other financing sources (uses)	(421,687)	(474,017)	(52,330)
Net change in fund balances	(230)	182,076	182,306
Fund balances, January 1	1,122,806	1,122,806	-
Fund balances, December 31	$ 1,122,576	$ 1,304,882	$ 182,306

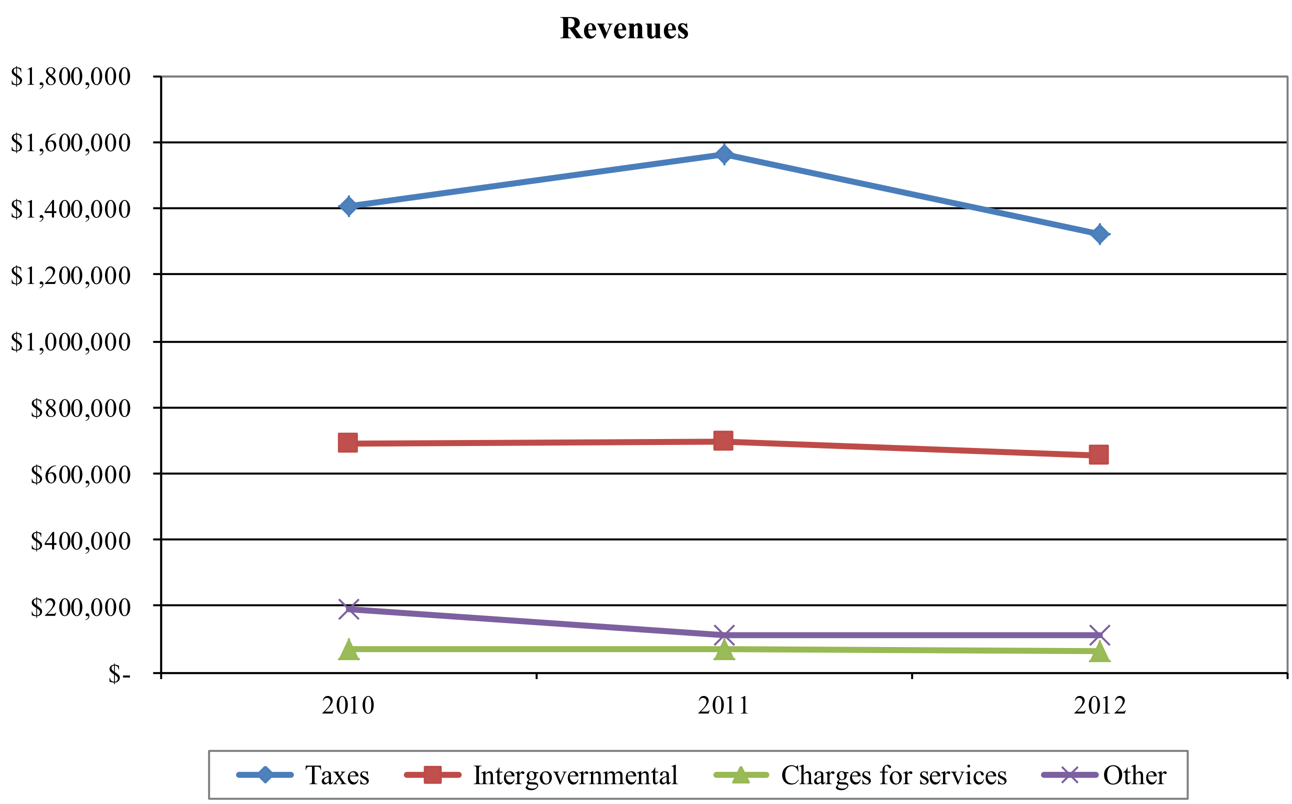
- The most significant revenue variance was for intergovernmental revenue which was over budget by $76,293. The majority of this increase related to local government aid coming in $73,735 higher than budget.

- The most significant expenditure variance was in the general government and public safety functions which were under budget by $67,074 and $62,049, respectively.

A summary and comparison of 2012, 2011, and 2010 General fund revenues and transfers in are as follows:

Revenue Source	2010	2011	2012	Percent of Total	Per Capita
Taxes	$ 1,409,523	$ 1,561,902	$ 1,320,776	61.4 %	$ 365
Licenses and permits	67,062	50,592	48,217	2.2	13
Intergovernmental	689,802	697,180	655,259	30.5	181
Charges for services	68,595	66,951	63,019	2.9	17
Fines and forfeitures	30,963	27,774	18,825	0.9	5
Interest on investments	6,155	23,980	29,544	1.4	8
Miscellaneous	24,197	11,555	13,253	0.6	4
Transfers in	62,673	-	-	-	-
Total revenues and transfers	$ 2,358,970	$ 2,439,934	$ 2,148,893	100.0 %	$ 593

The sources of 2012, 2011, and 2010 revenues and transfers are presented graphically as follows:



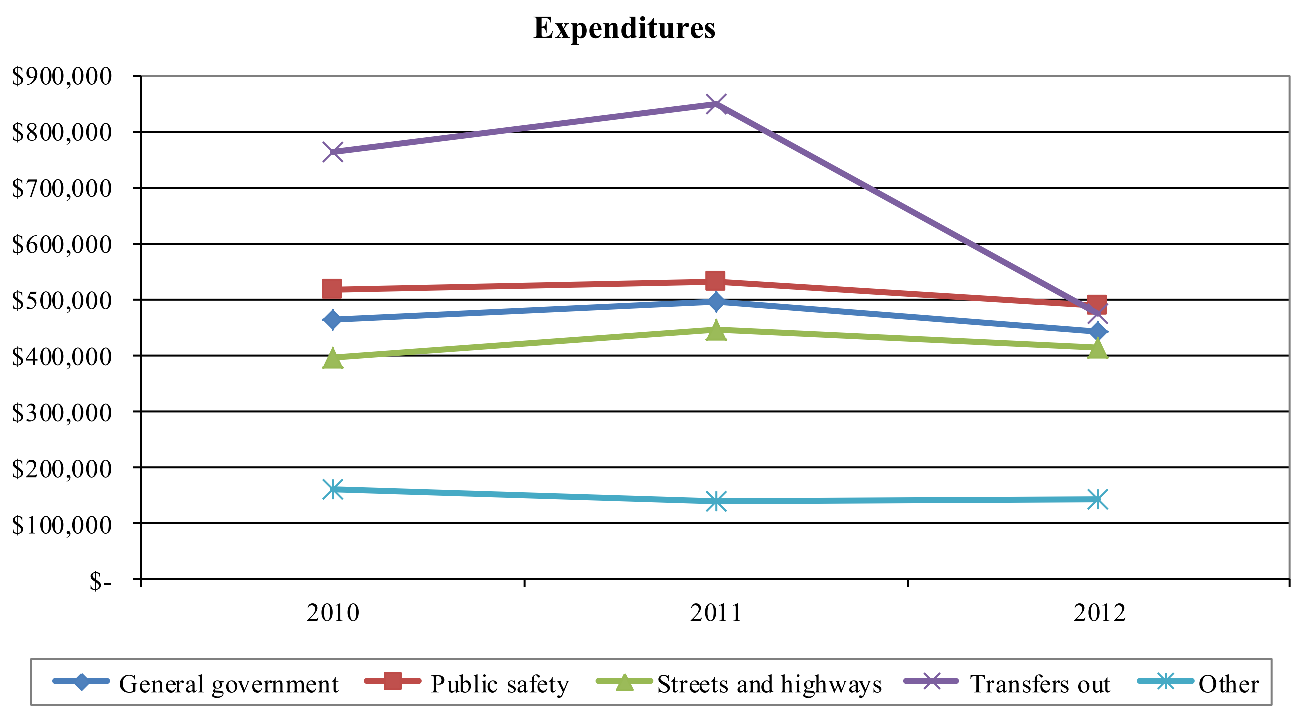
A summary and comparison of 2012, 2011, and 2010 General fund expenditures and transfers out are as follows:

Program	2010	2011	2012		Percent of Total	Per Capita	Peer Group Per Capita
Current							
General government	$ 463,843	$ 494,674	$ 443,745		22.6 %	$ 123	$ 125
Public safety	519,522	532,136	491,013		25.0	136	222
Streets and highways	395,110	445,912	414,043		21.1	114	112
Sanitation	3,831	4,515	5,255		0.3	1	-
Culture and recreation	77,552	49,628	51,285		2.6	14	56
Economic development	79,329	83,226	84,489		4.3	23	5
Total current	1,539,187	1,610,091	1,489,830		75.9	411	520
Debt service	1,218	786	1,468		0.1	-	-
Transfers out	764,301	849,873	475,519	*	24.0	131	-
Total expenditures and transfers	$ 2,304,706	$ 2,460,750	$ 1,966,817		100.0 %	$ 542	$ 520

* Decrease in transfer out related to the issuance of the 2011A crossover refunding bonds. A transfer from the General fund to support the debt service payments was no longer necessary.

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 approximately 120 fourth class cities (populations 2,500-10,000) across the State.

The 2012, 2011 and 2010 expenditures and transfers are presented graphically as follows:



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, 2012	Fund Balances December 31, 2011	Increase (Decrease)
Nonmajor			
Melrose Area Development Authority (MADA)	$ (17,536)	$ (5,893)	$ (11,643)
MADA Revolving Loan	563,776	548,699	15,077
Senior Activity Center	3,064	3,993	(929)
PIA Asset Building	522	775	(253)
Tri-Cap Bus	3,741	3,012	729
Fire Department	163,922	451,714	(287,792)
Total	$ 717,489	$ 1,002,300	$ (284,811)

All funds should have sufficient resources to provide for their operations but occasionally deficits will occur. MADA's deficit is expected to be funded with future revenue in excess of expenditures. In addition to the fund balance above, MADA Revolving Loan fund has approximately $458 thousand in current loans receivable.

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 2005	$ 214,134	$ 1,835,998	$ 1,785,000	02/01/13
Lease Revenue Bonds of 2008	417,500	417,962	2,110,000	02/01/29
G.O. Refunding Bonds of 2011	285,558	509,682	2,155,000	02/01/20
Total G.O. and Lease Revenue Bonds	$ 917,192	$ 2,763,642	$ 6,050,000	

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, 2012	2011	Increase (Decrease)
Major			
Capital improvements	$ 3,372,323	$ 3,049,418	$ 322,905

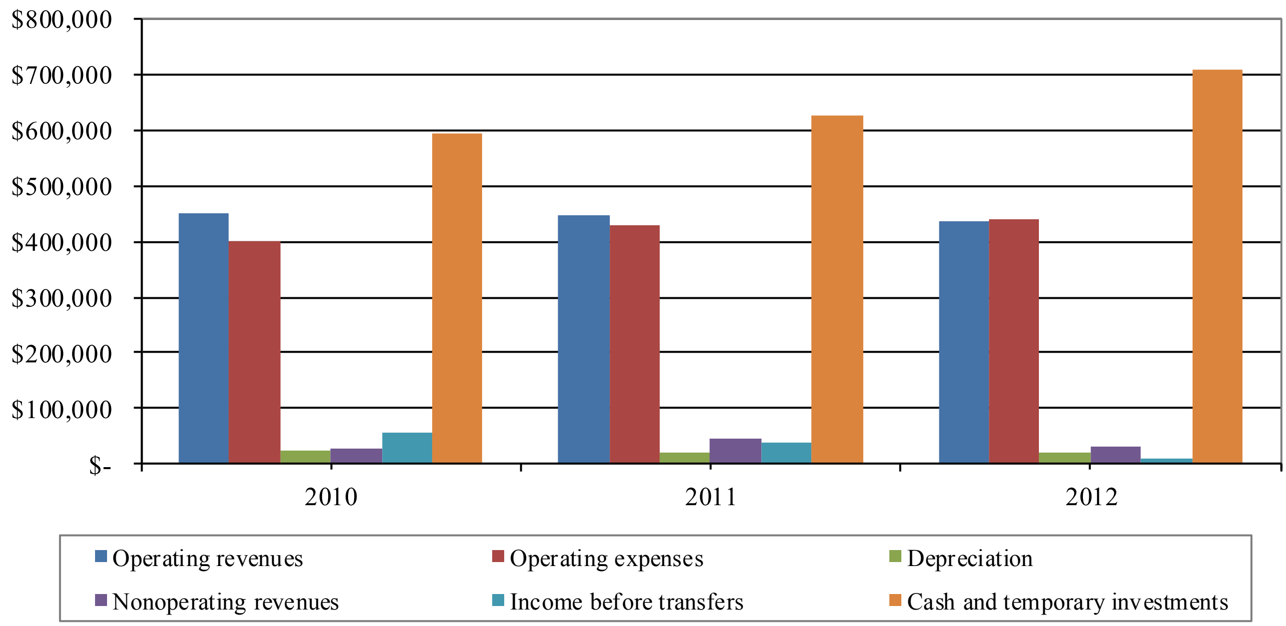
In 1990, several of the designated funds within the General fund were transferred to establish the Capital Improvements fund. Other revenue sources, which were available, have been transferred to this fund. This fund gives the City the ability to finance its capital improvement projects internally rather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

Proprietary Funds

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

Ambulance Fund Operations

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 451,436	100.0 %	$ 445,868	100.0 %	$ 435,805	100.0 %
Operating expenses	(398,937)	(88.4)	(430,755)	(96.6)	(439,093)	(100.8)
Depreciation	(24,337)	(5.4)	(21,649)	(4.9)	(20,613)	(4.7)
Operating income (loss)	28,162	6.2	(6,536)	(1.5)	(23,901)	(5.5)
Nonoperating revenues	28,610	6.3	45,638	10.2	32,969	7.6
Change in net position	$ 56,772	12.5 %	$ 39,102	8.7 %	$ 9,068	2.1 %
Cash and temporary investments	$ 593,600		$ 626,014		$ 709,534	

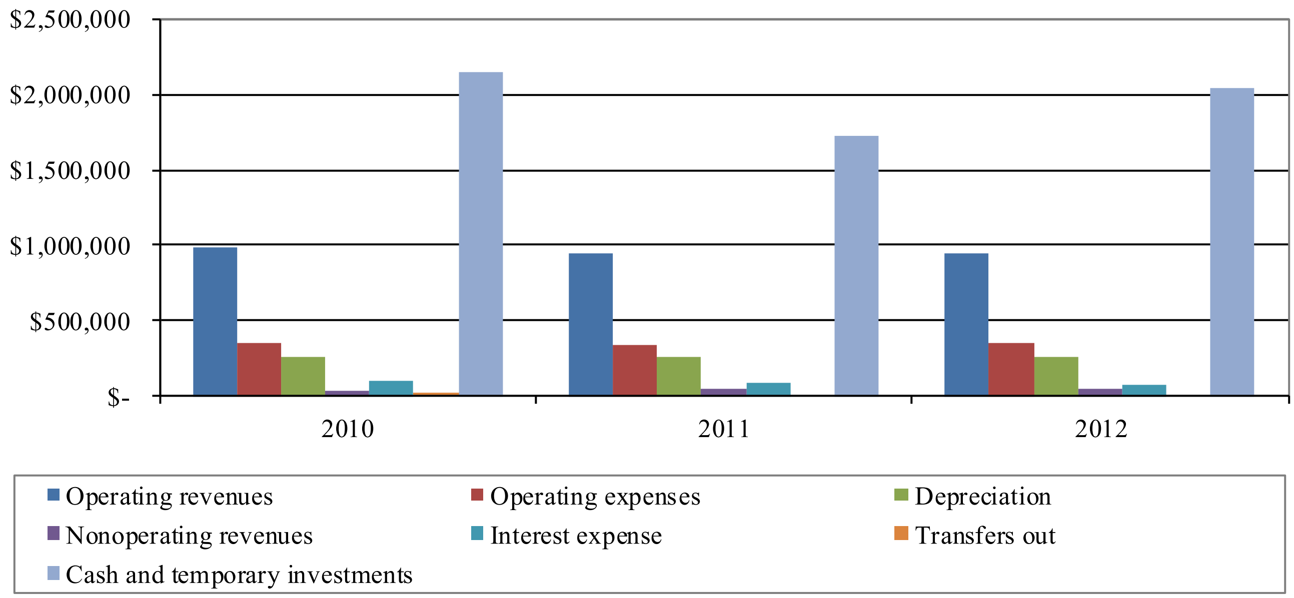


The cash balance increased from prior year and is at a level sufficient to provide for working capital and other needs. The change in net position was positive and the fund has healthy reserves relative to operations.

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

Water Fund Operations

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 981,434	100.0 %	$ 949,882	100.0 %	$ 951,674	100.0 %
Operating expenses	(352,809)	(35.9)	(343,325)	(36.1)	(345,475)	(36.3)
Depreciation	(257,517)	(26.2)	(257,976)	(27.2)	(260,395)	(27.4)
Operating income	371,108	37.9	348,581	36.7	345,804	36.3
Nonoperating revenues	36,175	3.7	44,659	4.7	44,741	4.7
Interest expense	(101,131)	(10.3)	(85,134)	(9.0)	(68,423)	(7.2)
Income before transfers	306,152	31.3	308,106	32.4	322,122	33.8
Transfers out	(14,649)	(1.5)	-	-	-	-
Change in net position	$ 291,503	29.8 %	$ 308,106	32.4 %	$ 322,122	33.8 %
Cash and temporary investments	$ 2,144,580		$ 1,726,851		$ 2,038,792	
Bonds payable	$ 2,520,700		$ 1,915,700		$ 1,659,700	

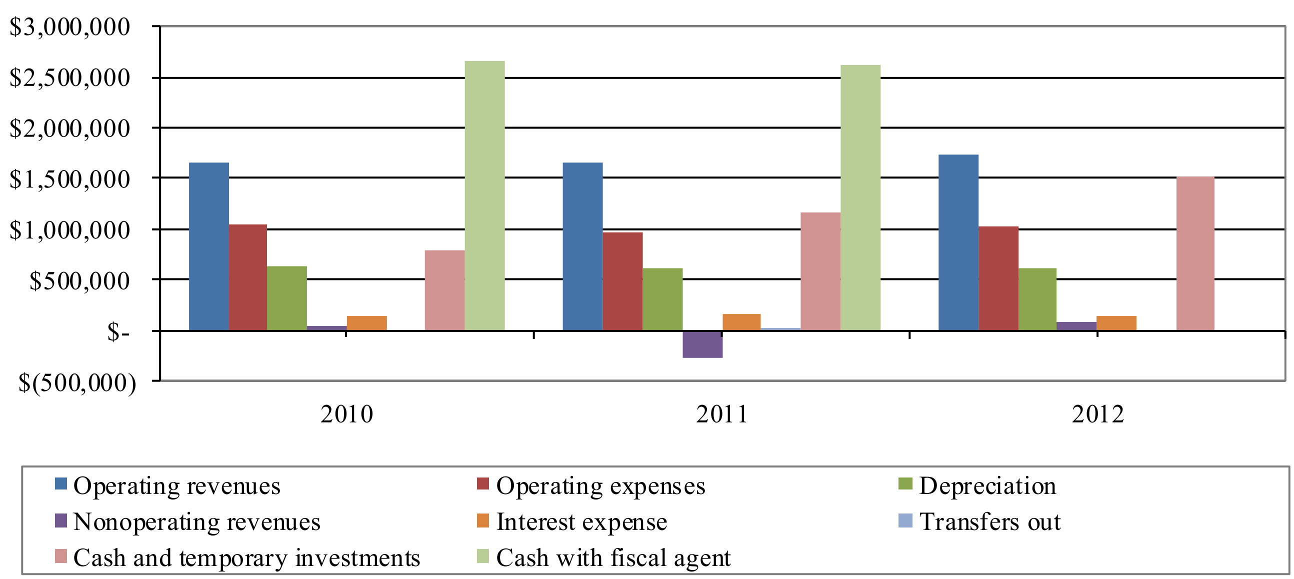


The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations and debt service.

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

Wastewater Fund Operations

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 1,660,803	100.0 %	$ 1,658,618	100.0 %	$ 1,727,246	100.0 %
Operating expenses	(1,046,055)	(63.0)	(963,794)	(58.1)	(1,033,137)	(59.8)
Depreciation	(638,852)	(38.5)	(621,716)	(37.5)	(619,471)	(35.9)
Operating income (loss)	(24,104)	(1.5)	73,108	4.4	74,638	4.3
Nonoperating revenues (expenses)	38,136	2.3	(273,874)	(16.5)	75,652	4.4
Interest expense	(141,558)	(8.5)	(152,805)	(9.2)	(137,595)	(8.0)
Income (loss) before contributions and transfers	(127,526)	(7.7)	(353,571)	(21.3)	12,695	0.7
Contributed assets	-	-	11,330	0.7	-	-
Transfers in	3,295	0.2	-	-	-	-
Transfers out	-	-	(159)	-	-	-
Change in net position	$ (124,231)	(7.5) %	$ (342,400)	(20.6) %	$ 12,695	0.7 %
Cash and temporary investments	$ 799,865		$ 1,165,366		$ 1,512,937	
Cash with fiscal agent	$ 2,651,484		$ 2,621,455		$ -	
Bonds payable	$ 4,340,000		$ 4,180,000		$ 1,415,000	

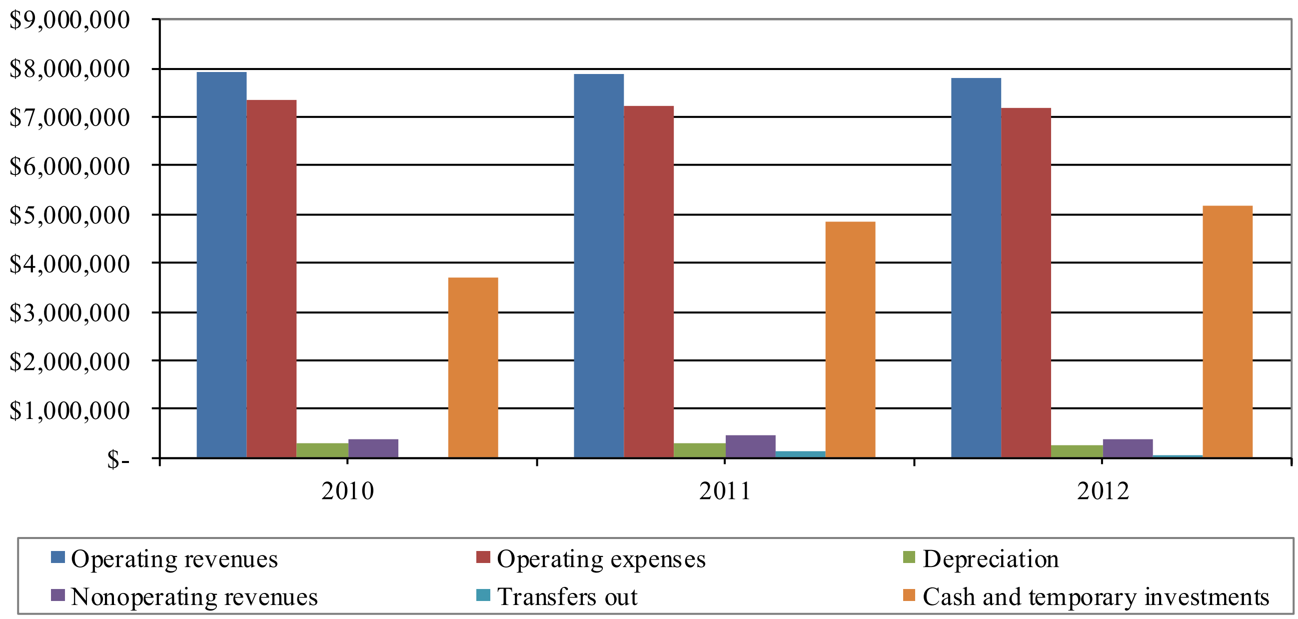


The cash balance remains strong in relation to operations but like the Water fund, it will be important to maintain cash flow to cover future debt service. In 2010, the City issued $1,415,000 of crossover refunding bonds, and transferred $1,250,000 to escrow to pay the $2,600,000 called Revenue Bonds of 2004 on December 1, 2012. The significant nonoperating expense in 2011 related to the disposal of capital assets.

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

Electric Fund Operations

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 7,911,444	100.0 %	$ 7,898,304	100.0 %	$ 7,787,972	100.0 %
Operating expenses	(7,354,529)	(93.0)	(7,218,060)	(91.4)	(7,198,775)	(92.4)
Depreciation	(310,876)	(3.9)	(303,682)	(3.8)	(276,986)	(3.6)
Operating income	246,039	3.1	376,562	4.8	312,211	4.0
Nonoperating revenues	375,505	4.7	449,476	5.7	385,529	5.0
Income before transfers	621,544	7.8	826,038	10.5	697,740	9.0
Transfers out	-	-	(155,733)	(2.0)	(6,477)	(0.1)
Change in net position	$ 621,544	7.8 %	$ 670,305	8.5 %	$ 691,263	8.9 %
Cash and temporary investments	$ 3,703,154		$ 4,847,601		$ 5,189,697	
Appropriated cash	$ 3,146,947		$ 3,000,000		$ 3,000,000	



In 2012, the operating income decreased from prior year as a result of a decrease in operating expenses and depreciation in excess of the decrease in operating revenues. The cash balance again increased significantly 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.

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	2009	2010	2011	2012
Debt to assets	Total liabilities/total assets	Government-wide	24%	25%	26%	20%
			34%	*37%*	*33%*	*N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	122%	219%	132%	206%
			261%	*102%*	*106%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 3,556	$ 3,555	$ 3,659	$ 2,519
			$ 2,713	*$ 3,125*	*$ 2,826*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 488	$ 489	$ 462	$ 470
			$ 399	*$ 407*	*$ 500*	*N/A*
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 674	$ 599	$ 539	$ 483
			$ 625	*$ 624*	*$ 640*	*N/A*
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 147	$ 53	$ 44	$ 175
			$ 310	*$ 265*	*$ 229*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	84%	82%	80%	80%
			68%	*61%*	*64%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	61%	59%	56%	54%
			67%	*59%*	*65%*	*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.

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. 61 - *The Financial Reporting Entity: Omnibus an Amendment of GASB Statements No. 14 and No. 34*

Summary

The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14 and the related financial reporting requirements of Statement No. 34, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances.

This Statement clarifies the reporting of equity interests in legally separate organizations as well. It requires a primary government to report its equity interest in a component unit as an asset.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting, and disclosing information about component units and equity interest transactions of a financial reporting entity.

GASB Statement No. 66 - *Technical Corrections- an Amendment of GASB Statements No. 10 and No. 62*

Summary

The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54*, Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The provisions of this Statement are effective for financial statements for `periods beginning after December 15, 2012. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement resolve conflicting accounting and financial reporting guidance that could diminish the consistency of financial reporting and thereby enhance the usefulness of the financial reports.

Future Accounting Standard Changes - Continued

GASB Statement No. 67 - *The Financial Reporting for Pension Plans- an Amendment to GASB Statement No. 25*

Summary

The objective of this Statement is to improve financial reporting by state and local governmental pension plans. 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 Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are

administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

The requirements of Statements No. 25 and No. 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.

This Statement is effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by the pension plans that are within its scope. The new information will enhance the decision-usefulness of the financial reports of these pension plans, their value for assessing accountability, and their transparency by providing information about measures of net pension liabilities and explanations of how and why those liabilities changed from year to year. The net pension liability information, including ratios, will offer an up-to-date indication of the extent to which the total pension liability is covered by the fiduciary net position of the pension plan. The comparability of the reported information for similar types of pension plans will be improved by the changes related to the attribution method used to determine the total pension liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison to actuarially determined rates, when such rates are determined. In that circumstance, it also will provide information about whether employers and nonemployer contributing entities, if applicable, are keeping pace with actuarially determined contribution measures. In addition, new information about rates of return on pension plan investments will inform financial report users about the effects of market conditions on the pension plan's assets over time and provide information for users to assess the relative success of the pension plan's investment strategy and the relative contribution that investment earnings provide to the pension plan's ability to pay benefits to plan members when they come due.

Future Accounting Standard Changes - Continued

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.

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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

April 2, 2013
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants