CITY OF MELROSE
MELROSE, MINNESOTA

MANAGEMENT LETTER

FOR THE YEAR ENDED
DECEMBER 31, 2011

ABDO
EICK &
MEYERS LLP
Certified Public Accountants & Consultants

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MELROSE, MINNESOTA

MANAGEMENT LETTER

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ABDO
EICK &
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5201 Eden Avenue
Suite 250
Edina, MN 55436

April 2, 2012

Management, Honorable Mayor and 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, 2011. 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 December 6, 2011. 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 deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed on the following page, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

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. 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 that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency presented as finding 2011-1 on the following page to be a significant deficiency internal control over financial reporting.

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2011-1 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 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.

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. The significant accounting policies used by the City are described in Note 1 to the financial statements. The requirements of GASB statement No. 54 was adopted for the year ended December 31, 2011. 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. Management has corrected all such misstatements.

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.

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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, 2012**.**

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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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, 2011.

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 decreased $20,816 from 2010. The fund balance of $1,122,806 is 46 percent of the 2011 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 Office of the State Auditor (the OSA) has issued a *Statement of Position* relating to fund balance stating "a local government should identify fund balance separately between reserved and unreserved fund balance. The local government may assign and report some or all of the fund balance as designated and undesignated." The OSA also recommends local governments adopt a formal policy on the level of unreserved fund balance that should be maintained in the General and special revenue funds. This helps address citizen concerns as to the use of fund balance and tax levels.

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

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

- The City is vulnerable to legislative actions at the State and Federal level. The State imposed reductions of market value credit aid and local government aid for some cities for 2011. Levy limits have also been implemented for municipalities in past legislative sessions. An adequate fund balance will provide a temporary buffer against those aid adjustments and levy limits.

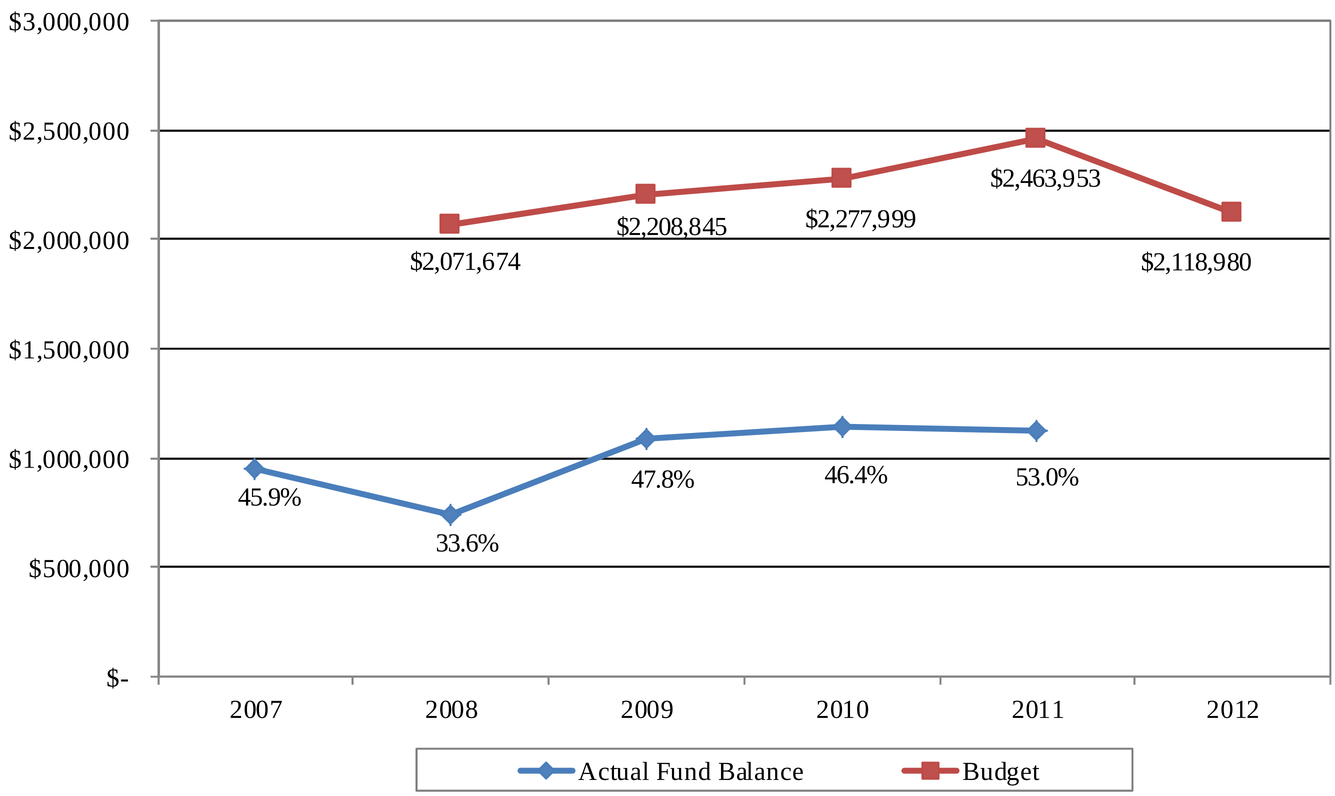
- Expenditures not anticipated at the time the annual budget was adopted may need immediate Council action. These would include capital outlay, replacement, lawsuits and other items. An adequate fund balance will provide the financing needed for such expenditures.

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

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

Year	Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2007	$ 951,526	2008	$ 2,071,674	45.9 %
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

Fund Balance as a Percent of Next Year's Budget



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A summary of the 2011 operations are as follows:

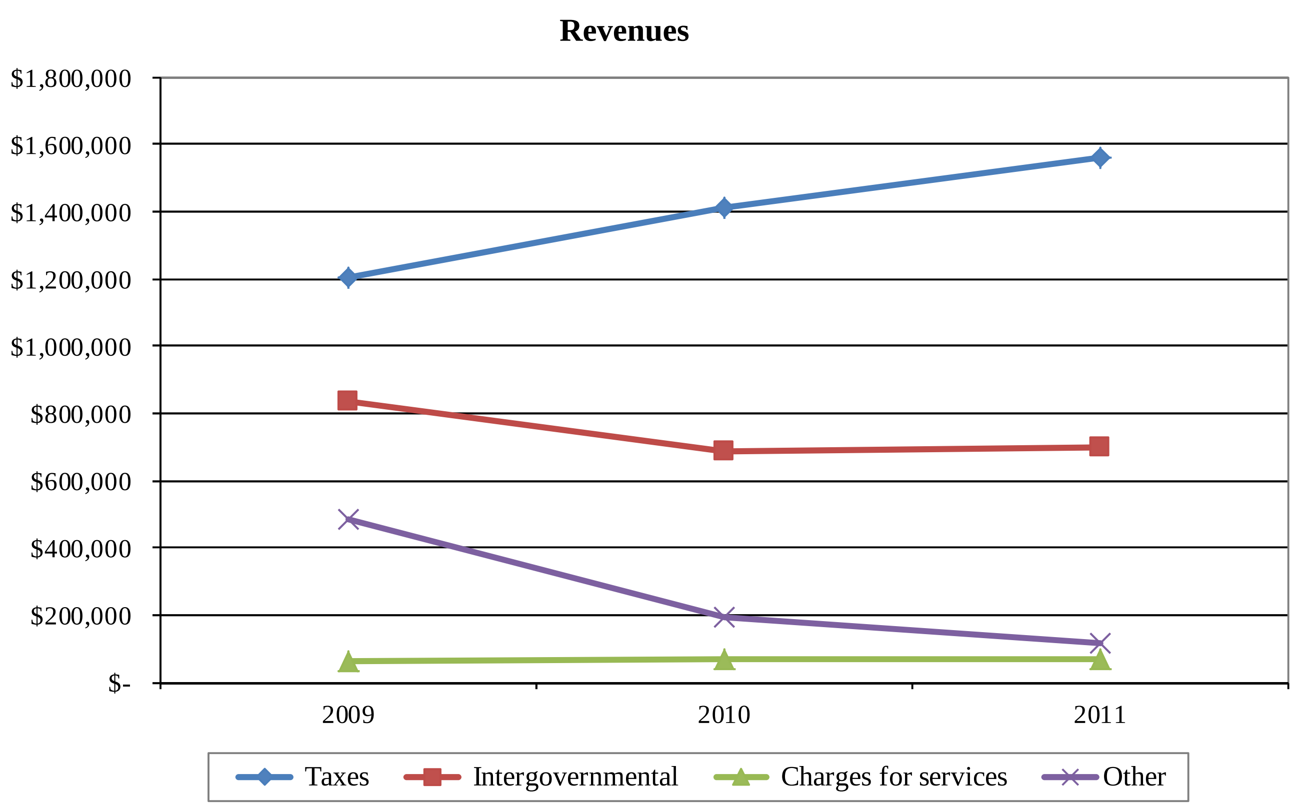
	Final Budget Amounts	Actual Amounts	Variance with Final Budget
Revenues	$ 2,423,953	$ 2,439,934	$ 15,981
Expenditures	1,633,148	1,610,877	22,271
Excess of revenues over expenditures	790,805	829,057	38,252
Other financing sources (uses)			
Transfers in	40,000	-	(40,000)
Transfers out	(830,805)	(849,873)	(19,068)
Total other financing sources (uses)	(790,805)	(849,873)	(59,068)
Net change in fund balances	-	(20,816)	(20,816)
Fund balances, January 1	1,143,622	1,143,622	-
Fund balances, December 31	$ 1,143,622	$ 1,122,806	$ (20,816)

- The most significant expenditure variance was in the general government function which was under budget by $43,858.

A summary and comparison of 2011, 2010, and 2009 General fund revenues and transfers in are as follows:

Revenue Source	2009	2010	2011	Percent of Total	Per Capita
Taxes	$ 1,206,790	$ 1,409,523	$ 1,561,902	64.0 %	$ 434
Licenses and permits	66,591	67,062	50,592	2.1	14
Intergovernmental	837,404	689,802	697,180	28.6	194
Charges for services	62,047	68,595	66,951	2.7	19
Fines and forfeitures	24,153	30,963	27,774	1.1	8
Interest on investments	23,702	6,155	23,980	1.0	7
Miscellaneous	11,742	24,197	11,555	0.5	3
Transfers in	356,331	62,673	-	-	-
Total revenues and transfers	$ 2,588,760	$ 2,358,970	$ 2,439,934	100.0 %	$ 679

The sources of 2011, 2010, and 2009 revenues and transfers are presented graphically as follows:

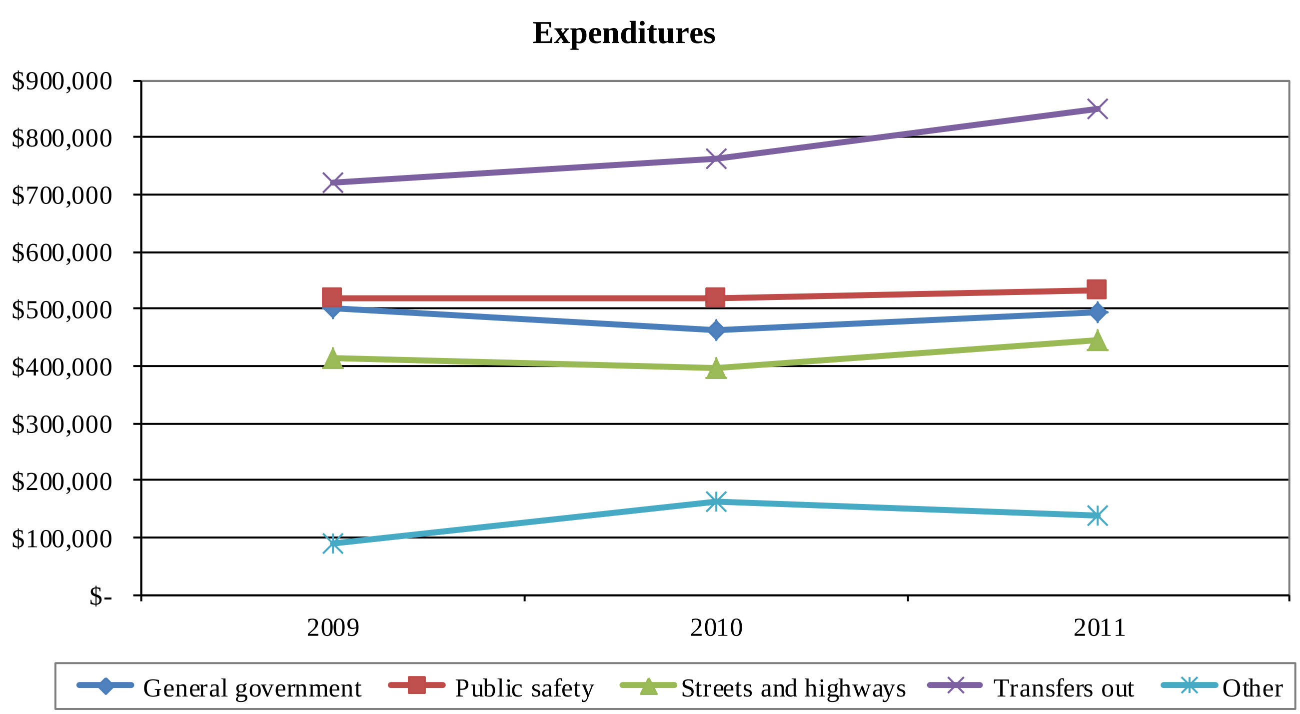


A summary and comparison of 2011, 2010, and 2009 General fund expenditures and transfers out are as follows:

Program	2009	2010	2011	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 500,315	$ 463,843	$ 494,674	20.1 %	$ 137	$ 123
Public safety	519,505	519,522	532,136	21.6	148	204
Streets and highways	412,401	395,110	445,912	18.1	124	108
Sanitation	3,818	3,831	4,515	0.2	1	-
Culture and recreation	-	77,552	49,628	2.0	14	47
Economic development	79,160	79,329	83,226	3.4	23	4
Total current	1,515,199	1,539,187	1,610,091	65.4	447	486
Capital outlay	-	-	-	-	-	18
Debt service	4,892	1,218	786	-	-	-
Transfers out	720,805	764,301	849,873	34.6	236	-
Total expenditures and transfers	$ 2,240,896	$ 2,304,706	$ 2,460,750	100.0 %	$ 683	$ 504

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 2011, 2010 and 2009 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 (Deficits) December 31, 2011	Fund Balances (Deficits) December 31, 2010	Increase (Decrease)
Nonmajor			
Melrose Area Development Authority (MADA)	$ (5,893)	$ 5,158	$ (11,051)
MADA Revolving Loan	548,699	390,435	158,264
Senior Activity Center	3,993	2,367	1,626
PIA Asset Building	775	1,663	(888)
Tri-Cap Bus	3,012	417	2,595
Fire Department	451,714	360,451	91,263
Total	$ 1,002,300	$ 760,491	$ 241,809

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 $225 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 2004	$ 231,694	$ 992,506	$ 770,000	02/01/12
Improvement Bonds of 2005	415,083	2,273,396	1,950,000	02/01/13
Lease Revenue Bonds of 2008	407,339	407,339	2,195,000	02/01/29
G.O. Refunding Bonds of 2011	86	86	2,155,000	02/01/20
Total G.O. and Lease Revenue Bonds	$ 1,054,202	$ 3,673,327	$ 7,070,000	

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, 2011	Fund Balances December 31, 2010	Increase (Decrease)
Major			
Capital improvements	$ 3,049,418	$ 2,586,995	$ 462,423

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 designation policy.

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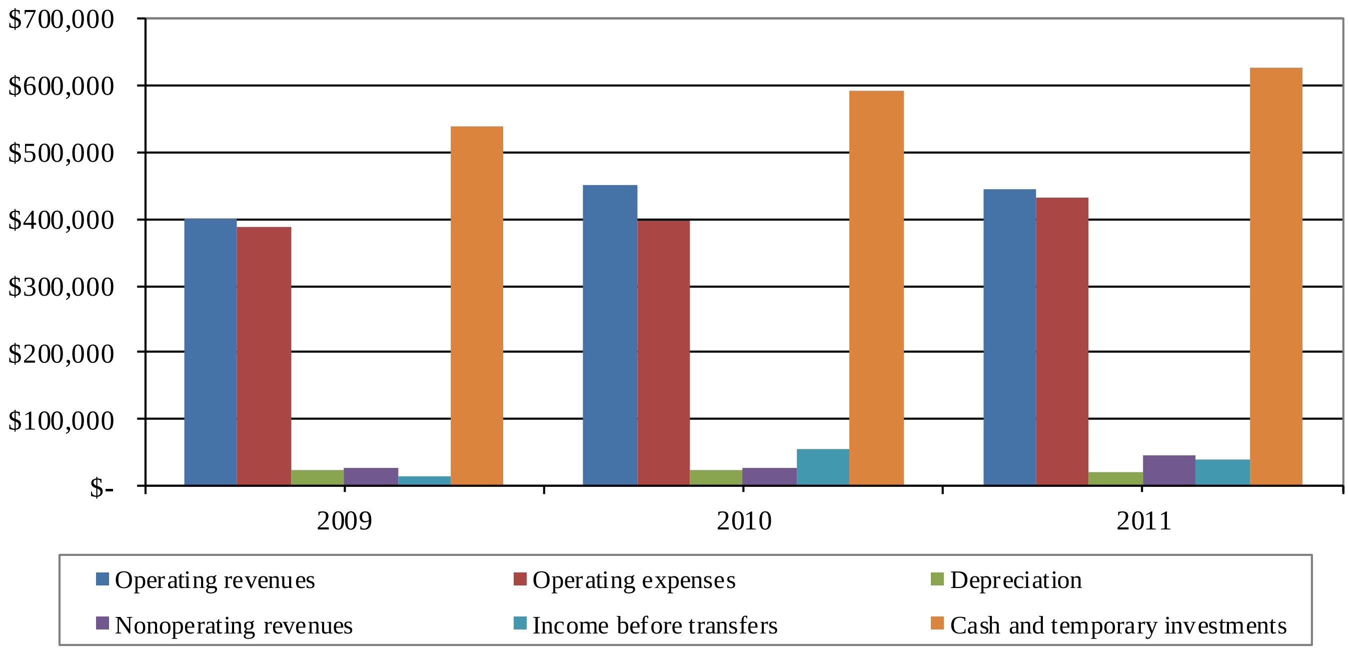
Proprietary Funds

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

Ambulance Fund Operations

	2009		2010		2011	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 401,789	100.0 %	$ 451,436	100.0 %	$ 445,868	100.0 %
Operating expenses	(389,574)	(97.0)	(398,937)	(88.4)	(430,755)	(96.6)
Depreciation	(24,551)	(6.1)	(24,337)	(5.4)	(21,649)	(4.9)
Operating income (loss)	(12,336)	(3.1)	28,162	6.2	(6,536)	(1.5)
Nonoperating revenues	27,581	6.9	28,610	6.3	45,638	10.2
Change in fund net assets	$ 15,245	3.8 %	$ 56,772	12.5 %	$ 39,102	8.7 %
Cash and temporary investments	$ 537,694		$ 593,600		$ 626,014	

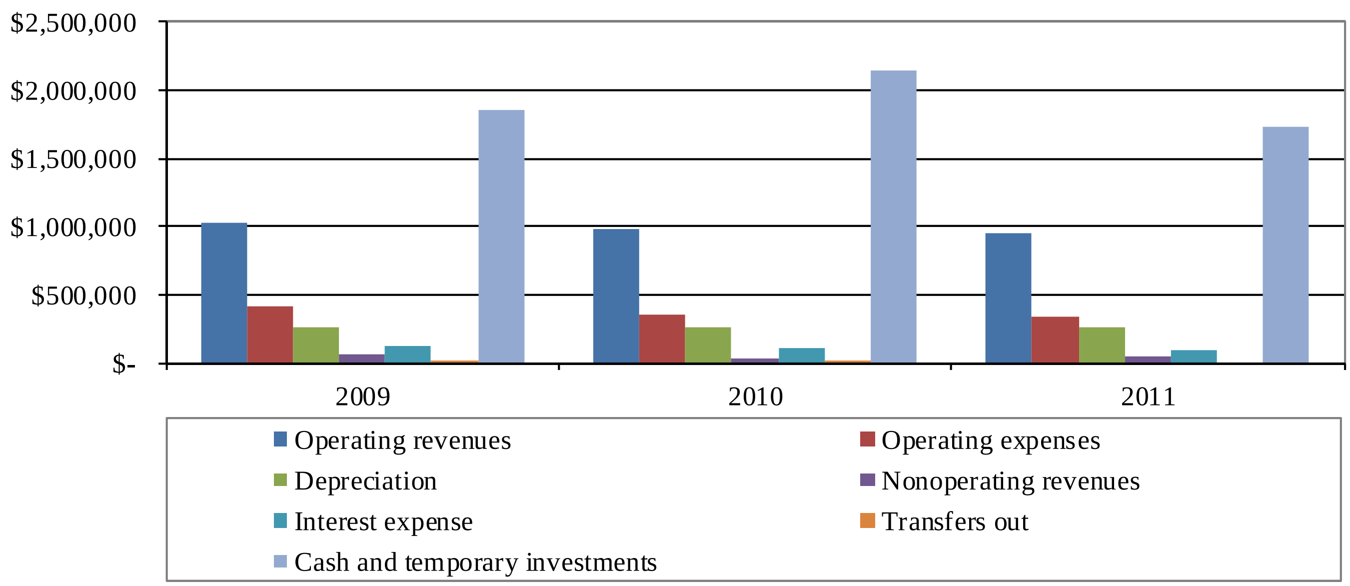


The cash balance increased from prior year and is at a level sufficient to provide for working capital and other needs. The change in net assets was positive and the fund has healthy reserves relative to operations.

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

Water Fund Operations

	2009		2010		2011	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 1,020,789	100.0 %	$ 981,434	100.0 %	$ 949,882	100.0 %
Operating expenses	(409,820)	(40.1)	(352,809)	(35.9)	(343,325)	(36.1)
Depreciation	(257,417)	(25.2)	(257,517)	(26.2)	(257,976)	(27.2)
Operating income	353,552	34.7	371,108	37.9	348,581	36.7
Nonoperating revenues	55,713	5.5	36,175	3.7	44,659	4.7
Interest expense	(118,246)	(11.6)	(101,131)	(10.3)	(88,656)	(9.3)
Income before contributions and transfers	291,019	28.6	306,152	31.3	304,584	32.1
Contributed assets	23,208	2.3	-	-	-	-
Transfers out	(13,878)	(1.4)	(14,649)	(1.5)	-	-
Change in fund net assets	$ 300,349	29.5 %	$ 291,503	29.8 %	$ 304,584	32.1 %
Cash and temporary investments	$ 1,852,839		$ 2,144,580		$ 1,726,851	
Bonds payable	$ 2,749,700		$ 2,520,700		$ 1,915,700	

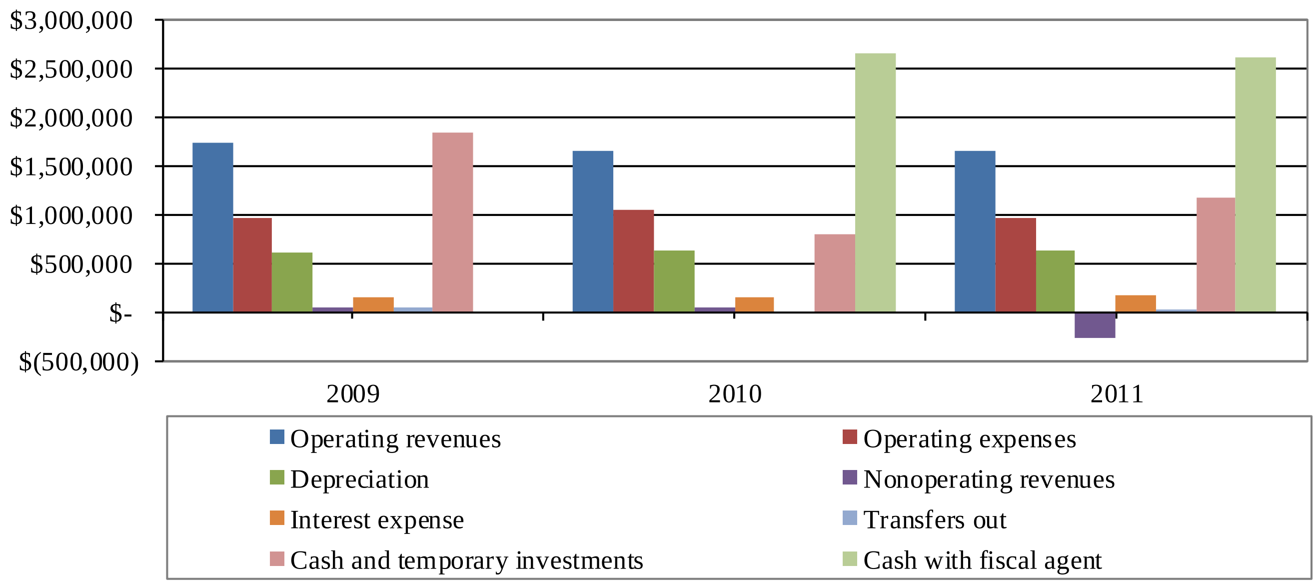


The operating income has been adequate to support cash flow needs in the past and is expected to remain sufficient but it is always important to review cash flow each year to determine if rates are adequate to cover operations and debt service.

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

Wastewater Fund Operations

	2009		2010		2011	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 1,746,880	100.0 %	$ 1,660,803	100.0 %	$ 1,658,618	100.0 %
Operating expenses	(971,693)	(55.6)	(1,046,055)	(63.0)	(963,794)	(58.1)
Depreciation	(600,851)	(34.4)	(638,852)	(38.5)	(621,716)	(37.5)
Operating income (loss)	174,336	10.0	(24,104)	(1.5)	73,108	4.4
Nonoperating revenues	52,309	3.0	38,136	2.3	(273,874)	(16.5)
Interest expense	(141,199)	(8.1)	(141,558)	(8.5)	(175,136)	(10.6)
Income (loss) before contributions and transfers	85,446	4.9	(127,526)	(7.7)	(375,902)	(22.7)
Contributed assets	43,439	2.5	-	-	11,330	0.7
Transfers in	-	-	3,295	0.2	-	-
Transfers out	(36,817)	(2.1)	-	-	(159)	-
Change in fund net assets	$ 92,068	5.3 %	$ (124,231)	(7.5) %	$ (364,731)	(22.0) %
Cash and temporary investments	$ 1,843,840		$ 799,865		$ 1,165,366	
Cash with fiscal agent	$ -		$ 2,651,484		$ 2,621,455	
Bonds payable	$ 3,080,000		$ 4,340,000		$ 4,180,000	

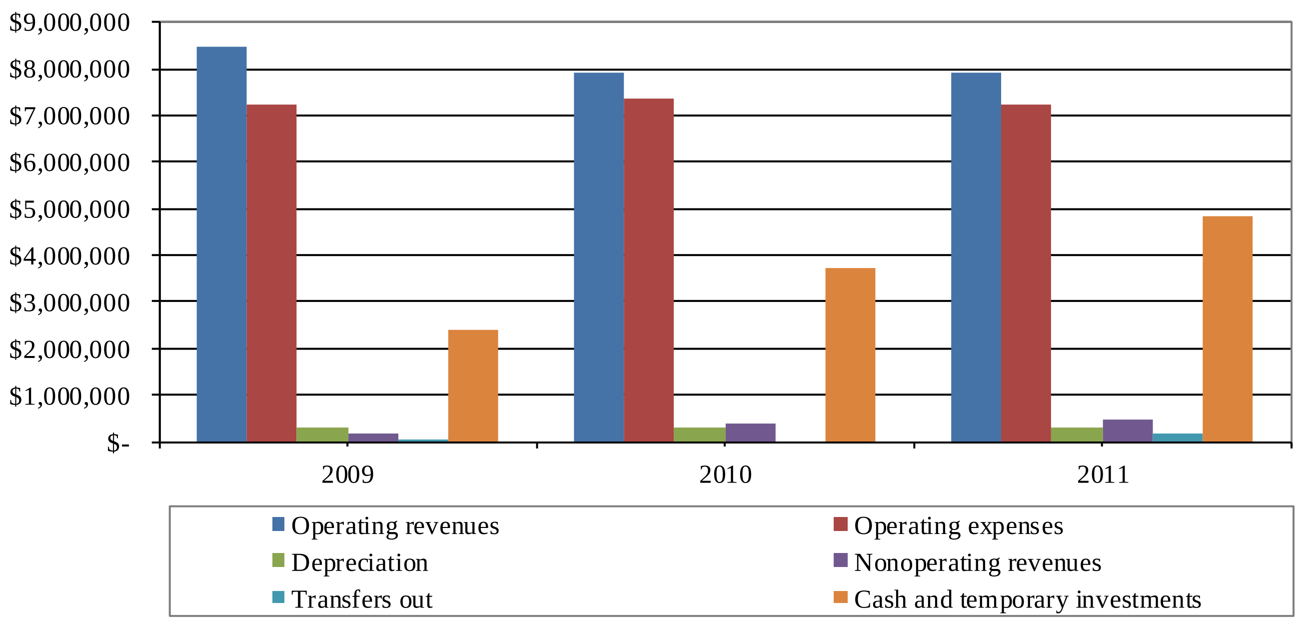


The cash balance remains strong in relation to operations but like the Water fund, it will be important to maintain cash flow to cover future debt service. In 2010, the City issued $1,415,000 of crossover refunding bonds, and transferred $1,250,000 to escrow to pay the $2,600,000 called Revenue Bonds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

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

Electric Fund Operations

	2009		2010		2011	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 8,460,960	100.0 %	$ 7,911,444	100.0 %	$ 7,898,304	100.0 %
Operating expenses	(7,216,666)	(85.3)	(7,354,529)	(93.0)	(7,218,060)	(91.4)
Depreciation	(313,840)	(3.7)	(310,876)	(3.9)	(303,682)	(3.8)
Operating income (loss)	930,454	11.0	246,039	3.1	376,562	4.8
Nonoperating revenues	173,414	2.0	375,505	4.8	453,653	5.7
Income before transfers	1,103,868	13.0	621,544	7.9	826,038	10.5
Transfers out	(56,000)	(0.7)	-	-	(155,733)	(2.0)
Change in fund net assets	$ 1,047,868	12.3 %	$ 621,544	7.9 %	$ 670,305	8.5 %
Cash and temporary investments	$ 2,387,152		$ 3,703,154		$ 4,847,601	
Appropriated cash	$ 3,571,947		$ 3,146,947		$ 3,000,000	



In 2011, the operating income increased from prior year as a result of a decrease in operating expenses. 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.

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	Pension Benefit Per Year of Service
12/31/11	*	*	*	*	$ 1,250
12/31/10	$ 326,205	$ 351,783	$ (25,578)	92.7 %	1,250
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

* - At the time of report preparation, information is unavailable.

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	2008	2009	2010	2011
Debt to assets	Total liabilities/total assets	Government-wide	26%	24%	25%	26%
			34%	*34%*	*37%*	*N/A*
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	220%	122%	219%	132%
			163%	*261%*	*102%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 3,863	$ 3,556	$ 3,555	$ 3,659
			$ 2,677	*$ 2,713*	*$ 3,125*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 442	$ 488	$ 489	$ 462
			$ 401	*$ 399*	*$ 407*	*N/A*
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 589	$ 674	$ 599	$ 539
			$ 663	*$ 625*	*$ 624*	*N/A*
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 774	$ 147	$ 53	$ 44
			$ 323	*$ 310*	*$ 265*	*N/A*
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	86%	84%	82%	80%
			70%	*68%*	*61%*	*N/A*
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	61%	61%	59%	56%
			67%	*67%*	*59%*	*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. 60 - *Accounting and Financial Reporting for Service Concession Arrangements*

Summary

The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties. This Statement also provides guidance for governments that are operators in a service concession arrangement.

This Statement requires disclosures about a service concession arrangement including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments.

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement improve financial reporting by establishing recognition, measurement, and disclosure requirements for SCAs for both transferors and governmental operators, requiring governments to account for and report SCAs in the same manner, which improves the comparability of 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.

Future Accounting Standard Changes - Continued

GASB Statement No. 62 - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*

Summary

The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations.
2. Accounting Principles Board Opinions.
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting.*

The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

How the Changes in This Statement Will Improve Financial Reporting

The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source.

GASB Statement No. 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*

Summary

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position.

Future Accounting Standard Changes - Continued

GASB Statement No. 64 - *Derivative Instruments: Application of Hedge Accounting Termination Provisions - an Amendment of GASB Statement No. 53*

Summary

The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or swap counterparty's credit support provider, is replaced.

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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

April 2, 2012
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants