CITY OF ROCKVILLE
ROCKVILLE, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2009

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

11 Civic Center Plaza
Suite 300
P.O. Box 3166
Mankato, MN 56002-3166

April 7, 2010

Management, Honorable Mayor and City Council
City of Rockville
Rockville, 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 Rockville, Minnesota (the City), for the year ended December 31, 2009 and have issued our report thereon dated April 7, 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 plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

Also, 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. We are responsible for communicating significant matters related to 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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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 described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 considered the deficiency described in the accompanying Schedule of Findings and Responses as finding 2009-2 to be a material weakness.

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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 described in the accompanying Schedule of Findings and Responses as finding 2009-1 to be a significant deficiency.

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. However, based on recent auditing standards, 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 ensure adequate internal control over safeguarding of assets and the reliability of financial records and reporting.

Cause: From a practical standpoint, we prepare the statements and determine the fairness of the presentation at the same time in connection with out audit. This is not unusual for us to do with organizations 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. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for accuracy; we have answered any questions that management might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosures in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements.

Recommendation: Under these circumstances, the most effective controls lie in management's knowledge of the City's financial operations. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost and other considerations. Regarding the specific situation listed above, we would offer the following specific recommendation: 1) Utilize a disclosure checklist to ensure all required disclosures are present and agree to work papers, and 2) Agree your Banyon receipt and disbursement information to the amount reported in the financial statements plus or minus any applicable accruals.

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.

Updated Progress since Prior Year

No changes have been made in this finding in the current year.

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2009-2 Material Audit Adjustments

Condition: During our audit, adjustments were needed to record several accounting and audit adjustments, including some adjustments that would be considered material audit adjustments.

Criteria: The financial statements are the responsibility of the City's management.

Cause: City staff has not prepared a year end trial balance reflecting all necessary accounting entries.

Effect: It is likely that if a misstatement were to occur, it would not be detected by the City's system of internal control. The audit firm cannot serve as a compensating control over this deficiency.

Recommendation: We recommend that management review each journal entry, obtain an understanding of why the entry was necessary and modify current procedures to ensure that future corrections are not needed.

Management Response

Management will review and gain an understanding of the audit adjustments in order to reduce the number of entries necessary for future audits.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that is required to be reported under *Government Auditing Standards* or Minnesota statutes.

Planned Scope and Timing of the Audit

We performed the audit according to planned scope and timing previously communicated to you through various means.

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. In August 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for the City's fiscal year 2009. Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. During the year 2009, the City calculated its OPEB liability using the alternative measurement method and determined that the calculated liability was immaterial. At this point, the City anticipates it will not incur material future explicit or implicit OPEB costs for its employees and therefore, no liability will be recorded. We noted no transactions entered into by the governmental unit 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 estimate made relates to depreciation on capital assets. Management's estimate of depreciation is based on the estimated useful lives of the assets.

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 difficulties in dealing with management in performing our audit.

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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 consider 3 journal entries to be material audit adjustments.

A journal entry was made to adjust transfers totaling $339,944.

A journal entry was made to record depreciation for the Enterprise funds totaling $344,839.

A journal entry was made to record accounts receivable at year end totaling $93,992.

In total, we prepared 23 journal entries, compared to 16 entries in the previous year. These entries are necessary to adjust balances to year end amounts. Adjusting journal entries proposed by the auditor and made by management were discussed with management as part of the audit process.

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 the audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated April 7, 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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Financial Position and Results of Operations

Our principal observations and recommendations are summarized below. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended December 31, 2009.

General Fund

All general governmental functions of the City which are not accounted for in separate funds are included in the General fund.

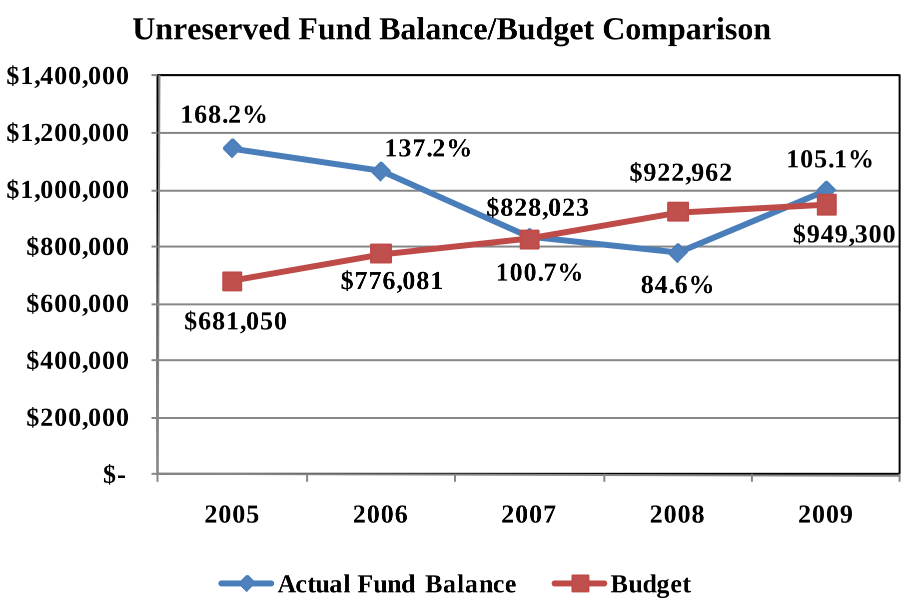
Minnesota municipalities must maintain substantial amounts of fund balance in order to meet their liquidity and working capital needs as an operating entity. That is because a substantial portion of your revenue sources (taxes and intergovernmental revenues) are received in the last two months of each six-month cycle.

As you can see from the following information, it is necessary to maintain fund balance in order to keep pace with the increasing operating budget. *This information is also presented in graphic form below*.

Year	Unreserved Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2005	$ 1,145,399	2006	$ 681,050	168.2 %
2006	1,064,526	2007	776,081	137.2
2007	833,478	2008	828,023	100.7
2008	780,853	2009	922,962	84.6
2009	998,105	2010	949,300	105.1

The unreserved fund balance for 2009 has $650,275 designated for various future purposes.

The following is an analysis of the General fund's unreserved fund balance for the past five years compared to the following year's budget:



The unreserved fund balance increased by $217,252 in 2009. The total unreserved fund balance of $998,105 represents 105.1 percent of the budget. Many other organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC) recommend that a fund balance reserve be anywhere from 35 to 50 percent of planned expenditures. We concur with those recommendations.

Although there is no legislation regulating fund balance, it is a good policy to designate intended use of fund balance. This helps address citizen concerns as to the use of fund balance and tax levels. The City should consider documenting designations for intended use of fund balance at and above the fifty percent level. This documentation could be accomplished by an annual resolution to identify intended use of available fund balance. We recommend a minimum fund balance for working capital be approximately 40 percent to 50 percent of planned disbursements. So at the current level, the fund balance is considered higher than what is recommended.

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 2009 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues	$ 936,508	$ 954,951	$ 18,443
Expenditures	989,015	738,565	250,450
Excess (deficiency) of revenues over (under) expenditures	(52,507)	216,386	268,893
Other financing sources (uses)			
Transfers in	-	3,198	3,198
Transfers out	(1,000)	(1,000)	-
Total other financing sources (uses)	(1,000)	2,198	3,198
Net change in fund balances	$ (53,507)	218,584	$ 272,091
Fund balances, January 1		780,853	
Fund balances, December 31		$ 999,437	

Actual revenues were over budget by $18,443. The major sources over budget were as follows:

- Interest earnings of $20,526.

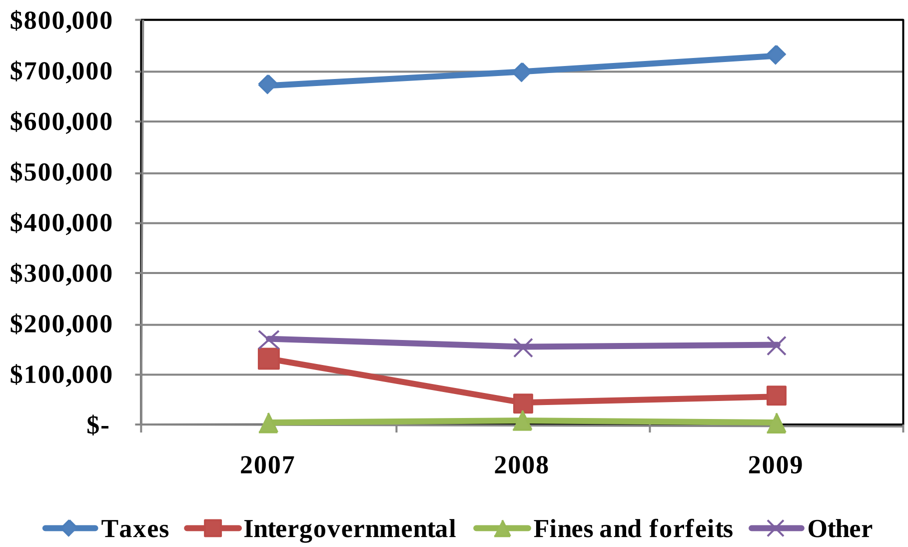
Actual expenditures were under budget by $250,450. The major uses under budget were as follows:

- Current expenditures for general government - $66,401
- Current expenditures for streets and highways - $72,392

A comparison of General fund revenues for the last three years is represented below:

Source	2007	2008	2009	Percent of Total	Per Capita
Taxes	$ 673,397	$ 697,599	$ 732,565	76.7 %	$ 271
Special assessments	19,148	10,443	7,901	0.8	3
Licenses and permits	87,610	51,909	28,430	3.0	11
Intergovernmental	132,625	43,393	58,179	6.1	22
Charges for services	573	48,470	74,701	7.8	28
Fines and forfeits	6,069	10,732	5,621	0.6	2
Investment earnings	38,196	24,800	39,155	4.1	14
Miscellaneous	24,948	18,979	8,399	0.9	3
Total revenues	$ 982,566	$ 906,325	$ 954,951	100.0 %	$ 353

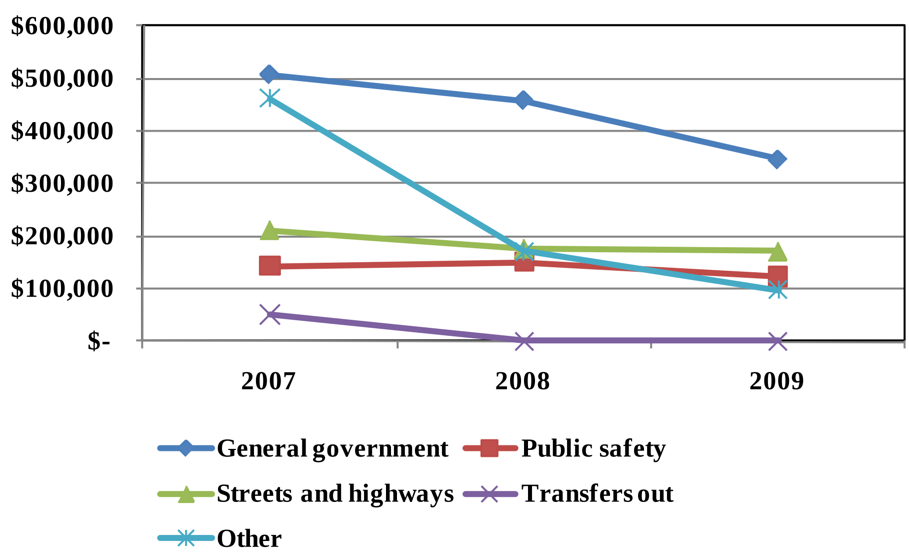
General Fund Revenues by Source



A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2007	2008	2009	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 508,827	$ 459,369	$ 345,593	46.8 %	$ 128	137
Public safety	143,586	151,860	123,458	16.7	46	188
Streets and highways	212,550	176,828	171,083	23.1	63	106
Culture and recreation	33,570	34,667	28,745	3.9	11	37
Total current	898,533	822,724	668,879	90.5	247	468
Capital outlay	415,974	111,015	44,932	6.1	17	409
Debt service	12,730	25,211	24,754	3.3	9	-
Transfers out	51,672	-	1,000	0.1	-	-
Total expenditures and transfers	$ 1,378,909	$ 958,950	$ 739,565	100.0 %	$ 247	$ 468

General Fund Expenditures by Program



Special Revenue Funds

Special revenue funds have revenue from specific sources to be used for specific purpose. Listed below are the special revenue funds of the City along with the fund balances (deficits) for 2009 and 2008 and the net change:

Fund	Fund Balances (Deficits) December 31, 2009	Fund Balances (Deficits) December 31, 2008	Increase (Decrease)
Major			
Economic Development Authority	$ 251,396	$ 241,932	$ 9,464
Nonmajor			
Public Land Dedication	52,850	93,923	(41,073)
Lions Park Improvement	-	3,198	(3,198)
Rocori Trail	82,273	-	82,273
Annual Event	133	(367)	500
Road Maintenance	119,689	131,568	(11,879)
Total	$ 506,341	$ 470,254	$ 36,087

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 parks and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.
- Tax increments - Pledged exclusively for tax increment/economic development districts.
- 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 project fund
- Investment earnings
- State or federal grants
- Transfers from other funds

The following is a summary of Debt Service fund assets and outstanding debt as of December 31, 2009:

Debt Description	Total Cash and Temporary Investments (Deficits)	Total Assets	Outstanding Debt	Maturity Date
Revenue Bonds:				
2005A Public Project Lease (City Facilities)	$ 323,798	$ 342,304	$ 2,380,000	2027
G.O. Improvement Bonds:				
2004 G.O. Improvement Bonds	23,254	807,858	630,000	2015
2008A G.O. Improvement Bonds	30,554	99,654	230,000	2018
Total G.O. Improvement Bonds	53,808	907,512	860,000	
Total All Debt Service Funds	$ 377,606	$ 1,249,816	$ 3,240,000	
Future Interest on Debt			$ 1,401,185	

Capital Projects Funds

Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds. The table below compares 2009 fund balances with 2008:

Fund	Fund Balances December 31, 2009	2008	Decrease
CR82 Street Improvements	$ -	$ 19,222	$ (19,222)

All projects have been completed and closed as of December 31, 2009.

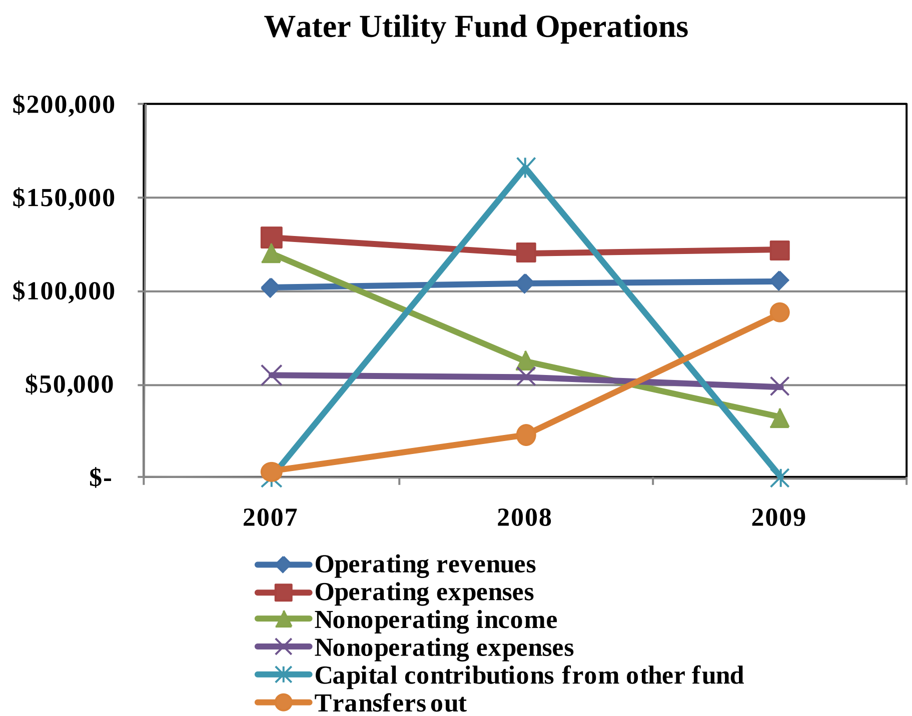
Enterprise Funds

Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises - where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Water Utility Fund

A comparison of Water Utility fund operations and cash and investments balances for the past three years is as follows:

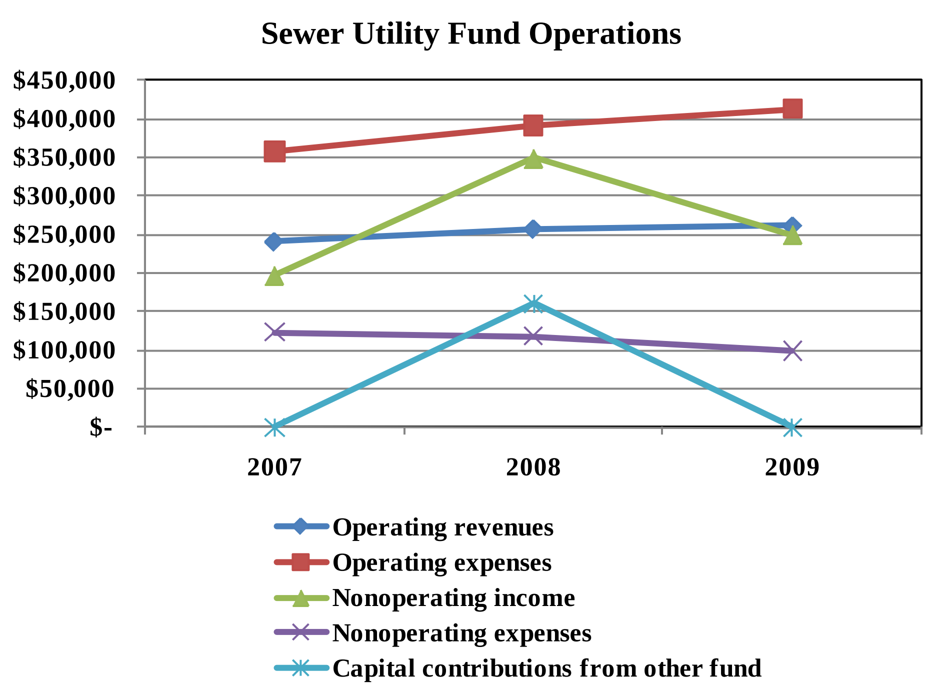
	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 102,004	100.0 %	$ 104,249	100.0 %	$ 105,772	100.0 %
Operating expenses	(128,719)	(126.2)	(120,575)	(115.6)	(122,005)	(115.3)
Operating loss	(26,715)	(26.2)	(16,326)	(15.6)	(16,233)	(15.3)
Nonoperating income	120,744	118.4	63,078	60.5	32,158	30.4
Nonoperating expenses	(55,208)	(54.1)	(54,495)	(52.3)	(48,944)	(46.3)
Income (loss) before contributions and transfers	38,821	38.1	(7,743)	(7.4)	(33,019)	(31.2)
Capital contributions from other fund	-	-	166,407	159.6	-	-
Transfers out	(3,328)	(3.3)	(23,033)	(22.1)	(88,558)	(83.7)
Change in net assets	$ 35,493	34.8 %	$ 135,631	130.1 %	$ (121,577)	(114.9) %
Cash and investments	$ 411,143		$ 405,571		$ 430,090	
Long-term debt payable	$ 1,336,000		$ 1,320,000		$ 1,443,000	



Sewer Utility Fund

A comparison of Sewer Utility fund operations and cash and investment balances for the past three years is as follows:

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 241,071	100.0 %	$ 257,908	100.0 %	$ 261,752	100.0 %
Operating expenses	(358,583)	(148.7)	(392,207)	(152.1)	(413,030)	(157.8)
Operating loss	(117,512)	(48.7)	(134,299)	(52.1)	(151,278)	(57.8)
Nonoperating income	197,083	81.8	349,155	135.4	250,231	95.6
Nonoperating expenses	(123,692)	(51.3)	(118,117)	(45.9)	(99,827)	(38.1)
Income (loss) before capital contributions	(44,121)	(18.2)	96,739	37.4	(874)	(0.3)
Capital contributions from other fund	-	-	160,490	62.2	-	-
Change in net assets	$ (44,121)	(18.2) %	$ 257,229	99.6 %	$ (874)	(0.3) %
Cash and investments	$ 2,435,009		$ 1,687,890		$ 1,689,463	
Long-term debt payable	$ 313,812		$ 7,817,579		$ 7,334,187	



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. The peer group averages were used for Cities of the 4th class (2,500 - 10,000). The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities regardless of size) ratios are shown below.

			Year			
Ratio	Calculation	Source	2006	2007	2008	2009
Current	Current assets/current liabilities	Government-wide	4.3	4.3	4.2	4.5
			5.7	4.5	6.1	N/A
Debt to assets	Total liabilities/total assets	Government-wide	0.5	0.6	0.5	0.5
			0.3	0.3	0.3	N/A
Debt service coverage	Net cash provided by operations/	Enterprise funds	1.0	1.0	0.1	0.1
	enterprise fund debt payments		1.5	1.8	1.6	N/A
Debt per capita	Bonded debt/population	Government-wide	$ 5,519	$ 5,456	$ 4,740	$ 4,441
			$ 2,306	$ 2,503	$ 2,677	N/A
Taxes per capita	Tax revenues/population	Government-wide	$ 315	$ 311	$ 359	$ 370
			$ 366	$ 399	$ 401	N/A
Current expenditures per capita	Governmental fund current	Governmental funds	$ 356	$ 350	$ 323	$ 263
	expenditures/population		N/A	$ 553	$ 663	N/A
Capital expenditures per capita	Governmental fund capital	Government-wide	$ 432	$ 337	$ 69	$ 20
	outlay/population		N/A	$ 409	$ 323	N/A
Capital assets % left to depreciate -	Net capital assets/	Government-wide	96%	96%	91%	88%
Business-type	gross capital assets		67%	66%	67%	N/A
Charges to total operating revenues -	Governmental charges for services/	Government-wide	10%	12%	16%	11%
Governmental	governmental operating revenue		23%	22%	13%	N/A
Unrestricted net assets to	Unrestricted net assets/	Government-wide	577%	577%	409%	459%
operating expenses	operating expenses		96%	88%	108%	N/A

Represents City of Rockville
Represents Peer Group Ratio

The following are explanations on deviations from the peer group benchmarks:

- **Debt service coverage** – In 2008 there was a prepayment of approximately $790,000 of the PFA loan and in 2009 there was a refunding issue in which approximately $1,300,000 was paid off. The majority of the debt is also funded by special assessments which would have an impact on this ratio.
- **Taxes per capita –** The taxes per capita are below the peer group average from 2008. The is good considering the city collects significantly less in local government aid in comparison to the cities in the peer group.
- **Capital expenditures per capita –** The relatively low capital expenditures per capita was due to an effort in the last two years in budget cuts. There are funds designated for future improvements that will increase this amount in future years.
- **Unrestricted net assets to operating expenses –** This percentage is higher than the peer group because of the requirements for debt payments in the Sewer fund.

Current Ratio (Liquidity Ratio)

The current ratio is a comparison of a city's current assets to its current liabilities. The current ratio is an indication of a city's ability to meet short-term debt obligations. Acceptable current ratios vary from industry to industry, but a current ratio between 1 and 2 is considered standard. If a city's current assets are in this range, then it is generally considered to have good short-term financial strength. If current liabilities exceed current assets (the current ratio is below 1), then the city may have problems meeting its short-term obligations. If the current ratio is too high, then the city may not be efficiently utilizing its current assets.

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 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 1.

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.

Charges for Service to Total Operating Revenues (Common-size Ratio)

This percentage is arrived at by dividing charges for service by total operating revenues from governmental operations. This percentage indicates the percent of governmental operating revenues that are funded by user charges versus other revenues. It measures the amount of control a city has in funding its governmental operating costs.

Unrestricted Net Assets to Total Expenses (Common-size Ratio)

This percentage is arrived at by dividing total expenses by the unrestricted net assets of the city. It indicates percent of unrestricted funds available at year end to pay for a current year expenses. Approximately every 8 percent represents a month of funds available to cover expenses, so a percentage of 25 percent would indicate funds available to cover 3 months of expenses.

Other Items

Monthly Depreciation Estimates

The City records monthly depreciation expense estimates. This provides Council and management with current and updated operational information for the City's enterprise funds. The amount of this estimate for the coming year for the Water fund is $5,300 per month and the Sewer fund is $23,500 per month.

Written Policies and Procedures

The City has implemented written policies and procedures. We recommend the City continue creating and adopting written policies and procedures for various other activities that are deemed important. These written policies and procedures are important to keep developing and improving which will be helpful if there is staff turnover and improvement of controls.

Current and Future Statute and Accounting Standard Changes

GASB Statement No. 51 - *Accounting and Financial Reporting for Intangible Assets*

This statement was issued in June 2007 and is effective for periods beginning after June 15, 2009.

The new standard characterizes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. Examples of intangible assets include easements, computer software, water rights, timber rights, patents, and trademarks.

This statement requires that intangible assets be classified as capital assets (except for those explicitly excluded from the scope of the new standard, such as capital leases). Relevant authoritative guidance for capital assets should be applied to these intangible assets. The statement provides additional guidance that specifically addresses the unique nature of intangible assets, including:

- Requiring that an intangible asset be recognized in the statement of net assets only if it is considered identifiable
- Establishing a specified-conditions approach to recognizing intangible assets that are internally generated (for example, patents and copyrights)
- Providing guidance on recognizing internally generated computer software
- Establishing specific guidance for the amortization of intangible assets.

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
- *Committee* - 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 the members of the Council, management and the Minnesota Office of the State Auditor, and is not intended to be and should not be used by anyone other than those specified parties.

The comments and recommendation in this report are purely constructive in nature, and should be read in this context. 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.

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 7, 2010
Mankato, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants