



CITY OF NORTH MANKATO
NORTH MANKATO, MINNESOTA

MANAGEMENT LETTER

FOR THE YEAR ENDED
DECEMBER 31, 2012

 **ABDO
EICK &
MEYERS** LLP
Certified Public Accountants & Consultants

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

Management, Honorable Mayor and City Council
City of North Mankato, Minnesota

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund and the aggregate remaining fund information of the City of North Mankato (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, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated December 11, 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 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 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

Management of the City is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit of the financial statements, we considered the City's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

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 a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a certain deficiency in internal control, described in the following page as item 2012-1 that we consider to be a significant deficiency.



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 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 our 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 Organization'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 situations 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 accounting information from your accounting software to the amounts 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 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 or other matters that are required to be reported under *Government Auditing Standards* or Minnesota statutes.

Planned Scope and Timing of the Audit

We performed the audit according to the 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. The requirements of GASB statements No. 63 and 65 were adopted for the year ended December 31, 2012. 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. Significant estimates affecting the financial statements include the capital asset basis, the depreciation on capital assets as well as the liability for the City's Other Post Employment Benefits (OPEB).

Management's estimate of capital asset basis is based on estimated historical cost of the capital assets and depreciation is based on the estimated useful lives of capital assets. Management's estimate of its OPEB liability is based on several factors including, but not limited to, anticipated retirement age for active employees, life expectancy, turnover, and healthcare cost trend rate. 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

We 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. The City should establish more detailed processes and procedures to reduce the total number of entries in each category. The City will receive better and timelier information if the preparation of year end entries is completed internally.



Management Representations

We have requested certain representations from management that are included in the management representation letter dated June 18, 2013.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.



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, 2012.

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.

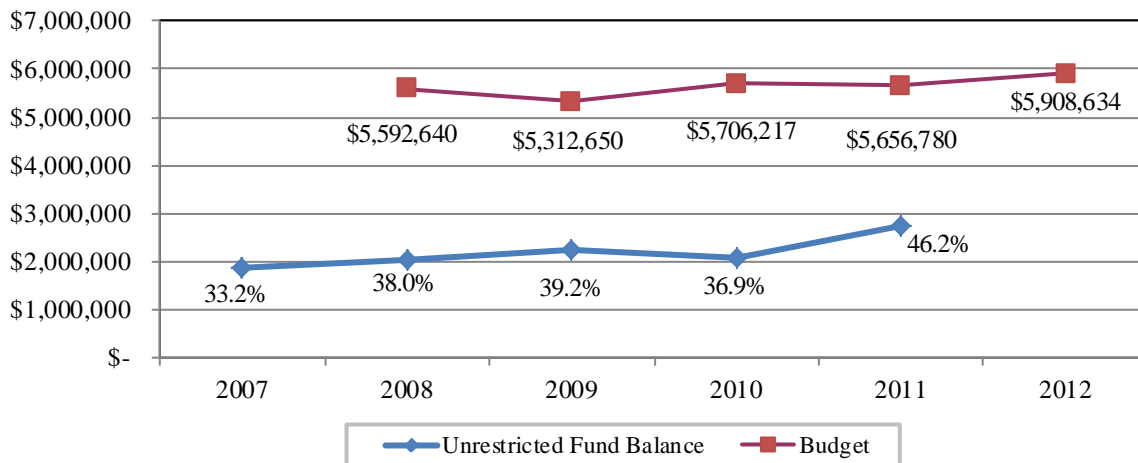
As you can see from the following information, it is necessary to maintain fund balance in order to keep pace with the increasing operating budget. *This information is also presented in graphic form below.*

Year	Unassigned Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2008	\$ 1,855,865	2009	\$ 5,592,640	33.2 %
2009	2,018,628	2010	5,312,650	38.0
2010	2,238,480	2011	5,706,217	39.2
2011	2,085,321	2012	5,656,780	36.9
2012	2,731,388	2013	5,908,634	46.2

We have compiled a peer group average derived from information available from the Office of the State Auditor for Cities of the 3rd class which have populations of 10,000-20,000. In 2010 and 2011, the average General fund balance as a percentage of expenditures was 54 percent and 76, percent, respectively. Based on comparison to the peer groups, the City’s General fund balance is below that average.

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

Unrestricted Fund Balance/Budget Comparison





The General fund balance increased by \$656,452 in 2012. The total unrestricted fund balance of \$2,731,388 represents 46.2 percent of the 2013 budget. Many other organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC) recommend that unassigned fund balance 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 assign 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 assignments 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 unassigned fund balance be approximately 40 percent to 50 percent of planned disbursements. So at the current level, the fund balance is considered about 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 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 2012 General fund operations are summarized as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget
Revenues	\$ 5,449,150	\$ 5,832,180	\$ 383,030
Expenditures	<u>5,656,780</u>	<u>5,519,517</u>	<u>137,263</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(207,630)</u>	<u>312,663</u>	<u>520,293</u>
Other financing sources (uses)			
Transfers in	207,630	461,177	253,547
Transfers out	<u>-</u>	<u>(117,388)</u>	<u>(117,388)</u>
Total other financing sources (uses)	<u>207,630</u>	<u>343,789</u>	<u>136,159</u>
Net change in fund balances	<u>\$ -</u>	656,452	<u>\$ 656,452</u>
Fund balances, January 1		<u>2,161,885</u>	
Fund balances, December 31		<u>\$ 2,818,337</u>	

Some of the larger variance items are as follows:

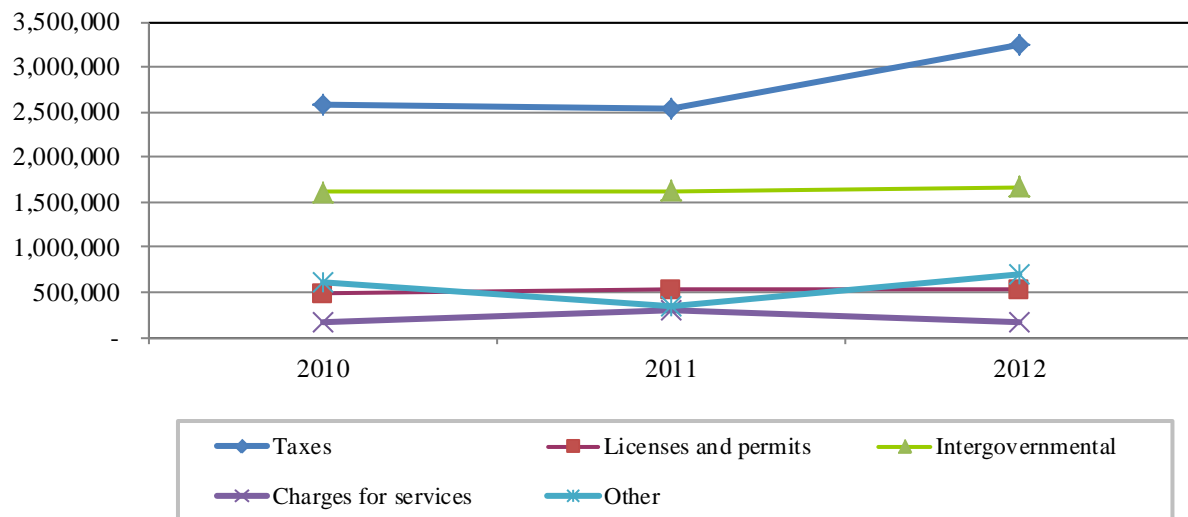
- Licenses and permits revenue was over budget by \$194,152
- State street maintenance aid was over budget by \$114,888
- Public works expenditures were under budget by \$59,069
- Culture and recreation expenditures were under budget by \$50,528
- Capital outlay was over budget by \$30,303



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

Source	2010	2011	2012	Percent of Total	Per Capita
Taxes	\$ 2,580,734	\$ 2,539,135	\$ 3,244,213	51.6 %	\$ 242
Special assessments	7,138	5,101	49,776	0.8	4
Licenses and permits	477,704	521,628	526,752	8.4	39
Intergovernmental	1,610,705	1,622,556	1,670,304	26.5	124
Charges for services	166,735	296,966	164,327	2.6	12
Fines and forfeits	37,566	29,492	27,172	0.4	2
Investment earnings	12,526	7,170	1,367	-	-
Miscellaneous	196,338	95,581	148,269	2.4	11
Transfers in	351,353	212,630	461,177	7.3	34
Total revenues and transfers	\$ 5,440,799	\$ 5,330,259	\$ 6,293,357	100.0 %	\$ 468

General Fund Revenues by Source

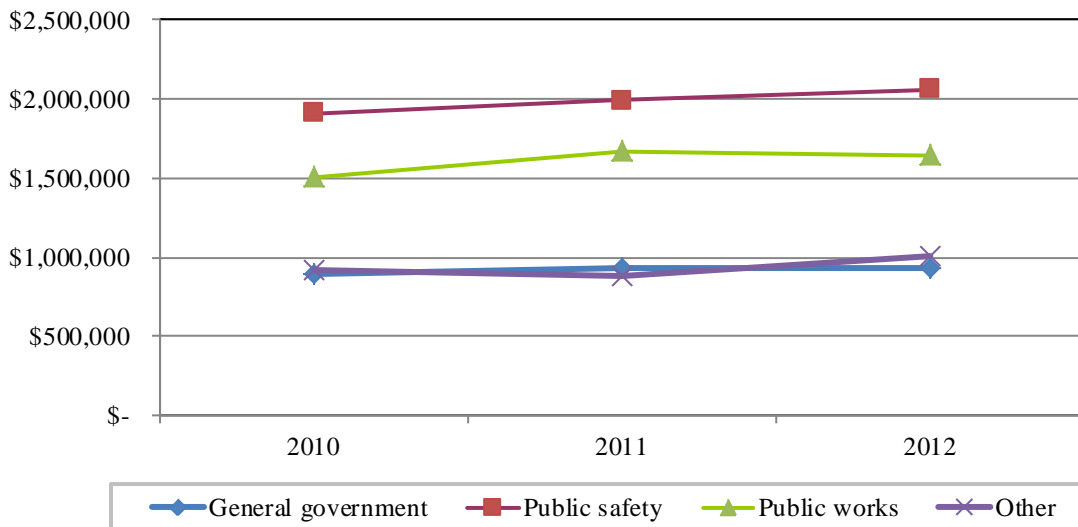




A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2010	2011	2012	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	\$ 896,372	\$ 937,067	\$ 927,260	16.4 %	\$ 69	\$ 97
Public safety	1,910,513	1,993,515	2,060,175	36.5	153	221
Public works	1,505,529	1,669,898	1,643,266	29.2	122	91
Culture and recreation	809,027	804,517	771,837	13.7	57	53
Miscellaneous	87,005	76,349	76,676	1.4	6	16
Total current	5,208,446	5,481,346	5,479,214	97.2	407	478
Capital outlay	24,008	5,300	40,303	0.7	3	13
Transfers out	-	-	117,388	2.1	9	-
Total expenditures and transfers	\$ 5,232,454	\$ 5,486,646	\$ 5,636,905	100.0 %	\$ 419	\$ 491

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 for 2012 and 2011 and the net change:

Fund	Fund Balances December 31,		Increase (Decrease)
	2012	2011	
Library	\$ 39,421	\$ 50,583	\$ (11,162)
Bookmobile	39,840	42,463	(2,623)
Library Endowment	51,049	50,997	52
Community Development Block Grant	-	(13,101)	13,101
Community Development	217,440	248,503	(31,063)
Local Option Sales Tax	850,729	940,925	(90,196)
Park Development	14,180	14,180	-
Parkland	82,357	65,279	17,078
Flood Control	38,359	37,159	1,200
Contingency	28,069	40,445	(12,376)
Total	<u>\$ 1,361,444</u>	<u>\$ 1,477,433</u>	<u>\$ (115,989)</u>

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 projects 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, 2012:

Debt Description	Total Cash and Temporary Investments	Total Assets	Outstanding Debt	Maturity Date	
General Obligation Bonds					
G.O. Equipment Certificates - 2006D	\$ 68,457	\$ 68,457	\$ 615,000	02/01/15	(1)
G.O. Equipment Certificates - 2009A	-	-	127,000	12/01/14	(1)
Bond Reserve	-	1,150,675	-	N/A	
G.O. Capital Improvements - 2008C	102	300,644	1,425,000	02/01/19	
G.O. Capital Improvements - 2012A	-	-	430,000	02/01/20	
Total G.O. Bonds	68,559	1,519,776	2,597,000		
G.O. Special Assessment Bonds					
2001B G.O. Improvement Bonds	10,131	19,615	-	Matured	
2004 G.O. Improvement Bonds	438,984	727,627	-	Matured	
2005A G.O. Improvement Bonds	-	-	540,000	02/01/20	(2)
2005D G.O. Improvement Bonds	491,628	1,704,408	615,000	02/01/13	(2)
2005C G.O. Refunding Bonds	17	48,457	-	Matured	(3)
2006A G.O. Improvement Bonds	-	-	1,465,000	02/01/14	(4)
2006C G.O. Improvement Bonds	-	-	900,000	02/01/18	(4)
2007A G.O. Improvement Bonds	89,150	1,360,720	990,000	02/01/18	
2008A G.O. Improvement Bonds	-	100,761	1,245,000	02/01/19	
2009D G.O. Improvement Bonds	31,312	2,954,415	2,805,000	04/01/25	
2010A G.O. Improvement Bonds	45,000	45,000	2,305,000	12/01/27	
2010C G.O. Refunding Bonds	1,508,596	3,867,367	3,155,000	02/01/22	
2012A G.O. Crossover Refunding Bonds	-	-	465,000	02/01/16	
Total G.O. Special Assessment Bonds	2,614,818	10,828,370	14,485,000		
G.O. Revenue Bonds					
1998B G.O. Revenue (PFA) Bonds	-	-	191,000	08/20/19	(3)
2009C G.O. Sales Tax Revenue Bonds	-	-	2,160,000	12/01/24	
2010B G.O. Sales Tax Revenue Bonds	-	-	700,000	12/01/25	
Total G.O. Revenue Bonds	-	-	3,051,000		
Note Payable					
2011 Note to Port Authority	-	-	3,215,000	02/01/34	
Total All Debt Service Funds	\$ 2,683,377	\$ 12,348,146	\$ 23,348,000		
Future Interest on Debt			\$ 4,878,242		

(1) (2) (3) (4) These four issues are reported in a single Debt Service fund

The City's outstanding debt is required to be funded by various resources such as special assessments, tax increments, property taxes, transfers from enterprise funds, etc. Special assessments and tax increments are usually certified once to the County for collection, but tax levies need to be certified annually. We recommend management pay particular attention to annual tax levies and transfers listed in each bond issue book to ensure proper funding of debt service.

The City refunded a number of its bond issues to spread payments over a longer period of time. We recommend the City continue to monitor these deficits and future funding of debt service payments.

**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 2012 fund balances with 2011:

Fund	Fund Balances		Increase (Decrease)
	December 31,		
	2012	2011	
Major			
2011 Construction	\$ 1,013,755	\$ 4,518,957	\$ (3,505,202)
Nonmajor			
Equipment Certificates	(61,162)	(331)	(60,831)
Local Option Sales Tax	(564,153)	-	(564,153)
Capital Facilities and Equipment Replacement - General	-	4,946	(4,946)
2012 Construction	(83,233)	(7,349)	(75,884)
2013 Construction	(8,121)	-	(8,121)
 Total	 \$ 297,086	 \$ 4,516,223	 \$ (4,219,137)

The City should analyze project's status each year and close those that are completed.



Enterprise Funds

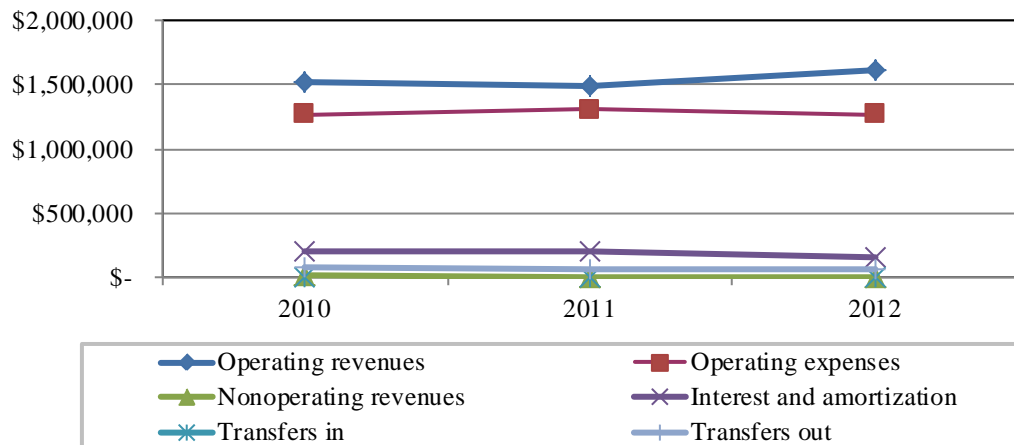
Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises- where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Water Utility Fund

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

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	\$ 1,515,957	100.0 %	\$ 1,492,282	100.0 %	\$ 1,614,738	100.0 %
Operating expenses	(1,268,241)	(83.7)	(1,311,817)	(87.9)	(1,271,171)	(78.8)
Operating income	247,716	16.3	180,465	12.1	343,567	21.2
Nonoperating revenues	13,440	0.9	7,562	0.5	7,384	0.5
Interest and amortization	(205,307)	(13.5)	(210,827)	(14.1)	(162,281)	(10.0)
Income (loss) before transfers	55,849	3.7	(22,800)	(1.5)	188,670	11.7
Transfers in	-	-	-	-	2,464	0.2
Transfers out	(75,088)	(5.0)	(65,540)	(4.4)	(65,540)	(4.1)
Change in net position	<u>\$ (19,239)</u>	<u>(1.3) %</u>	<u>\$ (88,340)</u>	<u>(5.9) %</u>	<u>\$ 125,594</u>	<u>7.8 %</u>
Cash and temporary investments	<u>\$ 132,862</u>		<u>\$ 908,542</u>		<u>\$ 1,049,285</u>	
Due from other funds	<u>\$ 1,905,000</u>		<u>\$ 1,083,000</u>		<u>\$ 1,083,000</u>	
Restricted assets - cash with fiscal agent	<u>\$ -</u>		<u>\$ 875,527</u>		<u>\$ -</u>	
Bonds payable	<u>\$ 5,982,333</u>		<u>\$ 5,671,916</u>		<u>\$ 4,471,083</u>	

Water Utility Fund Operations



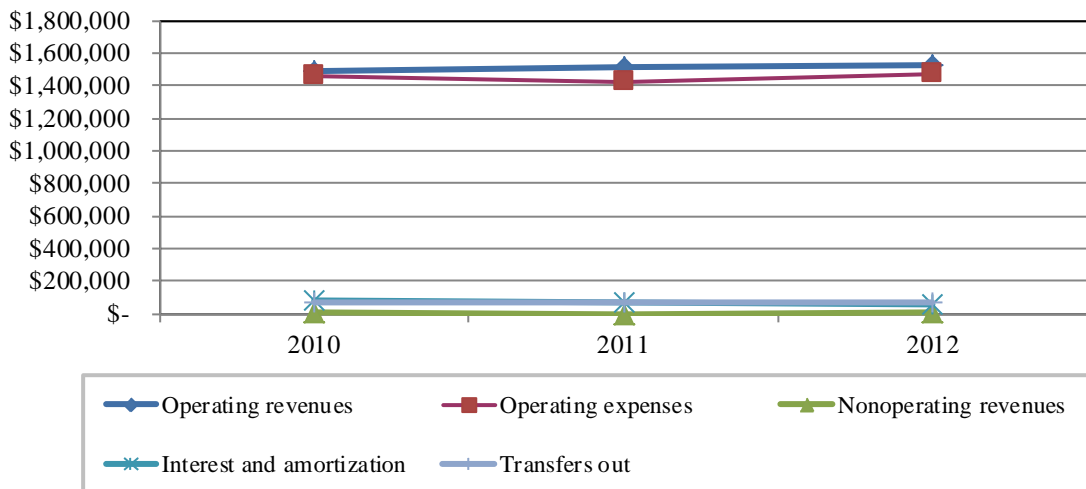


Sewer Utility Fund

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

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	\$ 1,490,287	100.0 %	\$ 1,510,772	100.0 %	\$ 1,525,340	100.0 %
Operating expenses	(1,463,176)	(98.3)	(1,426,806)	(94.4)	(1,473,521)	(96.6)
Operating income	27,111	1.7	83,966	5.6	51,819	3.4
Nonoperating revenues	10,157	0.7	634	-	2,724	0.2
Interest and amortization	(81,214)	(5.4)	(72,102)	(4.8)	(58,860)	(3.9)
Income (loss) before transfers	(43,946)	(3.0)	12,498	0.8	(4,317)	(0.3)
Transfers out	(70,760)	(4.7)	(72,880)	(4.8)	(72,880)	(4.8)
Change in net position	<u>\$ (114,706)</u>	<u>(7.7) %</u>	<u>\$ (60,382)</u>	<u>(4.0) %</u>	<u>\$ (77,197)</u>	<u>(5.1) %</u>
Cash and temporary investments	<u>\$ 105,094</u>		<u>\$ 504,245</u>		<u>\$ 396,780</u>	
Due from other funds	<u>\$ 750,000</u>		<u>\$ 353,000</u>		<u>\$ 353,000</u>	
Bonds payable	<u>\$ 1,979,757</u>		<u>\$ 1,711,940</u>		<u>\$ 1,431,018</u>	

Sewer Utility Fund Operations



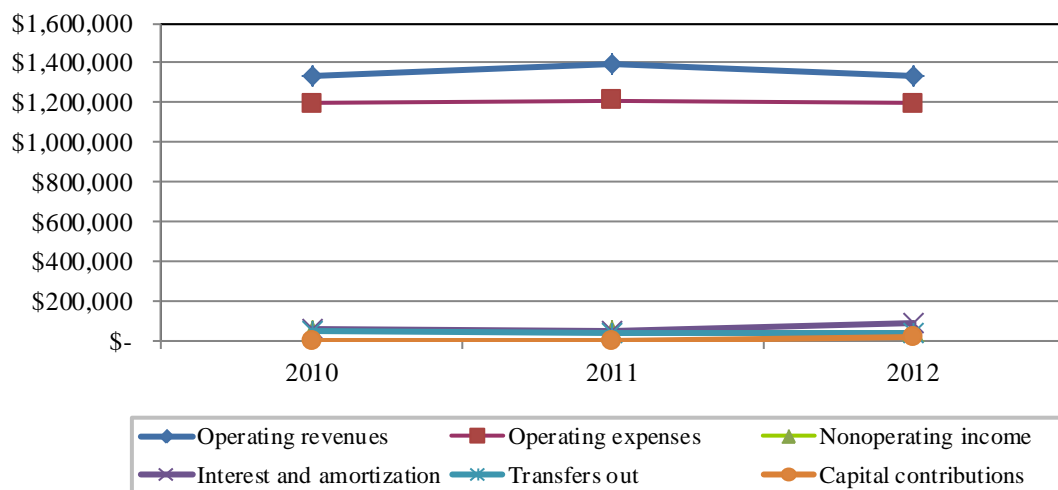


Sanitary Collection Fund

A comparison of Sanitary Collection fund operations for the past three years is as follows:

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	\$ 1,335,497	100.0 %	\$ 1,394,977	100.0 %	\$ 1,333,111	100.0 %
Operating expenses	(1,195,603)	(89.5)	(1,210,158)	(86.8)	(1,196,115)	(89.8)
Operating income	139,894	10.5	184,819	13.2	136,996	10.2
Nonoperating income	50,000	3.7	50,000	3.6	50,000	3.8
Interest and amortization	(57,040)	(4.3)	(53,327)	(3.8)	(96,184)	(7.2)
Income before contributions and transfers	132,854	9.9	181,492	13.0	90,812	6.8
Capital contributions, net	-	-	-	-	(17,060)	(1.3)
Transfers out	(55,105)	(4.1)	(46,460)	(3.3)	(46,460)	(3.5)
Change in net position	\$ 77,749	5.8 %	\$ 135,032	9.7 %	\$ 27,292	2.0 %
Cash and temporary investments	\$ 1,392		\$ 71,389		\$ 184,161	
Restricted assets - cash with fiscal agent	\$ -		\$ -		\$ 900,666	
Bonds payable	\$ 1,180,000		\$ 1,120,000		\$ 1,995,000	

Sanitary Collection Fund Operations



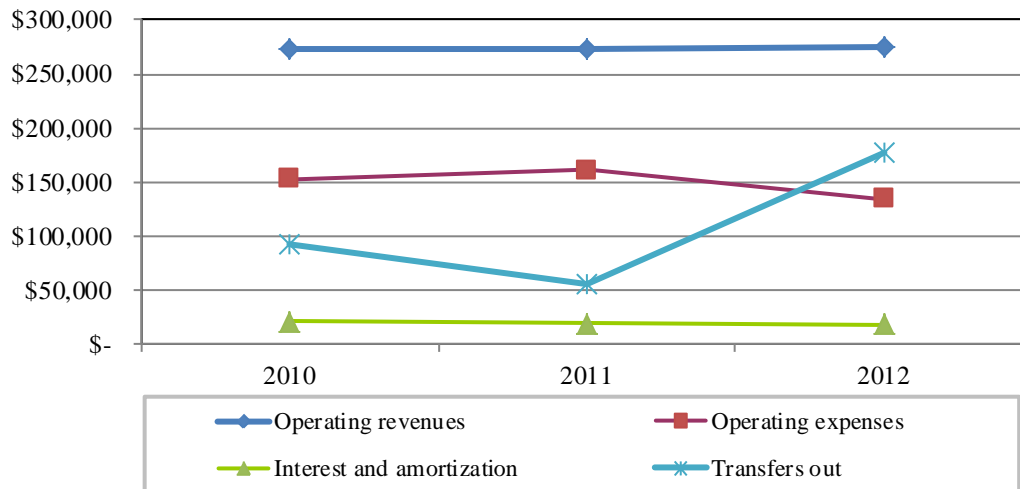


Storm Water Fund

A comparison of Storm Water fund operations for the past three years is as follows:

	2010		2011		2012	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	\$ 272,530	100.0 %	\$ 272,689	100.0 %	\$ 274,823	100.0 %
Operating expenses	(152,926)	(56.1)	(161,426)	(59.2)	(134,609)	(49.0)
Operating income	119,604	43.9	111,263	40.8	140,214	51.0
Interest and amortization	(20,944)	(7.7)	(19,618)	(7.2)	(18,611)	(6.8)
Income before transfers	98,660	36.2	91,645	33.6	121,603	44.2
Transfers out	(92,824)	(34.1)	(56,750)	(20.8)	(176,750)	(64.3)
Change in net position	<u>\$ 5,836</u>	<u>2.1 %</u>	<u>\$ 34,895</u>	<u>12.8 %</u>	<u>\$ (55,147)</u>	<u>(20.1) %</u>
Cash and temporary investments	<u>\$ 100,507</u>		<u>\$ 141,974</u>		<u>\$ 25,148</u>	
Bonds payable	<u>\$ 558,167</u>		<u>\$ 527,334</u>		<u>\$ 493,167</u>	

Storm Water Fund Operations



We recommend the City continue to review rates annually and determine if increases are required to:

- Fund continuing operating expenses.
- Maintain contingency requirements for unexpected repairs.
- Provide for capital replacement requirements.



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 from the Office of the State Auditor for cities of the 3rd class (10,000 to 20,000). 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.

Ratio	Calculation	Source	Year			
			2009	2010	2011	2012
Debt to assets	Total liabilities/total assets	Government-wide	42%	44%	45%	44%
			<i>30%</i>	<i>36%</i>	<i>32%</i>	<i>N/A</i>
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	1.4	1.0	1.2	0.7
			<i>1.5</i>	<i>0.8</i>	<i>0.9</i>	<i>N/A</i>
Debt per capita	Bonded debt/population	Government-wide	\$ 2,113	\$ 2,107	\$ 2,052	\$ 2,047
			<i>\$ 2,076</i>	<i>\$ 2,503</i>	<i>\$ 2,253</i>	<i>N/A</i>
Taxes per capita	Tax revenues/population	Government-wide	\$ 408	\$ 429	\$ 405	\$ 458
			<i>\$ 396</i>	<i>\$ 468</i>	<i>\$ 442</i>	<i>N/A</i>
Current expenditures per capita	Governmental fund current expenditures / population	Governmental funds	\$ 465	\$ 482	\$ 529	\$ 501
			<i>\$ 600</i>	<i>\$ 632</i>	<i>\$ 636</i>	<i>N/A</i>
Capital expenditures per capita	Governmental fund capital expenditures / population	Governmental funds	\$ 272	\$ 286	\$ 287	\$ 390
			<i>\$ 355</i>	<i>\$ 284</i>	<i>\$ 257</i>	<i>N/A</i>
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	64%	65%	69%	69%
			<i>65%</i>	<i>67%</i>	<i>63%</i>	<i>N/A</i>
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	91%	88%	85%	82%
			<i>66%</i>	<i>68%</i>	<i>68%</i>	<i>N/A</i>

Represents City of North Mankato

Represents Peer Group Ratio

**Debt-to-Assets Leverage Ratio (Solvency Ratio)**

The debt-to-assets leverage ratio is a comparison of a city's total liabilities to its total assets or the percentage of total assets that are provided by creditors. It indicates the degree to which the City's assets are financed through borrowings and other long-term obligations (i.e. a ratio of 50 percent would indicate half of the assets are financing with outstanding debt).

Debt Service Coverage Ratio (Solvency Ratio)

The debt coverage ratio is a comparison of cash generated by operations to total debt service payments (principal and interest) of enterprise funds. This ratio indicates if there are sufficient cash flows from operations to meet debt service obligations. Except in cases where other nonoperating revenues (i.e. taxes, assessments, transfers from other funds, etc.) are used to fund debt service payments, an acceptable ratio would be above 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.



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.

* * * * *

This communication is intended solely for the information and use of management, City Council, 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.

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
Certified Public Accountants

June 18, 2013
Mankato, Minnesota