CITY OF HENDERSON
HENDERSON, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2009

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

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Certified Public Accountants & Consultants

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

February 18, 2010

Management, Honorable Mayor and City Council
City of Henderson
Henderson, 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 Henderson, Minnesota (the City) for the year ended December 31, 2009, and have issued our report thereon dated February 18, 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, *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 accordance with accounting principles generally accepted in the United States of America and *Government Auditing Standards*. Our audit of the financial statements does not relieve you or management of your responsibilities.

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 of designing our auditing procedures 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 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 on the following pages, 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 following pages as finding 2009-3 to be a material weakness.

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 deficiencies described in the following pages as findings 2009-1 and 2009-2 to be significant deficiencies.

**2009-1 Segregation of Duties (Finding Since 2007)**

Condition: During our audit we reviewed internal control procedures over payroll, disbursements, cash receipts and utility billing and found the City to have limited segregation of duties in these areas.

Criteria: There are four general categories of duties: authorization, custody, record keeping and reconciliation. In an ideal system, different employees perform each of these four major functions. In other words, no one person has control of two or more of these responsibilities.

Effect: The existence of this limited segregation of duties increases the risk of fraud.

**Internal Control over Payroll**

Cause: As a result of the small number of staff, the Administrator/Clerk-Treasurer controls and maintains the check stock, approves time cards, runs payroll, prepares and signs checks, posts activity to the general ledger, reconciles bank accounts, prepares payroll tax returns, and maintains the payroll records.

Recommendation: Currently, the City Council and Mayor are involved in the payroll process through signing checks, approving general ledger postings, putting checks in envelopes, reconciliations, tax returns, payroll records, compensated absences, and accrued wages. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*Updated Progress From Prior Year*

The Council is very involved in overseeing the financial reports and now reviews time cards. Since 2008 sign off sheets are being used to provide documentation of this oversight.

**Internal Control over Disbursements**

Cause: As a result of the small number of staff, the Administrative Assistant sets up vendors, posts activity to general ledger, prepares checks, mails checks to vendors, maintains the purchase journal and accounts payable records.

Recommendation: Currently, the City Council reviews and signs off on activity posted to general ledger, reviews checks before they are processed, and the mayor reviews disbursements before checks are signed. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*Updated Progress From Prior Year*

The Council is very involved in overseeing the financial reports. The Administrator/Clerk-Treasurer now opens the mail. Since 2008, sign off sheets are being used to provide documentation of this oversight.

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**2009-1 Segregation of Duties (Finding Since 2007) - Continued**

**Internal Control over Cash Receipts**

Cause: As a result of the small number of staff, the Administrative Assistant sets up customers, posts activity to the general ledger, receives and endorses checks and currency, prepares the deposit, generates billing statements, and maintains the receipts journal and receivable records.

Recommendation: Currently, the City Council reviews and reconciles deposits and receivables monthly. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*Updated Progress From Prior Year*

The Council is very involved in overseeing the financial reports. Since 2008, sign off sheets are being used to provide documentation of this oversight.

**Internal Control over Utility Billing**

Cause: As a result of the small number of staff, the Administrator/Clerk-Treasurer opens mail, takes the deposit to the bank, reviews adjustments to accounts, and controls the accuracy completeness of and access to utility billing program and data files.

Recommendation: Currently, Council members review the accuracy and completeness of reports in fund accounting and utility billing, and approve adjustments to accounts. We believe these procedures significantly mitigate the risk related to segregation of duties and should be continued.

*Management Response*

The City has already taken measures to attempt to comply even though the City is relatively small and the number of clerical/bookkeeping staff they can employ is limited. The Council has addressed this circumstance by active participation in the City's affairs. This includes approval of expenditures, regular review of financial statements and budget comparisons, approval of adjustments to accounts, and approval of the reconciliation of the utility subledger to the general ledger. The Administrative Assistant now prepares the bank deposits and reconciles the receivable subledger.

*Updated Progress From Prior Year*

The Council is very involved in overseeing the financial reports. Since 2008, sign off sheets are being used to provide documentation of this oversight.

**2009-2 Financial Report Preparation (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. 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 organizations of your size. 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 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 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 a disclosure checklist is 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.

*Updated Progress from Prior Year*

No progress has been made with this finding in the current year.

**2009-3 Material Audit Adjustments (Finding Since 2007)**

Condition: During our audit, adjustments were needed to correct coding and reclassify amounts to correct funds.

Criteria: Such adjustments should be detected and made by the City's personnel.

Cause: City staff has not prepared a year end trial balance reflecting all necessary accruals and year end adjustments without auditor assistance.

Effect: This indicates that it would be likely that a misstatement may occur and not be detected by the City's system of internal control. The audit firm cannot serve as a compensating control for 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*

The City will review all adjusting entries posted this year and make all such necessary adjustments in the future. The Accountant will continue to monitor all financial activity and adjust account balances as needed throughout the year and at year end to prevent material misstatements from occurring.

*Updated Progress from Prior Year*

Improvement was made in this area during 2009. However, we believe that the adjusting entry made to record the tax anticipation certificates to the balance sheet caused this finding to be a material weakness.

**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 the following instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or Minnesota statutes.

**2009-4 Out of State Travel Policy (Finding Since 2008)**

Condition: During our audit, we noted that the City did not have an out-of-state travel policy, which is now required by State statutes.

Criteria: Minnesota statute § 471.661 requires that Cities adopt an out-of-state travel policy. This policy should specify when travel outside the state is appropriate, applicable expense limits, and procedures for approval. The policy also must be reviewed annually and made available for public inspection.

Cause: The Statute was new in the prior year and the City has not yet developed a policy.

Effect: The City is not in compliance with State statutes.

Recommendation: The City should adopt a policy addressing these issues to avoid future legal compliance findings in this area.

*Management Response*

The City passed an Out of State Travel Policy subsequent to year end.

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**2009-5 Limitation on Outstanding Warrants (Finding Since 2007)**

Condition: During our audit, we examined the activity in the City's municipal warrants account with First State Bank of Le Center. This balance reached a level of $627,080 on March 26, 2009 which is excess of legal limitations.

Criteria: Minnesota statute 471.69 forbids statutory cities from having outstanding warrants in excess of the average amount received from tax collections for the past three years plus ten percent. Actual tax collections for the past three years were $532,432, $494,030, and $477,074. This creates a limitation on warrants of $501,179.

Cause: For cash flow purposes, the City was forced to issue warrants throughout the year in order to pay bills within the time allotted.

Effect: The City is not in compliance with State statutes.

Recommendation: The City should adopt a policy addressing these issues to avoid future legal compliance findings in this area.

*Management Response*

The City financial advisors, Ehlers and Associates, prepared financial management plans for the General Government and Enterprise Funds and new policies and procedures were adopted shortly thereafter. The City issued temporary debt certificates in March 2009 which should assist in correcting this problem and eliminate it by the end of 2010. The problem and finding is still expected to exist in the 2010 audit.

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**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. 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 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 consider one journal entry to be material

A journal entry was made to reclass tax anticipation certificates of $305,000 as a liability rather than another financing source.

In total, we prepared 17 journal entries, compare to 32 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 our audit.

**Management Representations**

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

**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, 2009.

**General Fund**

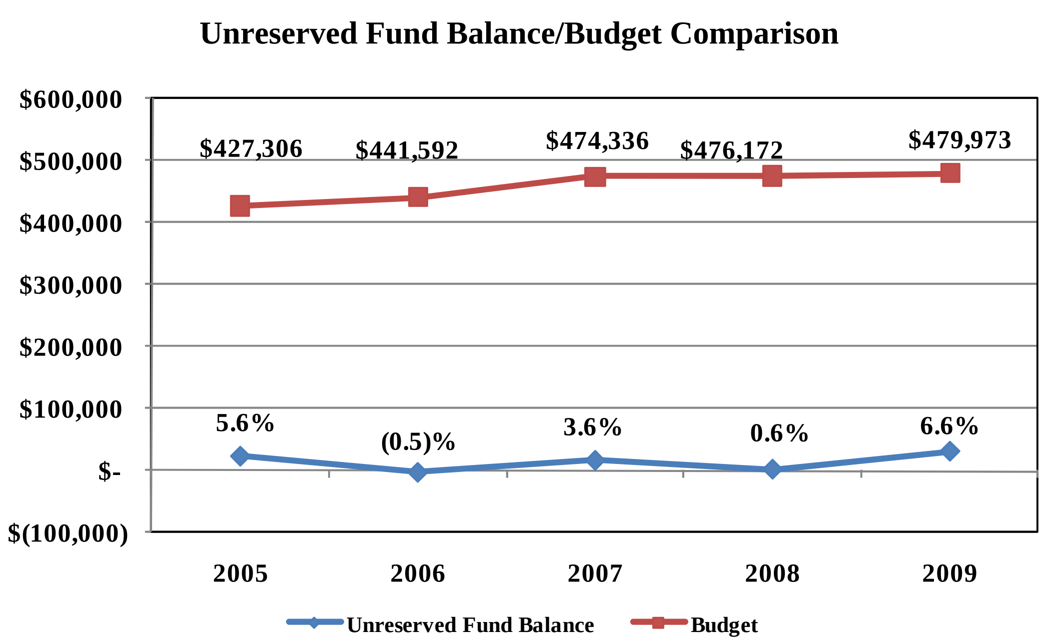
All general governmental functions of the City which are not accounted for in separate funds are included in the General fund.

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 | $ 23,737 | 2006 | $ 427,306 | 5.6 % |
| 2006 | (2,345) | 2007 | 441,592 | (0.5) |
| 2007 | 16,925 | 2008 | 474,336 | 3.6 |
| 2008 | 2,805 | 2009 | 476,172 | 0.6 |
| 2009 | 31,749 | 2010 | 479,973 | 6.6 |

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 fund balance increased by $33,508 in 2009. The total unreserved fund balance of $31,749 represents 6.6 percent of the 2010 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 lower than what is recommended. The City has been at these levels for a number of years now and should develop a long range plan to address the City's cash flow issues.

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.

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The 2009 General fund operations are summarized as follows:

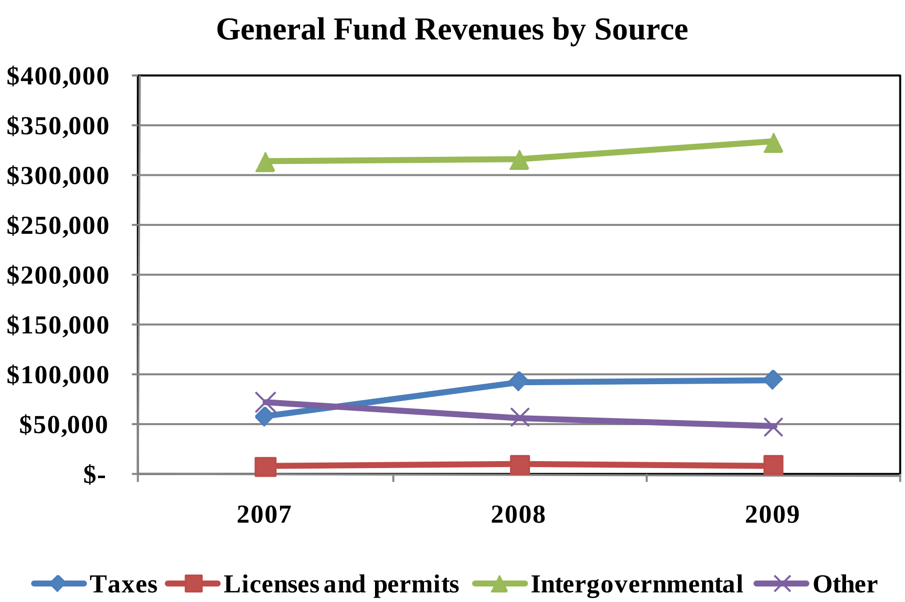
| | Final Budgeted Amounts | Actual Amounts | Variance with Final Budget - Positive (Negative) |
|---|---|---|---|
| Revenues | $ 492,442 | $ 476,079 | $ (16,363) |
| Expenditures | 446,850 | 454,429 | (7,579) |
| Excess of revenues over expenditures | 45,592 | 21,650 | (23,942) |
| Other financing sources | | | |
| Transfers in | 11,858 | 11,858 | - |
| Debt issued | 305,000 | - | (305,000) |
| Net change in fund balances | $ 362,450 | 33,508 | $ (328,942) |
| Fund balances, January 1 | | 2,805 | |
| Fund balances, December 31 | | $ 36,313 | |

A few larger budget variances are as follows:

- Property tax revenue fell short of budget by $18,885.
- Current public safety expenditures exceeded budget by $5,247.
- Current streets and highways expenditures exceeded budget by $17,684 while streets and highways capital expenditures were below budget by $14,909.
- Capital outlay in total fell short of budget by $15,909.
- Debt issued fell short of budget by $305,000 because the tax anticipation certificates are a short term liability and not considered a budget item.

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

| Source | 2007 | 2008 | 2009 | Percent of Total | Per Capita |
|---|---|---|---|---|---|
| Taxes | $ 58,596 | $ 93,565 | $ 95,084 | 19.5 % | $ 101 |
| Licenses and permits | 8,257 | 10,638 | 9,831 | 2.0 | 10 |
| Intergovernmental | 315,183 | 317,369 | 334,385 | 68.6 | 356 |
| Charges for services | 9,417 | 7,742 | 6,516 | 1.3 | 7 |
| Fines and forfeits | 22,433 | 11,051 | 18,204 | 3.7 | 19 |
| Investment earnings | - | - | 29 | - | - |
| Miscellaneous | 14,357 | 15,020 | 12,030 | 2.5 | 13 |
| Transfers in | 27,100 | 24,000 | 11,858 | 2.4 | 13 |
| Total revenues and transfers | $ 455,343 | $ 479,385 | $ 487,937 | 100.0 % | $ 519 |

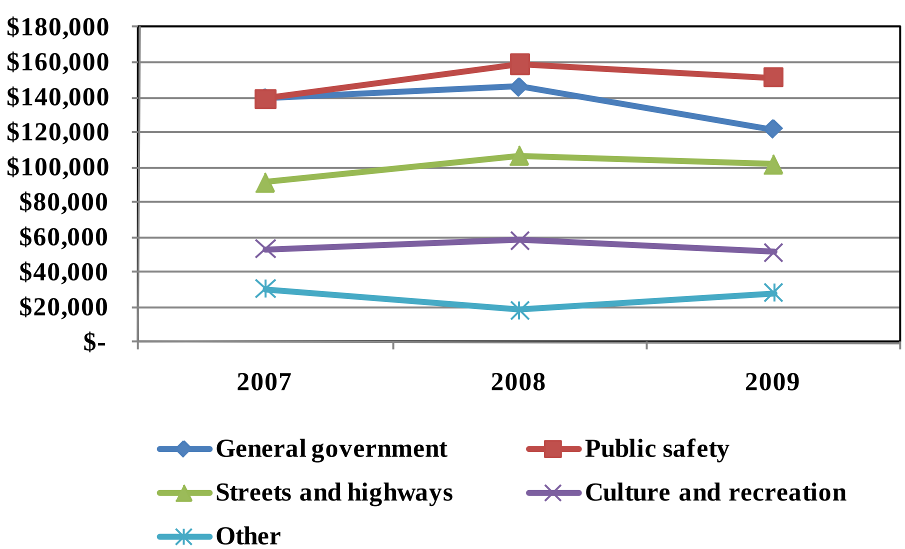


A comparison of General fund expenditures for the last three years is presented below:

| Program | 2007 | 2008 | 2009 | Percent of Total | Per Capita | Peer Group Per Capita |
|---|---|---|---|---|---|---|
| Current | | | | | | |
| General government | $ 139,818 | $ 146,185 | $ 121,630 | 26.8 % | $ 129 | $ 184 |
| Public safety | 139,157 | 159,058 | 151,332 | 33.3 | 161 | 186 |
| Streets and highways | 91,495 | 106,685 | 101,709 | 22.4 | 108 | 117 |
| Health | 200 | 200 | - | - | - | - |
| Culture and recreation | 53,305 | 58,187 | 51,480 | 11.3 | 55 | 48 |
| Economic development | 195 | 406 | - | - | - | 7 |
| Unallocated | 577 | - | - | - | - | 14 |
| Total current | 424,747 | 470,721 | 426,151 | 93.8 | 453 | $ 556 |
| Capital outlay | 10,415 | 12,428 | 6,370 | 1.4 | 7 | |
| Debt service | 19,002 | 5,363 | 21,908 | 4.8 | 23 | |
| Total expenditures | $ 454,164 | $ 488,512 | $ 454,429 | 100.0 % | $ 483 | |

The above chart compares the amount your City spends per capita, in comparison to a peer group. The peer group average is compiled from information available on the website of the Office of the State Auditor. Different peer group averages are used for Cities of the 4th class (a separate subgroup of those under 2,500 population has been developed for comparison purposes).

**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 | 2008 | Increase (Decrease) |
|---|---|---|---|
| Major | | | |
| Fire | $ 14,660 | $ 2,822 | $ 11,838 |
| Nonmajor | | | |
| Revenue | (61,845) | (73,065) | 11,220 |
| Economic Development Authority | (22,372) | (63,393) | 41,021 |
| Historic Henderson | 2,919 | 2,318 | 601 |
| Fire Truck Donations | - | 38,824 | (38,824) |
| Total nonmajor | (81,298) | (95,316) | 14,018 |
| Total | $ (66,638) | $ (92,494) | $ 25,856 |

Progress has been made in reducing the Revenue and Economic Development Authority funds deficits during the current year. We would encourage the City to continually monitor all deficits until eliminated.

**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, 2009:

| Debt Description | Total Cash and Investments | Total Assets | Outstanding Debt | Maturity Date |
|---|---|---|---|---|
| General Obligation Bonds: | | | | |
| 2004A G.O. Equipment | $ - | $ - | $ 52,000 | 2009 |
| 2005A G.O. Equipment | 9,811 | 9,811 | 32,000 | 2010 |
| Total G.O. Bonds | 9,811 | 9,811 | 84,000 | |
| G.O. Tax Increment Bonds: | | | | |
| G.O. Tax Increment Refunding Bonds of 2003A | 5,475 | 5,475 | - | Matured |
| G.O. Tax Increment Bonds of 1998 | 1,231 | 31,966 | - | Matured |
| G.O. Refunding Bonds of 2006A | - | - | 170,000 | 2015 |
| G.O. Tax Increment Bonds of 2007 | (8,040) | 10,801 | 233,000 | 2019 |
| Total G.O. Tax Increment Bonds | (1,334) | 48,242 | 403,000 | |
| G.O. Special Assessment Bonds: | | | | |
| Permanent Improvement Revolving | (54,739) | 404 | - | |
| G.O. Refunding Bonds of 2003A | 1,475 | 1,706 | 50,000 | 2012 |
| G.O. Improvement Bonds of 1998 | 1,119 | 1,119 | - | Matured |
| G.O. Refunding Bonds of 2006A | - | - | 990,000 | 2020 |
| G.O. Improvement Bonds of 2002 | 5,392 | 5,392 | 620,000 | 2023 |
| G.O. Improvement Bonds of 2003A | 34,081 | 281,723 | 345,000 | 2012 |
| G.O. Refunding Bonds of 2005A | 7,414 | 7,414 | 770,000 | 2021 |
| Total G.O. Special Assessment Bonds | (5,258) | 297,758 | 2,775,000 | |
| G.O. Revenue Bonds | | | | |
| Revenue Debt PIR | 75 | 126 | - | |
| G.O. Improvement Bonds of 2003A | 91 | 91 | 45,000 | 2012 |
| G.O. Revenue Refunding Bonds of 2003A | 23 | 23 | 65,000 | 2012 |
| G.O. Water and Sewer Revenue Bonds of 2000B | 11 | 11 | 275,000 | 2023 |
| G.O. Refunding and Utility Revenue Bonds of 2006A I | 155 | 155 | 50,000 | 2014 |
| G.O. Refunding and Utility Revenue Bonds of 2006A II | 29,620 | 29,620 | 190,000 | 2020 |
| G.O. Refunding and Utility Revenue Bonds of 2006A III | 81 | 81 | 68,750 | 2020 |
| G.O. Refunding and Utility Revenue Bonds of 2006A IV | 2,404 | 2,404 | 41,250 | 2020 |
| G.O. Storm Sewer Utility Revenue Bonds of 2007B | 150 | 150 | 75,900 | 2023 |
| G.O Revenue Bonds of 2009A | - | - | 308,000 | 2020 |
| Total G.O. Revenue Bonds | 32,610 | 32,661 | 1,118,900 | |
| Capital Leases: | | | | |
| City Hall Lease | (28,729) | (28,729) | 19,482 | 2010 |
| Library Lease | 7,688 | 7,688 | 128,203 | 2016 |
| Total Capital Leases | (21,041) | (21,041) | 147,685 | |
| Total All Debt Service Funds | $ 14,788 | $ 367,431 | $ 4,528,585 | |
| Future Interest on Debt | | | $ 1,982,986 | |

Any funds with matured bonds should be closed to other funds.

**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 (deficits) with 2008:

| Fund | Fund Balances December 31, 2009 | Fund Balances December 31, 2008 | Increase (Decrease) |
|---|---|---|---|
| Nonmajor | | | |
| Water/Sewer Connections | $ - | $ 3,061 | $ (3,061) |
| Storm Drainage Project | - | 29,529 | (29,529) |
| Capital Improvement | - | 1,858 | (1,858) |
| Siren | 10 | - | 10 |
| Total | $ 10 | $ 34,448 | $ (34,438) |

The City should analyze projects' status each year and close those that are completed. Any deficits should be evaluated to ensure they are consistent with financing expectations.

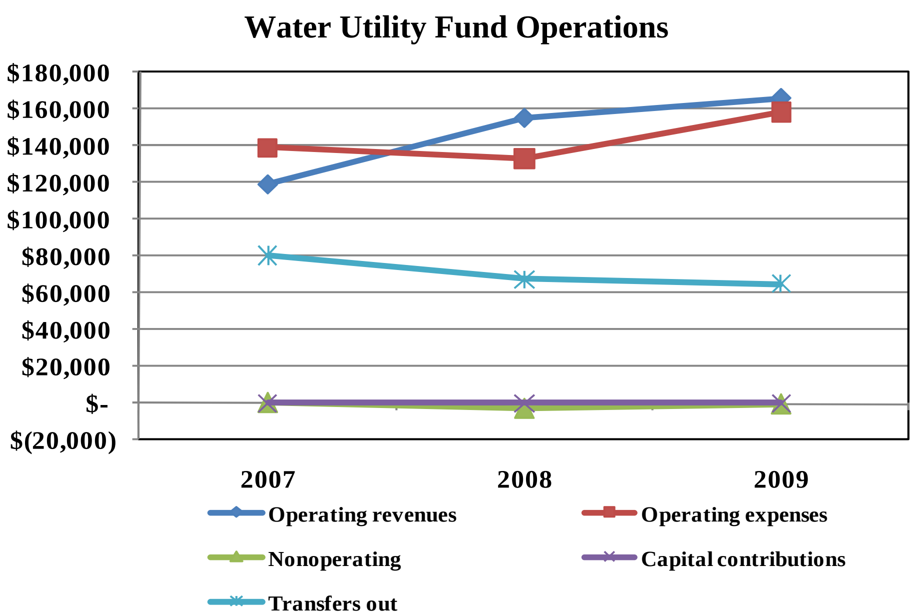
**Enterprise Funds**

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:

| | 2007 | | 2008 | | 2009 | |
|---|---|---|---|---|---|---|
| | Total | Percent | Total | Percent | Total | Percent |
| Operating revenues | $ 118,972 | 100.0 % | $ 154,997 | 100.0 % | $ 165,773 | 100.0 % |
| Operating expenses | (139,105) | (117.0) | (133,247) | (86.1) | (158,254) | (95.4) |
| Operating income (loss) | (20,133) | (17.0) | 21,750 | 13.9 | 7,519 | 4.6 |
| Nonoperating income (expense) | 452 | 0.4 | (2,539) | (1.6) | (281) | (0.2) |
| Income (loss) before transfers | (19,681) | (16.6) | 19,211 | 12.3 | 7,238 | 4.4 |
| Transfers in | - | - | - | - | 3,061 | 1.8 |
| Transfers out | (80,600) | (67.7) | (67,500) | (43.5) | (68,000) | (41.0) |
| Change in net assets | $ (100,281) | (84.3) % | $ (48,289) | (31.2) % | $ (57,701) | (34.8) % |
| Cash and temporary investments | $ (21,388) | | $ 1,095 | | $ 12,070 | |
| Bonds/loans payable | $ 29,900 | | $ 28,700 | | $ 27,100 | |

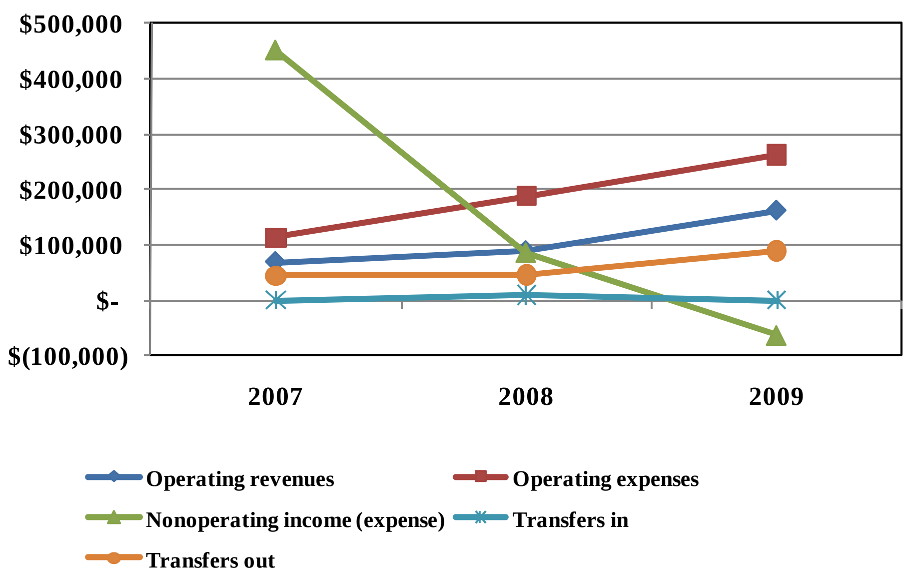


**Sewer Utility Fund**

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

| | 2007 | | 2008 | | 2009 | |
|---|---|---|---|---|---|---|
| | Total | Percent | Total | Percent | Total | Percent |
| Operating revenues | $ 69,630 | 100.0 % | $ 89,368 | 100.0 % | $ 162,270 | 100.0 % |
| Operating expenses | (113,301) | (162.7) | (188,046) | (210.4) | (263,692) | (162.5) |
| Operating loss | (43,671) | (62.7) | (98,678) | (110.4) | (101,422) | (62.5) |
| Nonoperating income (expense) | 452,175 | 649.4 | 87,541 | 98.0 | (61,766) | (38.1) |
| Income (loss) before transfers | 408,504 | 586.7 | (11,137) | (12.4) | (163,188) | (100.6) |
| Transfers in | - | - | 10,000 | 11.2 | - | - |
| Transfers out | (44,600) | (64.1) | (46,000) | (51.5) | (90,050) | (55.5) |
| Change in net assets | $ 363,904 | 522.6 % | $ (47,137) | (52.7) % | $ (253,238) | (156.1) % |
| Cash and temporary investments | $ 715,797 | | $ (14,900) | | $ 39,131 | |
| Bonds/loans payable | $ 2,405,726 | | $ 3,954,195 | | $ 4,068,122 | |

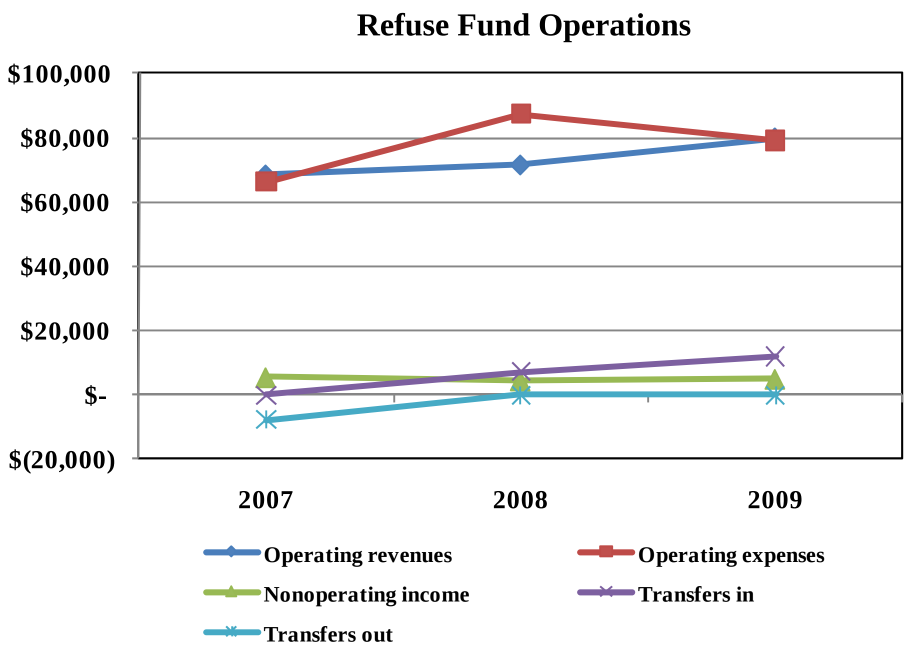
**Sewer Utility Fund Operations**



**Refuse Fund**

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

| | 2007 | | 2008 | | 2009 | |
|---|---|---|---|---|---|---|
| | Total | Percent | Total | Percent | Total | Percent |
| Operating revenues | $ 68,450 | 100.0 % | $ 71,530 | 100.0 % | $ 79,853 | 100.0 % |
| Operating expenses | (66,393) | (97.0) | (87,490) | (122.4) | (79,151) | (99.1) |
| Operating income (loss) | 2,057 | 3.0 | (15,960) | (22.4) | 702 | 0.9 |
| Nonoperating income | 5,551 | 8.1 | 4,547 | 6.4 | 5,039 | 6.3 |
| Income (loss) before transfers | 7,608 | 11.1 | (11,413) | (16.0) | 5,741 | 7.2 |
| Transfers in | - | - | 7,200 | 10.1 | 12,000 | 15.0 |
| Transfers out | (7,700) | (11.2) | - | - | - | - |
| Change in net assets | $ (92) | (0.1) % | $ (4,213) | (5.9) % | $ 17,741 | 22.2 % |
| Cash and temporary investments | $ (15,511) | | $ (15,769) | | $ 1,863 | |




The Water Utility and Refuse fund operations are basically just generating enough cash to cover its operating expenses. The Sewer Utility fund's operating expenses are greatly exceeding its operating revenues. The funds are not generating enough cash to make debt service transfers or provide for any capital reserves for future replacements.

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.

## Government-wide and Other Ratios

### 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 used are for cities of the 4th class (a separate subgroup of those under 2,500 population has been developed for comparison purposes). 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) ratios are shown below.

| | | | Year | | | |
|---|---|---|---|---|---|---|
| Ratio | Calculation | Source | 2006 | 2007 | 2008 | 2009 |
| Current | Current assets/current liabilities | Government-wide | 0.8 | 0.6 | 0.2 | 0.4 |
| | | | 9.5 | 6.6 | 9.1 | N/A |
| Debt to assets | Total liabilities/total assets | Government-wide | 60% | 63% | 60% | 60% |
| | | | 32% | 33% | 32% | N/A |
| Debt service coverage | Net cash provided by operations/ enterprise fund debt payments | Enterprise funds | N/A | N/A | 381.4 | 0.1 |
| | | | 132.0 | 109.1 | 94.9 | N/A |
| Debt per capita | Bonded debt/population | Government-wide | $ 7,508 | $ 8,543 | $ 9,040 | $ 8,900 |
| | | | $ 2,728 | $ 3,074 | $ 2,888 | N/A |
| Taxes per capita | Tax revenues/population | Government-wide | $ 473 | $ 497 | $ 568 | $ 627 |
| | | | $ 363 | $ 377 | $ 385 | N/A |
| Current expenditures per capita | Governmental fund expenditures/ population | Governmental funds | $ 532 | $ 572 | $ 623 | $ 561 |
| | | | N/A | $ 644 | $ 646 | N/A |
| Capital expenditures per capita | Governmental fund expenditures/ population | Governmental funds | $ 170 | $ 404 | $ 55 | $ 389 |
| | | | N/A | $ 454 | $ 292 | N/A |
| Capital assets % left to depreciate - Governmental | Net capital assets/ gross capital assets | Government-wide | 78% | 75% | 72% | 71% |
| | | | 64% | 63% | 60% | N/A |
| Capital assets % left to depreciate - Business-type | Net capital assets/ gross capital assets | Government-wide | 61% | 76% | 82% | 80% |
| | | | 62% | 62% | 61% | N/A |
| Charges to total operating revenues - Governmental | Governmental charges for services/ governmental operating revenue | Government-wide | 13% | 12% | 10% | 10% |
| | | | 16% | 17% | 13% | N/A |
| Unrestricted net assets to operating expenses | Unrestricted net assets/ operating expenses | Government-wide | 0% | 4% | -11% | -25% |
| | | | 111% | 165% | 113% | N/A |

**Represents City of Henderson**
**Represents Peer Group Average**

**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 Utility fund is $6,000 per month, the Sewer Utility fund is $11,000 per month, and $155 for the Refuse Utility fund per month.

**Written Policies and Procedures**

With the new auditing standards that came into effect during 2007, this in an important part of the City's internal control, and will be helpful if there is staff turnover. The City currently has written job descriptions, a capital asset policy, and investment policy. They are planning on drafting policies for out of state travel, accounting, internal control, budget and other financial, personnel management, loss control, and similar policies.

507.625.2727 • Fax 507.388.9139
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**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 users about fund balance by providing clearer, more structured fund balance classifications, and clarifying the definitions of existing governmental fund types.

GASB No. 54 distinguishes fund balance between amounts that are considered non-spendable, such as fund balance associated with inventories, and other amounts that are classified based on the relative strength of the constraints that control the purposes for which specific amounts can be spent. The following classifications and definitions will be used:

- *Restricted* - amounts constrained by external parties, constitutional provision, or enabling legislation
- *Committed* - amounts constrained by a government using its highest level of decision-making authority
- *Assigned* - amounts a government intends to use for a particular purpose
- *Unassigned* - amounts that are not constrained at all will be reported in the general fund.

In addition to the classifications of fund balance, the standard clarified the definitions of individual governmental fund types, for example, special revenue funds, debt service funds, and capital project funds.

* * * * * * *

This report is intended solely for the information and use of the members of the Council, management, and others within the administration of the City 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

February 18, 2010
Mankato, Minnesota

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