

CITY OF HENDERSON
HENDERSON, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2010

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

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, 2010, and have issued our report thereon dated March 10, 2011. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Auditing Standards Generally Accepted in the United States of America, *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 2010-3 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 2010-1 and 2010-2 to be significant deficiencies.



2010-1

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.

**2010-1 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.

**2010-2 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.

**2010-3 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 2010. However, we believe that the adjusting entries made to close funds and adjust debt service and capital asset activity 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or Minnesota statutes.

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 \$10,500 per month, and \$40 for the Environmental Services Utility fund per month.

Written Policies and Procedures

With the new auditing standards that came into effect during 2007, this is 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.



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. 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. A prior period adjustment was required to properly account for infrastructure and debt service balances between governmental and business-type activities.

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 proposed three journal entries that we consider to be audit entries or corrections of management decisions. They relate to the following situations:

- A material audit entry was required to adjust debt service activity to the proper funds.
- A material audit entry was required to adjust debt activity and fund balance as business-type due to closing governmental funds.
- A prior period adjustment was required to properly account for debt and capital assets activity as business-type.

We also assisted in preparing a number of year end accounting entries. These were necessary to adjust the City's records at year end to correct ending balances. 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 March 10, 2011.

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 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, 2010.

General Fund

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

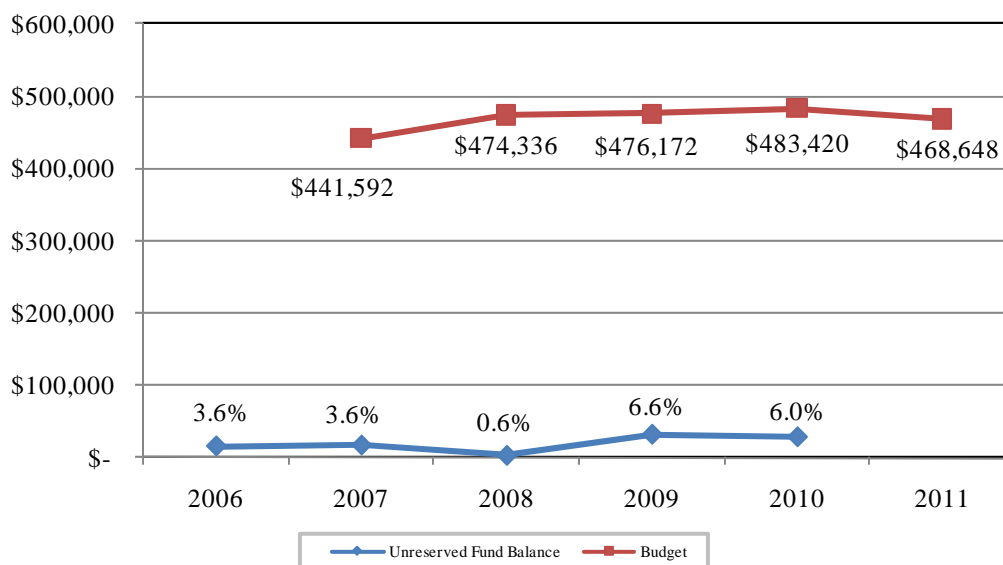
Minnesota municipalities must maintain substantial amounts of fund balance in order to meet their liquidity and working capital needs as an operating entity. That is because a substantial portion of your revenue sources (taxes and intergovernmental revenues) are received in the last two months of each 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
2006	\$ 15,746	2007	\$ 441,592	3.6 %
2007	16,925	2008	474,336	3.6
2008	2,805	2009	476,172	0.6
2009	31,749	2010	483,420	6.6
2010	28,273	2011	468,648	6.0

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:

Unreserved Fund Balance/Budget Comparison





The fund balance decreased by \$2,036 in 2010. The total unreserved fund balance of \$28,273 represents 6.0 percent of the 2011 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 fund balance 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 imposed reductions of market value credit aid and local government aid for some cities for 2009 and 2010. The Governor has recently presented increased reductions of 2010 funding as well as reductions of 2011 funding. Levy limits have also been implemented for municipalities in past legislative sessions. An adequate fund balance will provide a temporary buffer against those aid adjustments 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 2010 General fund operations are summarized as follows:

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues	\$ 488,173	\$ 485,175	\$ 468,906	\$ (16,269)
Expenditures	<u>784,973</u>	<u>483,420</u>	<u>474,363</u>	<u>9,057</u>
Excess (deficiency) of revenues over (under) expenditures	<u>(296,800)</u>	<u>1,755</u>	<u>(5,457)</u>	<u>(7,212)</u>
Other financing sources				
Transfers in	-	-	3,671	3,671
Debt issued	295,000	-	-	-
Transfers out	<u>-</u>	<u>-</u>	<u>(250)</u>	<u>(250)</u>
Net change in fund balances	<u>\$ (1,800)</u>	<u>\$ 1,755</u>	(2,036)	<u>\$ (3,791)</u>
Fund balances, January 1			<u>36,313</u>	
Fund balances, December 31			<u>\$ 34,277</u>	

A few larger budget variances are as follows:

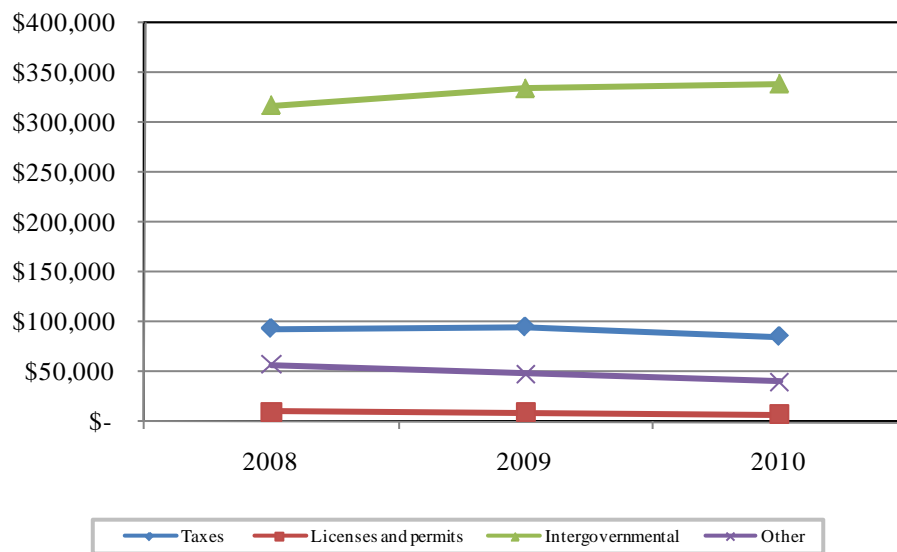
- 2010 disaster expenditures were under budget by \$19,168.
- Current streets and highways expenditures exceeded budget by \$6,971 while streets and highways capital expenditures were over budget by \$4,485.
- Parks expenditures exceeded budget by \$7,170.



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

Source	2008	2009	2010	Percent of Total	Per Capita
Taxes	\$ 93,565	\$ 95,084	\$ 85,491	18.1 %	\$ 92
Licenses and permits	10,638	9,831	7,563	1.6	8
Intergovernmental	317,369	334,385	339,193	71.8	367
Charges for services	7,742	6,516	8,984	1.9	10
Fines and forfeits	11,051	18,204	17,487	3.7	19
Investment earnings	-	29	40	-	-
Miscellaneous	15,020	12,030	10,148	2.1	11
Transfers in	24,000	11,858	3,671	0.8	4
Total revenues and transfers	\$ 479,385	\$ 487,937	\$ 472,577	100.0 %	\$ 511

General Fund Revenues by Source



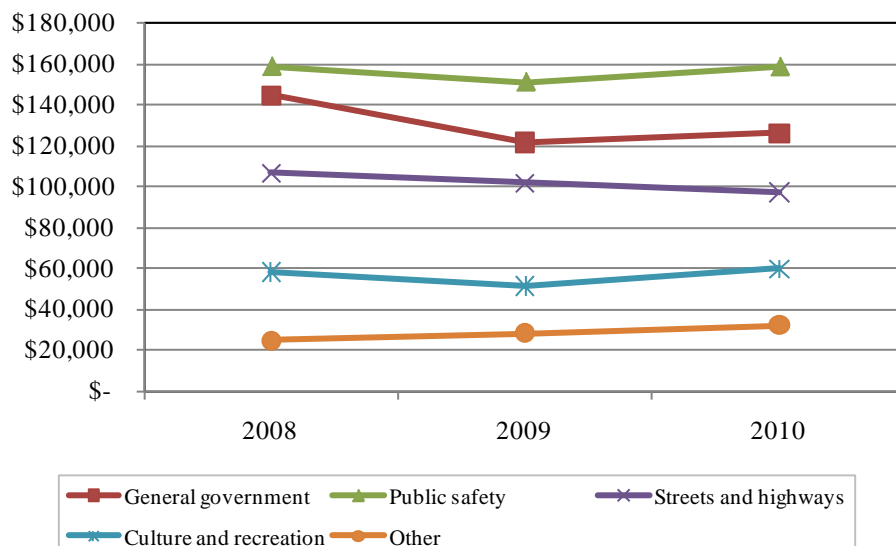


A comparison of General fund expenditures for the last three years is presented below:

Program	2008	2009	2010	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	\$ 144,642	\$ 121,630	\$ 126,205	26.6 %	\$ 136	\$ 163
Public safety	159,058	151,332	158,888	33.6	172	202
Streets and highways	106,685	101,709	97,201	20.5	105	115
Health	200	-	-	-	-	-
Culture and recreation	58,187	51,480	59,791	12.6	65	51
Economic development	1,949	-	1,579	0.3	2	6
Unallocated	-	-	25	-	-	10
Transfers out	4,993	-	(250)	(0.1)	-	-
Total current	475,714	426,151	443,689	93.6	480	\$ 547
Capital outlay	12,428	6,370	7,323	1.5	8	
Debt service	5,363	21,908	23,351	4.9	25	
Total expenditures	\$ 493,505	\$ 454,429	\$ 474,363	100.0 %	\$ 513	

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 2010 and 2009 and the net change:

Fund	Fund Balances (Deficits)		Increase (Decrease)
	2010	2009	
Major			
Fire	\$ 29,688	\$ 14,660	\$ 15,028
Nonmajor			
Revenue	(52,308)	(61,845)	9,537
Economic Development Authority	(915)	(22,372)	21,457
Historic Henderson	-	2,919	(2,919)
Total nonmajor	(53,223)	(81,298)	28,075
Total	\$ (23,535)	\$ (66,638)	\$ 43,103

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, 2010:

Debt Description	Total Cash and Investments	Total Assets	Outstanding Debt	Maturity Date
G.O. Tax Increment Bonds:				
G.O. Refunding Bonds of 2006A	\$ -	\$ -	\$ 145,000	2015
G.O. Tax Increment Bonds of 2007	(26,859)	11,278	228,000	2019
Total G.O. Tax Increment Bonds	(26,859)	11,278	373,000	
G.O. Special Assessment Bonds:				
Permanent Improvement Revolving	(65,360)	(25,077)	-	
G.O. Refunding Bonds of 2006A	-	-	915,000	2020
G.O. Improvement Bonds of 2002	2	2	585,000	2023
G.O. Improvement Bonds of 2003A	(84,800)	169,352	235,000	2012
G.O. Refunding Bonds of 2005A	16,111	16,111	720,000	2021
Total G.O. Special Assessment Bonds	(134,047)	160,388	2,455,000	
Capital Leases:				
Library Lease	7,259	7,259	112,804	2016
Total All Debt Service Funds	\$ (153,647)	\$ 178,925	\$ 2,940,804	
Future Interest on Debt			\$ 718,756	

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 2010 fund balances with 2009:

Fund	Fund Balances December 31,		Increase (Decrease)
	2010	2009	
Nonmajor			
Siren	\$ 10	\$ 10	\$ -

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

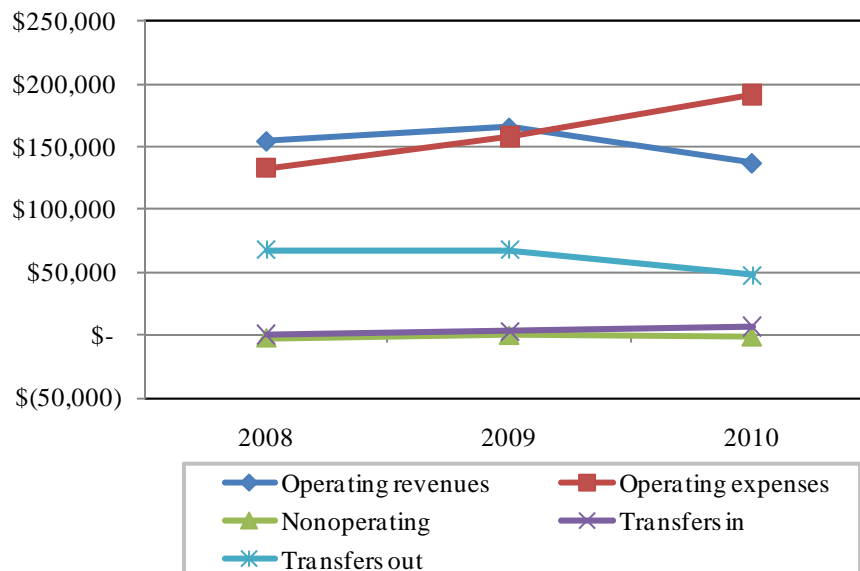
Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprises- where the intent is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Water Utility Fund

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

	2008		2009		2010	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	\$ 154,997	100.0 %	\$ 165,773	100.0 %	\$ 137,430	100.0 %
Operating expenses	(133,247)	(86.1)	(158,254)	(95.4)	(191,615)	(139.3)
Operating income (loss)	21,750	13.9	7,519	4.6	(54,185)	(39.3)
Nonoperating expense	(2,539)	(1.6)	(281)	(0.2)	(1,761)	(1.3)
Income (loss) before transfers	19,211	12.3	7,238	4.4	(55,946)	(40.6)
Transfers in	-	-	3,061	1.8	6,521	4.7
Transfers out	(67,500)	(43.5)	(68,000)	(41.0)	(47,650)	(34.7)
Change in net assets	<u>\$ (48,289)</u>	<u>(31.2) %</u>	<u>\$ (57,701)</u>	<u>(34.8) %</u>	<u>\$ (97,075)</u>	<u>(70.6) %</u>
Cash and cash equivalents (deficits)	<u>\$ 1,095</u>		<u>\$ 12,070</u>		<u>\$ (17,752)</u>	
Bonds/loans payable	<u>\$ 28,700</u>		<u>\$ 27,100</u>		<u>259,600</u>	

Water Utility Fund Operations



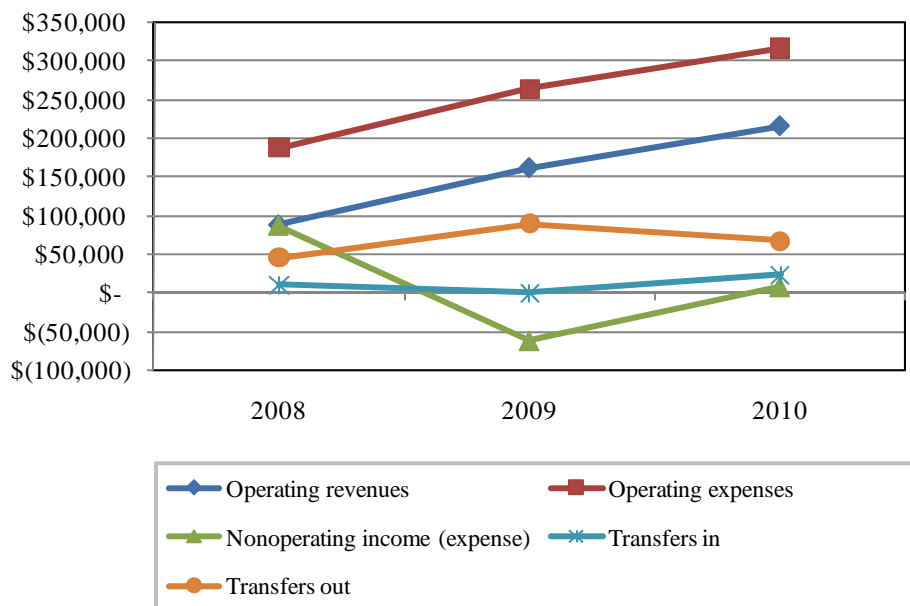


Sewer Utility Fund

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

	2008		2009		2010	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	\$ 89,368	100.0 %	\$ 162,270	100.0 %	\$ 215,532	100.0 %
Operating expenses	(188,046)	(210.4)	(263,692)	(162.5)	(316,993)	(147.1)
Operating loss	(98,678)	(110.4)	(101,422)	(62.5)	(101,461)	(47.1)
Nonoperating income (expense)	87,541	98.0	(61,766)	(38.1)	8,064	3.7
Loss before transfers	(11,137)	(12.4)	(163,188)	(100.6)	(93,397)	(43.4)
Transfers in	10,000	11.2	-	-	23,484	10.9
Transfers out	(46,000)	(51.5)	(90,050)	(55.5)	(67,350)	(31.2)
Change in net assets	<u>\$ (47,137)</u>	<u>(52.7) %</u>	<u>\$ (253,238)</u>	<u>(156.1) %</u>	<u>\$ (137,263)</u>	<u>(63.7) %</u>
Cash and cash equivalents (deficits)	<u>\$ (14,900)</u>		<u>\$ 39,131</u>		<u>\$ (88,703)</u>	
Bonds/loans payable	<u>\$ 3,954,195</u>		<u>\$ 4,068,122</u>		<u>4,449,200</u>	

Sewer Utility Fund Operations



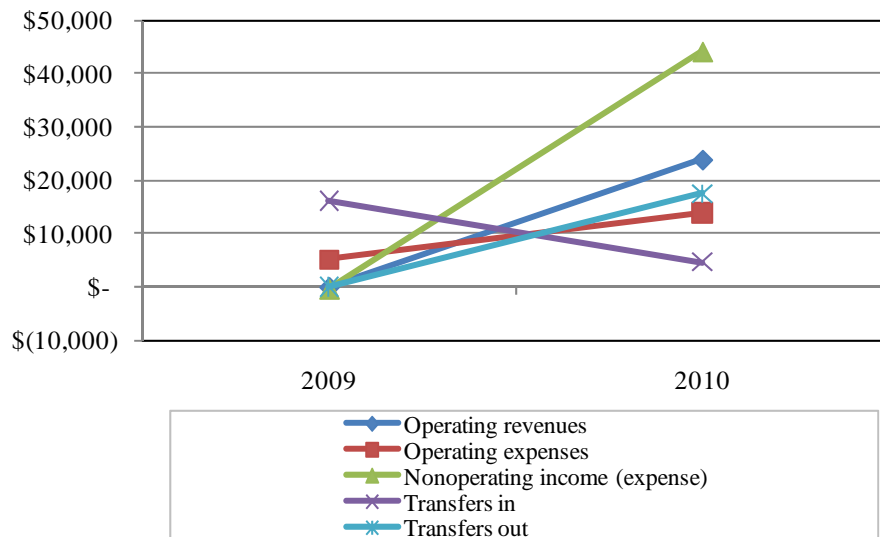


Environmental Services Fund

A comparison of Environmental Services fund operations for the past two years is as follows:

	2009		2010	
	Total	Percent	Total	Percent
Operating revenues	\$ -	100.0 %	\$ 23,855	100.0 %
Operating expenses	(5,150)	-	(13,972)	(58.6)
Operating income (loss)	(5,150)	100.0	9,883	41.4
Nonoperating income (expense)	(500)	-	44,181	185.2
Income (loss) before transfers	(5,650)	100.0	54,064	226.6
Transfers in	16,129	-	4,687	19.7
Transfers out	-	-	(17,500)	(73.4)
Change in net assets	<u>\$ 10,479</u>	<u>100.0 %</u>	<u>\$ 41,251</u>	<u>172.9 %</u>
Cash and cash equivalents	<u>\$ 10,479</u>		<u>\$ 8,051</u>	
Long-term debt payable	<u>\$ -</u>		<u>\$ 123,750</u>	

Environmental Services Fund Operations



The Environmental services fund operations are basically just generating enough cash to cover its operating expenses. The Water and Sewer Utility funds' operating expenses are greatly exceeding its operating revenues for the current year. 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.

Ratio	Calculation	Source	Year			
			2007	2008	2009	2010
Debt to assets	Total liabilities/total assets	Government-wide	63%	60%	60%	59%
			33%	32%	31%	N/A
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	N/A	0.3	0.3	0.4
			1.1	1.0	0.0	N/A
Debt per capita	Bonded debt/population	Government-wide	\$ 8,543	\$ 9,040	\$ 8,900	\$ 8,349
			\$ 3,074	\$ 2,888	\$ 2,716	N/A
Taxes per capita	Tax revenues/population	Government-wide	\$ 497	\$ 568	\$ 627	\$ 694
			\$ 377	\$ 385	\$ 380	N/A
Current expenditures per capita	Governmental fund expenditures/ population	Governmental funds	\$ 572	\$ 623	\$ 561	\$ 646
			\$ 644	\$ 646	\$ 608	N/A
Capital expenditures per capita	Governmental fund expenditures/ population	Governmental funds	\$ 404	\$ 55	\$ 389	\$ 10
			\$ 454	\$ 292	\$ 158	N/A
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	75%	72%	71%	68%
			63%	60%	60%	N/A
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	76%	82%	80%	77%
			62%	61%	60%	N/A

Represents City of Henderson

Represents Peer Group Average

**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.



Current and Future Statute and Accounting Standard Changes

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.

GASB Statement No. 59 – Financial Instruments Omnibus

Summary

The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. This Statement provides for the following amendments:

- Statement 31 is clarified to indicate that a 2a7-like pool, as described in Statement 31, is an external investment pool that operates in conformity with the Securities and Exchange Commission's (SEC) Rule 2a7 as promulgated under the Investment Company Act of 1940, as amended.
- Statement No. 40, Deposit and Investment Risk Disclosures, is amended to indicate that interest rate risk information should be disclosed only for debt investment pools—such as bond mutual funds and external bond investment pools—that do not meet the requirements to be reported as a 2a7-like pool.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2010. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting by providing more complete information, by improving consistency of measurements, and by providing clarifications of existing standards. Emphasizing the applicability of SEC requirements to 2a7-like external investment pools provides practitioners with improved guidance. Finally, limiting interest rate risk disclosures for investments in mutual funds, external investment pools, and other pooled investments to debt investment pools provides better guidance regarding the applicability of interest rate risk disclosures.



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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.

March 10, 2011
Mankato, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants