Management Letter

City of Henderson

Henderson, Minnesota

For the Year Ended
December 31, 2014

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

People + Process. Going Beyond the Numbers

ABDO
EICK &
MEYERS LLP
Certified Public Accountants & Consultants

February 17, 2015

Management, Honorable Mayor and City Council
City of 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, 2014, and have issued our report thereon dated February 17, 2015. Professional standards require that we provide you with the following information related to our audit. We have communicated such information in out letter dated December 18, 2014. 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

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the following pages as item 2014-003 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 items 2014-001 and 2014-002 to be significant deficiencies.

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2014-001 Segregation of duties

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.

2014-001 Segregation of duties - 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.

2014-002 Financial report preparation

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.

2014-003 Material audit adjustments

Condition: During our audit, two adjustments were needed to correct coding and reclassify amounts to correct funds. The following are related to the reclassification and adjustment that was made during the audit:

- To record and adjust activity related to 2014 debt activity.
- To record and adjust activity related to 2014 interfund activity.

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

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

Management response:

The City will review all adjusting entries posted this year and make all such necessary adjustments in the future. The Administrator/Clerk-Treasurer 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 2014 as the number of journal entries decreased by 11. However, we believe that the adjusting entries made to adjust the 2014 debt and interfund 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 from 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.*

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. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2014. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. Estimates used by the City include compensated absences and capital asset basis and depreciation lives.

- Compensated absences are based on estimated payout of unused vacation and sick leave for each employee.

- Management's estimate of depreciation is based on the estimated useful lives of the assets. Depreciation is calculated using the straight-line method.

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 two journal entries that we consider to be material audit entry or correction of management decisions. They relate to the following situations:

- To record and adjust activity related to 2014 debt activity.

- To record and adjust activity related to 2014 interfund activity.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated February 17, 2015.

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.

Other Matters

With respect to the supplementary information accompanying the financial statements, we made certain inquiries of management and evaluated the form, content, and methods of preparing the information to determine that the information complies with accounting principles generally accepted in the United States of America, the method of preparing it has not changed from the prior period, and the information is appropriate and complete in relation to our audit of the financial statements. We compared and reconciled the supplementary information to the underlying accounting records used to prepare the financial statements or to the financial statements themselves.

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 $5,550 per month, the Sewer Utility fund is $16,900 per month, and $440 for the Environmental Services Utility fund per month.

Written Policies and Procedures

Written policies and procedures are 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 and a capital asset policy. They are planning on drafting policies for out of state travel, investment, accounting, internal control, budget and other financial, personnel management, loss control, and similar policies.

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, 2014.

General Fund

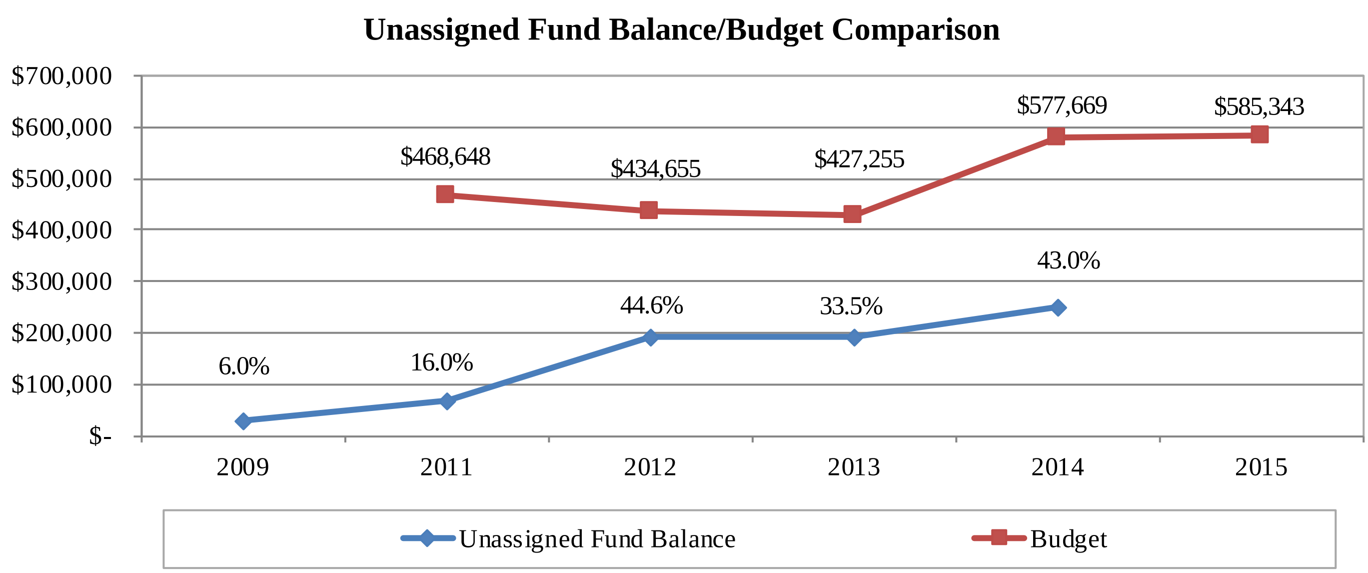
All general governmental functions of the City which are not accounted for in separate funds are included in the General fund.

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. We commend the City for progress made over the last five years in increasing General fund balance to a healthy level. *This information is also presented in graphic form below*

Year	Unassigned Fund Balance December 31	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2010	$ 28,273	2011	$ 468,648	6.0 %
2011	69,747	2012	434,655	16.0
2012	190,344	2013	427,255	44.6
2013	193,282	2014	577,669	33.5
2014	251,885	2015	585,343	43.0

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



We have compiled a peer group average derived from information we have requested from the Office of the State Auditor and then compiled the data for Cities of the 4th class which have populations below 2,500. In 2012 and 2013, the average General fund balance as a percentage of expenditures was 86 percent and 86 percent, respectively. Based on comparison to the peer groups, the City's General fund balance is below that average.

Fund balance increased by $32,892 in 2014. The total unassigned fund balance of $251,885 represents 43.0 percent of the 2015 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. Currently, the City's policy is to maintain an unassigned fund balance of an amount not less than 20 percent of next year's budgeted expenditures of the General fund.

Although there is no legislation regulating fund balance, it is a good policy to assign or commit the 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 commitments and/or assignments for intended use of fund balance at and above the fifty percent level. This documentation could be accomplished by an annual resolution to identify intended use of available fund balance. We recommend a minimum fund balance for working capital be approximately 40 percent to 50 percent of planned expenditures. At the current level, fund balance is considered slightly below what is recommended.

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

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

- The City is vulnerable to legislative actions at the State and Federal level. The State continually adjusts the local government aid formulas. We also have seen the State mandate levy limits for cities over 2,500 in population. An adequate fund balance will provide a temporary buffer against those aid adjustments or levy limits.

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

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

The 2014 General fund operations are summarized as follows:

	Budgeted Amounts Original	Budgeted Amounts Final	Actual Amounts	Variance with Final Budget
Revenues	$ 538,487	$ 538,487	$ 688,391	$ 149,904
Expenditures	577,669	573,669	664,496	(90,827)
Excess (deficiency) of revenues over (under) expenditures	(39,182)	(35,182)	23,895	59,077
Other financing sources (uses)				
Debt issued	40,000	40,000	-	(40,000)
Transfers in	-	-	21,714	21,714
Transfers out	-	(4,000)	(12,717)	(8,717)
Total other financing sources (uses)	40,000	36,000	8,997	(27,003)
Net change in fund balances	$ 818	$ 818	32,892	$ 32,074
Fund balances, January 1			224,177	

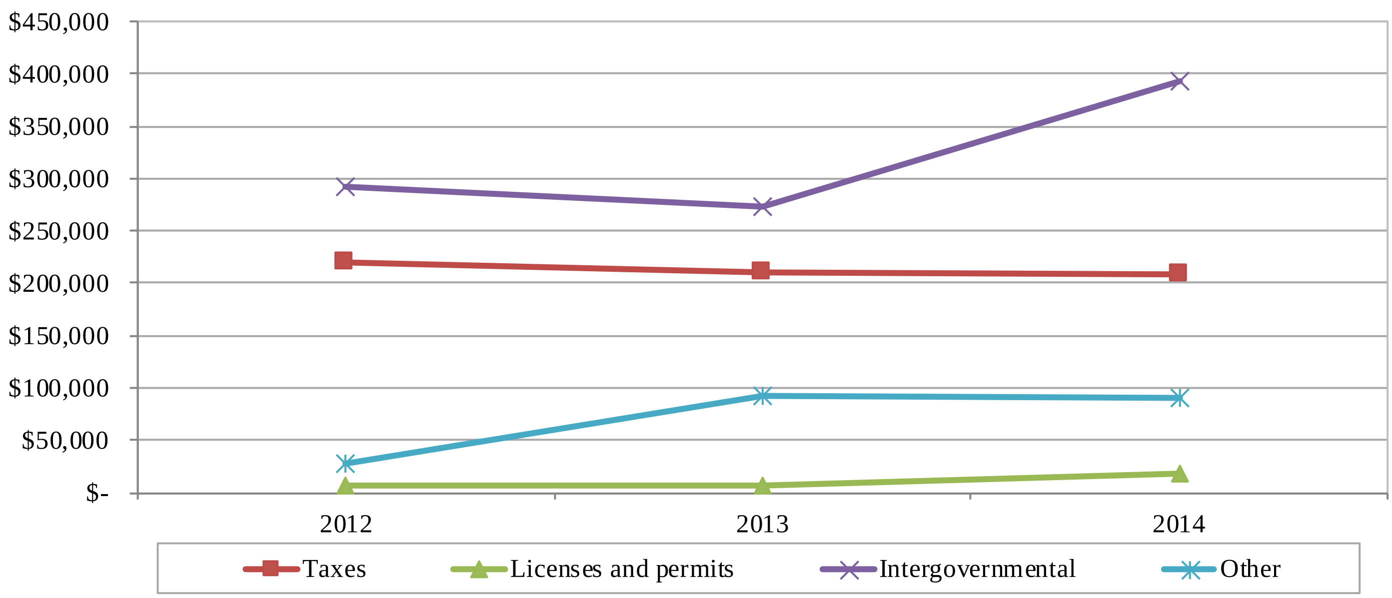
In 2014, larger budget variances were as follows:

- FEMA revenue of $74,868 and total disaster costs of $75,124 were unbudgeted.
- The City received a $34,000 unbudgeted contribution from the Fire Relief Association which in turn was paid to the Henderson Area Joint Fire District.
- Other services and charges for the library were under budget by $14,366.
- Capital outlay in public safety was $20,758 over budget due to the purchase of a foam system for a fire truck and a pump replacement due to flooding.

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

Source	2012	2013	2014	Percent of Total	Per Capita
Taxes	$ 219,048	$ 211,147	$ 207,847	29.3 %	$ 232
Special assessments	392	6	20	-	-
Licenses and permits	7,303	7,528	18,833	2.7	21
Intergovernmental	291,563	274,188	392,593	55.2	438
Charges for services	7,764	8,780	6,282	0.9	7
Fines and forfeits	4,195	5,190	8,130	1.1	9
Investment earnings	442	874	1,109	0.2	1
Miscellaneous	15,334	36,685	53,577	7.5	60
Transfers in	10	40,715	21,714	3.1	24
Total revenues and transfers	$ 546,051	$ 585,113	$ 710,105	100.0 %	$ 792

General Fund Revenues by Source



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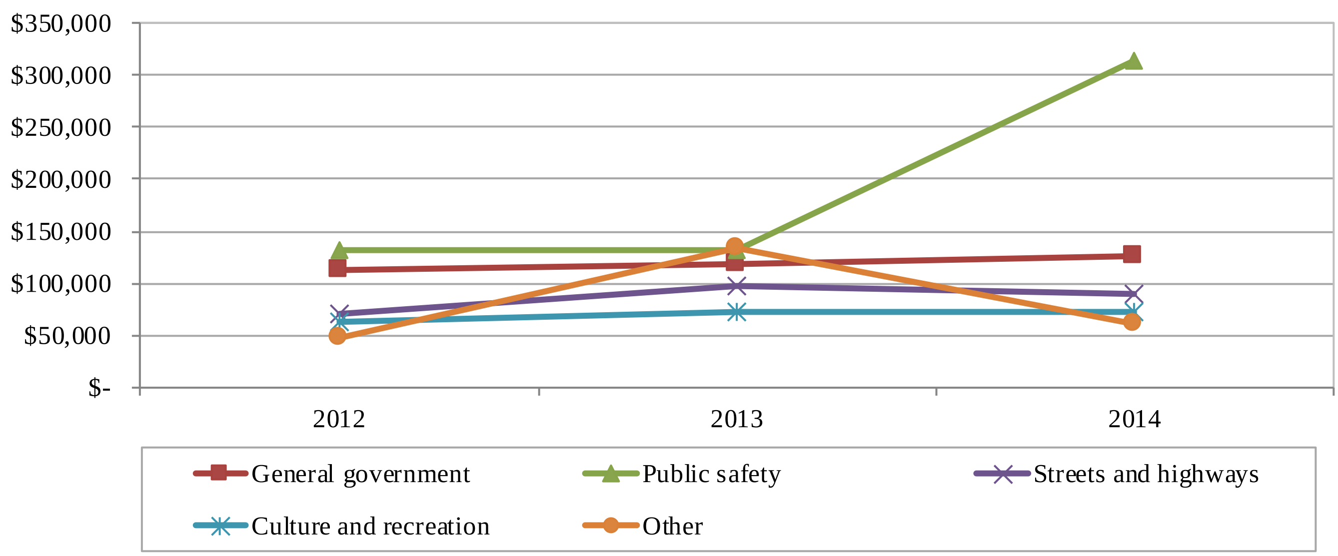
A comparison of General fund expenditures for the last three years is presented below:

Program	2012	2013	2014	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	$ 112,363	$ 118,333	$ 127,027	19.1 %	$ 142	$ 190
Public safety	132,460	132,883	314,461	47.3	351	210
Streets and highways	70,015	98,245	90,240	13.6	101	161
Culture and recreation	62,443	73,118	71,888	10.8	80	67
Economic development	1,579	1,579	-	-	-	10
Unallocated	-	-	75	-	-	20
Total current	378,860	424,158	603,691	91	674	658
Capital outlay	1,363	40,277	44,437	6.7	50	68
Debt service	44,525	91,772	16,368	2.5	18	-
Transfers out	-	-	12,717	1.9	14	-
Total expenditures	$ 424,748	$ 556,207	$ 664,496	100.0 %	$ 742	$ 726

The above chart compares the amount your City spends per capita, in comparison to a peer group. The peer group average is compiled from derived information we have derived from information we have requested from 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 for 2014 and 2013 and the net change:

Fund	Fund Balances December 31 2014	Fund Balances December 31 2013	Increase
Major			
Economic Development Authority	$ 44,575	$ 35,413	$ 9,162

The increase in the EDA fund balance was mainly attributable to the MNCS loan of $37,000 being paid in full during the year.

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.

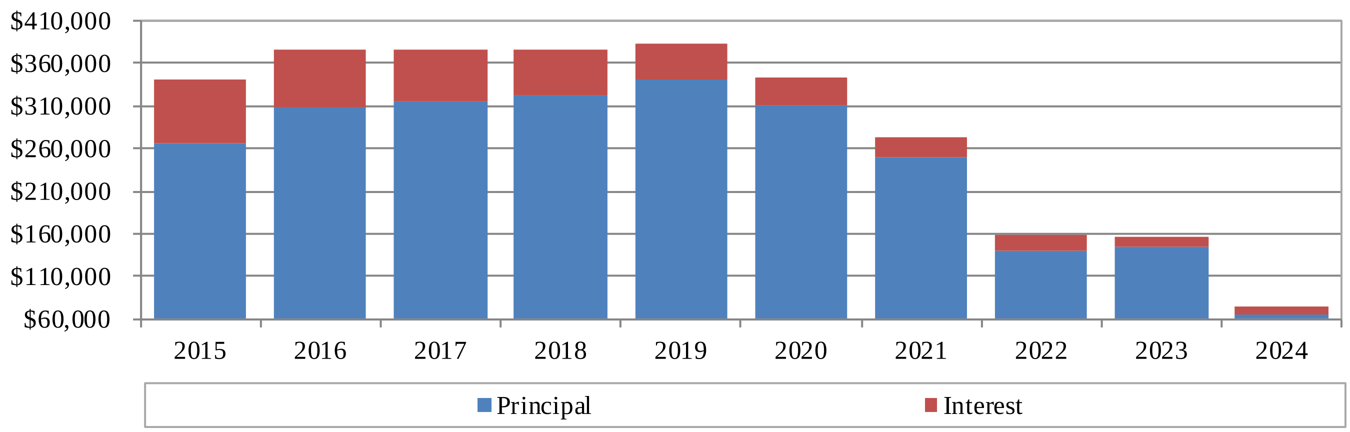
In addition to the above pledged assets, other funding sources may be received by Debt Service funds as follows:

- 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, 2014:

Debt Description	Total Cash and Investments	Total Assets	Outstanding Debt	Maturity Date
General Obligation Bonds				
2011C G.O. Tax Abatement Bonds	$ 34,056	$ 34,056	$ 470,000	2028
2013A G.O. Equipment Certificates	8,568	8,568	85,000	2023
2014A G.O. Bonds	8,044	8,044	245,000	2024
Total G.O. Bonds	50,668	50,668	800,000	
G.O. Tax Increment Bonds				
G.O. Tax Increment Bonds of 2007	203	203	155,000	2019
G.O. Special Assessment Bonds				
Permanent Improvement Revolving	(123,651)	7,642	-	
G.O. Improvement Bonds of 2002	5,529	5,529	440,000	2023
G.O. Improvement Bonds of 2006A	377	377	590,000	2020
G.O. Improvement Bonds of 2003A	116,637	116,637	125,000	2023
G.O. Refunding Bonds of 2005A	20,477	20,477	515,000	2021
Total G.O. Special Assessment Bonds	19,369	150,662	1,670,000	
Total All Debt Service Funds	$ 70,240	$ 201,533	$ 2,625,000	
Future Interest on Debt			$ 204,004	

The annual debt service requirements for the next 10 years for the debt detailed above are as follows:



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

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Capital Projects Funds

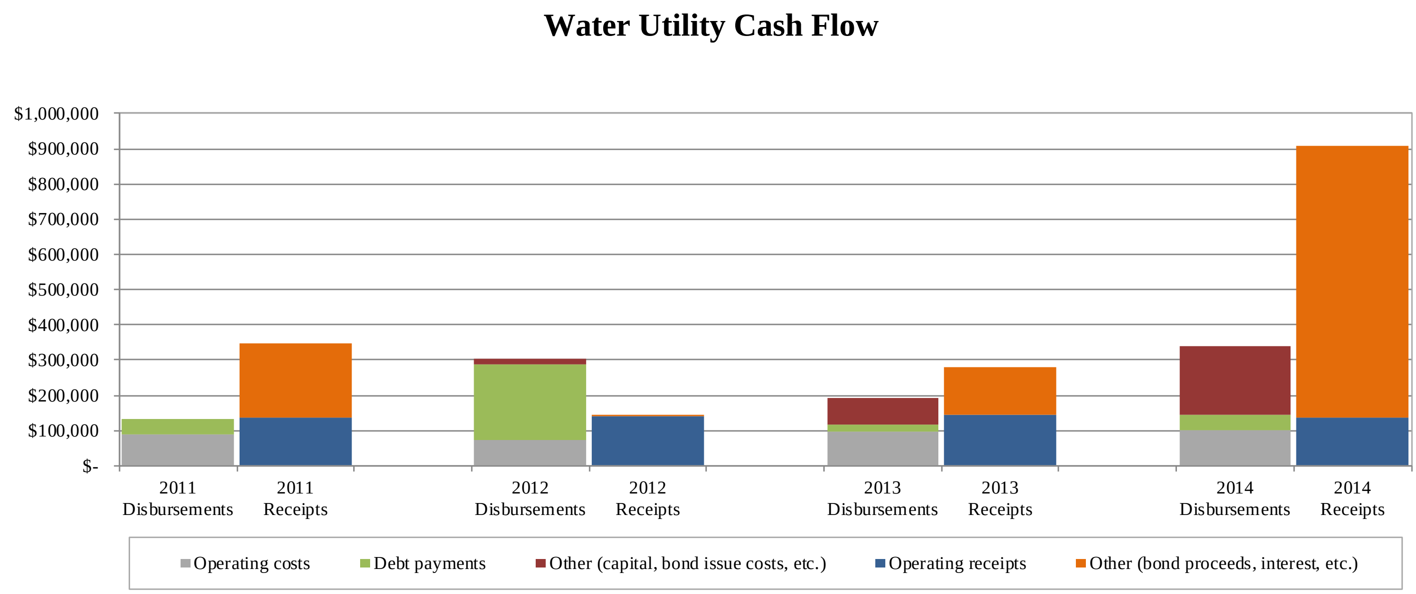
Capital projects funds are used to account for the acquisition and construction of major capital facilities other than those financed by proprietary funds. The table below compares 2014 fund balances with 2013:

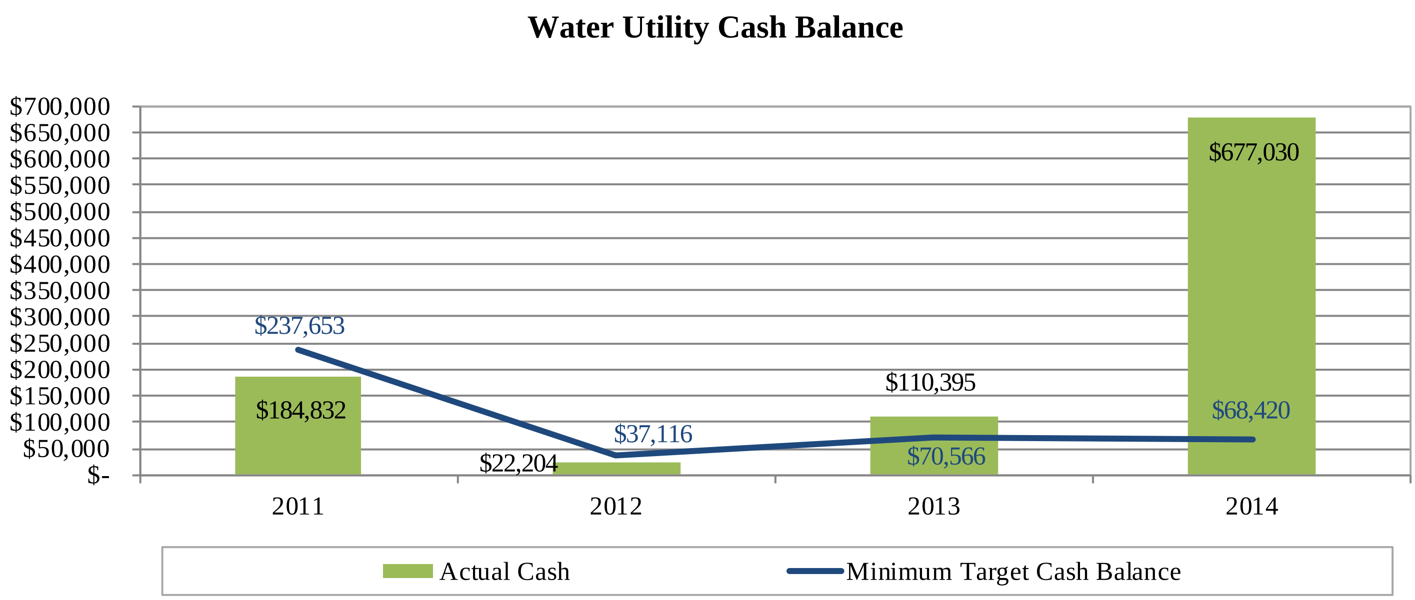
Fund	Fund Balances December 31 2014	Fund Balances December 31 2013	Decrease
Major			
ARMER FEMA Radio Grant	$ -	$ 33,753	$ (33,753)
Nonmajor			
2012-2013 Equipment Certificates	-	7,298	(7,298)
Total	$ -	$ 41,051	$ (41,051)

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. The *ARMER FEMA Radio Grant fund* is a capital project fund created in 2013 that accounts for intergovernmental revenues and related costs related to the host purchase of radios for Firefighters. Both projects were completed during 2014 and closed to the General fund.

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. The results of the operations in terms of cash flow and the breakdown of the cash balances for the past four years are as follows:



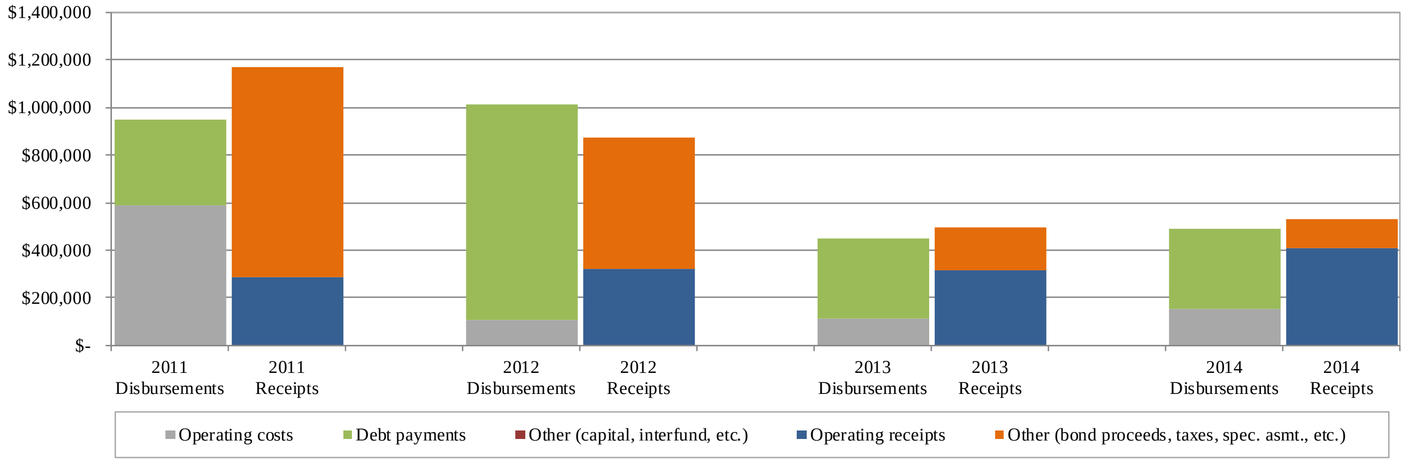


The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments.

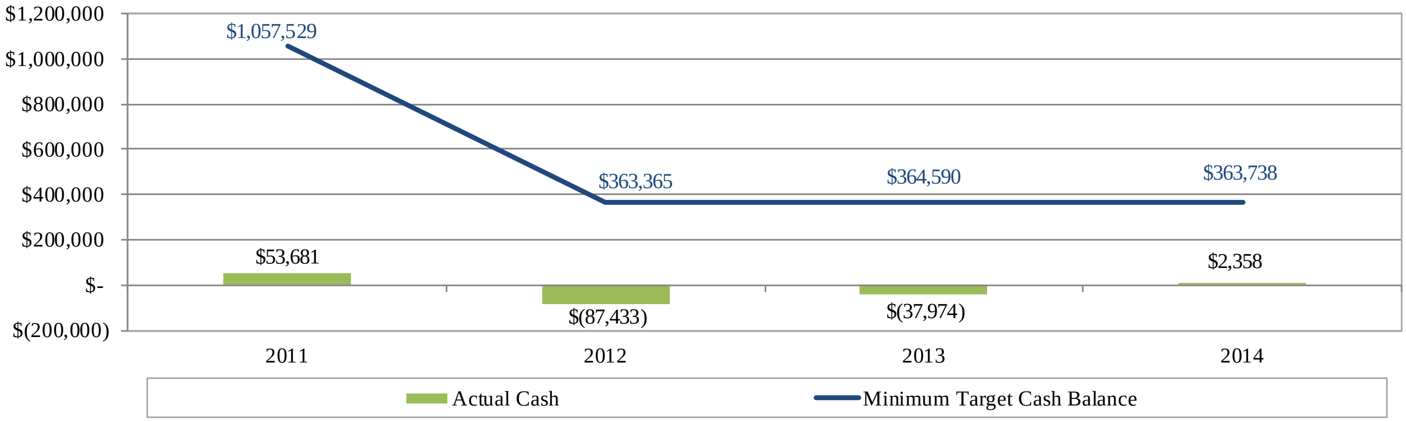
	2011	2012	2013	2014
Bonds payable	$ 429,250	$ 223,900	$ 349,000	$ 1,089,100

Increases in cash and investment balances in 2011 and 2013 were attributable to bond issuances of $200,000 ($50,000 for refunding purposes) and $135,000, respectively. Cash and investment balances in 2014 include unspent bond proceeds of $606,273. We recommend a cash flow projection be created to determine if rates and tax levies are sufficient to cover operating costs, debt payments, repairs, and future replacement/expansion.

Sewer Utility Cash Flow



Sewer Utility Cash Balance

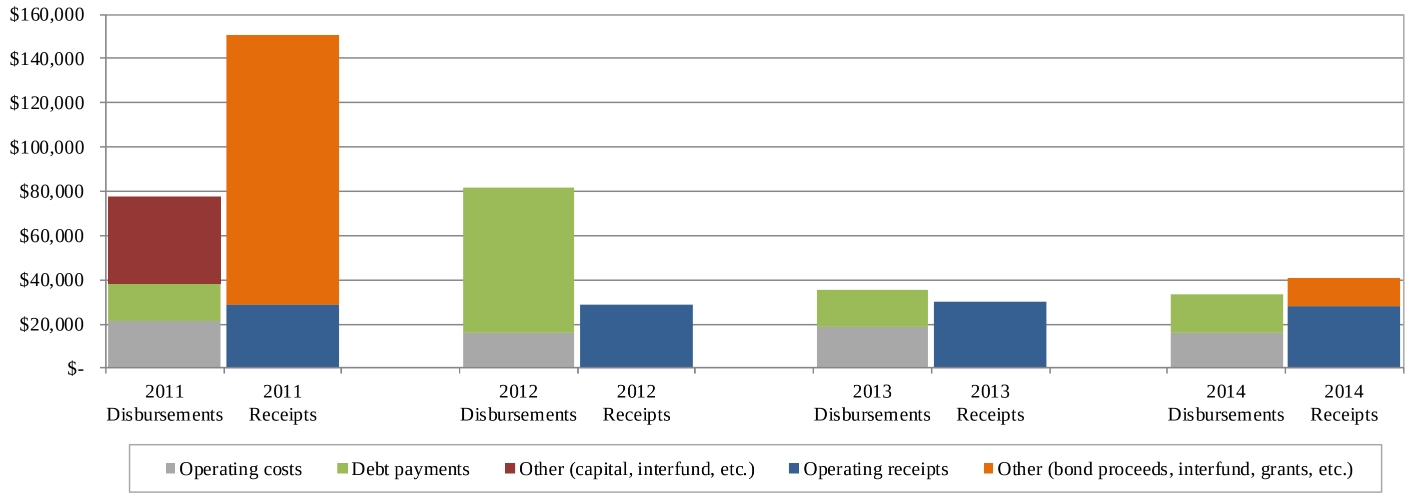


The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments.

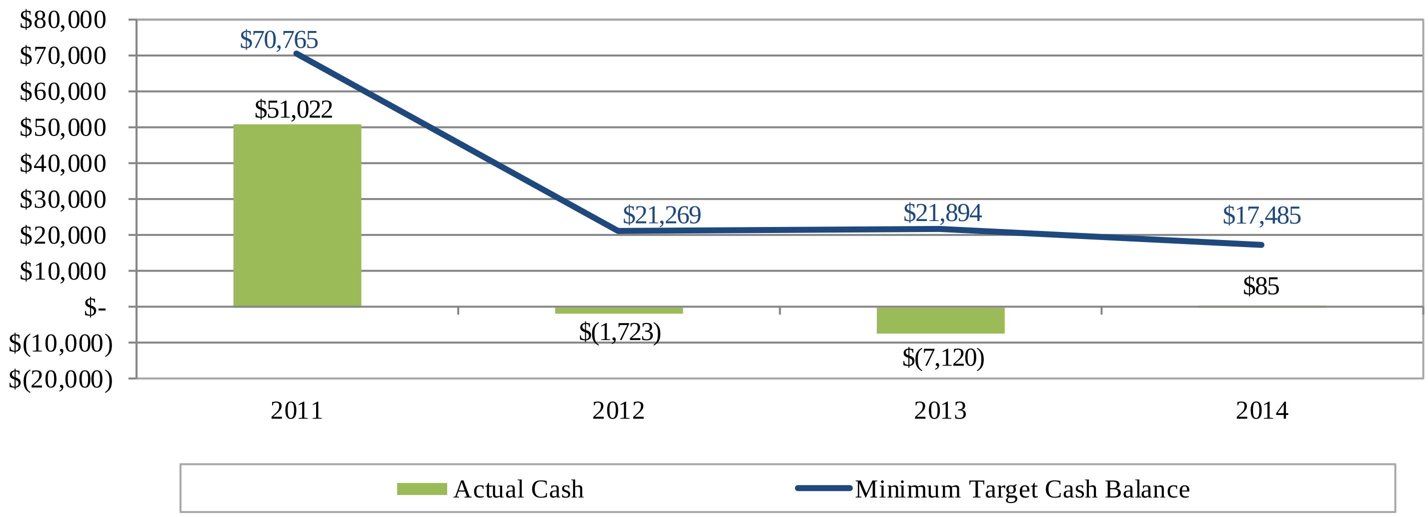
	2011	2012	2013	2014
Bonds payable	$ 4,771,000	$ 3,950,800	$ 3,684,700	$ 3,415,600

Over the past four years, operating receipts were insufficient to cover operating costs and debt payments. Increases in cash and investment balances in 2011 were attributable to a bond issuance of $315,000 ($165,000 for refunding purposes). Additionally, cash balances annually fell short of targeted balances. We recommend a cash flow projection be created to determine if rates and tax levies are sufficient to cover operating costs, debt payments, repairs, and future replacement/expansion.

Environmental Services Utility Cash Flow



Environmental Services Utility Cash Balance



The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments.

	2011	2012	2013	2014
Bonds payable	$ 173,750	$ 113,300	$ 99,300	$ 85,300

The Environmental Services fund operations are generating just enough cash to cover its operating expenses. Increases in cash and investment balances in 2011 were attributable to a bond issuance of $80,000 ($50,000 for refunding purposes). Additionally, while performance is much improved over prior years, the fund is still not generating enough cash to make debt service transfers or provide for any capital reserves for future replacements. We recommend a cash flow projection be created to determine if rates and tax levies are sufficient to cover operating costs, debt payments, repairs, and future replacement/expansion.

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 we have requested from of the Office of the State Auditor. The peer group averages used is 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	2011	2012	2013	2014
Debt to assets	Total liabilities/total assets	Government-wide	62%	55%	54%	55%
			32%	*36%*	*36%*	*N/A*
Debt service coverage	Net cash provided by operations/	Enterprise funds	-90%	20%	61%	74%
	enterprise fund debt payments		*89%*	*90%*	*99%*	*N/A*
Debt per capita	Bonded debt/population	Government-wide	$ 12,008	$ 8,099	$ 7,719	$ 8,125
			$ 3,647	*$ 3,207*	*$ 3,309*	*N/A*
Taxes per capita	Tax revenues/population	Government-wide	$ 754	$ 774	$ 764	$ 588
			$ 636	*$ 444*	*$ 466*	*N/A*
Current expenditures per capita	Governmental fund expenditures/	Governmental	$ 630	$ 1,043	$ 629	$ 718
	population	funds	*$ 891*	*$ 849*	*$ 805*	*N/A*
Capital expenditures per capita	Governmental fund expenditures/	Governmental	$ 17	$ 50	$ 379	$ 649
	population	funds	*$ 238*	*$ 310*	*$ 293*	*N/A*
Capital assets % left to depreciate -	Net capital assets/	Government-wide	65%	63%	61%	59%
Governmental	gross capital assets		*59%*	*57%*	*57%*	*N/A*
Capital assets % left to depreciate -	Net capital assets/	Government-wide	74%	70%	67%	65%
Business-type	gross capital assets		*62%*	*61%*	*59%*	*N/A*

Represents City of Henderson
Represents Peer Group Average

Debt-to-Assets Leverage Ratio (Solvency Ratio)

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

Debt Service Coverage Ratio (Solvency Ratio)

The debt coverage ratio is a comparison of cash generated by operations to total debt service payments (principal and interest) of enterprise funds. This ratio indicates if there are sufficient cash flows from operations to meet debt service obligations. Except in cases where other nonoperating revenues (i.e. taxes, assessments, transfers from other funds, etc.) are used to fund debt service payments, an acceptable ratio would be above 1.

Debt per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total bonded debt by the population of the city and represents the amount of bonded debt obligation for each citizen of the city at the end of the year. The higher the amount, the more resources are needed in the future to retire these obligations through taxes, assessments or user fees.

Taxes per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total tax revenues by the population of the city and represents the amount of taxes for each citizen of the city for the year. The higher this amount is, the more reliant the city is on taxes to fund its operations.

Current Expenditures per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total current governmental expenditures by the population of the City and represents the amount of governmental expenditure for each citizen of the City during the year. Since this is generally based on ongoing expenditures, we would expect consistent annual per capita results.

Capital Expenditures per Capita (Funding Ratio)

This dollar amount is arrived at by dividing the total governmental capital outlay expenditures by the population of the City and represents the amount of capital expenditure for each citizen of the City during the year. Since projects are not always recurring, the per capita amount will fluctuate from year to year.

Capital Assets Percentage (Common-size Ratio)

This percentage represents the percent of governmental or business-type capital assets that are left to be depreciated. The lower this percentage, the older the city's capital assets are and may need major repairs or replacements in the near future. A higher percentage may indicate newer assets being constructed or purchased and may coincide with higher debt ratios or bonded debt per capita.

Future Accounting Standard Changes

The following Governmental Accounting Standards Board (GASB) Statements have been issued and may have an impact on future City financial statements: **(1)**

GASB Statement No. 68 - *The Accounting and Financial Reporting of Pensions- an Amendment of GASB Statement No. 27*

The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement.

This Statement is effective for fiscal years beginning after June 15, 2014. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve the decision-usefulness of information in employer and governmental nonemployer contributing entity financial reports and will enhance its value for assessing accountability and interperiod equity by requiring recognition of the entire net pension liability and a more comprehensive measure of pension expense. Decision-usefulness and accountability also will be enhanced through new note disclosures and required supplementary information.

GASB Statement No. 71 - *Pension Transition for Contributions Made Subsequent to the Measure Date - an Amendment of GASB Statement No. 68*

Summary

The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

Statement No. 68 requires a state or local government employer (or nonemployer contributing entity in a special funding situation) to recognize a net pension liability measured as of a date (the measurement date) no earlier than the end of its prior fiscal year. If a state or local government employer or nonemployer contributing entity makes a contribution to a defined benefit pension plan between the measurement date of the reported net pension liability and the end of the government's reporting period, Statement No. 68 requires that the government recognize its contribution as a deferred outflow of resources. In addition, Statement No. 68 requires recognition of deferred outflows of resources and deferred inflows of resources for changes in the net pension liability of a state or local government employer or nonemployer contributing entity that arise from other types of events. At transition to Statement No. 68, if it is not practical for an employer or nonemployer contributing entity to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, paragraph 137 of Statement No. 68 required that beginning balances for deferred outflows of resources and deferred inflows of resources not be reported.

Consequently, if it is not practical to determine the amounts of all deferred outflows of resources and deferred inflows of resources related to pensions, contributions made after the measurement date of the beginning net pension liability could not have been reported as deferred outflows of resources at transition. This could have resulted in a significant understatement of an employer or nonemployer contributing entity's beginning net position and expense in the initial period of implementation.

This Statement amends paragraph 137 of Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement No. 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts.

The provisions of this Statement are required to be applied simultaneously with the provisions of Statement No. 68.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will eliminate the source of a potential significant understatement of restated beginning net position and expense in the first year of implementation of Statement No. 68 in the accrual-basis financial statements of employers and nonemployer contributing entities. This benefit will be achieved without the imposition of significant additional costs.

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This communication is intended solely for the information and use of management, the City Council, others within the City, and the Minnesota Office of the State Auditor and is not intended to be, and should not be, used by anyone other than these specified parties.

The comments and recommendation in this report are purely constructive in nature, and should be read in this context. Our audit would not necessarily disclose all weaknesses in the system because it was based on selected tests of the accounting records and related data.

If you have any questions or wish to discuss any of the items contained in this letter, please feel free to contact us at your convenience. We wish to thank you for the continued opportunity to be of service, and for the courtesy and cooperation extended to us by your staff.

Abdo, Eick & Meyers, LLP

ABDO, EICK & MEYERS, LLP
Mankato, Minnesota
February 17, 2015