Management Report

for

City of Saint Peter, Minnesota

December 31, 2010

MMKR
CERTIFIED PUBLIC ACCOUNTANTS

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To the City Council and Management
City of Saint Peter, Minnesota

We have prepared this management report in conjunction with our audit of the City of Saint Peter, Minnesota's (the City) financial statements for the year ended December 31, 2010. The purpose of this report is to communicate information relevant to city finances in Minnesota and to provide comments resulting from our audit process. We have organized this report into the following sections:

- Audit Summary
- Funding Cities in Minnesota
- Governmental Funds Overview
- Financial Trends and Conditions
- Accounting and Auditing Updates

We would be pleased to further discuss any of the information contained in this report or any other concerns that you would like us to address. We would also like to express our thanks for the courtesy and assistance extended to us during the course of our audit.

This report is intended solely for the information and use of management, those charged with governance of the City, and those who have responsibility for oversight of the financial reporting process and is not intended to be, and should not be, used by anyone other than these specified parties.

Malloy, Montague, Karnowski, Radosevich, & Co., P.A.

June 28, 2011

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AUDIT SUMMARY

The following is a summary of our audit work, key conclusions, and other information that we consider important or that is required to be communicated to the City Council, administration, or those charged with governance of the City.

OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA, *GOVERNMENT AUDITING STANDARDS*, AND THE U.S. OFFICE OF MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

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 as of and for the year ended December 31, 2010. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America, *Government Auditing Standards*, and OMB Circular A-133, as well as certain information related to the planned scope and timing of our audit. We have communicated such information to you verbally and in our audit engagement letter. Professional standards also require that we communicate to you the following information related to our audit.

PLANNED SCOPE AND TIMING OF THE AUDIT

We performed the audit according to the planned scope and timing previously discussed and coordinated in order to obtain sufficient audit evidence and complete an effective audit.

AUDIT OPINION AND FINDINGS

Based on our audit of the City's financial statements for the year ended December 31, 2010:

- We issued an unqualified opinion on the City's financial statements.

- We reported one finding related to our testing of internal controls and compliance over financial reporting. We reported that due to the small number of office staff, the City has a limited segregation of duties in several areas, which we consider a significant deficiency in internal controls.

- The results of our testing disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards.*

- We noted that the Schedule of Expenditures of Federal Awards is fairly stated, in all material respects, in relation to the basic financial statements.

- We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses in our testing of major federal programs.

- The results of our tests indicate that the City has complied, in all material respects, with the compliance requirements that could have a direct and material effect on each major federal program.

- We have reported one finding based on our testing of the City's compliance with Minnesota laws and regulations. Minnesota Statutes require that if a city's deposits exceed federal deposit insurance coverage, excess deposits must be covered by corporate surety bonds or collateral that has a market value of at least 110 percent of such excess. This requirement was not met for the City's deposit accounts at June 30, 2010.

SIGNIFICANT ACCOUNTING POLICIES

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 of the notes to basic financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year.

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.

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. Professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the City's financial reporting process (that is, cause future financial statements to be materially misstated).

We did not have any audit adjustments to report as none of the adjustments made by us during the audit procedures had a significant effect on the financial reporting process. We did have one adjustment that was not reported in the City's financial statements for the City's net other post-employment benefit (OPEB) liability of $115,643 because it did not have a significant effect on the City's financial reporting process.

ACCOUNTING ESTIMATES AND MANAGEMENT JUDGMENTS

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 estimates affecting the financial statements of the City include the following:

- Useful lives for the depreciation of capital assets
- Self-insurance reserves
- Severance liabilities based on compensated absences
- Valuation of assets held for resale

Management expects any differences between estimates and actual amounts of these estimates to be insignificant. We evaluated the key factors and assumptions used by management in the areas discussed above in determining that they are reasonable in relation to the financial statements taken as a whole.

DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT

We encountered no significant difficulties in dealing with management in performing and completing our audit.

DISAGREEMENTS WITH MANAGEMENT

For purposes of this report, 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 June 28, 2011.

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.

FUNDING CITIES IN MINNESOTA

LEGISLATION

The following is a summary of significant legislative activity passed in calendar year 2010 affecting the finances of Minnesota cities:

Local Government Aid and Market Value Homestead Credit – The 2009 legislative session ended without an agreement on how to address significant projected state budget deficits for the 2009 and 2010 fiscal years. The Governor vetoed the budget bill proposed by the Legislature and balanced the budget using his power of unallotment. The Governor's unallotment plan included delays in the payment of state revenues to school districts, and a reduction in appropriations to other state programs, including local government aid (LGA) and market value homestead credit (MVHC) to Minnesota cities. The unallotments included reductions of approximately $128 million to calendar year 2010 LGA and MVHC, calculated at 7.64 percent of the total calendar year 2009 aggregated levy and LGA of the city, not to exceed $55 per capita. Cuts were to be first taken from LGA and then from MVHC, as necessary. Cities with populations below 1,000 and below the state-wide average tax base per capita were exempted from these cuts.

The February 2010 state budget forecast predicted an additional shortfall of $994 million for the remainder of the 2010–2011 biennium. The 2010 Legislature passed a supplemental budget bill in April that addressed roughly $312 million of the additional shortfall. The bill reduced fiscal 2010 LGA and MVHC for cities by an additional $52.5 million, calculated at 3.43 percent of the total 2010 aggregated levy, LGA, and taconite aid of the city, not to exceed $28 per capita. These cuts were to be first taken from MVHC and then from LGA, as necessary. Cities with populations below 1,000 exempted from previous LGA and MVHC cuts were included in this round of cuts.

The April 2010 supplemental budget bill also reduces city LGA and MVHC for fiscal 2011 by $56.5 million. About $25.4 million of this reduction is a permanent extension of the MVHC portion of the cuts originally made through the Governor's unallotments. The Legislature also made a permanent reduction of $31.1 million to the state's annual LGA appropriation for cities, beginning in 2011.

In May 2010, the Minnesota Supreme Court issued a ruling on a lawsuit overturning the Governor's unallotment of funding to a state special nutrition program. The decision, which applied only to the cuts to this specific program, called into question all of the Governor's July 2009 unallotments. In a one-day special session in May, the 2010 Legislature took action to ratify the majority of the Governor's 2010 unallotments, and dealt with the remaining projected shortfall.

Levy Limitations – A 2008 law limited general operating property tax levy increases for cities with populations over 2,500 to an inflationary increase based on the state determined implicit price deflator (IPD) to a maximum of 3.9 percent annually for the next three calendar years. Modifications were made in subsequent legislative sessions to allow cities subject to levy limitation to declare "special levies" to replace the LGA and MVHC losses described above. The 2010 Legislature also established a floor of zero percent for the inflationary increase, so levies would not be reduced in the event of IPD deflation. The Governor's proposal to extend levy limits was not adopted by the 2010 Legislature, and levy limits remain set to expire after the 2011 tax year. However, the extension of levy limits is expected to be revisited by the 2011 Legislature.

State Stimulus/Jobs Bill – This jobs creation bill included a number of provisions that applied to cities, including:

- Authority for local governments to finance energy conservation improvements and collect repayments as special assessments at the request of the property owner.
- Creation of a new "compact development" type of tax increment financing (TIF) district.
- Expanded authority to use TIF for general economic development for one year.
- Expanded authority to use excess TIF to finance new private development.
- Expanded authority for certain cities to use TIF for housing replacement in response to the foreclosure crisis.

Interest Rates on Awards and Judgments – The 2010 Legislature exempted government entities from a 2009 law change that increased the required interest rate on awards and judgments over $50,000 to 10 percent, returning the rate to the pre-2009 maximum of the greater of 4 percent or the secondary market rate of one year U.S. Treasury bills as determined in December each year.

Pension Funding and Sustainability – The 2010 Legislature made a number of changes to improve the sustainability of state-wide pension plans, including those administered by the Public Employees Retirement Association (PERA). Among the changes to the Public Employee Retirement Fund Coordinated Plan were required increases to the employer and employee contribution rates of 0.25 percent of salary each, effective January 1, 2011. Public Employee's Police and Fire Fund employee and employer contribution rates also increased 0.2 percent and 0.3 percent of salary, respectively, effective January 1, 2011.

STATE OUTLOOK AND IMPORTANCE OF INTERNAL CONTROLS

The state of Minnesota has experienced a series of major budget shortfalls and a steadily deteriorating financial condition in recent years. Local governments and other entities dependent on the state for funding have, in turn, had to deal with the resulting state aid cuts, holdbacks, and unallotments. For the fiscal year 2010–2011 biennium, the state budget was balanced using several large accounting "shifts" and one-time federal stabilization funds that greatly reduced the amount of actual aid reductions necessary. The accounting shifts included delaying state aid payments to and accelerating property tax revenue recognition of Minnesota school districts, essentially utilizing cash "borrowed" from the districts to help balance the state budget. The state intends to pay these shifts back when it has the financial ability.

Current state budget projections for 2011–2012 predict further significant shortfalls that will need to be addressed. Realistically, the state has already used up most of the accounting shifts available for this purpose, and additional federal assistance cannot be counted on. The economy, while showing some signs of recovery, is unlikely to turn around quickly enough to solve the state's budget issues in the short-term. All of this adds up to a period of continued financial uncertainty and a strong likelihood of further funding cuts for Minnesota municipalities.

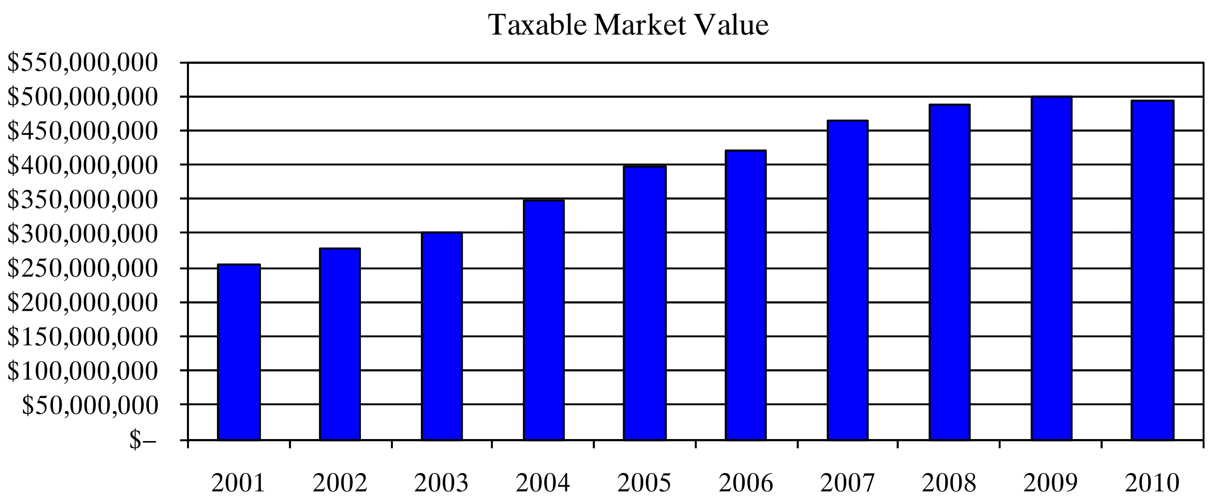
These circumstances have resulted in a sustained cycle of budget reductions for most Minnesota cities. Among our clients, we have seen numerous examples of staffing cuts and reassignments that have potentially weakened internal controls by reducing the segregation of accounting duties or delaying the performance of key control procedures. Unfortunately, the economic downturn has also placed additional financial strain on many individuals, elevating the risk of fraud and theft. Recent communications from the Minnesota Office of the State Auditor have reported a substantial increase in incidents of fraud and theft involving local governments reported to their office recently. A sound system of internal controls is critical to safeguarding city assets and assuring that accurate and timely financial information is available to manage the City. When faced with difficult budgetary decisions, we encourage our clients to remain mindful of these factors and to continue to make sound financial controls a top priority.

PROPERTY TAXES

Minnesota cities rely heavily on local property tax levies to support their governmental fund activities. In recent years this dependence has been heightened, as revenue from state aids and fees related to new development have dwindled due to the struggling economy. This has placed added pressure on local taxpayers already beset by higher unemployment, lower property values, and tighter credit markets. As a result, municipalities in general are experiencing increases in tax delinquencies, abatements, and foreclosures. This instability has led to significant fiscal challenges for many local governments, and increased the investing public's concerns about the security of the municipal debt market.

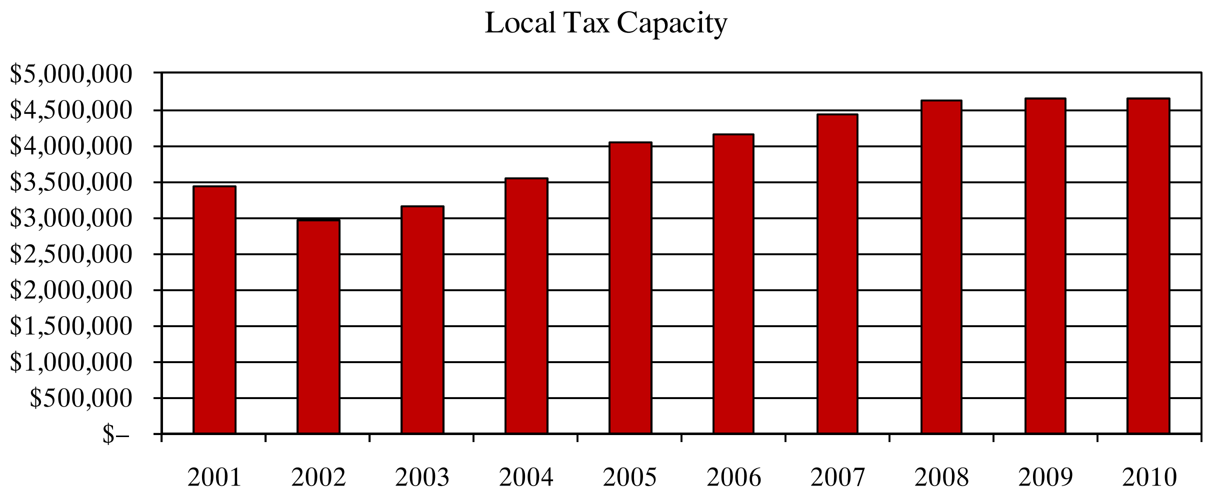
Property values within Minnesota cities experienced average increases of 1.5 percent for taxes payable in 2009 and an average decrease of 3.0 percent for those payable in 2010, reflecting the weak housing market and economic recession experienced in recent years. In comparison, the City's market value increased by 2.5 percent in 2009 and decreased by 1 percent in 2010. It is important to remember that the 2010 market value is based on estimated values as of January 1, 2009, and the housing market is still experiencing difficult times.

The following graph shows the City's changes in taxable market value over the past 10 years:



Tax capacity is considered the actual base available for taxation. It is calculated by applying the state's property classification system to each property's market value. Each property classification, such as commercial or residential, has a different calculation and uses different rates. Consequently, a city's total tax capacity will change at a different rate than its total market value, as tax capacity is affected by the proportion of the City's tax base that is in each property classification from year-to-year, as well as legislative changes to tax rates. Your city's tax capacity increased 0.7 percent for 2009 and increased 0.1 percent for 2010.

The following graph shows the City's change in tax capacities over the past 10 years:



The following table presents the average tax rates applied to city residents for each of the last two levy years, along with comparative state-wide rates. The general increase in rates reflects both the increased reliance of local governments on property taxes and the recent decline in tax capacities previously discussed.

Rates expressed as a percentage of net tax capacity

	All Cities State-Wide		**City of Saint Peter**	
	2009	2010	**2009**	**2010**
Average tax rate				
City	36.9	39.2	**37.9**	**43.4**
County	39.3	41.0	**51.0**	**51.5**
School	22.0	23.0	**14.8**	**13.8**
Special taxing	5.5	5.9	**0.6**	**0.5**
Total	103.7	109.1	**104.3**	**109.2**

The City's portion of the average property tax rate for city residents has historically been higher than state-wide averages. The average tax rate for the City as a whole increased significantly in fiscal 2010 and is very similar to the state-wide total averages.

GOVERNMENTAL FUNDS OVERVIEW

This section of the report provides you with an overview of the financial trends and activities of the City's governmental funds. Governmental funds include the General Fund, special revenue, debt service, and capital project funds. We have also included the most recent comparative state-wide averages available from the State Auditor. The reader needs to consider the effect of inflation and other known changes or differences when comparing this data. Also, certain data on these tables may be classified differently than how they appear on the City's financial statements in order to be more comparable to the state-wide information, particularly in separating capital expenditures from current expenditures.

We have designed this section of our management report using per capita data in order to better identify unique or unusual trends and activities of your city. We intend for this type of comparative and trend information to complement, rather than duplicate, information in the Management's Discussion and Analysis. An inherent difficulty in presenting per capita information is the accuracy of the population count, which for most years is based on estimates.

GOVERNMENTAL FUNDS REVENUE

The amounts received from the typical major sources of revenue will naturally vary between cities based on their particular situation. This would include the City's stage of development, location, size and density of its population, property values, services it provides, and other attributes. The following table presents the City's revenue per capita of its governmental funds for the past three years, together with state-wide averages:

Governmental Funds Revenue per Capita
With State-Wide Averages by Population Class

	State-Wide			**City of Saint Peter**		
Year	December 31, 2009			**2008**	**2009**	**2010**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**10,884**	**10,917**	**10,917**
Property taxes	$ 367	$ 365	$ 391	**$ 211**	**$ 187**	**$ 197**
Tax increments	46	62	59	**46**	**45**	**40**
Franchise and other taxes	23	34	36	**9**	**12**	**11**
Special assessments	86	47	62	**29**	**10**	**13**
Licenses and permits	21	19	27	**19**	**15**	**28**
Intergovernmental revenues	284	273	168	**270**	**307**	**286**
Charges for services	82	80	77	**33**	**34**	**36**
Other	81	76	61	**157**	**145**	**114**
Total revenue	$ 990	$ 956	$ 881	**$ 774**	**$ 755**	**$ 726**

The City's lower than average tax revenue is primarily the result of the City relying on enterprise fund activities to finance the City's activities. This is due to the large amount of non-taxable property within the City.

In 2010, governmental funds revenue per capital decrease $29 per capita. The largest decline was in other revenues totaling $31. This decline is a result of a decline in the number of Washington Terrace lots sold in fiscal 2010 and a decline in the principal and interest payments received on an economic development note receivable in 2010.

It is important to note that this table does not include operating transfers, which are used by the City to support governmental fund activities. This information is not included in the table as the comparable information is not available.

GOVERNMENTAL FUNDS EXPENDITURES

Similar to our discussion of revenues, the expenditures of governmental funds will vary from state-wide averages and from year-to-year, based on the City's circumstances. Expenditures are classified into three types as follows:

- **Current** – These are typically the general operating type expenditures occurring on an annual basis, and are primarily funded by general sources such as taxes and intergovernmental revenues.

- **Capital Outlay and Construction** – These expenditures do not occur on a consistent basis, more typically fluctuating significantly from year-to-year. Many of these expenditures are project-oriented, which are often funded by specific sources that have benefited from the expenditure, such as special assessment improvement projects.

- **Debt Service** – Although the expenditures for the debt service may be relatively consistent over the term of the respective debt, the funding source is the important factor. Some debt may be repaid through specific sources such as special assessments or redevelopment funding, while other debt may be repaid with general property taxes.

The City's expenditures per capita of its governmental funds for the past three years, together with state-wide averages, are presented in the following table:

Governmental Funds Expenditures per Capita
With State-Wide Averages by Population Class

	State-Wide			**City of Saint Peter**		
Year	December 31, 2009			**2008**	**2009**	**2010**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**10,884**	**10,917**	**10,917**
Current						
General government	$ 120	$ 107	$ 79	**$ 103**	**$ 104**	**$ 107**
Public safety	217	233	241	**205**	**207**	**211**
Street maintenance and lighting	112	106	82	**117**	**102**	**102**
Parks and recreation	61	81	86	**132**	**103**	**99**
All other	81	81	96	**76**	**127**	**79**
	$ 591	$ 608	$ 584	**$ 633**	**$ 643**	**$ 598**
Capital outlay and construction	$ 336	$ 325	$ 267	**$ 145**	**$ 234**	**$ 84**
Debt service						
Principal	$ 196	$ 135	$ 126	**$ 89**	**$ 104**	**$ 84**
Interest and fiscal	73	51	39	**46**	**54**	**37**
	$ 269	$ 186	$ 165	**$ 135**	**$ 158**	**$ 121**

The City's governmental funds current per capita expenditures were less compared to state-wide averages for cities in the same population class for fiscal 2009. The departments that were higher than state-wide averages include parks and recreation. Parks and recreation expenditures are typically higher than average as the operation of the City's community center is included in these numbers.

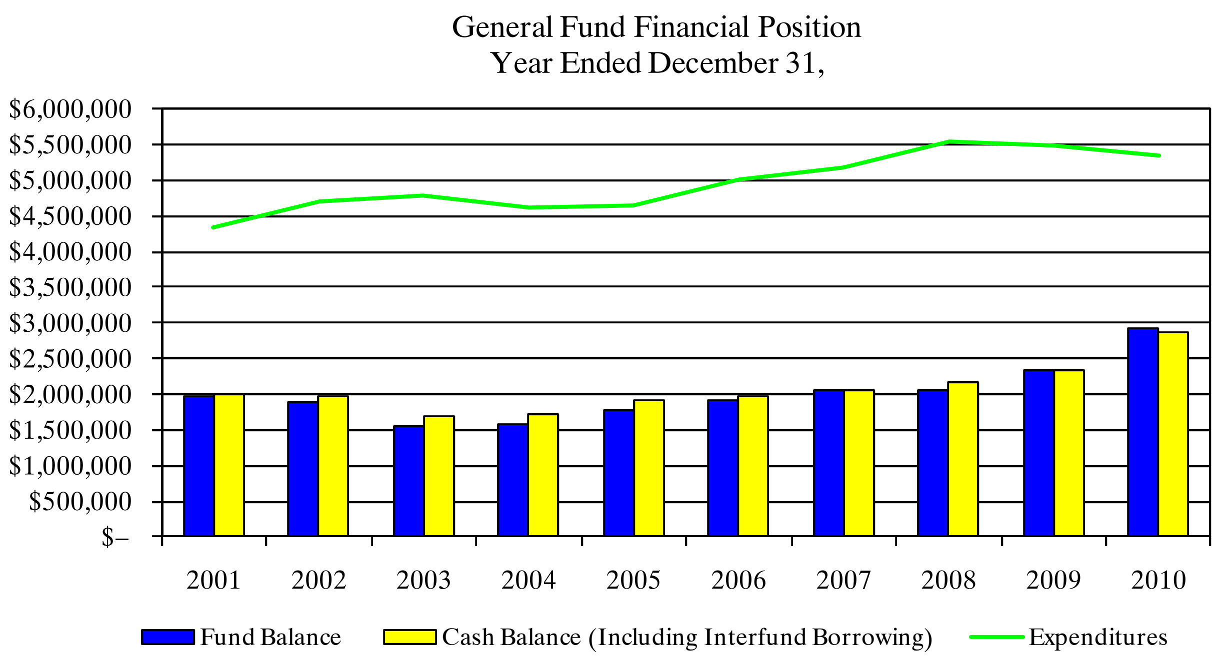
The City's governmental funds current per capita expenditures decreased $45 per capita in calendar 2010. Most of the decrease was in the "all other" category. This category fluctuates significantly from year-to-year in the City as expenditures change each year based on the level of economic development revolving loans being issued. The "all other" category includes economic development revolving loans totaling $15 per capita, which was a significant decrease over the past fiscal year due to minimal loans awarded in fiscal 2010.

FINANCIAL TRENDS AND CONDITIONS

GENERAL FUND

The City's General Fund accounts for the financial activity of the basic services provided to the community. The primary services included within this fund are the administration of the municipal operation, police and fire protection, building inspection, street and highway maintenance, and parks and recreation.

The following graph displays the City's General Fund trends of financial position and changes in the volume of financial activity. Fund balance and cash balance are typically used as indicators of financial health or equity, while annual expenditures are often used to measure the size of the operation.



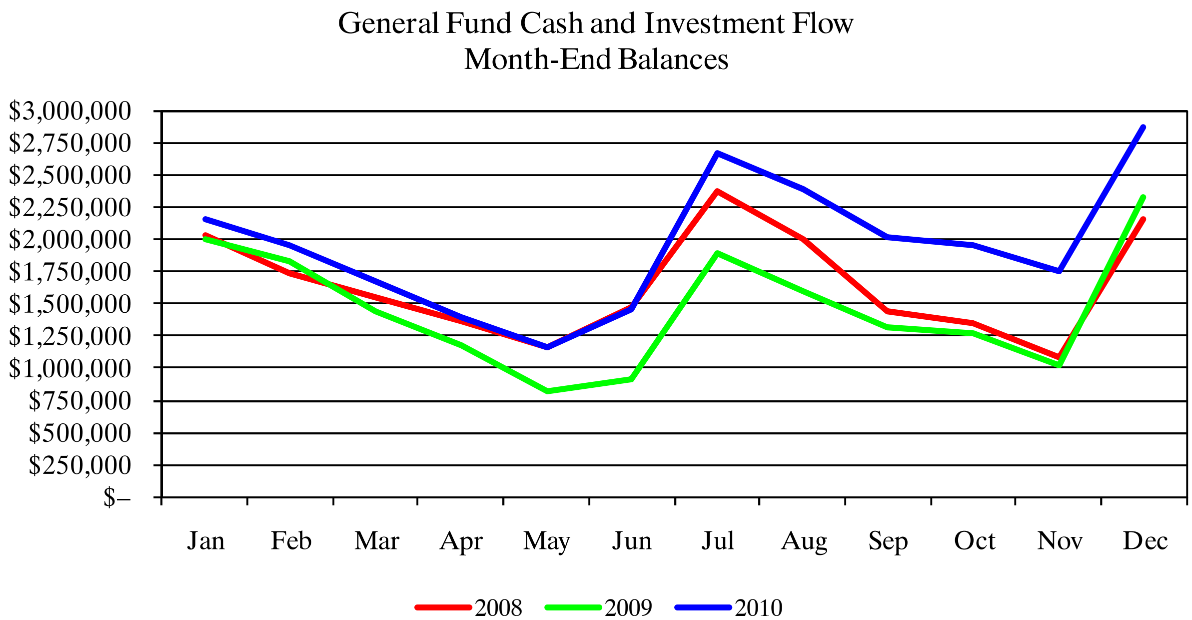
The City's General Fund financial position improved in 2010, ending the year with a fund balance of $2,918,878 and a cash balance, including interfund borrowing, of $2,870,061. In 2010, the City's fund balance increased $593,181.

As the graph illustrates, the City has generally been able to maintain healthy cash and fund balance levels as the volume of financial activity has grown. This is an important factor because a government, like any organization, requires a certain amount of equity to operate. A healthy financial position allows the City to avoid volatility in tax rates; helps minimize the impact of state funding changes; allows for the adequate and consistent funding of services, repairs, and unexpected costs; and is a factor in determining the City's bond rating and resulting interest costs. Maintaining an adequate fund balance has become increasingly important given the fluctuations in state funding for cities in recent years.

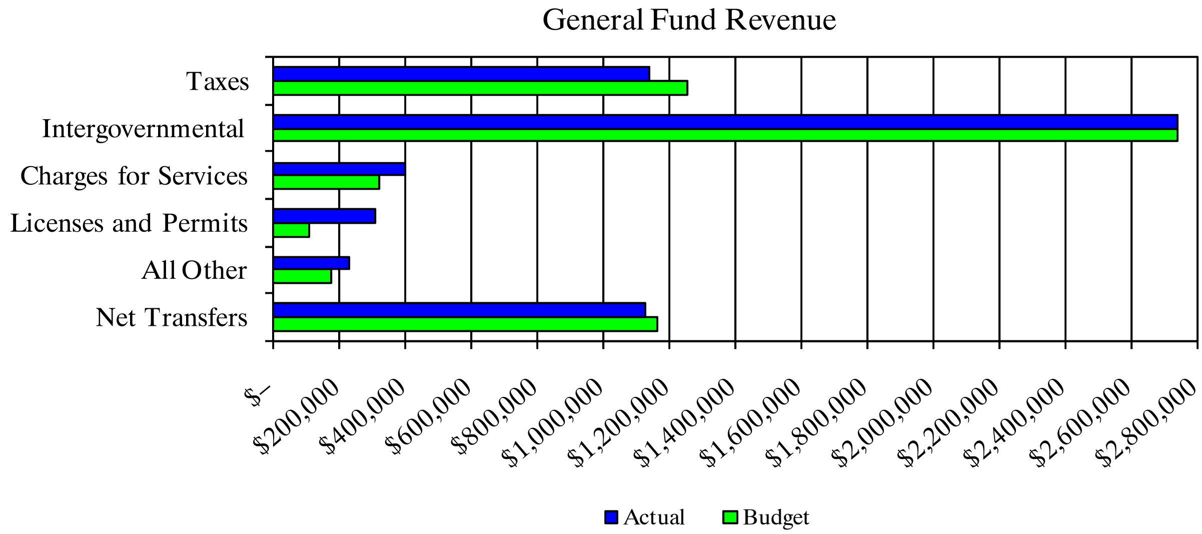
Fund balance as a percentage of expenditures is a good measure of financial position. This ratio is used to measure fund balance, taking into account increases in expenditures from year-to-year. Fund balance as a percentage of expenditures was 54.6 percent at December 31, 2010.

A trend that is typical to Minnesota local governments, especially the General Fund of cities, is the unusual cash flow experienced throughout the year. The City's General Fund cash disbursements are made fairly evenly during the year other than the impact of seasonal services such as snowplowing, street maintenance, and park activities. Cash receipts of the General Fund are quite a different story. Taxes and state aids comprise almost 81 percent of the fund's total annual revenue. Approximately half of these revenues are received by the City in July and the rest in December. Consequently, the City needs to have adequate cash reserves to finance its everyday operations between these payments.

The following graph illustrates the monthly cash flow of the General Fund in recent years. Adequate fund balances in the General Fund have provided for positive month-end balances for all three years presented.

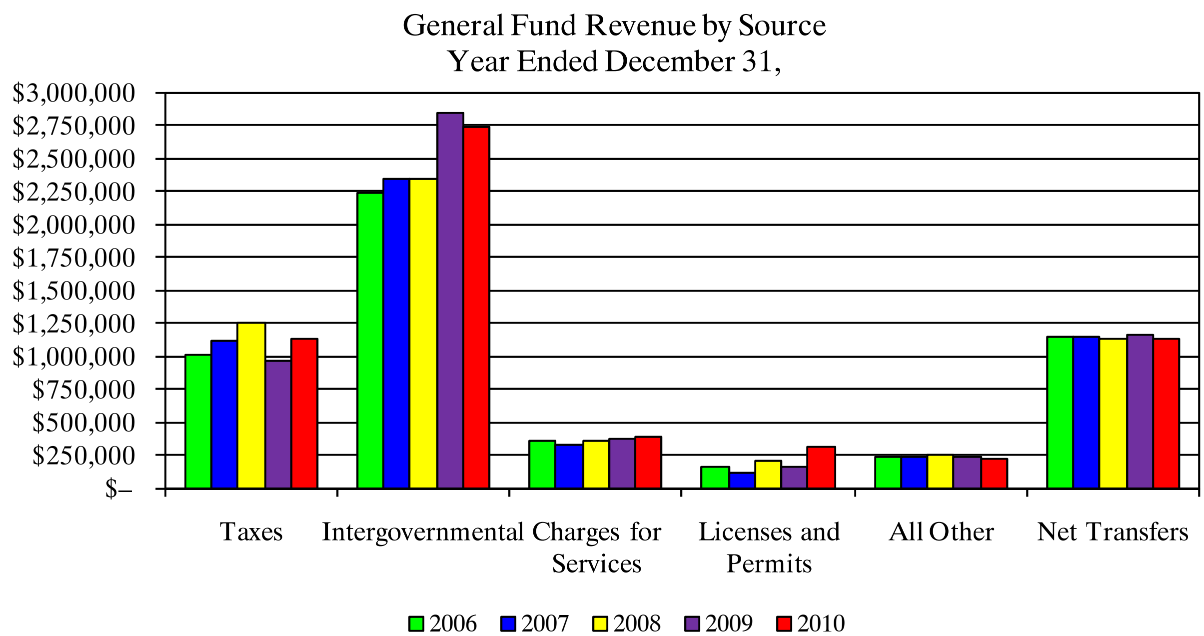


The following graph reflects the City's General Fund revenues net transfers, budget and actual, for 2010:



Total General Fund revenues and net transfers in 2010 were $5,940,028, which was $190,312 (3.3 percent) greater than the final budget. Property tax revenue was under budget by $119,812, due to the state unallotment of the City's MVHC aid. Licenses and permits and charges for services were over budget by $201,626 and $78,424, respectively due to an increase in the commercial sector capital projects in the City.

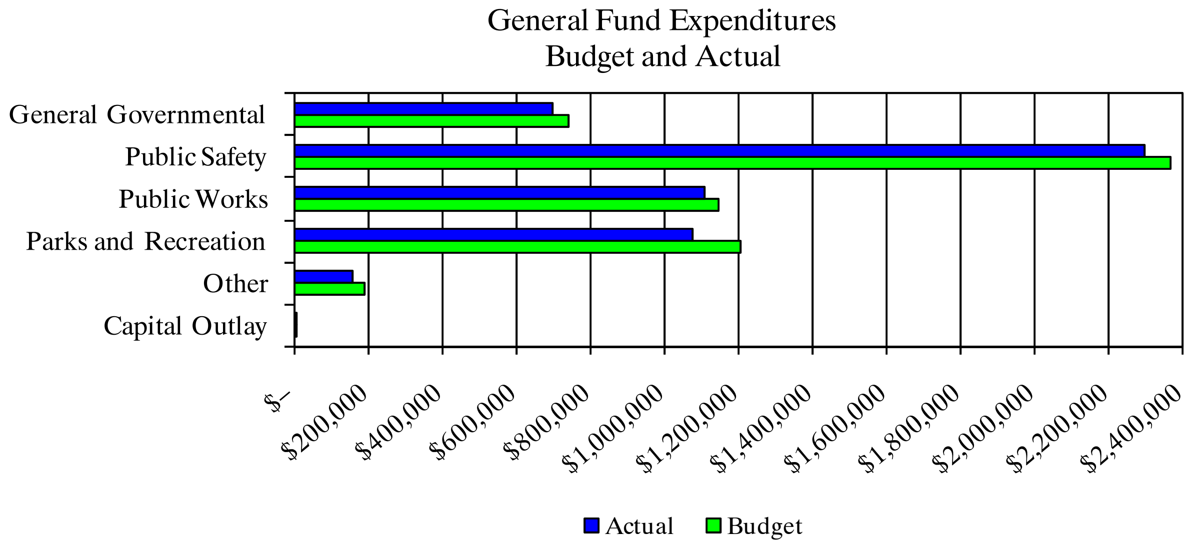
The following graph presents the City's General Fund revenue sources for the last five years:



Revenues and net transfers in for the year ended December 31, 2010 increased by $179,295, or 3.1 percent. Revenue increases were mainly from taxes, which increased about $166,805, mainly due to an increase in the current year levy.

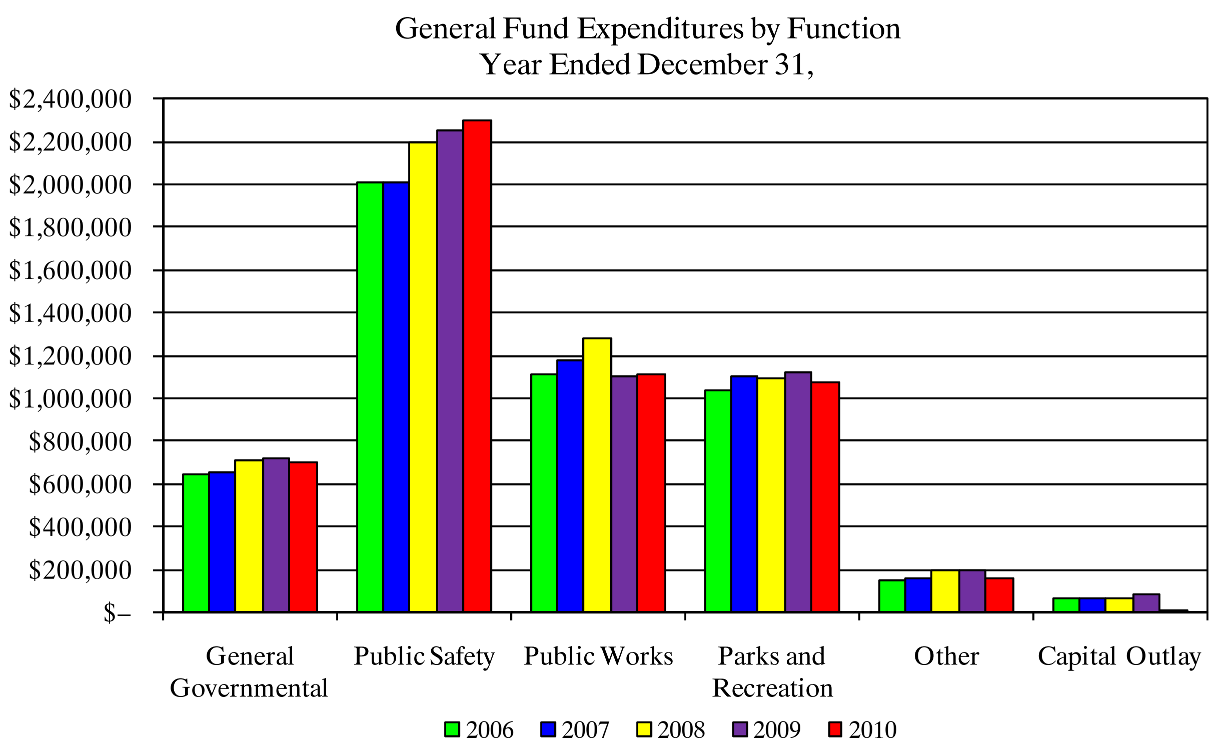
Due to the large amount of tax exempt property in the City, the City has historically relied heavily on intergovernmental revenue (mainly state aid) and transfers from its enterprise funds to help support General Fund operations.

The following illustrations provide the components of the City's General Fund spending for 2010 compared to budget:



Total General Fund expenditures for 2010 were $5,346,847, which was $316,636 (5.6 percent) less than the budget. Expenditures were under budget in most departments due to continued cost containment measures implemented by the City. General government costs were under budget by $41,766, mainly due to legal fees being lower than budgeted. Public safety expenditures were under budget by $72,300, mainly due to salary and benefit costs being lower than budgeted. Parks and recreation program costs were also under budget by $130,474.

The following graph presents the components of the City's General Fund spending for the past 5 years:



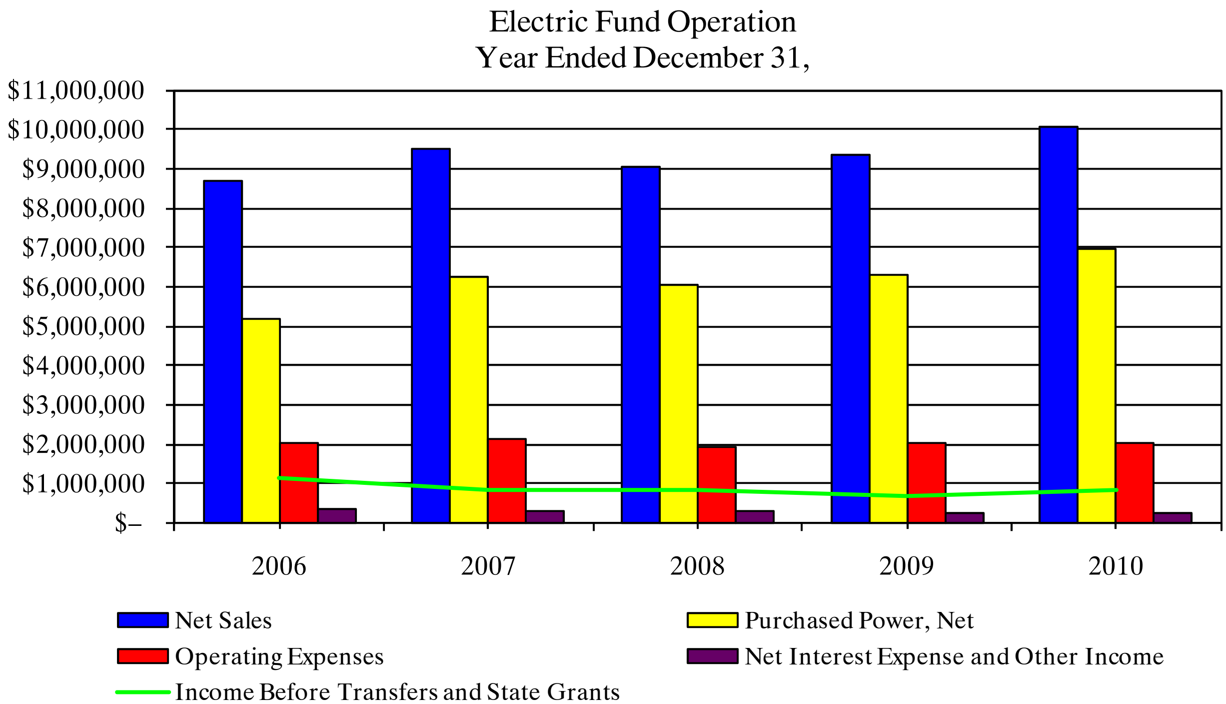
In 2010, total General Fund expenditures decreased $138,841, or 2.5 percent. The largest decrease was in General Fund expenditures for capital outlay which decreased approximately $79,000.

ENTERPRISE FUNDS

The enterprise funds comprise a considerable portion of the City's activities. These funds help to defray overhead and administrative costs and provide additional support to general government operations by way of annual transfers. We understand the City is proactive in reviewing these activities on an ongoing basis and we want to reiterate the importance of continually monitoring these operations. Over the years we have emphasized to our city clients the importance of these utility operations being self-sustaining, preventing additional burdens on general governmental funds. This would include the accumulation of net assets for future capital improvements and to provide a cushion in the event of a negative trend in operations.

Electric Fund

The following graph presents five years of comparative data for the City's Electric Fund:

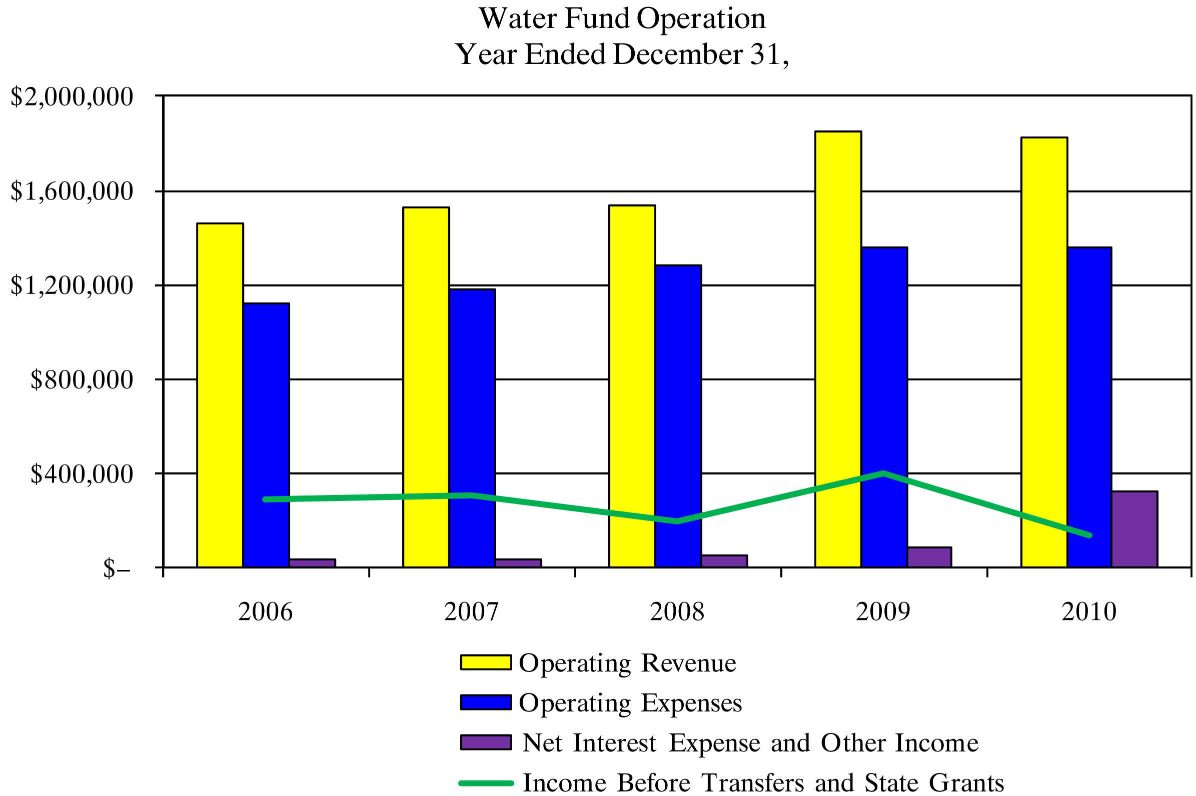


At December 31, 2010, the Electric Fund had total net assets of $15,922,378, of which $1,061,428 was restricted for debt service; $9,890,609 was invested in capital assets, net of related debt; and $4,970,341 was unrestricted. The Electric Fund ended the year with working capital of $4,534,941.

The Electric Fund operating revenue was $10,068,637 for 2010, an increase of about $731,683 (7.3 percent), mainly due to both an increase in usage and rates. Purchased power increased $654,171, or 10.4 percent. Operating expenses decreased $35,361 (1.8 percent) in 2010 mainly due to decreases in professional service costs.

Water Fund

The following graph presents selected data for the City's Water Fund for the past five years:

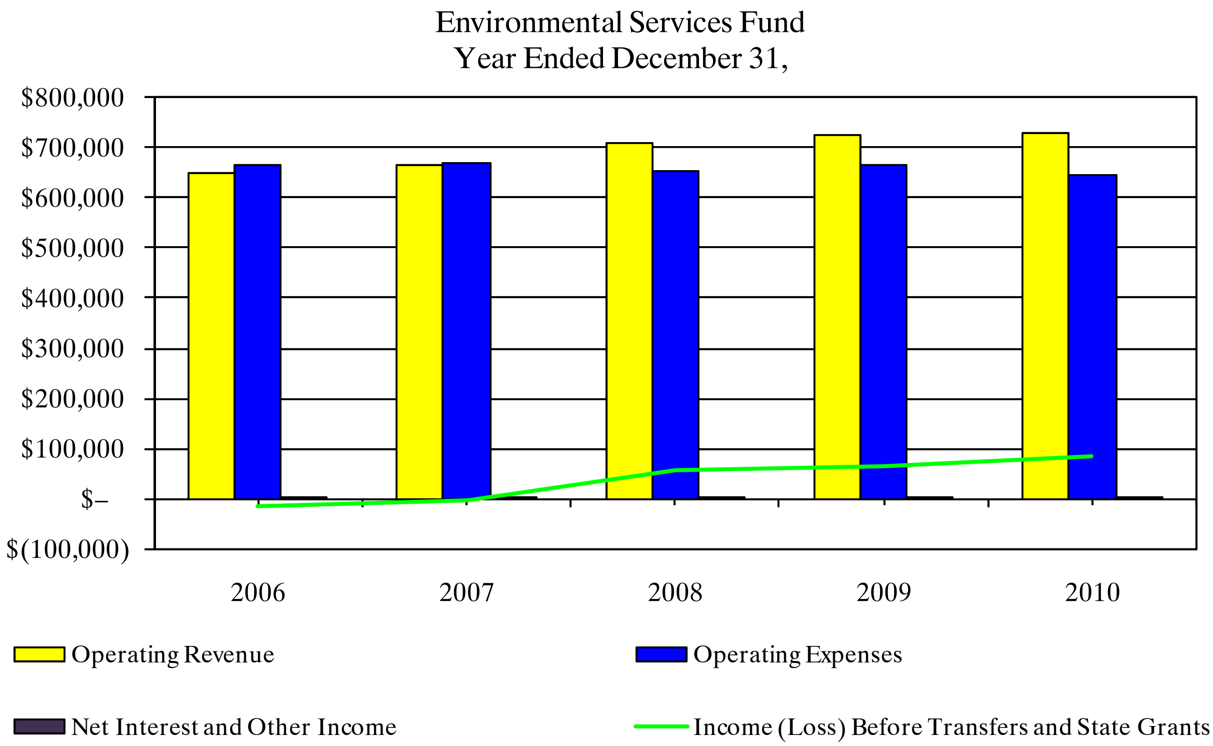


At December 31, 2010, the Water Fund had total net assets of $11,587,167, of which $9,896,346 was invested in capital assets, net of related debt and $1,690,821 was unrestricted. The Water Fund ended the year with working capital of $1,460,417.

The Water Fund operating revenue was $1,825,045 for 2010, a decrease of about $23,716 (1.3 percent) which was the result of a decrease in the current year water usage which was offset by a rate increase. Operating expenses decreased about $5,098 (0.4 percent) more than the prior year. The Water Fund experienced an increase in interest expense of $240,575 related to a recent bond issue for new projects in the past few years.

Environmental Services Fund

The following graph presents selected data for the City's Environmental Services Fund for the past five years:

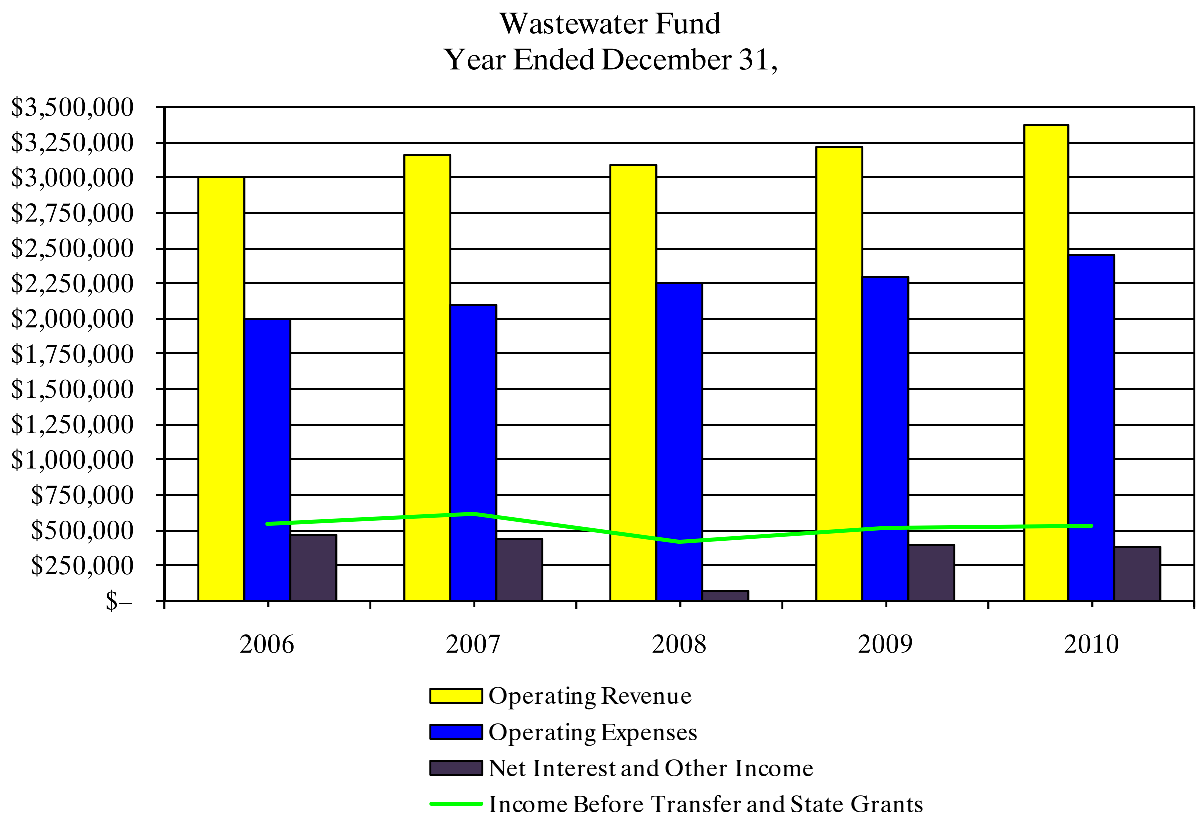


At December 31, 2010, the Environmental Services Fund had total net assets of $229,698, of which $18,960 was invested in capital assets, net of related debt and $210,738 was unrestricted. The Environmental Services Fund ended the year with working capital of $224,338.

The Environmental Services Fund operating revenue was $727,110 for 2010, an increase of $778. Operating expenses decreased about $21,189 (3.2 percent) compared to the prior year.

Wastewater Fund

The following graph presents selected data for the City's Wastewater Fund for the past five years:



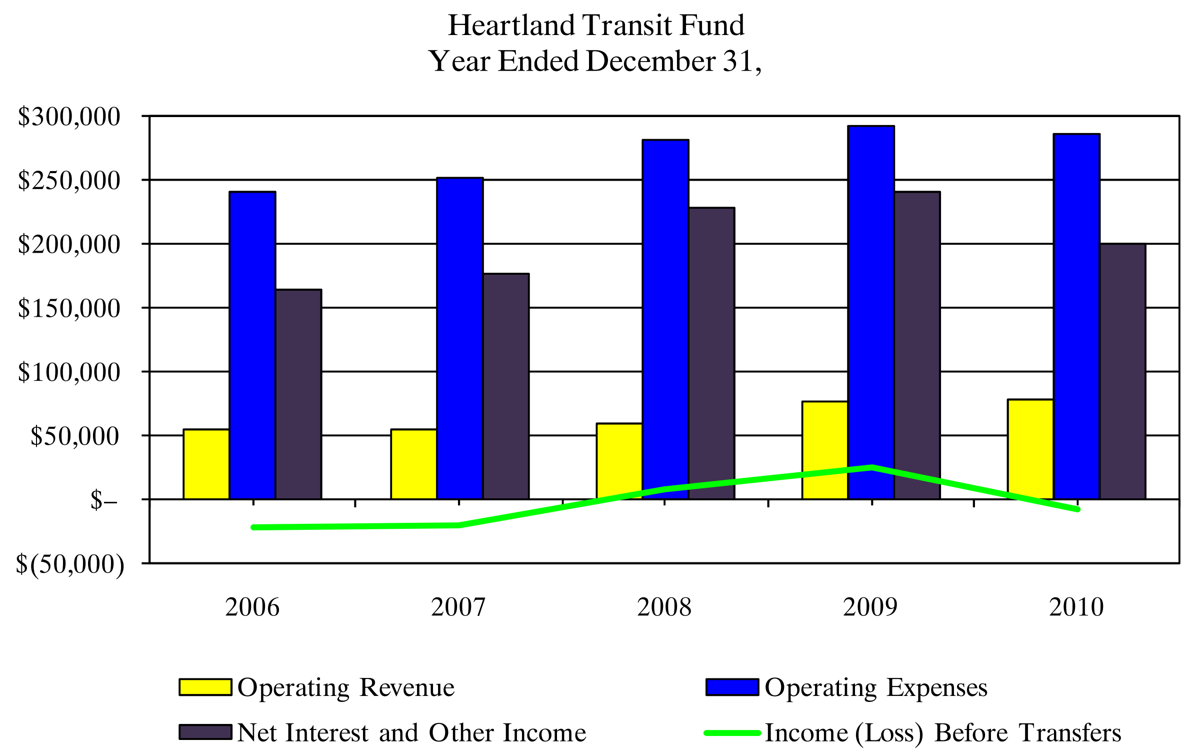
At December 31, 2010, the Wastewater Fund had total net assets of $15,659,622, of which $14,622,957 was invested in capital assets, net of related debt; $402,767 was restricted; and $633,898 was unrestricted. The Wastewater Fund ended the year with a deficit working capital balance of ($51,097).

Because the debt service principal and interest payments on the debt issues of this fund continue to increase, it will be important that the City continue to analyze long-term financial projections to ensure the Wastewater Fund has available liquid assets to make these payments.

The Wastewater Fund operating revenue was $3,369,009 for 2010, an increase of about $156,891 (4.9 percent), mainly due to a small increase in the gallons billed in the current year along with an increase in the rates. Operating expenses increased about $146,949 (6.4 percent) to $2,447,173 in 2010, as a number of expense categories were higher than the prior year, including repairs and maintenance ($38,196), supplies and materials ($39,536), and utilities and bulk energy ($53,758).

Heartland Transit Fund

The following graph presents selected data for the City's Heartland Transit Fund for the past five years:

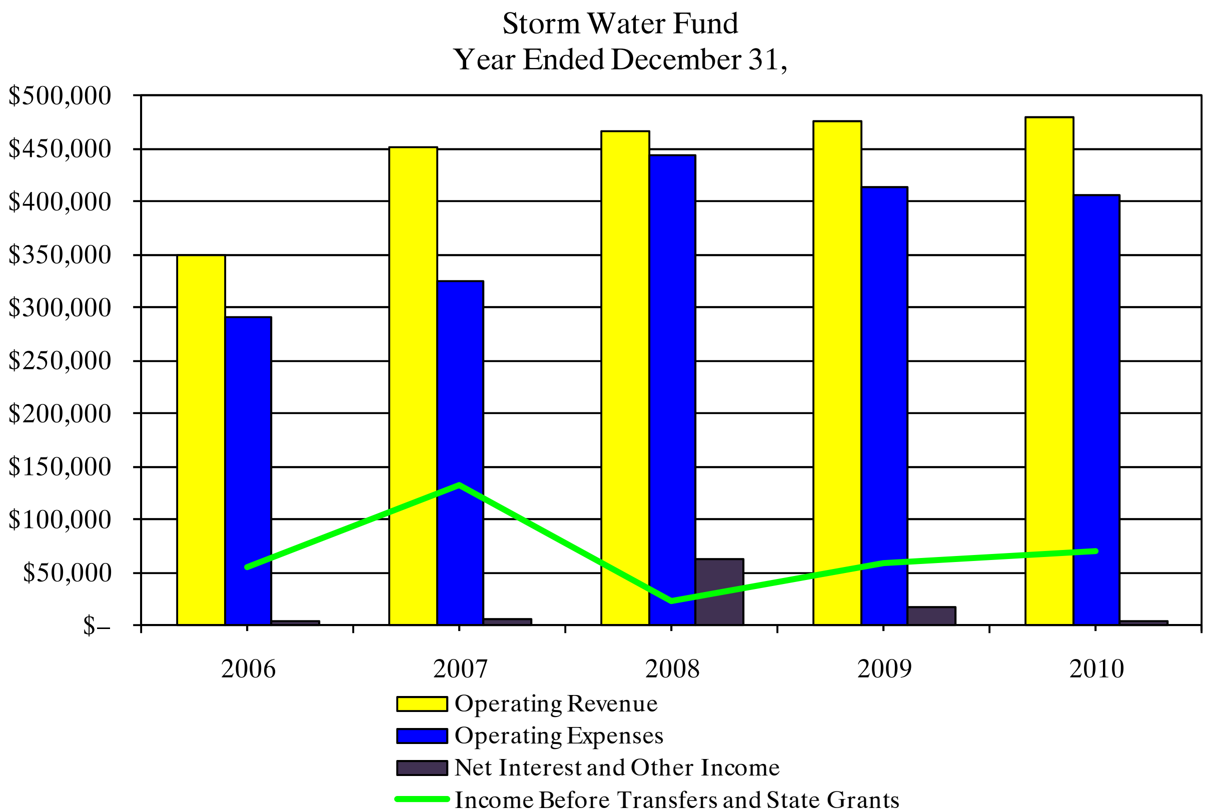


At December 31, 2010, the Heartland Transit Fund had total net assets of $66,478, of which $75,049 was invested in capital assets, net of related debt and a deficit balance of ($8,571) was unrestricted. The Heartland Transit Fund ended the year with a deficit working capital balance of ($8,313).

The Heartland Transit Fund operating revenue was $78,703 for 2010, an increase of $1,093. Operating expenses decreased $6,808 from the prior year. State and federal grant income decreased $40,121 in fiscal 2010, which was the main reason for the decline in operating results reflected in the table above.

Storm Water Fund

The following graph presents selected data for the City's Storm Water Fund for the past five years:

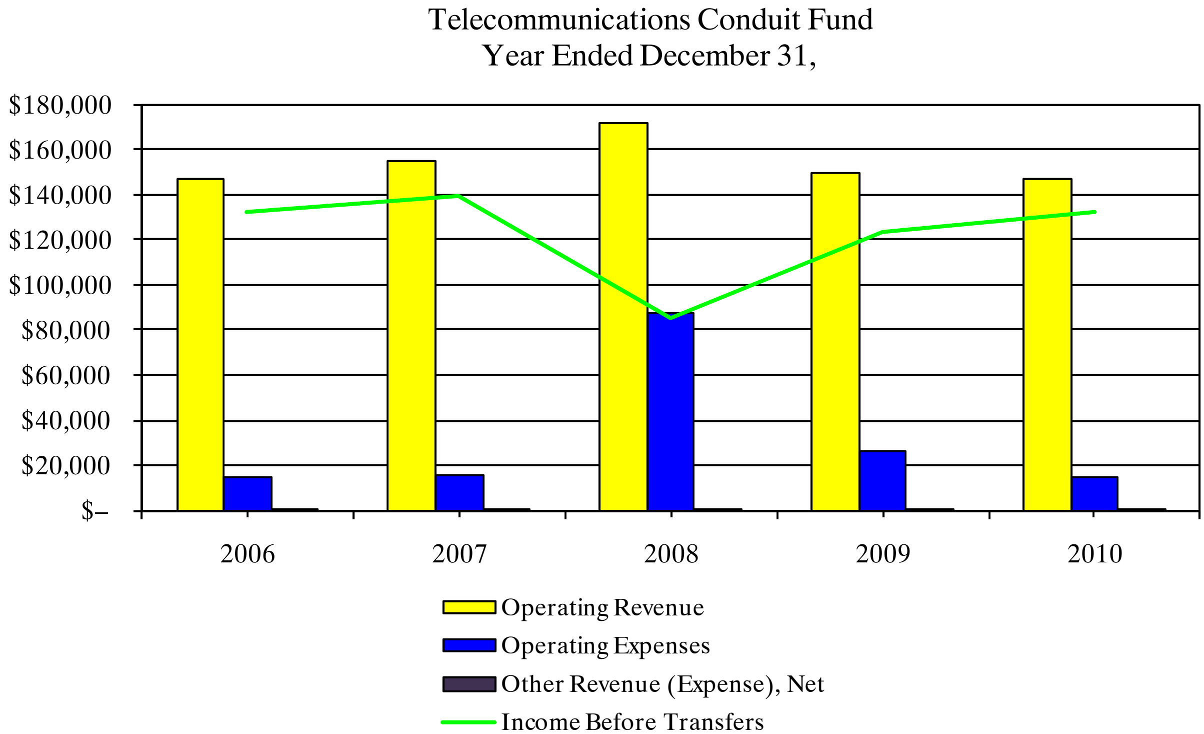


At December 31, 2010, the Storm Water Fund had total net assets of $5,102,826, of which $4,550,951 was invested in capital assets, net of related debt and $551,875 is considered unrestricted. The Storm Water Fund ended the year with working capital of $501,598.

The Storm Water Fund operating revenue was $480,057 for 2010, an increase of $5,021. Operating expenses decreased $8,735 to $404,915 in 2010.

Telecommunications Conduit Fund

The following graph presents selected data for the City's Telecommunications Conduit Fund for the past five years:

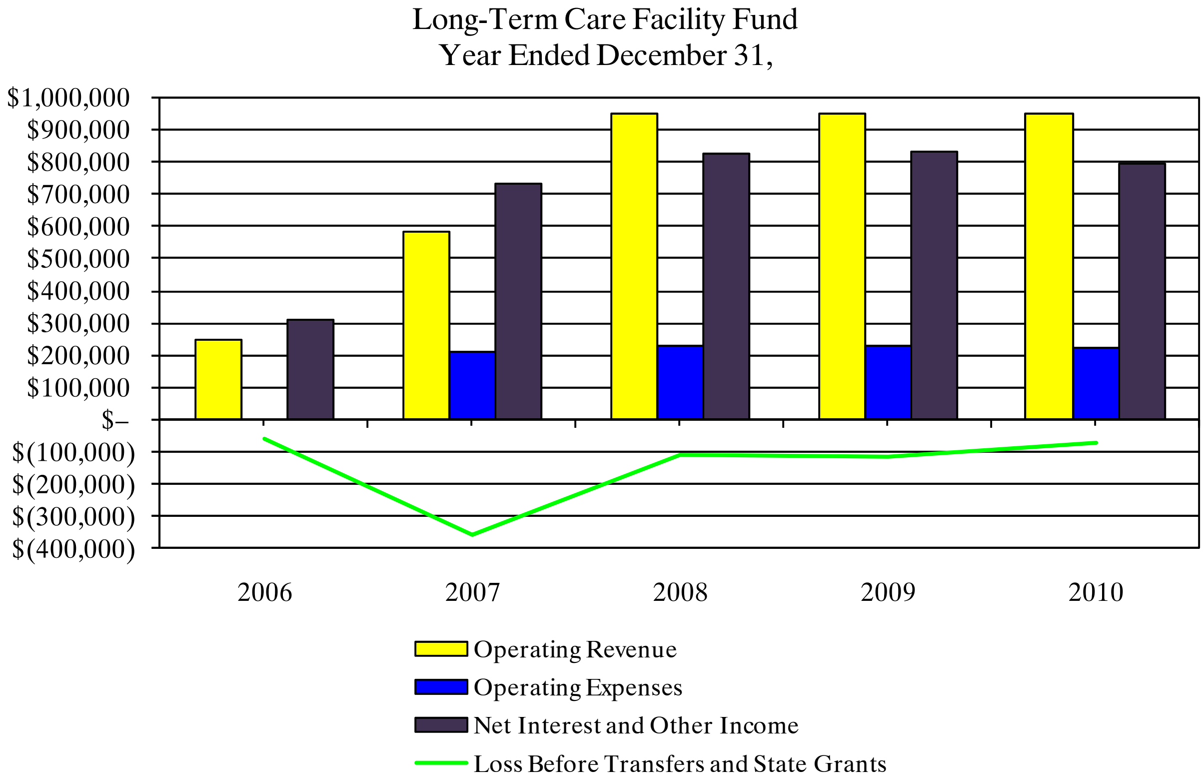


At December 31, 2010, the Telecommunications Conduit Fund had total net assets of $290,701, of which $282,614 was invested in capital assets, net of related debt and $8,087 was considered unrestricted. The Telecommunications Conduit Fund ended the year with working capital of $8,087.

The Telecommunications Conduit Fund operating revenue was $146,881 for 2010, a decrease of $3,137 (2.1 percent). Operating expenses decreased $12,129 from the prior year related to decreases in professional services of $12,305 in the current year.

Long-Term Care Facility Fund

The following graph presents selected data for the City's Long-Term Care Facility Fund for the past five years:

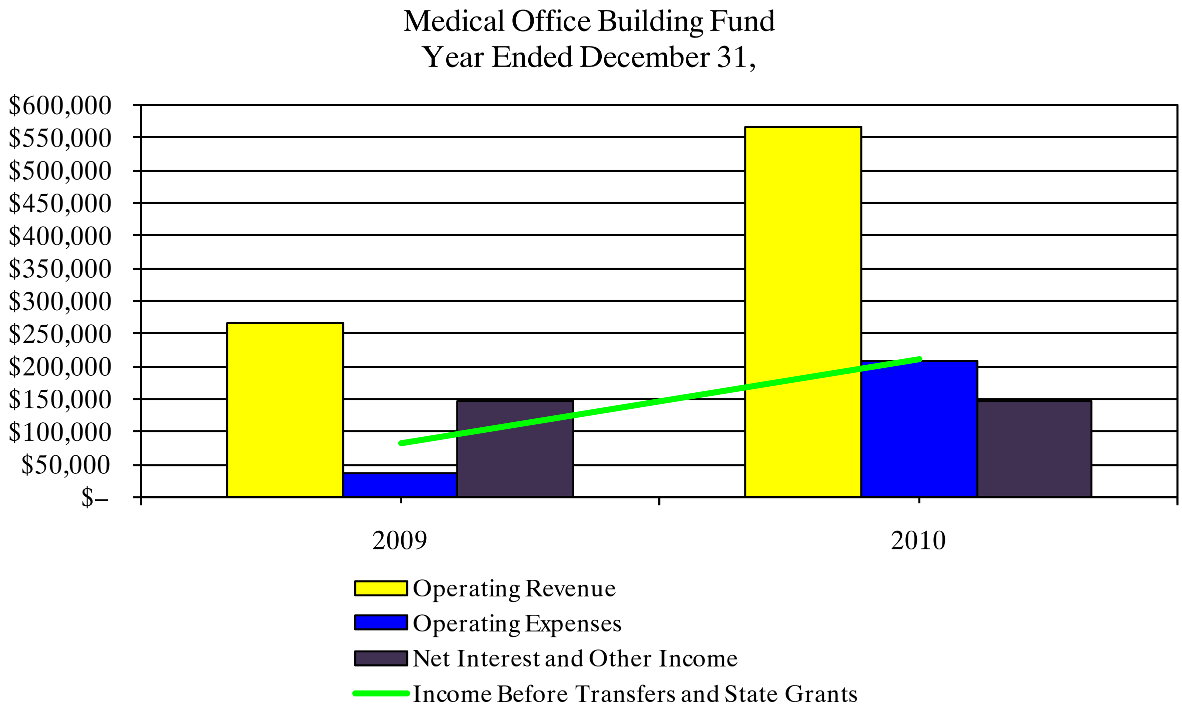


At December 31, 2010, the Long-Term Care Facility Fund had a total net assets deficit of ($712,269), of which a deficit of ($835,172) was invested in capital assets, net of related debt; $106,800 was restricted for debt service; and $16,103 was considered unrestricted.

The Long-Term Care Facility Fund is used to collect lease revenue and pay debt service on the long-term care facility.

Medical Office Building Fund

The following table presents selected data for the City's Medical Office Building Fund for the past two years:



At December 31, 2010, the Medical Office Building Fund had total net assets of $3,220,481, of which $2,963,139 was invested in capital assets, net of related debt; and $257,342 was unrestricted.

The Medical Office Building Fund is used to account for the construction of the new medical office building which opened in 2009. This fund is also used to collect lease revenue and pay debt service on this same facility.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The City's financial statements include fund-based information that focuses on budgetary compliance, and the sufficiency of the City's current assets to finance its current liabilities. The Governmental Accounting Standards Board (GASB) Statement No. 34 reporting model also requires the inclusion of two government-wide financial statements designed to present a clear picture of the City as a single, unified entity. These government-wide statements provide information on the total cost of delivering services, including capital assets and long-term liabilities.

Statement of Net Assets

The Statement of Net Assets essentially tells you what your city owns and owes at a given point in time, the last day of the fiscal year. Theoretically, net assets represent the resources the City has leftover to use for providing services after its debts are settled. However, those resources are not always in spendable form, or there may be restrictions on how some of those resources can be used. Therefore, the Statement of Net Assets divides the net assets into three components:

- **Invested in Capital Assets, Net of Related Debt** – The portion of net assets reflecting equity in capital assets (i.e. capital assets minus related debt).
- **Restricted Net Assets** – The portion of net assets equal to resources whose use is legally restricted minus any non-capital-related liabilities payable from those same resources.
- **Unrestricted Net Assets** – The residual balance of net assets after the elimination of *invested in capital assets, net of related debt* and *restricted net assets*.

The following table presents the City's net assets as of December 31, 2010 and 2009 for governmental activities and business-type activities:

	As of December 31, 2010	As of December 31, 2009	Increase (Decrease)
Net assets			
Governmental activities			
Invested in capital assets, net of related debt	$ 21,518,399	$ 18,240,391	$ 3,278,008
Restricted	7,165,093	10,285,029	(3,119,936)
Unrestricted	4,012,078	1,832,966	2,179,112
Total governmental activities	32,695,570	30,358,386	2,337,184
Business-type activities			
Invested in capital assets, net of related debt	41,465,453	45,573,842	(4,108,389)
Restricted	1,570,995	1,178,214	392,781
Unrestricted	8,330,634	4,876,462	3,454,172
Total business-type activities	51,367,082	51,628,518	(261,436)
Total net assets	$ 84,062,652	$ 81,986,904	$ 2,075,748

Many of the City's net assets are restricted by virtue of external restrictions (statutory reserves) or by the nature of the fund they are in. Further, a significant portion of net assets have been identified as invested in capital assets, net of related debt, which leaves the balance to unrestricted.

Statement of Activities

The Statement of Activities tracks the City's yearly revenues and expenses, as well as any other transactions that increase or reduce total net assets. These amounts represent the full cost of providing services. The Statement of Activities provides a more comprehensive measure than just the amount of cash that changed hands, as reflected in the fund-based financial statements. This statement includes the cost of supplies used, depreciation of long-lived capital assets, and other accrual-based expenses.

The following table presents the change in net assets of the City for the years ended December 31, 2010 and 2009:

	2010			2009
	Expenses	Program Revenues	Net Difference	Net Difference
Net (expense) revenue				
Governmental activities				
General government	$ 1,365,379	$ 493,695	$ (871,684)	$ (825,279)
Public safety	2,416,244	744,965	(1,671,279)	(1,662,465)
Public works	1,617,306	1,087,288	(530,018)	(1,433,492)
Parks and recreation	1,419,589	134,835	(1,284,754)	(1,316,197)
Economic development	932,456	318,908	(613,548)	(296,453)
Interest on long-term debt	394,206	–	(394,206)	(592,178)
Business-type activities				
Electric	9,397,141	10,070,045	672,904	439,403
Water	1,697,463	1,825,801	128,338	3,348,217
Environmental services	643,048	727,436	84,388	62,420
Wastewater	2,836,726	3,370,057	533,331	505,259
Transit	286,001	279,010	(6,991)	25,229
Storm sewer	415,085	480,100	65,015	73,847
Telecommunications conduit	14,505	146,881	132,376	123,384
Long-term care facility	1,021,600	950,514	(71,086)	(112,913)
Medical office building	357,481	567,022	209,541	81,213
	$ 24,814,230	$ 21,196,557	(3,617,673)	(1,580,005)
General revenues				
Taxes			2,699,655	2,626,486
Unrestricted grants and contributions			2,625,153	2,733,461
Investment earnings			310,427	492,095
Transfers – component units			–	1,453,808
Other revenues			58,186	99,859
Total general revenues			5,693,421	7,405,709
Change in net assets			$ 2,075,748	$ 5,825,704

One of the goals of this statement is to provide a side-by-side comparison to illustrate the difference in the way the City's governmental and business-type operations are financed. The table clearly illustrates the dependence of the City's governmental operations on general revenues, such as property taxes and unrestricted grants. It also shows if the City's business-type activities are generating sufficient program revenues (service charges and program-specific grants) to cover expenses. This is critical given the current downward pressures on the general revenue sources.

ACCOUNTING AND AUDITING UPDATES

GASB STATEMENT NO. 54 – FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS

The objective of this statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This statement establishes fund balance classifications (nonspendable, restricted, committed, assigned, and unassigned) that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The definitions of the general, special revenue, capital projects, debt service, and permanent fund types are clarified by the provisions in this statement; which could necessitate changes in fund structure, particularly for existing special revenue funds. Elimination of the reserved component of fund balance in favor of a restricted classification will enhance the consistency between information reported in the government-wide statements and information in the governmental fund financial statements and avoid confusion about the relationship between reserved fund balance and restricted net assets. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2010.

GASB STATEMENT NO. 60 – ACCOUNTING AND FINANCIAL REPORTING FOR SERVICE CONCESSION ARRANGEMENTS

This statement provides accounting and financial reporting guidance for governments that participate as either a transferor or an operator in a service concession arrangement (SCA). SCAs are arrangements whereby a government transfers the rights to operate one of its capital assets to a third party operator (either a private party or another government) for consideration, with the operator then being compensated from the fees or charges collected in connection with the operation of the asset. To qualify as an SCA, an arrangement must meet all of the following criteria: 1) the transferor must convey to the operator both the right and the obligation to use one of its capital assets to provide services to the public; 2) the operator must provide significant consideration to the transferor; 3) the operator must be compensated from the fees or charges it collects from third parties; 4) the transferor must have the ability to either determine, modify, or approve what services are to be provided to whom at what price; and 5) the transferor must retain a significant residual interest in the service utility of the asset. This statement provides guidance to governments that are party to an SCA for reporting the assets, obligations, and flow of revenues that result from the arrangement; along with the required financial statement disclosures. The requirements of this statement must be implemented for fiscal year ending December 31, 2012, with earlier implementation encouraged.

GASB STATEMENT NO. 61 – THE FINANCIAL REPORTING ENTITY: OMNIBUS

This statement amends the current guidance in GASB Statement No. 14, “The Financial Reporting Entity,” for identifying and presenting component units. This statement changes the fiscal dependency criterion for determining component units. Potential component units that meet the fiscal dependency criterion for inclusion in the financial reporting entity under existing guidance will only be included if there is also “financial interdependency” (an ongoing relationship of potential financial benefit or burden) with the primary government. This statement also clarifies the types of relationships that are considered to meet the “misleading to exclude” criterion for inclusion as a component unit; changes the criteria for blending component units; gives direction for the determination and disclosure of major component units; and adds a requirement to report an explicit, measurable equity interest in a discretely presented component unit in a statement of position prepared using the economic resources measurement focus. The requirements of this statement must be implemented for fiscal year ending June 30, 2013, with earlier implementation encouraged.