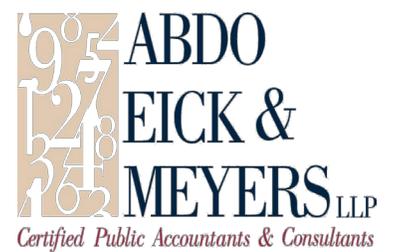


CITY OF MADISON LAKE
MADISON LAKE, MINNESOTA

MANAGEMENT LETTER

FOR THE YEAR ENDED
DECEMBER 31, 2013



Management, Honorable Mayor and City Council
City of Madison Lake, 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 Madison Lake, Minnesota (the City) as of and for the year ended December 31, 2013, which collectively comprise the City's basic financial statements and have issued our report thereon dated March 18, 2014. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated December 4, 2013. Professional standards also require that we communicate to you the following information related to our audit.

Our Responsibility under Auditing Standards Generally Accepted in the United States of America and *Government Auditing Standards*

As stated in our engagement letter, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. 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.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We consider the deficiencies described on the following pages as items 2013-001 and 2013-002 to be significant deficiencies.

2013-001 Segregation of duties

Condition: During our audit, we reviewed internal control procedures over payroll, disbursements, cash receipts, utility billing and investment transactions 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 Deputy Clerk controls and maintains the check stock, sets up employee records, posts activity to the general ledger, prepares payroll tax returns, and maintains the payroll records.

Recommendation: While we recognize the number of staff is not large enough to eliminate this deficiency it is important that the Council is aware of this condition and monitor all financial information. We recommend that in addition to approving payroll disbursements and wage rates, the City Council review amounts earned and accrued for compensated absences on an annual basis to compensate for control deficiencies with respect to payroll accruals. Additional controls might include review of payroll registers, earnings records, payroll reports, etc.

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 review of payroll registers, earnings records and payroll reports by the City Administrator.

Updated progress since prior year:

There is no change in this finding.

Internal control over disbursements

Cause: As a result of the small number of staff, the Deputy Clerk controls and maintains the check stock, sets up vendors, opens the mail, prepares checks, maintains the purchase journal and accounts payable records, and posts transactions to the general ledger.

Recommendation: While we recognize the number of staff is not large enough to eliminate this deficiency, we recommend that an individual separate from the Deputy Clerk review cancelled checks received with the bank statement and investigate items such as; void checks, inconsistencies in check sequence, possible alterations, and unusual payees. This individual should also review bank reconciliations for accuracy and timeliness of preparation. It is important that the Council is aware of this condition and monitor all financial information.

Management response:

The Council 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.

Updated progress since prior year:

There is no change in this finding.

2013-001 Segregation of duties - Continued

Internal control over cash receipts

Cause: As a result of the small number of staff, the Deputy Clerk sets up customers, maintains receipts journal and accounts receivable records, posts transactions to the general ledger, receives and endorses checks and currency, and prepares the deposit.

Recommendation: While we recognize the number of staff is not large enough to eliminate this deficiency it is important that the Council is aware of this condition and monitor all financial information. Additional controls might include obtaining and reviewing monthly receipt information.

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 review of deposits and regular review of financial statements and budget comparisons.

Updated progress since prior year:

There is no change in this finding.

Internal control over utility billing

Cause: As a result of the small number of staff, the Deputy Clerk approves new accounts, sets up customers and rates in the billing system, generates statements, enters readings, prepares the deposit and makes adjustments to accounts.

Recommendation: While we recognize the number of staff is not large enough to eliminate this deficiency it is important that the Council is aware of this condition and monitors all financial information. Additional controls might include reviewing billing registers, exception reports, adjustments to accounts and employee billing records.

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. The City is in the process of implementing online utility bill pay which will reduce the risk to the City.

Updated progress since prior year:

There is no change in this finding.

2013-001 Segregation of duties - Continued

Internal control over investment transactions

Cause: As a result of the small number of staff, the City Administrator receives investment statements in the mail, initiates transactions, maintains investment sub ledgers, and reconciles investment accounts.

Recommendation: While we recognize staff is not large enough to eliminate this deficiency it is important that the Council is aware of this condition and monitor all financial information. We recommend the City adopt an investment policy which outlines procedures for investment transactions that can be followed by the City Administrator.

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.

Updated progress since prior year:

There is no change in this finding.

2013-002 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: Under these circumstances, the most effective controls lie in management's knowledge of the City's financial operations. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost and other considerations. Regarding the specific situation listed above, we would offer the following specific recommendation: 1) Utilize a disclosure checklist to ensure all required disclosures are present and agree to work papers, and 2) Agree your Banyon receipt and disbursement information to the amount reported in the financial statements plus or minus any applicable accruals.

Management response:

For now, the City's management accepts the degree of risk associated with this condition and thoroughly reviews a draft of the financial statements.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free 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*.

Monthly Depreciation Estimates

The City records monthly depreciation expense estimates. This provides Council and management with current and updated operational information for the City's enterprise funds. The amount of this estimate for the coming year for the Water Utility fund is \$6,800 per month and the Sewer Utility fund is \$10,000 per month.

Written Policies and Procedures

Currently the City has very few written policies and procedures. We recommend the City start creating and adopting written policies and procedures. This could include accounting policies and procedures, investment policy, job descriptions and any other deemed important. This is an important part of the City's internal control and will be helpful if there is staff turnover.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you through various means.

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. The requirements of GASB statement No. 61 was adopted for the year ended December 31, 2013. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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

Management's estimate of capital asset basis is based on estimated historical cost of the capital assets and depreciation is based on the estimated useful lives of capital assets. We evaluated the key factors and assumptions used to develop these accounting estimates in determining that it is reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

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 no journal entries that we consider to be audit entries or corrections of management decisions.

We also assisted in preparing a number of year-end accounting entries. These were necessary to adjust the City's records at year end to correct ending balances. The City should establish more detailed processes and procedures to reduce the total number of entries in each category. The City will receive better and timelier information if the preparation of year-end entries is completed internally. We would be happy to provide training in order to reduce the number of entries in subsequent years.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 18, 2014.

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.

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, 2013.

General Fund

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

Minnesota municipalities must maintain substantial amounts of fund balance in order to meet their liquidity and working capital needs as an operating entity. That is because a substantial portion of your revenue sources (taxes and intergovernmental revenues) are received in the last two months of each six-month cycle.

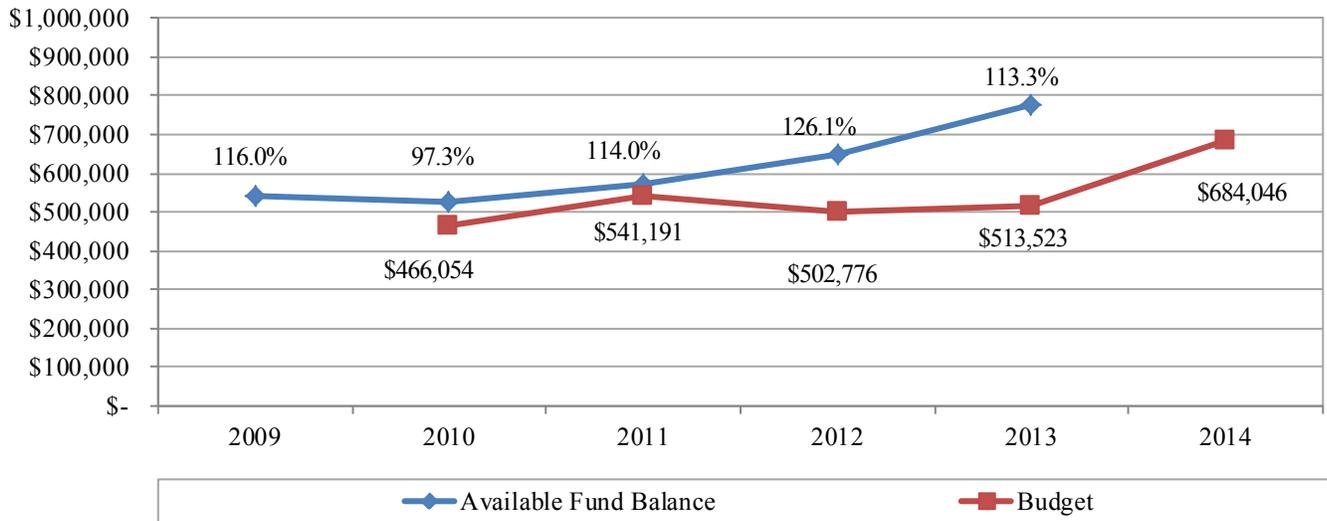
As you can see from the following information, it is necessary to maintain fund balance in order to keep pace with the increasing operating budget. *This information is also presented in graphic form below.*

Year	Available Fund Balance December 31 (1)	Budget Year	General Fund Budget	Percent of Fund Balance to Budget
2009	\$ 540,597	2010	\$ 466,054	116.0 %
2010	526,685	2011	541,191	97.3
2011	573,395	2012	502,776	114.0
2012	647,643	2013	513,523	126.1
2013	775,233	2014	684,046	113.3

(1) Includes amounts assigned for capital outlay.

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

Available Fund Balance/Budget Comparison



We have compiled a peer group average derived from information we have requested from the Office of the State Auditor and then compiled data for Cities of the 4th class which have populations below 2,500. In 2011 and 2012, the average General fund balance as a percentage of expenditures was 82 percent and 86, percent, respectively. Based on comparison to the peer groups, the City’s General fund balance is above that average.

The General fund balance increased by \$123,238 in 2013. The total available (including assigned) fund balance of \$775,233 represents 113.3 percent of the 2014 budget. Many other organizations, including the Office of the State Auditor (the OSA) and League of Minnesota Cities (LMC) recommend that a fund balance reserve be anywhere from 35 to 50 percent of planned expenditures. We concur with those recommendations.

Although there is no legislation regulating fund balance, it is a good policy to assign intended use of fund balance. This helps address citizen concerns as to the use of fund balance and tax levels. The City should consider documenting assignments for intended use of fund balance at and above the 50 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. So at the current level, the fund balance exceeds 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 2013 General fund operations are summarized as follows:

	Budgeted Amounts		Actual Amounts	Variance with Final Budget
	Original	Final		
Revenues	\$ 575,447	\$ 575,447	\$ 579,414	\$ 3,967
Expenditures	513,523	513,523	491,608	21,915
Excess of revenues over expenditures	61,924	61,924	87,806	25,882
Other financing sources (uses)				
Transfers in	42,518	42,518	143,398	100,880
Transfers out	(104,442)	(104,442)	(107,966)	(3,524)
Total other financing sources (uses)	(61,924)	(61,924)	35,432	97,356
Net change in fund balances	\$ -	\$ -	123,238	\$ 123,238
Fund balances, January 1			672,542	
Fund balances, December 31			\$ 795,780	

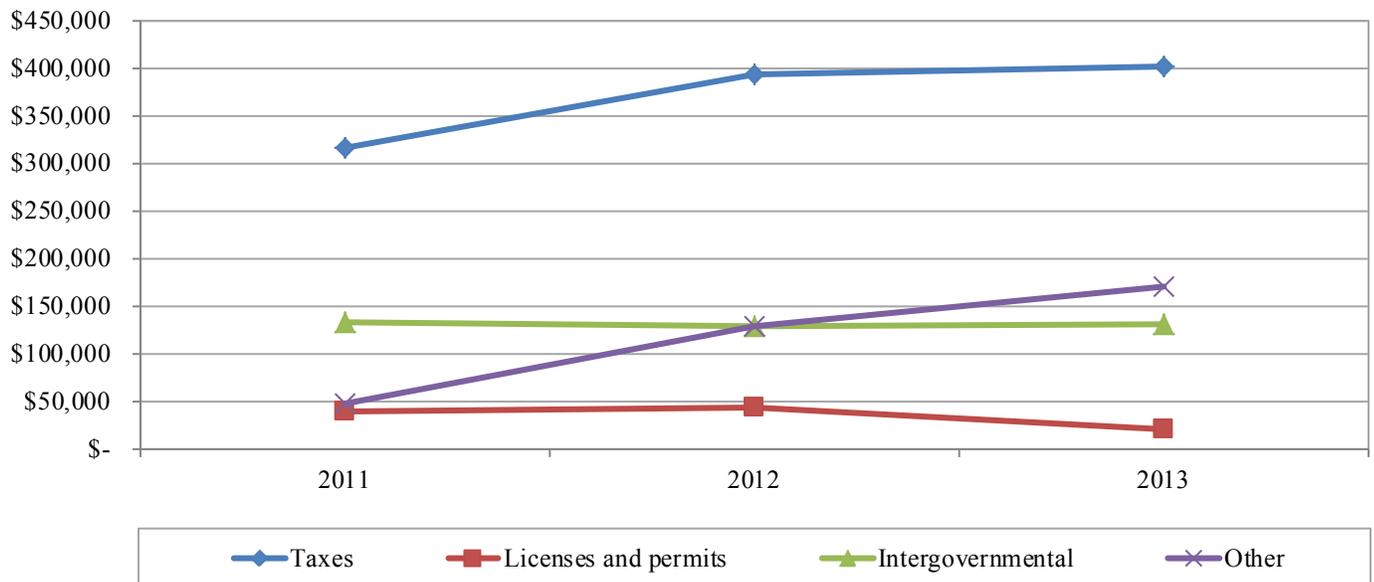
A few of the larger budget variances are as follows:

- Investment earnings were under budget by \$5,831. This is due to a decrease in market value of investments.
- Intergovernmental revenues were over budget by \$9,827.
- Fines and forfeits were under budget by \$8,038.
- City clerk personal services expenditures were under budget by \$9,400.
- Transfers in were over budget by \$100,880. This was due to the closing of the 2003 G.O. Refunding Bonds fund closing to the General fund.
- Public safety capital outlay expenditures were under budget by \$18,347.

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

Source	2011	2012	2013	Percent of Total	Per Capita
Taxes	\$ 314,946	\$ 392,255	\$ 402,085	55.7 %	\$ 382
Licenses and permits	38,349	42,852	20,458	2.8	19
Intergovernmental	132,345	128,689	130,228	18.0	124
Charges for services	2,296	2,692	3,125	0.4	3
Fines and forfeits	28,150	29,349	11,962	1.7	11
Investment earnings	7,304	3,425	1,169	0.2	1
Miscellaneous	9,257	21,279	10,387	1.4	10
Transfers in	-	71,736	143,398	19.8	136
Total revenues and transfers	\$ 532,647	\$ 692,277	\$ 722,812	100.0 %	\$ 686

General Fund Revenues by Source

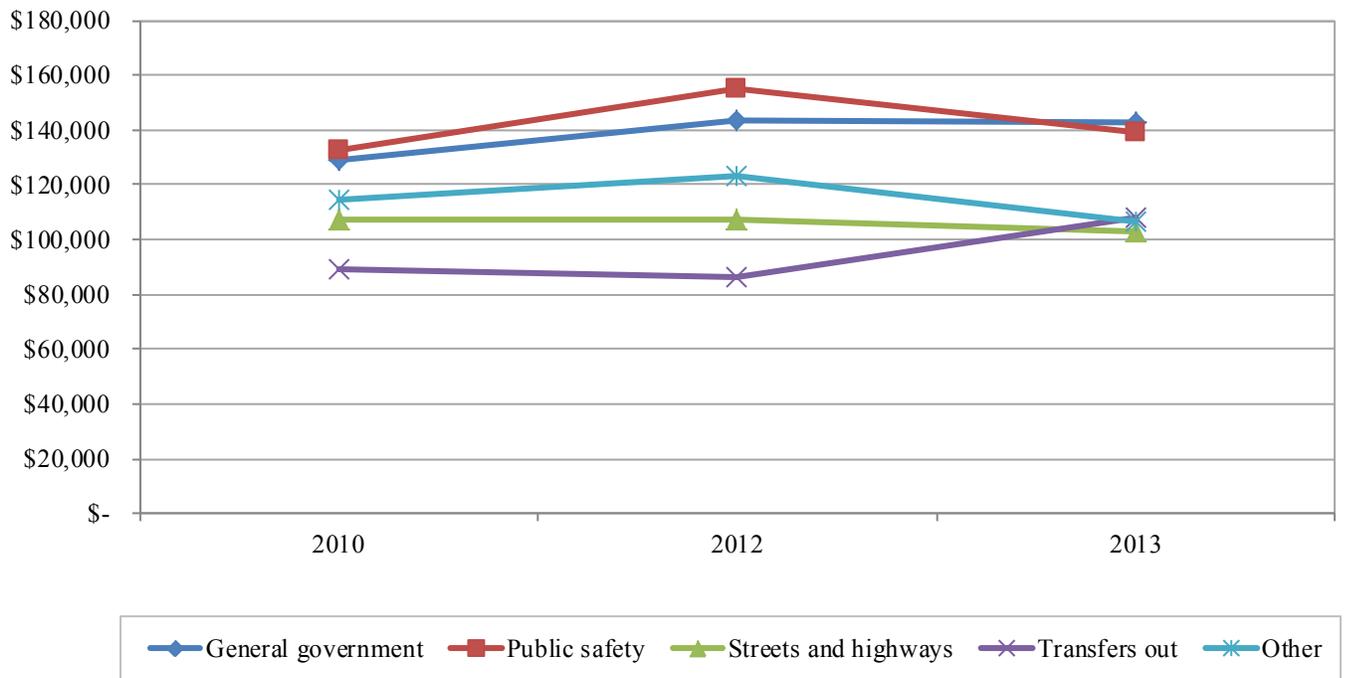


A comparison of General fund expenditures and transfers for the last three years is presented below:

Program	2011	2012	2013	Percent of Total	Per Capita	Peer Group Per Capita
Current						
General government	\$ 129,018	\$ 143,180	\$ 142,516	23.8 %	\$ 135	\$ 182
Public safety	132,579	155,410	139,428	23.3	132	212
Streets and highways	107,168	107,460	103,121	17.2	98	158
Culture and recreation	10,535	10,457	10,223	1.7	10	70
Economic development	5,054	6,380	6,532	1.1	6	6
Miscellaneous	905	772	811	0.1	1	25
Total current	385,259	423,659	402,631	67.2	382	653
Capital outlay	97,825	105,247	88,977	14.8	84	69
Transfers out	89,363	86,116	107,966	18.0	103	-
Total expenditures and transfers	<u>\$ 572,447</u>	<u>\$ 615,022</u>	<u>\$ 599,574</u>	<u>100.0 %</u>	<u>\$ 569</u>	<u>\$ 722</u>

The above chart compares the amount your City spends per capita, in comparison to a peer group. The peer group average is 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 populations 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 2013 and 2012 and the net change:

Fund	Fund Balances December 31,		Increase (Decrease)
	2013	2012	
Major			
Fire	\$ 443,011	\$ 387,744	\$ 55,267
Economic Development Loan - Federal	385,830	313,227	72,603
Nonmajor			
Economic Development Loan - State	23,116	20,091	3,025
Gambling	1,861	4,114	(2,253)
Total	<u>\$ 853,818</u>	<u>\$ 725,176</u>	<u>\$ 128,642</u>

Debt Service Funds

Debt Service funds are a type of governmental fund to account for the accumulation of resources for the payment of interest and principal on debt (other than enterprise fund debt).

Debt Service funds may have one or a combination of the following revenue sources pledged to retire debt as follows:

- Property taxes - Primarily for general City benefit projects such as parks and municipal buildings. Property taxes may also be used to fund special assessment bonds which are not fully assessed.
- Tax increments - Pledged exclusively for tax increment/economic development districts.
- Capitalized interest portion of bond proceeds - After the sale of bonds, the project may not produce revenue (tax increments or special assessments) for a period of one to two years. Bonds are issued with this timing difference considered in the form of capitalized interest.
- Special assessments - Charges to benefited properties for various improvements.

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

- Residual project proceeds from the related capital projects fund
- Investment earnings
- State or Federal grants
- Transfers from other funds

The following is a summary of Debt Service fund assets and outstanding debt as of December 31, 2013:

Debt Description	Total Cash and Investments	Total Assets	Outstanding Debt	Maturity Date
G.O. Special Assessment Bonds				
G.O. Public Improvement Revolving Bonds of 2004B	\$ 51,794	\$ 137,273	\$ 90,000	2016
G.O. Improvement Bonds of 2004A	32,265	41,965	60,000	2015
G.O. Improvement Bonds of 2006A	16,203	25,248	75,000	2018
	<u>\$ 100,262</u>	<u>\$ 204,486</u>	<u>\$ 225,000</u>	
Total All Debt Service Funds				
			<u>\$ 15,904</u>	
Future Interest on Debt				

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 assessment 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.

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 2013 fund balances with 2012:

Fund	Fund Balances		Increase (Decrease)
	December 31, 2013	2012	
Major			
Public Improvement Revolving	\$ 693,566	\$ 665,931	\$ 27,635
2014 Construction Fund	(634,586)	-	(634,586)
Nonmajor			
Tax Increment District #2-8	-	(4,198)	4,198
Northwest Project	-	9,288	(9,288)
	<u>\$ 58,980</u>	<u>\$ 671,021</u>	<u>\$ (612,041)</u>
Total			

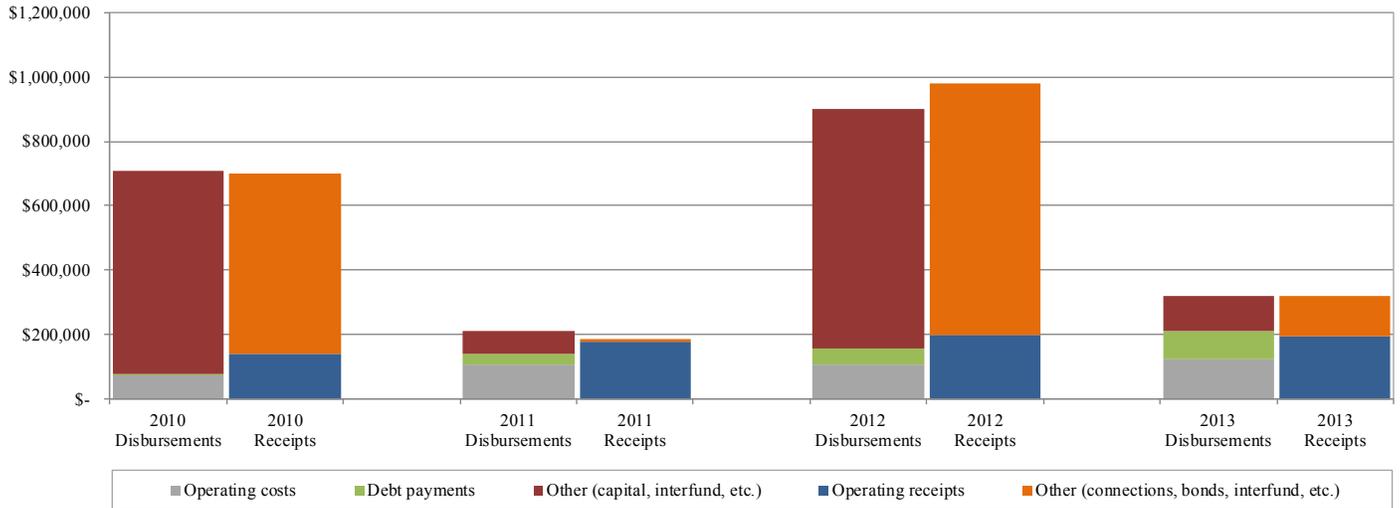
The City should analyze projects' status each year and close those that are completed. Any deficits should be evaluated to ensure they are consistent with financing expectations. The 2014 Construction fund deficit is planned to be funded with the issuance of bonds in 2014.

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.

A comparison of the enterprise fund cash flow and cash balances for the past four years is as follows:

Water Utility Cash Flow



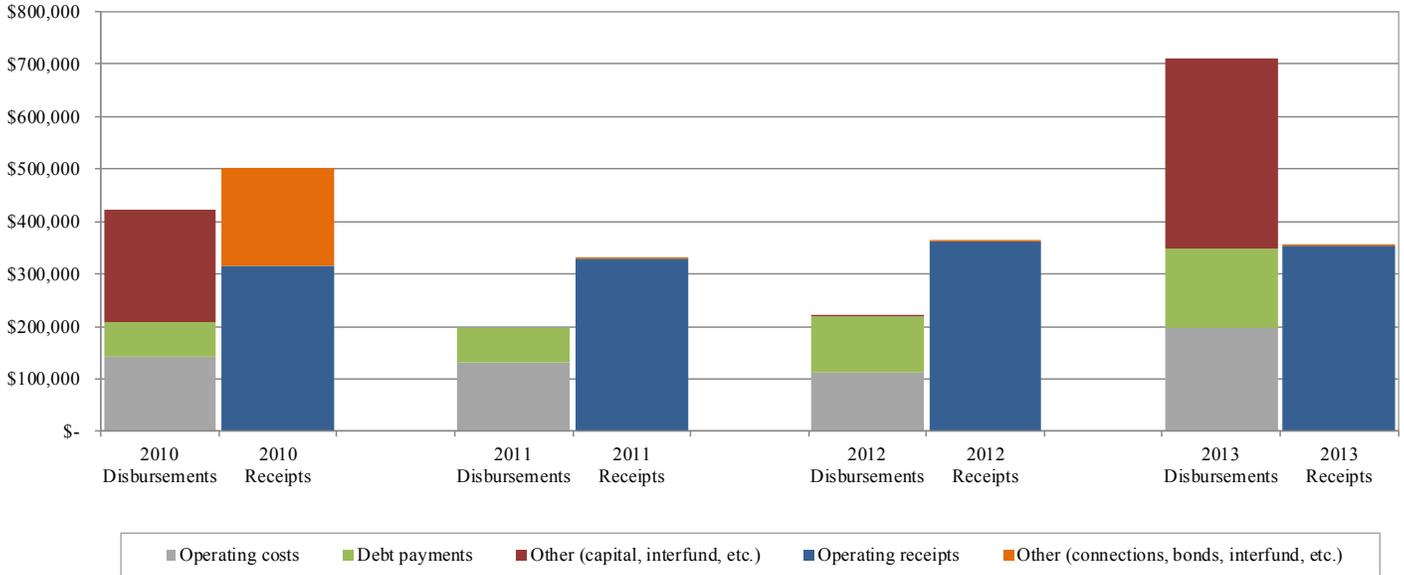
Water Utility Cash Balance



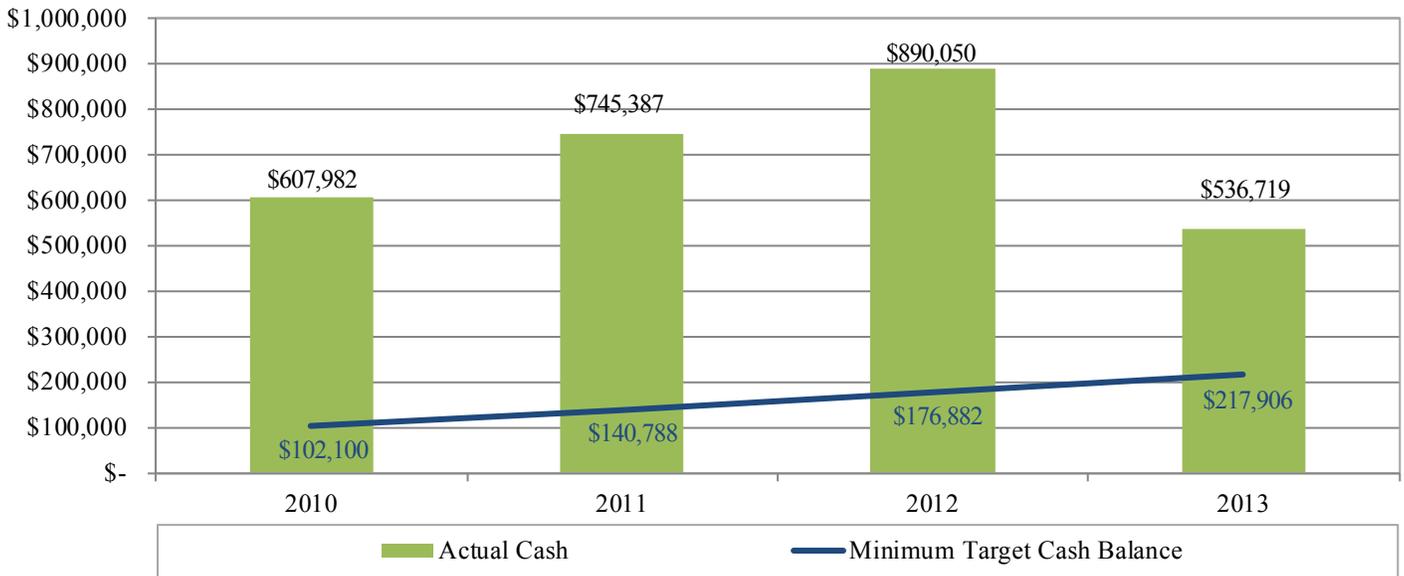
The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments.

	2010	2011	2012	2013
Bonds payable	<u>\$ 564,919</u>	<u>\$ 546,139</u>	<u>\$ 1,316,495</u>	<u>\$ 1,278,781</u>

Sewer Utility Cash Flow



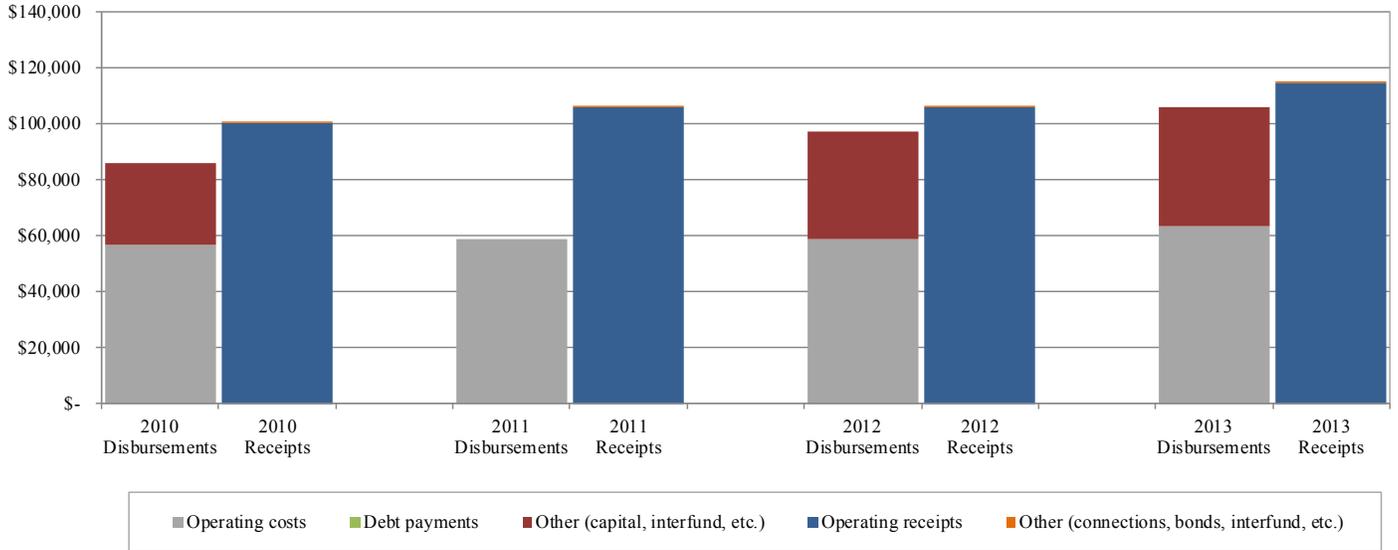
Sewer Fund Cash Balance



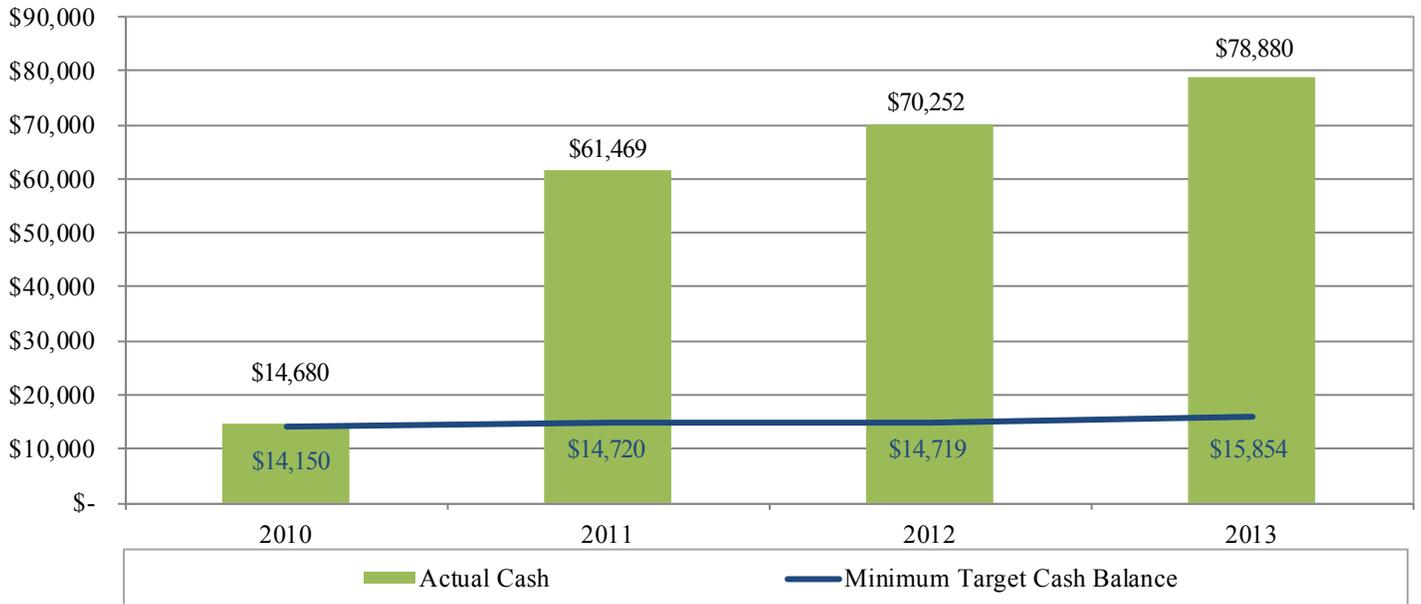
The minimum target cash balance is based on 25 percent of the operating costs plus one year of debt services payments. The Sewer Fund has advanced money for the 2014 construction fund in the amount of \$359,071 as of December 31, 2013.

	2010	2011	2012	2013
Bonds and loans payable	<u>\$ 589,992</u>	<u>\$ 535,916</u>	<u>\$ 1,650,214</u>	<u>\$ 1,532,923</u>

Refuse Utility Cash Flow



Refuse Utility Cash Balance



The minimum target cash balance is based on 25 percent of the operating costs.

Government-wide and Other Ratios

Ratio Analysis

The following captures a few ratios from the City's financial statements that give some additional information for trend and peer group analysis. The peer group average is derived from information we have requested from the Office of the State Auditor. The peer group averages used are for cities of the 4th class (a separate subgroup of those under 2,500 population has been developed for comparison purposes). The majority of these ratios facilitate the use of economic resources focus and accrual basis of accounting at the government-wide level. A combination of liquidity (ability to pay its most immediate obligations), solvency (ability to pay its long-term obligations), funding (comparison of financial amounts and economic indicators to measure changes in financial capacity over time) and common-size (comparison of financial data with other cities) ratios are shown below.

	Calculation	Source	Year			
			2010	2011	2012	2013
Debt to assets	Total liabilities/total assets	Government-wide	22% <i>37%</i>	19% <i>32%</i>	33% <i>36%</i>	31% <i>N/A</i>
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	2.1 <i>1.0</i>	2.4 <i>0.9</i>	2.4 <i>0.9</i>	2.0 <i>N/A</i>
Debt per capita	Bonded debt/population	Government-wide	\$ 2,037 <i>\$ 3,125</i>	\$ 1,595 <i>\$ 3,647</i>	\$ 3,293 <i>\$ 3,207</i>	\$ 2,884 <i>N/A</i>
Taxes per capita	Tax revenues/population	Government-wide	\$ 429 <i>\$ 407</i>	\$ 409 <i>\$ 636</i>	\$ 444 <i>\$ 444</i>	\$ 440 <i>N/A</i>
Current expenditures per capita	Governmental fund current expenditures / population	Governmental funds	\$ 611 <i>\$ 804</i>	\$ 504 <i>\$ 891</i>	\$ 507 <i>\$ 849</i>	\$ 478 <i>N/A</i>
Capital expenditures per capita	Governmental fund capital outlay / population	Governmental funds	\$ 193 <i>\$ 229</i>	\$ 207 <i>\$ 238</i>	\$ 479 <i>\$ 310</i>	\$ 2,177 <i>N/A</i>
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	45% <i>61%</i>	42% <i>59%</i>	39% <i>59%</i>	45% <i>N/A</i>
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	65% <i>59%</i>	52% <i>62%</i>	62% <i>61%</i>	52% <i>N/A</i>

Represents City of Madison Lake

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 financing with outstanding debt).

Debt Service Coverage Ratio (Solvency Ratio)

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

Bonded Debt per Capita (Funding Ratio)

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

Taxes per Capita (Funding Ratio)

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

Current Expenditures per Capita (Funding Ratio)

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

Capital Expenditures per Capita (Funding Ratio)

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

Capital Assets Percentage (Common-size Ratio)

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

Future Accounting Standard Changes

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

GASB Statement No. 67 - *The Financial Reporting for Pension Plans- an Amendment to GASB Statement No. 25*

Summary

The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

This Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria.

The requirements of Statements No. 25 and No. 50 remain applicable to pension plans that are not administered through trusts covered by the scope of this Statement and to defined contribution plans that provide postemployment benefits other than pensions.

This Statement is effective for financial statements for fiscal years beginning after June 15, 2013. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will improve financial reporting primarily through enhanced note disclosures and schedules of required supplementary information that will be presented by the pension plans that are within its scope. The new information will enhance the decision-usefulness of the financial reports of these pension plans, their value for assessing accountability, and their transparency by providing information about measures of net pension liabilities and explanations of how and why those liabilities changed from year to year. The net pension liability information, including ratios, will offer an up-to-date indication of the extent to which the total pension liability is covered by the fiduciary net position of the pension plan. The comparability of the reported information for similar types of pension plans will be improved by the changes related to the attribution method used to determine the total pension liability. The contribution schedule will provide measures to evaluate decisions related to the assessment of contribution rates in comparison to actuarially determined rates, when such rates are determined. In that circumstance, it also will provide information about whether employers and nonemployer contributing entities, if applicable, are keeping pace with actuarially determined contribution measures. In addition, new information about rates of return on pension plan investments will inform financial report users about the effects of market conditions on the pension plan's assets over time and provide information for users to assess the relative success of the pension plan's investment strategy and the relative contribution that investment earnings provide to the pension plan's ability to pay benefits to plan members when they come due.

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.

Future Accounting Standard Changes - Continued

GASB Statement No. 69 - *Government Combinations and Disposals of Government Operations*

Summary

This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations include a variety of transactions referred to as mergers, acquisitions, and transfers of operations.

The distinction between a government merger and a government acquisition is based upon whether an exchange of significant consideration is present within the combination transaction. Government mergers include combinations of legally separate entities without the exchange of significant consideration. This Statement requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. This Statement also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. This Statement defines the term operations for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations.

A disposal of a government's operations results in the removal of specific activities of a government. This Statement provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold. This Statement requires disclosures to be made about government combinations and disposals of government operations to enable financial statement users to evaluate the nature and financial effects of those transactions.

The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis. Earlier application is encouraged.

How the Changes in This Statement Will Improve Financial Reporting

Until now, governments have accounted for mergers, acquisitions, and transfers of operations by analogizing to accounting and financial reporting guidance intended for the business environment, generally APB Opinion No. 16, Business Combinations. This Statement provides specific accounting and financial reporting guidance for combinations in the governmental environment. This Statement also improves the decision usefulness of financial reporting by requiring that disclosures be made by governments about combination arrangements in which they engage and for disposals of government operations.

GASB Statement No. 70 - *Accounting and Financial Reporting for Nonexchange Financial Guarantees*

Summary

Some governments extend financial guarantees for the obligations of another government, a not-for-profit organization, a private entity, or individual without directly receiving equal or approximately equal value in exchange (a nonexchange transaction). As a part of this nonexchange financial guarantee, a government commits to indemnify the holder of the obligation if the entity or individual that issued the obligation does not fulfill its payment requirements. Also, some governments issue obligations that are guaranteed by other entities in a nonexchange transaction. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

This Statement requires a government that extends a nonexchange financial guarantee to recognize a liability when qualitative factors and historical data, if any, indicate that it is more likely than not that the government will be required to make a payment on the guarantee. The amount of the liability to be recognized should be the discounted present value of the best estimate of the future outflows expected to be incurred as a result of the guarantee. When there is no best estimate but a range of the estimated future outflows can be established, the amount of the liability to be recognized should be the discounted present value of the minimum amount within the range.

Future Accounting Standard Changes - Continued

This Statement requires a government that has issued an obligation guaranteed in a nonexchange transaction to report the obligation until legally released as an obligor. This Statement also requires a government that is required to repay a guarantor for making a payment on a guaranteed obligation or legally assuming the guaranteed obligation to continue to recognize a liability until legally released as an obligor. When a government is released as an obligor, the government should recognize revenue as a result of being relieved of the obligation. This Statement also provides additional guidance for intra-entity nonexchange financial guarantees involving blended component units.

This Statement specifies the information required to be disclosed by governments that extend nonexchange financial guarantees. In addition, this Statement requires new information to be disclosed by governments that receive nonexchange financial guarantees.

The provisions of this Statement are effective for reporting periods beginning after June 15, 2013. Earlier application is encouraged. Except for disclosures related to cumulative amounts paid or received in relation to a nonexchange financial guarantee, the provisions of this Statement are required to be applied retroactively. Disclosures related to cumulative amounts paid or received in relation to a nonexchange financial guarantee may be applied prospectively.

How the Changes in This Statement Will Improve Financial Reporting

The requirements of this Statement will enhance comparability of financial statements among governments by requiring consistent reporting by those governments that extend nonexchange financial guarantees and by those governments that receive nonexchange financial guarantees. This Statement also will enhance the information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees. This Statement also will augment the ability of financial statement users to assess the probability that governments will repay obligation holders by requiring disclosures about obligations that are issued with this type of financial guarantee.

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.

Future Accounting Standard Changes - Continued

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.

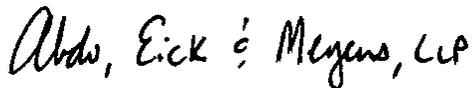
¹ *Note.* From GASB Pronouncements Summaries. Copyright 2014 by the Financial Accounting Foundation, 401 Merritt 7, Norwalk, CT 06856, USA, and is reproduced with permission.

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This communication is intended solely for the information and use of management, the City Council, management, and 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
Mankato, Minnesota
March 18, 2014