Management Report

for

City of Saint Peter, Minnesota

December 31, 2011

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, 2011. 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 18, 2012

Malloy, Montague, Karnowski, Radosevich, & Co., P.A.
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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, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City as of and for the year ended December 31, 2011. 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.

We did not audit the discretely presented component units' financial statements. These include the financial statements of the River's Edge Hospital and Clinic and the Housing and Redevelopment Authority (HRA). Those statements were audited by other auditors whose reports have been furnished to us. Our opinion on the basic financial statements, insofar as it relates to the amounts included for these organizations as component units of the City, is based solely on the reports of the other auditors.

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, 2011:

- 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 reported one deficiency involving internal control over compliance and operations. The deficiency is considered to be a significant deficiency in our testing of major federal programs and relates to the Capitalization Grant for Drinking Water State Revolving Funds. The result of our tests noted one instance of noncompliance relating to cash management applicable to this grant. As noted in the grant agreement, the requests for reimbursements were to be made by the City on a reimbursement basis only. During our audit testing, it was noted that the City did not properly disburse funds before grant funds were received by the City for one reimbursement request for this grant.

- We reported no findings in our testing of the City's compliance with Minnesota laws and regulations.

FOLLOW-UP ON PRIOR YEAR FINDINGS AND RECOMMENDATIONS

As a part of our audit of the City's financial statements for the year ended December 31, 2011, we performed procedures to follow-up on the findings and recommendations that resulted from our prior year audit. We reported the following findings that were corrected by the City in the current year.

- Minnesota Statute § 118A.03 requires that if a city's deposits exceed federal insurance coverage, excess deposits must be covered by corporate surety bonds or collateral that have a market value of at least 110 percent of such excess. Based on our testing, this requirement was not a finding for the City's deposit account for the year ended December 31, 2011.

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. For the year ended December 31, 2011, the City has implemented Governmental Accounting Standards Board (GASB) Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions." This statement established new fund balance classifications 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. It also clarifies existing governmental fund type definitions to improve the comparability of governmental fund financial statements

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.

We noted one uncorrected misstatement in the City's financial statements related to the City not reporting the City's net other post-employment benefit (OPEB) liability of $65,905. Management has determined that its effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

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:

- **Depreciation** – Management's estimates of depreciation expense are based on the estimated useful lives of the assets.
- **Self-insurance reserves** – Management's estimates of costs for unreported claims are based on the past history of claims reported.
- **Severance liabilities –** Management's estimate based on current rates of pay and sick leave balances.
- **Land Held for Resale –** Management's estimate is based on this asset are based on net realizable value (lower of cost or estimated sales price).
- **Allowance for Doubtful Accounts –** Management's estimate of the allowance for doubtful accounts is based on historical water and sewer revenues, historical loss levels, and an analysis of the collectability of individual accounts.

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.

The financial statement disclosures are neutral, consistent, and clear.

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 18, 2012.

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 INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. Other information, including the introductory section, combining and individual fund statements and schedules, and supplemental information accompanying the basic financial statements are presented for purposes of additional analysis and are not required parts of the basic financial statements.

With respect to the combining and individual fund statements and schedules 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 combining and individual fund statements and schedules to the underlying accounting records used to prepare the basic financial statements or to the basic financial statements themselves.

With respect to the introductory section and supplemental information accompanying the financial statements, our procedures were limited to reading this other information, and in doing so we did not identify any material inconsistencies with the audited financial statements.

FUNDING CITIES IN MINNESOTA

LEGISLATION

The 2011 legislative session began with the state facing a projected budget deficit of $6.2 billion (later revised down to $5.0 billion in the February 2011 Economic Forecast) for the 2012–2013 biennium. In addition, the 2010 election dramatically changed the state's political landscape. A Democratic Governor was in power for the first time since 1991, while Republicans had majority control of both the House and the Senate for the first time since 1971. Predictably, as the session progressed, the Governor and Legislature had difficulty agreeing on a state budget for the next biennium. Shortly after the 2011 regular session ended, the Governor vetoed eight major state appropriation bills and the omnibus tax bill passed by the Legislature, which left the majority of state agencies without a budget for the next fiscal year. This resulted in a shutdown of "nonessential" state agencies that began July 1, 2011 and effectively ended with the passing of appropriation bills in a special session on July 19th and 20th.

The large projected budget deficit facing the 2011 Legislature was typical of the financial challenges the state has experienced in recent years. Unfavorable economic conditions have caused a steady deterioration of the state's financial condition, which has resulted in a series of cuts and holdbacks in state aids to local governments and other entities. As was the case in the last biennium, the Legislature utilized several one-time revenue sources, transfers, and accounting shifts to minimize the need for tax increases or state aid cuts to balance the state budget.

The following is a summary of significant legislative activity passed in calendar year 2011 affecting the finances of Minnesota cities:

Local Government Aid (LGA) and Market Value Homestead Credit (MVHC) – One of the appropriation bills passed in the 2011 special session was the omnibus tax bill, which includes the appropriations for LGA and MVHC.

The Legislature retroactively reduced the fiscal 2011 appropriation for LGA by approximately $102 million, leaving a total appropriation of $425.3 million for 2011 LGA. Minnesota cities will receive 2011 LGA equal to the lesser of their final 2010 LGA (after the cuts by the Legislature and Governor) or their 2011 certified LGA amount. The first half LGA payment for 2011 was also delayed one week to July 27, so the reduced LGA amounts could be recomputed after the government shutdown. The total LGA appropriation for fiscal 2012 will be $425.2 million, with cities again receiving the lesser of their 2010 actual or 2011 certified amounts. In essence, this bill extended the LGA cuts originally made in fiscal 2010 for the two subsequent years. For fiscal 2013 and beyond, the LGA appropriation is set at $426.4 million, to be allocated using the LGA formula.

The omnibus tax bill also extended the 2010 MVHC reductions of approximately $48 million to fiscal 2011, with cities to receive the same allocation. Beginning in fiscal 2012, the MVHC reimbursement program is eliminated. Rather than receiving a property tax credit, qualifying homeowner taxpayers will have a portion of the market value of their house excluded from their taxable market value. This new system will provide homeowners property tax relief by shifting a portion of their potential tax burden to other property classifications, rather than directly reducing their taxes through a state paid tax credit reimbursement. While this new homestead exclusion is calculated in a similar manner to the repealed MVHC, the actual tax relief to individual homeowner taxpayers may vary significantly depending on the makeup of the taxing jurisdictions that levy on their particular property.

The agriculture market value credit, however, will continue as a state-paid tax credit.

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. 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 2011 Legislature passed an omnibus tax bill during the regular session that would have extended levy limits for two years (taxes payable in 2012 and 2013). However, this was among the bills vetoed by the Governor, and the final omnibus tax bill passed in the special session did not address levy limits.

Sales and Use Taxes – A number of changes and clarifications were made to Minnesota sales and use tax provisions, including:

- Made water used directly for public safety purposes (fighting fires) exempt from sales tax.
- Expanded the sales tax exemption for the lease of motor vehicles used as ambulances to the lease of vehicles used for emergency response.
- Added townships to the list of entities exempt from sales tax.
- Provided an exemption from sales tax for technology and electricity for qualifying large data centers as a business incentive.
- Clarified the sales tax regulations for online hotel sales.

"Buy American" Provision Repealed – The "Buy American" provision, enacted in 2010, which prohibited public employers from purchasing or requiring employees to purchase any uniforms, safety equipment, or protective accessories not manufactured in the United States, was repealed. Cities may continue to purchase American-made uniforms and equipment, but they are not required to do so.

Prohibition of Referendum Spending – Political subdivisions, including cities, are prohibited from expending funds to promote a referendum to support imposing a local option sales tax. The political subdivision may only expend funds to conduct the referendum.

Tax Exempt Period for Economic Development Property – The maximum allowable holding period for property held by a political subdivision for economic development to be exempt from property taxes was increased from eight years to nine years.

Concurrent Detachment of Parcels – State law for the concurrent detachment of property from one city to another has been changed. In the past, both cities involved had to support the change for it to be considered. Now, if the property owner and one of the involved cities petition for the detachment, the proposed boundary adjustment qualifies for consideration.

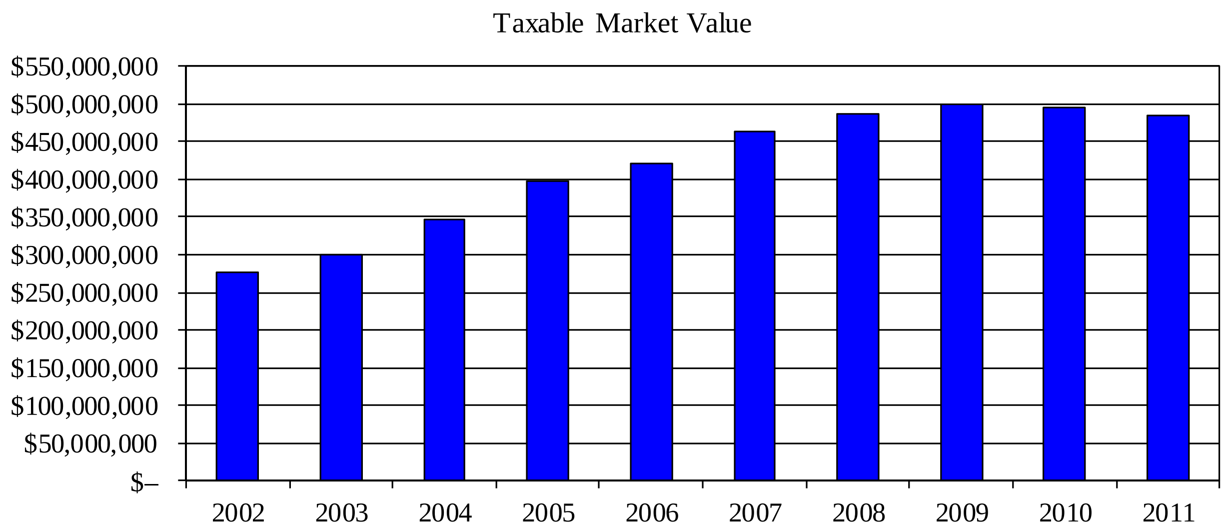
Civil Immunity for Donated Public Safety Equipment – Immunity from civil tort claims is extended to municipalities that donate public safety equipment to another municipality, unless the claim is a direct result of fraud or intentional misrepresentation. The statute defines "public safety equipment" as vehicles and equipment used in firefighter, ambulance and emergency medical treatment services, rescue, and hazardous material response.

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 decreases of 3.0 percent and 5.7 percent for taxes payable in 2010 and 2011, respectively, reflecting the weak housing market and economic conditions experienced in recent years. In comparison, the City's taxable market value decreased 1.0 percent for taxes payable in 2010 and 2.1 percent for taxes payable in 2011. The market value for taxes payable in 2011 is based on estimated values as of January 1, 2010.

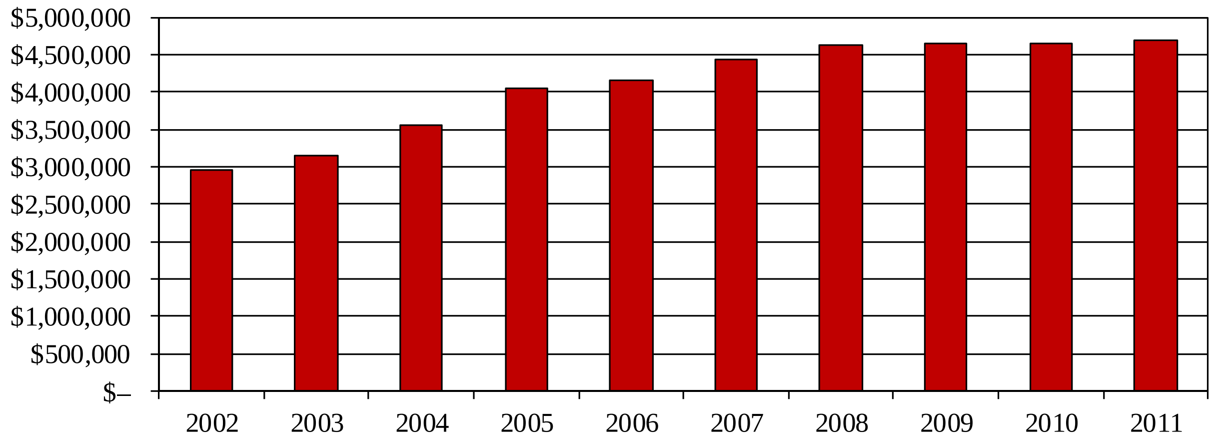
The following graph shows the City's changes in taxable market value over the past 10 years:



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 0.1 percent for 2010 and increased 0.7 percent for 2011.

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

Local Tax Capacity



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**	
	2010	2011	**2010**	**2011**
Average tax rate				
City	39.2	42.5	**43.4**	**43.5**
County	41.0	43.7	**51.5**	**52.8**
School	23.0	25.2	**13.8**	**15.6**
Special taxing	5.9	6.4	**0.5**	**0.5**
Total	109.1	117.8	**109.2**	**112.4**

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 in fiscal 2011 but the increase is smaller than what is being experienced state-wide.

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, 2010			**2009**	**2010**	**2011**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**10,917**	**11,196**	**11,196**
Property taxes	$ 386	$ 359	$ 407	**$ 187**	**$ 192**	**$ 187**
Tax increments	45	52	56	**45**	**39**	**45**
Franchise and other taxes	26	34	30	**12**	**11**	**11**
Special assessments	74	60	66	**10**	**12**	**8**
Licenses and permits	19	22	29	**15**	**28**	**13**
Intergovernmental revenues	291	271	149	**307**	**279**	**424**
Charges for services	89	83	76	**34**	**35**	**30**
Other	73	70	57	**145**	**111**	**111**
Total revenue	$ 1,003	$ 951	$ 870	**$ 755**	**$ 708**	**$ 829**

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 2011, governmental funds revenue per capita increased $121 per capita. The largest increase was in intergovernmental revenues. This includes grants from floods, Municipal Street Aid, and other state grants.

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, 2010			**2009**	**2010**	**2011**
Population	2,500–10,000	10,000–20,000	20,000–100,000	**10,917**	**11,196**	**11,196**
Current						
General government	$ 125	$ 102	$ 85	**$ 104**	**$ 105**	**$ 126**
Public safety	227	223	235	**207**	**205**	**208**
Street maintenance and lighting	108	107	86	**102**	**99**	**109**
Parks and recreation	75	93	87	**103**	**122**	**127**
All other	81	81	91	**127**	**51**	**95**
	$ 616	$ 606	$ 584	**$ 643**	**$ 582**	**$ 665**
Capital outlay and construction	$ 299	$ 321	$ 232	**$ 234**	**$ 82**	**$ 220**
Debt service						
Principal	$ 180	$ 181	$ 111	**$ 104**	**$ 82**	**$ 110**
Interest and fiscal	63	53	43	**54**	**36**	**31**
	$ 243	$ 234	$ 154	**$ 158**	**$ 118**	**$ 141**

The City's governmental funds current per capita expenditures were less than state-wide averages for cities in the same population class for fiscal 2010. The departments that were lower than state-wide averages include public safety, street maintenance and lighting, and other.

The City's governmental funds current per capita expenditures increased $83 per capita in fiscal 2011. General government expenditures increased due to the demolition of the old hospital and nursing home facility totaling about $25 per capita. The "all other" 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. In fiscal 2011, loans issued increased $23 per capita. The "all other" category includes tax increment district activity that can vary each year based on changes in yearly activity.

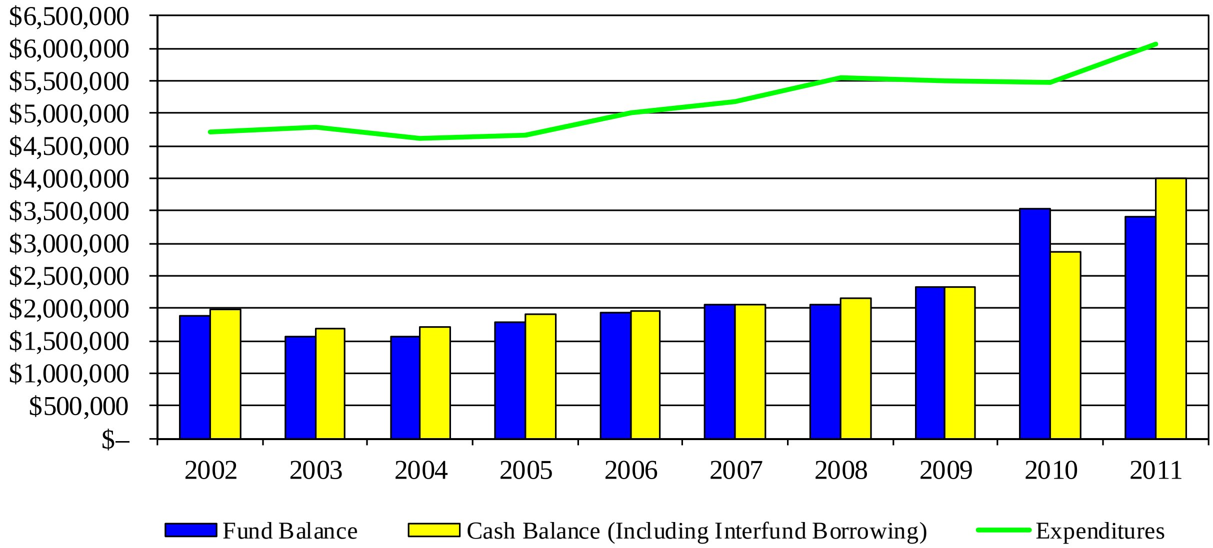
FINANCIAL TRENDS AND CONDITIONS

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.

General Fund Financial Position
Year Ended December 31,



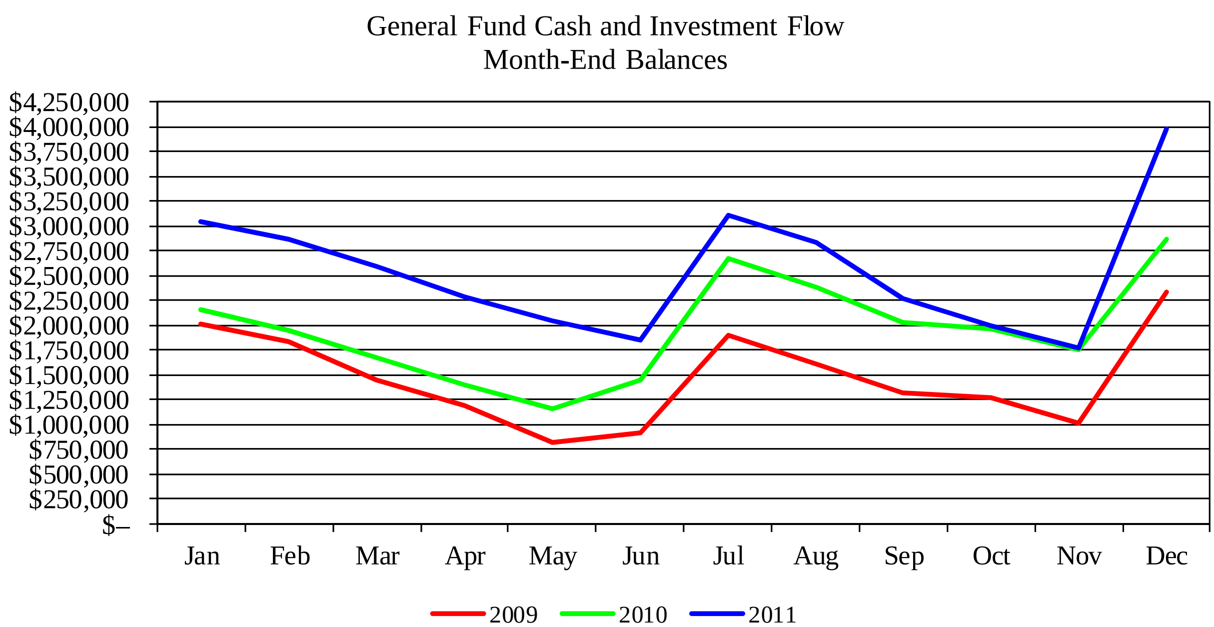
The City's General Fund financial position improved in 2011, ending the year with a fund balance of $3,397,334 and a cash balance, including interfund borrowing, of $3,984,891. In 2011, the City's fund balance decreased $122,184.

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.

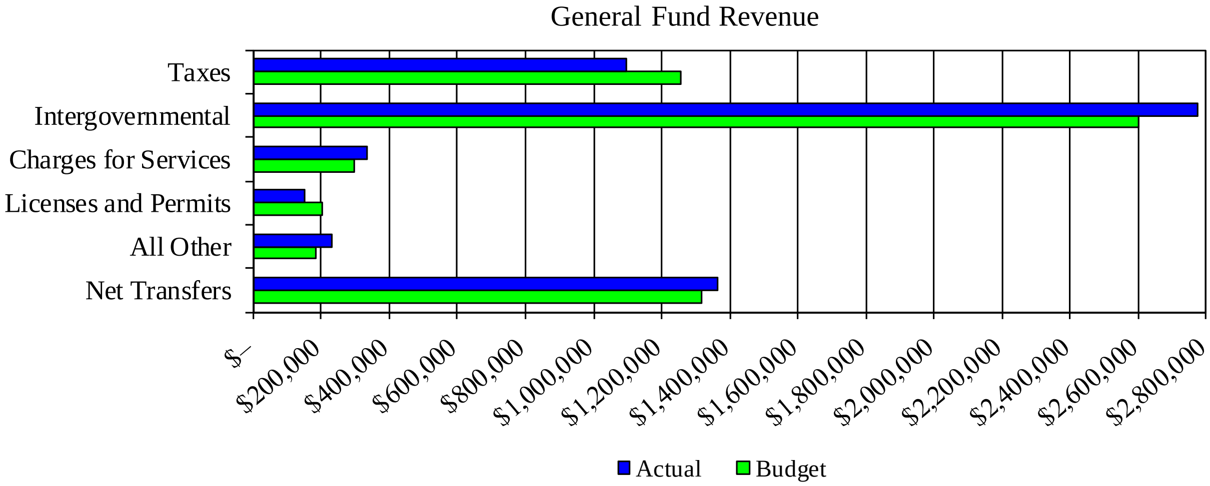
The City Council has formally adopted a fund balance policy regarding the fund balance for the General Fund. The policy establishes that the City will strive to maintain an unassigned fund balance in the General Fund in the range of 35 to 50 percent of the following year's budgeted expenditures. At December 31, 2011 the unassigned fund balance of the General Fund was 51.8 percent of the subsequent year's budgeted expenditures.

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 84 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.

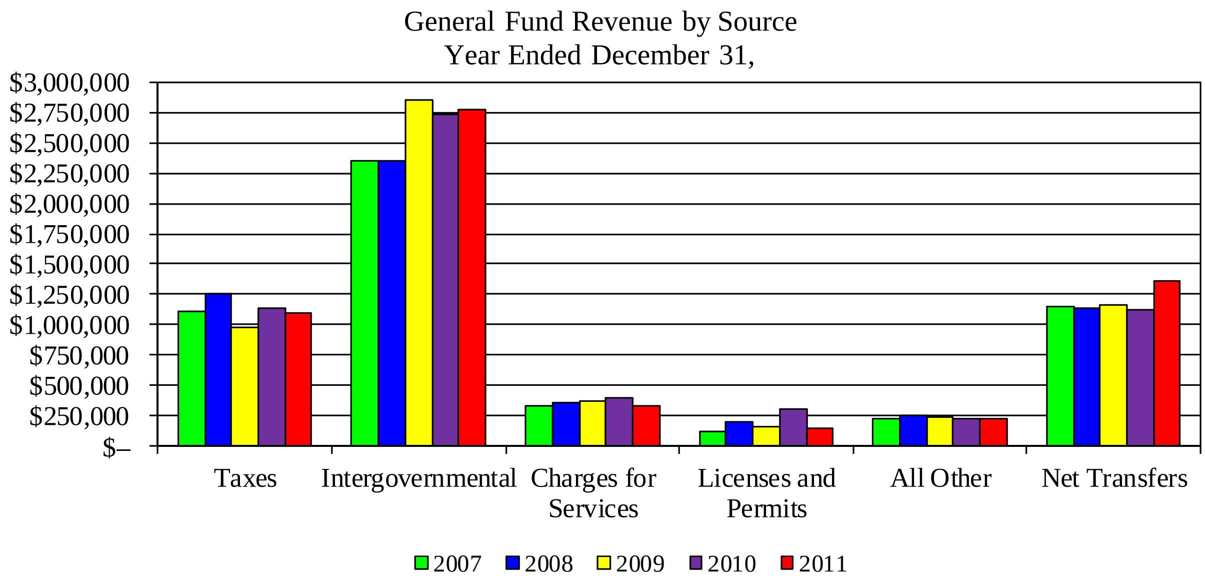


The following graph reflects the City's General Fund revenues and net transfers, budget and actual, for 2011:



Total General Fund revenues and net transfers in 2011 were $5,950,636, which was $87,068 (1.5 percent) more than the final budget.

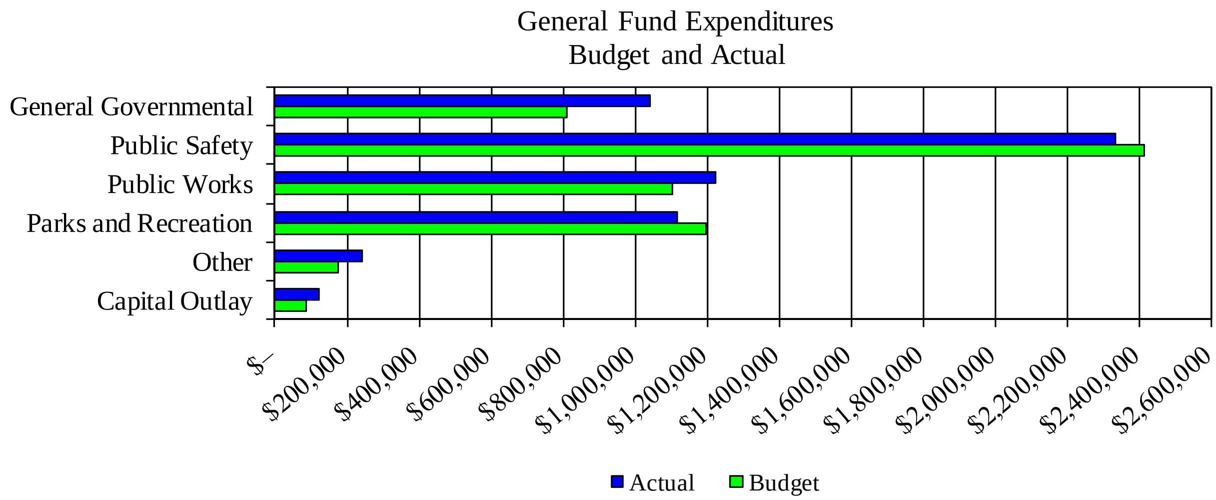
The following graph presents the City's General Fund revenue sources for the last five years:



Revenues and net transfers for the year ended December 31, 2011 increased by $10,608. Revenue decreases were mainly from charges for services and licenses and permits, which decreased by $60,757 and $158,797, respectively. The decrease in charges for services is related to an overall decrease in commercial building activity. Further, the decrease in licenses and permits revenue is related to a decrease in the amount of building and demolition permits. Net transfers increased $235,155.

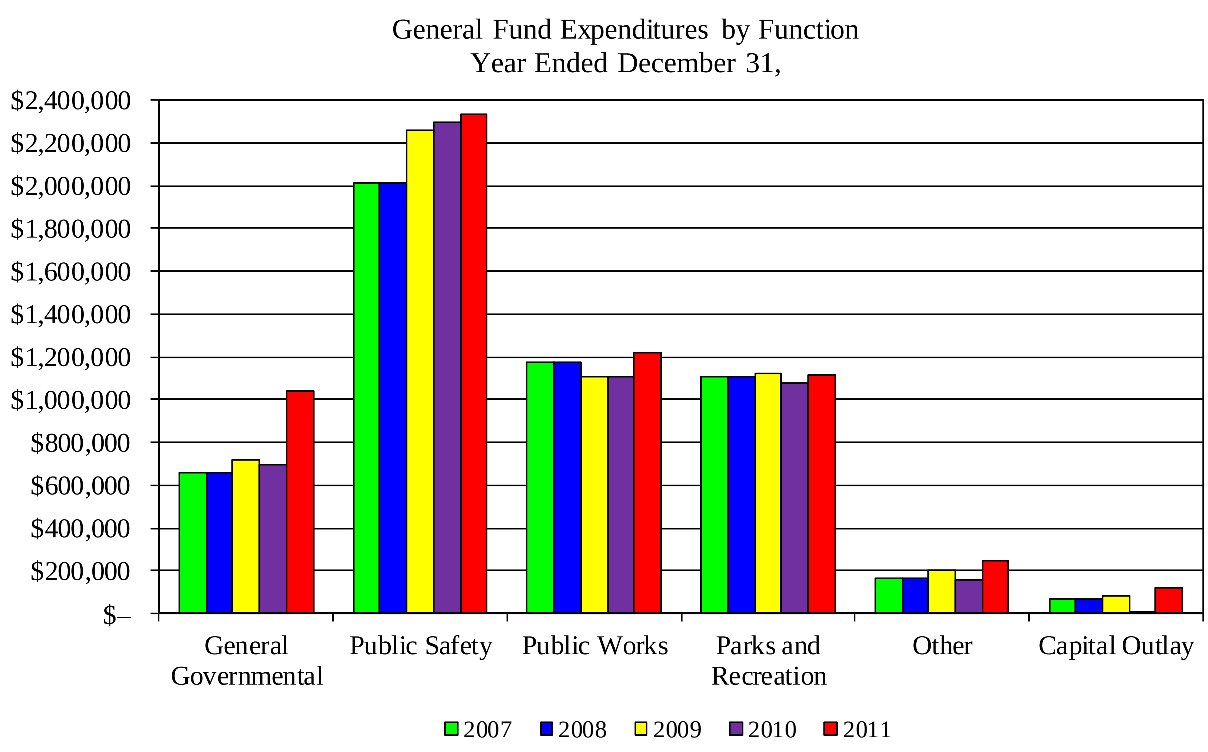
Due to the large amount of tax exempt property in the City, the City has historically relied heavily on intergovernmental revenue (mainly state aid) and transfers from its enterprise funds to help support General Fund operations.

The following illustrations provide the components of the City's General Fund spending for 2011 compared to budget:



Total General Fund expenditures for 2011 were $6,072,820, which was $285,552 (4.9 percent) greater than the budget. General government costs were over budget by $227,385 (28 percent), mainly due to the increased expenditures related to the demolition of the old hospital and nursing home facility. Public works costs were over budget by $116,068 due to more than expected street maintenance in the current year.

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



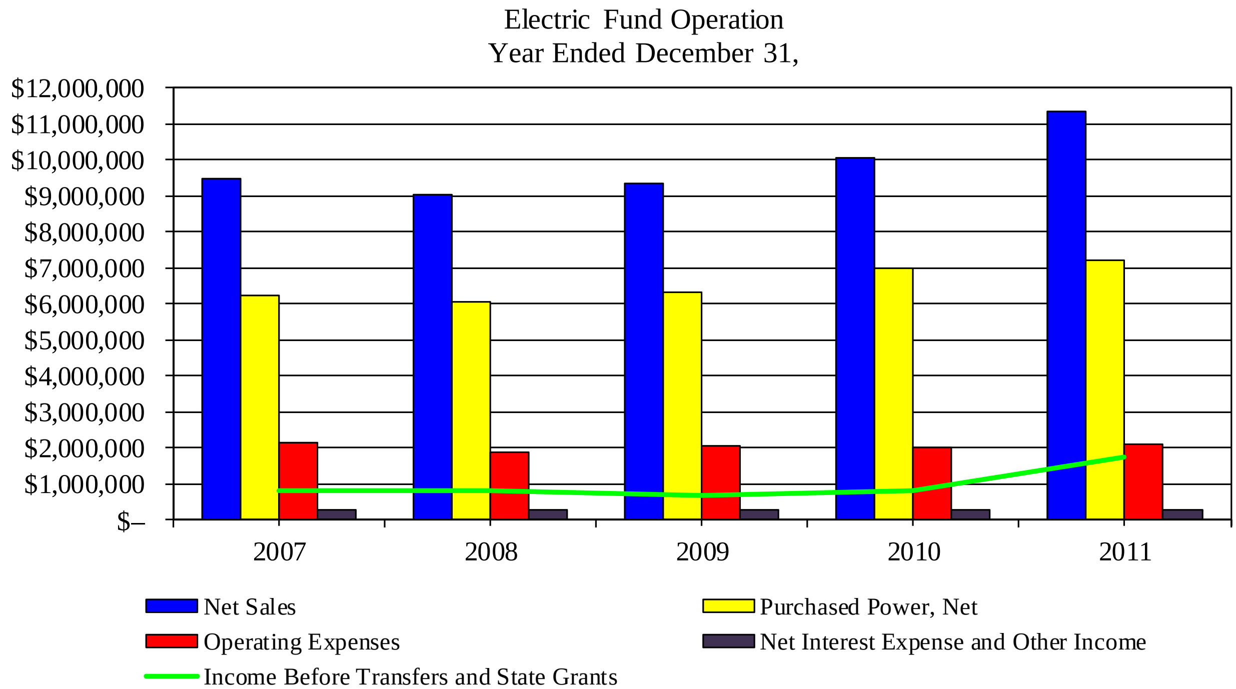
In 2011, total General Fund expenditures increased $725,973, or 13.6 percent. The largest increase was in general government expenditures for the demolition of the old hospital and nursing home facility, which increased approximately $340,000. General Fund expenditure increases were also due to the implementation of GASB Statement No. 54, which eliminated the use of the Old Hospital and Insurance Special Revenue Funds. As a result, these were moved into the General Fund of the City in fiscal 2011.

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:

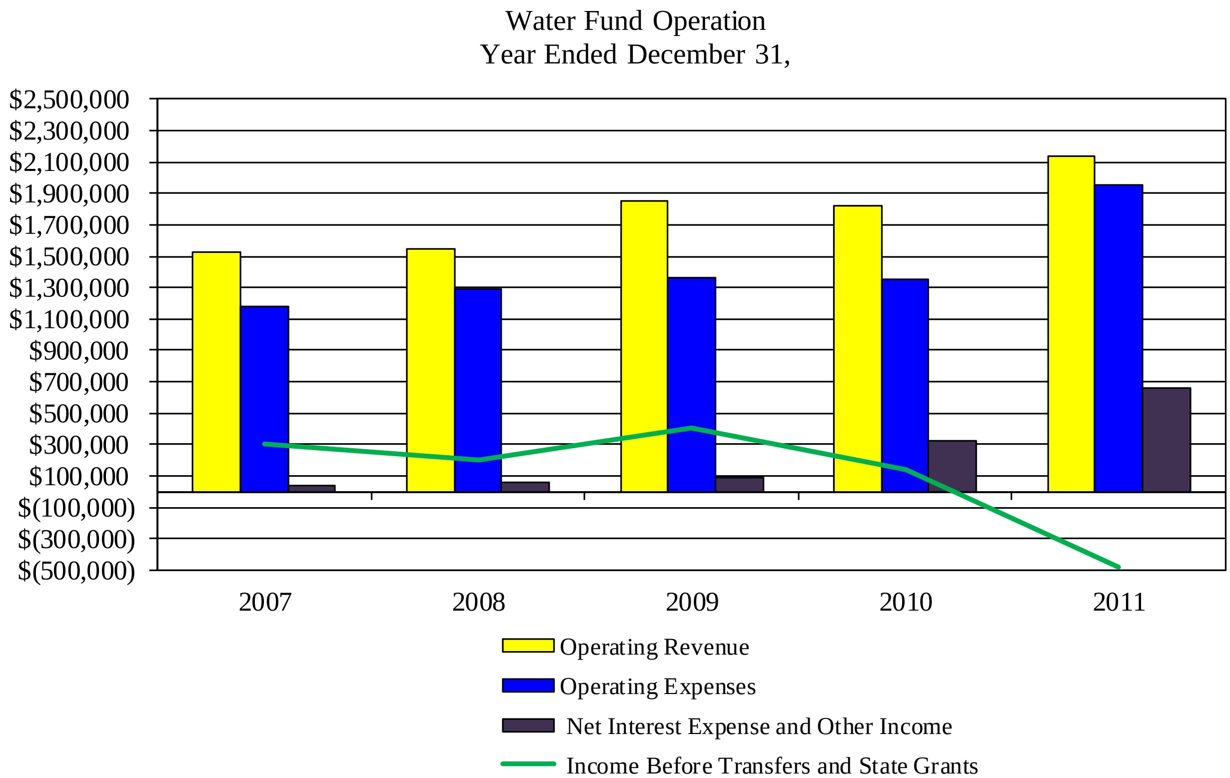


At December 31, 2011, the Electric Fund had total net assets of $16,744,324, of which $1,061,428 was restricted for debt service; $13,985,485 was invested in capital assets, net of related debt; and $1,697,321 was unrestricted. The Electric Fund ended the year with working capital of $1,232,394.

The Electric Fund operating revenue was $11,364,529 for 2011, an increase of about $1,295,892 (12.9 percent), mainly due to both an increase in usage and rates. Purchased power increased $249,431, or 3.6 percent. Operating expenses increased by $99,976 (5 percent) in 2011 mainly due to increases in supplies and materials.

Water Fund

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



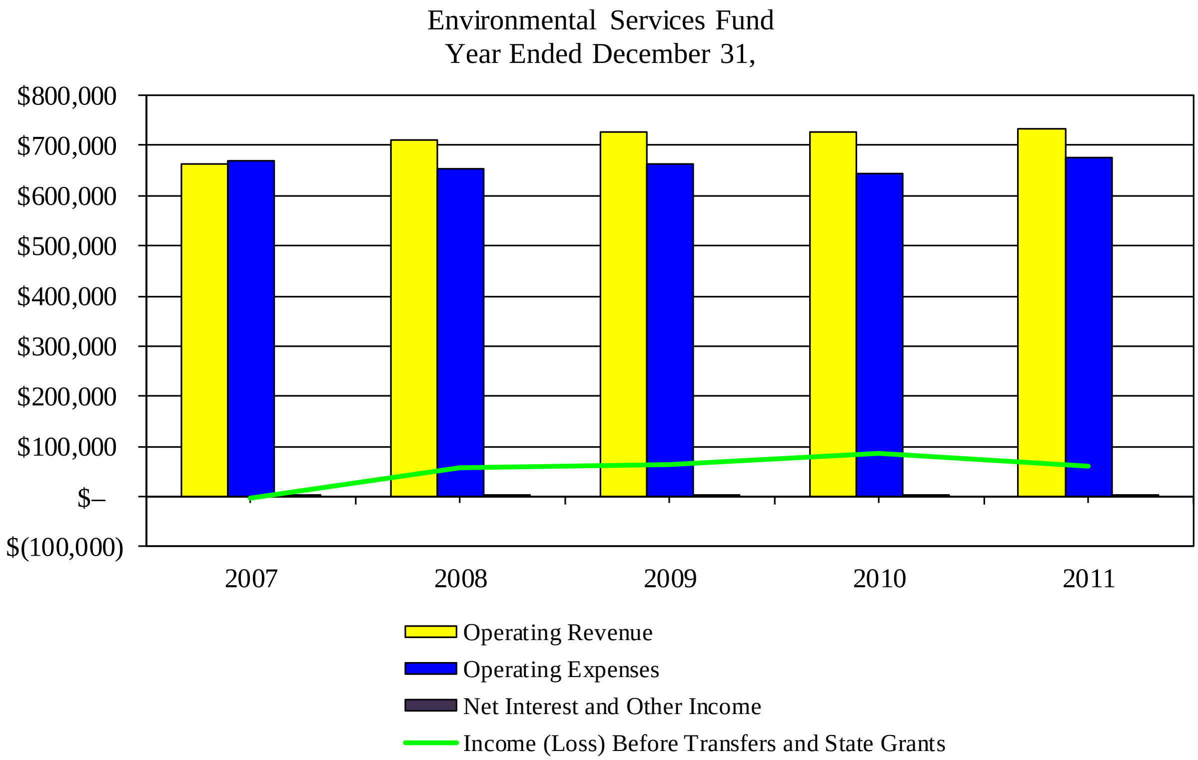
At December 31, 2011, the Water Fund had total net assets of $10,923,858, of which $8,062,666 was invested in capital assets, net of related debt and $2,861,192 was unrestricted. The Water Fund ended the year with working capital (net of restricted cash for current bond refunding) of $988,827.

The Water Fund operating revenue was $2,134,939 for 2011, an increase of about $309,894 (16.9 percent) which was a result of an increase in the water usage, water rates, and the opening of the new water treatment facility. Operating expenses increased by $600,638, or 44.3 percent, which was related to an increase in the water purification expense due to the new water treatment facility that was opened in the current year. The Water Fund also experienced an increase in interest expense of $201,365 related to recent bond issues for new projects in the past few years.

Although this fund is in a healthy financial position, we suggest that the City continues to review the water rates on an annual basis. This is especially important considering the decline in the operating results over the past two years. Water rates are generally designed to cover operating costs and provide an accumulation of resources for significant repairs and replacements, and an operating cushion for potential negative years in financial operations.

Environmental Services Fund

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

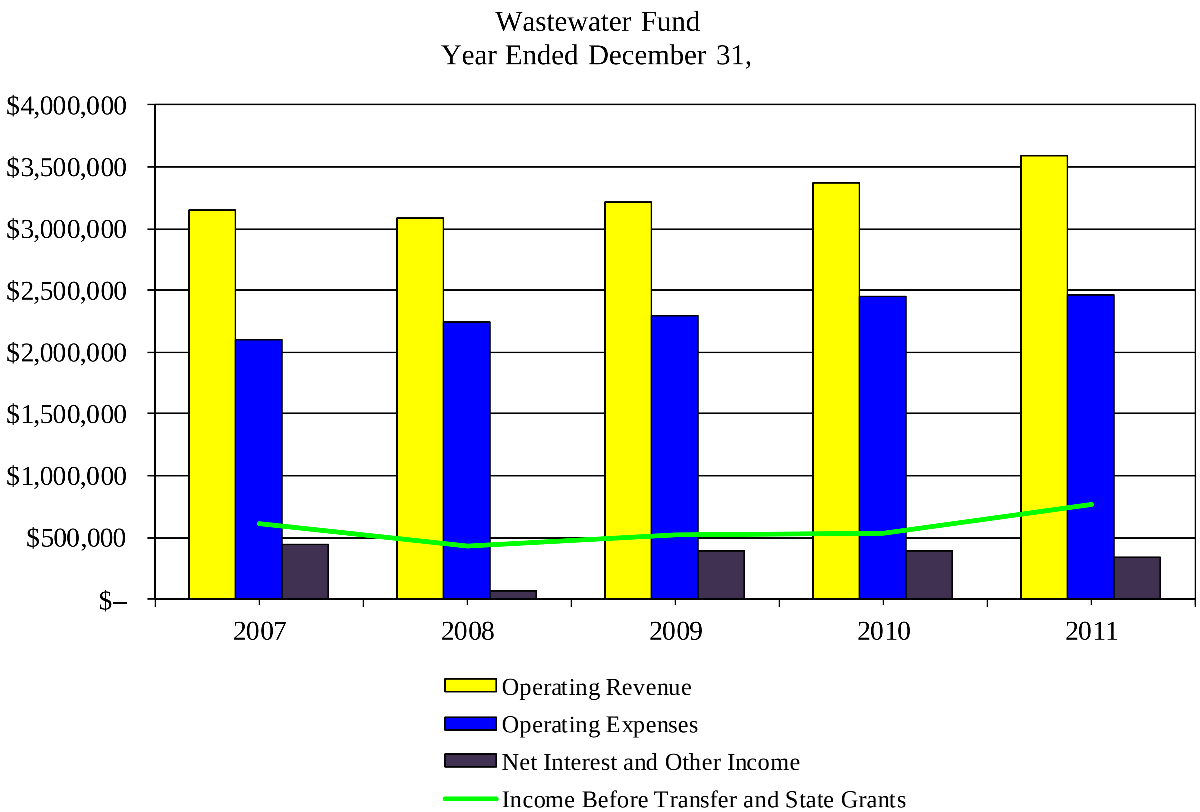


At December 31, 2011, the Environmental Services Fund had total net assets of $288,686, of which $16,231 was invested in capital assets, net of related debt and $272,455 was unrestricted. The Environmental Services Fund ended the year with working capital of $287,801.

The Environmental Services Fund operating revenue was $734,790 for 2011, an increase of $7,680 (1.1 percent). Operating expenses increased about $31,213 (4.9 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:

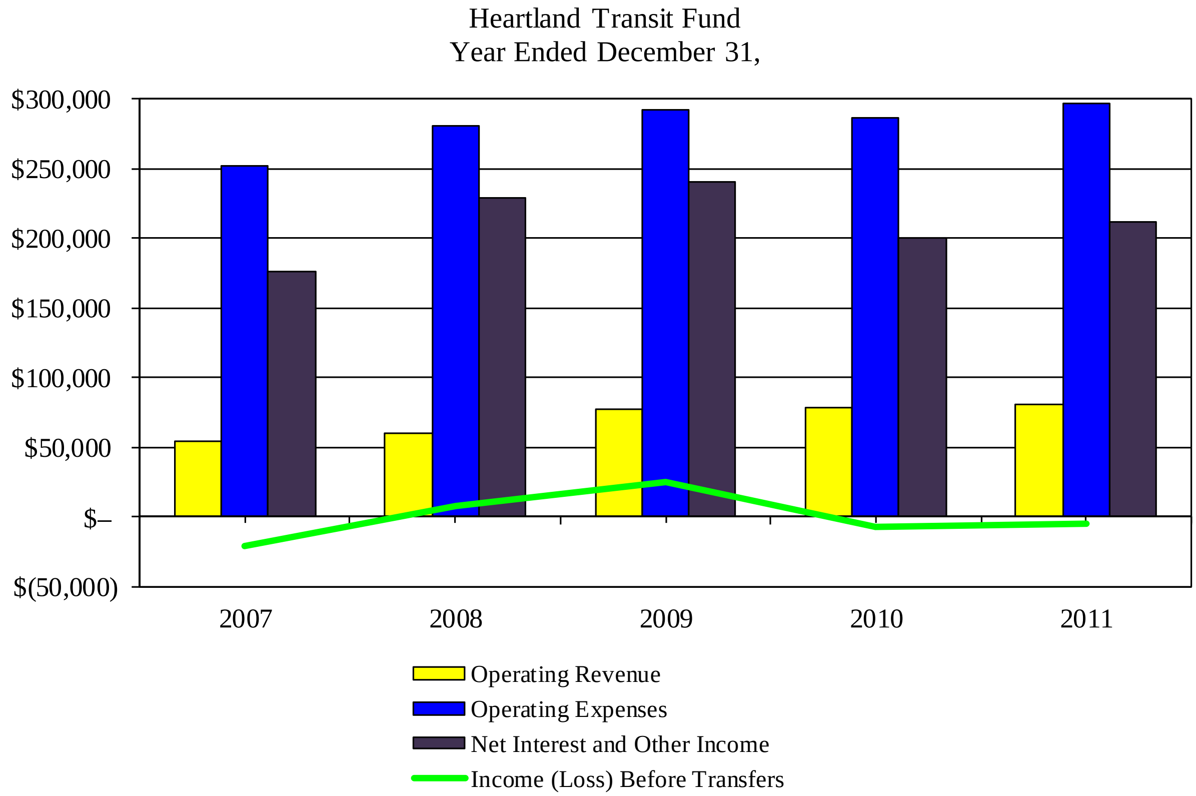


At December 31, 2011, the Wastewater Fund had total net assets of $16,193,219, of which $15,010,322 was invested in capital assets, net of related debt; $464,507 was restricted; and $718,390 was unrestricted. The Wastewater Fund ended the year with working capital balance of $83,957.

The Wastewater Fund operating revenue was $3,583,727 for 2011, an increase of about $214,718 (6.4 percent), mainly due an increase in the total gallons billed. Operating expenses increased about $21,991 or 0.9 percent.

Heartland Transit Fund

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

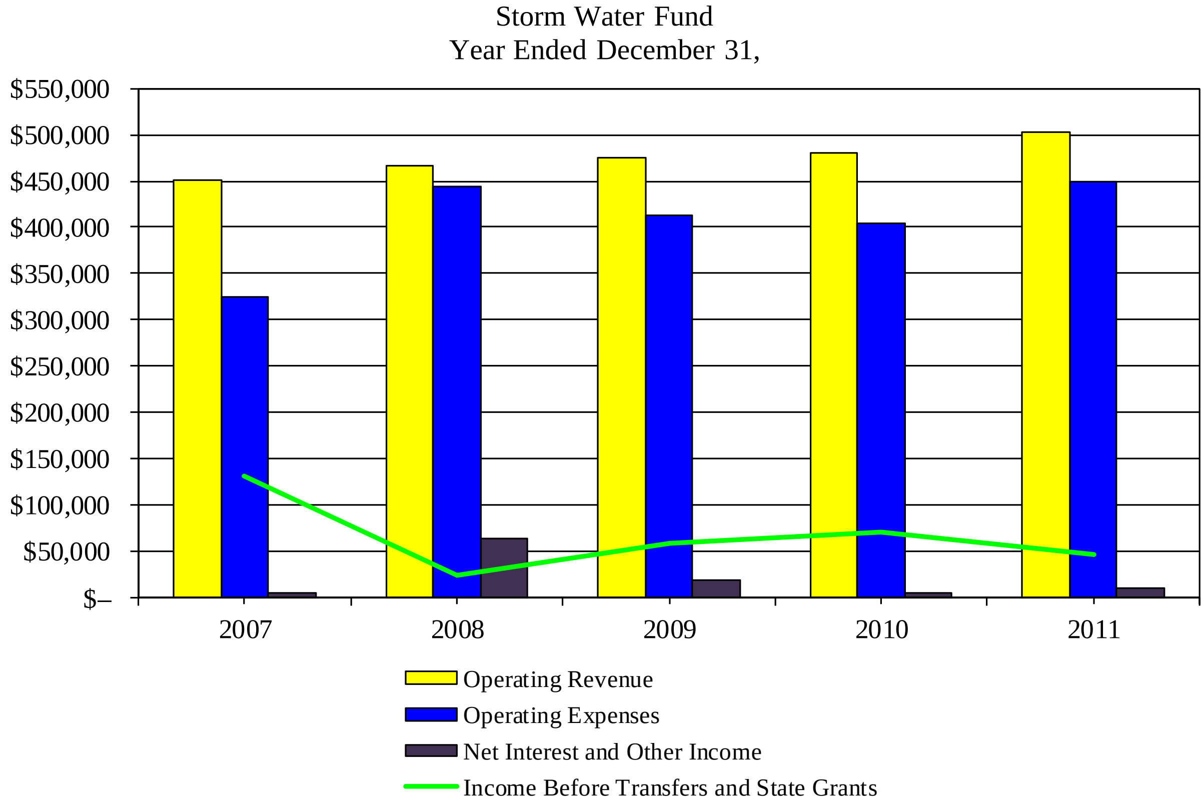


At December 31, 2011, the Heartland Transit Fund had total net assets of $62,345, of which $53,241 was invested in capital assets, net of related debt and a balance of $9,104 was unrestricted. The Heartland Transit Fund ended the year with a working capital balance of $10,382.

The Heartland Transit Fund operating revenue was $80,972 for 2011, an increase of $2,269. Operating expenses increased by $11,411 from the prior year.

Storm Water Fund

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

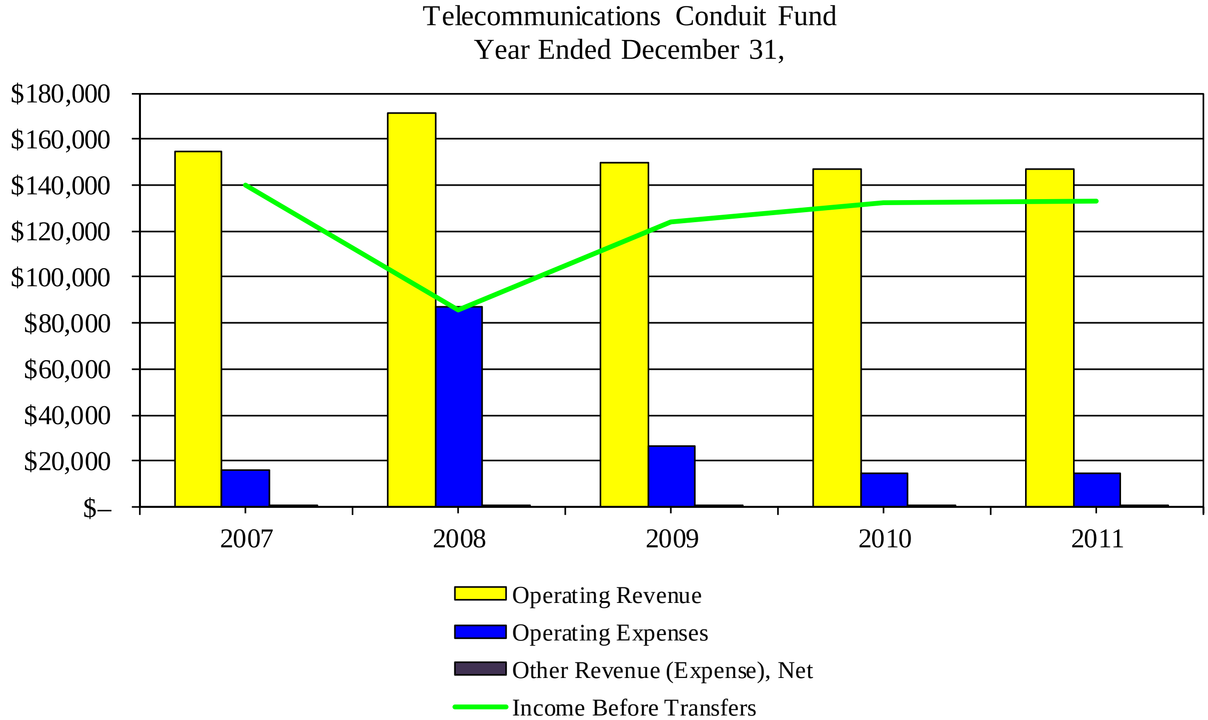


At December 31, 2011, the Storm Water Fund had total net assets of $5,135,575, of which $4,489,678 was invested in capital assets, net of related debt and $645,897 is considered unrestricted. The Storm Water Fund ended the year with working capital of $540,485.

The Storm Water Fund operating revenue was $502,293 for 2011, an increase of $22,236, or 4.6 percent. Operating expenses increased $43,981 in 2011, or 10.9 percent, due partly to an increase in personal services and depreciation expense.

Telecommunications Conduit Fund

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

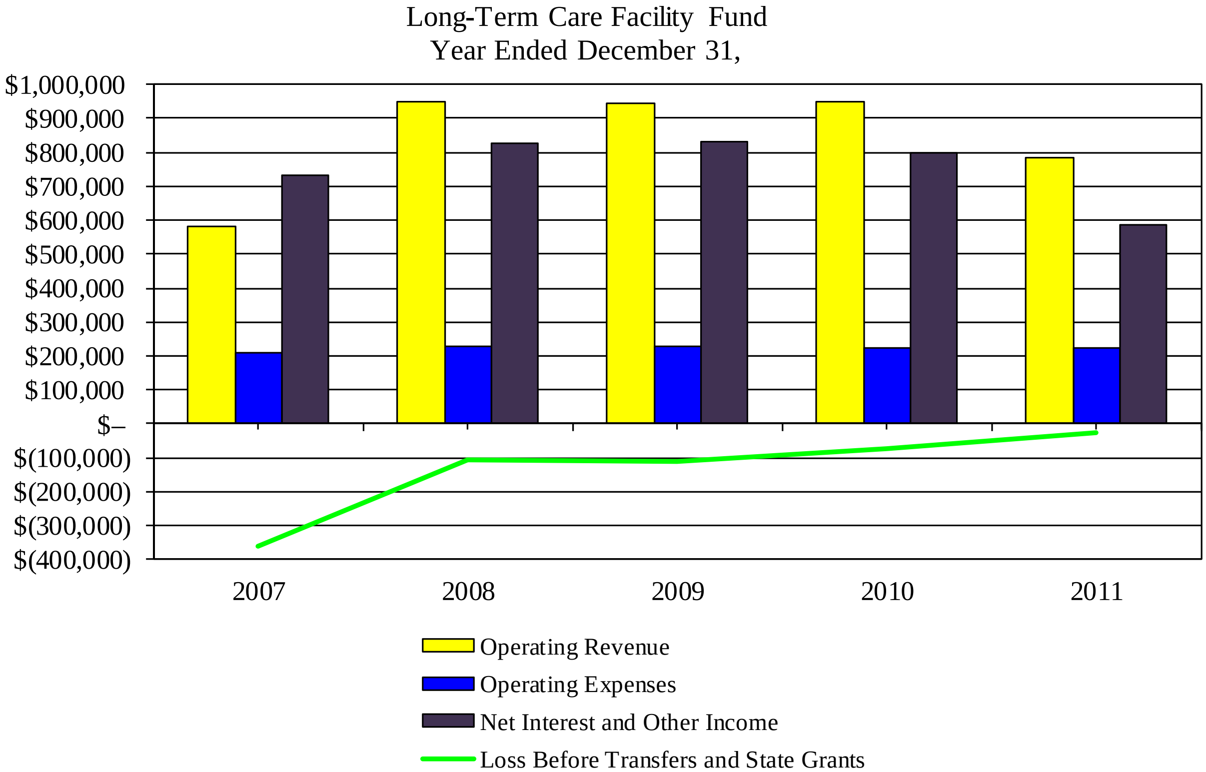


At December 31, 2011, the Telecommunications Conduit Fund had total net assets of $276,561, of which $268,349 was invested in capital assets, net of related debt and $8,212 was considered unrestricted. The Telecommunications Conduit Fund ended the year with working capital of $8,212.

The Telecommunications Conduit Fund operating revenue was $147,182 for 2011, an increase of $301 (0.2 percent). Operating expenses decreased $241 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:

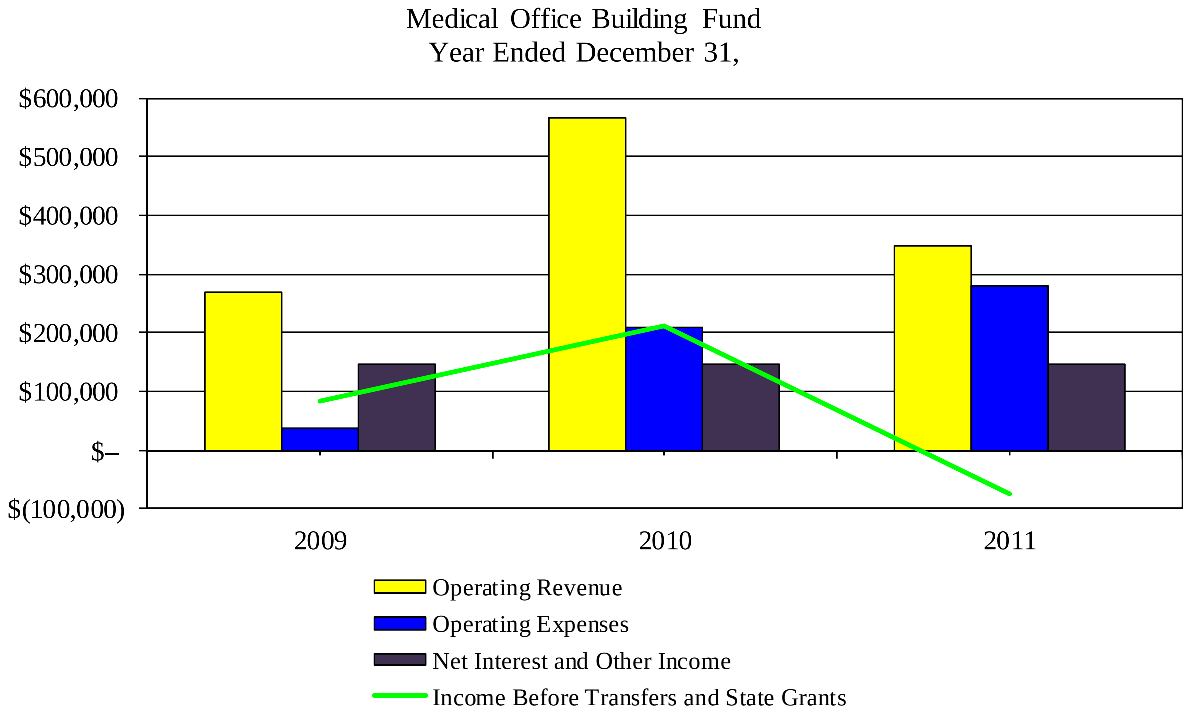


At December 31, 2011, the Long-Term Care Facility Fund had a total net assets deficit of ($740,763), of which a deficit of ($858,087) was invested in capital assets, net of related debt; $106,800 was restricted for debt service; and $10,524 was considered unrestricted.

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 three years:



At December 31, 2011, the Medical Office Building Fund had total net assets of $3,146,293, of which $2,908,638 was invested in capital assets, net of related debt; and $237,655 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.

In fiscal 2010, this fund received a one-time revenue for construction improvements.

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 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: net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The following table presents the City's net assets as of December 31, 2011 and 2010 for governmental activities and business-type activities:

	As of December 31,		Increase
	2011	2010	(Decrease)
Net assets			
Governmental activities			
Invested in capital assets, net of related debt	$ 20,130,564	$ 21,518,399	$ (1,387,835)
Restricted	6,293,170	7,165,093	(871,923)
Unrestricted	3,809,040	4,012,078	(203,038)
Total governmental activities	30,232,774	32,695,570	(2,462,796)
Business-type activities			
Invested in capital assets, net of related debt	43,936,523	41,465,453	2,471,070
Restricted	43,936,523	1,570,995	42,365,528
Unrestricted	6,460,750	8,330,634	(1,869,884)
Total business-type activities	94,333,796	51,367,082	42,966,714
Total net assets	$ 124,566,570	$ 84,062,652	$ 40,503,918

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, 2011 and 2010:

	2011			2010
	Expenses	Program Revenues	Net Difference	Net Difference
Net (expense) revenue				
Governmental activities				
General government	$ 5,913,176	$ 673,549	$ (5,239,627)	$ (871,684)
Public safety	2,444,982	496,489	(1,948,493)	(1,671,279)
Public works	1,940,707	1,972,911	32,204	(530,018)
Parks and recreation	1,728,040	158,885	(1,569,155)	(1,284,754)
Economic development	521,741	162,548	(359,193)	(613,548)
Interest on long-term debt	330,985	–	(330,985)	(394,206)
Business-type activities				
Electric	9,835,101	11,510,389	1,675,288	672,904
Water	2,638,840	2,135,695	(503,145)	128,338
Environmental services	674,261	735,116	60,855	84,388
Wastewater	2,837,925	3,604,727	766,802	533,331
Transit	297,412	293,279	(4,133)	(6,991)
Storm sewer	461,177	518,786	57,609	65,015
Telecommunications conduit	14,264	147,182	132,918	132,376
Long-term care facility	812,286	783,792	(28,494)	(71,086)
Medical office building	424,400	349,123	(75,277)	209,541
	$ 30,875,297	$ 23,542,471	(7,332,826)	(3,617,673)
General revenues				
Taxes			2,544,562	2,699,655
Unrestricted grants and contributions			2,658,545	2,625,153
Investment earnings			145,262	310,427
Other revenues			169,587	58,186
Gain on sale of assets			15,000	–
Total general revenues			5,532,956	5,693,421
Change in net assets			$ (1,799,870)	$ 2,075,748

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.

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 periods beginning after December 15, 2011, 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 periods beginning after June 15, 2012, with earlier implementation encouraged.

GASB STATEMENT NO. 63 – FINANCIAL REPORTING OF DEFERRED OUTFLOWS OF RESOURCES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources; which are defined as the consumption or acquisition of net assets, respectively, applicable to a future reporting period. The statement amends certain reporting requirements in GASB Statement No. 34 and related pronouncements, providing a format for a new Statement of Net Position, which reports deferred outflows of resources and deferred inflows of resources separately from assets and liabilities. It also renames the residual of assets, deferred outflows of resources, liabilities, and deferred inflows of resources as net position, rather than net assets. The requirements of this statement must be implemented for periods beginning after December 15, 2011, with earlier implementation encouraged.

GASB PENSION EXPOSURE DRAFTS

In June 2011, GASB issued two exposure drafts on accounting and reporting for pensions, one for the reporting of pension benefits within the financial statements of participating employers and the other for pension plan financial reporting. These two exposure drafts are intended to update or replace the current guidance for pension reporting in GASB Statement Nos. 25 and 27.

The exposure drafts propose a variety of changes in financial statement presentation, measurement, and required disclosures relating to pension benefits. Included are proposed major changes in how employers that participate in cost-sharing defined benefit pension plans, such as TRA and PERA, account for pension benefit expenses and liabilities. Currently, employers participating in such plans recognize pension expenses and liabilities only to the extent of their contractually required annual contributions to the plan. The exposure draft proposes that those employers recognize their proportionate share of the collective net pension liability and collective pension expense for all participating employers. If adopted, this guidance could have a significant impact on the financial statements of the participating employers, as participants in plans with a substantial unfunded liability would be required to report their proportionate share of the unfunded liability in their government-wide financial statements.

The proposed effective dates for both exposure drafts are for periods beginning after June 15, 2012, if certain conditions are met, otherwise for periods beginning after June 30, 2013.

FEDERAL FUNDING ACCOUNTABILITY AND TRANSPARENCY ACT (TRANSPARENCY ACT)

Effective October 1, 2010, the Transparency Act requires federal award recipients to report specific data, including compensation data in certain circumstances, related to subawards. One of the key requirements of the Transparency Act was the creation of a single, searchable website that provides the public with greater access to information on federal spending. The Transparency Act requires recipients to report first-tier subaward and executive compensation data for new federal grants as of October 1, 2010, if the initial award is equal to or over $25,000. Pass through entities (primary recipients) must report subaward data through the Federal Funding Accountability and Transparency Subaward Reporting System (FSRS) by the end of the month following the month in which the subaward obligation is made. For a more detailed discussion of the Transparency Act see Part 3, Section L of the 2011 U.S. Office of Management and Budget (OMB) Circular A-133 *Compliance Supplement* available at www.whitehouse.gov/omb. The OMB has issued several documents that provide guidance on the Transparency Act, including *Open Government Directive – Federal Spending Transparency* and *Subaward and Compensation Data Reporting*, available at www.whitehouse.gov/omb/open.