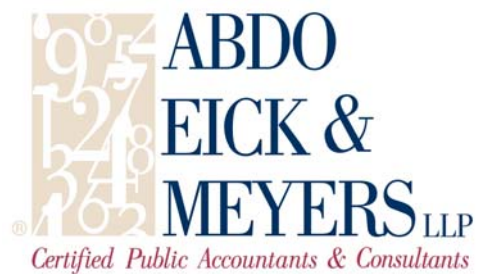




CITY OF KENYON
KENYON, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2008



5201 Eden Avenue
Suite 370
Edina, MN 55436

Management, Honorable Mayor and Council
City of Kenyon, 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 Kenyon, Minnesota (the City), for the year ended December 31, 2008 and have issued our report thereon dated April 8, 2009. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Auditing Standards Generally Accepted in the United States of America 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.

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. As part of our audit, we considered the internal control of the City. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the 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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and one we considered to be a material weakness.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. We consider the deficiencies on the following pages to be significant deficiencies in internal control over financial reporting:



2008-3 Limited Segregation of Duties Related to Cash Disbursements (finding since 2007)

Condition: During our audit we reviewed procedures over transaction cycles related to cash disbursements, utility billing, and payroll and found the City to have limited segregation of duties related to the disbursements cycle.

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.

Cause: The bookkeeper of the City maintains and controls the check stock, prepares checks, records disbursements, initiates wire transfers, and prepares the bank reconciliation

Effect: The existence of this limited segregation of duties increases the risk of fraud.

Recommendation: While we recognize the number of staff is not large enough to eliminate these deficiencies entirely, we believe the risk has been reduced with better monitoring through a commissioner reviewing cancelled checks and having someone in the office other than the bookkeeper received and open unopened bank statements.

City Council should also be reminded of their duties over finance at least annually. Some typical monitoring duties would include the following tasks:

- Claims approval is an important control and should be at the front of the meeting to ensure that the council reviews the claims closely.
- A thorough review of budget versus actual reporting and narrative at least quarterly.
- Monitor progress over the development of documented policies and procedures.
- The check sequence should be reported in each set of approved minutes. The council should review the order the checks approved to ensure that they move in sequence and any gaps in number are explained.
- Consider personnel policies that require someone else to fill finance duties for a period of time. A mandatory vacation period of one week for all finance staff and distribution of their duties for that week is often recommended.

Management Response: Management intends to carry out some of these recommendations during 2009, taking into consideration cost versus benefit.



2008-4 Preparation of Financial Statements (finding since 2007)

- Condition:* As in prior years, we were requested to draft the audited financial statements and related footnote disclosures as part of our regular audit services. Recent auditing standards require auditors to communicate this situation to the Council as an internal control deficiency. Ultimately, it is management's responsibility to provide for the preparation of your statements and footnotes, and the responsibility of the auditor to determine the fairness of presentation of those statements. 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 can not be part of your internal control process.
- Criteria:* Internal controls should be in place to ensure adequate internal control over safeguarding of assets and the reliability of financial records and reporting.
- Cause:* From a practical standpoint, we both prepare the statements and determine the fairness of the presentation at the same time in connection with our audit. This is not unusual for us to do with organizations 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. As in prior years, we have instructed management to review a draft of the auditor prepared financials in detail for accuracy; we have answered any questions that management might have, and have encouraged research of any accounting guidance in connection with the adequacy and appropriateness of classification of disclosures in your statements. We are satisfied that the appropriate steps have been taken to provide you with the completed financial statements.
- 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 situations 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 accounting information from Banyon to the amounts reported in the financial statements.
- Management Response:* For now, the City accepts the degree of risk associated with this condition and thoroughly reviews a draft of the financial statements.



A material weakness is a significant deficiency, or combination of significant deficiencies, that result in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control. We identified the following deficiency in internal control over financial reporting as a material weakness:

2008-5 Liquor Store Inventory Reconciliation (finding since 2007)

- Condition:* Liquor store inventory point of sale system did not reconcile with the year end counts performed by staff.
- Criteria:* The point of sale system is designed to track purchases, sales, and inventory balances at the point of sale or purchase. Having a point of sale system adds additional controls over products being brought in and taken out of the store. The system's inventory balances were significantly different from the actual counts at year end.
- Cause:* Unknown.
- Effect:* Without the reconciliation of the point of sale system to the actual inventory, management is not able to track current inventory balances, gross profit percentages and other valuable information.
- Recommendation:* We recommend cycle counts be done on a bi-weekly basis until management is comfortable the system is operating properly. Cycle counts consist of counting all of one type of product and matching it to the inventory point of sale system. Once management is satisfied the system operating properly, cycle counts could be done on a weekly basis. Inventory adjust reports should be printed and retained for each cycle count. Management can then use these reports to notice trends as far as whether they are making adjustment to the same product each time a count is performed. If this is the case, it can raise concerns of theft. Currently, there is no way of determining whether theft has occurred other than seeing a drop in gross profit percentage at the end of the year.
- Management Response:* The City is currently in the process of changing management and procedures and plans to implement the above recommendation during 2009.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, the objective of our tests was not to provide an opinion on compliance with such provisions. We noted the following instances of noncompliance with Minnesota statutes:

2008-1 Unauthorized Investments (finding since 2007)

Condition: Auditing for legal compliance requires a review of the City's deposits and investments. Our study indicated an instance of non-compliance that we believe is required to be remedied.

Criteria: Allowed investments are listed under State statute 118A.04.

Cause: The City received shares of common stock as a dividend from its insurance company.

Effect: The common stock does not meet the qualifications listed under statute 118A.04.

Recommendation: While we recognize that the stock was sold during 2008, we recommend that the City continue to monitor these dividends from its insurance company to avoid future noncompliance.

Management Response: The stock was sold on March 27, 2008.

2008-2 Out of State Travel Policy

Condition: During our audit, we noted that the City had not developed or approved an out of state travel policy.

Criteria: Minnesota statute §471.661 requires that the City develop a policy that controls travel outside the state of Minnesota for elected officials of the City. The policy needs to be approved by a recorded vote, and should include: 1) when travel outside the state is appropriate; 2) applicable expense limits; and 3) procedures for approval of the travel. The policy must be made available for public inspection and should be reviewed annually.

Cause: The City has not developed or approved an appropriate out of state travel policy. This statute applies to the City regardless of out of state travel expenditures.

Effect: The City is out of compliance with Minnesota statute.

Recommendation: We recommend the City review the statute and develop and approve an appropriate policy.

Management Response: Management plans to follow recommendation described above.

Planned Scope and Timing of the Audit

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



Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statement in a different period than when the transaction occurred.

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 significant estimate affecting the financial statements was depreciation and historical costs for capital assets.

Management's estimate of depreciation is based on estimated useful lives of the assets. We evaluated the key factors and assumptions used to develop depreciation 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. 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 the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting or auditing matter 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 representations letter dated April 8, 2009.

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 prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Financial Position and Results of Operations

Our principal observations and recommendations are summarized on the following pages. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended December 31, 2008.

General Fund

The General fund is used to account for resources traditionally associated with government, which are not required legally or by sound principal management to be accounted for in another fund. The General fund balance decreased \$124,992 from 2007. The total fund balance is \$529,367, which is 47.2 percent of the 2009 budgeted expenditures. We recommend the fund balance be maintained at a level sufficient to fund operations until the major revenue sources are received in June. We feel a reserve of approximately 40 to 50 percent of planned expenditures and transfers out is adequate to meet working capital and small emergency needs.

Minnesota cities 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.

The Office of the State Auditor (the OSA) has issued a *Statement of Position* relating to fund balance stating "a local government should identify fund balance separately between reserved and unreserved fund balance. The local government may assign and report some or all of the fund balance as designated and undesignated." We recommend local governments adopt a formal policy on the level of unreserved fund balance that should be maintained in the general and special revenue funds. This helps address citizen concerns as to the use of fund balance and tax levels.

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

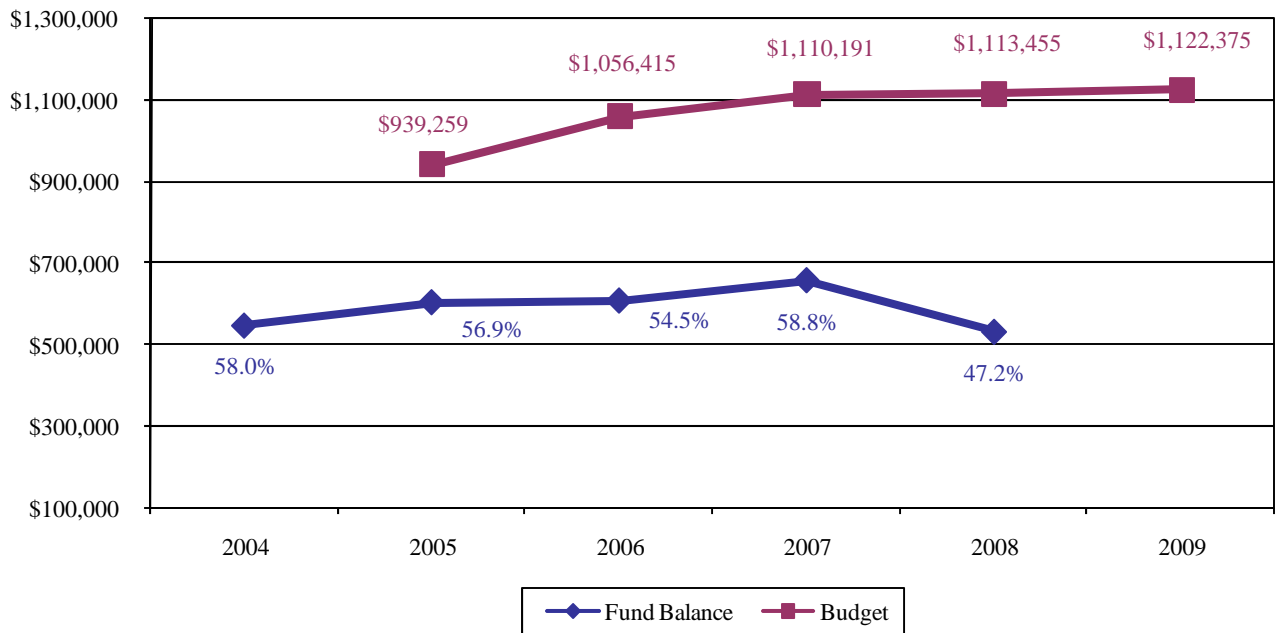
- Expenditures are incurred somewhat evenly throughout the year. However, property tax and state aid revenues are not received until the second half of the year. An adequate fund balance will provide the cash flow required to finance the General fund expenditures.
- The City is vulnerable to legislative actions at the State and Federal level. The State continually adjusts the local government aid and property tax credit 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 a bond rating. The result will be better interest rates in future bond sales.



A table summarizing the General fund balance in relation to budget follows:

Year	Fund Balance	Budget Year	Following Year Budget	Percent of Fund Balance to Budget
2004	\$ 544,478	2005	\$ 939,259	58.0 %
2005	601,085	2006	1,056,415	56.9
2006	605,181	2007	1,110,191	54.5
2007	654,359	2008	1,113,455	58.8
2008	529,367	2009	1,122,375	47.2

Fund Balance as a Percent of Next Year's Budget





A summary of the 2008 operations is as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues	\$ 1,028,455	\$ 981,761	\$ (46,694)
Expenditures	1,051,055	1,125,940	(74,885)
Deficiency of revenues under expenditures	(22,600)	(144,179)	(121,579)
Other financing sources (uses)			
Transfers in	85,000	79,777	(5,223)
Interest revenue from interfund activity	-	1,810	1,810
Transfers out	(62,400)	(62,400)	-
Total other financing sources (uses)	22,600	19,187	(3,413)
Net change in fund balances	-	(124,992)	(124,992)
Fund balances, January 1	654,359	654,359	-
Fund balances, December 31	<u>\$ 654,359</u>	<u>\$ 529,367</u>	<u>\$ (124,992)</u>

Some of the line items with significant variances are highlighted below:

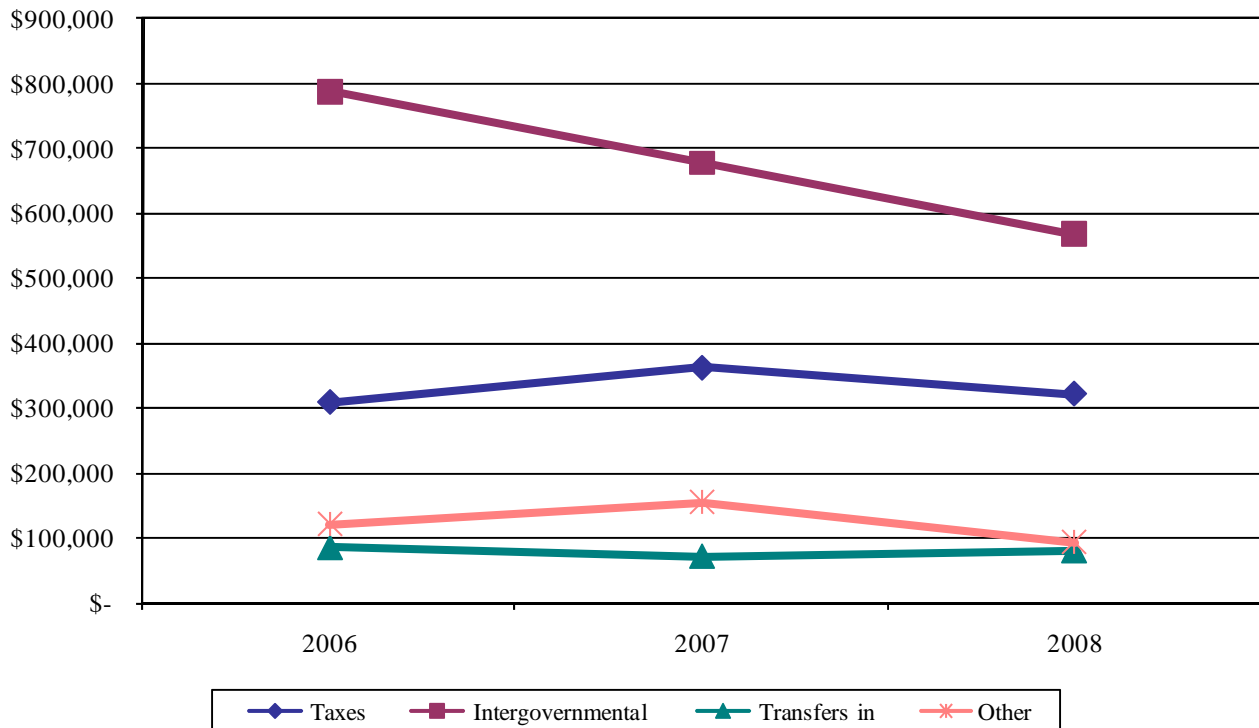
- Local government aid was \$47,719 less than anticipated, all of which is a result of the State of Minnesota's 2008 unallotment to the City.
- Personal services within public safety were over budget by \$25,480. This was due primarily to overtime salaries exceeding the 2008 budget by 379 percent (\$14 thousand). Policy was amended in 2008 to address this issue and reduce overtime.
- Personal services within general government for City administration was \$52,378 below expectations.
- General government engineering was \$67,136 more than anticipated due to unbudgeted projects completed in 2008.



A comparison between 2006, 2007 and 2008 revenues and transfers is presented below:

Source	2006	2007	2008	Percent of Total
Taxes	\$ 309,323	\$ 362,495	\$ 322,355	30.3 %
Licenses and permits	5,663	5,833	6,172	0.6
Intergovernmental	788,501	678,186	567,865	53.4
Charges for services	66,061	68,338	66,008	6.2
Fines and forfeits	4,510	5,978	7,765	0.7
Investment earnings	6,011	7,705	(6,166)	(0.6)
Miscellaneous	39,820	67,328	17,762	1.7
Interest revenue from interfund activity	-	-	1,810	0.2
Transfers in	84,853	71,174	79,777	7.5
Total revenues and transfers	\$ 1,304,742	\$ 1,267,037	\$ 1,063,348	100.0 %

A graphical presentation of 2006, 2007 and 2008 revenues and transfers follows:

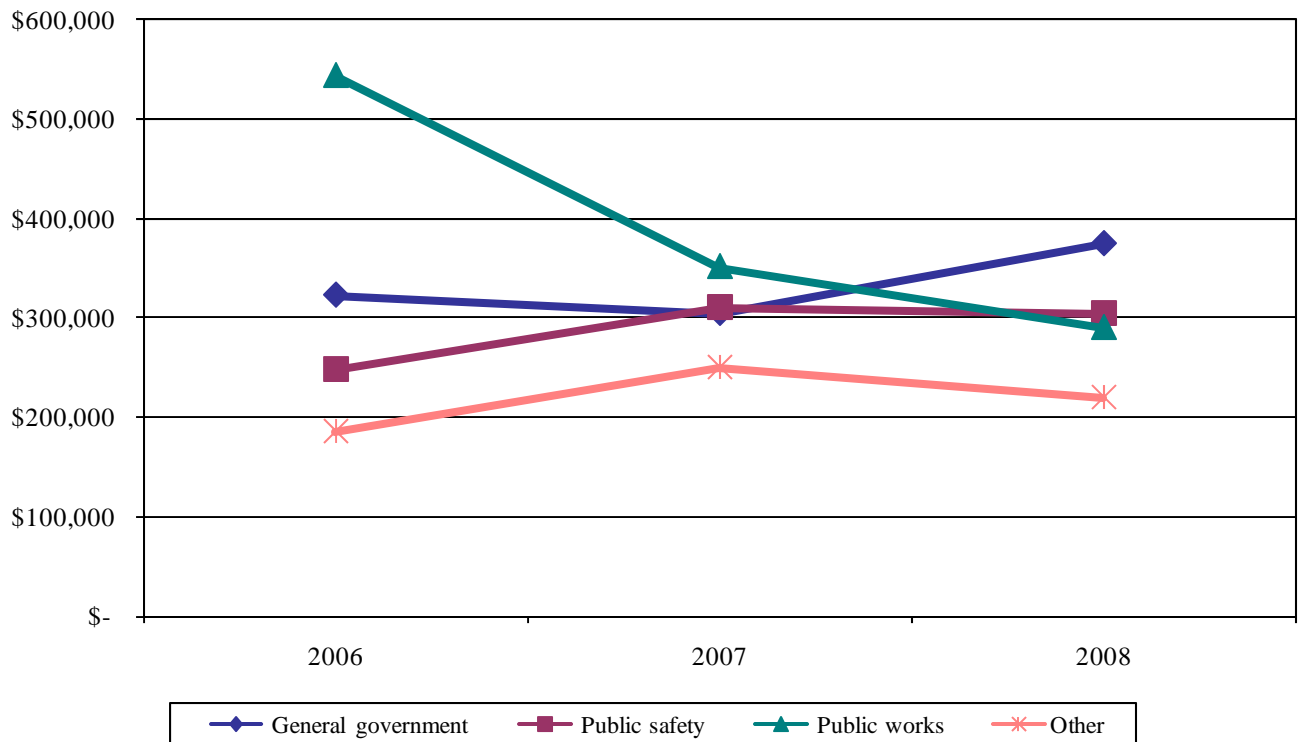




A comparison between 2006, 2007 and 2008 expenditures and transfers is presented below:

Program	2006	2007	2008	Percent of Total
General government	\$ 323,171	\$ 304,995	\$ 374,536	31.4 %
Public safety	247,932	310,696	304,124	25.6
Public works	543,957	351,938	290,673	24.5
Sanitation and recycling	34,300	34,656	34,692	2.9
Culture and recreation	74,180	79,398	82,814	7.0
Capital outlay	11,906	65,976	39,101	3.3
Transfers out	65,200	70,200	62,400	5.3
Total expenditures and transfers	\$ 1,300,646	\$ 1,217,859	\$ 1,188,340	100.0 %

A graphical presentation of 2006, 2007 and 2008 expenditures and transfers totals by program follows:





Special Revenue Funds

Special revenue funds accounting for revenues sources that are legally restricted to expenditures for specified purposes. The funds in this account group included:

Fund	Fund Balances (Deficits)		Increase (Decrease)
	December 31,		
	2008	2007	
Nonmajor			
Canning Company/Elevator	\$ -	\$ 12,137	\$ (12,137)
Ambulance	6,026	4,677	1,349
Fire	4,977	(7,342)	12,319
Library	39,658	29,091	10,567
Economic Development Authority	52,758	48,564	4,194
Gunderson House	7,166	683	6,483
Special Purpose Donation	10,953	-	10,953
Security State Bank TIF	-	23,710	(23,710)
Coast to Coast TIF	-	2,265	(2,265)
2004 Tax Abatement/TIF Sun Home	249	205	44
Total	<u>\$ 121,787</u>	<u>\$ 113,990</u>	<u>\$ 7,797</u>

It is important that all funds maintain a sufficient fund balance to provide working capital. Decreases from 2007 are a result of closing the related fund.

Capital Projects Funds

The capital projects fund account for the acquisition and construction of major capital facilities other than those financed by proprietary funds. As projects are completed, any remaining funds should be transferred to their funding source. The following summarizes fund balances (deficits) for capital projects:

Fund	Fund Balances (Deficits)		Increase (Decrease)
	December 31,		
	2008	2007	
Major			
2006 Trondheim Road Extension	\$ (119,101)	\$ (120,271)	\$ 1,170
Capital Outlay	333,196	578,214	(245,018)
Nonmajor			
Municipal Building	<u>(388,903)</u>	<u>(391,903)</u>	<u>3,000</u>
Total	<u>\$ (174,808)</u>	<u>\$ 66,040</u>	<u>\$ (240,848)</u>

The Trondheim Road Extension fund and Municipal Building fund have deficit fund balances at the end of the year. It appears future revenues may not be sufficient to eliminate the deficits. It has been discussed that levy may need to be set aside to close out the municipal building fund and future assessment levies will close out the 2006 Trondheim Road Extension fund.



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

All debt service funds with the total assets and debt remaining to be paid are shown below:

Debt Description	December 31, 2008			Final Maturity Date
	Total Cash	Total Assets	Outstanding Debt	
2007 G.O. Refunding	\$ 136,700	\$ 167,394	\$ 1,180,000	2/1/2020
2000 EDA Public Project Revenue Bonds	12,594	12,606	-	
Total	\$ 149,294	\$ 180,000	\$ 1,180,000	

Special assessments 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. The amounts levied for collection in previous years have not matched the levy as scheduled by the City’s bond book for the 2007 G.O. Refunding bonds. As a result, the Council should be aware that future levies will need to be more than originally scheduled in order to meet State statute 475.61 which requires that if levies are “collected in full, they, together with estimated collections of special assessments and other revenues pledged for payment of the obligations, will produce at least five percent in excess of the amount needed to meet the principal and interest payments on the obligations when due.”

The 2000 EDA Public Project Revenue Bonds was refunded in 2007 and is considered defeased. Accordingly, this fund should be closed in 2009 to either the 2007 G.O. Refunding debt service fund or the Economic Development Authority fund. We have discussed closing the fund with management and Council will need to decide which fund to close it too.



Enterprise Funds

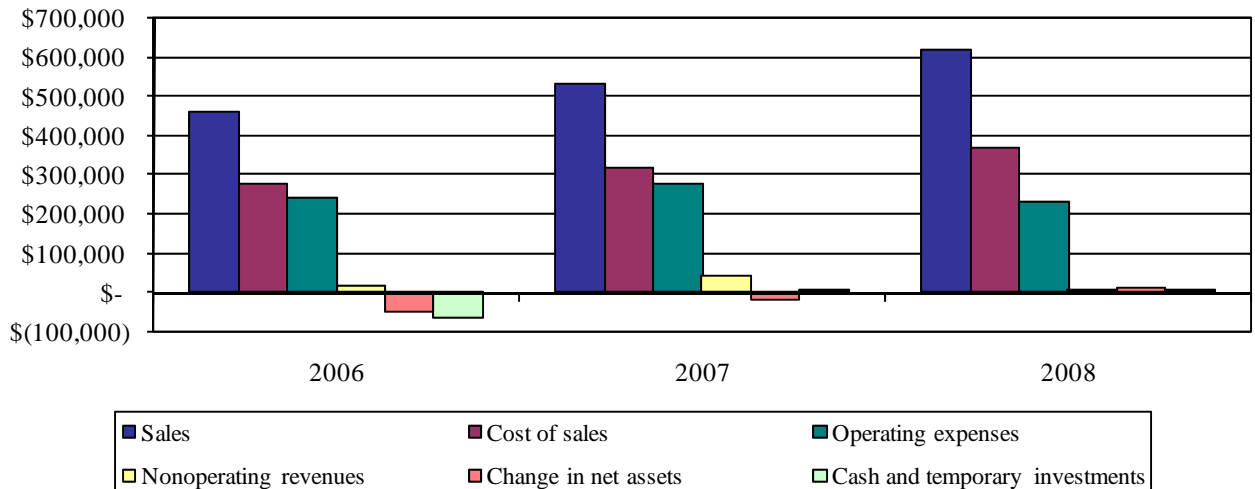
The activities of the Enterprise funds include the liquor, sewer, storm sewer, electric, and water. The electric and water operations, under the direction of the Utilities Commission, are included in the financial statements since Council has the ultimate oversight responsibility for their operations.

Liquor Fund

A comparison of the past three years Liquor fund operations is as follows:

	2006		2007		2008	
	Amount	Percent of Sales	Amount	Percent of Sales	Amount	Percent of Sales
Sales	\$ 461,887	100.0 %	\$ 531,306	100.0 %	\$ 616,930	100.0 %
Cost of sales	(274,972)	(59.5)	(316,237)	(59.5)	(370,777)	(60.1)
Gross profit	186,915	40.5	215,069	40.5	246,153	39.9
Operating expenses	(242,861)	(52.6)	(277,460)	(52.2)	(229,887)	(37.3)
Income (loss)						
from operations	(55,946)	(12.1)	(62,391)	(11.7)	16,266	2.6
Nonoperating revenues	15,116	3.3	45,192	8.5	4,576	0.7
Transfers out	(10,000)	(2.2)	-	-	(10,000)	(1.6)
Change in net assets	<u>\$ (50,830)</u>	<u>(11.0) %</u>	<u>\$ (17,199)</u>	<u>(3.2) %</u>	<u>\$ 10,842</u>	<u>1.7 %</u>
Cash and temporary investments (deficits)	<u>\$ (63,460)</u>		<u>\$ 5,779</u>		<u>\$ 5,793</u>	
Advances from other funds	<u>\$ -</u>		<u>\$ 79,258</u>		<u>\$ 64,188</u>	

Liquor Fund Summary





Sales increased significantly in 2008 (15 percent). This along with a decrease in operating expenses led to a positive income from operations for the first time in several years. The decrease in expenses came mainly from the payout of severance to the former store manager completed in 2007. Management should continue to evaluate operations to ensure that the store generates positive cash flow and remains profitable. The General fund advanced \$79,258 to the Liquor fund to cover the deficit cash balance at the end of 2007, of which a portion has been paid during 2008, resulting in an ending balance of \$64,188.

Minnesota statute §340A.602 requires cities to hold a public hearing on the future of their liquor store if the liquor operation has failed to make a profit prior to any inter-fund transfers in at least two of the past three years. The hearing must take place not more than 45 days prior to the end of the fiscal year following the three-year period. After the hearing, the council may, on its own motion, or must, upon petition of 5 percent or more of the registered voters of the city, submit the question on whether the city should continue liquor store operations by a date determined by city council to the voters at the general or special election. The date to discontinue operation, designated by the city council, must not be more than 30 months after the election. The City will need to have a public hearing in 2009 to discuss the continuing losses and consider whether the long-term profitability can be assured.

The Office of the State Auditor annually publishes a report analyzing the operation of municipal liquor stores in the state. The last most recent year of published information is for the year ended December 31, 2007. The statewide averages for all operations are summarized below.

	Combined On and Off Sale		
	2005	2006	2007
	Percent of Sales	Percent of Sales	Percent of Sales
Sales	100.0 %	100.0 %	100.0 %
Cost of sales	<u>61.4</u>	<u>60.3</u>	<u>60.8</u>
Gross profit	38.6	39.7	39.2
Operating expenses	<u>35.8</u>	<u>36.1</u>	<u>35.9</u>
Operating income	2.8	3.6	3.3
Nonoperating revenue	<u>1.5</u>	<u>0.9</u>	<u>0.9</u>
Income before transfers	<u>4.3 %</u>	<u>4.5 %</u>	<u>4.2 %</u>

Source: Analysis of Municipal Liquor Store Operations, for the year ended December 31, 2007

Published by the Minnesota Office of the State Auditor

The gross profit percentage of the City has remained around 40 percent over the three years presented but each combined operation has quite a different mix of what makes up their on and off-sale. The more important statistic is the operating expenses and the income before transfers. The bottom line for the City is getting closer to the state wide averages and operating expenses (37.1 for 2008, however 52.6 and 52.2 percent of sales in 2006 and 2007, respectively) have greatly improved in relation to the 2005, 2006, and 2007 statewide averages.

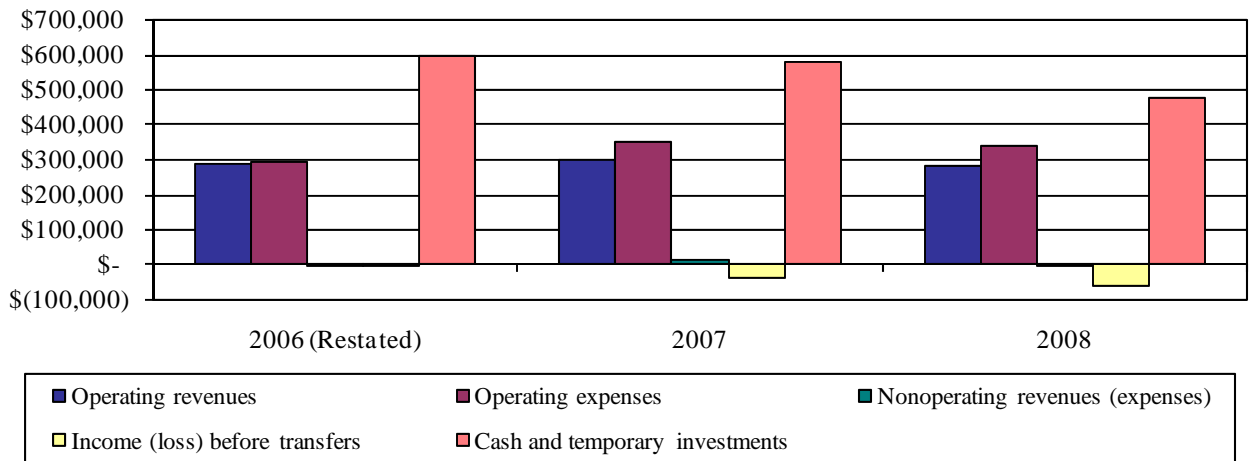


Sewer Fund

A comparison of the past three year's Sewer fund operations is as follows:

	2006 (Restated)		2007		2008	
	Amount	Percent of Revenues	Amount	Percent of Revenues	Amount	Percent of Revenues
Operating revenues	\$ 289,361	100.0 %	\$ 297,670	100.0 %	\$ 285,211	100.0 %
Operating expenses	296,118	102.3	350,962	117.9	338,577	118.7
Operating loss	(6,757)	(2.3)	(53,292)	(17.9)	(53,366)	(18.7)
Nonoperating revenues (expenses)	3,097	1.1	15,972	5.4	(4,963)	(1.7)
Income (loss) before contributions and transfers	(3,660)	(1.2)	(37,320)	(12.5)	(58,329)	(20.4)
Capital contributions	-	-	131,382	44.1	-	-
Transfers in	69,839	24.1	-	-	-	-
Change in net assets	<u>\$ 66,179</u>	<u>22.9 %</u>	<u>\$ 94,062</u>	<u>31.6 %</u>	<u>\$ (58,329)</u>	<u>(20.4) %</u>
Cash and temporary investments	<u>\$ 599,343</u>		<u>\$ 579,968</u>		<u>\$ 475,945</u>	
Bonds payable	<u>\$ 445,000</u>		<u>\$ 335,000</u>		<u>\$ 215,000</u>	

Sewer Operations Summary



The cash balance remains strong relative to operations but it is necessary to maintain a higher balance due to outstanding bonds. Operating expenses decreased from 2007, however there were costs of \$50,889 in repairs and maintenance in 2007 compared to \$25,592 in 2008. A significant increase in personal services went from \$79,463 in 2007 to \$103,558 in 2008. Charges for services have not covered operating expenses during the past three years. The City completed a rate study in 2008. Rates should be reviewed annually to ensure charges for services will cover operating expenses.

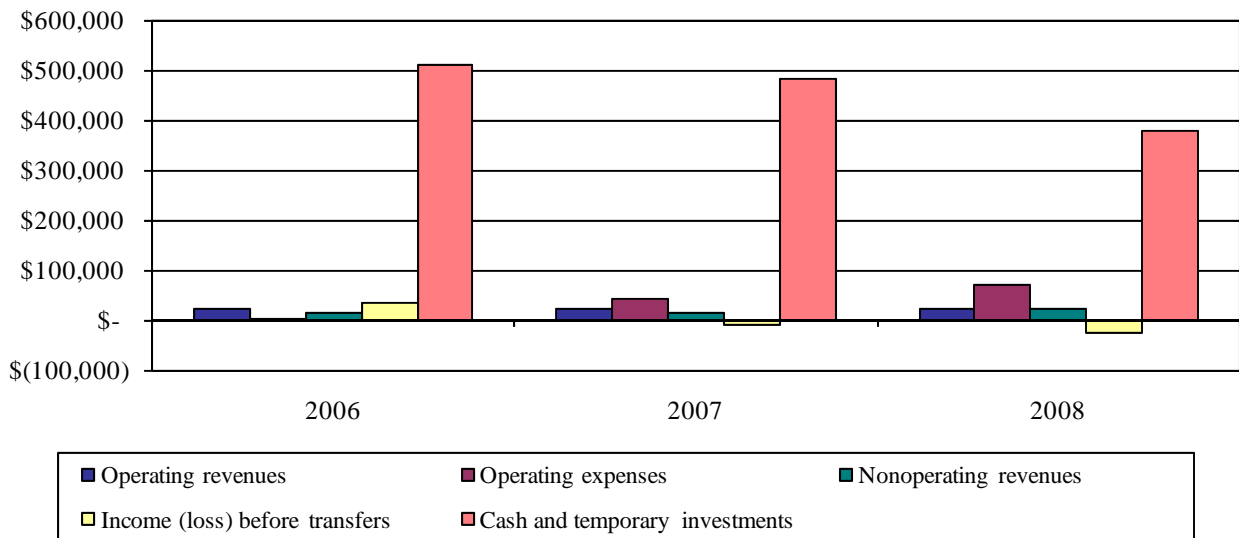


Storm Sewer Fund

A comparison of the past three year's Storm Sewer fund operations is as follows:

	2006		2007		2008	
	Amount	Percent of Revenues	Amount	Percent of Revenues	Amount	Percent of Revenues
Operating revenues	\$ 23,352	100.0 %	\$ 23,679	100.0 %	\$ 23,593	100.0 %
Operating expenses	2,457	10.5	45,592	192.5	71,158	301.6
Operating income (loss)	20,895	89.5	(21,913)	(92.5)	(47,565)	(201.6)
Nonoperating revenues	15,789	67.6	14,739	62.2	25,466	107.9
Income (loss) before contributions and transfers	36,684	157.1	(7,174)	(30.3)	(22,099)	(93.7)
Capital contributions	-	-	86,322	364.6	-	-
Transfers out	-	-	(35,138)	(148.4)	-	-
Change in net assets	<u>\$ 36,684</u>	<u>157.1 %</u>	<u>\$ 44,010</u>	<u>185.9 %</u>	<u>\$ (22,099)</u>	<u>(93.7) %</u>
Cash and temporary investments	<u>\$ 510,583</u>		<u>\$ 482,521</u>		<u>\$ 378,089</u>	

Storm Sewer Operations Summary



In 2007, the City reclassified activities of the Storm Sewer fund to the enterprise funds. As such, comparative information has been provided, however the 2006 information does not include depreciation on capital assets because these assets were added in 2007 through a prior period adjustment. The cash balance at the end of 2008 remains strong compared to operations. The operating loss in 2008 is a result of the Mogren Hill Street and Front Street Drain Improvement project expenses. This project was below the City's threshold for capital assets and was thus expensed in full in 2008.

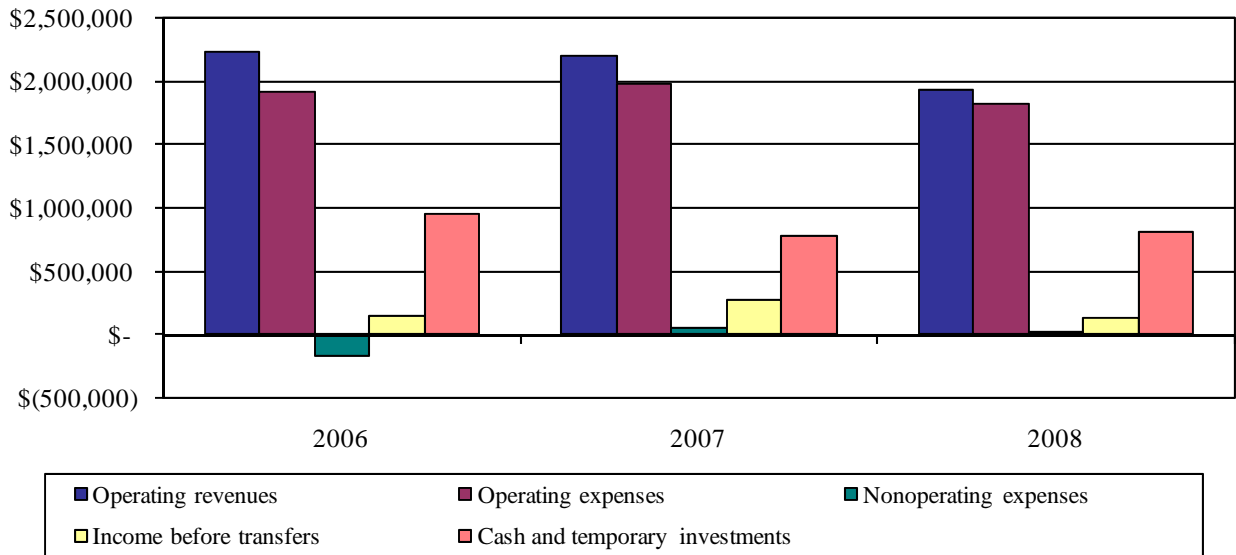


Electric Fund

A comparison of the past three years Electric fund operations is as follows:

	2006		2007		2008	
	Amount	Percent of Revenues	Amount	Percent of Revenues	Amount	Percent of Revenues
Operating revenues	\$ 2,235,977	100.0 %	\$ 2,206,029	100.0 %	\$ 1,927,064	100.0 %
Operating expenses	1,917,082	85.7	1,984,749	90.0	1,814,327	94.1
Operating income	318,895	14.3	221,280	10.0	112,737	5.9
Nonoperating revenues (expenses)	(168,563)	(7.5)	58,235	2.6	14,632	0.8
Income before transfers	150,332	6.8	279,515	12.6	127,369	6.7
Transfers out	(74,853)	(3.3)	(71,174)	(3.2)	(69,777)	(3.6)
Change in net assets	<u>\$ 75,479</u>	<u>3.5 %</u>	<u>\$ 208,341</u>	<u>9.4 %</u>	<u>\$ 57,592</u>	<u>3.1 %</u>
Unrestricted cash and temporary investments	<u>\$ 856,246</u>		<u>\$ 781,762</u>		<u>\$ 807,452</u>	
Bonds payable	<u>\$ 1,420,000</u>		<u>\$ 1,220,000</u>		<u>\$ 925,000</u>	

Electric Operations Summary



The operating income and cash balance remain strong and also has good operating margins. In 2008, operating revenues decreased by 13 percent while the operating expenditures decreased by 9 percent. Although the City completed a rate study in 2008, it is important the Commission review the rates each year to ensure that any permanent increases in expenses are considered within the rate structure.

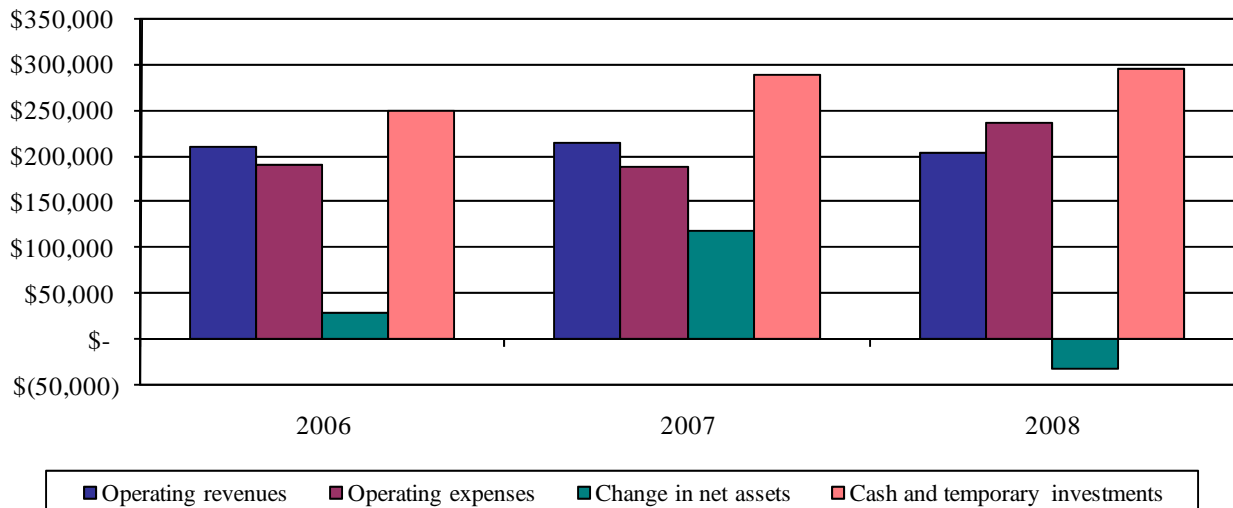


Water Fund

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

	2006		2007		2008	
	Amount	Percent	Amount	Percent	Amount	Percent
Operating revenues	\$ 209,820	100.0 %	\$ 215,312	100.0 %	\$ 203,746	100.0 %
Operating expenses	190,622	90.9	188,951	87.8	235,292	115.5
Operating income (loss)	19,198	9.1	26,361	12.2	(31,546)	(15.5)
Nonoperating revenues (expenses)	9,861	4.7	28,148	13.1	(246)	(0.1)
Income (loss) before contributions and transfers	29,059	13.8	54,509	25.3	(31,792)	(15.6)
Capital contributions	-	-	64,042	29.7	-	-
Change in net assets	\$ 29,059	13.8 %	\$ 118,551	55.0 %	\$ (31,792)	(15.6) %
Cash and temporary investments	\$ 250,293		\$ 288,385		\$ 294,674	
Bonds payable	\$ 107,000		\$ 98,000		\$ 88,000	

Water Operations Summary



In 2008 the operating expenses increased 25 percent while the operating revenue decreased 6 percent. This resulted in an operating loss for the year. It is important the Commission review the rates each year to ensure that any permanent increases in expense are considered within the rate structure. Although the City completed a rate study in 2008, it is important the Commission review the rates each year to ensure that any permanent increases in expense are considered within the rate structure. Cash has remained strong compared to operations for the past three years.



Ratio Analysis

The following captures a few ratios from the City’s financial statements that give some additional information for trend and peer group analysis. The peer group average is derived from information available on the website of the Office of the State Auditor. Different peer group averages are used for Cities of the 5th class (population under 2,500). 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 regardless of size) ratios are shown below.

Ratio	Calculation	Source	2005	2006	2007	2008
Debt to assets	Total liabilities/total assets	Government-wide	27.7%	24.7%	21.6%	18.2%
			34.7%	32.2%	33.1%	N/A
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	137.4%	128.4%	124.0%	85.7%
			109.0%	131.6%	109.1%	N/A
Debt per capita	Bonded debt/population	Government-wide	\$2,262	\$1,629	\$1,765	\$1,413
			\$2,705	\$2,728	\$3,074	N/A
Taxes per capita	Tax revenues/population	Government-wide	\$ 351	\$ 294	\$ 355	\$ 363
			\$ 331	\$ 363	\$ 377	N/A
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	77.7%	76.5%	76.3%	76.0%
			64.1%	63.9%	63.3%	N/A
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	51.5%	49.7%	49.9%	47.7%
			63.4%	62.3%	61.8%	N/A

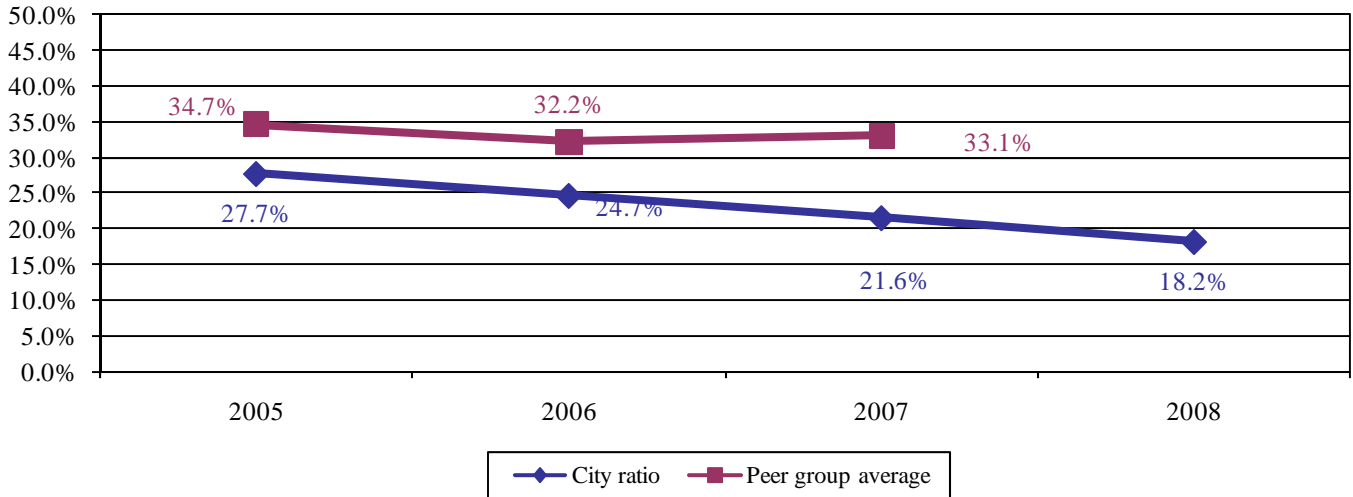
Represents the City of Kenyon

Peer Group ratio



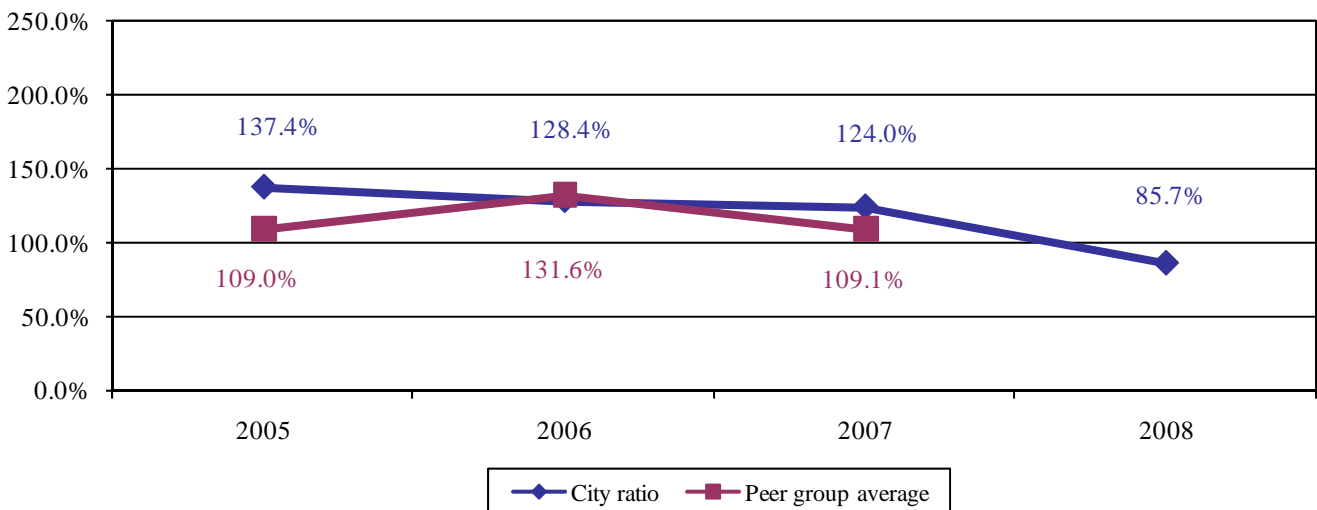
Debt-to-Assets Leverage Ratio (Solvency Ratio)

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)

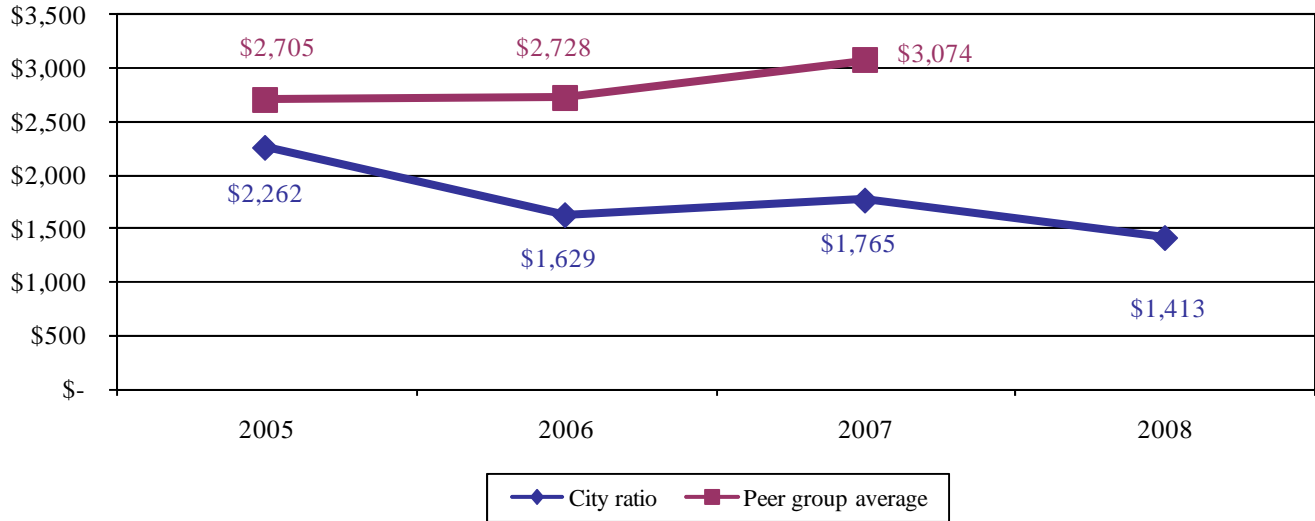
The debt coverage ratio is a comparison of cash generated by operations to total debt service payments (principal and interest) of enterprise funds. This ratio indicates if there are sufficient cash flows from operations to meet debt service obligations. Except in cases where other nonoperating revenues (i.e. taxes, assessments, transfers from other funds, etc.) are used to fund debt service payments, an acceptable ratio would be above 100 percent.





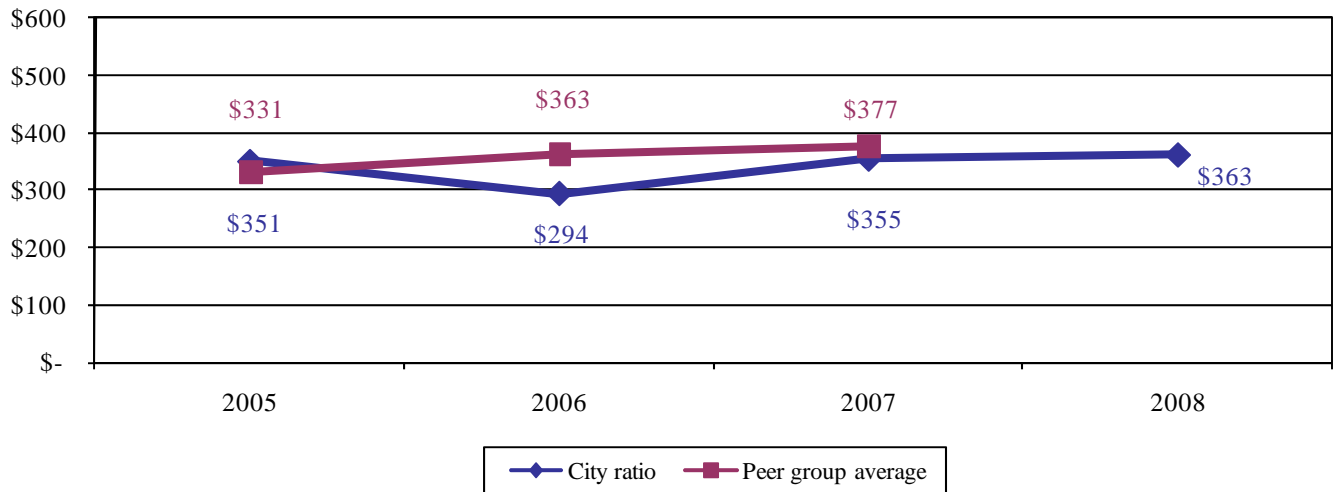
Bonded Debt per Capita (Funding Ratio)

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.

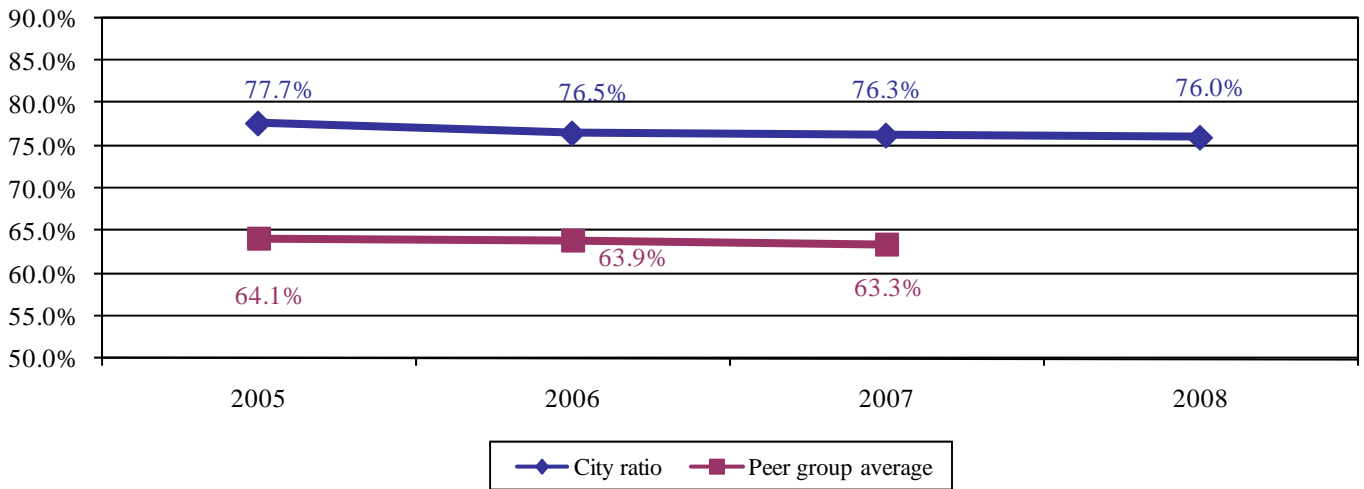




Capital Assets Percentage (Common-size Ratio)

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.

Governmental Activities



Business-type Activities





Other Matters

Lack of Approval of Overtime and Compensatory Time

- Condition:* During our audit we reviewed procedures over transaction cycles related to payroll and found the City to have areas that are in need of improvement.
- Criteria:* The City has adopted a personnel policy. Certain events occurred during the year that appear to be in violation of the requirements established in the personnel policy: 1) the immediate supervisor must give specific approval prior to overtime being earned, 2) use compensatory time will not count as time worked for purposes of computing overtime for non-exempt employees, 3) employee requests to receive compensatory time in lieu of paid overtime must be approved by the employee's supervisor
- Cause:* We noted that the timesheets for the billing clerk and bookkeeper for the pay period ending May 9, 2008, were not signed. Timesheets during this period included overtime without supporting approval of the overtime and overtime being paid without subtracting off compensatory time being used.
- Effect:* These events are in violation of the City's personnel policy.
- Recommendation:* While we recognize that the City was without a City administrator during the year, a substitute supervisor could have performed the duties of payroll approval. Currently, the City's personnel policy does not address the approval of timesheets by a supervisor or prior approval of overtime by a supervisor. We recommend that the policy include a supervisor approval of timesheets and overtime, especially for those employees paid on an hourly basis.



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:

GASB Statement No. 45 - *Accounting and Financial Reporting by Employers for Post employment Benefits Other Than Pensions*

This statement is effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Governments that were phase 1 governments for the purpose of implementation of Statement No. 34 - those with annual revenues of \$100 million or more - are required to implement this statement in financial statements for periods beginning after December 15, 2006.
- Governments that were phase 2 governments for the purpose of implementation of Statement No. 34 - those with total annual revenues of \$10 million or more but less than \$100 million - are required to implement this statement in financial statements for periods beginning after December 15, 2007.
- Governments that were phase 3 governments for the purpose of implementation of Statement No. 34 - those with total annual revenues of less than \$10 million - are required to implement this statement in financial statements for periods beginning after December 15, 2008.

Statement No. 45 gives the following summary, "In addition to pensions, many state and local governmental employers provide other post employment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes post employment healthcare, as well as other forms of post employment benefits (for example, life insurance) when provided separately from a pension plan. This statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers."

GASB Statement No. 51 - *Accounting and Financial Reporting for Intangible Assets*

This statement was issued in June 2007 and is effective for periods beginning after June 15, 2009.

The new standard characterizes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. Examples of intangible assets include easements, computer software, water rights, timber rights, patents, and trademarks.

This statement requires that intangible assets be classified as capital assets (except for those explicitly excluded from the scope of the new standard, such as capital leases). Relevant authoritative guidance for capital assets should be applied to these intangible assets. The statement provides additional guidance that specifically addresses the unique nature of intangible assets, including:

- Requiring that an intangible asset be recognized in the statement of net assets only if it is considered identifiable
- Establishing a specified-conditions approach to recognizing intangible assets that are internally generated (for example, patents and copyrights)
- Providing guidance on recognizing internally generated computer software
- Establishing specific guidance for the amortization of intangible assets.



GASB Statement No. 54 – Fund Balance

This statement was issued in March of 2009 and is effective for periods beginning after June 15, 2010. This new standard is intended to improve the usefulness of information provided to financial report uses about fund balance by providing clearer, more structured fund balance classifications, and clarifying the definitions of existing governmental fund types.

GASB No. 54 distinguishes fund balance between amounts that are considered non-spendable, such as fund balance associated with inventories, and other amounts that are classified based on the relative strength of the constraints that control the purposes for which specific amounts can be spent. The following classifications and definitions will be used:

- *Restricted* - amounts constrained by external parties, constitutional provision, or enabling legislation
- *Committed* - amounts constrained by a government using its highest level of decision-making authority
- *Assigned* - amounts a government *intends* to use for a particular purpose
- *Unassigned* - amounts that are not constrained at all will be reported in the general fund.

In addition to the classifications of fund balance, the standard clarified the definitions of individual governmental fund types, for example, special revenue funds, debt service funds, and capital project funds.

* * * * *

This report is intended solely for the information and use of Council, management 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.

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. The comments and recommendations in the report are purely constructive in nature, and should be read in this context.

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 opportunity to be of service and for the courtesy and cooperation extended to us by your staff.

April 8, 2009
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants