CITY OF KENYON
KENYON, MINNESOTA

MANAGEMENT LETTER

YEAR ENDED
DECEMBER 31, 2009

ABDO EICK & MEYERS LLP
Certified Public Accountants & Consultants

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Certified Public Accountants & Consultants

5201 Eden Avenue
Suite 370
Edina, MN 55436

April 6, 2010

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, 2009 and have issued our report thereon dated April 6, 2010. 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 over financial reporting 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 over financial reporting. 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

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described on the following pages as findings 2009-2, 2009-3 and 2009-4, that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

2009-2 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 misstatement or 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 the administrator reviewing cancelled checks and unopened bank statements.

The City 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: The Council reviews all checks on a monthly basis and approves these by check sequence. A summary statement compares the actual expense and revenues to the budgeted expense and revenues. This process is incorporated in the approval of the consent agenda.

2009-3 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 cannot 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.

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2009-4 Liquor Store Inventory Reconciliation (finding since 2007)

Condition:	The liquor store's point of sale inventory system is not used regularly to reconcile inventory or analyze profits. Also, there is no formal review of variance reports after physical cycle counts are done.
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 control over products being purchased and sold at the store.
Cause:	Unknown.
Effect:	Without regularly documented reconciliations of the point of sale system to the actual inventory, management is not able to track variance trends.
Recommendation:	We recommend cycle counts be done on a semi-monthly basis. Cycle counts consist of counting all of one type of product and matching it to the inventory point of sale system. Inventory adjustment reports should be printed and retained for each cycle count. Management can then use these reports to notice trends such as whether they are making adjustments to the same product each time a count is performed. If this is the case, it may raise concerns of theft. This will be an important step in 2010 especially with the decrease in gross profit percentage.
Management Response:	The City changed the management structure in 2009 and has implemented an inventory cycle count on a semi-monthly basis.

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:

2009-1 Advertisement for Bids

Condition:	Minnesota statute 412.311 requires that bids be published for at least ten days in advance of the last day for the submission of bids. During 2009 the Kenyon Municipal Utilities Commission (the Commission) had a bid that was published for a period of less than ten days.
Criteria:	Bids must be published for at least ten days in advance of the last day for the submission of bids in the official newspaper.
Cause:	The Commission did not publish its request for bids in the official newspaper for at least ten days in advance of the last day for the submission of bids. The Commission only published the request for eight days prior to the date of submission.
Effect:	The Commission did not comply with the requirements of Minnesota statute 412.311.
Recommendation:	We recommend those in charge of requesting bids review requirements prior to requesting the bids.
Management Response:	The Commission board and staff have been notified of the non-compliance and will review these requirements in the future **.**

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. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were 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 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 total, we prepared 21 journal entries identified in the table below. These entries are necessary to adjust balances to the proper year end amount. It is important that the City understand these entries and prepare to make them in the future. Internal preparation enhances the quality and timeliness of internal information.

Accounting entries	14
Audit entries	7
Total	21

We have provided descriptions for all of the audit entries detected as a result of audit procedures that were corrected by management below:

- Adjust tax and assessment revenue and receivables for $41,002 in various funds.
- Adjust the value of a capital asset by increasing capital outlay by $5,885 in the Capital Outlay fund. This entry was made in order to state that asset at historical cost. This entry also increased construction in process in the government-wide financial statements by the same amount.
- Record building improvements of $38,189 as a capital asset in the government-wide financial statements.
- During the year a fire truck was sold to a neighboring city. This fire truck was fully depreciated with an original cost of $75,000. An entry was made to adjust the government-wide financial statements for the decrease in the asset and the related decrease accumulated depreciation.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representations letter dated April 6, 2010.

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, 2009.

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 increased $101,720 from 2008. The total fund balance is $631,087, which is 59.5 percent of the 2010 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.

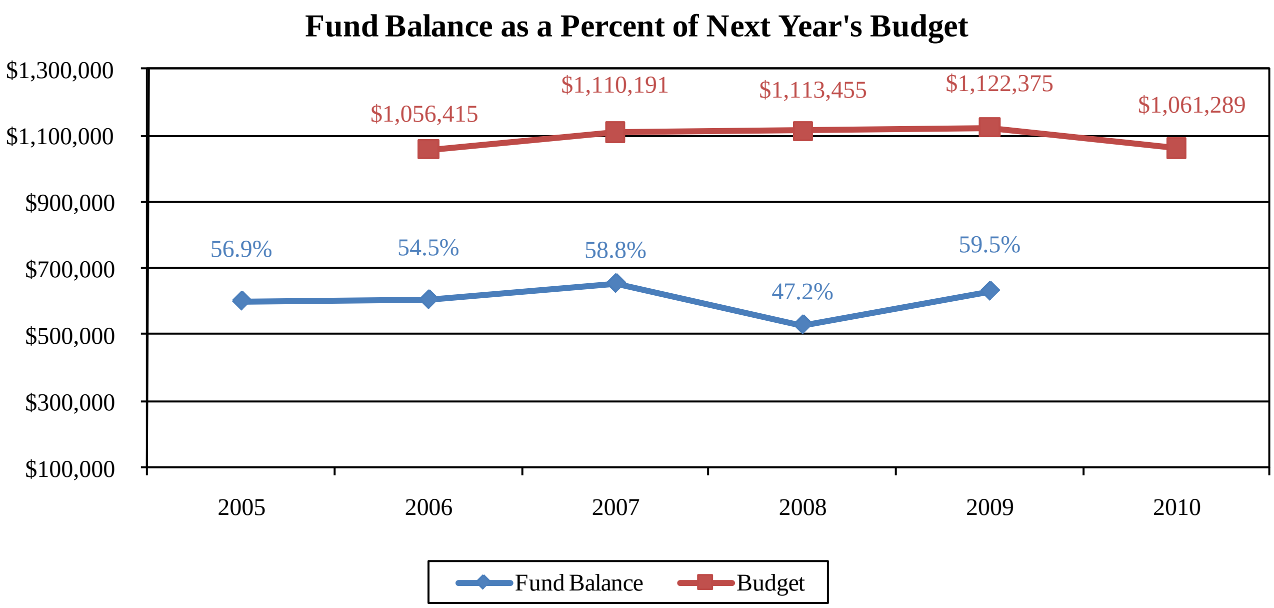
- The City is vulnerable to legislative actions at the State and Federal level. The State continually adjusts the local government aid and property tax credit formulas. We also have seen the State mandate levy limits for cities over 2,500 in population. An adequate fund balance will provide a temporary 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
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
2009	631,087	2010	1,061,289	59.5



We have compiled peer group average fund balance information from reports available on the website of the Office of the State Auditor for Cities of the 4th class (under 2,500) and from Abdo, Eick & Meyers' client base of approximately 100 cities. In 2008 the average General fund balance as a percentage of expenditures was 47.2 percent. Based on comparison to the peer groups, the City's General fund balance is lower than average but improved significantly in 2009.

A summary of the 2009 operations is as follows:

	Final Budgeted Amounts	Actual Amounts	Variance with Final Budget - Positive (Negative)
Revenues	$ 1,069,028	$ 995,571	$ (73,457)
Expenditures	999,415	950,238	49,177
Excess of revenues over expenditures	69,613	45,333	(24,280)
Other financing sources (uses)			
Transfers in	118,000	106,347	(11,653)
Sale of capital assets	-	6,250	6,250
Transfers out	(56,210)	(56,210)	-
Total other financing sources (uses)	61,790	56,387	(5,403)
Net change in fund balances	131,403	101,720	(29,683)
Fund balances, January 1	529,367	529,367	-
Fund balances, December 31	$ 660,770	$ 631,087	$ (29,683)

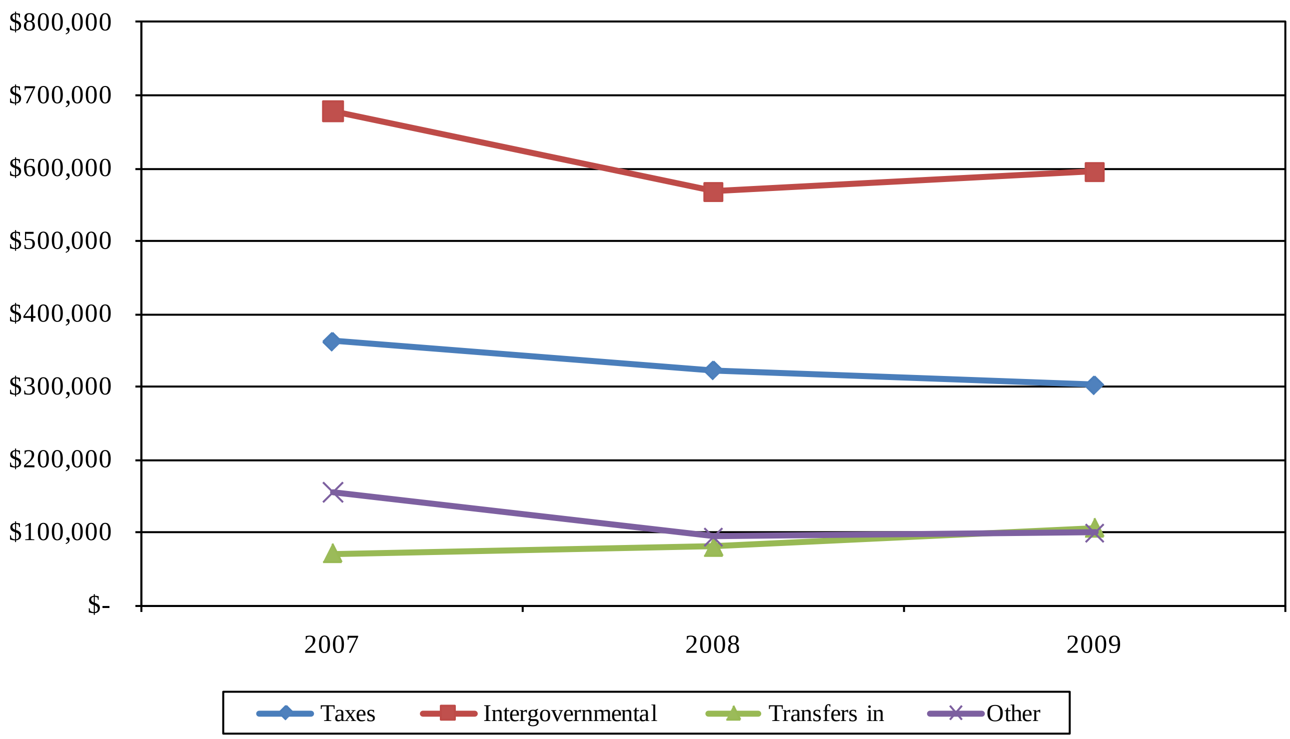
Some of the line items with significant variances are highlighted below:

- Property tax revenue was $59,020 less than anticipated. This was primarily due to budgeting the market value credit within the tax levy line item and again in the market value credit line item.
- Local government aid was $37,488 less than anticipated due to unallotments at the State level.
- Miscellaneous revenues were $12,916 higher than anticipated.
- Public works expenditures were $33,096 lower than anticipated.
- Culture and recreation expenditures were $20,950 lower than anticipated.

A comparison between 2007, 2008 and 2009 revenues and transfers is presented below:

Source	2007	2008	2009	Percent of Total	Per Capita
Taxes	$ 362,495	$ 322,355	$ 301,418	27.2 %	$ 173
Licenses and permits	5,833	6,172	4,251	0.4	2
Intergovernmental	678,186	567,865	594,879	54.0	341
Charges for services	68,338	66,008	65,750	6.0	38
Fines and forfeits	5,978	7,765	7,548	0.7	4
Investment earnings	7,705	(4,356)	5,059	0.5	3
Miscellaneous	67,328	17,762	16,666	1.5	10
Transfers in	71,174	79,777	106,347	9.7	61
Total revenues and transfers	$ 1,267,037	$ 1,063,348	$ 1,101,918	100.0 %	$ 632

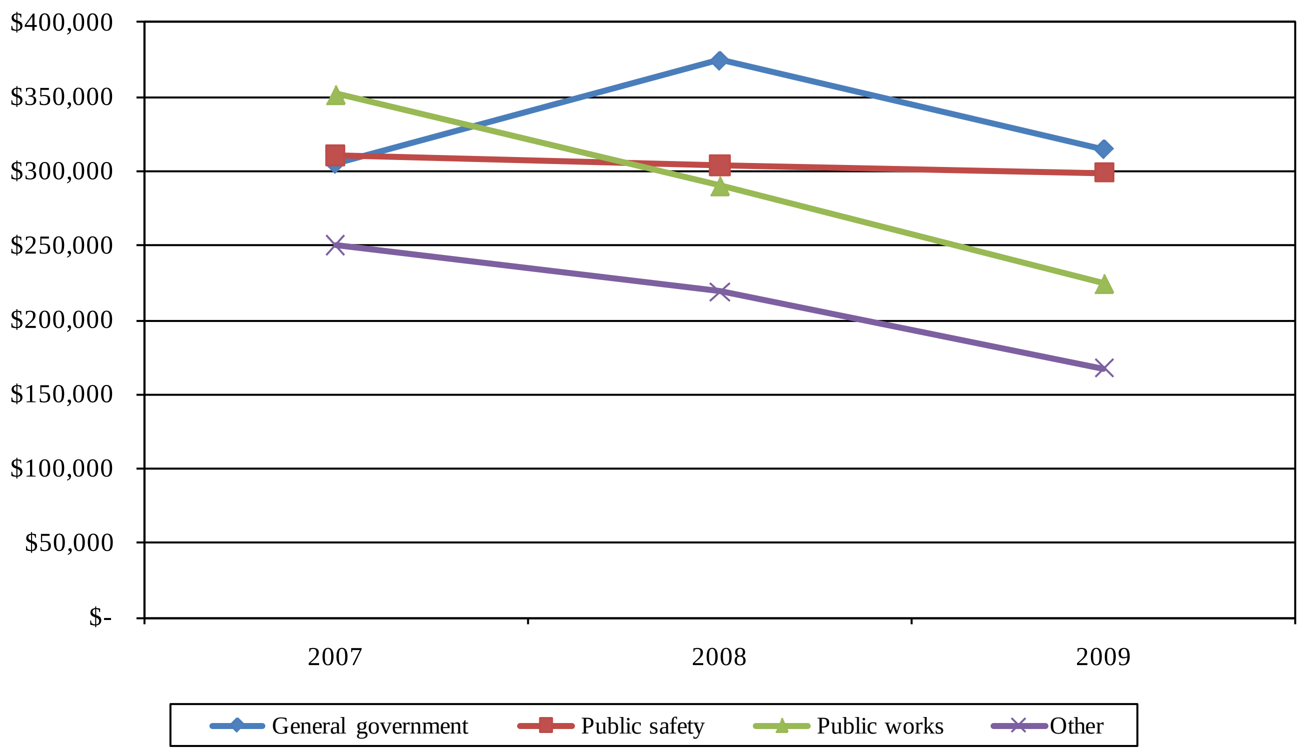
A graphical presentation of 2007, 2008 and 2009 revenues and transfers follows:



A comparison between 2007, 2008 and 2009 expenditures and transfers is presented below:

Program	2007	2008	2009	Percent of Total	Per Capita	Peer Group Per Capita
General government	$ 304,995	$ 374,536	$ 314,942	31.3 %	$ 181	$ 184
Public safety	310,696	304,124	299,083	29.7	171	186
Public works	351,938	290,673	225,054	22.4	129	118
Sanitation and recycling	34,656	34,692	34,704	3.4	20	N/A
Culture and recreation	79,398	82,814	64,210	6.4	37	48
Capital outlay	65,976	39,101	12,245	1.2	7	80
Transfers out	70,200	62,400	56,210	5.6	32	N/A
Total expenditures and transfers	$ 1,217,859	$ 1,188,340	$ 1,006,448	100.0 %	$ 577	$ 616

A graphical presentation of 2007, 2008 and 2009 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 fund type group included:

Fund	Fund Balances December 31, 2009	Fund Balances December 31, 2008	Increase (Decrease)
Nonmajor			
Ambulance	$ 6,085	$ 6,026	$ 59
Fire	5,128	4,977	151
Library	44,687	39,658	5,029
Economic Development Authority	81,475	52,758	28,717
Gunderson House	9,896	7,166	2,730
Police Forfeiture	175	-	175
Special Purpose Donation	11,424	10,953	471
2004 Tax Abatement/TIF Sun Home	1,119	249	870
Total	$ 159,989	$ 121,787	$ 38,202

It is important that all funds maintain a sufficient fund balance to provide working capital.

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) December 31, 2009	Fund Balances (Deficits) December 31, 2008	Increase (Decrease)
Major			
2006 Trondheim Road Extension	$ (119,680)	$ (119,101)	$ (579)
Nonmajor			
Municipal Building	(385,903)	(388,903)	3,000
Capital Outlay	343,129	333,196	9,933
Total	$ (162,454)	$ (174,808)	$ 12,354

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 tax levies 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:

	December 31, 2009			Final
Debt Description	Total Cash	Total Assets	Outstanding Debt	Maturity Date
2007 G.O. Refunding	$ 138,405	$ 139,866	$ 1,020,000	2/1/2020

The following chart is the estimated cash flow analysis for the 2007 G.O. refunding bond. The debt service requirements include a $425 fiscal agent fee each year.

Levy Year	Collection/ Payment Year	Estimated Beginning Cash Balance	Debt Service Requirement	Scheduled Levy	Estimated Interest and Assessments	Estimated Ending Cash Balance
2009	2010	$ 138,405	$ (198,095)	$ 152,052	$ 2,740	$ 95,102
2010	2011	95,102	(123,385)	124,040	951	96,708
2011	2012	96,708	(119,965)	125,830	967	103,540
2012	2013	103,540	(121,355)	121,830	1,035	105,050
2013	2014	105,050	(117,555)	124,130	1,051	112,676
2014	2015	112,676	(118,655)	91,230	1,127	86,378
2015	2016	86,378	(90,117)	88,155	864	85,280
2016	2017	85,280	(87,043)	85,080	853	84,170
2017	2018	84,170	(83,930)	86,930	842	88,012
2018	2019	88,012	(85,675)	88,570	880	91,787
2019	2020	91,787	(87,210)	-	918	5,495

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." Above is the schedule of levies to and estimated cash reserves to the end of the debt service requirements.

The 2000 EDA Public Project Revenue Bonds was refunded in 2007 and is considered defeased. Accordingly, this fund was closed in 2009 to the 2007 G.O. Refunding debt service fund.

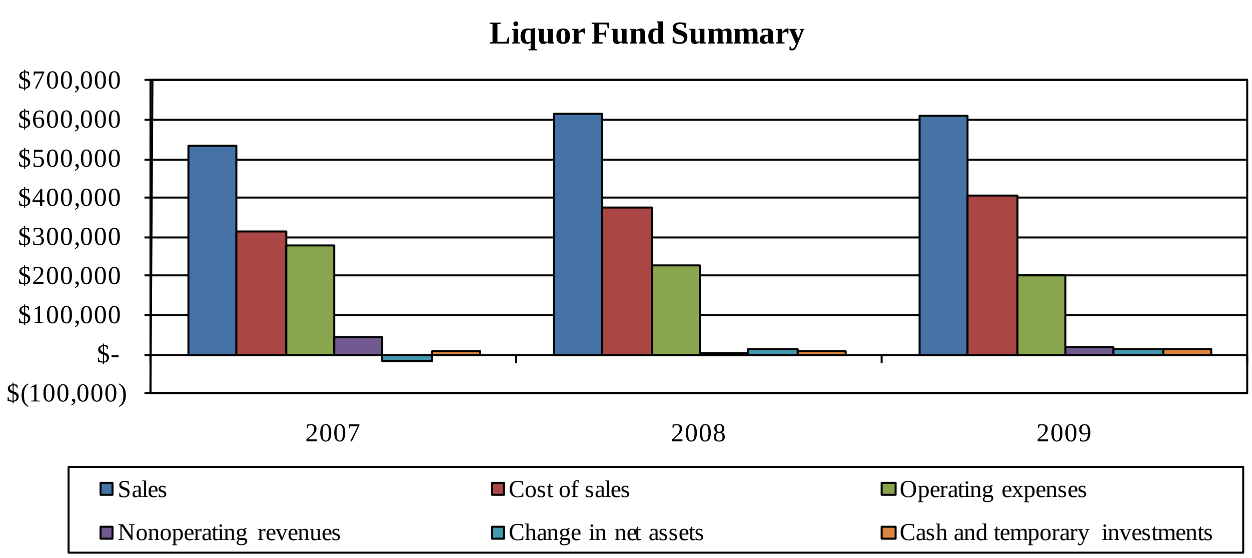
Enterprise Funds

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:

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Sales	$ 531,306	100.0 %	$ 616,930	100.0 %	$ 607,617	100.0 %
Cost of sales	(316,237)	(59.5)	(373,709)	(60.6)	(406,779)	(66.9)
Gross profit	215,069	40.5	243,221	39.4	200,838	33.1
Operating expenses	(277,460)	(52.2)	(226,955)	(36.8)	(204,503)	(33.7)
Income (loss) from operations	(62,391)	(11.7)	16,266	2.6	(3,665)	(0.6)
Nonoperating revenues	45,192	8.5	4,576	0.7	16,628	2.7
Transfers out	-	-	(10,000)	(1.6)	-	-
Change in net assets	$ (17,199)	(3.2) %	$ 10,842	1.7 %	$ 12,963	2.1 %
Cash and temporary investments	$ 5,779		$ 5,793		$ 12,784	
Advances from other funds	$ 79,258		$ 64,188		$ 48,737	



Sales were down 1.5 percent from 2008 and the fund had an operating gain of $12,963 in 2009. 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 2009, resulting in an ending balance of $48,737.

The Office of the State Auditor annually publishes a report analyzing the operation of municipal liquor stores in the state. The most recent year of published information is for the year ended December 31, 2008. The statewide averages for all operations are summarized below.

	Combined On and Off Sale		
	2006	2007	2008
	Percent of Sales	Percent of Sales	Percent of Sales
Sales	100.0 %	100.0 %	100.0 %
Cost of sales	60.3	60.8	62.4
Gross profit	39.7	39.2	37.6
Operating expenses	36.1	35.9	35.3
Operating income	3.6	3.3	2.3
Nonoperating revenue	0.9	0.9	0.5
Income before transfers	4.5 %	4.2 %	2.8 %

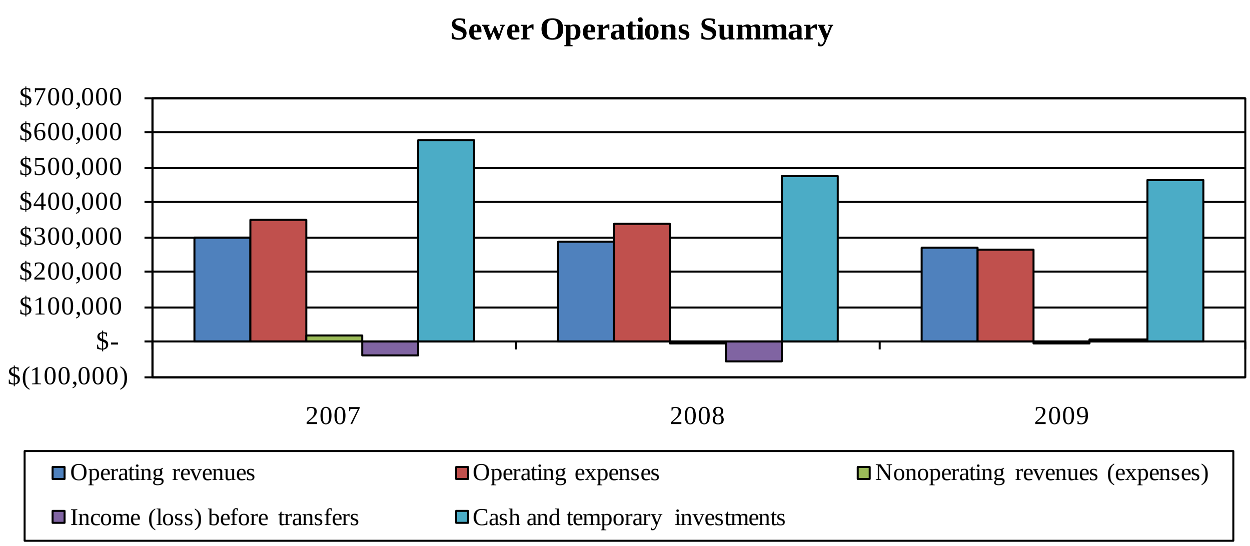
Source: Analysis of Municipal Liquor Store Operations, for the year ended December 31, 2008
Published by the Minnesota Office of the State Auditor

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 (34.6 percent and 37.3 percent for 2009 and 2008 respectively, however 52.2 percent of sales in 2007) have greatly improved in relation to the 2006, 2007, and 2008 statewide averages.

Sewer Fund

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

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 297,670	100.0 %	$ 285,211	100.0 %	$ 269,909	100.0 %
Operating expenses	350,962	117.9	338,577	118.7	261,030	96.7
Operating income	(53,292)	(17.9)	(53,366)	(18.7)	8,879	3.3
Nonoperating revenues (expenses)	15,972	5.4	(4,963)	(1.7)	(3,974)	(1.5)
Income (loss) before contributions	(37,320)	(12.5)	(58,329)	(20.4)	4,905	1.8
Capital contributions	131,382	44.1	-	-	-	-
Change in net assets	$ 94,062	31.6 %	$ (58,329)	(20.4) %	$ 4,905	1.8 %
Cash and temporary investments	$ 579,968		$ 475,945		$ 461,079	
Bonds payable	$ 335,000		$ 215,000		$ 90,000	

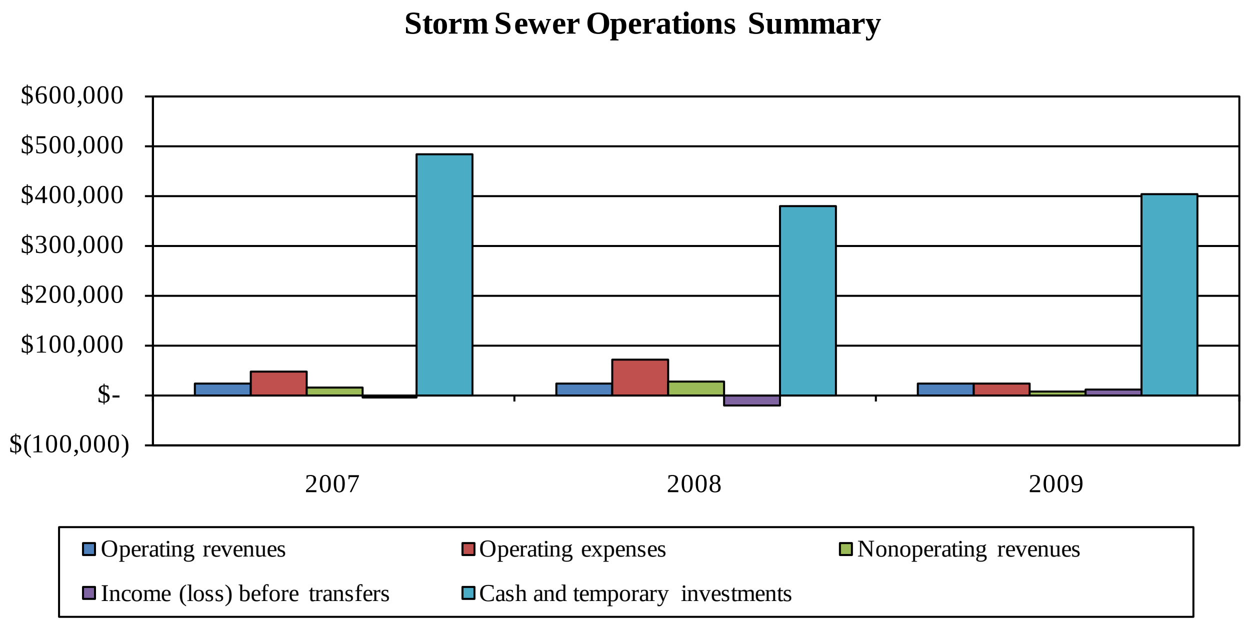


The cash balance remains strong relative to operations but it is necessary to maintain a higher balance due to outstanding bonds. Operating expenses decreased from 2008, this was largely due to the cost of personal services decreasing by $77,653 from 2008. Charges for services covered operating expenses during the past year. The City completed a rate study in 2009 and will be reviewing the rates each year.

Storm Sewer Fund

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

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 23,679	100.0 %	$ 23,593	100.0 %	$ 23,886	100.0 %
Operating expenses	45,592	192.5	71,158	301.6	21,230	88.9
Operating income (loss)	(21,913)	(92.5)	(47,565)	(201.6)	2,656	11.1
Nonoperating revenues	14,739	62.2	25,466	107.9	5,640	23.6
Income (loss) before contributions and transfers	(7,174)	(30.3)	(22,099)	(93.7)	8,296	34.7
Capital contributions	86,322	364.6	-	-	-	-
Transfers out	(35,138)	(148.4)	-	-	-	-
Change in net assets	$ 44,010	185.9 %	$ (22,099)	(93.7) %	$ 8,296	34.7 %
Cash and temporary investments	$ 482,521		$ 378,089		$ 400,713	

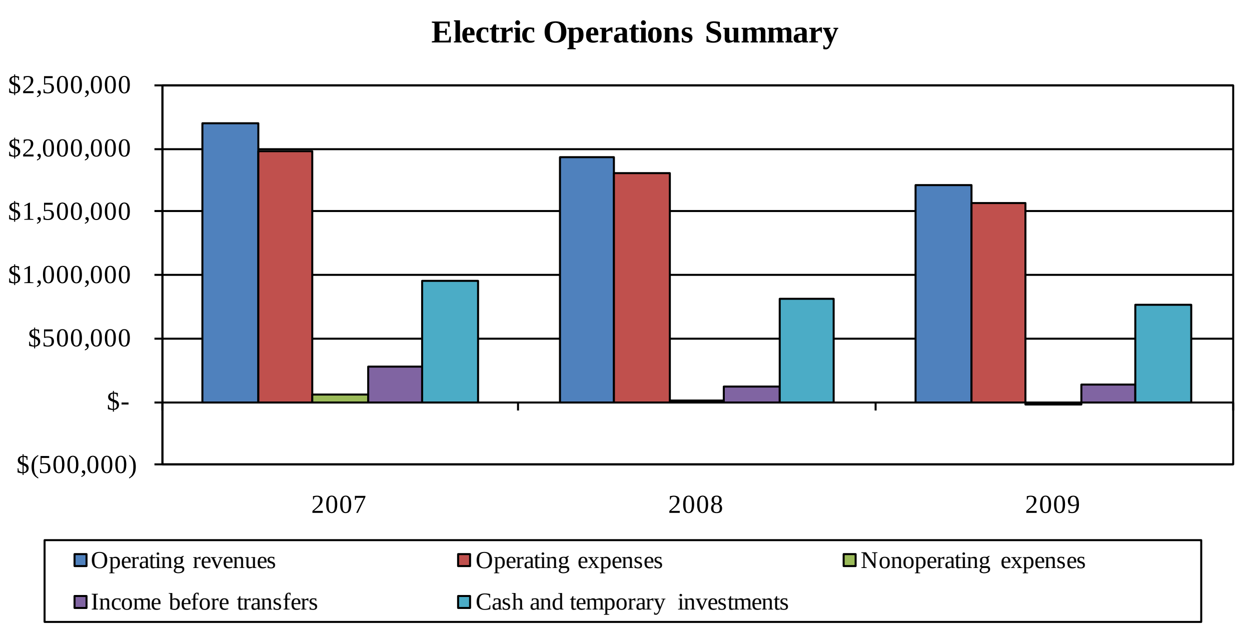


The cash balance at the end of 2009 remains strong compared to operations. Charges for services were sufficient to cover operating costs in 2009.

Electric Fund

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

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 2,206,029	100.0 %	$ 1,927,064	100.0 %	$ 1,704,739	100.0 %
Operating expenses	1,984,749	90.0	1,813,352	94.1	1,572,941	92.3
Operating income	221,280	10.0	113,712	5.9	131,798	7.7
Nonoperating revenues (expenses)	58,235	2.6	13,657	0.7	(3,324)	(0.2)
Income before transfers	279,515	12.6	127,369	6.6	128,474	7.5
Transfers out	(71,174)	(3.2)	(69,777)	(3.6)	(98,447)	(5.8)
Change in net assets	$ 208,341	9.4 %	$ 57,592	3.0 %	$ 30,027	1.7 %
Unrestricted cash and temporary investments	$ 781,762		$ 807,452		$ 760,996	
Bonds payable	$ 1,220,000		$ 925,000		$ 695,000	

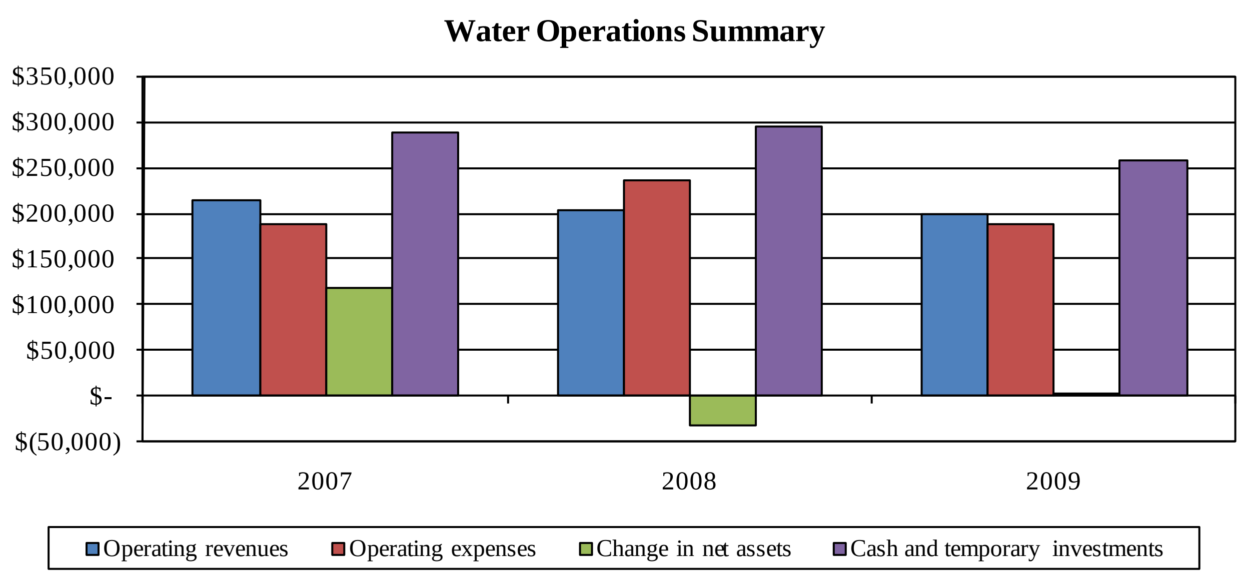


The operating income and cash balance remain strong and also has good operating margins. In 2009, operating revenues decreased by 11.5 percent while the operating expenses decreased by 14.2 percent. The Commission completed a rate study in 2009 and will be reviewing the rates each year.

Water Fund

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

	2007		2008		2009	
	Total	Percent	Total	Percent	Total	Percent
Operating revenues	$ 215,312	100.0 %	$ 202,304	100.0 %	$ 198,632	100.0 %
Operating expenses	188,951	87.8	235,292	116.3	188,288	94.8
Operating income (loss)	26,361	12.2	(32,988)	(16.3)	10,344	5.2
Nonoperating revenues	28,148	13.1	1,196	0.6	983	0.5
Income (loss) before contribitions	54,509	25.3	(31,792)	(15.7)	11,327	5.7
Capital contributions	64,042	29.7	-	-	-	-
Change in net assets	$ 118,551	55.0 %	$ (31,792)	(15.7) %	$ 3,427	1.7 %
Cash and temporary investments	$ 288,385		$ 294,674		$ 257,102	
Bonds payable	$ 98,000		$ 88,000		$ 78,000	



In 2009 the operating expenses decreased 20 percent while the operating revenue decreased 4 percent. It is important the Commission review the rates each year to ensure that any permanent increases in expense are considered within the rate structure. The Commission completed a rate study in 2009 and will be reviewing 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 4th class cities with populations less than 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	2006	2007	2008	2009
Debt to assets	Total liabilities/total assets	Government-wide	24.7%	21.6%	18.2%	15.2%
			32.2%	33.1%	31.7%	N/A
Debt service coverage	Net cash provided by operations/ enterprise fund debt payments	Enterprise funds	128.4%	124.0%	85.7%	118.9%
			131.6%	109.1%	94.9%	N/A
Debt per capita	Bonded debt/population	Government-wide	$ 1,629	$ 1,765	$ 870	$ 681
			$ 2,728	$ 3,074	$ 2,488	N/A
Current expenditures per capita	Governmental fund current expenditures/population	Governmental funds	$ 848	$ 793	$ 831	$ 674
			N/A	$ 644	$ 645	N/A
Capital expenditures per capita	Governmental fund capital outlay/population	Governmental funds	$ 98	$ 82	$ 236	$ 63
			N/A	$ 454	$ 292	N/A
Taxes per capita	Tax revenues/population	Government-wide	$ 294	$ 355	$ 363	$ 354
			$ 363	$ 377	$ 385	N/A
Capital assets % left to depreciate - Governmental	Net capital assets/ gross capital assets	Government-wide	76.5%	76.3%	76.0%	74.2%
			63.9%	63.3%	59.6%	N/A
Capital assets % left to depreciate - Business-type	Net capital assets/ gross capital assets	Government-wide	49.7%	49.9%	47.7%	45.3%
			62.3%	61.8%	60.9%	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 financed with outstanding debt).

Debt Service Coverage Ratio (Solvency Ratio)

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

Current Expenditures per Capita (Funding Ratio)

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

Capital Expenditures per Capita (Funding Ratio)

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

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.

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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. 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 users 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.

Abdo Eick & Meyers, LLP

April 6, 2010
Minneapolis, Minnesota

ABDO, EICK & MEYERS, LLP
Certified Public Accountants

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