

City of Morning Sun

**Independent Auditor's Reports
Financial Statements and Supplementary Information
Auditor's Report on Compliance
Comments and Recommendations**

June 30, 2004

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City of Morning Sun

Officials

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
Patricia A. Schaefer	Mayor	December, 2005
Roxanne Martin	Mayor-Pro tem	December, 2005
Mike Dean	Council Member	December, 2005
Roger Hobbs	Council Member	December, 2005
Tom Bryant	Council Member	December, 2007
Bryan Townsley	Council Member	December, 2007
Kathy Stocker	City Treasurer	Not Elected
Holly Fletcher	City Clerk	Not Elected

James Walker, CPA
James Egerton, CPA
Kimberly Hunsaker, CPA
Melodee Walker, CPA
Stephanie Hoschek, CPA
William Hesse, LPA



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Independent Auditor's Report

To the Honorable Mayor and Members of City Council
City of Morning Sun, Iowa

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Morning Sun, Iowa, as of and for the year ended June 30, 2004, which collectively comprise the City's basic financial statements listed in the table of contents. These financial statements are the responsibility of the City of Morning Sun's management. Our responsibility is to express opinions on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinions.

As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles. Also, as permitted by the Code of Iowa, the accounting records of the City have not been audited for all prior years. Accordingly, we were unable to satisfy ourselves as to the distribution by fund of the total fund balance at July 1, 2003.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to verify the distribution by fund of the total fund balance at July 1, 2003, as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the respective cash basis financial position of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Morning Sun as of June 30, 2004, and the respective changes in cash basis financial position for the year then ended in conformity with the basis of accounting described in Note 1.

As described in Note 12, during the year ended June 30, 2004, the City adopted Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments; Statement No. 37, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus; Statement No. 38, Certain Financial Statement Note Disclosures; and Statement No. 41, Budgetary Comparison Schedule - Perspective Differences.

In accordance with Government Auditing Standards, we have also issued our reports dated November 16, 2004 on our consideration of the City of Morning Sun's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis on pages 4 through 9 and budgetary comparison information on pages 20 through 21 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We applied limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the City of Morning Sun's basic financial statements. Other supplementary information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Walker Egerton & Hunsaker PC

November 16, 2004

City of Morning Sun Management's Discussion and Analysis

The City of Morning Sun provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended June 30, 2004. We encourage readers to consider this information in conjunction with the City's financial statements, which follow.

Because the City is implementing new reporting standards for this fiscal year with significant changes in content and structure, much of the information is not easily comparable to prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the City's financial position and results of operations.

2004 FINANCIAL HIGHLIGHTS

- Revenues of the City's governmental activities increased 36.5%, or approximately \$121,200, from fiscal 2003 to fiscal 2004. Property tax decreased approximately \$11,400 due to a reduction in State reimbursements and the rollback. The City received a CDBG grant of \$146,100, accounting for most of the increase in overall receipts.
- Disbursements increased 19.9%, or approximately \$79,400 in fiscal 2004 from fiscal 2003. Disbursements of the CDBG grant amounted to \$146,100.
- The City's total cash basis net assets increased more than 10.6%, or approximately \$20,700, from June 30, 2003 to June 30, 2004.
- The City did not raise property tax rates in 2003-2004 and absorbed the loss in reduced state reimbursements. Increased costs in employee benefits were offset by increasing the health insurance deductible and decreasing the City's share of the premium and increasing the employee share.

USING THIS ANNUAL REPORT

The annual report consists of a series of financial statements and other information as follows:

- Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the City's financial activities.
- The Government-wide Financial Statements consist of a Statement of Activities and Net Assets. This statement provides information about the activities of the City as a whole and presents an overall view of the City's finances.
- The Fund Financial Statements tell how governmental services were financed in the short term as well as what remains for future spending. Fund financial statements report the City's operations in more detail than the government wide statements by providing information about the most significant funds.
- Notes to Financial Statements provide additional information essential to a full understanding of the data provided in the basic financial statements.
- Required Supplementary Information further explains and supports the financial statements with a comparison to the City's budget for the year.
- Other Supplementary Information provides detailed information about the nonmajor governmental funds.

Basis of Accounting

The City maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles. Therefore, when reviewing the financial information and discussion within this annual report, the reader should keep in mind the limitations resulting from the use of the cash basis of accounting.

REPORTING THE CITY'S FINANCIAL ACTIVITIES

Government-wide Financial Statements

One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Activities and Net Assets reports information which helps answer this question.

The Statement of Activities and Net Assets presents the City's net assets. Over time, increases or decreases in the City's net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The Statement of Activities and Net assets is divided into two kinds of activities:

- Governmental Activities include public safety, public works, culture and recreation, community and economic development, general government, debt service and capital projects. Property tax and state and federal grants finance most of these activities.
- Business Type Activities include the waterworks and the sanitary sewer system. These activities are financed primarily by user charges.

Fund Financial Statements

The City has two kinds of funds:

A) Governmental funds account for most of the City's basic services. These focus on how money flows into and out of those funds, and the balances at year-end that are available for spending. The governmental funds include: 1) the General Fund, 2) the Special Revenue Funds, such as Road Use Tax and Urban Renewal Tax Increment, 3) the Debt Service Fund, 4) the Capital Projects Fund and 5) the Permanent Fund. The governmental fund financial statements provide a detailed, short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs.

The required financial statements for governmental funds include a statement of cash receipts, disbursements and changes in cash balances.

B) Proprietary funds account for the City's Enterprise Funds. Enterprise Funds are used to report business type activities. The City maintains the Enterprise Funds to provide information for the water, sewer, gas, and solid waste funds, considered to be major funds of the City.

The required financial statements for proprietary funds include a statement of cash receipts, disbursements and changes in cash balances.

Reconciliation's between the government-wide statement and the fund financial statements follow the fund financial statements.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of financial position. The City's cash balance for governmental activities decreased from a year ago by approximately \$25,000. The analysis that follows focuses on the changes in cash balance for governmental activities.

Changes in Cash Basis Net Assets of Governmental Activities	Year ended June 30,	
	<u>2004</u>	<u>2003</u>
Receipts and transfers:		
Property tax	\$ 123,659	\$ 135,032
Tax increment financing collections	33,674	32,591
Road use funds	73,146	80,440
Grants and reimbursements	146,124	-
Use of money and property	809	2,191
Charges for services	27,060	23,746
Other receipts	<u>49,013</u>	<u>58,254</u>
Total receipts and transfers	<u>453,485</u>	<u>332,254</u>
Disbursements:		
Public safety	27,214	54,581
Public works	87,366	83,127
Culture and recreation	44,680	44,920
Community and economic development	146,124	37,347
General government	96,752	102,080
Debt service	<u>76,373</u>	<u>77,065</u>
Total disbursements	<u>478,509</u>	<u>399,120</u>
(Decrease) in cash basis net assets	(25,024)	(66,866)
Cash basis net assets beginning of year	<u>61,135</u>	<u>128,001</u>
Cash basis net assets end of year	<u>\$ 36,111</u>	<u>\$ 61,135</u>

The City's total receipts for governmental activities increased by 36.5%, or \$121,000. The total cost of all programs and services increased by approximately \$79,400. The only significant increase in receipts was primarily the result of proceeds received from the issuance of the CDBG grant.

The City is currently selling lots in the Garland Addition to promote economic development. The Garland Addition is located in a tax increment financing district which will generate funds to help make new streets and put in new utilities in the area.

The City received a CDBG grant of the housing rehabilitation program. Ten homes in Morning Sun have been improved or are in the process of being improved. The program has been a success and the City is considering applying for another grant in the future.

The cost of all governmental activities this year was \$478,500. However, as shown in the Statement of Activities and Net Assets on page 10, the amount taxpayers ultimately financed for these activities was \$295,400 because some of the cost was paid by those directly benefited from the programs (\$30,445) or by other governments and organizations that subsidized certain programs with grants and contributions (\$152,640). The City paid for the remaining "public benefit" portion of governmental activities with approximately \$295,400 in tax (some of which could only be used for certain programs) and with other receipts, such as interest and general entitlements.

Changes in Cash Basis Net Assets of Business Type Activities	Year Ended June 30,	
	<u>2004</u>	<u>2003</u>
Program receipts		
Water charges	\$ 108,269	\$ 107,069
Gas service	328,915	307,096
Sewer service	76,025	76,557
Garbage	47,447	48,492
Other miscellaneous receipts	<u>6,672</u>	<u>4,129</u>
Total receipts	<u>567,328</u>	<u>543,343</u>
Disbursements and transfers:		
Water	88,710	119,369
Gas service	332,597	307,828
Sewer service	46,606	52,712
Garbage	<u>53,670</u>	<u>53,502</u>
Total disbursements and transfers	<u>521,583</u>	<u>533,411</u>
Increase in cash balance	45,745	9,932
Cash basis net assets beginning of year	<u>133,874</u>	<u>123,942</u>
Cash basis net assets end of year	<u>\$ 179,619</u>	<u>\$ 133,874</u>

Total business type activities receipts for the fiscal year were \$567,300 compared to \$543,300 last year. This increase was due primarily to increased usage from the prior year. The cash balance increased by approximately \$45,700. Total disbursements for the fiscal year decreased by approximately 2.22% to a total of \$521,600.

INDIVIDUAL MAJOR GOVERNMENTAL FUND ANALYSIS

The City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of the City's funds is to provide information on near-term inflows, outflows and cash balances of spendable resources. The following are the major reasons for the changes in fund balances of the major funds from the prior year.

Governmental Funds

- The General Fund is the chief operating fund of the City. At the end of the current fiscal year, the cash balance of the General Fund was a negative \$51,300, a decrease of \$3,700 from the prior year.
- The Road Use Tax Fund (RUTF) cash balance decreased by \$6,000 to a negative \$2,300 during the fiscal year. This decrease is attributable to the City spending down the RUTF balance. State road tax funds are distributed based upon population and road miles and accordingly, the City's portion of these funds is larger as it has taken on additional road miles through agreement and by state law.

Proprietary Funds

The cash balance of the Enterprise Funds increased by approximately \$45,700 to \$179,600.

BUDGETARY HIGHLIGHTS

Over the course of the year, the City amended its budget. The amendment was approved on May 17, 2004 and resulted in an increase in operating disbursements primarily related to the CDBG grant of approximately \$269,000. The City had sufficient cash balances to absorb these additional costs.

DEBT ADMINISTRATION

At June 30, 2004, the City had approximately \$677,400 in bonds and other long-term debt, compared to approximately \$722,500 last year, as shown below.

Outstanding debt at year-end	June 30,	
	<u>2004</u>	<u>2003</u>
General obligation bonds	\$ 381,362	\$ 403,509
Revenue bonds-sewer	140,000	156,000
Revenue bonds-water	<u>156,000</u>	<u>163,000</u>
Total	<u>\$ 677,362</u>	<u>\$ 722,509</u>

The Constitution of the State of Iowa limits the amount of general obligation debt that cities can issue to 5% of the assessed value of all taxable property within the City's corporate limits. The City's outstanding combined general obligation debt and urban renewal tax increment financing revenue bonds of \$381,400 is below its constitutional debt limit of \$990,400.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's elected and appointed officials and citizens considered many factors when setting the 2005 fiscal year budget, tax rates, and fees that will be charged for various City activities. Those factors may include the economy, employment rates, operating expenses, capital projects, and increases in service and state mandates.

Inflation in the State continues to be somewhat lower than the national Consumer Price Index increase. The State's CPI increase was 3.2 percent for fiscal year 2004 compared with the national rate of 3.4 percent. Inflation has been modest here due in part to the slowing of the residential housing market and modest increases in energy prices in 2003-2004.

Multiple indicators are taken into account when adopting the budget for fiscal year 2004/2005. Receipts were decreased by 9.5%, while disbursements were decreased by 15%. Due to continued reduction in State payments our future capital projects have been reduced by 50% to absorb the losses from State receipts.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. Questions concerning any of the information provided in this report or request for additional information should be addressed in writing to the City Clerk, City of Morning Sun, 11 E. Division, Morning Sun, Iowa 52640.

Respectfully submitted,

Patricia A. Schaefer
Mayor

City of Morning Sun
Statement of Activities and Net Assets - Cash Basis
As of and for the year ended June 30, 2004

	<u>Program Receipts</u>				<u>Net (Disbursements) Receipts and Changes in Cash Basis Net Assets</u>		
	<u>Disbursements</u>	<u>Charges for Service</u>	<u>Operating Grants Contributions, and Restricted Interest</u>	<u>Capital Grants Contributions and Restricted Interest</u>	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
Functions / Programs:							
Governmental activities:							
Public safety	\$ 27,214	\$ 5,638	\$ 2,645	\$ -	\$ (18,931)	\$ -	\$ (18,931)
Public works	87,366	-	-	-	(87,366)	-	(87,366)
Culture and recreation	44,680	3,510	3,871	-	(37,299)	-	(37,299)
Community and economic development	146,124	-	-	146,124	-	-	-
General government	96,752	21,297	-	-	(75,455)	-	(75,455)
Debt service	76,373	-	-	-	(76,373)	-	(76,373)
Capital projects	-	-	-	-	-	-	-
Total government activities	<u>478,509</u>	<u>30,445</u>	<u>6,516</u>	<u>146,124</u>	<u>(295,424)</u>	<u>-</u>	<u>(295,424)</u>
Business type activities:							
Water	88,710	108,269	-	-	-	19,559	19,559
Gas	332,597	328,915	-	-	-	(3,682)	(3,682)
Sewer	46,606	76,025	-	-	-	29,419	29,419
Garbage	53,670	47,447	-	-	-	(6,223)	(6,223)
Total business type activities	<u>521,583</u>	<u>560,656</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>39,073</u>	<u>39,073</u>
Total	<u>\$ 1,000,092</u>	<u>\$ 591,101</u>	<u>\$ 6,516</u>	<u>\$ 146,124</u>	<u>(295,424)</u>	<u>39,073</u>	<u>(256,351)</u>
General Receipts:							
Property tax levied for:							
General purposes					123,659	-	123,659
Tax increment financing					33,673	-	33,673
Road use tax					73,146	-	73,146
Unrestricted investment earnings					809	350	1,159
Transfers					-	-	-
Miscellaneous					39,113	6,322	45,435
Total general receipts and transfers					<u>270,400</u>	<u>6,672</u>	<u>277,072</u>
Change in cash basis net assets					(25,024)	45,745	20,721
Cash basis net assets beginning of year					<u>61,135</u>	<u>133,874</u>	<u>195,009</u>
Cash basis net assets end of year					<u>\$ 36,111</u>	<u>\$ 179,619</u>	<u>\$ 215,730</u>
Cash Basis Net Assets:							
Restricted:							
Streets					\$ (2,307)	\$ -	\$ (2,307)
Capital projects					12,870	-	12,870
Other purposes					6,150	-	6,150
Unrestricted					<u>19,398</u>	<u>179,619</u>	<u>199,017</u>
Total cash basis net assets					<u>\$ 36,111</u>	<u>\$ 179,619</u>	<u>\$ 215,730</u>

See notes to financial statements.

City of Morning Sun
Statement of Cash Receipts, Disbursements and Changes in Cash Balances
Governmental Funds
As of and for the year ended June 30, 2004

	Special Revenue							
	General	Road Use	TIF	Debt Service	Water Tower Capital Project	Other Nonmajor Governmental	Total	
Receipts:								
Property tax	\$ 123,459	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 123,459	
Tax increment financing collections	-	-	33,673	-	-	-	33,673	
Other taxes	200	-	-	-	-	-	200	
Use of money and property	809	-	-	-	-	-	809	
License and permits	800	-	-	-	-	-	800	
Intergovernmental	9,559	73,146	-	-	-	146,124	228,829	
Charges for services	27,060	-	-	-	-	-	27,060	
Miscellaneous	26,345	-	-	-	-	12,310	38,655	
Total receipts	188,232	73,146	33,673	-	-	158,434	453,485	
Disbursements:								
Operating:								
Public safety	27,214	-	-	-	-	-	27,214	
Public works	8,263	79,103	-	-	-	-	87,366	
Culture and recreation	44,680	-	-	-	-	-	44,680	
Community and economic development	-	-	-	-	-	146,124	146,124	
General government	96,752	-	-	-	-	-	96,752	
Debt service	-	-	-	76,373	-	-	76,373	
Capital projects	-	-	-	-	-	-	-	
Total disbursements	176,909	79,103	-	76,373	-	146,124	478,509	
Excess (deficiency) of receipts over disbursements	11,323	(5,957)	33,673	(76,373)	-	12,310	(25,024)	
Other financing sources (uses):								
Bond proceeds	-	-	-	-	-	-	-	
Operating transfers in (out)	(58,900)	-	6,160	58,900	-	(6,160)	-	
Net change in cash balances	(47,577)	(5,957)	39,833	(17,473)	-	6,150	(25,024)	
Cash balances beginning of year	(3,707)	3,650	11,686	36,636	12,870	-	61,135	
Cash balances end of year	\$ (51,284)	\$ (2,307)	\$ 51,519	\$ 19,163	\$ 12,870	\$ 6,150	\$ 36,111	
Cash Basis Fund Balances								
Reserved:								
Debt service	\$ -	\$ -	\$ 51,519	\$ 19,163	\$ -	\$ -	\$ 70,682	
Unreserved:								
General fund	(51,284)	-	-	-	-	-	(51,284)	
Special revenue fund	-	(2,307)	-	-	-	6,150	3,843	
Capital projects fund	-	-	-	-	12,870	-	12,870	
Total cash basis fund balances	\$ (51,284)	\$ (2,307)	\$ 51,519	\$ 19,163	\$ 12,870	\$ 6,150	\$ 36,111	

See notes to financial statements.

City of Morning Sun
Statement of Cash Receipts, Disbursements and Changes in Cash Balances
Proprietary Funds
As of and for the year ended June 30, 2004

	Enterprise Funds					<u>Total</u>
	<u>Water Service</u>	<u>Gas Service</u>	<u>Sewer Service</u>	<u>Garbage Service</u>	<u>Utility Deposits</u>	
Receipts:						
Use of money and property:						
Charges for services	\$ 108,269	\$ 328,915	\$ 76,025	\$ 47,447	\$ -	\$ 560,656
Interest	-	210	140	-	-	350
Miscellaneous	-	-	-	1,359	4,963	6,322
Total receipts	<u>108,269</u>	<u>329,125</u>	<u>76,165</u>	<u>48,806</u>	<u>4,963</u>	<u>567,328</u>
Disbursements:						
Business type activities	50,871	328,665	39,802	53,670	3,487	476,495
Capital outlay	37,839	445	6,804	-	-	45,088
Debt service	-	-	-	-	-	-
Total disbursements	<u>88,710</u>	<u>329,110</u>	<u>46,606</u>	<u>53,670</u>	<u>3,487</u>	<u>521,583</u>
Excess (deficiency) of receipts over disbursements	<u>19,559</u>	<u>15</u>	<u>29,559</u>	<u>(4,864)</u>	<u>1,476</u>	<u>45,745</u>
Other financing sources (uses):						
Operating transfers in	-	-	-	-	-	-
Operating transfers out	-	-	-	-	-	-
Net change in cash balances	19,559	15	29,559	(4,864)	1,476	45,745
Cash balances, beginning of year	<u>(25,345)</u>	<u>83,608</u>	<u>53,992</u>	<u>(2,791)</u>	<u>24,410</u>	<u>133,874</u>
Cash balances, end of year	<u>\$ (5,786)</u>	<u>\$ 83,623</u>	<u>\$ 83,551</u>	<u>\$ (7,655)</u>	<u>\$ 25,886</u>	<u>\$ 179,619</u>
Cash Basis Fund Balances						
Reserved for equipment replacement	\$ -	\$ 42,370	\$ 42,093	\$ -	\$ -	\$ 84,463
Unreserved	<u>(5,786)</u>	<u>41,253</u>	<u>41,458</u>	<u>(7,655)</u>	<u>25,886</u>	<u>95,156</u>
Total cash basis fund balances	<u>\$ (5,786)</u>	<u>\$ 83,623</u>	<u>\$ 83,551</u>	<u>\$ (7,655)</u>	<u>\$ 25,886</u>	<u>\$ 179,619</u>

See notes to financial statements.

City of Morning Sun
Notes to Financial Statements
Year Ended June 30, 2004

Note 1. Summary of Significant Accounting Policies

The City of Morning Sun is a political subdivision of the State of Iowa located in Louisa County. It was first incorporated in 1867 and operates under the Home Rule provisions of the Constitution of Iowa. The City operates under the Mayor-Council form of government with the Mayor and Council Members elected on a non-partisan basis. The City provides numerous services to citizens, including public safety, public works, culture, recreation, community and economic development, and general government services. The City also provides water, gas, solid waste and sewer utilities for its citizens.

Reporting Entity

For financial reporting purposes, the City of Morning Sun has included all funds, organizations, agencies, boards, commissions and authorities. The City has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the City to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the City. The City has no component units which meet the Governmental Accounting Standards Board criteria.

Jointly Governed Organizations

The City participates in several jointly governed organizations that provide goods or services to the citizenry of the City but do not meet the criteria of a joint venture since there is no ongoing financial interest or responsibility by the participating governments. City officials are members of the following boards and commission: Des Moines County Solid Waste Commission. A copy of that audit report is available at 1818 West Burlington Avenue, Burlington, Iowa.

Other organizations which City officials are members of are the Planning & Zoning Commission and Board of Adjustments.

Basis of Presentation

Government-wide Financial Statements - The Statement of Activities and Net Assets reports information on all of the nonfiduciary activities of the City. For the most part, the effect of interfund activity has been removed from this statement. Governmental activities, which are supported by tax and intergovernmental revenues, are reported separately from business type activities, which rely to a significant extent on fees and charges for services.

City of Morning Sun
Notes to Financial Statements
Year Ended June 30, 2004

Note 1. Summary of Significant Accounting Policies (continued)

The Statement of Activities and Net Assets presents the City's nonfiduciary net assets. Net assets are reported in two categories:

Restricted net assets result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the definition of the preceding category. Unrestricted net assets often have constraints on resources imposed by management, which can be removed or modified.

The Statement of Activities and Net Assets demonstrates the degree to which the direct disbursements of a given function are offset by program receipts. Direct disbursements are those clearly identifiable with a specific function. Program receipts include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function and 2) grants, contributions and interest on investments restricted to meeting the operational or capital requirements of a particular function. Property tax and other items not properly included among program receipts are reported instead as general receipts.

Fund Financial Statements - Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. All remaining governmental funds are aggregated and reported as nonmajor governmental funds.

The City reports the following major governmental funds:

The General Fund is the general operating fund of the City. All general tax receipts and other receipts not allocated by law or contractual agreement to some other fund are accounted for in this fund. From the fund are paid the general operating disbursements, the fixed charges and the capital improvement costs that are not paid from other funds.

Special Revenue:

The Road Use Tax Fund is used to account for road construction and maintenance.

The Urban Renewal Tax Increment Fund is used to account for urban renewal projects financed by tax increment financing.

The Debt Service Fund is utilized to account for the payment of interest and principal on the City's general long-term debt.

The Capital Projects Fund is used to account for all resources used in the acquisition and construction of capital facilities.

City of Morning Sun
Notes to Financial Statements
Year Ended June 30, 2004

Note 1. Summary of Significant Accounting Policies (continued)

The City reports the following major proprietary funds:

The Water Fund accounts for the operation and maintenance of the City's water system.

The Sewer Fund accounts for the operation and maintenance of the City's waste water treatment and sanitary sewer system.

The Gas Fund accounts for the operation and maintenance of the City's gas system.

The Sanitation Fund (garbage) accounts for the operation and maintenance of the City's solid waste collection system.

Measurement Focus and Basis of Accounting

The City of Morning Sun maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles.

Proprietary funds distinguish operating receipts and disbursements from non-operating items. Operating receipts and disbursements generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All receipts and disbursements not meeting this definition are reported as non-operating receipts and disbursements.

Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information. During the year ended June 30, 2004, Culture & Recreation, General Government, Debt Service, and Business Type functions exceeded the amounts budgeted.

Note 2. Pension and Retirement Benefits

The City contributes to the Iowa Public Employees Retirement System (IPERS), which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa 50306-9117.

Plan members are required to contribute 3.70% of their annual covered salary and the City is required to contribute 5.75% of annual covered payroll, except for police employees, in which case the percentages are 5.93% and 8.90%, respectively. For the year ended June 30, 2003, the contribution rates for police employees and the City were 6.04% and 9.07%, respectively, and for the year ended June 30, 2002, the contribution rates for police employees and the City were 6.20% and 9.29%, respectively. Contribution requirements are established by state statute. The City's contribution to IPERS for the years ended June 30, 2004 was \$7,625, equal to the required contribution.

**City of Morning Sun
Notes to Financial Statements
Year Ended June 30, 2004**

Note 3. Bonds and Notes Payable

Bond Indebtedness

Annual debt service requirements to maturity for general obligation bonds, urban renewal tax increment financing revenue bonds and revenue notes are as follows:

Year Ending June 30,	General Obligation Bonds		Revenue Bonds		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2005	\$ 22,450	\$ 19,406	\$ 23,000	\$ 12,506	\$ 45,450	\$ 31,912
2006	24,761	15,389	26,000	11,460	50,761	26,849
2007	67,151	14,270	28,000	10,278	95,151	24,548
2008	21,000	10,316	28,000	8,994	49,000	19,310
2009	22,000	9,489	30,000	7,712	52,000	17,201
2010-2014	121,000	33,927	92,000	20,708	213,000	54,635
2015-2020	<u>103,000</u>	<u>7,869</u>	<u>69,000</u>	<u>8,686</u>	<u>172,000</u>	<u>16,555</u>
	<u>\$ 381,362</u>	<u>\$ 110,666</u>	<u>\$ 296,000</u>	<u>\$ 80,344</u>	<u>\$ 677,362</u>	<u>\$ 191,010</u>

The resolutions providing for the issuance of the sewer and water revenue notes include the following similar provisions:

- (a) The bonds will only be redeemed from the future earnings of the enterprise activity and that the bond holders hold a lien on the future earnings of the fund.
- (b) Sufficient monthly cash transactions shall be made to separate revenue bond retirement accounts for the purpose of making the bond principal and interest payments when due.
- (c) Monthly cash transfers are to be made to the sewer reserve account until a \$24,000 minimum balance is accumulated. At June 30, 2004, this fund had a balance of \$42,100 and is included as part of the Sewer Revenue funds.
- (d) All funds remaining after payment of all maintenance and operating expenses and required transfers shall be placed in revenue surplus accounts. These accounts are restricted for the purpose of paying for any improvement, extension, or repair to the systems or for bond and interest payments which the other accounts might be unable to make.

The interest rate on the general obligation bonds range from 3.53% to 6.90%. The total interest expense recorded for the year ended June 30, 2004 was \$30,374.

City of Morning Sun
Notes to Financial Statements
Year Ended June 30, 2004

Note 4. Cash and Investments

The City's deposits in banks at June 30, 2004 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The City is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the City Council; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The City had no investments meeting the disclosure requirements of Governmental Accounting Standards Board Statement No. 3.

The City recorded interest receipts during the year of \$800.

Note 5. Compensated Absences

City employees accumulate a limited amount of earned but unused vacation hours for subsequent use or for payment upon termination, retirement or death. These accumulations are not recognized as disbursements by the City until used or paid. The City's approximate liability for earned vacation payments payable to employees at June 30, 2004, primarily relating to the General Fund is \$5,900, based on rates of pay in effect at June 30, 2004.

Note 6. Risk Management

The City of Morning Sun is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. The City assumes liability for any deductibles and claims in excess of coverage limitations. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

Note 7. Related Party Transactions

The City has business transactions between the City and current City officials or employees during the year ended June 30, 2004 totaling \$26,586.

City of Morning Sun
Notes to Financial Statements
Year Ended June 30, 2004

Note 8. Commitments

In the normal course of business, the City has various outstanding commitments that are not reflected in the accompanying financial statements. The principal commitments of the City are as follows:

ANR regulator station	\$ 18,900
Library shelving	1,600
Gas meters	<u>2,338</u>
	\$ <u>22,838</u>

Note 9. Joint Venture

The City is a participant in the Des Moines County Regional Waste Commission, a political subdivision pursuant to the Code of Iowa Chapter 28E. The purpose of the agreement is to provide area governments with solid waste disposal sources. The City currently provides one member of the fifteen-member board. Financial statements of the Waste Commission are available at the Commission office, 1818 West Burlington Avenue, West Burlington, Iowa.

Note 10. Deficit Fund Balance

The following funds had deficit balances at June 30, 2004: General fund \$51,284; Road Use \$2,307; Water service \$5,786; and Garbage service \$7,655. These deficit balances were a result of project costs incurred prior to availability of funds and failure to transfer funds at the appropriate times.

Note 11. Budget Overexpenditure

Per the Code of Iowa, disbursements may not legally exceed budgeted appropriations at the functional level. During the year ended June 30, 2004 disbursements in the Culture and recreation, General government, Debt service, and Business type activities exceeded the amount budgeted.

Note 12. Accounting Change

Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments; Statement No. 37, Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus; Statement No. 38, Certain Financial Statement Note Disclosures, and Statement No. 41, Budgetary Comparison Schedule - Perspective Differences, were implemented for the year ended June 30, 2004. The statements create new basic financial statements for reporting the City's financial activities. The financial statements now include a government-wide financial statement and fund financial statements which present information for individual major funds rather than by fund type. Nonmajor funds are presented in total in one column.

City of Morning Sun
Notes to Financial Statements
Year Ended June 30, 2004

Note 13. Interfund Transfers

The detail of interfund transfers for the year ended June 30, 2004 is as follows:

Transfer to:	
Sewer Reserve	\$ 6,240
Debt Service	58,900
Tax Increment Financing	<u>6,160</u>
	<u>\$ 71,300</u>
Transfer from:	
Sewer Revenue	\$ 6,240
General Fund	58,900
Economic Development	<u>6,160</u>
	<u>\$ 71,300</u>

City of Morning Sun
Budgetary Comparison Schedule
of Receipts, Disbursements, and Changes in Balances -
Budget and Actual (Cash Basis) - All Governmental Funds and Proprietary Funds
Actual to Budget
Year Ended June 30, 2004

	Governmental Funds <u>Actual</u>	Proprietary Fund Type <u>Actual</u>	Less Funds not Required to be Budgeted	<u>Net</u>	Budgeted <u>Original</u>	Amounts <u>Final</u>	Final to Net <u>Variance</u>
Receipts:							
Property tax	\$ 123,459	\$ -	\$ -	\$ 123,459	\$ 121,466	\$ 121,466	\$ 1,993
Tax increment financing collections	33,673	-	-	33,673	27,000	27,000	6,673
Other city taxes	200	-	-	200	4,932	4,932	(4,732)
Use of money and property	809	350	-	1,159	20,000	20,000	(18,841)
Licenses and permits	800	-	-	800	6,550	6,550	(5,750)
Intergovernmental	228,829	-	-	228,829	65,879	239,879	(11,050)
Charges for service	27,060	560,656	-	587,716	449,150	539,150	48,566
Miscellaneous	38,655	6,322	-	44,977	6,000	12,310	32,667
Total receipts	<u>453,485</u>	<u>567,328</u>	<u>-</u>	<u>1,020,813</u>	<u>700,977</u>	<u>971,287</u>	<u>49,526</u>
Disbursements:							
Public safety	27,214	-	-	27,214	28,431	28,431	1,217
Public works	87,366	-	-	87,366	69,000	89,000	1,634
Culture and recreation	44,680	-	-	44,680	43,714	43,712	(968)
Community and economic development	146,124	-	-	146,124	1,100	175,100	28,976
General government	96,752	-	-	96,752	85,832	85,832	(10,920)
Debt service	76,373	-	-	76,373	40,648	40,648	(35,725)
Capital projects	-	-	-	-	-	-	-
Business type activities	-	521,583	-	521,583	417,075	492,075	(29,508)
Non-program	-	-	-	-	-	-	-
Total disbursements	<u>478,509</u>	<u>521,583</u>	<u>-</u>	<u>1,000,092</u>	<u>685,800</u>	<u>954,798</u>	<u>(45,294)</u>
Excess (deficiency) of receipts over disbursements	(25,024)	45,745	-	20,721	15,177	16,489	
Other financing sources	-	-	-	-	1,312	-	
Net change in cash balances	(25,024)	45,745	-	20,721	16,489	16,489	
Balances beginning of year	<u>61,135</u>	<u>133,874</u>	<u>-</u>	<u>195,009</u>	<u>157,731</u>	<u>157,731</u>	
Balances end of year	<u>\$ 36,111</u>	<u>\$ 179,619</u>	<u>\$ -</u>	<u>\$ 215,730</u>	<u>\$ 174,220</u>	<u>\$ 174,220</u>	

See accompanying independent auditor's report.

City of Morning Sun
Notes to Required Supplementary Information - Budgetary Reporting
June 30, 2004

In accordance with the Code of Iowa, the City Council annually adopts a budget on the cash basis following required public notice and hearing for all funds, except blended component units, Internal Service, non-expendable trust, and agency funds (when they exist). The annual budget may be amended during the year utilizing similar statutorily prescribed procedures.

Formal and legal budgetary control is based upon ten major classes of disbursements known as functions, not by fund or fund type. These ten functions are: public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, business type activities and non-program. Function disbursements required to be budgeted include disbursements for the General Fund, Special Revenue Funds, Debt Service Fund, Capital Projects Funds and Proprietary Funds. Although the budget document presents function disbursements by fund, the legal level of control is at the aggregated function level, not by fund. During the year, a budget amendment increased budgeted disbursements by \$270,310. The budget amendments are reflected in the final budgeted amounts.

During the year ended June 30, 2004, disbursements did not exceed the amounts budgeted.

City of Morning Sun
Statement of Cash Receipts, Disbursements and Changes in Cash Balances
Nonmajor Governmental Funds
As of and for the year ended June 30, 2004

	<u>Housing Rehabilitation</u>	<u>Water Tower Lots Project</u>	<u>Total</u>
Receipts:			
Miscellaneous	\$ -	\$ 12,310	\$ 12,310
Intergovernmental:			
CDBG Grant	<u>146,124</u>	<u>-</u>	<u>146,124</u>
Total receipts	<u>146,124</u>	<u>12,310</u>	<u>158,434</u>
Disbursements:			
Community & Economic Development			
Contractual services	<u>146,124</u>	<u>-</u>	<u>146,124</u>
	<u>146,124</u>	<u>-</u>	<u>146,124</u>
Total disbursements	<u>146,124</u>	<u>-</u>	<u>146,124</u>
Excess (deficiency) of receipts over disbursements	-	12,310	12,310
Other financing sources (uses):			
Operating transfers in	-	-	-
Operating transfers (out)	<u>-</u>	<u>(6,160)</u>	<u>6,160</u>
	<u>-</u>	<u>(6,160)</u>	<u>6,160</u>
Net change in cash balances	-	6,150	18,470
Cash balances, beginning of year	<u>-</u>	<u>-</u>	<u>-</u>
Cash balances, end of year	<u>\$ -</u>	<u>\$ 6,150</u>	<u>\$ 6,150</u>

See accompanying independent auditor's report.

**City of Morning Sun
Statement of Indebtedness
Year Ended June 30, 2004**

<u>Obligation</u>	<u>Date of Issuance</u>	<u>Interest Rates</u>	<u>Amount Originally Issued</u>	<u>Balance Beginning of Year</u>	<u>Issued During Year</u>	<u>Redeemed During Year</u>	<u>Balance End of Year</u>	<u>Interest Paid</u>
General obligation bonds:								
Sewer improvement Series 1996	12/01/96	4.19%	\$ 242,000	\$ 181,000	\$ -	\$ 11,000	\$ 170,000	\$ 7,584
General obligation Series 2000	06/01/00	3.53%	182,000	162,000	-	7,000	155,000	5,719
Iowa State Bank (City hall)	06/21/02	6.90%	65,000	<u>60,509</u>	<u>-</u>	<u>4,147</u>	<u>56,362</u>	<u>4,117</u>
				<u>403,509</u>	<u>-</u>	<u>22,147</u>	<u>381,362</u>	<u>17,420</u>
Revenue bonds:								
Sewer Revenue - GMAC	07/13/72	5.00%	408,000	156,000	-	16,000	140,000	7,800
Water Revenue Series 2000	06/01/00	3.53%	183,000	<u>163,000</u>	<u>-</u>	<u>7,000</u>	<u>156,000</u>	<u>5,754</u>
				<u>319,000</u>	<u>-</u>	<u>23,000</u>	<u>296,000</u>	<u>13,554</u>
Total				<u>\$ 722,509</u>	<u>\$ -</u>	<u>\$ 45,147</u>	<u>\$ 677,362</u>	<u>\$ 30,974</u>

See accompanying independent auditor's report.

**City of Morning Sun
Bond and Note Maturities
June 30, 2004**

General Obligation Bonds:

Year Ending <u>June 30,</u>	Interest <u>Rate</u>	Sewer Improvement Notes Dec 1, 1996 <u>Amount</u>	Interest <u>Rate</u>	Water Improvement Notes June 1, 2000 <u>Amount</u>	Interest <u>Rate</u>	City Hall Iowa State Bank June 21, 2002 <u>Amount</u>	<u>Total</u>
2005	4.19%	\$ 11,000	3.53%	\$ 7,000	6.90%	\$ 4,450	\$ 22,450
2006	4.19%	12,000	3.53%	8,000	6.90%	4,761	24,761
2007	4.19%	12,000	3.53%	8,000	6.90%	47,151	67,151
2008	4.19%	13,000	3.53%	8,000	0.0%	-	21,000
2009	4.19%	13,000	3.53%	9,000	0.0%	-	22,000
2010	4.19%	14,000	3.53%	9,000	0.0%	-	23,000
2011	4.19%	14,000	3.53%	9,000	0.0%	-	23,000
2012	4.19%	15,000	3.53%	9,000	0.0%	-	24,000
2013	4.19%	15,000	3.53%	10,000	0.0%	-	25,000
2014	4.19%	16,000	3.53%	10,000	0.0%	-	26,000
2015	4.19%	17,000	3.53%	10,000	0.0%	-	27,000
2016	4.19%	18,000	3.53%	11,000	0.0%	-	29,000
2017		-	3.53%	11,000	0.0%	-	11,000
2018		-	3.53%	12,000	0.0%	-	12,000
2019		-	3.53%	12,000	0.0%	-	12,000
2020		-	3.53%	12,000	0.0%	-	12,000
		<u>\$ 170,000</u>		<u>\$ 155,000</u>		<u>\$ 56,362</u>	<u>\$ 381,362</u>

Revenue bonds:

Year Ending <u>June 30,</u>	Interest <u>Rate</u>	Sewer Revenue July 13, 1972 <u>Amount</u>	Interest <u>Rate</u>	Water Revenue June 1, 2001 <u>Amount</u>	<u>Total</u>
2005	5.00%	\$ 16,000	3.53%	\$ 7,000	\$ 23,000
2006	5.00%	18,000	3.53%	8,000	26,000
2007	5.00%	20,000	3.53%	8,000	28,000
2008	5.00%	20,000	3.53%	8,000	28,000
2009	5.00%	21,000	3.53%	9,000	30,000
2010	5.00%	21,000	3.53%	9,000	30,000
2011	5.00%	24,000	3.53%	9,000	33,000
2012		-	3.53%	9,000	9,000
2013		-	3.53%	10,000	10,000
2014		-	3.53%	10,000	10,000
2015		-	3.53%	11,000	11,000
2016		-	3.53%	11,000	11,000
2017		-	3.53%	11,000	11,000
2018		-	3.53%	12,000	12,000
2019		-	3.53%	12,000	12,000
2020		-	3.53%	12,000	12,000
		<u>\$ 140,000</u>		<u>\$ 156,000</u>	<u>\$ 296,000</u>

See accompanying independent auditor's report.

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Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting

To the Honorable Mayor and
Members of the City Council

We have audited the financial statements of the City of Morning Sun, as of and for the year ended June 30, 2004, and have issued our report thereon dated November 16, 2004. Our report expressed an unqualified opinion on the financial statements which were prepared in conformity with an other comprehensive basis of accounting. We conducted our audit in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the City of Morning Sun's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards.

Comments involving statutory and other legal matters about the City's operations for the year ended June 30, 2004 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the City. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Morning Sun's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Part I of the accompanying Schedule of Findings.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. None of the reportable conditions described above is a material weakness.

This report, a public record by law, is intended solely for the information and use of the officials, employees and citizens of the City of Morning Sun and other parties to whom the City of Morning Sun may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the City of Morning Sun during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Walker Egerton & Hunsaker PC

November 16, 2004

**City of Morning Sun
Schedule of Findings
Year Ended June 30, 2004**

Part I: Findings Related to the Financial Statements

REPORTABLE CONDITIONS

I-A-04 Segregation of Duties - One important aspect of the internal control structure is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible.

Recommendation - We realize that with a limited number of office employees, segregation of duties is difficult. However, the City should review its control procedures to obtain the maximum internal control possible under the circumstances.

Response - We will consider this.

Conclusion - Response acknowledged. The City could segregate duties to the extent possible with existing personnel and utilize administrative personnel to provide additional control through review of financial transactions and reports.

Part II: Other Findings Related to Statutory Reporting

II-A-04 Official Depositories - A resolution naming official depositories has been approved by the City. The maximum deposit amounts stated in the resolution were not exceeded during the year ended June 30, 2004.

II-B-04 Certified Budget - Disbursements during the year ended June 30, 2004 exceeded the amounts budgeted in the culture & recreation, general government, debt service, and business type activities functions. Chapter 384.20 of the Code of Iowa states in part that public monies may not be expended or encumbered except under an annual or continuing appropriation.

The City published a notice of public hearing on the budget including a summary of the proposed budget as required by Chapter 384.16 of the Code of Iowa.

Recommendation - The budget should have been amended in sufficient amounts in accordance with Chapter 384.18 of the Code of Iowa before disbursements were allowed to exceed the budget.

Response - The budget will be amended in the future, if applicable.

Conclusion - Response accepted.

II-C-04 Questionable Disbursements - We noted no disbursements that did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-D-04 Travel Expense - No disbursements of City money for travel expenses of spouses of City officials or employees were noted.

II-E-04 Business Transactions - Business transactions between the City and city officials or employees are detailed as follows:

<u>Name, Title, and Business connections</u>	<u>Transaction Description</u>	<u>Amount</u>
Brenda Springsteen, employee, spouse of Frank Springsteen, Springsteen Tiling, Inc.	Construction, per bid Tiling and dozing	\$26,273
Tom Bryant, Council Member	Miscellaneous labor	313

The construction transaction does not appear to represent a conflict of interest since it was entered into through competitive bidding.

In accordance with Chapter 362.5(10) of the Code of Iowa, the transactions with the Council Member do not appear to represent conflicts of interest since total transactions were less than \$1,500 during the fiscal year.

Recommendation - The City should continue to assess its purchase policies to prevent possible conflicts of interest.

Response - We will continue to review our procedures to insure conflicts do not arise.

Conclusion - Response accepted.

II-F-04 Bond Coverage - Surety bond coverage of City officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

II-G-04 Council Minutes - No transactions were found that we believe should have been approved in the Council minutes but were not.

II-H-04 Bonds and Revenue Notes - The City has paid Sewer Revenue notes at June 30, 2004 from the Debt Service Fund. The revenue note resolutions specify these payments are to come directly from the enterprise funds.

Recommendation -The City should pay principal and interest from the Sewer Revenue funds as specified in the resolutions.

Response - We will comply in the future.

Conclusion - Response accepted.

II-I-04 Deposits and Investments - We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa and the City's investment policy.

II-J-04 Financial Condition - The following funds had deficit balances at June 30, 2004: General fund \$51,284; Road use \$2,307; Water service \$5,786; and the Garbage services fund \$7,655.

Recommendation -We understand that project costs incurred prior to receipt revenue collections and property tax collections created the deficit in these accounts. However, the City should monitor the progress of the receipts and property tax collections and review the control procedures throughout the collection period.

Response - We will consider this.

Conclusion - Response accepted.

II-J-04 Fire Department Activities - The Volunteer Fire Department maintains a separate checking account for donations, fund raising activities and fire department disbursements. Certain disbursements from this account may not meet the requirements of public purpose.

Recommendation -The City should review and record all activities of the Fire Department and record these accounts on the City of Morning Sun's financial statements.

Response - We will consider this.

Conclusion - Response accepted.

FINANCIAL STATEMENTS

SUPPLEMENTARY INFORMATION