

CITY OF MOUNT VERNON, IOWA
INDEPENDENT AUDITOR'S REPORTS
BASIC FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS
June 30, 2007

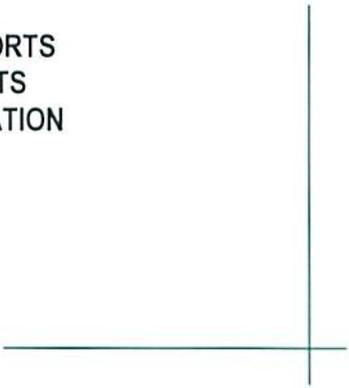


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CITY OF MOUNT VERNON

Officials

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
Paul Tuerler	Mayor	December 31, 2007
Diane Hoffman	Mayor Pro tem	December 31, 2007
Neil Rud	Council Member	December 31, 2007
Jim Moore	Council Member	December 31, 2009
Marty Christensen	Council Member	December 31, 2007
Jerry Niederhauser	Council Member	December 31, 2009
Michael R. Beimer	City Administrator/Clerk	December 31, 2007
Scott Peterson	Attorney	December 31, 2007
Sara L. Smith	Attorney	December 31, 2007

Independent Auditor's Report

To the Honorable Mayor and
Members of the City Council
Mount Vernon, 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 Mount Vernon, Iowa, as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards 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 accounting principles generally accepted in the United States of America.

In our opinion, 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 Mount Vernon as of June 30, 2007, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 28, 2007 on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 6 through 17 and 38 through 40 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Mount Vernon's basic financial statements. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the four years ended June 30, 2006 (which are not presented herein) and expressed unqualified opinions on those financial statements, which were prepared in conformity with another comprehensive basis of accounting. The supplementary information included in Schedules 1 through 4 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.

Clifton Gunderson LLP

Cedar Rapids, Iowa
November 28, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

Mount Vernon, Iowa 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, 2007. We encourage readers to consider this information in conjunction with the City's financial statements, which follow.

2007 FINANCIAL HIGHLIGHTS

- Revenues of the City's governmental activities decreased 15.7%, from \$2,828,844 to \$2,384,904, from fiscal 2006 to fiscal 2007. Tax increment financing collections decreased \$144,339 and licenses and permits proceeds decreased approximately \$32,647 due in part to adjusting the fees schedule in March of 2004, but also due largely to expiration of the local option sales tax. The local option sales tax was passed to allow for the extra 1 cent collection in calendar years 2005 and 2006. The total local option sales tax funds collected in calendar year 2005 was \$644,998, of which \$494,396 was collected in fiscal year 2006. Total funds collected to date for this fund, including accrued interest, amounts to \$1,491,466. Revenues are to be utilized for the construction of a new fire station and/or a new community center. A percentage formula as to which project will receive funding and in what amounts was not on the ballot initiative that was passed.
- On October 10, 2003, the State of Iowa announced budget cuts to the FY2004 budget that would take place immediately. After the Revenue Estimating Conference announced a decrease of \$142.2 million in estimated state general fund revenues for fiscal year 2004, Governor Tom Vilsack immediately announced a 2.5% cut in state spending. These cuts resulted in revenue reductions to the City of Mount Vernon in the following areas: property tax credits, machinery and equipment reimbursement, bank franchise tax and state Library of Iowa Open Access. This created a shortfall of \$8,661 for General Fund revenues for FY2005, and all succeeding fiscal years, including fiscal year 2007. It is not anticipated that these funds will be reinstated.
- Additionally, after all cities in Iowa had certified their budgets for FY2004, the state announced across the board budget cuts that severely affected the cities' ability to deliver essential services. Certain revenue sources were eliminated entirely, such as monies and credits and utility replacement excise tax. The effect on Mount Vernon's General Fund for FY2004 (and all subsequent year General Fund revenues) was a budget shortfall of \$43,041 for consolidated property and approximately \$8,000 for utility replacement excise tax. The total shortfall for FY2007, with all of the cuts and reductions, was and will be in the future, approximately \$60,000 per year. It is not anticipated that any of these funds will be reinstated.
- Disbursements for governmental activities increased 67%, from \$2,562,540 to \$4,297,015, from fiscal 2006 to fiscal 2007. Public safety, culture and recreation, debt service, capital projects, and community and economic development disbursements increased approximately \$20,615, \$15,662, \$1,854,330, \$50,303 and \$15,729, respectively.

- The City's total cash basis net assets increased 54.7%, from \$4,534,861 to \$7,016,549, from June 30, 2006 to June 30, 2007. Of this amount, the assets of the governmental activities increased by \$2,015,321 and the assets of the business type activities increased by \$466,367. The majority of this increase in cash basis revenues is attributable to the General Obligation Bonds, Series 2007, being sold prior to close of books on June 30, 2007. The newly issued bonds will provide approximately \$2.5 million in street construction, street reconstruction and street resurfacing in succeeding fiscal years, leading to a planned, phased-in comprehensive street improvements program. The last major street initiative occurred in 1991.

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 Statement consists 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 statement 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 of the City's budget for the year.

Other Supplementary Information provides detailed information about the non-major 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 accounting principles generally accepted in the United States of America. 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 Statement

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. State shared revenues from Road Use Tax allocation, based on a per capita basis, fund most of the Public Works, or Streets, operational expenditures.
- Business Type Activities include the waterworks, the sanitary sewer system, solid waste and the storm sewer system. These activities are financed primarily by user charges.

Fund Financial Statements

The City has two kinds of funds:

- 1) 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 statement for governmental funds is a statement of cash receipts, disbursements and changes in cash balances.

- 2) Proprietary funds account for the City's Enterprise Funds. Enterprise Funds are used to report business type activities. The City maintains four Enterprise Funds to provide separate information for the water, storm water, solid waste and sewer funds, all of which are considered to be major funds of the City except for the storm water fund.

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

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 increased sharply from a year ago, increasing from \$3,719,431 to \$5,734,752. The vast majority of this increase is attributable to the Series 2007 General Obligation Bonds being sold in FY07. The analysis that follows focuses on the changes in cash balances for governmental activities.

**Changes in Cash Basis Net Assets
of Governmental Activities
(Expressed in Thousands)**

	Year Ended June 30,	
	2007	2006
Receipts and transfers:		
Program receipts:		
Charges for service	\$ 209	\$ 247
Operating grants, contributions and restricted interest	360	354
General receipts:		
Property tax	1,587	1,594
Local option sales tax	30	494
Grants and contributions not restricted to specific purposes	81	80
Unrestricted interest on investments	86	30
Other general receipts	32	29
Bond proceeds	4,429	1,222
Total receipts and transfers	6,814	4,050
Disbursements and transfers:		
Public safety	549	528
Public works	264	380
Culture and recreation	285	269
Community and economic development	54	39
General government	270	266
Debt service	2,366	512
Capital projects	508	569
Transfers, net	502	134
Total disbursements and transfers	4,798	2,697
Increase (decrease) in cash basis net assets	2,016	1,353
Cash basis net assets, beginning of year	3,719	2,366
Cash basis net assets, end of year	\$ 5,735	\$ 3,719

The City's total receipts for governmental activities increased by 68%, or \$2,763,542. The total cost of all programs and services increased by \$2,101,763, or 78%, with no new programs added this year.

The City property tax rates for 2007 remained the same as last year. With the exception of two voted increases, the library tax levy and the capital equipment levy for the fire department, the base tax rate has remained unchanged for the last 14 years. Additionally, the property tax levy rate for fiscal year 2007 remained at the same rate of 12.99%. Based on increases in the total assessed valuation, with the primary increases being derived from new construction, property tax receipts are budgeted to increase by an additional \$92,036, from \$717,387 in FY07 to \$809,423 for FY08 next year.

The cost of all governmental activities this year was \$4,798,728, compared to \$2,696,962 last year. However, as shown in the Statement of Activities and Net Assets on pages 19-22, the amount taxpayers ultimately financed for these activities was only \$3,727,758 because some of the cost was paid by those who directly benefited from the programs (charges for service \$209,408) or by other governments and organizations that subsidized certain programs with grants and contributions of \$359,849. Overall, the City's governmental activities receipts, including intergovernmental aid and fees for service, decreased in 2007 from \$601,853 to \$569,257. The City paid for the remaining "public benefit" portion of governmental activities with \$3,727,758 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
(Expressed in Thousands)**

	<u>Year Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>
Receipts and transfers:		
Program receipts:		
Charges for service:		
Water	\$ 445	\$ 394
Sewer	393	344
Solid waste	306	303
Storm water	32	31
General receipts:		
Unrestricted interest on investments	66	28
Other general receipts	12	16
Transfers, net	<u>502</u>	<u>134</u>
Total receipts and transfers	<u>1,756</u>	<u>1,250</u>
Disbursements and transfers:		
Water	395	630
Sewer	602	471
Solid waste	280	286
Storm water	<u>12</u>	<u>13</u>
Total disbursements and transfers	<u>1,289</u>	<u>1,400</u>
Decrease in cash basis net assets	467	(150)
Cash basis net assets, beginning of year	<u>815</u>	<u>965</u>
Cash basis net assets, end of year	<u>\$ 1,282</u>	<u>\$ 815</u>

Total business type activities receipts and net transfers for the fiscal year were \$1,755,143 compared to \$1,250,374 last year. The cash balance increased \$466,361 from the prior year. Total disbursements and transfers for the fiscal year decreased by 8% to a total of \$1,288,776.

INDIVIDUAL MAJOR GOVERNMENTAL FUND ANALYSIS

As Mount Vernon completed the year, its governmental funds reported a combined fund balance of \$5,734,752, an increase of \$2,015,321 above last year's total of \$3,719,431. The following are the major reasons for the changes in fund balances of the major funds from the prior year.

- The General Fund cash balance increased \$68,873 from the prior year to \$364,581. This increase is greater than the General Fund increase in FY2006 of \$25,468.
- The Local Option Sales Tax Fund cash balance increased \$44,670 during the fiscal year. The City intends to use these receipts in the future for the construction of either a new fire station or a community center.
- The Road Use Tax Fund cash balance increased by \$88,379 to \$53,713 during the fiscal year. The City conducted a special census in the fall of 2004 to capture new residents that were not part of the 2000 census. It is anticipated that this special census will eventually result in an increase of approximately \$250,000 of road use tax funds between now and the next census, due to the road use tax distribution formula. The City intends to use this money to upgrade the condition of all City roads. One of the significant reasons for the shortfall in the Road Use Tax cash balance in FY06 was the purchase of a new dump truck/snow plow. The cost of this new unit was approximately \$95,000, with all of the features that were added. The cost of the new unit was apportioned between the Public Works and Water and Sewer Utilities. This is the first new truck of this type purchased since 1996. The City's truck fleet is aging and steps need to be undertaken to shorten the amortization period of the existing trucks still in use to ensure that the City maintains a viable truck fleet. Since its creation in 1942 until FY2001, RUTF revenues steadily increased. RUTF revenues decreased for the first time in FY2001. A slumping economy and a decline in gasoline sales due to less travel by the general public were the primary factors. An increase in the use of ethanol-blended gasoline also contributed to the decrease in revenues. To encourage its use, the fuel tax on ethanol gasoline is one-cent less than non-ethanol unleaded gasoline. This results in less revenue for the Road Use Tax Fund. Projections of rising fuel costs will undoubtedly have an adverse effect on RUTF revenues collected in FY2008.
- The Urban Renewal Tax Increment Fund was established in 1992 to account for major urban renewal projects within the City's business district. At the end of the fiscal year, the cash balance was \$119,333, a decrease of \$577,327 from the previous year. This was due to a conscious decision to decrease the amount of reserves in that fund, per state code. An internal loan from the Sewer Reserve Fund was established to fund identified urban renewal projects, as outlined under the City's Urban Renewal Ordinance in the prior year. These proceeds will be used for various construction and refurbishing projects within the urban renewal district. The principal and interest are repaid each year from the Urban Renewal Tax Increment Fund, and then a new loan is established by resolution to service the debt on the upcoming year's urban renewal projects. In May of 2006, the City of Mount Vernon adopted, by Ordinance, an amended Urban Renewal Plan, which now incorporates the entire corporate city limits in the Urban Renewal District. The primary reason in so doing was for the repair and replacement of crumbling infrastructure in the older portions of the City that, prior to the adoption of the amendment, were not eligible for Tax Increment Financing. By including the entire City in one contiguous Urban Renewal District, the City will have the financial wherewithal to embark on a continuous program of infrastructure repair, within the statutory limits as prescribed by the Tax Increment Financing formula, to benefit low to moderate income families. The City will need to remain vigilant to ensure that sufficient funds are allocated to the General Fund in so doing.

- In the Spring of 2007, the City defeased approximately \$1.9 million in old bonds, comprised of the residual balances of the 1991 Street Bond and the 1998A General Obligation Bond, and additionally issued approximately \$2.5 million in new General Obligation Bonds for the purposes of a comprehensive, multi-year streets improvements program. The administration has taken a proactive policy stance on repairs and upgrades to the City's aging infrastructure. Before the bonds went to market, the City utilized the services of Standard and Poors to set about achieving a favorable rating which would have a net affect of lower interest rates on the issue from bond buyers. Due to the financial health of the City and the City's sufficient cash reserves, the City was initially given an "A" rating, which was considered extremely good for a first time rating. Additionally, when the low bid buyer purchased the bond package, they paid for insurance on the bonds, which then had the new effect of achieving an "AAA" rating for the City. There were approximately 12 bidders for the competitive bonds sale, which was held electronically in City offices the day of the sale. The services of Standard and Poors, for their rating services, cost \$5,000; however, this rating achieved a net savings of over \$122,000 in interest charges between how the bond market was performing on unrated tax-free municipal bonds and rated bonds. The net interest on the bonds sold was approximately 3.9%, which was very favorable.
- The Debt Service Fund cash balance increased by \$92,763 to \$113,414 during the fiscal year.

INDIVIDUAL MAJOR BUSINESS TYPE FUND ANALYSIS

- The Water Fund cash balance increased by \$16,994 to \$253,014, due primarily to an increase in charges for service receipts.
- The Sewer Fund cash balance increased by \$393,731 to \$810,463, due primarily to decreases in sewer operational expenses and equipment maintenance and repairs over the prior year and the repayment of the prior year's loan from the Sewer Fund to the Tax Increment Finance Fund.
- The Solid Waste Fund cash balance increased from \$116,595 to \$150,754, due primarily to a slight adjustment in accounting for certain costs attributable to this utility, and the entering into of a 7-year contract with a new waste hauler, resulting in estimated savings over the previous contract of approximately \$20,000 per year, on a 7-year cycle.
- The Storm Water Fund was newly established in June 2004, and, subsequently, there was minimal expense and minimal revenue recorded in FY2007. Rates are based upon an Equivalent Residential Unit (ERU) of \$1.50 per month. The utility will be used to fund storm sewer improvements within the City. The Storm Water Fund cash balance increased from \$46,083 to \$67,566.

BUDGETARY HIGHLIGHTS

Over the course of the year, the City amended its budget once, in May 2007. The amendment was approved on May 21, 2007, and resulted in an increase in operating disbursements related to a cost overrun of approximately \$33,100 for public safety, \$10,000 for general government (much of which was additional unanticipated attorney fees due to a major revision of the City's subdivision and zoning ordinances), and community and economic development of \$35,000 (which reflects a policy change of the distribution of funds for the newly created Tourism and Marketing Board), and an increase of Debt Fund of \$2,120,000 to account for the newly issued Series 2007 General Obligation Bonds. The City had sufficient cash balances to absorb these additional costs.

DEBT ADMINISTRATION

At June 30, 2007, the City had \$6,250,000 in bonds and other long-term debt, compared to \$4,095,000 last year, as shown below.

Outstanding Debt at Year End (Expressed in Thousands)

	<u>Year Ended June 30,</u>	
	<u>2007</u>	<u>2006</u>
General obligation bonds	\$ 5,590	\$ 3,390
Revenue notes	<u>660</u>	<u>705</u>
Total	<u>\$ 6,250</u>	<u>\$ 4,095</u>

The City does now carry a general obligation bond rating assigned by the national rating agency Standard and Poors of an "A" rating (with a new effect of a "AAA" rating). The Constitution of the State of Iowa limits the amount of general obligation debt cities can issue to 5% of the assessed value of all taxable property within the City's corporate limits. The City's outstanding general obligation debt of \$5,590,000 is significantly below its constitutional debt limit of \$8,938,612.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES AND COMMENTARY ON THE U.S. ECONOMY

Mount Vernon's elected and appointed officials and citizens considered many factors when setting the fiscal year 2008 budget, tax rates, and fees that will be charged for various City activities. One of those factors is the economy. The City's population growth has mirrored the population growth of Linn County during 1999-2005, averaging per year gains of approximately 1.5 percent, or approximately 9 percent during this time frame. This compares with the State's population growth rate of approximately 6.9 percent and the national rate of 3.9 percent during the same time frame.

Inflation in the state continues to be somewhat lower than the national Consumer Price Index increase. The U.S CPI increase was 3.17 percent for the 12-month period that ended in July for fiscal year 2007 compared with the fiscal year 2006 rate of 3.2 percent. The CPI is a measure of the changes in retail prices of a fixed market grouping of consumer goods and services. Inflation has been modest in the state due in part to the slowing of the residential housing market due to rising interest rates as compared to rates in the 5.4% range to posting of new home rates in the 7% range. Overall, the housing market may wane a bit as a gradual rise in long-term mortgage rates takes a modest toll. Most home buyers hold 30-year fixed rate mortgages. As was noted previously in this report, in March of 2005, the City went to contracting out the building inspection services, as opposed to performing the inspections with in-house staff. This alone resulted in a revenue shortfall of approximately \$45,000, and with the present contract service, it is predicted that contracting out will cost approximately \$45,000 to \$60,000, depending on the demand for building permits, primarily due to new construction in succeeding years, with said contract services being revenue neutral. In January of 2006, the City entered into a contract with the Linn County Building Department to realize a reduction in building cost fee schedules. As noted, this new contract will be revenue neutral; however, by contracting with the Linn County Building Department, there will be significant savings as much as 50% for persons taking out building permits over the previous contractor, making the permitting process more affordable for the residents of Mount Vernon. It is anticipated that Mount Vernon's demand for new housing will remain viable as long as interest rates do not move sharply up.

Building permits issued for new housing construction are averaging approximately 20 per year, with a high of 27 compared to 17 in 2007. Mount Vernon relies heavily upon the residential tax base for funding programs within the City's General Fund. The City experienced increases in energy prices in 2006-2007.

It is anticipated that energy costs will continue to rise in 2007-2008, especially in the wake of natural disasters and unstable world oil markets that affect the prices of energy at all levels. Management feels that energy prices, consumer confidence, mounting credit card debt, adjustments in the Federal Reserve rate and correction in the stock market remain the linchpins on whether the U.S. economy sinks or swims in 2008. If this scenario occurs, it is possible that there may be a sudden, sharp drop in housing construction, financial strains on many homeowners' incomes and a major chill in consumer confidence.

The completion of the Federal Reserve rate hike campaign last June did little to remove uncertainty in the markets. With the overnight rate pegged at 5.25%, the markets were free to speculate on the timing of the first rate cut despite the Fed's pronouncements to the contrary. The Fed has made it clear that they are more concerned about inflation than economic growth at this point, and they are biased to raise rates. However, investors have simply vacillated between many imminent rate cuts and no imminent rate cuts. As it stands today, the market is in a holding pattern with no visible rate change expectations as growth has slowed and inflation remains above the Fed's comfort zone.

Nationally, economic growth softened as expected in the first quarter of 2007 as the housing and auto sectors continued their declines. First quarter real GDP growth came in at a mere 0.7 percent for the quarter and 1.9 percent year-over-year, the slowest quarterly growth in four years. Despite the slowdown, management feels that there is sufficient strength that will provide stronger growth in the second half of calendar year 2007.

Unfortunately, housing sector concerns will likely continue for the foreseeable future. Headwinds still loom as mortgage lenders tighten lending standards and builders have yet to fully correct the mismatch between housing demand and supply. With unsold homes representing 6.5 months demand nationally, builders must cut construction significantly to bring balance back to this sector.

Outside of the housing sector, the economy appears to be holding its own. The consumer remains active in light of higher energy costs and rising inflation. Management sees the availability of jobs as the driving factor for the consumer. As long as jobs are plentiful and wages continue to rise, management believes the consumer will continue to spend and support growth. Sustaining the jobs market is a sustainable improvement in exports. Booming economic growth abroad and a weaker dollar are boosting exports. The increase in exports will continue to foster domestic job growth and give economic growth to an area that has been sluggish for two decades.

Market concerns about sub-prime mortgages and private equity activity continue to exert pressure performance of all bond sectors outside Treasury's. Even equity market elation over the same issues is turning toward concern about market liquidity; however, management does not expect the current economic problems to result in a recession.

In early 2006, cities across Iowa were asked to participate in a fiscal condition survey sponsored by the National League of Cities and administered by the League of Minnesota Cities. A similar survey was administered last year for Iowa communities, along with several other states throughout the Midwest. For the 2006 survey the League of Minnesota Cities attempted to branch out from the Midwest to include other regions of the country. The states that responded to the 2006 fiscal condition survey included Georgia, Illinois, Minnesota, North and South Dakota, Pennsylvania, Tennessee and Iowa.

Similar to the 2005 Fiscal Conditions Survey, cities throughout Iowa noted significant challenges in maintaining fiscal conditions from the previous year. Strains born from tightening state budgets and property tax limitations have trickled down to cities in Iowa over the past several years. These lean years have been highlighted by cities thinking outside the box for additional revenues.

Ability to Meet Financial Needs

In responses mirroring the 2005 survey, Iowa communities ranked near the bottom in communities' ability to meet financial needs from one year to the next. While other states throughout the Midwest seemed to hover toward the middle percentages of being able to maintain adequate financial resources for cities, Iowa's numbers paint a different picture. In FY 2004, 29 percent of Iowa communities felt they would be able to better meet financial needs of the city for FY 2005. In FY 2005, when projecting for FY 2006, this number drops to 28 percent. Only Pennsylvania (28 and 25 percent) ranks below Iowa, while the survey average for every state was at nearly 44 percent.

Revenue Shortfalls

Iowa communities appear to be acclimating to the loss of state funding and continuing pressure on property taxes due to the roll back and the general fund levy limit. State revenue shortfalls from FY 2004 were reported by 73.5 percent of cities as an issue. As communities throughout the state have adjusted to the loss of state shared revenues in the years prior to FY 2005, only 59.7 percent of Iowa communities reported state funding shortfalls as being an issue. While this number is still rather high and above the survey average of 44.4 percent, it is an improvement from FY 2004.

Obviously, fiscal comparisons between states are difficult. For example, cities in Iowa do not receive a significant amount of revenue from the State of Iowa when compared to cities in other states. In many states, budget conditions at the state level impacted local budgets as states reduced their payments to cities.

Cities throughout the state continue to note increased estimated funding shortages in property tax revenues. FY 2004 saw 34.3 percent of a shortfall, while in FY 2005 the number of cities jumped to 43.2 percent. Iowa, once again, ranked higher than the survey average of 37.14 percent. Cities in Iowa typically rely on property tax revenues to a greater degree than other states. When combined with the continuing erosion of property values due to the roll back and the statutory general fund levy limit a significant number of cities in Iowa feel revenue constraints for city operations.

Actions Taken for FY 2008

Because many of Iowa's communities already tax the maximum levy limit and have used their emergency fund levy, most Iowa's property tax rates have limited capacity to increase. This lack of capacity to increase is demonstrated with Iowa falling far below most states in property tax increases. As opposed to a majority of states responding to the survey, Iowa communities could not answer shortfalls by increasing property taxes. Iowa ranks above the survey average for decreases in general taxes at 7.2 percent compared to an average of 5.2 percent and ranks below the survey average for taxing increases at 33.8 percent compared to an average of 43.4 percent. Even though cities throughout the state feel the effect of tightening budgets, citizens have yet to bare the significant costs to balance these shortfalls.

Conclusions

Alternative revenue and delivery methods such as inter-agency local agreements and use of fees and charges for services may see increases while cities attempt to find stability in revenue sources. These may not only serve as solutions to current issues, but could also create a solid base for additional resources.

These indicators were taken into account when adopting the budget for fiscal year 2008. Amounts available for appropriation in the operating budget are \$9,298,078, an increase of 11.26% over the final 2007 budget. Property tax (benefiting from the increases in assessed valuations) and urban renewal tax increment financing collections, and possible bond sales to finance certain capital improvement projects, are expected to lead this increase. The City will use these increases in receipts to finance programs we currently offer and to defray a portion of the costs of carrying out major urban renewal projects of the City. Budgeted disbursements are expected to rise by approximately \$1,044,347, a decrease of budgeted disbursements from \$2,131,264 in FY07. Increased wage and cost-of-living adjustments, increases in the public safety fund, street reconstruction and maintenance, the possibility of a new fire station and urban renewal projects represent the largest increases. It was felt by the administration that the City needs to reinvest itself in infrastructure-related public works projects, as reflected by the sharp upswings in the appropriations for spending in these sectors. Requests for Proposals have been sent out to investigate the needs and costs associated with upgrading the City's sanitary sewerage mains and interceptors. It is possible that the anticipated report contained in the proposal may lead to adjusting the rates for the sewer utility in case sewer revenue bonds are issued to pay for repairs, depending on the extent of the proposal. The City also intends to drill 2 new wells and add a second municipal water treatment in the Northeast sector of town to accommodate a growing demand for water and to stay proactive with regards to consumer demand and anticipated growth. The City has added no major new programs or initiatives to the 2008 budget; however, Council made a conscious policy decision to transfer all of the funds it was estimated to receive after July 1, 2006, from the hotel/motel tax to a newly created independent Marketing and Tourism Board, for the purposes of economic development for FY07. By State code, one-half of all revenues received from the collection of taxes from this fund are to be used for Tourism and Tourism-related activities and programs. It was estimated that this revenue source contribution would be approximately \$50,000 each year. At the close of the books on June 30, 2007, the City had received \$50,493 for this purpose. For FY08, the City made the policy decision to cap future expenditures for this fund at \$50,000, regardless of the revenues generated from the Hotel/Motel Tax Fund. Additionally, the City has embarked on a proactive, conscious policy decision to invest in the repairs and upgrades of its aging infrastructure.

If these estimates are realized, the City's budgeted cash balance from all sources, including transfers and the sale of bonds and cash reserves, is expected to increase by approximately \$2,687,010 by the close of 2008. The City will have sufficient cash reserves if all estimates are realized.

PROPERTY TAX ROLL-BACK

The Iowa Department of Revenue issues an Assessment Limitation Order to county auditors to adjust actual property values. The percentages for fiscal year 2004 through 2007 are as follows:

<u>Property Classification</u>	<u>FY2007</u>	<u>FY2006</u>	<u>FY2005</u>	<u>FY2004</u>
Residential	45.9960%	47.9642%	48.4558%	51.3874%
Commercial	99.1509%	100%	99.2570%	100%
Agricultural	100%	100%	100%	100%
Industrial	100%	100%	100%	100%

The January 1, 2006 property tax valuation serves as the basis for calculating property taxes for 2008. Since 1978, residential, commercial and agricultural classifications have been subject to the assessment limitation order, or roll back, that limits annual growth in property to 4% with a further restriction that growth in residential property cannot exceed that of agricultural property, whichever is less. The result is an annual rolling-back of residential values. A significant decline in agricultural land productivity has resulted in low values on agricultural land for tax purposes. The limitation can also be applied to industrial and commercial property when necessary. This low value has resulted in a significant adjustment to residential property taxes. It appears that residential roll back will decrease further for valuations as of January 1, 2007, payable 2008-2009. It was hoped that the roll-back would recover slightly, in an even-numbered year without revaluation of existing properties and equalization orders being absent. However, once again the link to agricultural valuation growth forced the roll back down. Without the link between residential and agricultural growth, the residential roll back would have actually increased. The City of Mount Vernon has realized substantial residential growth in the last decade, which has partially offset the decline attributable to the roll back factor.

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. If you have questions about this report or need additional financial information, contact Michael R. Beimer, City Administrator, 213 First Street West, Mount Vernon, Iowa.

BASIC FINANCIAL STATEMENTS

CITY OF MOUNT VERNON

Statement of Activities and Net Assets - Cash Basis

As of and for the year ended June 30, 2007

	<u>Disbursements</u>	<u>Program Receipts</u>	
		<u>Charges for Services</u>	<u>Operating Grants, Contributions and Restricted Interest</u>
Functions/Programs:			
Governmental activities:			
Public safety	\$ 548,890	\$ 28,527	\$ 8,504
Public works	264,064	-	347,631
Culture and recreation	284,887	107,244	3,714
Community and economic development	54,270	-	-
General government	270,390	73,637	-
Debt service	2,366,083	-	-
Capital projects	508,431	-	-
Total governmental activities	<u>4,297,015</u>	<u>209,408</u>	<u>359,849</u>
Business type activities:			
Storm water	11,733	32,271	-
Water	395,000	445,003	-
Sewer	602,141	392,887	-
Solid waste	279,902	306,145	-
Total business type activities	<u>1,288,776</u>	<u>1,176,306</u>	<u>-</u>
Total	<u>\$ 5,585,791</u>	<u>\$ 1,385,714</u>	<u>\$ 359,849</u>

General Receipts

Property and other city tax levied for:	
General purposes	
Tax increment financing	
Debt service	
Local option sales tax	
Grants and contributions not restricted to specific purposes	
Unrestricted interest on investments	
Miscellaneous	
Bond proceeds	
Transfers	
Total general receipts and transfers	

**Net (Disbursements) Receipts and
Changes in Cash Basis Net Assets**

<u>Governmental Activities</u>	<u>Business Type Activities</u>	<u>Total</u>
\$ (511,859)	\$ -	\$ (511,859)
83,567	-	83,567
(173,929)	-	(173,929)
(54,270)	-	(54,270)
(196,753)	-	(196,753)
(2,366,083)	-	(2,366,083)
(508,431)	-	(508,431)
<u>(3,727,758)</u>	<u>-</u>	<u>(3,727,758)</u>
-	20,538	20,538
-	50,003	50,003
-	(209,254)	(209,254)
-	26,243	26,243
<u>-</u>	<u>(112,470)</u>	<u>(112,470)</u>
<u>(3,727,758)</u>	<u>(112,470)</u>	<u>(3,840,228)</u>
890,092	-	890,092
571,260	-	571,260
125,469	-	125,469
29,550	-	29,550
80,686	-	80,686
86,447	65,505	151,952
32,143	11,619	43,762
4,429,145	-	4,429,145
(501,713)	501,713	-
<u>5,743,079</u>	<u>578,837</u>	<u>6,321,916</u>

(continued)

CITY OF MOUNT VERNON

Statement of Activities and Net Assets - Cash Basis

As of and for the year ended June 30, 2007

	<u>Disbursements</u>	<u>Program Receipts</u>
		Operating Grants, Contributions and Restricted Interest
	<u>Charges for Services</u>	
Change in cash basis net assets		
Cash basis net assets, beginning of year		
Cash basis net assets, end of year		
Cash Basis Net Assets		
Restricted:		
Streets		
Maintenance and improvements		
Urban renewal purposes		
Debt service		
Cemetery perpetual care		
Other purposes		
Unrestricted		
Total Cash Basis Net Assets		

**Net (Disbursements) Receipts and
Changes in Cash Basis Net Assets**

Governmental Activities	Business Type Activities	Total
2,015,321	466,367	2,481,688
<u>3,719,431</u>	<u>815,430</u>	<u>4,534,861</u>
<u>\$ 5,734,752</u>	<u>\$ 1,281,797</u>	<u>\$ 7,016,549</u>
\$ 53,713	\$ -	\$ 53,713
3,447,135	358,642	3,805,777
119,333	-	119,333
113,414	93,660	207,074
71,525	-	71,525
1,565,051	-	1,565,051
<u>364,581</u>	<u>829,495</u>	<u>1,194,076</u>
<u>\$ 5,734,752</u>	<u>\$ 1,281,797</u>	<u>\$ 7,016,549</u>

The accompanying notes are an integral part of the financial statements.

CITY OF MOUNT VERNON

Statement of Cash Receipts, Disbursements
and Changes in Cash Balances - Governmental Funds

As of and for the year ended June 30, 2007

	Special Revenue			
	General	Road Use Tax	Urban Renewal Tax Increment	Local Option Sales Tax
Receipts:				
Property tax	\$ 631,761	\$ -	\$ -	\$ -
Tax increment financing	-	-	571,261	-
Other city tax	73,725	-	-	29,550
Licenses and permits	57,439	-	-	-
Use of money and property	52,747	-	27,539	15,120
Intergovernmental	7,462	347,632	-	-
Charges for service	107,965	-	-	-
Miscellaneous	61,850	4,811	-	-
Total receipts	<u>992,949</u>	<u>352,443</u>	<u>598,800</u>	<u>44,670</u>
Disbursements:				
Operating:				
Public safety	548,890	-	-	-
Public works	-	264,064	-	-
Culture and recreation	284,887	-	-	-
Community and economic development	54,270	-	-	-
General government	195,916	-	-	-
Debt service	-	-	-	-
Capital projects	-	-	143,645	-
Total disbursements	<u>1,083,963</u>	<u>264,064</u>	<u>143,645</u>	<u>-</u>
Excess (deficiency) of receipts over (under) disbursements	<u>(91,014)</u>	<u>88,379</u>	<u>455,155</u>	<u>44,670</u>
Other financing sources (uses):				
Bond proceeds	-	-	-	-
Operating transfers in	159,887	-	-	-
Operating transfers out	-	-	(1,032,482)	-
Total other financing sources (uses)	<u>159,887</u>	<u>-</u>	<u>(1,032,482)</u>	<u>-</u>

<u>Capital Projects</u>				
<u>Debt Service</u>	<u>2006 Water Improvement</u>	<u>2007 Street Improvement</u>	<u>Nonmajor</u>	<u>Total</u>
\$ 101,709	\$ -	\$ -	\$ 258,331	\$ 991,801
23,760	-	-	-	595,021
483	-	-	-	103,758
-	-	-	-	57,439
-	813	-	6,418	102,637
-	-	-	-	355,094
-	-	-	-	107,965
-	2,500	-	2,028	71,189
<u>125,952</u>	<u>3,313</u>	<u>-</u>	<u>266,777</u>	<u>2,384,904</u>
-	-	-	-	548,890
-	-	-	-	264,064
-	-	-	-	284,887
-	-	-	-	54,270
-	-	-	74,474	270,390
2,366,083	-	-	-	2,366,083
-	296,460	34,658	33,668	508,431
<u>2,366,083</u>	<u>296,460</u>	<u>34,658</u>	<u>108,142</u>	<u>4,297,015</u>
<u>(2,240,131)</u>	<u>(293,147)</u>	<u>(34,658)</u>	<u>158,635</u>	<u>(1,912,111)</u>
-	-	4,429,145	-	4,429,145
2,610,240	-	277,346	-	3,047,473
(277,346)	-	(2,117,346)	(122,012)	(3,549,186)
<u>2,332,894</u>	<u>-</u>	<u>2,589,145</u>	<u>(122,012)</u>	<u>3,927,432</u>

(continued)

CITY OF MOUNT VERNON

**Statement of Cash Receipts, Disbursements
and Changes in Cash Balances - Governmental Funds**

As of and for the year ended June 30, 2007

	Special Revenue			
	General	Road Use Tax	Urban Renewal Tax Increment	Local Option Sales Tax
Net change in cash balances	68,873	88,379	(577,327)	44,670
Cash balances, beginning of year	295,708	(34,666)	696,660	1,491,466
Cash balances, end of year	\$ 364,581	\$ 53,713	\$ 119,333	\$ 1,536,136

Cash Basis Fund Balances

Reserved:				
Debt service	\$ -	\$ -	\$ -	\$ -
Unreserved:				
General fund	364,581	-	-	-
Special revenue funds	-	53,713	119,333	1,536,136
Capital projects fund	-	-	-	-
Permanent fund	-	-	-	-
Total cash basis fund balance	\$ 364,581	\$ 53,713	\$ 119,333	\$ 1,536,136

Exhibit B

<u>Capital Projects</u>				
<u>Debt Service</u>	<u>2006 Water Improvement</u>	<u>2007 Street Improvement</u>	<u>Nonmajor</u>	<u>Total</u>
92,763	(293,147)	2,554,487	36,623	2,015,321
<u>20,651</u>	<u>959,282</u>	<u>-</u>	<u>290,330</u>	<u>3,719,431</u>
<u>\$ 113,414</u>	<u>\$ 666,135</u>	<u>\$ 2,554,487</u>	<u>\$ 326,953</u>	<u>\$ 5,734,752</u>
\$ 113,414	\$ -	\$ -	\$ -	\$ 113,414
-	-	-	-	364,581
-	-	-	28,915	1,738,097
-	666,135	2,554,487	226,513	3,447,135
<u>-</u>	<u>-</u>	<u>-</u>	<u>71,525</u>	<u>71,525</u>
<u>\$ 113,414</u>	<u>\$ 666,135</u>	<u>\$ 2,554,487</u>	<u>\$ 326,953</u>	<u>\$ 5,734,752</u>

The accompanying notes are an integral part of the financial statements.

CITY OF MOUNT VERNON

Statement of Cash Receipts, Disbursements
and Changes in Cash Balances - Proprietary Funds

As of and for the year ended June 30, 2007

	<u>Water</u>	<u>Sewer</u>	<u>Solid Waste</u>	<u>Nonmajor Storm Water</u>	<u>Total</u>
Operating receipts:					
Use of money and property	\$ 19,152	\$ 37,863	\$ 7,545	\$ 945	\$ 65,505
Charges for service	445,003	392,887	306,145	32,271	1,176,306
Miscellaneous	<u>1,066</u>	<u>10,182</u>	<u>371</u>	<u>-</u>	<u>11,619</u>
Total operating receipts	465,221	440,932	314,061	33,216	1,253,430
Operating disbursements:					
Business type activities	<u>395,000</u>	<u>521,856</u>	<u>279,902</u>	<u>11,733</u>	<u>1,208,491</u>
Excess (deficiency) of operating receipts over (under) operating disbursements	70,221	(80,924)	34,159	21,483	44,939
Non-operating disbursements:					
Debt service	<u>-</u>	<u>80,285</u>	<u>-</u>	<u>-</u>	<u>80,285</u>
Excess (deficiency) of receipts over (under) disbursements	<u>70,221</u>	<u>(161,209)</u>	<u>34,159</u>	<u>21,483</u>	<u>(35,346)</u>
Other financing sources (uses):					
Operating transfers in	110,628	597,361	-	-	707,989
Operating transfers out	<u>(163,855)</u>	<u>(42,421)</u>	<u>-</u>	<u>-</u>	<u>(206,276)</u>
Total other financing sources (uses)	<u>(53,227)</u>	<u>554,940</u>	<u>-</u>	<u>-</u>	<u>501,713</u>
Net change in cash balances	16,994	393,731	34,159	21,483	466,367
Cash balances, beginning of year	<u>236,020</u>	<u>416,732</u>	<u>116,595</u>	<u>46,083</u>	<u>815,430</u>
Cash balances, end of year	<u>\$ 253,014</u>	<u>\$ 810,463</u>	<u>\$ 150,754</u>	<u>\$ 67,566</u>	<u>\$ 1,281,797</u>
Cash Basis Fund Balances					
Reserved for maintenance and improvements	\$ 212,036	\$ 146,606	\$ -	\$ -	\$ 358,642
Reserved for debt service	7,217	86,443	-	-	93,660
Unreserved	<u>33,761</u>	<u>577,414</u>	<u>150,754</u>	<u>67,566</u>	<u>829,495</u>
Total cash basis fund balances	<u>\$ 253,014</u>	<u>\$ 810,463</u>	<u>\$ 150,754</u>	<u>\$ 67,566</u>	<u>\$ 1,281,797</u>

The accompanying notes are an integral part of the financial statements.

CITY OF MOUNT VERNON

Notes to Financial Statements

June 30, 2007

(1) Summary of Significant Accounting Policies

The City of Mount Vernon, a political subdivision of the State of Iowa located in Linn County, 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 and recreation, community and economic development and general government services. The City also provides water, sewer and solid waste utilities for its citizens.

A. Reporting Entity

For financial reporting purposes, the City 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 following component unit is an entity that is legally separate from the City, but is so intertwined with the City that it is, in substance, part of the City. However, the financial transactions of this component unit have not been displayed because they are not material.

The Mt. Vernon Fire Department was established by adopting its own constitution and by-laws. The Fire Department collects donations which are used to purchase items which are not included in the City's budget.

The police and fire reserve organizations have governing authorities independent from the City and are not considered to be component units of the City. As such, their activity is not included in the financial statements of the City.

B. Basis of Presentation

Government-wide Financial Statement - 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 MOUNT VERNON
Notes to Financial Statements

June 30, 2007

(1) Summary of Significant Accounting Policies (continued)

B. Basis of Presentation (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 the 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.

CITY OF MOUNT VERNON
Notes to Financial Statements
June 30, 2007

(1) Summary of Significant Accounting Policies (continued)

B. Basis of Presentation (continued)

The Local Option Sales Tax Fund is used to account for the receipt and expenditure of local option sales taxes.

The 2007 Street Improvement Fund is used to account for street improvement projects undertaken in 2007.

The 2006 Water Improvement Fund is used to account for water improvement projects undertaken in 2006.

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

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 Solid Waste Fund accounts for the costs associated with solid waste removal which is funded through user fees.

C. Measurement Focus and Basis of Accounting

The City of Mount Vernon 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 accounting principles generally accepted in the United States of America.

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.

D. Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information.

CITY OF MOUNT VERNON
Notes to Financial Statements

June 30, 2007

(2) Deposits

The City's deposits in banks at June 30, 2007, 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.

(3) Bonds and Notes Payable

On May 17, 2007, the City issued \$4,410,000 in General Obligation Bonds with an average interest rate of 4.02 percent to advance refund \$1,840,000 of 1998 wastewater treatment plant expansion with an average interest rate of 4.65 percent. Net proceeds of \$4,385,236 (after payment of issuance costs and underwriter's premium of \$11,306) were used to purchase U.S. Government securities. Those securities were deposited in an irrevocable trust with an escrow agent to provide for payment of the following: (i) interest on the 1998 wastewater treatment plant expansion as the same becomes due to and including June 1, 2017, and (ii) prepayment of the principal of the 1998 wastewater treatment plant expansion on June 1, 2017.

As a result, \$1,840,000 of the 1998 wastewater treatment plant expansion is considered to be defeased and the liability for those notes have been removed from the City's indebtedness amount. The City advance refunded the 1998 wastewater treatment plant expansion to reduce its total debt service payments over the next ten years by almost \$52,500 and to obtain an economic gain (difference between the present values of the debt service payments on the old and new debt) of approximately \$42,000.

CITY OF MOUNT VERNON
Notes to Financial Statements
June 30, 2007

(3) Bonds and Notes Payable (continued)

Annual debt service requirements to maturity for general obligation bonds and notes and revenue notes are as follows:

Year Ending June 30,	General Obligation Bonds & Notes		Revenue Notes		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2008	\$ 485,000	\$ 289,264	\$ 45,000	\$ 32,860	\$ 530,000	\$ 322,124
2009	400,000	246,407	50,000	30,767	450,000	277,174
2010	420,000	227,396	50,000	28,443	470,000	255,839
2011	430,000	207,311	55,000	26,117	485,000	233,428
2012	450,000	186,586	55,000	23,450	505,000	210,036
2013	460,000	164,810	60,000	20,783	520,000	185,593
2014	480,000	142,186	60,000	17,752	540,000	159,938
2015	505,000	118,731	65,000	14,723	570,000	133,454
2016	525,000	93,813	70,000	11,440	595,000	105,253
2017	395,000	67,613	75,000	7,800	470,000	75,413
2018	190,000	41,600	75,000	3,900	265,000	45,500
2019	200,000	34,000	-	-	200,000	34,000
2020	210,000	26,000	-	-	210,000	26,000
2021	215,000	17,600	-	-	215,000	17,600
2022	<u>225,000</u>	<u>9,000</u>	<u>-</u>	<u>-</u>	<u>225,000</u>	<u>9,000</u>
Total	<u>\$5,590,000</u>	<u>\$1,872,317</u>	<u>\$ 660,000</u>	<u>\$ 218,035</u>	<u>\$6,250,000</u>	<u>\$2,090,352</u>

The resolutions providing for the issuance of the revenue notes include the following provisions:

- a) The notes will only be redeemed from the future earnings of the enterprise activity and the note holders hold a lien on the future earnings of the fund.
- b) Certain notes may be called for redemption by the City.
- c) Sufficient monthly transfers shall be made to a separate sewer revenue note sinking account for the purpose of making the note principal and interest payments when due. The minimum amount to be deposited in the sinking fund in any month is one-sixth of the interest installment coming due on the next interest payment date plus one-twelfth of the principal installment coming due on the next principal date.

CITY OF MOUNT VERNON
Notes to Financial Statements

June 30, 2007

(3) Bonds and Notes Payable (continued)

- d) Funds remaining in the sewer revenue account after the payment of all current expenses and required transfers into the sinking fund will be disbursed as follows: (1) a separate sewer revenue debt service reserve fund will be established in amounts equal to at least the lesser of the maximum amount of principal and interest coming due in any succeeding fiscal year or 10% of the stated principal amount of the sale of the notes to the public; (2) a separate sewer revenue improvement fund will be established and a minimum of \$400 will be deposited into this fund each month until a balance of \$50,000 is reached.

The City is insured by the Iowa Communities Assurance Pool and policies existing at June 30, 2007 expire on June 30, 2008.

The City also has fidelity bond insurance coverage through EMC Insurance Companies in the amount of \$100,000. The current policy expires on July 1, 2007, but has been renewed through July 1, 2008.

The City has not maintained a separate sewer revenue account from which transfers were to be made into an operations and maintenance fund as required by the sewer revenue note resolutions. Instead, the revenue fund and operations and maintenance fund were treated as one fund.

(4) Pension and Retirement Benefits

The City contributes to the Iowa Public Employees Retirement Systems (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.

Most regular plan members are required to contribute 3.70% of their annual covered salary and the City is required to contribute 5.75% of covered salary. Certain employees in special risk occupations and the City contribute an actuarially determined contribution rate. Contribution requirements are established by state statute. The City's contributions to IPERS for the years ended June 30, 2007, 2006 and 2005 were \$57,867, \$53,006, and \$50,198, respectively, equal to the required contributions for each year.

CITY OF MOUNT VERNON
Notes to Financial Statements

June 30, 2007

(5) Compensated Absences

City employees accumulate a limited amount of earned but unused vacation and sick leave 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 and sick leave termination payments payable to employees at June 30, 2007, primarily relating to the General Fund, is as follows:

<u>Type of Benefit</u>	<u>Amount</u>
Vacation	\$ 54,644
Sick leave	<u>151,961</u>
Total	<u>\$ 206,605</u>

This liability has been computed based on rates of pay as of June 30, 2007.

Sick leave is payable when used or upon termination, retirement or death. If at retirement or death an employee has at least 20 years of service, all of the accumulated sick leave will be paid, with the pay rate being the same as the employee's regular rate. Upon termination (voluntary/involuntary) the employee shall receive one half of all accumulated sick leave pay. Based on this computation, the minimum accumulated sick leave approximates \$75,981 at June 30, 2007.

The City is also potentially liable for severance pay for one of its employees. If the employee's contract is not renewed by the City Council, the City agrees to pay an amount equal to eight months of the employee's salary. Calculated based on rates of pay as of June 30, 2007, this amount approximates \$49,997.

(6) Meter Deposits

At June 30, 2007, the City was holding meter deposits from individuals in the amount of \$5,652.

CITY OF MOUNT VERNON
Notes to Financial Statements
June 30, 2007

(7) Interfund Transfers

The detail of interfund transfers for the year ended June 30, 2007 is as follows:

<u>Transfer to</u>	<u>Transfer from</u>	<u>Amount</u>
Debt Service	Special Revenue: Urban Renewal Tax Increment	\$ 324,493
	Capital Project: 2007 Street Improvement	2,117,346
	Enterprise: Water	148,959
	Sewer	<u>19,442</u>
		<u>2,610,240</u>
General Fund	Enterprise: Water	14,896
	Sewer	22,979
	Special Revenue: Employee Benefits	<u>122,012</u>
		<u>159,887</u>
2007 Street Improvement	Debt Service	<u>277,346</u>
Enterprise: Sewer	Special Revenue: Urban Renewal Tax Increment	<u>597,361</u>
Enterprise: Water	Special Revenue: Urban Renewal Tax Increment	<u>110,628</u>
Total		<u>\$ 3,755,462</u>

Transfers generally move revenues from the fund statutorily required to collect the resources to the fund statutorily required to expend the resources.

The transfer between the Enterprise, Sewer fund and the Special Revenue, Urban Renewal Tax Increment fund is for the repayment of an inter-fund loan. See Note 10 for further discussion.

CITY OF MOUNT VERNON

Notes to Financial Statements

June 30, 2007

(8) Risk Management

The City 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.

(9) Commitments

The City has entered into various equipment purchase agreements and a construction contract totaling \$761,712. Through June 30, 2007, \$283,446 has been paid towards these commitments. The City has also entered into contracts for services to be performed for the City. These contracts require payments totaling \$31,295, of which \$14,947 has been paid through June 30, 2007.

The City has a contract for solid waste hauling that extends from July 1, 2005 through June 30, 2012. Payments under the contract are dependent upon the number of City residents.

(10) Inter-fund Loans

During the prior fiscal year, a loan totaling \$560,904 was made to the Special Revenue, Urban Renewal Tax Increment Fund by the Enterprise, Sewer Fund in order to fund capital projects. The loan was repaid during the current year, along with \$37,361 of interest calculated at 6.5%.

This information is an integral part of the accompanying financial statements.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF MOUNT VERNON

Budgetary Comparison Schedule of Receipts, Disbursements and
Changes in Balances - Budget and Actual (Cash Basis) -
All Governmental Funds and Proprietary Funds

Required Supplementary Information

Year ended June 30, 2007

	Governmental Funds Actual	Proprietary Funds Actual	Less Funds not Required to be Budgeted
Receipts:			
Property tax	\$ 991,801	\$ -	\$ -
Tax increment financing	595,021	-	-
Other city tax	103,758	-	-
Licenses and permits	57,439	-	-
Use of money and property	102,637	65,505	-
Intergovernmental	355,094	-	-
Charges for service	107,965	1,176,306	-
Miscellaneous	71,189	11,619	-
	<u>2,384,904</u>	<u>1,253,430</u>	<u>-</u>
Total receipts			
Disbursements:			
Public safety	548,890	-	-
Public works	264,064	-	-
Culture and recreation	284,887	-	-
Community and economic development	54,270	-	-
General government	270,390	-	-
Debt service	2,366,083	-	-
Capital projects	508,431	-	-
Business type activities	-	1,288,776	-
	<u>4,297,015</u>	<u>1,288,776</u>	<u>-</u>
Total disbursements			
Excess (deficiency) of receipts over (under) disbursements	(1,912,111)	(35,346)	-
Other financing sources, net	<u>3,927,432</u>	<u>501,713</u>	<u>-</u>
Excess (deficiency) of receipts and other financing sources over (under) disbursements and other financing uses	2,015,321	466,367	-
Balances, beginning of year	<u>3,719,431</u>	<u>815,430</u>	<u>-</u>
Balances, end of year	<u>\$ 5,734,752</u>	<u>\$ 1,281,797</u>	<u>\$ -</u>

Net	Budgeted Amounts		Final to Net Variance
	Original	Final	
\$ 991,801	\$ 1,008,794	\$ 1,008,794	\$ (16,993)
595,021	560,903	560,903	34,118
103,758	86,310	101,310	2,448
57,439	44,800	44,800	12,639
168,142	106,500	106,500	61,642
355,094	358,529	358,529	(3,435)
1,284,271	1,363,750	1,368,750	(84,479)
82,808	85,000	85,000	(2,192)
<u>3,638,334</u>	<u>3,614,586</u>	<u>3,634,586</u>	<u>3,748</u>
548,890	540,939	574,039	25,149
264,064	357,956	357,957	93,893
284,887	298,745	298,745	13,858
54,270	58,445	93,445	39,175
270,390	284,775	294,775	24,385
2,366,083	377,523	2,497,523	131,440
508,431	2,887,500	2,887,500	2,379,069
1,288,776	3,900,713	3,900,713	2,611,937
<u>5,585,791</u>	<u>8,706,596</u>	<u>10,904,697</u>	<u>5,318,906</u>
(1,947,457)	(5,092,010)	(7,270,111)	5,322,654
<u>4,429,145</u>	<u>2,405,000</u>	<u>4,525,000</u>	<u>(95,855)</u>
2,481,688	(2,687,010)	(2,745,111)	5,226,799
<u>4,534,861</u>	<u>5,374,835</u>	<u>5,374,835</u>	<u>(839,974)</u>
<u>\$ 7,016,549</u>	<u>\$ 2,687,825</u>	<u>\$ 2,629,724</u>	<u>\$ 4,386,825</u>

CITY OF MOUNT VERNON

Notes to Required Supplementary Information - Budgetary Reporting

June 30, 2007

The budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for the General Fund and each major Special Revenue Fund.

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 Fiduciary Funds. 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. 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, the Debt Service Fund, the Capital Projects Funds and the 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 \$2,198,101. The budget amendment is reflected in the final budgeted amounts.

OTHER SUPPLEMENTARY INFORMATION

CITY OF MOUNT VERNON

Schedule of Cash Receipts, Disbursements
and Changes in Cash Balances -
Nonmajor Governmental Funds

As of and for the year ended June 30, 2007

	Special Revenue		Capital Projects	
	Insurance Levy	Employee Benefits	Fire Department Equipment	Waste Water Treatment Plant
Receipts:				
Property tax	\$ 84,855	\$ 120,985	\$ 52,491	\$ -
Use of money and property	-	-	-	6,418
Miscellaneous	1,458	-	-	-
Total receipts	<u>86,313</u>	<u>120,985</u>	<u>52,491</u>	<u>6,418</u>
Disbursements:				
Operating:				
General government	74,474	-	-	-
Capital projects	-	-	10,198	23,470
Total disbursements	<u>74,474</u>	<u>-</u>	<u>10,198</u>	<u>23,470</u>
Excess (deficiency) of receipts over (under) disbursements	11,839	120,985	42,293	(17,052)
Other financing uses:				
Operating transfers out	-	(122,012)	-	-
Net change in cash balances	11,839	(1,027)	42,293	(17,052)
Cash balances, beginning of year	<u>17,076</u>	<u>1,027</u>	<u>118,600</u>	<u>82,672</u>
Cash balances, end of year	<u>\$ 28,915</u>	<u>\$ -</u>	<u>\$ 160,893</u>	<u>\$ 65,620</u>
Cash Basis Fund Balances				
Unreserved:				
Special revenue funds	\$ 28,915	\$ -	\$ -	\$ -
Capital project funds	-	-	160,893	65,620
Permanent fund	-	-	-	-
Total cash basis fund balances	<u>\$ 28,915</u>	<u>\$ -</u>	<u>\$ 160,893</u>	<u>\$ 65,620</u>

Schedule 1

<u>Permanent Cemetery Perpetual Care</u>	<u>Total</u>
\$ -	\$ 258,331
-	6,418
<u>570</u>	<u>2,028</u>
570	266,777
-	74,474
<u>-</u>	<u>33,668</u>
-	108,142
570	158,635
<u>-</u>	<u>(122,012)</u>
570	36,623
<u>70,955</u>	<u>290,330</u>
<u>\$ 71,525</u>	<u>\$ 326,953</u>
\$ -	\$ 28,915
-	226,513
<u>71,525</u>	<u>71,525</u>
<u>\$ 71,525</u>	<u>\$ 326,953</u>

CITY OF MOUNT VERNON

Schedule of Indebtedness

Year ended June 30, 2007

<u>Obligation</u>	<u>Date of Issue</u>	<u>Interest Rates</u>	<u>Amount Originally Issued</u>
General obligation bonds and capital loan notes:			
1988 City Hall construction	July 1, 1988	5.40-7.40%	\$ 510,000
1998 Wastewater treatment plant expansion	Sept. 1, 1998	4.50-4.75%	3,280,000
2006 Water improvements	April 1, 2006	3.625-3.90%	1,225,000
2007 Street improvements	May 17, 2007	4%	4,410,000
Total			
Revenue notes:			
1998 Sewer revenue notes (1998 wastewater treatment plant expansion)	Sept. 1, 1998	4.00-5.20%	\$1,000,000

Schedule 2

<u>Balance Beginning of Year</u>	<u>Issued During Year</u>	<u>Redeemed/ Defeased During Year</u>	<u>Balance End of Year</u>	<u>Interest Paid</u>	<u>Interest Due and Unpaid</u>
\$ 95,000	\$ -	\$ 45,000	\$ 50,000	\$ 7,030	\$ -
2,070,000	-	2,070,000	-	94,293	-
1,225,000	-	95,000	1,130,000	53,560	-
<u>-</u>	<u>4,410,000</u>	<u>-</u>	<u>4,410,000</u>	<u>-</u>	<u>-</u>
<u>\$3,390,000</u>	<u>\$4,410,000</u>	<u>\$2,210,000</u>	<u>\$5,590,000</u>	<u>\$ 154,883</u>	<u>\$ -</u>
<u>\$ 705,000</u>	<u>\$ -</u>	<u>\$ 45,000</u>	<u>\$ 660,000</u>	<u>\$ 34,885</u>	<u>\$ -</u>

CITY OF MOUNT VERNON

Bond and Note Maturities

June 30, 2007

Year Ending June 30,	General Obligation Bonds and Capital Loan Notes			
	2007 Street Improvements Issued May 17, 2007		2006 Water Improvements Issued April 1, 2006	
	Interest Rates	Amount	Interest Rates	Amount
2008	4.00%	\$ 330,000	3.625%	\$ 105,000
2009	4.00	285,000	3.625	115,000
2010	4.00	300,000	3.700	120,000
2011	4.00	310,000	3.750	120,000
2012	4.00	325,000	3.750	125,000
2013	4.00	335,000	3.750	125,000
2014	4.00	345,000	3.800	135,000
2015	4.00	365,000	3.850	140,000
2016	4.00	380,000	3.900	145,000
2017	4.00	395,000		-
2018	4.00	190,000		-
2019	4.00	200,000		-
2020	4.00	210,000		-
2021	4.00	215,000		-
2022	4.00	225,000		-
Total		<u>\$4,410,000</u>		<u>\$1,130,000</u>

Year Ending June 30,	Revenue Notes	
	Interest Rates	Amount
1998 Sewer Revenue Notes (1998 Wastewater Treatment Plant Expansion) Issued Sept. 1, 1998		
2008	4.65%	\$ 45,000
2009	4.65	50,000
2010	4.65	50,000
2011	4.85	55,000
2012	4.85	55,000
2013	5.05	60,000
2014	5.05	60,000
2015	5.05	65,000
2016	5.20	70,000
2017	5.20	75,000
2018	5.20	75,000
Total		<u>\$ 660,000</u>

Schedule 3

<u>1988 City Hall Construction</u>		
<u>Issued July 1, 1988</u>		<u>Total</u>
<u>Interest Rates</u>	<u>Amount</u>	
7.40%	\$ 50,000	\$ 485,000
	-	400,000
	-	420,000
	-	430,000
	-	450,000
	-	460,000
	-	480,000
	-	505,000
	-	525,000
	-	395,000
	-	190,000
	-	200,000
	-	210,000
	-	215,000
	-	225,000
	<u>\$ 50,000</u>	<u>\$5,590,000</u>

CITY OF MOUNT VERNON

Schedule of Receipts by Source and Disbursements by Function -
All Governmental Funds

For the Last Five Years

	Years Ended June 30,				
	2007	2006	2005	2004	2003
Receipts.					
Property tax	\$ 991,801	\$ 854,772	\$ 876,918	\$ 816,454	\$ 821,756
Tax increment financing collections	595,021	739,361	613,934	733,812	551,216
Other city tax	103,758	560,300	518,229	138,678	348,964
Licenses and permits	57,439	90,086	72,072	44,181	22,081
Use of money and property	102,637	43,350	29,333	24,856	31,831
Intergovernmental	355,094	342,940	333,602	346,631	409,540
Charges for service	107,965	113,589	93,816	103,887	93,205
Miscellaneous	71,189	84,446	117,918	132,311	119,841
Total	<u>\$2,384,904</u>	<u>\$2,828,844</u>	<u>\$2,655,822</u>	<u>\$2,340,810</u>	<u>\$2,398,434</u>
Disbursements:					
Operating:					
Public safety	\$ 548,890	\$ 528,275	\$ 518,300	\$ 477,261	\$ 505,845
Public works	264,064	380,354	363,862	297,335	269,850
Culture and recreation	284,887	269,225	310,357	265,166	238,634
Community and economic development	54,270	38,541	21,715	7,240	3,980
General government	270,390	265,636	265,671	203,634	238,995
Debt service	2,366,083	511,753	518,900	511,520	502,608
Capital projects	508,431	568,756	316,288	216,604	372,963
Total	<u>\$4,297,015</u>	<u>\$2,562,540</u>	<u>\$2,315,093</u>	<u>\$1,978,760</u>	<u>\$2,132,875</u>

**Independent Auditor's Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

To the Honorable Mayor and
Members of the City Council
Mount Vernon, 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 Mount Vernon, Iowa, as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements listed in the table of contents, and have issued our report thereon dated November 28, 2007. 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City of Mount Vernon's ability to initiate, authorize, record, process, or report financial data reliably in accordance with an other comprehensive basis of accounting such that there is more than a remote likelihood a misstatement of the City of Mount Vernon's financial statements that is more than inconsequential will not be prevented or detected by the City of Mount Vernon's internal control. We consider the deficiencies in internal control described in Part II of the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by the City of Mount Vernon's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we believe items II-C-07 and II-D-07 are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Mount Vernon's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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 one instance of non-compliance or other matters that are required to be reported under *Government Auditing Standards*. This item is detailed at item II-A-07.

Comments involving statutory and other legal matters about the City's operations for the year ended June 30, 2007 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.

City of Mount Vernon's responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we have expressed our conclusions on the City's responses, we did not audit the City of Mount Vernon's responses and, accordingly, we express no opinion on them.

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 Mount Vernon and other parties to whom the City of Mount Vernon 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 Mount Vernon 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.

Clifton Henderson LLP

Cedar Rapids, Iowa
November 28, 2007

CITY OF MOUNT VERNON

Schedule of Findings

Year ended June 30, 2007

Part I: SUMMARY OF THE INDEPENDENT AUDITOR'S RESULTS:

- (a) An unqualified opinion was issued on the financial statements which were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.
- (b) Significant deficiencies in internal control over financial reporting were disclosed by the audit of the financial statements, including material weaknesses.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

PART II: FINDINGS RELATED TO THE FINANCIAL STATEMENTS:

INSTANCES OF NON-COMPLIANCE:

II-A-07: Iowa Code 509A - We noted the City did not receive an actuarial report on the self-insured health insurance plan for the year ended June 30, 2006 as required by the Code of Iowa. The City did receive an actuarial report for the current year.

Recommendation - The City should implement procedures to insure the actuarial reports are performed when required. The report is required if plan expenses are greater than 2% of the City's general fund budget.

Response - The City had determined that the review was required for the year ended June 30, 2006, and made contact with the City's healthcare benefits consultant regarding the review. It wasn't until later that we discovered that the consultant does not provide actuarial services and so the review was not performed. In the future, as we did this year, we will determine if the review is required and will contact the actuary to perform this service.

Conclusion – Response accepted.

SIGNIFICANT DEFICIENCIES:

II-B-07: Segregation of Duties

Criteria:

The City should have adequate segregation of duties to provide for the accuracy and reliability of the financial statements.

Condition:

The City does not have complete segregation of duties over all accounting transactions.

CITY OF MOUNT VERNON

Schedule of Findings

Year ended June 30, 2007

PART II: FINDINGS RELATED TO THE FINANCIAL STATEMENTS: (CONTINUED)

SIGNIFICANT DEFICIENCIES: (CONTINUED)

II-B-07: Segregation of Duties (continued)

Context:

Internal controls that are in place could be averted, overridden, or not consistently implemented.

Effect:

As a result of this condition, there is a higher risk that errors or irregularities could occur and not be detected within a timely period.

Cause:

The City has a limited number of personnel performing accounting functions.

Recommendation:

When this condition exists, management's close supervision and review of accounting information is the best means of preventing or detecting errors and irregularities. We recommend the City review its operating procedures to obtain the maximum internal control possible under the circumstances.

Management Response:

With a limited number of office employees, segregation of duties is sometimes difficult. Management is aware of the lack of segregation of duties and has considered alternatives to improve the situation. Management is monitoring the situation and is segregating accounting duties where practical.

Conclusion:

Response accepted.

II-C-07: Preparation of Financial Statements

Criteria:

The City Council and management share the ultimate responsibility for the City's financial statements, including disclosures.

CITY OF MOUNT VERNON

Schedule of Findings

Year ended June 30, 2007

PART II: FINDINGS RELATED TO THE FINANCIAL STATEMENTS: (CONTINUED)

SIGNIFICANT DEFICIENCIES: (CONTINUED)

II-C-07: Preparation of Financial Statements (continued)

Condition:

The City has not implemented procedures, to the degree necessary, to perform a review and assume responsibility for the City's financial statements and related disclosures to provide a high level of assurance that potential omissions or other errors that are less than material, but more than inconsequential, would be identified and corrected. These review procedures would include the use of review aids, such as a disclosure checklist, and the monitoring of recent accounting developments that would affect the City. This is not a new or unusual situation but this is the first year of implementation of a new auditing standard which requires that this situation be communicated.

Context:

The City engages Clifton Gunderson to assist in preparing its financial statements and accompanying disclosures. While it is acceptable to outsource various accounting functions, the responsibility for internal control cannot be outsourced. The independent auditor cannot be considered part of the City's internal control system.

Effect:

As a result of this condition, there is a higher risk that financial statement omissions or other errors could occur and not be detected.

Cause:

The City has relied on the independent auditor to some degree to provide assurance that the financial statements, including disclosures, are not materially misstated.

Recommendation:

We recommend that sufficient financial statement and disclosure review procedures be performed by an individual possessing a thorough understanding of applicable generally accepted accounting principles and knowledge of the City's activities and operations.

Management Response:

The City does not have the resources to employ staff possessing the detailed understanding of applicable generally accepted accounting principles to the extent required to utilize such a disclosure checklist. We understand the list of GAAP requirements in these disclosure checklists exceeds 50 pages in length. As a result, the City of Mount Vernon has relied on the independent auditor to identify disclosures required in the financial statements.

CITY OF MOUNT VERNON

Schedule of Findings

Year ended June 30, 2007

PART II: FINDINGS RELATED TO THE FINANCIAL STATEMENTS: (CONTINUED)

SIGNIFICANT DEFICIENCIES: (CONTINUED)

II-C-07: Preparation of Financial Statements (continued)

Conclusion:

Response accepted.

II-D-07: Audit Adjustments

Criteria:

The City should have adequate procedures to provide for the accuracy and reliability of the trial balance given to the auditor.

Condition:

During the course of the audit, misstatements that had a material effect on the City's financial statements were discovered. Adjusting journal entries were made to correct these misstatements. This is not a new or unusual situation but this is the first year of implementation of a new auditing standard which requires that this situation be communicated.

Context:

Although adjustments during the course of an audit are not uncommon, the independent auditor cannot be considered part of the City's internal control system.

Effect:

As a result of this condition, there is a higher risk that misstatements that are material to the financial statements could occur and not be detected.

Cause:

The City has relied on the independent auditor to some degree to provide assurance that the financial statements are not materially misstated.

Recommendation:

We recommend that the City establish internal procedures to adjust all account balances prior to the audit.

Management Response:

Management believes their review of fund balances will result in potential financial statement misstatements being identified and corrected prior to audit.

Conclusion:

Response accepted.

CITY OF MOUNT VERNON

Schedule of Findings

Year ended June 30, 2007

PART III: OTHER FINDINGS RELATED TO REQUIRED STATUTORY REPORTING

- III-A-07 Certified Budget - Disbursements during the year ended June 30, 2007 did not exceed the amounts budgeted. Chapter 384.20 of the Code of Iowa states, in part, "Public monies may not be expended or encumbered except under an annual or continuing appropriation."
- III-B-07 Questionable Disbursements - We noted no disbursements that failed to meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- III-C-07 Travel Expense - No expenditures of City money for travel expenses of spouses of City officials or employees were noted.
- III-D-07 Business Transactions - We noted no business transactions between the City and City officials or employees.
- III-E-07 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.
- III-F-07 Council Minutes - No transactions were found that we believe should have been approved in the Council minutes but were not.
- III-G-07 Revenue Bonds - The provisions of the sewer revenue capital loan note resolution states that separate funds shall be established for both the income and revenue of the sewer system and the current disbursements of the sewer system and that a monthly transfer be made from the revenue fund to the disbursing fund in order to cover expenditures. A monthly transfer, as required by the bond agreement, has not been made from the revenue funds to the operation and maintenance fund.

Recommendation - Monthly transfers from a revenue fund to an operation and maintenance fund should be done according to the terms of the sewer revenue capital loan note resolution.

Response - The City feels that maintaining one fund for the sewer system revenues and expenses makes it easier to track and understand financial position at any given time. The City plans to continue with one fund for the sewer system revenues and expenses.

Conclusion - Response accepted.

- III-H-07 Deposits and Investments - No instances of noncompliance were noted with the deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa and the City's investment policy.

CITY OF MOUNT VERNON

Schedule of Findings

Year ended June 30, 2007

PART III: OTHER FINDINGS RELATED TO REQUIRED STATUTORY REPORTING (CONTINUED)

III-I-07 Economic Development - The City paid \$44,763 to the Mount Vernon Development Corporation which may not be an appropriate expenditure of public funds.

In accordance with Chapter 15A of the Code of Iowa and an Attorney General's opinion dated August 28, 1986, government financing of economic development may, in appropriate circumstances, serve a public purpose. The opinion advises the governing body to evaluate the public benefits to be obtained and discusses specific criteria to be considered in documenting the public purpose.

Recommendation - The Council should evaluate and document the public purpose served by the expenditure before authorizing further payments and should require the Development Corporation to provide documentation of how the funds were used to accomplish economic development activities.

Response - We have requested and received information documenting how these funds were expended and we will continue to request this information as applicable.

Conclusion - Response accepted.

CITY OF MOUNT VERNON

Audit Staff

This audit was performed by:

William Vincent, CPA, Audit Partner

Bradley Hauge, CPA, Audit Partner

Andy Johnson, CPA, Audit Manager

Jim Fitzpatrick, CPA, Senior Associate

Josh Barta, Associate

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