

Financial Statements

City of Keystone

June 30, 2008

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City of Keystone

List of Officials

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
Mark Andersen	Mayor	January 1, 2010
Mike Seeck	Council Member	January 1, 2010
Kathy Janss	Council Member	January 1, 2010
Jeff Junge	Council Member	January 1, 2010
Mike Kaiser	Council Member	January 1, 2012
Charles Peddicord	Council Member	January 1, 2012
Angie Hagen	City Clerk	Indefinite
Larry Schlue	City Attorney	Indefinite



Independent Auditor's Report

To the Honorable Mayor and
Members of the City Council
City of Keystone
Keystone, 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 Keystone, Iowa, as of and for the year ended June 30, 2008, which collectively comprise the City's basic financial statements listed in the table of contents. These financial statements are the responsibility of the management of the City of Keystone, Iowa. 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 that our audit provides a reasonable basis for our opinions.

As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles.

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 Keystone as of June 30, 2008, 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 March 31, 2009, on our consideration of the City of Keystone'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.

Budgetary comparison information on pages 17 through 18 is not a required part of the basic financial statements, but is 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.

The City of Keystone, Iowa, has not presented Management's Discussion and Analysis which introduces the basic financial statements by presenting certain financial information as well as management's analytical insight on that information that the Government Accounting Standards Board has determined is necessary to supplement, although not required to be part of the basic financial statements.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Keystone's basic financial statements. Other supplementary information included in Schedules 1 through 3, including the Schedule of Expenditures of Federal Awards required by U.S. Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments and Non-Profit Organizations, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited", on which we express no opinion, 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.

HONKAMP KRUEGER & CO., P.C.

A handwritten signature in cursive script that reads "Honkamp Krueger & Co." with a stylized flourish at the end.

Dubuque, Iowa
March 31, 2009

City of Keystone
Statement of Activities and Net Assets - Cash Basis
As of and for the Year Ended June 30, 2008

	Program Receipts			
	Disbursements	Charges for Service	Operating Grants, Contributions, and Restricted Interest	Capital Grants, Contributions, and Restricted Interest
Functions / Programs:				
Primary Government:				
Governmental Activities:				
Public Safety	\$ 32,979	\$ -	\$ 26,482	\$ -
Public Works	113,133	61,197	59,823	-
Culture and Recreation	68,078	10,375	5,845	-
General Government	25,296	455	-	-
Debt Service	104,724	-	-	-
Capital Projects	901	-	-	-
Total Governmental Activities	<u>345,111</u>	<u>72,027</u>	<u>92,150</u>	<u>-</u>
Business Type Activities:				
Water Utility	869,347	123,152	-	-
Sewer Utility	51,523	54,210	-	-
Total Business Type Activities	<u>920,870</u>	<u>177,362</u>	<u>-</u>	<u>-</u>
Total Primary Government	<u>\$ 1,265,981</u>	<u>\$ 249,389</u>	<u>\$ 92,150</u>	<u>\$ -</u>
General Receipts:				
Property Tax Levied for:				
General Purposes				
Tax Increment Financing				
Local Option Sales Tax				
Licenses, Permits, and Franchise Fees				
Unrestricted Interest on Investments				
Bond Proceeds				
Miscellaneous				
Transfers In (Out)				
Total General Receipts and Transfers				
Change in Cash Basis Net Assets				
Cash Basis Net Assets, Beginning of Year				
Cash Basis Net Assets, End of Year				
Cash Basis Net Assets				
Reserved				
Fire				
First Responder				
Customer Deposits				
Unreserved, Designated				
Unreserved, Undesignated				
Total Cash Basis Net Assets				

Exhibit A

Net (Disbursements) Receipts and Change in Cash Basis Net Assets

Governmental Activities	Business-Type Activities	Total
\$ (6,497)	\$ -	\$ (6,497)
7,887	-	7,887
(51,858)	-	(51,858)
(24,841)	-	(24,841)
(104,724)	-	(104,724)
(901)	-	(901)
(180,934)	-	(180,934)
-	(746,195)	(746,195)
-	2,687	2,687
-	(743,508)	(743,508)
(180,934)	(743,508)	(924,442)
88,039	-	88,039
106,243	-	106,243
56,360	-	56,360
-	-	-
7,568	8,793	16,361
-	803,029	803,029
10,647	-	10,647
13,383	(13,383)	-
282,240	798,439	1,080,679
101,306	54,931	156,237
358,775	18,026	376,801
\$ 460,081	\$ 72,957	\$ 533,038
\$ 30,015	\$ -	\$ 30,015
18,540	-	18,540
-	8,842	8,842
11,868	-	11,868
399,658	64,115	463,773
\$ 460,081	\$ 72,957	\$ 533,038

See Notes to Financial Statements

City of Keystone
Statement of Cash Receipts, Disbursements, and Changes
in Cash Balances - Governmental Funds
As of and for the Year Ended June 30, 2008

	General	Special Revenue		
		TIF	Road Use Tax	Local Option Tax
Receipts:				
Property Tax	\$ 88,039	\$ -	\$ -	\$ -
Tax Increment Financing Collections	-	106,243	-	-
Other City Tax	-	-	-	56,360
Licenses and Permits	1,405	-	-	-
Use of Money and Property	7,568	-	-	-
Intergovernmental	33,293	-	58,857	-
Charges for Service	68,119	-	-	-
Miscellaneous	13,150	-	-	-
Total Receipts	211,574	106,243	58,857	56,360
Disbursements:				
Operating:				
Public Safety	32,979	-	-	-
Public Works	58,483	12,262	42,388	-
Culture and Recreation	68,078	-	-	-
General Government	25,016	280	-	-
Debt Service	-	-	-	-
Capital Projects	-	901	-	-
Total Disbursements	184,556	13,443	42,388	-
Excess (Deficiency) of Receipts over (under) Disbursements	27,018	92,800	16,469	56,360
Other Financing Sources (Uses)				
Operating Transfers In	70,000	-	51,341	-
Operating Transfers (Out)	-	(110,000)	-	(102,682)
Total Other Financing Sources (Uses)	70,000	(110,000)	51,341	(102,682)
Net Change in Cash Balances	97,018	(17,200)	67,810	(46,322)
Cash Balances, Beginning of Year	145,000	32,730	134,723	46,322
Cash Balances, End of Year	\$ 242,018	\$ 15,530	\$ 202,533	\$ -
Cash Basis Fund Balances				
Reserved				
Fire	\$ 30,015	\$ -	\$ -	\$ -
First Responder	18,540	-	-	-
Unreserved, Designated				
Concessions	4,368	-	-	-
Park	7,500	-	-	-
Unreserved, Undesignated	181,595	15,530	202,533	-
Total Cash Basis Fund Balances	\$ 242,018	\$ 15,530	\$ 202,533	\$ -

Exhibit B

Debt Service	Total
\$ -	\$ 88,039
-	106,243
-	56,360
-	1,405
-	7,568
-	92,150
-	68,119
-	13,150
-	433,034
-	32,979
-	113,133
-	68,078
-	25,296
104,724	104,724
-	901
104,724	345,111
(104,724)	87,923
104,724	226,065
-	(212,682)
104,724	13,383
-	101,306
-	358,775
\$ -	\$ 460,081
\$ -	\$ 460,081
-	30,015
-	18,540
-	4,368
-	7,500
-	399,658
\$ -	\$ 460,081
\$ -	\$ 460,081

See Notes to Financial Statements

City of Keystone
Reconciliation of the Statement of Cash Receipts, Disbursements,
and Changes in Cash Balances to the Statement of Activities
and Net Assets - Governmental Funds
As of and for the Year Ended June 30, 2008

Total Governmental Funds Cash Balance (page 5)	\$ 460,081
 <i>Amounts Reported for Governmental Activities in the Statement of Activities and Net Assets Are Different because:</i>	
None	-
Cash Basis Net Assets of Governmental Activities (page 4)	\$ <u>460,081</u>
 Net Change in Cash Balances (page 5)	 \$ 101,306
 <i>Amounts Reported for Governmental Activities in the Statement of Activities and Net Assets Are Different because:</i>	
None	-
Change in Cash Balance of Governmental Activities (page 4)	\$ <u>101,306</u>

City of Keystone
Statement of Cash Receipts, Disbursements, and Changes in
Cash Balances - Proprietary Funds
As of and for the Year Ended June 30, 2008

	Enterprise Funds		Total
	Water	Sewer	
Operating Receipts:			
Use of Money and Property	\$ 8,768	\$ 25	\$ 8,793
Charges for Service	123,152	54,210	177,362
Total Operating Receipts	<u>131,920</u>	<u>54,235</u>	<u>186,155</u>
Operating Disbursements:			
Governmental Activities:			
Business Type Activities	869,347	51,523	920,870
Total Operating Disbursements	<u>869,347</u>	<u>51,523</u>	<u>920,870</u>
Excess (Deficiency) of Operating Receipts over (under) Operating Disbursements	<u>(737,427)</u>	<u>2,712</u>	<u>(734,715)</u>
Non-Operating Receipts (Disbursements):			
General Obligation Bond Proceeds	803,029	-	803,029
Total Non-Operating Receipts (Disbursements)	<u>803,029</u>	<u>-</u>	<u>803,029</u>
Excess (Deficiency) of Receipts over (under) Disbursements	<u>65,602</u>	<u>2,712</u>	<u>68,314</u>
Other Financing Sources (Uses)			
Operating Transfers in	45,671	45,671	91,342
Operating Transfers out	(62,180)	(42,545)	(104,725)
Total Other Financing Sources (Uses)	<u>(16,509)</u>	<u>3,126</u>	<u>(13,383)</u>
Net Change in Cash Balances	49,093	5,838	54,931
Cash Balances Beginning of Year	18,026	-	18,026
Cash Balances End of Year	<u>\$ 67,119</u>	<u>\$ 5,838</u>	<u>\$ 72,957</u>
Cash Basis Fund Balances:			
Reserved for Customer Deposits	\$ 8,842	\$ -	\$ 8,842
Unreserved	58,277	5,838	64,115
Total Cash Basis Fund Balance	<u>\$ 67,119</u>	<u>\$ 5,838</u>	<u>\$ 72,957</u>

City of Keystone
Reconciliation of the Statement of Cash Receipts, Disbursements,
and Changes in Cash Balances to the Statement of Activities
and Net Assets - Proprietary Funds
As of and for the Year Ended June 30, 2008

Total Enterprise Funds Cash Balance (page 7)	\$	72,957
 <i>Amounts Reported for Business Type Activities in the Statement of Activities and Net Assets Are Different because:</i>		
None		-
Cash Basis Net Assets of Business Type Activities (page 4)	\$	<u>72,957</u>
Net Change in Cash Balances (page 7)	\$	54,931
 <i>Amounts Reported for Business Type Activities in the Statement of Activities and Net Assets Are Different because:</i>		
None		-
Change in Cash Balance of Business Type Activities (page 4)	\$	<u>54,931</u>

City of Keystone

Notes to Financial Statements

NOTE 1. Nature of Organization and Significant Accounting Policies

The City of Keystone (the "City") is a political subdivision of the State of Iowa located in Benton County. It was first incorporated in 1894 and operates under the Home Rule provisions of the Constitution of Iowa. The City operates under the Mayor-Council form of government, with the Mayor and Council Members elected on a non-partisan basis. The City provides numerous services to citizens including public safety, public works, culture, recreation, public improvements, and general administrative services. The City also provides water and sewer utilities for its citizens.

The significant accounting policies of the City of Keystone are as follows:

Reporting Entity

For financial reporting purposes, the City of Keystone 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.

Basis of Presentation

Government-Wide Financial Statements – The Statement of Activities and Net Assets – Cash Basis reports information on all of the non-fiduciary 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.

The Statement of Activities and Net Assets – Cash Basis presents the City's non-fiduciary 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 not meeting the definition of the preceding category. Unrestricted net assets often have constraints on resources imposed by management, which can be removed or modified.

City of Keystone

Notes to Financial Statements

NOTE 1. Nature of Organization and Significant Accounting Policies (Continued)

Basis of Presentation (Continued)

The Statement of Activities and Net Assets – Cash Basis 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 non-major governmental funds.

The City reports the following major governmental funds:

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

Special Revenue:

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

The Tax Increment Financing Fund is used to account for TIF collections.

Debt Service:

The Debt Service Fund accounts for the payment of interest and principal on the City's general long-term debt except when authorized or required to be paid from other funds.

The City reports the following major proprietary funds:

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

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

City of Keystone

Notes to Financial Statements

NOTE 1. Nature of Organization and Significant Accounting Policies (Continued)

Basis of Presentation (Continued)

Measurement Focus and Basis of Accounting

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

Under the terms of grant agreements, the City funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants, and general receipts. Thus, when program disbursements are paid, there are both restricted and unrestricted cash basis net assets available to finance the program. It is the City's policy to first apply cost-reimbursement grant resources to such programs, followed by categorical block grants, and then by general receipts.

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

Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information. During the year ended June 30, 2008, disbursements exceeded the amount budgeted in the debt service, capital projects and business-type activities functions.

NOTE 2. Cash and Pooled Investments

The City's deposits in banks at June 30, 2008, 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.

City of Keystone

Notes to Financial Statements

NOTE 2. Cash and Pooled Investments (Continued)

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

The city had investments in the Iowa Public Agency Investment Trust which are valued at a cost of \$347,130.

Interest rate risk - The City's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) to instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the City.

Credit risk - The City's investment in the Iowa Public Agency Investment Trust is unrated.

NOTE 3. Bond and Notes Payable

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

Year Ending June 30	General Obligation Bonds		Revenue Bonds		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2009	\$ 55,000	\$ 15,016	\$ 28,000	\$ 18,434	\$ 83,000	\$ 33,450
2010	57,000	13,366	29,000	17,594	86,000	30,960
2011	59,000	11,656	30,000	16,724	89,000	28,380
2012	61,000	9,886	31,000	15,824	92,000	25,710
2013	62,000	8,056	32,000	14,894	94,000	22,950
2014	64,000	6,196	33,000	13,934	97,000	20,130
2015	66,000	4,276	34,000	12,944	100,000	17,220
2016	53,547	2,296	35,000	11,924	88,547	14,220
2017	23,000	690	36,000	10,874	59,000	11,564

City of Keystone

Notes to Financial Statements

NOTE 3. Bond and Notes Payable (Continued)

Year Ending June 30	General Obligation Bonds		Revenue Bonds		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2018	\$ ----	\$ ----	\$ 37,000	\$ 9,794	\$ 37,000	\$ 9,794
2019	----	----	38,000	8,684	38,000	8,684
2020	----	----	39,000	7,544	39,000	7,544
2021	----	----	41,000	6,374	41,000	6,374
2022	----	----	42,000	5,144	42,000	5,144
2023	----	----	43,000	3,884	43,000	3,884
2024	----	----	44,000	2,594	44,000	2,594
2025	----	----	42,482	1,274	42,482	1,274
TOTALS	\$ 500,547	\$ 71,438	\$ 614,482	\$ 178,438	\$ 1,115,029	\$ 249,876

The Water Revenue Bonds were issued for purposes which are consistent with the plans of the City to construct improvements and extensions to the Municipal Waterworks Utility. The bonds are not a general obligation of the City; however, the debt is subject to the constitutional debt limit of the City.

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

- (a) The bonds will only be redeemed from the future earnings of the enterprise activity and the bond holders hold a lien on the future earnings of the funds.
- (b) Gross revenues of the water utility shall be set aside into a water revenue account. This account shall be used in maintaining and operating the water utility and, after payment of operating expenses, shall be used to pay the principal and interest on the bonds. This account is also used to maintain the several separate accounts required to be set up by the bond resolutions.
- (c) Sufficient monthly transfers shall be made to a water revenue bonds sinking account for the purpose of making the bond principal and interest payments when the water revenue account does not have the funds available. The monthly amount required for the water revenue bonds sinking account shall not be less than one-sixth of the upcoming interest payment plus one-twelfth of the upcoming principal payment.

City of Keystone

Notes to Financial Statements

NOTE 3. Bond and Notes Payable (Continued)

- (d) Monthly transfers shall be made to a water revenue bonds reserve account of an amount equal to that deposited into the sewer revenue bonds sinking account until a specific minimum balance has been accumulated. Any additional amounts over the required water revenue bond reserve minimum balance should be deposited into the water revenue account. The water revenue bonds reserve account is restricted for the purpose of paying the principal and interest on the bonds when insufficient money is available in the respective sinking accounts.
- (e) All net revenues remaining from the water utility after first making the required payments into the water sinking account and the water reserve account, and after the water reserve account contains the required reserve fund balance, shall be transferred to the sewer surplus account. All monies credited to the surplus account shall be transferred and credited to the sinking account or reserve account whenever a deficiency may exist. If both the sinking account and the reserve account have the full amounts required to be deposited, any balance in the surplus account may be available to the City for operation of the water utility.

NOTE 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 3.9% of their annual salary, and the City is required to contribute 6.05% 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 contribution to IPERS for the years ended June 30, 2008, 2007, and 2006, were \$5,302, \$4,760, and \$3,988, respectively, equal to the required contributions for each year.

City of Keystone

Notes to Financial Statements

NOTE 5. Compensated Absences

The City of Keystone has one employee who accumulates a limited amount of earned but unused vacation, 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 compensated absences payable to employees at June 30, 2008, primarily relating to the Water Fund, is as follows:

<u>Type of Benefit</u>	<u>Amount</u>
Vacation	\$ 1,590

NOTE 6. Interfund Transfers

The detail of interfund transfers for the year ended June 30, 2008, is as follows:

<u>Transfer To:</u>	<u>Transfer From:</u>	<u>Amount</u>
Debt Service Funds	Enterprise Funds	
	Sewer	\$ 42,545
	Water	62,179
	Total	104,724
General Fund	Tax Increment Financing	70,000
Enterprise Funds:		
Water	Tax Increment Financing	20,000
Sewer	Tax Increment Financing	20,000
		110,000
	Total	\$ 214,724

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

NOTE 7. Related Party Transactions

The City had business transactions between the City and City officials, totaling \$3,401 during the year ended June 30, 2008.

City of Keystone

Notes to Financial Statements

NOTE 8. Risk Management

The City of Keystone, Iowa, 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 the past fiscal year.

NOTE 9. Subsequent Events

Subsequent to year-end, the City purchased a fire truck for a total of \$59,702.

Required Supplementary Information

City of Keystone
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, 2008

	Governmental Funds Actual	Proprietary Funds Actual	Less Funds not Required to be Budgeted
Receipts:			
Property Tax	\$ 88,039	\$ -	\$ -
Tax Increment Financing Collections	106,243	-	-
Other City Tax	56,360	-	-
Licenses and Permits	1,405	-	-
Use of Money and Property	7,568	8,793	-
Intergovernmental	92,150	-	-
Charges for Service	68,119	177,362	-
Miscellaneous	13,150	-	-
Total Receipts	433,034	186,155	-
Disbursements:			
Public Safety	32,979	-	-
Public Works	113,133	-	-
Culture and Recreation	68,078	-	-
General Government	25,296	-	-
Debt Service	104,724	-	-
Capital Projects	901	-	-
Business Type Activities	-	920,870	-
Total Disbursements	345,111	920,870	-
Excess (Deficiency) of Receipts over (under) Disbursements	87,923	(734,715)	-
Other Financing Sources, Net	13,383	789,646	-
Excess of Receipts and Other Financing Sources over Disbursements and Other Financing Uses	101,306	54,931	-
Balances, Beginning of Year	358,775	18,026	-
Balances, End of Year	\$ 460,081	\$ 72,957	\$ -

<u>Net</u>	<u>Budgeted Amount Original and Final</u>	<u>Final to Net Variance</u>
\$ 88,039	\$ 83,486	\$ 4,553
106,243	105,154	1,089
56,360	53,882	2,478
1,405	1,205	200
16,361	500	15,861
92,150	830,315	(738,165)
245,481	250,470	(4,989)
13,150	50,000	(36,850)
<u>619,189</u>	<u>1,375,012</u>	<u>(755,823)</u>
32,979	52,150	(19,171)
113,133	130,475	(17,342)
68,078	69,461	(1,383)
25,296	29,661	(4,365)
104,724	41,580	63,144
901	-	901
920,870	878,836	42,034
<u>1,265,981</u>	<u>1,202,163</u>	<u>63,818</u>
(646,792)	172,849	(819,641)
<u>803,029</u>	<u>-</u>	<u>803,029</u>
156,237	172,849	(16,612)
376,801	333,928	42,873
<u>\$ 533,038</u>	<u>\$ 506,777</u>	<u>\$ 26,261</u>

See Accompanying Independent Auditor's Report

City of Keystone

Notes to Required Supplementary Information – Budgetary Reporting

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 Internal Service Funds and 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, Debt Service Funds, Capital Projects Funds, and Proprietary Funds. Although the budget document presents function disbursements by fund, the legal level of control is at the aggregated function level, not by fund. The budget was not amended during the year

During the year ended June 30, 2008, disbursements exceeded the amount budgeted in the debt service, capital projects and business type activities functions.

Other Supplementary Information

**City of Keystone
Schedule of Indebtedness
Year Ended June 30, 2008**

<u>Obligation</u>	<u>Date of Issue</u>	<u>Interest Rates</u>	<u>Amount Originally Issued</u>	<u>Balance Beginning of Year</u>
General Obligation Bonds:				
Sewer Improvement	September 24, 2003	3.00%	\$ 504,000	\$ 386,000
Water Improvement	May 24, 2007	3.00%	435,000	-
Total General Obligation			<u>939,000</u>	<u>386,000</u>
Revenue Bonds:				
Water Revenue	May 24, 2007	3.00%	742,000	-
Total			<u>\$ 1,681,000</u>	<u>\$ 386,000</u>

Schedule 1

Issued during Year	Redeemed during Year	Principal Paid during Year	Balance End of Year	Interest Paid	Interest Due and Unpaid
\$ -	\$ -	\$ 30,000	\$ 356,000	\$ 11,580	\$ -
160,547	-	16,000	144,547	1,636	-
<u>160,547</u>	<u>-</u>	<u>46,000</u>	<u>500,547</u>	<u>13,216</u>	<u>-</u>
642,482	-	28,000	614,482	13,600	-
<u>\$ 803,029</u>	<u>\$ -</u>	<u>\$ 74,000</u>	<u>\$ 1,115,029</u>	<u>\$ 26,816</u>	<u>\$ -</u>

See Accompanying Independent Auditor's Report

**City of Keystone
Schedule of Bond and Note Maturities
Year Ended June 30, 2008**

Year Ending June 30,	General Obligation Bonds					Revenue Bond	
	Sewer Improvement Bond Issued September 24, 2003		Water Improvement Bond Issued May 24, 2007		Total General Obligation Bonds	Water Revenue Bond Issued May 24, 2007	
	Interest Rates	Amount	Interest Rates	Amount		Interest Rates	Amount
2009	3.00%	\$ 37,000	3.00%	\$ 18,000	\$ 55,000	3.00%	\$ 28,000
2010	3.00%	39,000	3.00%	18,000	57,000	3.00%	29,000
2011	3.00%	40,000	3.00%	19,000	59,000	3.00%	30,000
2012	3.00%	41,000	3.00%	20,000	61,000	3.00%	31,000
2013	3.00%	42,000	3.00%	20,000	62,000	3.00%	32,000
2014	3.00%	43,000	3.00%	21,000	64,000	3.00%	33,000
2015	3.00%	45,000	3.00%	21,000	66,000	3.00%	34,000
2016	3.00%	46,000	3.00%	7,547	53,547	3.00%	35,000
2017	3.00%	23,000		-	23,000	3.00%	36,000
2018		-		-	-	3.00%	37,000
2019		-		-	-	3.00%	38,000
2020		-		-	-	3.00%	39,000
2021		-		-	-	3.00%	41,000
2022		-		-	-	3.00%	42,000
2023		-		-	-	3.00%	43,000
2024		-		-	-	3.00%	44,000
2025		-		-	-	3.00%	42,482
Total		<u>\$ 356,000</u>		<u>\$ 144,547</u>	<u>\$ 500,547</u>		<u>\$ 614,482</u>

City of Keystone
Schedule of Receipts by Source and Disbursements by Function -
All Governmental Funds
For the Last Four Years

	2008	Unaudited		
		2007	2006	2005
Receipts:				
Property Tax	\$ 88,039	\$ 85,455	\$ 88,606	\$ 89,169
Tax Increment Financing				
Collections	106,243	105,563	104,641	101,112
Other City Tax	56,360	46,322	-	16,405
Licenses and Permits	1,405	1,205	1,356	1,205
Use of Money and Property	7,568	5,967	19,243	9,492
Intergovernmental	92,150	70,786	105,760	209,213
Charges for Services	68,119	66,621	219,547	66,173
Miscellaneous	13,150	25,140	33,822	24,779
Total	<u>\$ 433,034</u>	<u>\$ 407,059</u>	<u>\$ 572,975</u>	<u>\$ 517,548</u>
Disbursements:				
Operating:				
Public Safety	\$ 32,979	\$ 31,855	\$ 23,729	\$ 23,615
Public Works	113,133	143,151	123,547	112,729
Culture and Recreation	68,078	73,709	80,442	80,103
General Government	25,296	28,242	53,016	36,390
Community and Economic Development	-	-	563,837	-
Debt Service	104,724	42,487	-	46,185
Capital Projects	901	-	-	369,783
Total	<u>\$ 345,111</u>	<u>\$ 319,444</u>	<u>\$ 844,571</u>	<u>\$ 668,805</u>

City of Keystone
Schedule of Expenditures of Federal Awards
Year Ended June 30, 2008

<u>Grantor/Program</u>	<u>CFDA Number</u>	<u>Agency Pass- Through Number</u>	<u>Program Expenditures</u>
Indirect:			
U.S. Environmental Protection Agency			
Iowa Department of Natural Resources:			
Drinking Water State Revolving Fund	66.468	FS-06-05-DWSFR-034	\$ <u>598,597</u>
Total Direct			<u>598,597</u>
Department of Homeland Security			
Federal Emergency Management Agency:			
Public Assistance Grant	83.544	PA ID#: 011-41115-00	<u>8,107</u>
Total Indirect			<u>8,107</u>
Total			<u>\$ <u>606,704</u></u>

City of Keystone

Notes to the Schedule of Expenditures of Federal Awards Year Ended June 30, 2008

NOTE 1. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the City of Keystone, Iowa, and is presented in conformity with another comprehensive basis of accounting. The information on this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.



**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
City of Keystone
Keystone, Iowa

We have audited the accompanying financial statements of the governmental activities, business type activities, each major fund, and the aggregate remaining fund information of the City of Keystone, Iowa, as of and for the year ended June 30, 2008, which collectively comprises the City's basic financial statements listed in the table of contents, and have issued our report thereon dated March 31, 2009. Our report expressed unqualified opinions on the financial statements which were prepared in conformity with another comprehensive basis of accounting. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the City of Keystone's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, and not for the purpose of expressing our opinion on the effectiveness of the City of Keystone's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Keystone'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'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's financial statements that is more than inconsequential will not be prevented or detected by the City'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'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, we believe item II-A-08 is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Keystone's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of non-compliance or other matters that are described in Part IV of the accompanying Schedule of Findings and Questioned Costs.

Comments involving statutory and other legal matters about the City's operations for the year ended June 30, 2008, 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.

The City of Keystone's responses to findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. While we have expressed our conclusions on the City's responses, we did not audit the City of Keystone'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 Keystone and other parties to whom the City of Keystone may report including federal awarding agencies and pass-through entities. 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 Keystone 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.

HONKAMP KRUEGER & CO., P.C.

Honkamp Krueger & Co.

Dubuque, Iowa
March 31, 2009



**Independent Auditor's Report on Compliance
with Requirements Applicable to Each Major
Program and on Internal Control over Compliance
in Accordance with OMB Circular A-133**

To the Honorable Mayor and
Members of the City Council
City of Keystone
Keystone, Iowa

Compliance

We have audited the compliance of the City of Keystone, Iowa, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that are applicable to its major federal program for the year ended June 30, 2008. The City of Keystone's major federal program is identified in Part I of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grant agreements applicable to its major federal program is the responsibility of the City of Keystone's management. Our responsibility is to express an opinion on the City of Keystone's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the City of Keystone's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the City of Keystone's compliance with those requirements.

In our opinion, the City of Keystone complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2008.

Internal Control Over Compliance

The management of the City of Keystone is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grant agreements applicable to federal programs. In planning and performing our audit, we considered the City of Keystone's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City of Keystone's internal control over compliance.

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

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs at item III-A-08 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item III-A-08 to be a material weakness.

The City of Keystone's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the City's response and, accordingly, we express no opinion on it.

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 Keystone, and other parties to whom the City of Keystone may report, including federal awarding agencies and pass-through entities. This report is not intended to be and should not be used by anyone other than these specified parties.

HONKAMP KRUEGER & CO., P.C.



Dubuque, Iowa
March 31, 2009

City of Keystone

Schedule of Findings and Questioned Costs Year Ended June 30, 2008

Part I. Summary of the Independent Auditors' Results

- a. Unqualified opinions were 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 U.S. generally accepted accounting principles.
- 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.
- d. A significant deficiency in internal control over the major program was disclosed by the audit of the financial statements, which is considered to be a material weakness.
- e. An unqualified opinion was issued on compliance with requirements applicable to the major programs.
- f. The audit disclosed an audit finding which is required to be reported in accordance with the Office of Management and Budget. Circular A-133, Section .510(a).
- g. The major program was CFDA Number 66.468- Drinking Water State Revolving Fund.
- h. The dollar threshold used to distinguish between Type A and Type B programs was \$300,000.
- i. The City of Keystone did not qualify as a low-risk auditee.

Part II. Findings Related to the Financial Statements

Instances of Non-Compliance:

No matters were noted.

City of Keystone

Schedule of Findings and Questioned Costs (Continued) Year Ended June 30, 2008

Part II. Findings Related to the Financial Statements (Continued)

Significant Deficiencies:

II-A-08 **Segregation of Duties:** One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. We noted one employee has the ability to enter cash receipts, collect cash, make deposits, make entries to the general ledger, and sign checks.

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

Response: We feel risks are mitigated by the requirement that the mayor sign all checks. Checks are signed only after the city council has had the opportunity to review and approve each check and invoice. We would like to provide the recommended level of financial oversight, but are unable to do so. Like many cities our size, the economics of our situation prohibits us from hiring more office staff to provide for this function. The City will implement additional controls where possible.

Conclusion: Response acknowledged.

II-B-08 **Reconciliation of Utility Billings, Collections, and Delinquencies:** Utility billings, collections, and delinquent accounts were not reconciled throughout the year.

Recommendation: Procedures should be established to reconcile utility billings, collections, and delinquencies for each billing period.

Response: We will develop procedures to accomplish a more in depth reconciliation of utility billings and delinquencies. The issue will be presented at the next city council meeting and implemented as soon as possible.

Conclusion: Response acknowledged.

City of Keystone

Schedule of Findings and Questioned Costs (Continued) Year Ended June 30, 2008

Part III. Findings and Questioned Costs for Federal Awards

Instances of Non-Compliance:

No matters were reported.

Significant Deficiency:

CFDA Number 66.468: Drinking Water State Revolving Fund
Pass through Agency Number: FS-06-05-DWSFR-034

U.S. Environmental Protection Agency
Passed through Iowa Finance Authority

III-A-08 **Segregation of Duties over Federal Receipts:** A lack of segregation of duties over receipts and disbursements, including those related to federal programs, exist in the City's finance department. See audit finding II-A-08.

Part IV: Other Findings Related to Statutory Reporting

IV-A-08 **Certified Budget:** Disbursements during the year ended June 30, 2008 exceeded the amounts budgeted in the debt service, capital projects and business type activities functions. 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."

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

Response: We try to control costs and time by amending the budget once a year, but situations occur with City expenditures that are beyond our control. We will monitor funds more closely in the future and amend the budget before expenditures exceed the budget.

Conclusion: Response acknowledged.

IV-B-08 **Questionable Disbursements:** We noted no disbursements that did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

City of Keystone

Schedule of Findings and Questioned Costs (Continued) Year Ended June 30, 2008

Part IV: Other Findings Related to Statutory Reporting (Continued)

IV-C-08 **Travel Expense:** No disbursements of City money for travel expenses of spouses of City officials or employees were noted.

IV-D-08 **Business Transactions:** Business transactions between the City and City officials or employees are detailed as follows:

Name, Title, and Business Connection	Transaction Description	Amount
Charles Peddicord, Council Member Veterinarian	Stray Animal Care	\$ 64
Mike Seeck, Council Member Part Owner of M&K Automotive	Supplies	\$ 3,337

In accordance with Chapter 362.5(10) of the Code of Iowa, the transactions with Charles Peddicord, council member, do not appear to represent conflicts of interest since total transactions with this individual were less than \$1,500 during the year. However, the transactions with Mike Seeck, Council Member, exceeded \$1,500 during the year.

Recommendation: The City should comply with Chapter 362.5 of the Code of Iowa and limit transactions with city officials to \$1,500 per fiscal year.

Response: The council is aware of the use of M&K Automotive for repairs; however, the total amount consists of a number of routine maintenance charges throughout the year on a number of different vehicles. M&K Automotive is the only repair shop in our city. The council will, if a repair is needed over \$1,500, comply with the competitive bid process.

Conclusion: Response accepted.

IV-E-08 **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.

City of Keystone

Schedule of Findings and Questioned Costs (Continued) Year Ended June 30, 2008

Part IV: Other Findings Related to Statutory Reporting (Continued)

IV-F-08 **Council Minutes:** No transactions were found that we believe should have been approved in the Council minutes, but were not. Although Council Minutes were published, they were not published within fifteen days as required by Chapter 372.13(6) of the Code of Iowa. Also, the City did not publish annual gross salaries in accordance with an Attorney General's opinion dated April 12, 1978.

Recommendation: The City should comply with Chapter 372.13(6) of the Code of Iowa and publish minutes and annual individual salaries as required.

Response: We will be more diligent in publishing the board minutes within 15 days and will begin publishing gross salaries in accordance with State policy.

Conclusion: Response acknowledged.

IV-G-08 **Deposits and Investments:** The City held a certificate of deposit at Wells Fargo Bank which was not authorized by the Council.

Recommendation: The City should only deposit funds in allowable depositories.

Response: We will review and revise our policies and deposit only in allowable depositories.

Conclusion: Response accepted.

IV-H-08 **Revenue Bonds:** The 2007 Water Bond Resolution requires that the city maintain an account to be known as the "Water Revenue Bond Sinking Fund", into which the City should set aside from the future Net Revenues of the Utility, a portion of interest and premium payments coming due. The minimum balance of the sinking fund should be no less than 1/6 of the installment of interest coming due on the next interest payment date on the then outstanding Bonds and any Parity Obligations, plus an amount equal to 1/12 of the installment of principal coming due on such Bonds and any Parity Obligation on the next succeeding principal payment date.

Recommendation: The City should create and maintain a Water Revenue Bond Sinking Fund sufficient to meet the requirements of the bond agreement.

Response: The City will create and maintain a Water Revenue Bond Sinking fund sufficient to meet the requirements of the bond agreement.

Conclusion: Response accepted.

City of Keystone

Schedule of Findings and Questioned Costs (Continued) Year Ended June 30, 2008

Part IV: Other Findings Related to Statutory Reporting (Continued)

- IV-I-08 **Payment of General Obligation Bonds:** All general obligation bond and note payments were paid from the Debt Service Fund in accordance with Chapter 384.4 of the Code of Iowa.

City of Keystone
Corrective Action Plan for Federal Audit Findings
For the Year Ended June 30, 2008

Finding III-A-08. Lack of Segregation of Duties

Contact person responsible for corrective action: Angie Hagen (319) 442-3246

Corrective Action

Response: The City concurs with the recommendations, however, believes the supervision by management and City Council members are considered mitigating factors in the lack of segregation of duties. The City recognizes that it would not be cost-effective to hire additional personnel to maximize the segregation of accounting duties due to the size of the City. The City is aware of the condition and will continue to monitor and implement compensating controls.

Date of Completion

Ongoing.



HONKAMP KRUEGER & CO, P.C.

CPAs & Business Consultants

To the City Council
City of Keystone
Keystone, Iowa

We have audited the financial statements of City of Keystone (the "City") for the year ended June 30, 2008, and have issued our report thereon dated March 31, 2009. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated November 3, 2008, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered the City of Keystone's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the City of Keystone's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the City of Keystone's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major federal programs for the purpose of expressing an opinion on the City of Keystone's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the City of Keystone's compliance with those requirements.

Review of Internal Control

In planning and performing our audit of the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of Keystone (the "City") as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal

control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

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

Segregation of Duties

A limited number of the City's personnel perform many of the accounting and financial functions. Therefore, many of the aspects of an ideal internal accounting control structure are missing in the City due to an inadequate segregation of duties. We recognize that the hiring of additional personnel may not be the most cost-effective method to maximize the segregation of accounting duties. However, the City should be aware of this condition and realize that the concentration of duties and responsibilities given to a limited number of City personnel is not ideal with respect to the internal control structure.

Preparation of Financial Statements

The City does not have an internal system designed to provide for the preparation of the financial statements being audited. As auditors, we were requested to draft the financial statements and accompanying notes to the financial statements. It is the responsibility of management and those charged with governance to make the decision whether to accept the degree of risk with this condition because of cost or other considerations.

Of the significant deficiencies noted, we believe the lack of segregation of duties to be a material weakness.

Significant Audit Findings

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the City are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2008. We

noted no transactions entered into by the City during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was:

The disclosure of bond and notes payable in Note 3 to the financial statements. Lending agencies tend to rely on the information for future debt issues.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

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

Management Representations

We have requested certain representations from management that are included in the management representation letter dated May 18, 2009.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the City's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the City's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

We further consider the following matters to be control deficiencies that are of a lesser magnitude than a significant deficiency or material weakness.

Bond Register

The City does not maintain a current register summarizing general obligation, special assessment, and revenue bond or note indebtedness activity for the year. We recommend that a monthly register be kept to ensure that disbursements or expenditures (including principal and interest payable) and debt proceeds are properly recorded and classified.

Employee Handbook

The City does not have an employee handbook. Informal, unwritten, or undocumented understandings with employees may run the risk of discrimination, unlawful discharge, or harassment charges. The City should consider drafting a policy manual to define the rights and responsibilities of City employees. Such policies should include benefits available, policies and procedures which should be followed and provide guidance for employees who may have a grievance with the City.

Unclaimed Property

We noted that the City did not file an Unclaimed Property report with the State Treasurer prior to November 1 per the Code of Iowa, Chapter 556.11. As a reminder, this report is due annually to the State Treasurer before November 1.

Water Revenue Bond Sinking Fund

We noted that the City does not maintain a Water Revenue Bond Sinking Fund as required in the bond resolution. We recommend that the City create and maintain a Water Revenue Bond Sinking Fund sufficient to meet the requirements of the bond resolution.

This information is intended solely for the use of the City Council and management of the City of Keystone and is not intended to be and should not be used by anyone other than these specified parties.

HONKAMP KRUEGER & CO., P.C.



Dubuque, Iowa
March 31, 2009