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FINANCE & RECORDS

TO: Honorable Mayor and City Council

DATE: November 30, 2011

Iowa law requires that all cities publish within six months of the close of each fiscal year a complete set of financial statements presented in conformity with generally accepted accounting principles (GAAP) and audited in accordance with generally accepted auditing standards by a firm of licensed certified public accountants. Pursuant to that requirement, we hereby issue the comprehensive annual financial report of the City of Muscatine for the fiscal year ended June 30, 2011.

Management assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

McGladrey & Pullen, Certified Public Accountants, have issued an unqualified (“clean”) opinion on the City of Muscatine’s financial statements for the year ended June 30, 2011. The independent auditor’s report is located at the front of the financial section of this report.

Management’s discussion and analysis (MD&A) immediately follows the independent auditor’s report and provides a narrative introduction, overview, and analysis of the basic financial statements. MD&A complement this letter of transmittal and should be read in conjunction with it.

The independent audit of the financial statements of the City was part of a broader, federally mandated “Single Audit” designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the City’s internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are included in the compliance section of this report.

Profile of the Government

The City of Muscatine was incorporated in 1851 by a special act of the Iowa State Legislature and is located on the Mississippi River, which is the eastern boundary of the state of Iowa. The City is located 160 miles east of Des Moines, 200 miles west of Chicago, and is the county seat of Muscatine County. The City occupies a land area of approximately 17 square miles and serves a population of 22,886 people. The City is empowered to levy a tax on all property located within its boundaries.

“I remember Muscatine for its sunsets. I have never seen any
on either side of the ocean that equaled them” — Mark Twain

The City operates under the mayor-council form of government and has a City Administrator. Policy-making and legislative authority are vested in a mayor and seven council members. The city council is responsible, among other things, for passing ordinances and resolutions, adopting the budget, appointing committees, and hiring both the City Administrator and the City Attorney. The City Administrator is responsible for carrying out the policies and ordinances of the city council, for overseeing the day-to-day operations of the government, and for appointing the heads of various departments. The council is elected on a non-partisan basis. Council members serve four-year staggered terms and the mayor is elected to serve a two-year term. Five of the council members are elected by district. The mayor and the two remaining council members are elected at large.

The City provides a full range of services including police and fire protection; roadway maintenance; water pollution control; solid waste management; recreational and cultural activities and facilities; and a general aviation airport.

The City Council is required to hold a public hearing on and adopt a budget for each fiscal year no later than March 15th of the preceding year. The annual budget serves as the foundation for the City's financial planning and control. The budget is prepared by function, fund and department. The legal level of control is at the function level. The budget may be amended by resolution of City Council following a required public hearing.

The City's government-wide financial statements include two discretely presented component units. These component units are those entities for which the City is considered to be financially accountable. These entities are the Muscatine County Solid Waste Management Agency (Agency) and Muscatine Power and Water (MP&W). The Agency is comprised of eight governmental entities in Muscatine County and based on the City of Muscatine population, the City accounts for 56% of the board's voting authority. The City Council also approves the Agency's budget, sets its rate and approves any debt issuance. MP&W is a municipal utility which provides water, electric and communications services within the City of Muscatine and in other areas within Muscatine County. MP&W's governing board is appointed by the Mayor and approved by Council. MP&W provides a financial benefit to the City by providing electricity for City buildings and all street and traffic lighting free of charge to the City. These entities are reported in separate columns in the government-wide statements to emphasize that they are legally separate from the City.

Local Economy

The City of Muscatine has a history of business and industrial development equal to cities of much larger size. Muscatine is the corporate headquarters of HNI Corporation, makers of office furniture. Other major employers located in the Muscatine area include H.J. Heinz LP, food processing; Bridgestone-Bandag, makers of pre-cured tire tread rubber, Monsanto Company, herbicides and plastics; Raymond-Muscatine, front-end loaders, etc.; Muscatine Foods Corporation, corn distillates and feed; Stanley Consultants Inc., consulting engineers and architects; and Musco Sports Lighting LLC, sports lighting systems. The presence of many diverse companies has provided the Muscatine economy with economic stability and employment security for many years. Unemployment rates over the past ten calendar years ranged from 3.2% to 8.1% with the rate for 2010 at 7.6%. Prior to 2009 and 2010 when the rates were 8.1% and 7.6%, respectively, the highest previous rate was 4.6% in 2008. The recent higher rates are attributed to the local effect from the national economy. Muscatine Power and Water, the City of Muscatine's municipal light, water, and communications utility, operates the largest municipal power plant in the State of Iowa. This plant provides for abundant supplies of low cost electricity.

The City's Water Pollution Control Plant has undergone renovation over the years and currently has the capacity to triple the volume of wastewater it treats with only marginal increases in operating expenditures. The City operates a general aviation airport and has excellent railroad service provided by the Canadian Pacific Railroad.

All of these elements provide an excellent atmosphere for continued economic stability and growth.

Long-term Financial Planning

On May 10, 1994, the citizens of Muscatine first voted to implement a 1% local option sales tax for the purpose of funding storm and sanitary sewer renovation and extension projects. The tax was imposed effective July 1, 1994, for a five-year period. Voters approved continuation of the local option sales tax for two subsequent 5-year periods through June 30, 2009. This tax was used primarily for storm and sanitary storm sewer projects with the exception of 10% that was allocated to the Pearl of the Mississippi project from May 1, 2003 through June 30, 2009. The 1% local option sales tax generated over \$2.4 million in the most recent year.

In 2008 the City held an election for the continuation of this tax. The ballot question approved by voters will extend this tax for an additional ten years (through June 30, 2019) with up to 20% of the proceeds to be used for the City's Pavement Management Program with the remaining 80% to be used for storm and sanitary sewer improvement projects. Future sewer projects have been identified including those required by an Order for Compliance on Consent issued by the United States Environmental Protection Agency. Provisions of the Order require the City to complete separation of the combined sewers in the Hershey Avenue area by December 31, 2011, and separation for the remaining combined portions of the sewer system including the West Hill area by December 31, 2024. The election to continue the local option tax again received strong support by voters.

The City began a comprehensive Pavement Management Program in 2007. Allocations totaling over \$5 million funded the initial upgrade of streets throughout the City. These improvements were substantially completed by June 30, 2010. The initial costs of this program were funded with general obligation bond proceeds. Annual allocations to maintain all streets at this higher level began in 2010/2011 with funding from the 20% allocation of local option sales tax.

The City continues to complete improvements at the municipal airport as part of the long range plan for this facility. In 2010/2011 a snow removal tractor was purchased and construction began on a hangar access road. Projects for the upcoming year include airport runway lighting improvements and improvements to the hangar roofs.

In recent years the City of Muscatine was required to address funding reductions to the City's General Fund as a result of reductions in funding from the State of Iowa which began in 2003/2004 and continued in 2004/2005. The state eliminated approximately \$360,000 in annual funding to the City of Muscatine beginning in 2003/2004 and an additional \$70,000 annually was eliminated in 2004/2005.

In response to these factors, the City made a number of significant budget changes which included personnel reductions, funding transfers and consolidation of services. Full-time equivalent employees of the City are fifteen (15) less than what was included in the original 2003/2004 budget. As directed by Council these reductions were done, when possible, by not filling a number of positions as they became vacant either by retirement or attrition. Nine (9) of

these positions were eliminated when the City of Muscatine and Muscatine County combined their emergency dispatch services effective in September, 2004. Both entities have and will continue to benefit both financially and operationally by combining their dispatch services.

A key issue during the development of the City's 2010/2011 budget was the consideration of and ultimate adoption of a Utility Franchise Fee on Alliant Energy, the provider of natural gas to the community. The ordinance change adopting this fee provides that the fee may be up to 5% on natural gas sales by Alliant in the community. The initial rate was set at 2% which was effective July 1, 2010. The Revenue Purpose Statement adopted with this fee provides that a minimum of 25% of the fees collected will be used for property tax relief with the remainder available to fund a variety of other General Fund Services. A conservative estimate of \$180,000 of revenue from these fees was included in the 2010/2011 budget and actual revenues were \$227,680. The establishment of this new revenue source allowed the City to diversify its funding sources and will assist the City in continuing to fund its core General Fund services in upcoming years.

The City continued to make structural and operational changes in 2010/2011 in an effort to place the General Fund in a better financial position for 2011/2012 and future budget years. These included (1) a reduction of one full-time position in the Park Maintenance budget; seasonal staff was increased to partially offset this reduction for a net savings of \$49,300, (2) elimination of one full-time custodian position with contract cleaning services partially offsetting the cost savings for a net savings of \$7,400, (3) funding economic development administrative costs and the Chamber economic development allocation with Tax Increment Financing (TIF) funds (a total of \$137,500), (4) not filling the budgeted $\frac{3}{4}$ time Automatic Traffic Enforcement (Red Light Camera) Technician in the Police department net of the cost of creating an additional sergeant position for this function (\$30,000 savings), and (5) transferring the dredge operation to the Water Pollution Control fund (\$42,000 General Fund savings). These items total \$266,200 and provide a positive impact on the General Fund for 2011/2012 and will continue to have a positive impact on the General Fund in future years.

Relevant Financial Policies

The City's budget policies provide that the City's unreserved General Fund balance be at least 10% of budgeted General Fund expenditures. The City implemented Governmental Accounting Standards Board (GASB) Statement No. 54 in 2010/2011. This Statement provided for the following new classifications of governmental fund balances: nonspendable, restricted, committed, assigned, and unassigned. The unassigned portion of the General Fund balance is similar to the previous classification of unreserved balance referenced in the City's financial policies. The unassigned General Fund balance at June 30, 2011 was \$2,141,534 which was 14.3% of General Fund expenditures. This unassigned balance was \$420,899 higher than the prior year unreserved balance. This increase is attributed to several categories of revenues exceeding their budget estimates and most General Fund departments operating under their budget allocations. The major revenue sources which exceeded their budget estimates included hotel/motel taxes (\$53,665 over the budgeted amount), automatic traffic enforcement fines (\$148,533 over the estimate), and court fines (\$48,816 over the estimate).

For the 2011/2012 budget taxable property values increased by 2.6% which will provide \$156,174 more in tax funding from the general fund tax levy which has been at the maximum rate of \$8.10 per \$1,000 of valuation in all recent years. There was growth in residential property valuations of 6.55%. Commercial and industrial property valuations, however, decreased for 2011/2012 by 1.9% and .7%, respectively, due to revaluation of these properties by the County Assessor.

As noted in the previous section, beginning in 2010/2011 the City implemented a 2% utility franchise fee on the provider of natural gas services in the community. The availability of this new revenue source will assist in continuing to fund the City's core General Fund services to the community. This fee is budgeted to generate \$200,000 in the upcoming 2011/2012 fiscal year.

The City continues to claim less than the full amount of incremental taxes available from the Downtown and Southend Tax Increment Financing (TIF) areas. As growth in valuations in these areas has exceeded original projections, balances have been accumulating in these funds in advance of the debt schedules in effect. Not claiming the full amount allows a portion of the increased values in each area to go back onto regular taxable valuations of all taxing entities affected. Approximately \$606,000 of incremental taxes were not claimed by the City for 2010/2011 and this amount increased to \$900,000 for 2011/2012. This results in increased regular taxable values and increased taxes generated by the \$8.10 General Fund levy.

The effects of the changes implemented by City Council in 2010/2011 and as well as those implemented in previous years in reducing the General Fund workforce, combining services with Muscatine County, and claiming less than the full amount of incremental taxes will continue to be realized in future years. These changes as well as the implementation of the utility franchise fee beginning in 2010/2011 have placed the City in a more favorable position to address funding requirements for the provision of General Fund services in future years.

Major Initiatives

The City continues to strive to make significant capital improvements to the City's infrastructure and facilities. Major budget initiatives for 2011/2012 include (1) engineering design or construction for major improvements to Hershey Avenue, Cedar Street, and Colorado Street; (2) completion of the construction on the Hershey sewer separation project funded from local option sales tax revenues; (3) completion of the engineering design for separation of the combined sewers in the West Hill area and beginning construction on Phase I of this project; (4) completion of construction of the new Southend Fire Station; and (5) completion of construction on the comprehensive facilities improvements at the Water Pollution Control Plant (WPCP). The WPCP improvements total approximately \$18.5 million and are scheduled to be completed by the fall of 2011. These improvements will address plant and process requirements for the next 20-25 years.

Awards and Acknowledgements Updated

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Muscatine for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2010. This was the 17th consecutive year that the City has received this prestigious award. In order to be awarded a Certificate of Achievement, the City published an easily readable and efficiently organized CAFR. This report satisfied both GAAP and applicable legal requirements.

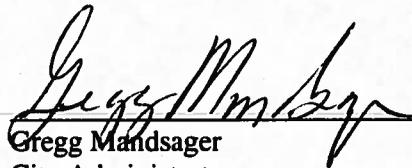
A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

In addition, the City has also received the GFOA's Distinguished Budget Presentation Award for its annual budget document for fiscal year 2011/2012. In order to qualify for the Distinguished Budget Presentation Award, the City's budget document was judged to be proficient in several categories, including as a policy document, a financial plan, an operations guide, and a

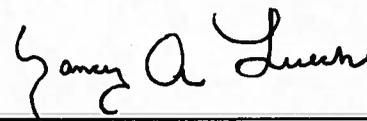
communications device. The award for the 2011/2012 budget was the 27th consecutive year that the City of Muscatine has received the GFOA's Award for Distinguished Budget Presentation. The GFOA's Distinguished Budget Presentation Award is good for a period of one year. The City of Muscatine plans to submit its budget document for the 2012/2013 fiscal year to the GFOA to again be considered for this award.

In regard to the preparation of this report and the accounting activity throughout the year in the Finance Department, we would like to express our appreciation to all members of this department for their assistance and contributions for this endeavor. Also appreciated is the continued interest and support by the members of the City Council in planning and conducting the financial operations of the city in a responsible and prudent manner in these times of limited resources and ever-increasing demands. Lastly, we would extend our appreciation to McGladrey & Pullen, Certified Public Accountants, for their assistance and suggestions in regard to the preparation of the Comprehensive Annual Financial Report.

Respectfully submitted,



Gregg Mandsager
City Administrator



Nancy A. Lueck
Finance Director