

**CITY OF PRESTON
ELECTRIC UTILITY**

FINANCIAL STATEMENTS
JUNE 30, 2004 AND 2003

CITY OF PRESTON ELECTRIC UTILITY

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**CITY OF PRESTON ELECTRIC UTILITY
OFFICIALS**

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
Steve Ritenour	Mayor	January 2005
Richard Rossmann	Mayor Pro Tem/Council Member	January 2005
Ken Larson	Council Member	January 2005
Carol Milder	Council Member	January 2007
Dave Jargo	Council Member	January 2005
Curtis Kilburg	Council Member	January 2007
Brenda Tebbe	City Clerk/Treasurer	Indefinite
James Bear	City Attorney	Indefinite



INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and
Members of the City Council:

We have audited the accompanying financial statements of the Electric Utility of the City of Preston, Iowa, as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the management of the City of Preston. Our responsibility is to express an opinion on these financial statements based on our audits.

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

As discussed in Note 1, the financial statements present only the Electric Utility of the City of Preston and are not intended to present fairly the financial position of the City of Preston and the results of its operations and the cash flows of its proprietary fund types in conformity with 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 financial position of the Electric Utility of the City of Preston as of June 30, 2004 and 2003, and the results of its operations and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 10 to the financial statements, for the year ended June 30, 2004, the City of Preston adopted Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*; Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*; Statement No. 38, *Certain Financial Statement Note Disclosures*; and Statement No. 41, *Budgetary Comparison Schedule – Perspective Differences*.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 12, 2004, on our consideration of the Electric Utility'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 the internal control over financial reporting or on 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.

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The Management's Discussion and Analysis, listed in the table of contents, 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 supplementary information. We did not audit the information and express no opinion on it.

Our audits were performed for the purpose of forming an opinion on the financial statements of the Electric Utility of the City of Preston. The combining fund financial statements are presented for purposes of additional analysis and are not a required part of the financial statements. The combining fund financial statements have been subjected to the auditing procedures applied in our audits of the aforementioned financial statements and, in our opinion, are fairly stated in all material respects in relation to the aforementioned financial statements taken as a whole.

Erin Barry LLP

Dubuque, Iowa
August 12, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

2004 FINANCIAL HIGHLIGHTS

- Operating revenues of the Electric Utility's governmental activities increased 1.9%, or \$12,794 from fiscal 2003 to fiscal 2004.
- Operating expenses increased 19.6%, or \$104,410, in fiscal 2004 from fiscal 2003. Power purchased, utilities, insurance, and depreciation expenses increased \$34,102, \$13,876, \$12,214, and \$44,893, respectively.
- The Electric Utility's net assets increased .2%, or \$2,333 from June 30, 2003 to June 30, 2004.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Electric Utility's financial statements consist of a statement of net assets, a statement of revenues, expenses, and changes in fund net assets and a statement of cash flows. This discussion and analysis is intended to serve as an introduction to the financial statements. This report also contains other supplementary information in addition to the financial statements themselves.

The statement of net assets presents information on all of the Electric Utility's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position is improving or deteriorating.

The statement of revenues, expenses, and changes in fund net assets presents information showing how the Electric Utility's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows.

The statement of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what cash was used for and what was the change in cash and cash equivalents during the reporting year.

FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of financial position. The analysis that follows focuses on the changes in the net assets.

	Year ended June 30,	
	2004	2003
NET ASSETS		
ASSETS		
Cash and cash equivalents	\$ 263,610	\$ 460,650
Receivables (net of allowance for uncollectibles)		
Customer accounts and unbilled usage	68,049	60,557
Accrued interest	-	466
Inventories	85,527	75,561
Prepaid insurance	17,562	16,595
Deposits	574	574
Restricted assets		
Cash and cash equivalents	119,918	53,024
Capital assets (net of accumulated depreciation)	<u>997,185</u>	<u>935,141</u>
Total assets	<u>1,552,425</u>	<u>1,602,568</u>
LIABILITIES		
Current liabilities:		
Accounts payable	39,566	19,001
Accrued sales and use tax	4,700	4,030
Current maturities of long-term debt	74,572	74,572
Compensated absences	2,348	2,687
Customer deposits	<u>4,224</u>	<u>3,024</u>
Total current liabilities	125,410	103,314
Long-term debt, excluding current maturities	<u>423,288</u>	<u>497,860</u>
Total liabilities	<u>548,698</u>	<u>601,174</u>
NET ASSETS		
Invested in capital assets, net of related debt	547,185	420,141
Restricted for:		
Electric principal and interest reserve	58,000	58,000
Electric improvement and extension	50,000	50,000
Other purposes	150	-
Unrestricted	<u>348,392</u>	<u>473,253</u>
Total net assets	<u>\$ 1,003,727</u>	<u>\$ 1,001,394</u>

Net assets of the Electric Utility increased from FY03 by .2%. The largest portion of the Electric Utility's net assets is the invested in capital assets (e.g., land, distribution system, buildings and equipment), less the related debt. The debt related to the investment in capital assets is liquidated with sources other than capital assets. Restricted net assets represent resources that are subject to external restrictions, constitutional provisions or enabling legislation on how they can be used. Unrestricted net assets, the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, legislation or other legal requirements, is \$348,392 at the end of this year.

Changes in Net Assets

	Year ended June 30,	
	2004	2003
Operating revenues:		
Charges for service	\$ 668,987	\$ 656,193
Operating expenses:		
Power purchased	235,779	201,677
Employee expense	84,906	79,242
Utilities	59,701	45,825
Repairs and maintenance	10,941	15,837
Supplies and services	98,705	100,148
Insurance	52,487	40,273
Depreciation	94,407	49,514
Total operating expenses	636,926	532,516
Operating income	32,061	123,677
Nonoperating revenues (expenses):		
Interest revenue	3,306	5,902
Miscellaneous income	13,869	10,115
Interest expense	(22,903)	(25,015)
Total nonoperating revenues (expenses)	(5,728)	(8,998)
Income before transfers	26,333	114,679
Transfers in (out) from (to) City of Preston	(24,000)	39,396
Change in net assets	2,333	154,075
Net assets beginning of year	1,001,394	847,319
Net assets end of year	\$ 1,003,727	\$ 1,001,394

The Electric Utility's rates stayed the same for fiscal year 2004. Revenues increased only slightly during the year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

CAPITAL ASSETS

The Electric Utility's capital assets include land, buildings, vehicles, machinery and equipment, tools, and distribution system. Capital assets totaled \$997,184 (net of accumulated depreciation) at June 30, 2004. Additional information on the Electric Utility's assets can be found in Note 4 to the financial statements in this report.

Capital Assets (Net of Accumulated Depreciation)

	June 30 2004	June 30 2003
Land	\$ 19,173	\$ 19,173
Buildings	40,889	30,874
Machinery and equipment	777,353	775,804
Vehicles	95,774	95,774
Tools	18,007	18,007
Distribution system	1,160,487	1,013,102
Construction in progress	-	2,499
Accumulated depreciation	<u>(1,114,499)</u>	<u>(1,020,092)</u>
	<u>\$ 997,184</u>	<u>\$ 935,141</u>

LONG-TERM DEBT

At June 30, 2004, the Electric Utility had \$497,860 in total long-term debt outstanding. Additional information on the Electric Utility's long-term debt can be found in Note 5 to the financial statements in this report.

ECONOMIC FACTORS BEARING ON THE ELECTRIC UTILITY'S FUTURE

The Electric Utility has not made any significant rate changes and does not expect any significant changes in the future.

CONTACTING THE ELECTRIC UTILITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the Electric Utility's finances and to show the Electric Utility's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Brenda Tebbe, City Clerk/Treasurer, P.O. Box 37, Preston, Iowa 52069.

FINANCIAL STATEMENTS

CITY OF PRESTON ELECTRIC UTILITY
STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
ASSETS		
Cash and cash equivalents	\$ 263,610	\$ 460,650
Receivables (net of allowance for uncollectibles):		
Customer accounts and unbilled usage	68,049	60,557
Accrued interest	-	466
Inventories	85,527	75,561
Prepaid insurance	17,562	16,595
Deposits	574	574
Restricted assets:		
Cash and cash equivalents	119,918	53,024
Capital assets (net of accumulated depreciation)	<u>997,185</u>	<u>935,141</u>
 Total assets	 <u>1,552,425</u>	 <u>1,602,568</u>
LIABILITIES		
Current liabilities:		
Accounts payable	39,566	19,001
Accrued sales and use tax	4,700	4,030
Current maturities of long-term debt - Note 5	74,572	74,572
Compensated absences	2,348	2,687
Customer deposits	<u>4,224</u>	<u>3,024</u>
Total current liabilities	125,410	103,314
 Long-term debt, excluding current maturities - Note 5	 <u>423,288</u>	 <u>497,860</u>
 Total liabilities	 <u>548,698</u>	 <u>601,174</u>
NET ASSETS		
Invested in capital assets, net of related debt	547,185	420,141
Restricted for:		
Electric principal and interest reserve	58,000	58,000
Electric improvement and extension	50,000	50,000
Other purposes	150	-
Unrestricted	<u>348,392</u>	<u>473,253</u>
 Total net assets	 <u>\$ 1,003,727</u>	 <u>\$ 1,001,394</u>

CITY OF PRESTON ELECTRIC UTILITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Charges for service	\$ 668,987	\$ 656,193
Operating expenses:		
Power purchased	235,779	201,677
Employee expense	84,906	79,242
Utilities	59,701	45,825
Repairs and maintenance	10,941	15,837
Supplies and services	98,705	100,148
Insurance	52,487	40,273
Depreciation	94,407	49,514
Total operating expenses	<u>636,926</u>	<u>532,516</u>
Operating income	<u>32,061</u>	<u>123,677</u>
Nonoperating revenues (expenses):		
Interest revenue	3,306	5,902
Miscellaneous income	13,869	10,115
Interest expense	<u>(22,903)</u>	<u>(25,015)</u>
Total nonoperating revenues (expenses)	<u>(5,728)</u>	<u>(8,998)</u>
Income before transfers	26,333	114,679
Transfers in (out) from (to) the City of Preston	<u>(24,000)</u>	<u>39,396</u>
Change in net assets	2,333	154,075
Net assets beginning of year	<u>1,001,394</u>	<u>847,319</u>
Net assets end of year	<u>\$ 1,003,727</u>	<u>\$ 1,001,394</u>

CITY OF PRESTON ELECTRIC UTILITY
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers and users	\$ 661,495	\$ 661,889
Cash received from other revenues	13,869	10,115
Cash paid for personal services	(85,245)	(79,725)
Cash paid to suppliers	<u>(446,111)</u>	<u>(395,854)</u>
Net cash provided by operating activities	<u>144,008</u>	<u>196,425</u>
Cash flows from noncapital financing activities:		
Transfers in (out) from (to) the City of Preston	<u>(24,000)</u>	<u>39,396</u>
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(156,451)	(316,116)
Repayment of long-term debt	(74,572)	(74,572)
Interest paid on long-term debt	<u>(22,903)</u>	<u>(25,015)</u>
Net cash used for capital and related financing activities	<u>(253,926)</u>	<u>(415,703)</u>
Cash flows from investing activities:		
Interest on cash and investments	<u>3,772</u>	<u>5,925</u>
Net decrease in cash and cash equivalents	(130,146)	(173,957)
Cash and cash equivalents beginning of year	<u>513,674</u>	<u>687,631</u>
Cash and cash equivalents end of year	<u>\$ 383,528</u>	<u>\$ 513,674</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 32,061	\$ 123,677
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	94,407	49,514
Miscellaneous income	13,869	10,115
Changes in assets and liabilities:		
(Increase) decrease in customer accounts and unbilled usage	(7,492)	5,696
(Increase) decrease in inventories	(9,966)	16,565
Increase in prepaid insurance	(967)	(7,300)
Increase (decrease) in accounts payable	20,565	(2,623)
Decrease in compensated absences	(339)	(483)
Increase in accrued sales and use tax	670	747
Increase in customer deposits	<u>1,200</u>	<u>517</u>
Net cash provided by operating activities	<u>\$ 144,008</u>	<u>\$ 196,425</u>

(continued)

CITY OF PRESTON ELECTRIC UTILITY
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2004 AND 2003

	<u>2004</u>	<u>2003</u>
Reconciliation of cash and cash equivalents at year end to specific assets included on the Statement of Net Assets:		
Current assets:		
Cash and cash equivalents	\$ 263,610	\$ 460,650
Restricted assets:		
Cash and cash equivalents:		
Customer deposits	4,224	3,024
Electric principal and interest reserve	58,000	-
Electric improvement and extension	50,000	50,000
Revenue note retirement	7,544	-
Other purposes	<u>150</u>	<u>-</u>
Cash and cash equivalents at year end	<u>\$ 383,528</u>	<u>\$ 513,674</u>

CITY OF PRESTON ELECTRIC UTILITY
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2004 AND 2003

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Preston is a political subdivision of the State of Iowa located in Jackson County. It was first incorporated in 1890 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 Electric Utility of the City of Preston provides electric service to customers within the Preston city limits. At June 30, 2004, the Electric Utility provided service to 429 residential, 101 commercial, and 26 municipal customers.

Reporting Entity

The financial statements include only those funds of the Electric Utility and are not intended to present all funds of the City of Preston, Iowa.

Measurement Focus and Basis of Accounting

The proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The proprietary funds of the Electric Utility apply all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Electric Utility are charges to customers for sales and services. Operating expenses for the Electric Utility include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The Electric Utility's accounting records are maintained by the City on the cash basis. However, for financial reporting purposes, the accounting records have been adjusted to the accrual method recognizing income when earned and expenses when incurred.

The Statement of Net Assets presents the Electric Utility's nonfiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories.

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt attributable to the acquisition, construction or improvement of those assets.

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.

NOTES TO FINANCIAL STATEMENTS

Unrestricted net assets consist of net assets not meeting the definition of the two preceding categories. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

When both restricted and unrestricted resources are available for use, it is the Electric Utility's policy to use restricted resources first, then unrestricted resources as they are needed.

Budgets and Budgetary Accounting

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. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures.

Formal and legal budgetary control is based upon nine major classes of disbursements known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, and business-type activities.

Accounts Receivable

Accounts receivable at June 30, 2004 and 2003, is recorded net of allowance for doubtful accounts of \$2,100 and \$1,700, respectively.

Unbilled Revenues

The customers served by the Electric Utility are billed on a monthly cycle basis. Meters are read approximately one week prior to billing; therefore, at the end of any accounting period, there are unbilled revenues. Unbilled amounts due the Electric Utility at the end of the fiscal year are estimated and included in accounts receivable.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market.

Restricted Assets

The Electric Utility includes in restricted assets those amounts received from customers as deposits on their electric accounts and for Green City Energy donations. Certain proceeds of revenue bonds, as well as certain resources set aside for their repayment, are also classified as restricted on the statement of net assets because their use is limited by applicable bond covenants.

Capital Assets

Capital assets include property, equipment, and vehicles. Capital assets are recorded at historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The costs of normal maintenance and repair not adding to the value of the asset or materially extend asset lives are not capitalized.

NOTES TO FINANCIAL STATEMENTS

Capital assets are stated at cost. Depreciation is computed using the straight-line method over the following estimated useful lives.

	<u>Years</u>
Buildings	10 – 50
Machinery and equipment	4 – 40
Vehicles	4 – 10
Tools	4 – 10
Distribution system	10 – 33

Compensated Absences

Employees of the Electric Utility may accrue up to 40 hours of unused vacation leave and up to 16 hours of unused personal leave in a year. Employees are paid each July for any unused vacation or personal leave from the prior year.

Employees are allowed to accumulate sick leave hours for later use. Employees are paid each July for one-half of any sick leave hours accumulated in excess of 720. Employees are not paid for unused sick leave hours upon termination.

The Electric Utility has recognized as a liability at June 30, 2004 and 2003, those amounts of accrued compensated absences which are payable in the following year.

Cash and Cash Equivalents

For purposes of the statement of cash flows, the Electric Utility considers all highly liquid investments (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents.

NOTE 2 – DEPOSITS AND POOLED INVESTMENTS

The Electric Utility's deposits in banks at June 30, 2004 and 2003, 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 Electric Utility 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.

At June 30, 2004 and 2003, the Electric Utility had investments in the Iowa Public Agency Investment Trust with a carrying and market value of \$0 and \$475,008, respectively, that are not subject to risk categorization.

The Electric Utility had no other investments at June 30, 2004 and 2003.

NOTES TO FINANCIAL STATEMENTS

NOTE 3 – INVENTORIES

Inventories are composed of the following at June 30:

	<u>2004</u>	<u>2003</u>
Fuel oil	\$ 5,604	\$ 3,135
Lube oil	4,399	2,090
Electric utility distribution	<u>75,524</u>	<u>70,336</u>
Total	<u>\$ 85,527</u>	<u>\$ 75,561</u>

NOTE 4 – CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2004, was as follows:

	<u>Balance Beginning of Year</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance End of Year</u>
Capital assets, not being depreciated:				
Land	\$ 19,173	\$ -	\$ -	\$ 19,173
Construction in progress	<u>2,499</u>	<u>-</u>	<u>2,499</u>	<u>-</u>
Total capital assets, not being depreciated	<u>21,672</u>	<u>-</u>	<u>2,499</u>	<u>19,173</u>
Capital assets, being depreciated:				
Buildings	30,874	10,015	-	40,889
Machinery and equipment	775,804	1,549	-	777,353
Vehicles	95,774	-	-	95,774
Tools	18,007	-	-	18,007
Distribution system	<u>1,013,102</u>	<u>147,385</u>	<u>-</u>	<u>1,160,487</u>
Total capital assets, being depreciated	<u>1,933,561</u>	<u>158,949</u>	<u>-</u>	<u>2,092,510</u>
Less accumulated depreciation for:				
Buildings	22,589	1,353	-	23,942
Machinery and equipment	501,979	20,889	-	522,868
Vehicles	95,774	-	-	95,774
Tools	17,564	66	-	17,630
Distribution system	<u>382,186</u>	<u>72,099</u>	<u>-</u>	<u>454,285</u>
Total accumulated depreciation	<u>1,020,092</u>	<u>94,407</u>	<u>-</u>	<u>1,114,499</u>
Total capital assets, being depreciated, net	<u>913,469</u>	<u>64,542</u>	<u>-</u>	<u>978,011</u>
Capital assets, net	<u>\$ 935,141</u>	<u>\$ 64,542</u>	<u>\$ 2,499</u>	<u>\$ 997,184</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

Depreciation expense was charged as follows:

Business-type activity:

Electric depreciation expense \$ 94,407

NOTE 5 – NOTES PAYABLE

A summary of changes in long-term liabilities for the year ended June 30, 2004, is as follows:

	Balance Beginning of Year	Increase	Decrease	Balance End of Year	Due Within One Year
Promissory note	\$ 57,432	\$ -	\$ 9,572	\$ 47,860	\$ 9,572
Revenue note	<u>515,000</u>	<u>-</u>	<u>65,000</u>	<u>450,000</u>	<u>65,000</u>
	<u>\$ 572,432</u>	<u>\$ -</u>	<u>\$ 74,572</u>	<u>\$ 497,860</u>	<u>\$ 74,572</u>

Promissory Note – On January 17, 2000, the City of Preston issued a promissory note in the amount of \$95,720 to finance the cost of a street project. The note is a general obligation of the City of Preston. The note will mature January 18 of each year up to and including January 18, 2010.

Debt	Issue Date	Amount Issued	Interest Rate	Balance June 30 2004
Promissory Note	1/17/00	\$ 95,720	0%	\$ 47,860

Revenue Note – On June 1, 2002, the City of Preston issued an electric revenue note in the amount of \$580,000 to finance the purchase and construction of a substation. The note will mature June 1 of each year up to and including June 1, 2010.

Debt	Issue Date	Amount Issued	Interest Rate	Balance June 30 2004
Electric Revenue Note	6/1/02	\$ 580,000	3.65%-5.00%	\$ 450,000

Annual debt service requirements to maturity for the promissory note and revenue note are as follows:

Year ending June 30	Promissory Note		Revenue Note		Principal	Interest
	Principal	Interest	Principal	Interest		
2005	\$ 9,572	\$ -	\$ 65,000	\$ 20,530	\$ 74,572	\$ 20,530
2006	9,572	-	70,000	17,930	79,572	17,930
2007	9,572	-	75,000	14,955	84,572	14,955
2008	9,572	-	75,000	11,618	84,572	11,618
2009	9,572	-	80,000	8,130	89,572	8,130
2010	<u>-</u>	<u>-</u>	<u>85,000</u>	<u>4,250</u>	<u>85,000</u>	<u>4,250</u>
Total	<u>\$ 47,860</u>	<u>\$ -</u>	<u>\$ 450,000</u>	<u>\$ 77,413</u>	<u>\$ 497,860</u>	<u>\$ 77,413</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

The resolutions providing for the issuance of the revenue note includes the following provisions:

- a. The note 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 funds.
- b. Sufficient monthly transfers shall be made to the Sinking Fund for the purpose of making the note principal and interest payments when due.
- c. At delivery of the note, a sum equal to \$58,000 shall be made to the Reserve Fund for the purpose of making the note principal and interest payments if deposits in the Sinking Fund are insufficient to make such payments.
- d. Additional monthly transfers of \$2,000 to the Improvement Fund shall be made until a specific minimum balance of \$50,000 has been accumulated. This account is restricted for the purpose of paying for the cost of capital improvements and extensions to the Utility.
- e. All funds remaining after first making the required payments into the Sinking Fund, the Reserve Fund, and Improvement Fund, and after the Reserve Fund contains the required Reserve Fund balance, the net revenues will be set aside into the Surplus Fund.

During the year ended June 30, 2004, the Electric Utility was in compliance with the revenue note provisions.

NOTE 6 – PENSION AND RETIREMENT BENEFITS

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

Plan members are required to contribute 3.70% of their annual covered salary and the Electric Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by state statute. The Electric Utility's contributions to IPERS for the years ended June 30, 2004, 2003, and 2002, were \$4,272, \$3,890, and \$3,530, respectively, equal to the required contributions for each year.

NOTE 7 – LEGAL COMPLIANCE WITH BUDGET

The City of Preston adopts a budget annually as required by Iowa law. The budget, which is prepared on the cash basis of accounting, includes those funds of the Electric Utility.

Following is a schedule comparing the business-type activities, which includes the Electric Fund's budget and actual disbursements using the cash basis of accounting for the year ended June 30, 2004:

Program	Budget	Actual	Variance – Unfavorable
Business-type activities	<u>\$ 1,614,950</u>	<u>\$ 1,683,937</u>	<u>\$ 68,987</u>

(continued on next page)

NOTES TO FINANCIAL STATEMENTS

NOTE 8 – RISK MANAGEMENT

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

NOTE 9 – TRANSFER

Transfer for the year ended June 30, 2004, consisted of the following:

Transfer out of Electric Utility to City of Preston	\$ <u>24,000</u>
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Transfer to the City is for payment in lieu of taxes.

NOTE 10 – ACCOUNTING CHANGE

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*; Statement No. 37, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus*; Statement No. 38, *Certain Financial Statement Note Disclosures*; and Statement No. 41, *Budgetary Comparison Schedule – Perspective Differences*, were implemented for the year ended June 30, 2004. The statements create new basic financial statements for reporting the Electric Utility’s financial activities.

NOTE 11 – NEW GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) STANDARDS

The Governmental Accounting Standards Board (GASB) has issued five statements not yet implemented by the City of Preston Electric Utility. The statements which might impact the City of Preston Electric Utility are as follows:

Statement No. 40, *Deposit and Investment Risk Disclosures* issued March 2003, will be effective for the City of Preston Electric Utility for the fiscal year ending June 30, 2005. This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* issued November 2003, will be effective for the City of Preston Electric Utility for the fiscal year ending June 30, 2006. This statement establishes accounting and financial reporting standards for impairment of capital assets and also clarifies and establishes accounting requirements for insurance recoveries.

Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* issued April 2004, will be effective for the City of Preston Electric Utility for the fiscal year ending June 30, 2008. This statement establishes uniform financial reporting standards for other postemployment benefit (OPEB) plans and supersedes the interim guidance included in Statement No. 26. This statement affects reporting by administrators or trustees of OPEB plan assets or by employers or sponsors that include OPEB plan assets as trust or agency funds in their financial reports.

NOTES TO FINANCIAL STATEMENTS

Statement No. 44, *Economic Condition Reporting: The Statistical Section* issued May 2004, will be effective for the City of Preston Electric Utility for the fiscal year ending June 30, 2006. This statement amends previous guidance regarding preparation of the statistical section for governments that issue a comprehensive annual financial report.

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* issued June 2004, will be effective for the City of Preston Electric Utility for the fiscal year ending June 30, 2009. This statement establishes standards for the measurement, recognition, and display of (OPEB) expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

The Utility's management has not yet determined the effect these statements will have on the Utility's financial statements.

SUPPLEMENTARY INFORMATION

CITY OF PRESTON ELECTRIC UTILITY
COMBINING STATEMENT OF NET ASSETS
JUNE 30, 2004
(WITH COMPARATIVE TOTALS FOR 2003)

	Electric		Totals	
	Revenue Fund	Customer Deposits	2004	2003
ASSETS				
Cash	\$ 263,610	\$ -	\$ 263,610	\$ 460,650
Receivables (net of allowance for uncollectibles)				
Customer accounts and unbilled usage	68,049	-	68,049	60,557
Accrued interest	-	-	-	466
Inventories	85,527	-	85,527	75,561
Prepaid insurance	17,562	-	17,562	16,595
Deposits	574	-	574	574
Restricted assets:				
Cash	115,694	4,224	119,918	53,024
Capital assets (net of accumulated depreciation)	997,185	-	997,185	935,141
Total assets	<u>1,548,201</u>	<u>4,224</u>	<u>1,552,425</u>	<u>1,602,568</u>
LIABILITIES				
Current liabilities:				
Accounts payable	39,566	-	39,566	19,001
Accrued sales and use tax	4,700	-	4,700	4,030
Current maturities of long-term debt	74,572	-	74,572	74,572
Compensated absences	2,348	-	2,348	2,687
Customer deposits	-	4,224	4,224	3,024
Total current liabilities	121,186	4,224	125,410	103,314
Long-term debt, excluding current maturities	423,288	-	423,288	497,860
Total liabilities	<u>544,474</u>	<u>4,224</u>	<u>548,698</u>	<u>601,174</u>
NET ASSETS				
Invested in capital assets, net of related debt	547,185	-	547,185	420,141
Restricted for:				
Electric principal and interest reserve	58,000	-	58,000	58,000
Electric improvement and extension	50,000	-	50,000	50,000
Other purposes	150	-	150	-
Unrestricted	348,392	-	348,392	473,253
Total net assets	<u>\$1,003,727</u>	<u>\$ -</u>	<u>\$1,003,727</u>	<u>\$1,001,394</u>

CITY OF PRESTON ELECTRIC UTILITY
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
YEAR ENDED JUNE 30, 2004
(WITH COMPARATIVE TOTALS FOR 2003)

	Electric	Customer	Totals	
	Revenue		Deposits	2004
	Fund			
Operating revenues:				
Charges for service	\$ 668,987	\$ -	\$ 668,987	\$ 656,193
Operating expenses:				
Power purchased	235,779	-	235,779	201,677
Employee expense	84,906	-	84,906	79,242
Utilities	59,701	-	59,701	45,825
Repairs and maintenance	10,941	-	10,941	15,837
Supplies and services	98,705	-	98,705	100,148
Insurance	52,487	-	52,487	40,273
Depreciation	94,407	-	94,407	49,514
Total operating expenses	636,926	-	636,926	532,516
Operating income	32,061	-	32,061	123,677
Nonoperating revenues (expenses):				
Interest revenue	3,306	-	3,306	5,902
Miscellaneous income	13,869	-	13,869	10,115
Interest expense	(22,903)	-	(22,903)	(25,015)
Total nonoperating revenues (expenses)	(5,728)	-	(5,728)	(8,998)
Income before transfers	26,333	-	26,333	114,679
Transfers in (out) from (to) the City of Preston	(24,000)	-	(24,000)	39,396
Change in net assets	2,333	-	2,333	154,075
Net assets beginning of year	1,001,394	-	1,001,394	847,319
Net assets end of year	\$ 1,003,727	\$ -	\$ 1,003,727	\$ 1,001,394

CITY OF PRESTON ELECTRIC UTILITY
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2004
(WITH COMPARATIVE TOTALS FOR 2003)

	Electric	Customer	Totals	
	Revenue Fund	Deposits	2004	2003
Cash flows from operating activities:				
Cash received from customers and users	\$ 661,495	\$ -	\$ 661,495	\$ 661,889
Cash received from other revenues	13,869	-	13,869	10,115
Cash paid for personal services	(85,245)	-	(85,245)	(79,725)
Cash paid to suppliers	(447,311)	1,200	(446,111)	(395,854)
Net cash provided by operating activities	<u>142,808</u>	<u>1,200</u>	<u>144,008</u>	<u>196,425</u>
Cash flows from noncapital financing activities:				
Transfers in (out) from (to) the City of Preston	<u>(24,000)</u>	<u>-</u>	<u>(24,000)</u>	<u>39,396</u>
Cash flows from capital and related financing activities:				
Acquisition of capital assets	(156,451)	-	(156,451)	(316,116)
Repayment of long-term debt	(74,572)	-	(74,572)	(74,572)
Interest paid on long-term debt	<u>(22,903)</u>	<u>-</u>	<u>(22,903)</u>	<u>(25,015)</u>
Net cash used for capital and related financing activities	<u>(253,926)</u>	<u>-</u>	<u>(253,926)</u>	<u>(415,703)</u>
Cash flows from investing activities:				
Interest on cash and cash investments	<u>3,772</u>	<u>-</u>	<u>3,772</u>	<u>5,925</u>
Net increase (decrease) in cash and cash equivalents	(131,346)	1,200	(130,146)	(173,957)
Cash and cash equivalents beginning of year	<u>510,650</u>	<u>3,024</u>	<u>513,674</u>	<u>687,631</u>
Cash and cash equivalents end of year	<u>\$ 379,304</u>	<u>\$ 4,224</u>	<u>\$ 383,528</u>	<u>\$ 513,674</u>

(continued)

CITY OF PRESTON ELECTRIC UTILITY
COMBINING STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2004
(WITH COMPARATIVE TOTALS FOR 2003)

	Electric	Customer	Totals	
	Revenue Fund	Deposits	2004	2003
Reconciliation of operating income to net cash provided by operating activities:				
Operating income	\$ 32,061	\$ -	\$ 32,061	\$ 123,677
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation	94,407	-	94,407	49,514
Miscellaneous income	13,869	-	13,869	10,115
Changes in assets and liabilities:				
(Increase) decrease in customer accounts and unbilled usage	(7,492)	-	(7,492)	5,696
(Increase) decrease in inventories	(9,966)	-	(9,966)	16,565
Increase in prepaid insurance	(967)	-	(967)	(7,300)
Increase (decrease) in accounts payable	20,565	-	20,565	(2,623)
Decrease in compensated absences	(339)	-	(339)	(483)
Increase in accrued sales and use tax	670	-	670	747
Increase in customer deposits	-	1,200	1,200	517
Net cash provided by operating activities	\$ 142,808	\$ 1,200	\$ 144,008	\$ 196,425
Reconciliation of cash and cash equivalents at year end to specific assets included on the Statement of Net Assets:				
Current assets:				
Cash and cash equivalents	\$ 263,610	\$ -	\$ 263,610	\$ 460,650
Restricted assets:				
Cash and cash equivalents:				
Customer deposits	-	4,224	4,224	3,024
Electric principal and interest reserve	58,000	-	58,000	-
Electric improvement and extension	50,000	-	50,000	50,000
Revenue note retirement	7,544	-	7,544	-
Other purposes	150	-	150	-
Cash and cash equivalents at year end	\$ 379,304	\$ 4,224	\$ 383,528	\$ 513,674



CPAs & BUSINESS ADVISORS

**REPORT ON COMPLIANCE AND OTHER MATTERS AND ON
INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Honorable Mayor and
Members of the City Council:

We have audited the financial statements of the Electric Utility of the City of Preston, Iowa, as of and for the year ended June 30, 2004, and have issued our report thereon dated August 12, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; Chapter 11 of the Code of Iowa; and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Electric Utility'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 an instance of non-compliance and other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings as item II-B-04.

Comments involving statutory and other legal matters about the Electric Utility's operations for the year ended June 30, 2004, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Electric Utility. 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. There were no prior year statutory comments and recommendations.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Electric Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Electric Utility's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in Part I of the accompanying Schedule of Findings as item I-A-04.

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A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management of the City of Preston, Iowa, in a separate letter dated August 12, 2004. Prior year reportable condition item I-A-04 has not been resolved.

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 Preston and other parties to whom the City of Preston 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 Preston 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.

Eric Bailey LLP

Dubuque, Iowa
August 12, 2004

**CITY OF PRESTON ELECTRIC UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2004**

Part I: Findings Related to the Financial Statements:

REPORTABLE CONDITION

I-A-04 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. One individual at the City has custody of receipts and performs all record keeping and reconciling functions for the accounts.

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 – The City Council feels they have segregated duties to the extent possible with the existing personnel.

Conclusion – Response accepted.

Part II: Other Findings Related to Required Statutory Reporting:

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

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

Recommendation – The budget should have been amended in sufficient amounts in accordance with Chapter 384.18 of the Code of Iowa before disbursements were allowed to exceed the budget. We recommend that City staff closely monitor the City's disbursements in the future to ensure that disbursements do not exceed the budget.

Response – The City staff in the future will monitor the City's disbursements to ensure that they do not exceed the budget.

Conclusion – Response accepted.

II-C-04 Questionable Expenditures - We noted no expenditures that fail to meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-D-04 Travel Expense - No expenditures of Electric Utility money for travel expenses of spouses of Electric Utility officials or employees were noted.

CITY OF PRESTON ELECTRIC UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2004

- II-E-04 Business Transactions - No business transactions between the Electric Utility and its officials or employees were noted.
- II-F-04 Bond Coverage - Surety bond coverage of City officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- II-G-04 Council Minutes - No transactions were found that we believe should have been approved in the Council minutes but were not.
- II-H-04 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the City’s investment policy were noted.
- II-I-04 Revenue Notes – During the year ended June 30, 2004, the Utility was in compliance with the revenue note provisions.