

MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Cedar Falls Utilities – Municipal Electric Utility

We have audited the accompanying balance sheets of the Municipal Electric Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2005, on our consideration of the 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 audits.

The management's discussion and analysis on pages 1 through 5 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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. However, we did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

March 30, 2005
Dubuque, Iowa

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MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Our discussion and analysis of the Municipal Electric Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2004 and 2003. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

Financial Highlights

- The Utility's net assets increased as a result of this year's operations. Total assets at year-end were \$89,839,916 and total liabilities were \$24,568,083 resulting in net assets of \$65,271,833.
- Operating revenues increased 10.3 percent to \$25,633,883 while operating expenses increased 3.5 percent to \$22,732,913 in 2004.
- During the year, the Utility had operating income of \$2,900,971. This compares to last year, when the Utility had operating income of \$1,281,559.
- The Utility delivered approximately 399,900,000 kilowatt hours (kWh) of electricity to its retail customers in 2004 as compared to approximately 389,600,000 kWh in 2003.

Overview of the Financial Statements

Management's discussion and analysis (MD&A) serves as an introduction to the financial statements, and the MD&A represents management's examination and analysis of the Utility's financial condition and performance. The financial statements report information about the Utility using full accrual accounting methods as utilized by similar entities in the private sector.

The balance sheets include the Utility's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the Utility and assessing the liquidity and flexibility of the Utility.

The statements of revenues, expenses and changes in net assets present the results of the Utility's activities (revenues and expenses) over the course of the fiscal year and can provide information about the Utility's recovery of its costs. Retail rates to purchase electricity are based on rates established by the Board of Trustees based on operating costs, debt service requirements, and anticipated capital needs. A fundamental objective of this rate model is to provide adequate revenue to cover all expenses.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Management Discussion and Analysis

December 31, 2004 and 2003

The statements of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, capital and related financing activities and investing activities. This statement provides answers to such questions as where did the cash come from, what was cash used for, and what was the change in cash balances during the reporting period.

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Utility's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events.

Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring, and planning.

Condensed Balance Sheet Information

	<u>2004</u>	<u>2003</u>
Current assets	\$18,331,471	\$17,297,152
Capital assets, net	53,065,285	42,335,172
Other noncurrent assets	<u>18,443,160</u>	<u>22,661,300</u>
Total assets	<u>\$89,839,916</u>	<u>\$82,293,624</u>
Current liabilities	5,960,342	4,065,142
Noncurrent liabilities	4,254,365	1,301,829
Long-term debt	<u>14,353,376</u>	<u>15,121,379</u>
Total liabilities	<u>\$24,568,083</u>	<u>\$20,488,350</u>
Invested in capital assets, net of related debt	42,826,327	34,420,776
Restricted	2,440,910	2,532,046
Unrestricted	<u>20,004,596</u>	<u>24,852,452</u>
Total net assets	<u>\$65,271,833</u>	<u>\$61,805,274</u>

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Sales of electricity	\$24,344,499	\$21,970,531
Other	<u>1,289,385</u>	<u>1,280,148</u>
Total operating revenues	<u>25,633,884</u>	<u>23,250,679</u>
System operation and maintenance	13,744,661	12,848,397
Depreciation and amortization	2,514,784	3,097,329
Service and administrative	<u>6,473,468</u>	<u>6,023,394</u>
Total operating expenses	<u>22,732,913</u>	<u>21,969,120</u>
Operating income	<u>2,900,971</u>	<u>1,281,559</u>
Interest income	711,606	535,205
Other, net	<u>(146,018)</u>	<u>(293,799)</u>
Total nonoperating revenues (expenses)	<u>565,588</u>	<u>241,406</u>
Change in net assets	3,466,559	1,522,965
Net assets, beginning of year	<u>61,805,274</u>	<u>60,282,309</u>
Net assets, end of year	<u>\$65,271,833</u>	<u>\$61,805,274</u>

Financial Analysis

Current assets increased 6.0 percent in 2004 primarily as a result of a decrease in cash and cash equivalents for the purchase of capital assets totaling approximately \$1,750,000 and an increase in local fuel inventory of approximately \$503,000 due to using approximately 2.1 percent more coal than in 2003 and an increase in the average cost per ton over \$1.43.

Other noncurrent assets decreased 18.6 percent in 2004 primarily due to investments made from the 2003 revenue bond issue in the construction fund maturing and being used to invest in the Council Bluffs 4 generation construction project. Other noncurrent assets also include the long-term note receivable from the Municipal Communication Utility. The total outstanding balance at December 31, 2004 was \$3,093,090.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Management Discussion and Analysis

December 31, 2004 and 2003

Current liabilities increased 46.6 percent in 2004 primarily as a result of the following: accounts payable increased approximately \$1,960,000 due primarily to power and transmission rent and wind energy for 2004 of approximately \$518,000; outstanding 2004 construction projects like the Industrial Park Substation and 161 KV line costs of approximately \$646,000; SCADA costs of approximately \$130,000, and warehouse construction costs of approximately \$128,000.

Noncurrent liabilities increased 226.8 percent in 2004 primarily due to the \$3,075,652 retainage held on the long-term construction project of Council Bluffs Energy Center Unit 4, in which the Utility is a 2.02 percent owner; and an increase of approximately \$279,000 in accrued severance that employees are entitled to receive upon retirement with 20 years of continuous service.

Long-term debt decreased 5.1 percent primarily due to the payment of principal and amortization of discount of over \$768,000 during 2004.

Sales of electricity increased 10.8 percent in 2004 primarily due to the impact of the general rate increase effective January 2004 of approximately 8.8 percent. Sales for resale were also a contributing factor to the total increase in sales of electricity. Sales for resale increased approximately \$213,000. Due to the market price of electricity being relatively high, the Utility ran our local units resulting in excess generation available to sell on the market.

Other operating revenues increased 0.7 percent in 2004 primarily as a result of increased interdepartmental rents of approximately \$63,000 and a decrease in gas turbine rent of \$53,000. The increase in rent relates to a telephone system upgrade of approximately \$28,000, computer purchases of approximately \$132,000, and approximately \$142,000 for customer billing software placed in service during 2003 which is owned by the Municipal Electric Utility and used by the Municipal Gas, Municipal Water, and Municipal Communications Utilities.

System operation and maintenance increased 7.0 percent in 2004 primarily due to several factors. As mentioned previously, due to the market price of electricity being relatively high, the Utility ran our local units. The Utility used 6,600 tons of coal more than during 2003. This represents an increase of 2.1 percent. The corresponding increase in the cost of the coal used is approximately \$464,000 or a 10 percent increase over 2003. Due to the increase in coal used, the associated costs of allowances, fuel handling, and ash disposal increased approximately \$134,000. The change in the fuel cost to be recovered from customers represents an additional expense or reduction in expense. The amount of the change in fuel cost to be recovered from December 31, 2003 to December 31, 2004 is a decrease in expense of approximately \$446,000. The Utility entered into a contract to purchase six megawatts of wind power. The wind power was first received in December 2002. The cost of the purchased wind power and the transmission cost of the wind power represent an increase of approximately \$17,000 from 2003.

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Management Discussion and Analysis

December 31, 2004 and 2003

Administrative and general expenses increased 7.5 percent in 2004 primarily due to an increase of approximately \$309,000 in employee insurance and benefit costs.

Other non-operating revenues and expenses, net, increased 134.3 percent in 2004 primarily due to a \$259,000 gain on the disposition of land, an increase of approximately \$92,000 in interest income earned and an increase of approximately \$290,000 in interest on long-term debt due to the 2003 revenue bonds.

Capital Assets and Debt Administration

Net capital assets represent 59.1 percent of total assets for the Utility. Net capital assets increased 25.3 percent from the prior year due to distribution system additions. Additional detail on the change in capital assets can be found in Note 4.

During 2002, the Board of Trustees approved the joint ownership agreement for the construction and operation of the Council Bluffs Energy Center Unit 4. The Utility will become a 2.02 percent owner which is approximately 16 megawatts. Our total estimated cost to construct is approximately \$25,000,000 and operation is expected to begin in 2007. Construction work in progress related to this project at December 31, 2004 is approximately \$7,465,709.

The Board of Trustees authorized the issuance of revenue bonds in an amount not to exceed \$35,000,000 for electric system improvements and extensions, including the construction of generation and transmission assets. On December 18, 2003 \$10,000,000 of revenue bonds were issued for the first phases of the projects. Additional detail on the issuance of revenue bonds can be found in Note 5.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Balance Sheets

December 31, 2004 and 2003

<u>Assets</u>	<u>2004</u>	<u>2003</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 100,548,512	\$ 96,564,370
Less accumulated depreciation	<u>58,601,755</u>	<u>56,422,028</u>
	41,946,757	40,142,342
Construction work in progress	<u>11,118,528</u>	<u>2,192,830</u>
Net capital assets (note 8)	<u>53,065,285</u>	<u>42,335,172</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Restricted (note 2)	5,622,994	10,030,000
Unrestricted	9,751,592	9,206,139
Note receivable (note 9)	<u>2,783,090</u>	<u>3,093,090</u>
Total noncurrent assets	<u>18,157,676</u>	<u>22,329,229</u>
Current assets:		
Cash and cash equivalents (note 1)	2,110,505	3,861,603
Investments (note 3)	7,579,469	7,485,000
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$34,256 in 2004 and \$22,800 in 2003	2,472,660	2,091,043
Due from affiliated utility (note 9)	-	181,779
Interest (note 9)	328,764	268,335
Current installment of note receivable (note 9)	310,000	471,500
Other	561,290	313,313
Inventories:		
Fuel	1,805,734	1,302,821
Material and supplies	760,175	685,069
Prepayments and other	623,998	117,644
Restricted - cash (note 2)	<u>1,778,876</u>	<u>519,045</u>
Total current assets	<u>18,331,471</u>	<u>17,297,152</u>
Deferred costs:		
Deferred costs	<u>285,484</u>	<u>332,071</u>
Total assets	<u>\$ 89,839,916</u>	<u>\$ 82,293,624</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2004</u>	<u>2003</u>
Long-term debt, less current installments (note 5)	\$ <u>14,353,376</u> :	<u>15,121,379</u>
Current liabilities:		
Accounts payable	3,293,274	1,330,781
Reserve for surplus declaration (note 9)	1,200,000	1,400,000
Accrued wages and vacations	441,030	358,839
Accrued interest	82,594	84,923
Other accrued expenses	158,444	145,599
Current installments of long-term debt (note 5)	785,000	745,000
Total current liabilities	<u>5,960,342</u>	<u>4,065,142</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	127,950	133,944
Other liabilities (note 5)	<u>4,126,415</u>	<u>1,167,885</u>
Total noncurrent liabilities	<u>4,254,365</u>	<u>1,301,829</u>
 Total liabilities	 <u>24,568,083</u>	 <u>20,488,350</u>
 <u>Net Assets</u>		
Invested in capital assets, net of related debt	42,826,327	34,420,776
Restricted - bond indentures (note 2)	2,440,910	2,532,046
Unrestricted	<u>20,004,596</u>	<u>24,852,452</u>
Total net assets	<u>65,271,833</u>	<u>61,805,274</u>
 Total liabilities and net assets	 \$ <u>89,839,916</u> :	 <u>82,293,624</u>

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Sales of electricity:		
Residential	\$ 10,070,822	\$ 9,099,188
Large industrial & commercial	1,574,962	1,479,814
Small industrial & commercial	8,489,530	7,644,487
Governmental (note 9)	2,274,275	2,043,968
Sales for resale	1,792,504	1,579,090
Interdepartmental	142,406	123,984
Total sales of electricity	<u>24,344,499</u>	<u>21,970,531</u>
Other operating revenues	1,289,385	1,280,148
Total operating revenues	<u>25,633,884</u>	<u>23,250,679</u>
Operating expenses:		
Production and generation:		
Fuel	5,182,276	5,288,726
Purchased power	2,660,981	2,145,982
Other	3,300,487	2,783,045
Transmission	800,577	948,671
Distribution	1,800,340	1,681,973
Depreciation and amortization	2,514,784	3,097,329
Customer accounts	647,114	624,574
Customer service and information expenses	365,479	344,531
Sales	70,063	83,304
Administrative and general (note 9)	4,571,719	4,318,590
Taxes other than income taxes	819,093	652,395
Total operating expenses	<u>22,732,913</u>	<u>21,969,120</u>
Operating income (loss)	<u>2,900,971</u>	<u>1,281,559</u>
Nonoperating revenues (expenses):		
Interest income (note 9)	711,606	535,205
Net increase (decrease) in the fair value of investments	(119,609)	(34,990)
Miscellaneous revenue (expense), net (note 9)	503,586	188,737
Interest expense on long-term debt	(525,051)	(442,911)
Interest expense on security deposits	(4,944)	(4,635)
Total nonoperating revenues (expenses)	<u>565,588</u>	<u>241,406</u>
Change in net assets	<u>3,466,559</u>	<u>1,522,965</u>
Net assets, beginning of year	<u>61,805,274</u>	<u>60,282,309</u>
Net assets, end of year	<u>\$ 65,271,833</u>	<u>\$ 61,805,274</u>

See accompanying notes to financial statements.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
 (A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 25,548,031	\$ 23,525,064
Cash paid to suppliers	(12,043,228)	(14,422,989)
Cash paid to employees	(2,686,399)	(2,623,467)
Payment in lieu of taxes to the City of Cedar Falls	(1,400,000)	(1,400,000)
Property tax paid	(370,108)	(285,922)
	<u>9,048,296</u>	<u>4,792,686</u>
Net cash provided by operating activities		
Cash flows from noncapital financing activities:		
Advance to affiliated utility	-	(181,779)
Proceeds from affiliated utility	181,779	384,196
Interest paid	(3,795)	(6,713)
	<u>177,984</u>	<u>195,704</u>
Net cash provided by noncapital financing activities		
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(745,000)	(749,738)
Proceeds from issuance of revenue bonds	-	9,865,834
Cost of issuance of revenue bonds	-	(55,250)
Proceeds from customer advances for construction	234,450	119,900
Refunds of customer advances for construction	(240,444)	(137,263)
Acquisition, construction and removal cost of capital assets	(13,183,137)	(3,656,378)
Proceeds from sale of capital assets	20,597	14,096
Reimbursement of utility construction costs	188,353	166,764
Interest paid	(762,517)	(415,557)
	<u>(14,487,698)</u>	<u>5,152,408</u>
Net cash provided by (used in) capital and related financing activities		
Cash flows from investing activities:		
Proceeds from repayment of loan by associated utility	471,500	310,000
Loan to associated utility	-	(161,500)
Proceeds from maturities of investment securities	18,486,000	25,005,000
Purchase of investment securities	(14,839,927)	(39,015,000)
Interest received	652,578	477,744
	<u>4,770,151</u>	<u>(13,383,756)</u>
Net cash provided by (used in) investing activities		
Net decrease in cash and cash equivalents	(491,267)	(3,242,958)
Cash and cash equivalents, beginning of year	<u>4,380,648</u>	<u>7,623,606</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 3,889,381</u>	<u>\$ 4,380,648</u>

See accompanying notes to financial statements.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows, Continued

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 2,900,971	\$ 1,281,559
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization of capital assets	2,514,784	3,097,329
Other income related to operating activities	503,586	188,737
(Increase) decrease in accounts receivable	(629,594)	59,971
(Increase) decrease in inventories	(578,018)	564,336
Increase in prepayments and other	(506,354)	(3,160)
Decrease in other assets	26,862	21,889
Increase (decrease) in accounts payable	1,962,493	(942,967)
Increase (decrease) in accrued wages and vacation	82,191	(114,143)
Decrease in reserve for surplus declaration	(200,000)	-
Increase (decrease) in other accrued expenses	12,845	(50,931)
Increase in other liabilities	<u>2,958,530</u>	<u>690,066</u>
Net cash provided by operating activities	<u>\$ 9,048,296</u>	<u>\$ 4,792,686</u>

See accompanying notes to financial statements.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Electric Utility (Utility) of the City of Cedar Falls, Iowa is a component unit of the City of Cedar Falls, Iowa. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

The Utility's present capacity consists of one wholly owned and two jointly owned coal-fired plants with a combined generating capacity of 88 megawatts. The Utility owns two wholly owned combustion turbines with a generating capacity of 53 megawatts. The Utility also owns 1.5 megawatts of generating capacity in a jointly owned wind turbine facility. The Utility owns a total of 142.5 megawatts of generating capacity.

The Utility, as a regulated utility, follows the Code of Federal Regulations Title 18-Conservation of Power and Water Resources, Chapter I-Federal Energy Regulatory Commission, Department of Energy.

In accordance with the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Utility applies only Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins issued on or before November 30, 1989.

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 4.63% in 2004 and 2003. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets.

The range of estimated service lives for the classes of capital assets are as follows: land improvements - 30 years, infrastructure - 10 to 150 years, buildings and improvements - 20 to 55 years, and equipment - 5 to 25 years. The depreciation provisions were equivalent to an overall composite rate of 2.8% and 3.6% of depreciable assets for 2004 and 2003, respectively.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred. At the time capital assets are retired, the original cost of the asset plus cost of removal less salvage are charged to accumulated depreciation.

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(c) Cash and Investments

The Utility's deposits at December 31 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 depositories to ensure there will be no loss of public funds.

Investments are stated at their fair value on the balance sheets. The Utility's investments stated at fair value reflect quoted market prices at the balance sheet date, for U.S. Treasury and government agency debt securities. The cost of certificates of deposit approximates fair value.

The Utility considers all highly liquid investments with maturity of three months or less at purchase to be cash equivalents for purposes of the statements of cash flows. Included in cash and cash equivalents at December 31, 2004 was \$500,000 for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

The Utility's cash and cash equivalents can be identified on the balance sheets as follows:

	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents	\$2,110,505	\$3,861,603
Restricted - cash	<u>1,778,876</u>	<u>519,045</u>
	<u>\$3,889,381</u>	<u>\$4,380,648</u>

(d) Inventories

Coal and oil inventories are valued at average cost. Materials and supplies are valued at average cost. Inventories are recorded as an expenditure at the time individual inventory items are consumed.

(e) Operating Revenues and Expenses

Operating revenues include revenues resulting from the sale of electricity, service revenues and sales of capacity. Operating expenses include expenses for power production, transmission, distribution, depreciation, customer accounts, customer service and informational, sales, and administrative and general. Nonoperating revenues and expenses include those derived from capital and related financing activities, noncapital financing activities and investing activities.

Revenues from the sale of electricity are based on billing rates, which are applied to customers' consumption of electricity. The Utility records estimated unbilled revenue, including amounts to be billed under a fuel adjustment clause, at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2004 and 2003, were \$805,822, and \$278,676, respectively, and are recorded in customer accounts receivable. The Utility uses a fuel adjustment clause whereby increases or decreases in fuel costs are billed to customers and included in operating revenue without changing base rates charged to its customers.

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(f) Bond Issue Costs

Unamortized bond issue costs are amortized over the life of the bonds using the effective interest method.

(g) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets and increased by unspent debt proceeds of this capital related debt. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

The Utility's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

The Utility uses a pooled cash account with affiliated utilities. Activity between utilities that are representative of lending/borrowing arrangements due to cash overdrafts in certain affiliated utilities at the end of the year are referred to as "due to/due from affiliated utilities".

(h) Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

(2) Restricted Assets

Restricted assets represent monies set aside under the terms of the bond resolutions relating to the Series 1999A, 1999B, and 2003 revenue bonds. In accordance with the covenants of the bond resolutions, monies are also segregated into various funds. The composition of these funds as of December 31 was as follows:

	<u>2004</u>	<u>2003</u>
Current assets - restricted:		
Bond reserve fund	\$ 1,500	\$ 739,962
Bond and interest fund	126,957	127,100
Construction fund	<u>1,650,419</u>	<u>(348,017)</u>
Restricted-cash	<u>1,778,876</u>	<u>519,045</u>
Noncurrent assets - restricted:		
Improvement and extension fund	1,000,000	1,000,000
Bond reserve fund	1,373,994	730,000
Construction fund	<u>3,249,000</u>	<u>8,300,000</u>
Restricted noncurrent investments	<u>5,622,994</u>	<u>10,030,000</u>
Total restricted assets	<u>\$ 7,401,870</u>	<u>\$10,549,015</u>

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(2) Restricted Assets, Continued

The monies deposited into the various funds have been invested in interest-bearing securities as required by the bond resolutions. Amounts deposited in the above funds may only be used for the purpose of paying principal and interest on the bonds when due or such other purposes as set forth in the bond resolutions and as a result are classified as restricted.

(3) Investments

The Utility is authorized by statute to invest public funds not currently needed for operating expenses 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 Board of Trustees, 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 Utility classifies its investments (including those presented as cash equivalents) into categories, which present an indication of the level of credit risk in relation to the nature of the investment and the custodial provisions. Category 1 securities are insured, registered, held by the Utility, or held by the Utility's agent in the Utility's name. Category 2 denotes uninsured and unregistered securities that are held by counterparty's trust department or agent in the Utility's name. Category 3 specifies uninsured and unregistered securities that are held by counterparty's trust department or agent in other than the Utility's name. Investments in IPAIT are not subject to risk categorization. Investments in IPAIT are recorded with cash and cash equivalents. The Utility's investments are classified as follows at December 31, 2004 and 2003 and carrying value equals fair value:

<u>Investment</u>	<u>Category</u>	<u>2004</u>	<u>2003</u>
Certificates of deposit	1	\$11,734,000	\$13,788,000
U.S. government and agency securities	2	<u>11,220,055</u>	<u>9,933,139</u>
		<u>\$22,954,055</u>	<u>\$26,721,139</u>

The Utility's investments can be identified on the balance sheets as follows:

	<u>2004</u>	<u>2003</u>
Current assets:		
Investments	\$ 7,579,469	\$ 7,485,000
Noncurrent investments:		
Restricted	5,622,994	10,030,000
Unrestricted	<u>9,751,592</u>	<u>9,206,139</u>
	<u>\$22,954,055</u>	<u>\$26,721,139</u>

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2004 and 2003 follows:

<u>2004</u>	<u>Beginning Balance</u>	<u>Additions and Transfers In</u>	<u>Deletions and Transfers Out</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 830,431	\$ 201,251	\$ 39,979	\$ 991,703
Construction work in progress	<u>2,192,830</u>	<u>13,617,734</u>	<u>4,692,036</u>	<u>11,118,528</u>
Total capital assets, not being depreciated	<u>3,023,261</u>	<u>13,818,985</u>	<u>4,732,015</u>	<u>12,110,231</u>
Capital assets, being depreciated:				
Land improvements	4,683	-	-	4,683
Infrastructure	71,702,410	2,856,219	310,547	74,248,082
Buildings and improvements	10,799,268	93,100	8,626	10,883,742
Equipment	<u>13,227,578</u>	<u>1,541,466</u>	<u>348,742</u>	<u>14,420,302</u>
Total capital assets, being depreciated	<u>95,733,939</u>	<u>4,490,785</u>	<u>667,915</u>	<u>99,556,809</u>
Less accumulated depreciation	(56,422,028)	(2,775,705)	(595,978)	(58,601,755)
Total capital assets, being depreciated, net	<u>39,311,911</u>	<u>1,715,080</u>	<u>71,937</u>	<u>40,955,053</u>
Capital assets, net	<u>\$42,335,172</u>	<u>\$15,534,065</u>	<u>\$4,803,952</u>	<u>\$53,065,285</u>
<u>2003</u>				
Capital assets, not being depreciated:				
Land	\$ 830,431	\$ -	\$ -	\$ 830,431
Construction work in progress	<u>643,947</u>	<u>3,865,960</u>	<u>2,317,077</u>	<u>2,192,830</u>
Total capital assets, not being depreciated	<u>1,474,378</u>	<u>3,865,960</u>	<u>2,317,077</u>	<u>3,023,261</u>
Capital assets, being depreciated:				
Land improvements	4,683	-	-	4,683
Infrastructure	70,797,666	1,296,323	391,579	71,702,410
Buildings and improvements	10,685,118	119,637	5,487	10,799,268
Equipment	<u>12,437,925</u>	<u>920,826</u>	<u>131,173</u>	<u>13,227,578</u>
Total capital assets, being depreciated	<u>93,925,392</u>	<u>2,336,786</u>	<u>528,239</u>	<u>95,733,939</u>
Less accumulated depreciation	(53,454,678)	(3,309,995)	342,645	(56,422,028)
Total capital assets, being depreciated, net	<u>40,470,714</u>	<u>(973,209)</u>	<u>185,594</u>	<u>39,311,911</u>
Capital assets, net	<u>\$41,945,092</u>	<u>\$2,892,751</u>	<u>\$2,502,671</u>	<u>\$42,335,172</u>

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2004 and 2003 was as follows:

	Beginning	Additions	Reductions	Ending	Amounts Due Within
2004	Balance			Balance	One Year
Series 1999A revenue bonds	\$ 3,925,000	\$ -	\$ 325,000	\$ 3,600,000	\$350,000
Series 1999B revenue bonds	2,075,000	-	185,000	1,890,000	195,000
Series 2003 revenue bonds	10,000,000	-	235,000	9,765,000	240,000
Unamortized discount on revenue bonds	(133,621)	-	(16,997)	(116,624)	-
Installment payment agreement	-	-	-	-	-
	<u>15,866,379</u>	<u>-</u>	<u>728,003</u>	<u>15,138,376</u>	<u>\$785,000</u>
Current installments of long-term debt	(745,000)	(40,000)	-	(785,000)	
Long-term debt, less current installments	<u>15,121,379</u>	<u>(40,000)</u>	<u>728,003</u>	<u>14,353,376</u>	
Customer advances for construction	133,944	234,450	240,444	127,950	
Other liabilities:					
Landfill closure	477,819	-	-	477,819	
Severance	294,146	278,798	-	572,944	
Contract payable	395,920	2,679,732	-	3,075,652	
Noncurrent liabilities	<u>1,301,829</u>	<u>3,192,980</u>	<u>240,444</u>	<u>4,254,365</u>	
Total noncurrent liabilities	<u>\$16,423,208</u>	<u>\$3,152,980</u>	<u>\$ 968,447</u>	<u>\$18,607,741</u>	
2003					
Series 1999A revenue bonds	\$4,230,000	\$ -	\$ 305,000	\$ 3,925,000	\$325,000
Series 1999B revenue bonds	2,250,000	-	175,000	2,075,000	185,000
Series 2003 revenue bonds	-	10,000,000	-	10,000,000	235,000
Unamortized discount on revenue bonds	-	(134,166)	(545)	(133,621)	-
Installment payment agreement	269,738	-	269,738	-	-
	<u>6,749,738</u>	<u>9,865,834</u>	<u>749,193</u>	<u>15,866,379</u>	<u>\$745,000</u>
Current installments of long-term debt	(749,738)	-	(4,738)	(745,000)	
Long-term debt, less current installments	<u>6,000,000</u>	<u>9,865,834</u>	<u>744,455</u>	<u>15,121,379</u>	
Customer advances for construction	151,307	119,900	137,263	133,944	
Other liabilities:					
Landfill closure	477,819	-	-	477,819	
Severance	-	294,146	-	294,146	
Contract payable	-	395,920	-	395,920	
Noncurrent liabilities	<u>629,126</u>	<u>809,966</u>	<u>137,263</u>	<u>1,301,829</u>	
Total noncurrent liabilities	<u>\$6,629,126</u>	<u>\$10,675,800</u>	<u>\$ 881,718</u>	<u>\$16,423,208</u>	

During 2003, the Utility issued \$10,000,000 of Series 2003 revenue bonds for the purpose of paying costs of improvements and extensions to the Utility, including the construction of generation and related transmission facilities to serve the Utility. The bonds mature in 2023 and interest rates throughout the term of the bonds are in a range between 3.25% and 4.50%.

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(5) Noncurrent Liabilities, Continued

The Series 1999A, 1999B, and 2003 revenue bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds are in a range between 3.25% and 7.125%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

Year	Series 1999A		Series 1999B		Series 2003	
	Principal Amount	Interest Amount	Principal Amount	Interest Amount	Principal Amount	Interest Amount
2005	\$ 350,000	\$ 255,874	\$ 195,000	\$ 92,463	\$ 240,000	\$ 390,150
2006	375,000	231,024	205,000	83,200	245,000	382,350
2007	400,000	204,399	215,000	73,463	250,000	374,388
2008	430,000	175,998	225,000	63,142	255,000	366,262
2009-2013	2,045,000	376,552	1,050,000	135,330	1,665,000	1,697,150
2014-2018	-	-	-	-	3,150,000	1,260,412
2019-2023	-	-	-	-	3,960,000	542,510
	<u>\$3,600,000</u>	<u>\$1,243,847</u>	<u>\$1,890,000</u>	<u>\$ 447,598</u>	<u>\$9,765,000</u>	<u>\$5,013,222</u>

The bond resolution provides certain covenants relating to the collection, segregation, and distribution of revenues from customers; places certain restrictions on future borrowing and leasing or disposition of assets; and requires that minimum insurance coverage be maintained.

Iowa Administrative Code rule 567-103.2(13) requires the Utility to place a final cover on its Leverage Road ash landfill site when it is closed and thereupon to have in place surveying monuments and an approved groundwater monitoring system. Iowa Administrative Code rule 567-103.2(14) requires the Utility to maintain the final cover, monitor ground water, and file reports with the Iowa Department of Natural Resources for thirty years following closure of the site. Although closure and post closure costs are paid only near or after the date that the landfill is closed, the Utility reports a portion of these closure and post closure costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. The \$477,819 reported as landfill closure and post closure care liability at December 31, 2004, represents the cumulative amount reported to date based on the use of 100% of the estimated capacity of the landfill. This is based on what it would cost to perform all closure and post closure care in 2005. The Utility expects to close the landfill no earlier than the year 2005. Actual costs may be higher due to inflation, changes in technology, or changes in regulations.

(6) Pension Plan

The Utility contributes to the Iowa Public Employees Retirement System, (IPERS) 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 IPERS, P.O. Box 9117, Des Moines, Iowa 50306-9117.

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(6) Pension Plan, Continued

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2004, 2003, and 2002 were \$272,558; \$248,500; and \$239,143; respectively, equal to the required contributions for each year.

(7) Income Tax Status

The Utility is exempt from federal and state income taxes under the applicable tax codes.

(8) Jointly-Owned Capital Assets

The Utility's share of jointly owned electric facilities at December 31, 2004 and 2003 is reflected in the following table. These facilities provide approximately 27% of the Utility's total generating capacity. The Utility is required to provide financing for its share of the facilities. The Utility's share of expenses associated with these facilities is included with the appropriate operating expenses in the statements of revenues, expenses and changes in net assets.

Facility	Capital Assets, Net			
	Percentage ownership	Capacity MW	2004	2003
Council Bluffs #3	3.1%	20.9	\$4,064,829	\$4,374,793
Neal #4	2.5	15.6	2,233,048	2,571,376
Iowa Distributed Wind Generation Project	65.8	1.5	917,916	961,000

(9) Related Party Transactions

The Utility uses a pooled cash account with affiliated utilities. Activity between utilities that are representative of lending/borrowing arrangements due to cash overdrafts in certain affiliated utilities at the end of the year are referred to as "due to/due from affiliated utility". At December 31, 2004 and 2003, the Utility had a due from affiliated utility of \$0.00 and \$181,779, respectively, under this agreement.

The Utility makes payments in lieu of taxes upon approval by the Board of Trustees to the City of Cedar Falls, Iowa. Expenses for 2004 and 2003 were \$1,200,000 and \$1,400,000, respectively, which were recorded in administrative and general expenses. Subsequent to December 31, 2004, the Utility's Board of Trustees approved a payment of \$1,200,000 related to payments in lieu of taxes for 2004.

In addition, the Utility provides electric service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$571,764 and \$478,584 in 2004 and 2003, respectively.

The Electric Utility has extended a loan to the Municipal Communications Utility of the City of Cedar Falls (Communications Utility), with an outstanding balance of \$3,093,090 and \$3,403,090 as of December 31, 2004 and 2003, respectively. Interest accrues on the loan at 3.10% and is paid semi-annually during January and July. Semi-annual principal payments continue through 2016. Accrued interest receivable was \$50,606 and \$55,585 at December 31, 2004 and 2003, respectively. Interest income for the years ended December 31, 2004 and 2003 was \$103,066 and \$112,665 respectively.

(Continued)

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(9) Related Party Transactions, Continued

During 2003, the Electric Utility extended a loan to the Municipal Gas Utility of the City of Cedar Falls (Gas Utility), with an outstanding balance of \$161,500 as of December 31, 2003. Interest accrues on the loan at 3.10%. Principal and interest were paid at maturity, July 2004. Accrued interest receivable was \$-0- and \$3,196 at December 31, 2004 and 2003, respectively. Interest income for the years ended December 31, 2004 and 2003 was \$2,496 and \$3,196, respectively.

For the years ended December 31, 2004 and 2003, the Utility earned a management fee of \$67,510 from the Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous nonoperating revenue.

(10) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and the participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,013,300 in aggregate for all participants and have insurance for claims above this amount.

Liabilities of the risk management account are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an estimated amount for claims that have been incurred but not reported (IBNR) which represent estimates of the eventual loss on claims arising prior to year-end. Changes in the balances of claims liabilities during the past two years are as follows:

	<u>2004</u>	<u>2003</u>
Unpaid claims, beginning of year	\$ 112,350	\$ 181,700
Current year claims and changes in estimates	1,593,270	1,149,399
Claim payments	<u>(1,543,395)</u>	<u>(1,218,749)</u>
Unpaid claims, end of year	<u>\$ 162,225</u>	<u>\$ 112,350</u>

The Utility has recorded \$94,090 and \$66,287 in accounts payable for its share of these unpaid claims at December 31, 2004 and 2003, respectively.

The Utilities are a member of the Iowa Municipalities Workers' Compensation Association (the Association), which was established to provide members a group self-insurance program for their workers' compensation liabilities. Approximately 470 governmental entities participate in the Association. A board of trustees consisting of seven members is elected by the members participating in the Association to manage and conduct the business and affairs of the Association.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(10) Risk Management, Continued

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2004.

Cash and cash equivalents and investments	\$22,960,768
Receivables	814,103
Other assets	668,545
Total assets	<u>\$24,443,416</u>
Total liabilities	18,559,769
Total equity	5,883,647
Total liabilities and equity	<u>\$24,443,416</u>
Total revenues	663,637
Total expenses	2,425,524
Distribution to members	-
Net decrease in equity	<u>\$ (1,761,887)</u>

There have been no instances where the amount of settlement has exceeded available coverage in the past three years. There has been no significant reduction in insurance coverage from coverage in the prior year.

(11) Commitments and Contingencies

The Utility jointly owns the Council Bluffs #3 generating unit and the Neal #4 generating unit (see note 8). Coal procurements are made by the agent for the joint owners on a system portfolio basis, which are a mix of 1, 2, and 3-year purchases to minimize risk. The Utility is obligated to purchase at least the annual amount of coal to operate the Utility's share at minimum load. The Utility's share of coal purchases for the years 2004 and 2003 were \$1,995,851 and \$1,926,908, respectively.

On July 29, 2002, the Board of Trustees approved the joint ownership agreement for the construction and operation of the Council Bluffs Energy Center Unit 4. The Utility will become a 2.02% owner which is approximately 15.97 megawatts. The Utility's total estimated cost to construct is \$25 million. Preliminary design work was started in 2003 with operations expected to begin in 2007.

The Utility is a party to various lawsuits arising in the normal course of business. The Utility believes the resolutions will not have a material adverse impact on its financial operations and net assets.

As of December 31, 2004, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$4,924,546.

(12) Subsequent Events

Effective January 1, 2005, the Board of Trustees approved a general electric rate increase. The average rate increase is approximately 5.0% for all of the customer classes with each rate increase for a customer class varying.

(Continued)



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**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 Board of Trustees
Cedar Falls Utilities – Municipal Electric Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Electric Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2004 and 2003, and have issued our report thereon dated March 30, 2005. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted a certain immaterial instance of non-compliance that is described in Part II of the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2004, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the 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.

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Utility in a separate letter dated March 30, 2005. There were no prior year reportable conditions.

This report, a public record by law, is intended solely for the information and use of the officials, employees, and the customers of the Utility and other parties to whom the Utility 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 Utility 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.

Eide Sallly LLP

Dubuque, Iowa
March 30, 2005

**CEDAR FALLS UTILITIES – MUNICIPAL ELECTRIC UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

Part I: Summary of the Independent Auditor's Results:

- (a) An unqualified opinion was issued on the financial statements.
- (b) No material weaknesses in internal control over financial reporting were noted.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

Part II: Other Findings Related to Statutory Reporting:

- II-A-04 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2004.
- II-B-04 Certified Budget - Disbursements during the year ended December 31, 2004, did not exceed the amounts budgeted.
- II-C-04 Questionable Expenditures - We noted no expenditures that we believe may 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 Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-04 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-04 Bond Coverage - Surety bond coverage of Utility 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 Board Minutes - No transactions were found that we believe should have been approved in the Board 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 Utility's investment policy were noted.
- II-I-04 Revenue Bonds - We noted no instances of non-compliance with the provisions of the Utility's revenue bond resolutions.

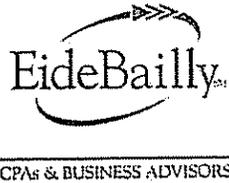
**CEDAR FALLS UTILITIES – MUNICIPAL ELECTRIC UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

II-J-04 Notice of Public Hearing – Notice of public hearing for public improvements with a total cost to the Utility of \$25,000 or more is to be published not less than four nor more than twenty days prior to the public hearing in accordance with Chapters 384.102 and 362.3 of the Code of Iowa. We noted several notices of public hearing that were published more than twenty days prior to the public hearing.

Recommendation – We recommend that the Utility examine the procedures in place regarding publication of notice of public hearing to ensure that they are in compliance with the requirements of the Code of Iowa in the future.

Response – We will change the process we have been using of counting clear days for notices. Going forward, we will count calendar days but not include the day of publication.

Conclusion – Response accepted.



INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Cedar Falls Utilities – Municipal Gas Utility

We have audited the accompanying balance sheets of the Municipal Gas Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2005, on our consideration of the 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 audits.

The management's discussion and analysis on pages 1 through 4 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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. However, we did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

March 30, 2005
Dubuque, Iowa

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MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Our discussion and analysis of the Municipal Gas Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2004 and 2003. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

Financial Highlights

- The Utility's net assets increased as a result of operations in 2004 and 2003. At December 31, 2004 and 2003, total assets were \$20,266,152 and \$21,054,557, respectively, and total liabilities were \$5,302,085 and \$6,170,882, respectively, resulting in net assets of \$14,964,067 and \$14,883,675, respectively.
- Operating revenues decreased 2.6 percent to \$14,883,766 while operating expenses increased 6.7 percent to \$14,779,740 in 2004. Operating revenues increased 27.2 percent to \$15,283,494 while operating expenses increased 25.5 percent to \$13,853,097 in 2003.
- During the year, the Utility had operating income of \$104,026. This compares to last year, when the Utility had operating income of \$1,430,397.

Overview of the Financial Statements

Management's discussion and analysis (MD&A) serves as an introduction to the financial statements, and the MD&A represents management's examination and analysis of the Utility's financial condition and performance. The financial statements report information about the Utility using full accrual accounting methods as utilized by similar entities in the private sector.

The balance sheets include the Utility's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the Utility and assessing the liquidity and flexibility of the Utility.

The statements of revenues, expenses and changes in net assets present the results of the Utility's activities (revenues and expenses) over the course of the fiscal year and can provide information about the Utility's recovery of its costs. Retail rates to purchase gas are based on rates established by the Board of Trustees based on operating costs, debt service requirements, and anticipated capital needs. A fundamental objective of this rate model is to provide adequate revenue to cover all expenses.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

The statements of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, capital and related financing activities and investing activities. This statement provides answers to such questions as where did the cash come from, what was cash used for, and what was the change in cash balances during the reporting period.

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of data provided in the statements. The notes present information about the Utility's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events.

Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring and planning.

Condensed Balance Sheet Information

	<u>2004</u>	<u>2003</u>
Current assets	\$ 8,260,068	\$ 9,375,634
Capital assets, net	10,800,847	10,467,493
Other noncurrent assets	<u>1,205,237</u>	<u>1,211,430</u>
Total assets	<u>\$20,266,152</u>	<u>\$21,054,557</u>
Current liabilities	3,198,925	3,670,553
Noncurrent liabilities	283,935	185,436
Long-term debt	<u>1,819,225</u>	<u>2,314,893</u>
Total liabilities	<u>\$ 5,302,085</u>	<u>\$ 6,170,882</u>
Invested in capital assets, net of related debt	8,481,622	8,127,600
Restricted	1,199,431	1,054,117
Unrestricted	<u>5,283,014</u>	<u>5,701,958</u>
Total net assets	<u>\$14,964,067</u>	<u>\$14,883,675</u>

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Sales of gas	\$14,856,834	\$15,265,110
Other	<u>26,932</u>	<u>18,384</u>
Total operating revenues	<u>14,883,766</u>	<u>15,283,494</u>
System operation and maintenance	12,105,153	11,514,682
Depreciation	600,068	588,297
Service and administrative	<u>2,074,519</u>	<u>1,750,118</u>
Total operating expenses	<u>14,779,740</u>	<u>13,853,097</u>
Operating income	<u>104,026</u>	<u>1,430,397</u>
Interest income	69,521	62,262
Other, net	<u>(93,155)</u>	<u>53,134</u>
Total nonoperating revenues (expenses)	<u>(23,634)</u>	<u>115,396</u>
Change in net assets	80,392	1,545,793
Net assets, beginning of year	<u>14,883,675</u>	<u>13,337,882</u>
Net assets, end of year	<u>\$14,964,067</u>	<u>\$14,883,675</u>

Financial Analysis

Current assets decreased 11.9 percent in 2004 primarily as the result of the following: cash and investments increased 35.4 percent as a result of approximately \$540,000 more cash provided by operating activities; reduction of accounts receivable of 15.7 percent; use of natural gas purchase options totaling approximately \$55,000 during 2004 and no options available at December 31, 2004.

Noncurrent liabilities increased 53.1 percent in 2004 primarily due to the recording of accrued retirement insurance benefits totaling approximately \$71,380 that employees are entitled to receive upon retirement with 20 years of continuous service; and an increase in customer advances for construction of 8.8 percent.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Sales of gas decreased 2.7 percent in 2004 primarily due to the rate restructuring and reduction effective January 1, 2004, with an overall effect of -5.0 percent; and the increase in the average PGA of \$.83 per mcf. The average PGA was \$4.23 per mcf and \$3.40 per mcf during 2004 and 2003, respectively. The \$.83 per mcf increase is approximately \$1,235,000 more revenue.

System operation and maintenance expenses increased 5.1 percent in 2004 primarily due to the increase in wholesale gas costs. This is reflected in the \$.83 per mcf increase in the average PGA from 2003 to 2004 and the increase in natural gas purchased of approximately \$1,033,283. System operation and maintenance expenses also increased due to the change in the fuel cost to be recovered from customers. The change in fuel cost to be recovered represents an additional expense or reduction in expense. The amount of the change in fuel cost to be recovered from December 31, 2003 to December 31, 2004 is a decrease in expense of approximately \$151,614. Also, the recording of accrued retirement insurance benefits resulted in an increase of approximately \$42,600 to system operation and maintenance expenses.

Interest income increased 11.7 percent in 2004 primarily due to a 14.7 percent increase in cash and cash equivalents that resulted in an increase in checking interest income. Although, the arbitrage rebate of interest income to the IRS of \$19,642 for excess earnings on the bond reserve fund for the 1994 Gas Revenue Bonds refunded in 2003 decreased interest income in 2004.

Other nonoperating revenues and expenses, net decreased \$146,289 in 2004 primarily due to the gain on disposition of the propane gas equipment of approximately \$177,000 in 2003. Interest expense decreased 14.1 percent from 2003 to 2004 since the redemption of the 1994 revenue bonds related interest accruals.

Capital Assets and Debt Administration

Net capital assets represent 53.3 percent of total assets for the Utility. Net capital assets increased 3.2 percent from the prior year primarily due to the carryover of several large projects. Additional detail on the change in capital assets can be found in Note 4.

On May 13, 2003, the Utility expended \$1,041,542 for the redemption of the outstanding series 1994 revenue bonds and related accrued interest. The Utility used their own funds, as well as, the proceeds of a loan from the Municipal Electric Utility in the amount of \$161,500 to extinguish the debt. During 2004 the outstanding balance of \$161,500 was paid to the Municipal Electric Utility. Additional detail on the redemption can be found in Note 5.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
 (A Component Unit of the City of Cedar Falls, Iowa)

Balance Sheets

December 31, 2004 and 2003

<u>Assets</u>	<u>2004</u>	<u>2003</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 16,473,574	\$ 15,956,691
Less accumulated depreciation	<u>6,102,294</u>	<u>5,549,813</u>
	10,371,280	10,406,878
Construction work in progress	<u>429,567</u>	<u>60,615</u>
Net capital assets	<u>10,800,847</u>	<u>10,467,493</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Restricted (note 2)	949,431	950,097
Unrestricted	<u>248,575</u>	<u>250,938</u>
Total noncurrent investments	<u>1,198,006</u>	<u>1,201,035</u>
Current assets:		
Cash and cash equivalents (note 1)	3,885,854	3,490,284
Investments (note 3)	766,069	685,569
Receivables:		
Customer accounts, less allowance for doubtful		
accounts of \$20,232 in 2004 and \$22,300 in 2003	3,025,508	3,320,062
Trade	65,234	1,441,706
Notes	-	24,126
Interest	22,257	13,032
Inventories:		
Material and supplies	131,395	124,837
Prepayments and other	41,035	98,533
Restricted - cash (note 2)	<u>322,716</u>	<u>177,485</u>
Total current assets	<u>8,260,068</u>	<u>9,375,634</u>
Deferred costs:		
Deferred costs	<u>7,231</u>	<u>10,395</u>
Total assets	<u>\$ 20,266,152</u>	<u>\$ 21,054,557</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2004</u>	<u>2003</u>
Long-term debt, less current installments (note 5)	\$ 1,819,225	\$ 2,314,893
Current liabilities:		
Accounts payable	2,201,795	3,212,028
Reserve for surplus declaration (note 9)	200,000	-
Notes payable	-	161,500
Accrued wages and vacations	161,671	129,865
Accrued interest	72,716	76,662
Other accrued expenses	62,743	65,498
Current installments of long-term debt (note 5)	500,000	25,000
Total current liabilities	<u>3,198,925</u>	<u>3,670,553</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	78,651	72,303
Other liabilities	205,284	113,133
Total noncurrent liabilities	<u>283,935</u>	<u>185,436</u>
 Total liabilities	 <u>5,302,085</u>	 <u>6,170,882</u>
 <u>Net Assets</u>		
Invested in captial assets, net of related debt	8,481,622	8,127,600
Restricted - bond indentures (note 2)	1,199,431	1,054,117
Unrestricted	5,283,014	5,701,958
Total net assets	<u>14,964,067</u>	<u>14,883,675</u>
 Total liabilities and net assets	 <u>\$ 20,266,152</u>	 <u>\$ 21,054,557</u>

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
 (A Component Unit of the City of Cedar Falls, Iowa)

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Sales of gas:		
Residential	\$ 8,693,179	\$ 9,830,813
Industrial	1,583,616	1,467,049
Commercial	3,574,998	3,119,989
Governmental (note 8)	873,009	725,954
Interdepartmental	132,032	121,305
Total sales of gas	<u>14,856,834</u>	<u>15,265,110</u>
Other operating revenues	26,932	18,384
Total operating revenues	<u>14,883,766</u>	<u>15,283,494</u>
Operating expenses:		
Production:		
Natural gas purchased for resale	11,144,540	10,262,870
Other	26,780	219,722
Distribution	933,833	1,032,090
Depreciation	600,068	588,297
Customer accounts	375,138	370,131
Customer service and information expenses	44,680	52,239
Sales	21,063	22,304
Administrative and general (note 8)	1,524,114	1,195,170
Taxes other than income taxes	109,524	110,274
Total operating expenses	<u>14,779,740</u>	<u>13,853,097</u>
Operating income (loss)	<u>104,026</u>	<u>1,430,397</u>
Nonoperating revenues (expenses):		
Interest income	69,521	62,262
Net increase (decrease) in the fair value of investments	(2,363)	938
Miscellaneous revenue (expense), net (note 8)	60,703	228,537
Interest expense on long-term debt	(151,495)	(176,341)
Total nonoperating revenues (expenses)	<u>(23,634)</u>	<u>115,396</u>
Change in net assets	80,392	1,545,793
Net assets, beginning of year	<u>14,883,675</u>	<u>13,337,882</u>
Net assets, end of year	<u>\$ 14,964,067</u>	<u>\$ 14,883,675</u>

See accompanying notes to financial statement.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 16,696,834	\$ 15,527,481
Cash paid to suppliers	(13,936,662)	(11,571,025)
Cash paid to employees	(938,313)	(1,068,551)
Net cash provided by operating activities	<u>1,821,859</u>	<u>2,887,905</u>
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(186,500)	(1,050,000)
Proceeds from note payable to affiliated utility	-	161,500
Proceeds from customer advances for construction	61,005	43,515
Refunds of customer advances for construction	(54,657)	(48,520)
Acquisition, construction and removal cost of capital assets	(934,675)	(559,337)
Proceeds from sale of capital assets	1,054	181,049
Reimbursement of utility construction costs	4,876	4,085
Interest paid	(172,265)	(187,530)
Net cash used in capital and related financing activities	<u>(1,281,162)</u>	<u>(1,455,238)</u>
Cash flows from investing activities:		
Proceeds from maturities of investment securities	1,977,186	2,388,966
Purchase of investment securities	(2,057,019)	(2,225,666)
Interest received	79,937	63,600
Net cash provided by investing activities	<u>104</u>	<u>226,900</u>
Net increase in cash and cash equivalents	540,801	1,659,567
Cash and cash equivalents, beginning of year	<u>3,667,769</u>	<u>2,008,202</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 4,208,570</u>	<u>\$ 3,667,769</u>

See accompanying notes to financial statements.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows, Continued

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 104,026	\$ 1,430,397
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	600,068	588,297
Other expense related to operating activities	60,703	228,537
(Increase) decrease in accounts receivable	1,695,152	(10,330)
(Increase) decrease in inventories	(6,558)	168,213
(Increase) decrease in prepayments and other	57,498	(60,098)
Increase (decrease) in accounts payable	(1,010,233)	471,564
Increase (decrease) in accrued wages and vacation	31,806	(49,778)
Increase in reserve for surplus declaration	200,000	-
Increase (decrease) in accrued expenses	(2,754)	7,970
Increase (decrease) in other liabilities	<u>92,151</u>	<u>113,133</u>
Net cash provided by operating activities	<u>\$ 1,821,859</u>	<u>\$ 2,887,905</u>

See accompanying notes to financial statements.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Gas Utility (Utility) of the City of Cedar Falls, Iowa is a component unit of the City of Cedar Falls, Iowa. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

The Utility, as a regulated utility, follows the Code of Federal Regulations Title 18 - Conservation of Power and Water Resources, Chapter I - Federal Energy Regulatory Commission, Department of Energy.

In accordance with the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Utility applies only Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins issued on or before November 30, 1989.

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 5.74% in 2004 and 2003. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated services and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 15 to 65 years, buildings and improvements - 30 to 45 years, and equipment - 20 to 85 years. The depreciation provisions were equivalent to an overall composite rate of 3.8% and 3.6% of depreciable assets for 2004 and 2003, respectively.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred. At the time capital assets are retired, the original cost of the asset plus cost of removal less salvage are charged to accumulated depreciation.

(c) Cash and Investments

The Utility's deposits at December 31 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 ensure there will be no loss of public funds.

Investments are stated at their fair value on the balance sheets. The Utility's investments stated at fair value reflect quoted market prices at the balance sheet date, for U.S. Treasury and government agency debt securities. The cost of certificates of deposit approximates fair value.

The Utility considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents for purposes of the statement of cash flows. Included in cash and cash equivalents at December 31, 2004 and 2003 was \$500,000, respectively for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(Continued)

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(c) Cash and Investments, Continued

The Utility's cash and cash equivalents can be identified on the balance sheet as follows:

	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents	\$3,885,854	\$3,490,284
Restricted - cash	<u>322,716</u>	<u>177,485</u>
Total cash and cash equivalents	<u>\$4,208,570</u>	<u>\$3,667,769</u>

(d) Inventories

Materials and supplies are valued at average cost. Inventories are recorded as an expenditure at the time individual inventory items are consumed.

(e) Natural Gas Commodity Purchases

The Utility has entered into agreements with natural gas suppliers to purchase gas for resale to our customers. Purchases under these contracts are considered "normal purchases and sales" under SFAS No. 133 and are not marked-to-market.

(f) Operating Revenues and Expenses

Operating revenues include revenues resulting from the sale of gas and service revenues. Operating expenses include expenses for power production, distribution, depreciation, customer accounts, customer service and informational, sales, and administrative and general. Nonoperating revenues and expenses include those derived from capital and related financing activities, noncapital financing activities, and investing activities.

Revenues from the sale of gas are based on billing rates, which are applied to customers' consumption of gas. The Utility records estimated unbilled revenue, including amounts to be billed under a purchased gas adjustment clause, at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2004 and 2003 were \$1,509,415 and \$1,446,554, respectively, and are recorded in customer accounts receivable. The Utility uses a purchased gas adjustment clause whereby increases and decreases in fuel costs are billed to customers and included in operating revenue without changing base rates charged to its customers.

(g) Debt Discount and Bond Issue Costs

Unamortized debt discount and bond issue costs are amortized over the life of the bonds using the effective interest method.

(h) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

(Continued)

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(h) Net Assets, Continued

The Utility's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

(i) Estimates

The preparation of the financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

(2) Restricted Assets

Restricted assets represent monies set aside under the terms of the bond resolutions relating to the Series 1992 and Series 1994 revenue bonds. In accordance with the covenants of the bond resolutions, the monies are segregated into various funds. The composition of these funds as of December 31 was as follows:

	<u>2004</u>	<u>2003</u>
Current assets - restricted:		
Bond reserve fund	\$ -	\$ 91,519
Bond and interest fund	322,716	85,966
Restricted - cash	<u>322,716</u>	<u>177,485</u>
Noncurrent assets - restricted:		
Bond reserve fund	629,431	629,431
Improvement and extension fund	320,000	320,666
Restricted noncurrent investments	<u>949,431</u>	<u>950,097</u>
Total restricted assets	<u>\$1,272,147</u>	<u>\$1,127,582</u>

The monies deposited into the various funds have been invested in interest-bearing securities as required by the bond resolutions. Amounts deposited in the above funds may only be used for the purpose of paying principal and interest on the bonds when due or such other purposes as set forth in the bond resolutions and as a result are classified as restricted.

(3) Investments

The Utility is authorized by statute to invest public funds not currently needed for operating expenses 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 Board of Trustees, 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.

(Continued)

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(3) Investments, Continued

The Utility classifies its investments (including those presented as cash equivalents) into categories, which present an indication of the level of credit risk in relation to the nature of the investment and the custodial provisions. Category 1 securities are insured, registered, held by the Utility, or held by the Utility's agent in the Utility's name. Category 2 denotes uninsured and unregistered securities that are held by counterparty's trust department or agent in the Utility's name. Category 3 specifies uninsured and unregistered securities that are held by counterparty's trust department or agent in other than the Utility's name. Investments in IPAIT are not subject to risk categorization. Investments in IPAIT are recorded with cash and cash equivalents. The Utility's investments are classified as follows at December 31, 2004 and 2003 and carrying value equals fair value:

<u>Investment</u>	<u>Category</u>	<u>2004</u>	<u>2003</u>
Certificates of deposit	1	\$1,715,500	\$1,635,666
U.S. government and agency securities	2	248,575	250,938
		<u>\$1,964,075</u>	<u>\$1,886,604</u>

The Utility's investments can be identified on the balance sheets as follows:

	<u>2004</u>	<u>2003</u>
Current assets:		
Investments	\$ 766,069	\$ 685,569
Noncurrent investments:		
Restricted	949,431	950,097
Unrestricted	248,575	250,938
	<u>\$1,964,075</u>	<u>\$1,886,604</u>

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2004 and 2003 follows:

<u>2004</u>	<u>Beginning Balance</u>	<u>Additions and Transfers In</u>	<u>Deletions and Transfers Out</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 41,350	\$ -	\$ -	\$ 41,350
Construction work in progress	60,615	928,779	559,827	429,567
Total capital assets, not being depreciated	<u>101,965</u>	<u>928,779</u>	<u>559,827</u>	<u>470,917</u>
Capital assets, being depreciated:				
Infrastructure	14,744,195	505,249	38,271	15,211,173
Buildings and improvements	662,952	16,675	1,884	677,743
Equipment	508,194	37,903	2,789	543,308
Total capital assets being depreciated	<u>15,915,341</u>	<u>559,827</u>	<u>42,944</u>	<u>16,432,224</u>
Less accumulated depreciation	<u>(5,549,813)</u>	<u>(600,068)</u>	<u>47,587</u>	<u>(6,102,294)</u>
Total capital assets, being depreciated, net	<u>10,365,528</u>	<u>(40,241)</u>	<u>(4,643)</u>	<u>10,329,930</u>
Capital assets, net	<u>\$10,467,493</u>	<u>\$888,538</u>	<u>\$555,184</u>	<u>\$10,800,847</u>

(Continued)

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(4) Capital Assets, Continued

2003	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 41,350	\$ -	\$ -	\$ 41,350
Construction work in progress	21,622	362,260	323,267	60,615
Total capital assets, not being depreciated	<u>62,972</u>	<u>362,260</u>	<u>323,267</u>	<u>101,965</u>
Capital assets, being depreciated:				
Infrastructure	15,342,300	308,715	906,820	14,744,195
Buildings and improvements	682,652	2,145	21,845	662,952
Equipment	496,915	12,407	1,128	508,194
Total capital assets being depreciated	<u>16,521,867</u>	<u>323,267</u>	<u>929,793</u>	<u>15,915,341</u>
Less accumulated depreciation	<u>(5,902,253)</u>	<u>(588,297)</u>	<u>940,737</u>	<u>(5,549,813)</u>
Total capital assets, being depreciated, net	<u>10,619,614</u>	<u>(265,030)</u>	<u>(10,944)</u>	<u>10,365,528</u>
Capital assets, net	<u>\$10,682,586</u>	<u>\$ 97,230</u>	<u>\$312,323</u>	<u>\$10,467,493</u>

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2004 and 2003 was as follows:

2004	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 1992 revenue bonds	\$2,350,000	\$ -	\$ 25,000	\$2,325,000	\$500,000
Unamortized discount on revenue bonds	(10,107)	-	(4,332)	(5,775)	-
	<u>2,339,839</u>	<u>-</u>	<u>20,668</u>	<u>2,319,225</u>	<u>\$500,000</u>
Current installments of long-term debt	(25,000)	(475,000)	-	(500,000)	
Long-term debt, less current installments	2,314,893	(475,000)	20,668	1,819,225	
Customer advances for Construction	72,303	61,005	54,657	78,651	
Other liabilities:					
Severance	113,133	92,151	-	205,284	
Noncurrent liabilities	<u>185,436</u>	<u>153,156</u>	<u>54,657</u>	<u>283,935</u>	
Total noncurrent liabilities	<u>\$2,500,329</u>	<u>\$(321,844)</u>	<u>\$ 75,325</u>	<u>\$2,103,160</u>	

(Continued)

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(5) Noncurrent Liabilities, Continued

2003	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 1994 revenue bonds	\$1,025,000	\$ -	\$1,025,000	\$ -	\$ -
Series 1992 revenue bonds	2,375,000	-	25,000	2,350,000	25,000
Unamortized discount on revenue bonds	(13,828)	-	(3,721)	(10,107)	-
	<u>3,386,172</u>	<u>-</u>	<u>1,046,893</u>	<u>2,339,893</u>	<u>\$ 25,000</u>
Current installments of long-term debt	(530,000)	-	(505,000)	(25,000)	
Long-term debt, less current installments	<u>2,856,172</u>	<u>-</u>	<u>541,279</u>	<u>2,314,893</u>	
Customer advances for construction	77,308	43,515	48,520	72,303	
Other liabilities:					
Severance	-	113,133	-	113,133	
Noncurrent liabilities	77,308	156,648	48,520	185,436	
Total noncurrent liabilities	<u>\$2,933,480</u>	<u>\$ 156,648</u>	<u>\$ 589,799</u>	<u>\$2,500,329</u>	

The Series 1992 and 1994 revenue bonds require annual principal payments, due July 1, and semiannual interest payments, due January 1 and July 1. Interest rates throughout the term of the bonds are in a range between 4.3% and 6.375%. The bonds are secured by the future net revenues of the Utility. The bonds mature and bear interest as follows:

Year	Series 1992	
	Principal Amount	Interest Amount
2005	\$ 500,000	\$145,431
2006	550,000	114,931
2007	600,000	80,831
2008	675,000	43,032
	<u>\$2,325,000</u>	<u>\$384,225</u>

On May 13, 2003, the Utility expended \$1,041,542 for the redemption of the outstanding Series 1994 revenue bonds. The Utility used their own funds, as well as, the proceeds of a loan from the Electric Utility in the amount of \$161,500 to extinguish the debt.

The bond resolution provides certain covenants relating to the collection, segregation, and distribution of revenues from customers; places certain restrictions on future borrowing and leasing or disposition of assets; and requires that minimum insurance coverage be maintained.

(6) Pension Plan

The Utility contributes to the Iowa Public Employees Retirement System (IPERS), 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 IPERS, P.O. Box 9117, Des Moines, Iowa 50306-9117.

(Continued)

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(6) Pension Plan, Continued

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2004, 2003, and 2002 were \$93,064; \$90,526; and \$89,103; respectively, equal to the required contributions for each year.

(7) Income Tax Status

The Utility is exempt from federal and state income taxes under the applicable tax codes.

(8) Related Party Transactions

The Utility provides gas service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$132,216 and \$134,721 in 2004 and 2003, respectively.

For the years ended December 31, 2004 and 2003, the Utility earned a management fee of \$20,800 from the Municipal Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous nonoperating revenue.

During 2003, the Electric Utility extended a loan to the Municipal Gas Utility of the City of Cedar Falls (Gas Utility), with an outstanding balance of \$161,500 as of December 31, 2003. Interest accrues on the loan at 3.10%. Principal and interest were paid at maturity, July 2004. Accrued interest receivable was \$-0- and \$3,196 at December 31, 2004 and 2003, respectively. Interest income for the years ended December 31, 2004 and 2003 was \$2,496 and \$3,196, respectively.

(9) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,013,300 in aggregate for all participants and have insurance for claims above this amount.

Liabilities of the risk management account are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an estimated amount for claims that have been incurred but not reported (IBNR) which represent estimates of the eventual loss on claims arising prior to year-end. Changes in the balances of claims liabilities during the past two years are as follows:

	<u>2004</u>	<u>2003</u>
Unpaid claims, beginning of year	\$ 112,350	\$ 181,700
Current year claims and changes in estimates	1,593,270	1,149,399
Claim payments	<u>(1,543,395)</u>	<u>(1,218,749)</u>
Unpaid claims, end of year	\$ <u>162,225</u>	\$ <u>112,350</u>

(Continued)

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(9) Risk Management, Continued

The Utility has recorded \$34,067 and \$24,717 in accounts payable for its share of these unpaid claims at December 31, 2004 and 2003, respectively.

The Utilities are a member of the Iowa Municipalities Workers' Compensation Association (the Association), which was established to provide members a group self-insurance program for their workers' compensation liabilities. Approximately 470 governmental entities participate in the Association. A board of trustees consisting of seven members is elected by the members participating in the Association to manage and conduct the business and affairs of the Association.

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2004.

Cash and cash equivalents and investments	\$22,960,768
Receivables	814,103
Other assets	668,545
Total assets	<u>\$24,443,416</u>
Total liabilities	18,559,769
Total equity	5,883,647
Total liabilities and equity	<u>\$24,443,416</u>
Total revenues	663,637
Total expenses	2,425,524
Distribution to members	0
Net decrease in equity	<u>\$(1,761,887)</u>

There have been no instances where the amount of settlement has exceeded available coverage in the past three years. There has been no significant reduction in insurance coverage from coverage in the prior year.

(10) Commitments and Contingencies

The Utility has natural gas transportation contracts with a pipeline, which expire in 2005 and 2025. Total payments include transportation charges and commodity charges. Minimum transportation payments for 2005 are expected to be approximately \$1,342,350 at current rates.

(11) Subsequent Events

On March 9, 2005 the Board of Trustees approved the redemption of the outstanding Series 1992 Revenue Bonds with the issuance of \$1,555,000 Gas Utility Revenue Refunding Capital Loan Notes and cash reserves.

(Continued)



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 Board of Trustees
Cedar Falls Utilities – Municipal Gas Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Gas Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2004 and 2003, and have issued our report thereon dated March 30, 2005. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted a certain immaterial instance of non-compliance that is described in Part II of the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2004, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the 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.

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Utility in a separate letter dated March 30, 2005. There were no prior year reportable conditions.

This report, a public record by law, is intended solely for the information and use of the officials, employees, and the customers of the Utility and other parties to whom the Utility 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 Utility 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.

Eide Bailly LLP

Dubuque, Iowa
March 30, 2005

**CEDAR FALLS UTILITIES – MUNICIPAL GAS UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

Part I: Summary of the Independent Auditor's Results:

- (a) An unqualified opinion was issued on the financial statements.
- (b) No material weaknesses in internal control over financial reporting were noted.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

Part II: Other Findings Related to Statutory Reporting:

- II-A-04 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2004.
- II-B-04 Certified Budget - Disbursements during the year ended December 31, 2004, did not exceed the amounts budgeted.
- II-C-04 Questionable Expenditures - We noted no expenditures that we believe may 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 Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-04 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-04 Bond Coverage - Surety bond coverage of Utility 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 Board Minutes - No transactions were found that we believe should have been approved in the Board 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 Utility's investment policy were noted.
- II-I-04 Revenue Bonds - We noted no instances of non-compliance with the provisions of the Utility's revenue bond resolutions.

**CEDAR FALLS UTILITIES – MUNICIPAL GAS UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

II-J-04 Notice of Public Hearing – Notice of public hearing for public improvements with a total cost to the Utility of \$25,000 or more is to be published not less than four nor more than twenty days prior to the public hearing in accordance with Chapters 384.102 and 362.3 of the Code of Iowa. We noted several notices of public hearing that were published more than twenty days prior to the public hearing.

Recommendation – We recommend that the Utility examine the procedures in place regarding publication of notice of public hearing to ensure that they are in compliance with the requirements of the Code of Iowa in the future.

Response – We will change the process we have been using of counting clear days for notices. Going forward, we will count calendar days but not include the day of publication.

Conclusion – Response accepted.



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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Cedar Falls Utilities -- Municipal Water Utility

We have audited the accompanying balance sheets of the Municipal Water Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2005, on our consideration of the 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 audits.

The management's discussion and analysis on pages 1 through 5 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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. However, we did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

March 30, 2005
Dubuque, Iowa

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MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Our discussion and analysis of the Municipal Water Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2004 and 2003. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

Financial Highlights

- The Utility's net assets increased as a result of operations. At December 31, 2004 and 2003, total assets were \$15,428,866 and \$14,688,715, respectively, and total liabilities were \$632,114 and \$226,836, respectively, resulting in net assets of \$14,796,752 and \$14,461,879, respectively.
- Operating revenues decreased 2.2 percent to \$1,770,841 while operating expenses increased 10.4 percent to \$2,127,701 in 2004. Operating revenues increased 6.1 percent to \$1,810,804 while operating expenses increased 1.1 percent to \$1,926,538 in 2003.
- During the year, the Utility had an operating loss of \$356,860. This compares to last year, when the Utility had operating loss of \$115,734.

Overview of the Financial Statements

Management's discussion and analysis (MD&A) serves as an introduction to the financial statements, and the MD&A represents management's examination and analysis of the Utility's financial condition and performance. The financial statements report information about the Utility using full accrual accounting methods as utilized by similar entities in the private sector.

The balance sheets include the Utility's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the Utility and assessing the liquidity and flexibility of the Utility.

The statements of revenues, expenses and changes in net assets present the results of the Utility's activities (revenues and expenses) over the course of the fiscal year and can provide information about the Utility's recovery of its costs. Retail rates to purchase water are based on rates established by the Board of Trustees based on operating costs, debt service requirements, and anticipated capital needs. A fundamental objective of this rate model is to provide adequate revenue to cover all expenses.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

The statements of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, capital and related financing activities and investing activities. This statement provides answers to such questions as where did the cash come from, what was cash used for, and what was the change in cash balances during the reporting period.

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of data provided in the statements. The notes present information about the Utility's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events.

Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring and planning.

Condensed Balance Sheet Information

	<u>2004</u>	<u>2003</u>
Current assets	\$ 2,808,242	\$ 2,774,884
Capital assets, net	11,645,324	10,936,951
Other noncurrent assets	<u>975,300</u>	<u>976,880</u>
Total assets	<u>\$15,428,866</u>	<u>\$14,688,715</u>
Current liabilities	228,574	181,583
Noncurrent liabilities	403,540	45,253
Long-term debt	-	-
Total liabilities	<u>\$ 632,114</u>	<u>\$ 226,836</u>
Net assets:		
Invested in capital assets, net of related debt	11,645,324	10,936,951
Restricted	-	-
Unrestricted	<u>3,151,428</u>	<u>3,524,928</u>
Total net assets	<u>\$14,796,752</u>	<u>\$14,461,879</u>

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Sales of water	\$ 1,719,548	\$ 1,757,121
Other	<u>51,293</u>	<u>53,683</u>
Total operating revenues	<u>1,770,841</u>	<u>1,810,804</u>
System operation and maintenance	874,180	781,276
Depreciation	374,758	328,863
Service and administrative	<u>878,763</u>	<u>816,399</u>
Total operating expenses	<u>2,127,701</u>	<u>1,926,538</u>
Operating income (loss)	<u>(356,860)</u>	<u>(115,734)</u>
Interest income	30,965	65,916
Other, net	<u>112,695</u>	<u>63,901</u>
Total nonoperating revenues (expenses)	<u>143,660</u>	<u>129,817</u>
Income (loss) before contributions	<u>(213,200)</u>	<u>14,083</u>
Capital contributions	<u>548,073</u>	<u>660,722</u>
Change in net assets	334,873	674,805
Net assets, beginning of year	<u>14,461,879</u>	<u>13,787,074</u>
Net assets, end of year	<u>\$14,796,752</u>	<u>\$14,461,879</u>

Financial Analysis

Current assets increased 1.2 percent in 2004 primarily due to the following factors: cash and cash equivalents increased 4.2 percent primarily due to an increase in customer accounts receivable; and a 3.6 percent decrease in materials & supplies inventory. Customer accounts receivable increased 4.3 percent due to 2004 collections being approximately 3.8 percent less than 2003 collections, 2004 billings being approximately 2.2 percent less than 2003 billings, and 2004 write-offs being approximately 44 percent more than 2003 write-offs. Materials & supplies decreased 3.6 percent due to an 87.8 percent increase in capital installations of water meters and a 78.0 percent increase in water main maintenance supply usage.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Current liabilities increased 25.9 percent in 2004 primarily due to 47.0 percent increase in all accounts payable. The accounts payable open items increased 62.0 percent primarily due to an increase in purchases and stockpiling of fill sand and roadstone and a 70.0 percent increase in street repairs from 2003.

Noncurrent liabilities increased 7.9 percent in 2004 due to the recording of accrued retirement insurance benefits totaling approximately \$45,000 that employees are entitled to receive upon retirement with 20 years of continuous service and at age 55 and an additional accrual of accrued severance of approximately \$13,000. They also increased due to the receipt of proceeds of \$300,000 for the Well #2 abandonment that are reserved for future construction before December 31, 2005.

System operation and maintenance expenses increased 11.9 percent in 2004 primarily due to the cleaning of three water towers costing approximately \$8,100, a 14.7 percent increase in well house maintenance, and approximately an \$11,000 increase in purchased power due to an approximately 11.0 percent increase in pumpage and the Municipal Electric Utility rate increase in January 2004. Also, the recording of accrued retirement insurance benefits resulted in an increase of approximately \$32,000 and an additional accrual of severance of approximately \$11,000 to system operation and maintenance expenses.

Service and administrative expenses increased 7.5 percent in 2004 primarily due to an increase of approximately \$56,000 in employee insurance costs; a 32.7 percent decrease in customer rebates related to the demand side management program, and an increase of approximately 9.9 percent in rent to the Municipal Electric Utility for office furniture and equipment. The increase in rent relates to a telephone system upgrade of approximately \$28,000; computer purchases of approximately \$132,000, and approximately \$142,000 for customer billing software owned by the Municipal Electric Utility and placed in service during 2003. Also, the recording of accrued retirement insurance benefits resulted in an increase of approximately \$13,000 to service and administrative expenses.

Interest income decreased 53.0 percent in 2004 primarily due to the arbitrage rebate of interest income to the IRS of \$38,153 for excess earnings on the bond reserve fund for the 1994 Water Revenue Bonds refunded in 2003.

Capital contributions decreased 17.0 percent in 2004 due to capital contributions being based on new developments requiring distribution extensions and there being approximately twice as many projects in 2003.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Capital Assets and Debt Administration

Net capital assets represent 75.5 percent of total assets for the Utility. Net capital assets increased 6.5 percent from the prior year primarily due to distribution extensions totaling approximately \$812,000 in 2004. Additional detail on the change in capital assets can be found in Note 4.

On May 13, 2003, the Utility expended \$954,177 for the redemption of the outstanding Series 1994 revenue bonds and related accrued interest. This redemption leaves the Utility with no outstanding debt at December 31, 2004.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Balance Sheets

December 31, 2004 and 2003

<u>Assets</u>	<u>2004</u>	<u>2003</u>
Capital assets: (note 3)		
Capital assets, in service	\$ 17,276,291	\$ 16,048,676
Less accumulated depreciation	<u>5,766,778</u>	<u>5,493,839</u>
	11,509,513	10,554,837
Construction work in progress	<u>135,811</u>	<u>382,114</u>
Net capital assets	<u>11,645,324</u>	<u>10,936,951</u>
Noncurrent assets:		
Noncurrent investments: (note 2)		
Unrestricted	<u>975,300</u>	<u>976,880</u>
Total noncurrent investments	<u>975,300</u>	<u>976,880</u>
Current assets:		
Cash and cash equivalents (note 1)	612,855	588,422
Investments (note 2)	1,850,000	1,850,000
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$3,528 in 2004 and \$2,800 in 2003	175,040	168,427
Interest	38,301	35,561
Other	23,077	22,650
Material and supplies	87,741	91,056
Prepayments and other	<u>21,228</u>	<u>18,768</u>
Total current assets	<u>2,808,242</u>	<u>2,774,884</u>
 Total assets	 <u>\$ 15,428,866</u>	 <u>\$ 14,688,715</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2004</u>	<u>2003</u>
Current liabilities:		
Accounts payable	\$ 148,216	\$ 100,816
Accrued wages and vacations	74,056	69,911
Other accrued expenses	<u>6,302</u>	<u>10,856</u>
Total current liabilities	<u>228,574</u>	<u>181,583</u>
Noncurrent liabilities: (note 4)		
Deferred credits	300,000	-
Other liabilities	<u>103,540</u>	<u>45,253</u>
Total liabilities	<u>632,114</u>	<u>226,836</u>
 <u>Net Assets</u> 		
Invested in captial assets, net of related debt	11,645,324	10,936,951
Unrestricted	<u>3,151,428</u>	<u>3,524,928</u>
Total net assets	<u>14,796,752</u>	<u>14,461,879</u>
Total liabilities and net assets	<u>\$ 15,428,866</u>	<u>\$ 14,688,715</u>

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
 (A Component Unit of the City of Cedar Falls, Iowa)

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Sales of water:		
Residential	\$ 1,269,924	\$ 1,302,390
Industrial	26,770	29,591
Commercial	293,922	307,045
Governmental (note 7)	101,467	88,695
Interdepartmental	27,465	29,400
Total sales of water	<u>1,719,548</u>	<u>1,757,121</u>
Other operating revenues	51,293	53,683
Total operating revenues	<u>1,770,841</u>	<u>1,810,804</u>
 Operating expenses		
Production:		
Purchased power from affiliated utility	107,198	96,025
Other	185,623	159,319
Distribution	581,359	525,932
Depreciation	374,758	328,863
Customer accounts	174,664	171,049
Customer service and information expenses	45,965	57,669
Sales	14,183	16,128
Administrative and general	583,062	515,776
Taxes other than income taxes	60,889	55,777
Total operating expenses	<u>2,127,701</u>	<u>1,926,538</u>
 Operating income (loss)	<u>(356,860)</u>	<u>(115,734)</u>
 Nonoperating revenues (expenses):		
Interest income	30,965	65,916
Net increase (decrease) in the fair value of investments	(1,580)	(23,120)
Miscellaneous revenue (expense), net (note 7)	94,379	93,180
Interest expense on long-term debt	19,896	(6,159)
Total nonoperating revenues (expenses)	<u>143,660</u>	<u>129,817</u>
 Income (loss) before contributions	<u>(213,200)</u>	<u>14,083</u>
 Capital contributions	<u>548,073</u>	<u>660,722</u>
 Change in net assets	334,873	674,805
 Net assets, beginning of year	<u>14,461,879</u>	<u>13,787,074</u>
 Net assets, end of year	<u>\$ 14,796,752</u>	<u>\$ 14,461,879</u>

See accompanying notes to financial statements.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 1,868,585	\$ 1,947,965
Cash paid to suppliers	(1,131,768)	(1,086,362)
Cash paid to employees	(525,447)	(504,109)
	<u>211,370</u>	<u>357,494</u>
Net cash provided by operating activities		
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	-	(935,000)
Contributions from contractors	7,560	1,356
Acquisition, construction and removal cost of capital assets	(650,900)	(502,827)
Proceeds from sale of capital assets	124,991	831
Reimbursement of utility construction costs	3,187	18,479
Proceeds from grant for capital construction	300,000	-
Interest paid	(38,153)	(45,327)
	<u>(253,315)</u>	<u>(1,462,488)</u>
Net cash used in capital and related financing activities		
Cash flows from investing activities:		
Proceeds from maturities of investment securities	1,850,000	3,830,000
Purchase of investment securities	(1,850,000)	(3,850,000)
Interest received	66,378	53,806
	<u>66,378</u>	<u>33,806</u>
Net cash provided by investing activities		
Net increase (decrease) in cash and cash equivalents	24,433	(1,071,188)
Cash and cash equivalents, beginning of year	<u>588,422</u>	<u>1,659,610</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 612,855</u>	<u>\$ 588,422</u>

See accompanying notes to financial statements.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows, Continued

Years Ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	\$ (356,860)	\$ (115,734)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation of capital assets	374,758	328,863
Other income related to operating activities	94,379	93,180
(Increase) decrease in accounts receivable	(7,040)	43,469
Decrease in materials and supplies	3,315	1,535
Increase in prepayments and other	(2,460)	(2,247)
Increase (decrease) in accounts payable	47,400	(13,136)
Increase (decrease) in accrued wages and vacation	4,145	(17,680)
Decrease in other accrued expenses	(4,554)	(6,009)
Increase in accrued severance	<u>58,287</u>	<u>45,253</u>
Net cash provided by operating activities	\$ <u>211,370</u>	\$ <u>357,494</u>
Noncash investing, capital and financing activities:		
Contributions from contractors in aid of construction	\$ <u>540,513</u>	\$ <u>659,366</u>

See accompanying notes to financial statements.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Water Utility (Utility) of the City of Cedar Falls, Iowa is a component unit of the City of Cedar Falls, Iowa. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

The Utility, as a regulated utility, follows the Code of Federal Regulations Title 18 - Conservation of Power and Water Resources, Chapter I - Federal Energy Regulatory Commission, Department of Energy.

In accordance with the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Utility applies only Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins issued on or before November 30, 1989.

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 5.88% in 2004 and 2003. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 20 to 70 years, buildings and improvements - 30 to 45 years, and equipment - 20 to 85 years. The depreciation provisions were equivalent to an overall composite rate of 2.3% and 2.2% of depreciable assets for 2004 and 2003, respectively.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred. At the time capital assets are retired, the original cost of the asset plus cost of removal less salvage are charged to accumulated depreciation.

(c) Cash and Investments

The Utility's deposits at December 31 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 ensure there will be no loss of public funds.

Investments are stated at their fair value on the balance sheets. The Utility's investments stated at fair value reflect quoted market prices at the balance sheet date, for U.S. Treasury and government agency debt securities. The cost of certificates of deposit approximates fair value.

The Utility considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents for purposes of the statement of cash flows. Included in cash and cash equivalents at December 31, 2004 and 2003 was \$250,000 for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(Continued)

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(c) Cash and Investments, Continued

The Utility's cash and cash equivalents can be identified on the balance sheet as follows:

	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents	\$612,855	\$588,422
Restricted - cash	<u> </u>	<u> </u>
Total cash and cash equivalents	<u>\$612,855</u>	<u>\$588,422</u>

(d) Inventories

Materials and supplies are valued at average cost. Inventories are recorded as an expenditure at the time individual inventory items are consumed.

(e) Operating Revenues and Expenses

Operating revenues include revenues resulting from the sale of water and service revenues. Operating expenses include expenses for power production, distribution, depreciation, customer accounts, customer service and informational, sales, and administrative and general. Nonoperating revenues and expenses include those derived from capital and related financing activities, noncapital financing activities, and investing activities.

Revenues from the sale of water are based on billing rates, which are applied to customers' consumption of water. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed as of December 31, 2004 and 2003, were \$69,267 and \$71,987, respectively, and are recorded in customer accounts receivable.

(f) Bond Issue Costs

Unamortized bond issue costs are amortized over the life of the bonds using the effective interest method.

(g) Capital Contributions

Contributions in aid of construction represent the actual cost of property contributed to the Utility and nonrefundable payments from consumers, which are used to partially offset the cost of the construction of additional capital assets.

(h) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

The Utility's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

(Continued)

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements
December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(i) Estimates

The preparation of the financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

(2) Investments

The Utility is authorized by statute to invest public funds not currently needed for operating expenses 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 Board of Trustees, 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 Utility classifies its investments into categories, which present an indication of the level of credit risk in relation to the nature of the investment and the custodial provisions. Category 1 securities are insured, registered, held by the Utility, or held by the Utility's agent in the Utility's name. Category 2 denotes uninsured and unregistered securities that are held by counterparty's trust department or agent in the Utility's name. Category 3 specifies uninsured and unregistered securities that are held by counterparty's trust department or agent in other than the Utility's name. Investments in IPAIT are not subject to risk categorization. Investments in IPAIT are recorded with cash and cash equivalents. The Utility's investments are classified as follows at December 31, 2004 and 2003 and carrying value equals fair value:

<u>Investment</u>	<u>Category</u>	<u>2004</u>	<u>2003</u>
Certificates of deposit	1	\$1,850,000	\$1,850,000
U.S. government and agency securities	2	<u>975,300</u>	<u>976,880</u>
		<u>\$2,825,300</u>	<u>\$2,826,880</u>

The Utility's investments can be identified on the balance sheets as follows:

	<u>2004</u>	<u>2003</u>
Current assets:		
Investments	\$1,850,000	\$1,850,000
Noncurrent investments:		
Restricted	-	-
Unrestricted	<u>975,300</u>	<u>976,880</u>
	<u>\$2,825,300</u>	<u>\$2,826,880</u>

(Continued)

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements
December 31, 2004 and 2003

(3) Capital Assets

A summary of capital assets activity for the years ended December 31, 2004 and 2003 follows:

2004	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 63,581	\$ -	\$ -	\$ 63,581
Construction work in progress	<u>382,114</u>	<u>1,011,862</u>	<u>1,258,165</u>	<u>135,811</u>
Total capital assets, not being depreciated	<u>445,695</u>	<u>1,011,862</u>	<u>1,258,165</u>	<u>199,392</u>
Capital assets, being depreciated:				
Infrastructure	15,430,976	1,206,743	29,833	16,607,886
Buildings and improvements	229,211	6,871	718	235,364
Equipment	<u>324,908</u>	<u>44,552</u>	-	<u>369,460</u>
Total capital assets being depreciated	<u>15,985,095</u>	<u>1,258,166</u>	<u>30,551</u>	<u>17,212,710</u>
Less accumulated depreciation	<u>(5,493,839)</u>	<u>(374,758)</u>	<u>101,820</u>	<u>(5,766,778)</u>
Total capital assets, being depreciated, net	<u>10,491,256</u>	<u>883,408</u>	<u>(71,268)</u>	<u>11,445,932</u>
Capital assets, net	<u>\$10,936,951</u>	<u>\$1,895,270</u>	<u>\$1,186,897</u>	<u>\$11,645,324</u>
2003				
Capital assets, not being depreciated:				
Land	\$ 63,581	\$ -	\$ -	\$ 63,581
Construction work in progress	<u>6,627</u>	<u>1,156,979</u>	<u>781,492</u>	<u>382,114</u>
Total capital assets, not being depreciated	<u>70,208</u>	<u>1,156,979</u>	<u>781,492</u>	<u>445,695</u>
Capital assets, being depreciated:				
Infrastructure	14,730,846	766,039	65,909	15,430,976
Buildings and improvements	228,343	868	-	229,211
Equipment	<u>310,528</u>	<u>14,585</u>	<u>205</u>	<u>324,908</u>
Total capital assets being depreciated	<u>15,269,717</u>	<u>781,492</u>	<u>66,114</u>	<u>15,985,095</u>
Less accumulated depreciation	<u>(5,229,648)</u>	<u>(328,863)</u>	<u>64,672</u>	<u>(5,493,839)</u>
Total capital assets, being depreciated, net	<u>10,040,069</u>	<u>452,629</u>	<u>1,442</u>	<u>10,491,256</u>
Capital assets, net	<u>\$10,110,227</u>	<u>\$1,609,608</u>	<u>\$782,934</u>	<u>\$10,936,951</u>

(Continued)

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements
December 31, 2004 and 2003

(4) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2004 and 2003 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
<u>2004</u>					
Accrued severance	\$ 45,253	\$ 58,287	\$ -	\$ 103,540	\$ -
Deferred credits	-	300,000	-	300,000	-
Noncurrent liabilities	<u>\$ 45,253</u>	<u>\$ 358,287</u>	<u>\$ -</u>	<u>\$ 403,540</u>	<u>\$ -</u>
<u>2003</u>					
Series 1994 revenue bonds	\$ 935,000	\$ -	\$ 935,000	\$ -	\$ -
Accrued severance	-	45,253	-	45,253	-
Noncurrent liabilities	<u>\$ 935,000</u>	<u>\$ 45,253</u>	<u>\$ 935,000</u>	<u>\$ 45,253</u>	<u>\$ -</u>

On May 13, 2003, the Utility expended \$954,177 for the redemption of the outstanding Series 1994 revenue bonds. The Utility used their own funds to extinguish the debt.

In January 2004, the Utility received \$300,000 as part of the agreement with the Iowa Comprehensive Petroleum Underground Storage Tank Fund Board regarding the site clean up of fuel-contaminated soil surrounding a previously replaced underground gasoline storage tank. As part of the agreement, a well was abandoned and the funds received are to be used for the replacement of this well or on system improvements to increase water production capacity. Any funds not spent by December 31, 2006, must be returned to the State of Iowa.

(5) Pension Plan

The Utility contributes to the Iowa Public Employees Retirement System (IPERS), 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 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 Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2004, 2003, and 2002, were \$50,737; \$46,444; and \$38,083; respectively, equal to the required contributions for each year.

(6) Income Tax Status

The Utility is exempt from federal and state income taxes under the applicable tax codes.

(7) Related Party Transactions

The Utility provides water service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$23,808 and \$6,448 in 2004 and 2003, respectively.

The Utility also provides billing and collection services to the City for the City's sanitary sewer system and garbage and refuse service. Revenues from the service provided amounted to \$87,600 and \$85,680 in 2004 and 2003, respectively, and are recorded in miscellaneous nonoperating revenue.

(Continued)

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements
December 31, 2004 and 2003

(7) Related Party Transactions, Continued

For the years ended December 31, 2004 and 2003, the Utility earned a management fee of \$1,690 from the Municipal Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous nonoperating revenue.

(8) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,013,300 in aggregate for all participants and have insurance for claims above this amount.

Liabilities of the risk management account are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an estimated amount for claims that have been incurred but not reported (IBNR) which represent estimates of the eventual loss on claims arising prior to year-end. Changes in the balances of claims liabilities during the past two years are as follows:

	<u>2004</u>	<u>2003</u>
Unpaid claims, beginning of year	\$ 112,350	\$ 181,700
Current year claims and changes in estimates	1,593,270	1,149,399
Claim payments	<u>(1,543,395)</u>	<u>(1,218,749)</u>
Unpaid claims, end of year	\$ <u>162,225</u>	\$ <u>112,350</u>

The Utility has recorded \$14,600 and \$10,111 in accounts payable for its share of these unpaid claims at December 31, 2004 and 2003, respectively.

The Utilities are a member of the Iowa Municipalities Workers' Compensation Association (the Association), which was established to provide members a group self-insurance program for their workers' compensation liabilities. Approximately 470 governmental entities participate in the Association. A board of trustees consisting of seven members is elected by the members participating in the Association to manage and conduct the business and affairs of the Association.

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2004.

Cash and cash equivalents and investments	\$22,960,768
Receivables	814,103
Other assets	<u>668,545</u>
Total assets	<u>\$24,443,416</u>
Total liabilities	18,559,769
Total equity	<u>5,883,647</u>
Total liabilities and equity	<u>\$24,443,416</u>
Total revenues	663,637
Total expenses	2,425,524
Distribution to members	-
Net decrease in equity	<u>\$ (1,761,887)</u>

(Continued)

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements
December 31, 2004 and 2003

(8) Risk Management, Continued

There have been no instances where the amount of settlement has exceeded available coverage in the past three years. There has been no significant reduction in insurance coverage in the prior year.

(9) Commitments and Contingencies

As of December 31, 2004, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$8,044.

(10) Subsequent Event

Effective January 1, 2005, the Board of Trustees approved a general water rate increase. The average rate increase is approximately 9.0% for all of the customer classes.



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 Board of Trustees
Cedar Falls Utilities – Municipal Water Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Water Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2004 and 2003, and have issued our report thereon dated March 30, 2005. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted a certain immaterial instance of non-compliance that is described in Part II of the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2004, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the 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.

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Utility in a separate letter dated March 30, 2005. There were no prior year reportable conditions.

This report, a public record by law, is intended solely for the information and use of the officials, employees, and the customers of the Utility and other parties to whom the Utility 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 Utility 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.

A handwritten signature in cursive script that reads "Eide Bailly LLP". The signature is written in dark ink and is positioned above the typed address and date.

Dubuque, Iowa
March 30, 2005

**CEDAR FALLS UTILITIES – MUNICIPAL WATER UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

Part I: Summary of the Independent Auditor's Results:

- (a) An unqualified opinion was issued on the financial statements.
- (b) No material weaknesses in internal control over financial reporting were noted.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

Part II: Other Findings Related to Statutory Reporting:

- II-A-04 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2004.
- II-B-04 Certified Budget - Disbursements during the year ended December 31, 2004, did not exceed the amounts budgeted.
- II-C-04 Questionable Expenditures - We noted no expenditures that we believe may 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 Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-04 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-04 Bond Coverage - Surety bond coverage of Utility 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 Board Minutes - No transactions were found that we believe should have been approved in the Board 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 Utility's investment policy were noted.
- II-I-04 Revenue Bonds - We noted no instances of non-compliance with the provisions of the Utility's revenue bond resolutions.

**CEDAR FALLS UTILITIES – MUNICIPAL WATER UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

II-J-04 Notice of Public Hearing – Notice of public hearing for public improvements with a total cost to the Utility of \$25,000 or more is to be published not less than four nor more than twenty days prior to the public hearing in accordance with Chapters 384.102 and 362.3 of the Code of Iowa. We noted several notices of public hearing that were published more than twenty days prior to the public hearing.

Recommendation – We recommend that the Utility examine the procedures in place regarding publication of notice of public hearing to ensure that they are in compliance with the requirements of the Code of Iowa in the future.

Response – We will change the process we have been using of counting clear days for notices. Going forward, we will count calendar days but not include the day of publication.

Conclusion – Response accepted.



CPAs & BUSINESS ADVISORS

INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Cedar Falls Utilities – Municipal Communications Utility

We have audited the accompanying balance sheets of the Municipal Communications Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2004 and 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2005, on our consideration of the 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 audits.

The management's discussion and analysis on pages 1 through 5 is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. 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. However, we did not audit the information and express no opinion on it.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

March 30, 2005
Dubuque, Iowa

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MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Our discussion and analysis of the Municipal Communications Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2004 and 2003. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

Financial Highlights

- The Utility's net assets increased as a result of operations. At December 31, 2004 and 2003, total assets were \$9,637,851 and \$9,619,637, respectively, and total liabilities were \$9,668,458 and \$10,683,188, respectively, resulting in deficit net assets of \$30,607 and \$1,063,551, respectively.
- Operating revenues increased 9.1 percent to \$7,047,702 while operating expenses increased 15.1 percent to \$5,838,527 in 2004. Operating revenues increased 17.9 percent to \$6,456,983 while operating expenses decreased 5.1 percent to \$5,071,403 in 2003.
- During the year, the Utility had operating income of \$1,209,175. This compares to last year, when the Utility had operating income of \$1,385,580.

Overview of the Financial Statements

Management's discussion and analysis (MD&A) serves as an introduction to the financial statements, and the MD&A represents management's examination and analysis of the Utility's financial condition and performance. The financial statements report information about the Utility using full accrual accounting methods as utilized by similar entities in the private sector.

The balance sheets include the Utility's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the Utility and assessing the liquidity and flexibility of the Utility.

The statements of revenues, expenses and changes in net assets present the results of the Utility's activities (revenues and expenses) over the course of the fiscal year and can provide information about the Utility's recovery of its costs. Retail rates to purchase communications services are based on rates established by the Board of Trustees based on operating costs, debt service requirements, and anticipated capital needs. A fundamental objective of this rate model is to provide adequate revenue to cover all expenses.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

The statements of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, noncapital financing activities, capital and related financing activities and investing activities. This statement provides answers to such questions as where did the cash come from, what was cash used for, and what was the change in cash balances during the reporting period.

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of data provided in the statements. The notes present information about the Utility's accounting policies, significant account balances and activities, material risks, and obligations.

Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring and planning.

Condensed Balance Sheet Information

	<u>2004</u>	<u>2003</u>
Current assets	\$ 1,347,447	\$ 1,181,056
Capital assets, net	7,335,051	7,459,727
Other noncurrent assets	<u>955,353</u>	<u>978,854</u>
Total assets	<u>\$ 9,637,851</u>	<u>\$ 9,619,637</u>
Current liabilities	1,566,983	1,728,244
Noncurrent liabilities	66,178	26,425
Long-term debt	<u>8,035,297</u>	<u>8,928,519</u>
Total liabilities	<u>\$ 9,668,458</u>	<u>\$10,683,188</u>
Invested in capital assets, net of related debt	(1,590,247)	(1,343,792)
Restricted	951,333	950,083
Unrestricted	<u>608,307</u>	<u>(669,842)</u>
Total net assets (deficit)	<u>\$ (30,607)</u>	<u>\$ (1,063,551)</u>

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Cable television	\$ 3,415,155	\$ 3,296,322
High speed data communications	<u>3,632,547</u>	<u>3,160,661</u>
Total operating revenues	<u>7,047,702</u>	<u>6,456,983</u>
System operation and maintenance	3,282,640	2,775,413
Depreciation	1,110,541	1,042,301
Service and administrative	<u>1,445,346</u>	<u>1,253,689</u>
Total operating expenses	<u>5,838,527</u>	<u>5,071,403</u>
Operating income	<u>1,209,175</u>	<u>1,385,580</u>
Interest expense	(396,920)	(426,360)
Other, net	<u>220,689</u>	<u>21,900</u>
Total nonoperating revenues (expenses)	<u>(176,231)</u>	<u>(404,460)</u>
Change in net assets	1,032,944	981,120
Net assets (deficit), beginning of year	<u>(1,063,551)</u>	<u>(2,044,571)</u>
Net assets (deficit), end of year	<u>\$ (30,607)</u>	<u>\$ (1,063,551)</u>

Financial Analysis

Current liabilities decreased 9.3 percent in 2004 primarily from the \$181,779 decrease in due-to affiliated utilities. This account includes activity between utilities sharing a pooled cash account representing lending/borrowing arrangements when cash shortfalls occur in an affiliated utility. Current liabilities also changed by an increase in accounts payable of approximately \$41,688 related to inventory, capital, and advertising surrounding the launch of HDTV in June of 2004 and continued development of residential and commercial areas of the City requiring expansion of the infrastructure and the need for material and supplies on hand. This is also reflected in the \$28,199 increase in Materials and Supplies Inventory during 2004.

Non-current liabilities increased 150.4 percent in 2004 primarily due to the accrual of severance and retirement health insurance benefits and a liability for Customer Advances for Construction. Advance lease payments are now all current liabilities as the agreement terms end in 2005.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

Customer Advances for Construction did not exist during 2003, but became policy and procedure during 2004 and accruals were recorded.

Total net assets (deficit) decreased 97.0 percent in 2004 primarily due to operating revenues increasing approximately \$590,719 due primarily to increases in the number of subscribers. Invested in capital assets, net of related debt is a deficit balance due to capital assets being funded by debt. Capital assets are depreciated between 7 to 20 years and the debt repayment is scheduled through 2016. Capital assets are depreciating at a larger proportion than the debt repayment schedule. Unrestricted net assets is a positive balance as a reflection of the Utility's net income during 2003 and 2004. The Utility increased rates in our product lines, adjusted product lines and implemented cost cutting measures throughout 2002, 2003 and 2004 which is reflective in the increase in net assets for 2004.

Cable television operating revenues increased 3.6 percent in 2004. An increase in the number of subscribers and the introduction of High Definition TV services primarily account for the increase in cable television operating revenues.

High speed data communications operating revenues increased 14.9 percent in 2004. An increase in the number of subscribers partially accounts for the increase. In January 2004 the discount provided to customers with bundled communication services and previously charged against high speed data communications revenues was reclassified as a cable TV discount and is now charged against basic revenues, this also accounts for the increase in high speed data revenues. Basic Service revenues decreased 24.9 percent in 2004 primarily due to this change in classification of the volume service discount. Also, high speed data communications revenues billed to other communities for transport and access has decreased approximately \$49,000 due to the loss of customers. However, Bulk Account revenues increased by \$46,000 during 2004.

System operation and maintenance expenses increased 18.2 percent in 2004 primarily due to the following: High Speed Data Internet Access Expense increased \$56,041 or 18.2% and Cable TV programming costs increased \$255,895 or 14.9% during 2004. This increase was driven by increased customers being served, increases in the amount of bandwidth high speed internet customers are using and the continuing increase of programming costs which recently have been increasing at a rate of 8 – 15 percent annually. Customer premise wiring expense increased primarily due to an increase in payroll being assigned to this account. The increase in customers drives the growth in payroll costs associated with customer premise wiring. Plant operations administrative expense increased approximately \$191,657 in 2004 due to payment of employee bonuses in April and increased employee health insurance and benefit costs. Further, an \$83,795 variance in Research and Development due to the cost of conducting both a feasibility study and market research study on Voice Over Internet Protocol contributes to this increase. Interest expense decreased 6.9 percent in 2004 primarily due to higher principal payments on long-term

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Management Discussion and Analysis

December 31, 2004 and 2003

debt and less interest paid in 2004. Other Non-operating Income increased by \$198,790 during 2004 primarily due to over \$190,000 in TIF monies received from the City of Cedar Falls for industrial/commercial development related infrastructure expansion.

Capital Assets and Debt Administration

Capital assets represent 76.1 percent of total assets for the Utility. Net capital assets decreased 1.7 percent from the prior year primarily due to higher depreciation than additions of infrastructure. Additional detail on the change in capital assets can be found in Note 4.

The Utility's total debt service in 2004, excluding the outstanding loan with the Municipal Electric Utility, was \$847,641 compared to \$858,755 during 2003.

The Utility has an outstanding loan with the Municipal Electric Utility totaling \$3,093,090 and \$3,403,090 at December 31, 2004 and 2003, respectively. Additional detail on the outstanding loan can be found in Note 5.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Balance Sheets

December 31, 2004 and 2003

<u>Assets</u>	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents (note 1)	\$ 44,293	\$ -
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$22,011 in 2004 and \$17,100 in 2003	866,438	806,439
Interest	14,407	10,921
Other	83,475	59,028
Material and supplies	242,291	214,091
Prepayments and other	26,373	19,940
Restricted - cash (note 2)	70,170	70,637
Total current assets	<u>1,347,447</u>	<u>1,181,056</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Restricted (note 2)	903,000	903,000
Total noncurrent investments	<u>903,000</u>	<u>903,000</u>
Capital assets: (note 4)		
Capital assets, in service	13,466,271	12,633,933
Less accumulated depreciation	6,197,308	5,258,759
	<u>7,268,963</u>	<u>7,375,174</u>
Construction work in progress	66,088	84,553
Net captial assets	<u>7,335,051</u>	<u>7,459,727</u>
Deferred costs, net of amortization	<u>52,353</u>	<u>75,854</u>
Total noncurrent assets	<u>8,290,404</u>	<u>8,438,581</u>
 Total assets	 <u>\$ 9,637,851</u>	 <u>\$ 9,619,637</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2004</u>	<u>2003</u>
Current liabilities:		
Accounts payable	\$ 382,964	\$ 341,275
Due to affiliated utilities (note 8)	-	181,779
Advance lease payments (note 5)	26,425	29,587
Accrued wages and vacation	90,980	96,819
Accrued interest	72,443	79,139
Other accrued liabilities	104,171	124,645
Current installments of long-term debt (note 5)	890,000	875,000
Total current liabilities	<u>1,566,983</u>	<u>1,728,244</u>
Noncurrent liabilities: (note 5)		
Advance lease payments	-	26,425
Customer advances for construction	30,939	-
Other noncurrent liabilities	35,239	-
Long-term debt, less current installments	<u>8,035,297</u>	<u>8,928,519</u>
Total noncurrent liabilities	<u>8,101,475</u>	<u>8,954,944</u>
Total liabilities	<u>9,668,458</u>	<u>10,683,188</u>
<u>Net Assets</u>		
Invested in capital assets, net of related debt	(1,590,247)	(1,343,792)
Restricted - bond indentures (note 2)	951,333	950,083
Unrestricted	<u>608,307</u>	<u>(669,842)</u>
Total net assets (deficit)	<u>(30,607)</u>	<u>(1,063,551)</u>
 Total liabilities and net assets	 <u>\$ 9,637,851</u>	 <u>\$ 9,619,637</u>

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
 (A Component Unit of the City of Cedar Falls, Iowa)

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues:		
Cable system revenues	\$ 3,415,155	\$ 3,296,322
Local private line revenue	140,775	127,204
Data services revenue	3,321,158	2,902,817
Network access revenue	170,614	130,640
Total operating revenues	<u>7,047,702</u>	<u>6,456,983</u>
Operating expenses:		
Plant specific and programming	2,632,520	2,311,130
Depreciation	1,110,541	1,042,301
Plant nonspecific	650,120	464,283
Customer operations	410,621	392,818
Sales	250,554	205,022
Corporate operations (note 8)	784,171	655,849
Total operating expenses	<u>5,838,527</u>	<u>5,071,403</u>
Operating income (loss)	<u>1,209,175</u>	<u>1,385,580</u>
Nonoperating revenues (expenses):		
Interest income	20,791	16,938
Miscellaneous revenue (expense), net	199,898	4,962
Interest expense on long-term debt (note 5)	(293,854)	(313,695)
Interest expense on affiliated note payable (note 5 and 8)	(103,066)	(112,665)
Total nonoperating revenues (expenses)	<u>(176,231)</u>	<u>(404,460)</u>
Change in net assets	1,032,944	981,120
Net assets (deficit), beginning of year	<u>(1,063,551)</u>	<u>(2,044,671)</u>
Net assets (deficit), end of year	<u>\$ (30,607)</u>	<u>\$ (1,063,551)</u>

See accompanying notes to financial statements.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 7,133,568	\$ 6,418,294
Cash paid to suppliers	(4,042,627)	(3,505,141)
Cash paid to employees	(669,377)	(607,037)
	<u>2,421,564</u>	<u>2,306,116</u>
Net cash provided by operating activities		
Cash flows from noncapital financing activities:		
Advance from affiliated utility	-	181,779
Payments on advance from affiliated utility	(181,779)	(384,196)
	<u>(181,779)</u>	<u>(202,417)</u>
Net cash used in noncapital financing activities		
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(875,000)	(830,000)
Proceeds from customer advances for construction	36,339	-
Refunds of customer advances for construction	(5,400)	-
Acquisition, construction and removal cost of capital assets	(1,089,623)	(813,759)
Proceeds from sale of capital assets	200	7,032
Reimbursement of utility construction costs	110,908	39,032
Interest paid	(390,687)	(449,173)
	<u>(2,213,263)</u>	<u>(2,046,868)</u>
Net cash used in capital and related financing activities		
Cash flows from investing activities:		
Proceeds from maturities of investment securities	903,000	838,000
Purchase of investment securities	(903,000)	(903,000)
Interest received	17,304	10,335
	<u>17,304</u>	<u>(54,665)</u>
Net cash provided by (used in) investing activities		
Net increase in cash and cash equivalents	43,826	2,166
Cash and cash equivalents, beginning of year	<u>70,637</u>	<u>68,471</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 114,463</u>	<u>\$ 70,637</u>

See accompanying notes to financial statements.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows, Continued

Years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 1,209,175	\$ 1,385,580
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	1,110,541	1,042,301
Other income related to operating activities	199,898	4,962
Amortization of advance lease payments	(29,587)	(29,588)
Increase in accounts receivable	(84,445)	(14,062)
Increase in materials and supplies	(28,199)	(33,605)
Increase in prepayments and other	(6,433)	(2,469)
Increase (decrease) in accounts payable	41,688	(4,551)
Decrease in accrued wages and vacation	(5,839)	(31,163)
Decrease in other accrued liabilities	(20,474)	(11,289)
Increase in accrued severance	<u>35,239</u>	<u>-</u>
Net cash provided by operating activities	<u>\$ 2,421,564</u>	<u>\$ 2,306,116</u>

See accompanying notes to financial statements.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Communications Utility (Utility) of the City of Cedar Falls, Iowa is a component unit of the City of Cedar Falls, Iowa (the City) created by public referendum on October 11, 1994 (date of inception). The Utility was formed to engage in the development and operation of a broadband communications system and the marketing of related services such as cable television and high-speed data communications. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Communications Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

The Utility, as a regulated utility, follows the Code of Federal Regulations Title 47 - Telecommunication, Chapter I - Federal Communications Commission.

In accordance with the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Utility applies only Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board opinions, and Accounting Research Bulletins issued on or before November 30, 1989.

(b) Cash and Investments

The Utility's deposits at December 31 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 ensure there will be no loss of public funds.

All investments held are certificates of deposit where cost approximates fair value.

The Utility considers all highly liquid investments with maturity of three months or less at purchase to be cash equivalents for purposes of the statements of cash flows.

The Utility's cash and cash equivalents can be identified on the balance sheet as follows:

	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents	\$ 44,293	\$ -
Restricted - cash	<u>70,170</u>	<u>70,637</u>
Total cash and cash equivalents	<u>\$ 114,463</u>	<u>\$ 70,637</u>

(c) Inventories

Materials and supplies are valued at average cost. Inventories are recorded as an expenditure at the time individual inventory items are consumed.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(d) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 4.92% in 2004 and 2003. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 7 to 20 years and equipment - 20 years. The depreciation provision was equivalent to an overall composite rate of 8.6% and 8.7% of depreciable assets for 2004 and 2003, respectively.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred. At the time capital assets are retired, the original cost of the asset plus cost of removal less salvage are charged to accumulated depreciation.

(e) Operating Revenues and Expenses

Operating revenues include revenues resulting from the sale of products and services. Operating expenses include expenses for plant specific and programming, depreciation, plant nonspecific, customer operations, sales, and corporate operations. Nonoperating revenues and expenses include those derived from capital and related financing activities, noncapital financing activities and investing activities.

Revenues are based on billing rates, which are applied to customers' consumption of communications services. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not billed at December 31, 2004 and 2003, were \$331,018 and \$315,850, respectively. Advance local private line operating lease rental payments received are deferred and recognized on a straight-line basis over the period of service.

(f) Deferred Costs

Organizational costs and other deferred costs are amortized over a five-year period.

Debt discount, debt premium and debt issue costs are amortized over the life of the debt using the effective interest method.

(g) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments.

The Utility's policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

(Continued)

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(1) Summary of Significant Accounting Policies, Continued

(h) Estimates

The preparation of the financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

(i) Net Assets (Deficit)

The Utility had a deficit in net assets of \$30,607 and \$1,063,551 at December 31, 2004 and 2003, respectively. The Utility intends to eliminate these deficits through future earnings of the utility.

(2) Restricted Assets

Restricted assets represent monies set aside under the terms of the bond resolution relating to the Series 1999 Capital Loan Notes. In accordance with the covenants of the bond resolution, the monies are segregated into various amounts.

The composition of these amounts at December 31 was as follows:

	<u>2004</u>	<u>2003</u>
Current assets - restricted:		
Bond and interest fund	\$ 70,170	\$ 70,637
Restricted - cash	<u>70,170</u>	<u>70,637</u>
Noncurrent assets - restricted:		
Bond reserve fund	403,000	403,000
Improvement and extension fund	<u>500,000</u>	<u>500,000</u>
Restricted noncurrent investments	<u>903,000</u>	<u>903,000</u>
Total restricted assets	<u>\$973,170</u>	<u>\$973,637</u>

The monies deposited into the various accounts have been invested in interest-bearing securities as required by the bond resolution. Amounts deposited in the above funds may only be used for the purposes as set forth in the bond resolution and as a result are classified as restricted.

(3) Investments

The Utility is authorized by statute to invest public funds not currently needed for operating expenses 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 Board of Trustees, 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.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(3) Investments, Continued

The Utility classifies its investments into categories, which present an indication of the level of credit risk in relation to the nature of the investment and the custodial provisions. Category 1 securities are insured, registered, held by the Utility, or held by the Utility's agent in the Utility's name. Category 2 denotes uninsured and unregistered securities that are held by counterparty's trust department or agent in the Utility's name. Category 3 specifies uninsured and unregistered securities that are held by counterparty's trust department or agent in other than the Utility's name. The Utility's investments are classified as follows at December 31, 2003 and 2002 and carrying value equals fair value:

<u>Investment</u>	<u>Category</u>	<u>2004</u>	<u>2003</u>
Certificates of deposit	1	<u>\$ 903,000</u>	<u>\$ 903,000</u>

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2004 and 2003 follows:

<u>2004</u>	<u>Beginning Balance</u>	<u>Additions and Transfers In</u>	<u>Deletions and Transfers Out</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Construction work in progress	\$ 84,553	\$ 989,313	\$1,007,778	\$ 66,088
Total capital assets, not being depreciated	<u>84,553</u>	<u>989,313</u>	<u>1,007,778</u>	<u>66,088</u>
Capital assets, being depreciated:				
Infrastructure	12,410,597	989,264	175,440	13,224,421
Equipment	223,336	18,514	-	241,850
Total capital assets being depreciated	<u>12,633,933</u>	<u>1,007,778</u>	<u>175,440</u>	<u>13,466,271</u>
Less accumulated depreciation	<u>(5,258,759)</u>	<u>(1,110,438)</u>	<u>171,889</u>	<u>(6,197,308)</u>
Total capital assets, being depreciated, net	<u>7,375,174</u>	<u>(102,660)</u>	<u>3,551</u>	<u>7,268,963</u>
Capital assets, net	<u>\$ 7,459,727</u>	<u>\$ 886,653</u>	<u>\$1,011,329</u>	<u>\$ 7,335,051</u>

(Continued)

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(4) Capital Assets, Continued

2003				
Capital assets, not being depreciated:				
Construction work in progress	\$ 74,373	\$ 788,209	\$ 778,029	\$ 84,553
Total capital assets, not being depreciated	<u>74,373</u>	<u>788,209</u>	<u>778,029</u>	<u>84,553</u>
Capital assets, being depreciated:				
Infrastructure	11,735,740	769,923	95,066	12,410,597
Equipment	211,847	11,489	-	223,336
Total capital assets being depreciated	<u>11,947,587</u>	<u>781,412</u>	<u>95,066</u>	<u>12,633,933</u>
Less accumulated depreciation	<u>(4,297,178)</u>	<u>(1,042,301)</u>	<u>80,720</u>	<u>(5,258,759)</u>
Total capital assets, being depreciated, net	<u>7,650,409</u>	<u>(260,889)</u>	<u>14,346</u>	<u>7,375,174</u>
Capital assets, net	<u>\$ 7,724,782</u>	<u>\$ 527,320</u>	<u>\$ 792,375</u>	<u>\$ 7,459,727</u>

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2004 and 2003 was as follows:

2004	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 1998 G.O. bonds	\$ 550,000	\$ -	\$ 35,000	\$ 515,000	\$ 35,000
Series 1999 G.O. bonds	555,000	-	40,000	515,000	40,000
Series 2002 G.O. bonds	1,985,000	-	255,000	1,730,000	260,000
Note payable to the Municipal Electric Utility	3,403,090	-	310,000	3,093,090	310,000
Series 1999 capital loan notes	3,310,000	-	235,000	3,075,000	245,000
Unamortized discount on debt	(6,261)	-	(1,287)	(4,974)	-
Unamortized premium on debt	6,690	-	4,509	2,181	-
	<u>9,803,519</u>	<u>-</u>	<u>878,222</u>	<u>8,925,297</u>	<u>890,000</u>
Current installments of long-term debt	<u>(875,000)</u>	<u>(15,000)</u>	<u>-</u>	<u>(890,000)</u>	
Long-term debt, less current installments	<u>8,928,519</u>	<u>(15,000)</u>	<u>878,222</u>	<u>8,035,297</u>	
Advance lease payments	56,012	-	29,587	26,425	<u>26,425</u>
Current advance lease payments	<u>(29,587)</u>	<u>-</u>	<u>(3,162)</u>	<u>(26,425)</u>	
Noncurrent advance lease payments	<u>26,425</u>	<u>-</u>	<u>26,425</u>	<u>-</u>	
Total noncurrent liabilities	<u>\$ 8,954,944</u>	<u>\$ (15,000)</u>	<u>\$ 904,647</u>	<u>\$ 8,035,297</u>	<u>\$ 916,425</u>

(Continued)

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(5) Noncurrent Liabilities, Continued

2003						
Series 1998 G.O. bonds	\$ 580,000	\$ -	\$ 30,000	\$ 550,000	\$ 35,000	
Series 1999 G.O. bonds	595,000	-	40,000	555,000	40,000	
Series 2002 G.O. bonds	2,210,000	-	225,000	1,985,000	255,000	
Note payable to the Municipal Electric Utility	3,713,090	-	310,000	3,403,090	310,000	
Series 1999 capital loan notes	3,535,000	-	225,000	3,310,000	235,000	
Unamortized discount on debt	(7,649)	-	(1,388)	(6,261)	-	
Unamortized premium on debt	12,401	-	5,711	6,690	-	
	<u>10,637,842</u>	<u>-</u>	<u>834,323</u>	<u>9,803,519</u>	<u>875,000</u>	
Current installments of long-term debt	<u>(830,000)</u>	<u>(45,000)</u>	<u>-</u>	<u>(875,000)</u>		
Long-term debt, less current installments	<u>9,807,842</u>	<u>(45,000)</u>	<u>834,323</u>	<u>8,928,519</u>		
Advance lease payments	85,600	-	29,588	56,012	<u>29,587</u>	
Current advance lease payments	<u>(29,587)</u>	<u>-</u>	<u>-</u>	<u>(29,587)</u>		
Noncurrent advance lease payments	<u>56,013</u>	<u>-</u>	<u>29,588</u>	<u>26,425</u>		
Total noncurrent liabilities	<u>\$ 9,863,855</u>	<u>\$ (45,000)</u>	<u>\$ 863,911</u>	<u>\$ 8,954,944</u>	<u>\$ 904,587</u>	

All general obligation (G.O.) bonds have been issued by the City on behalf of the Utility. The (G.O.) bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds are in a range between 2.5% and 5.50%. The total debt service obligations over the remaining term of the bonds are as follows:

Year	Series 1998		Series 1999		Series 2002	
	Principal Amount	Interest Amount	Principal Amount	Interest Amount	Principal Amount	Interest Amount
2005	\$ 35,000	\$ 24,338	\$ 40,000	\$ 25,260	\$ 260,000	\$ 53,391
2006	35,000	22,797	45,000	23,440	275,000	46,891
2007	40,000	21,240	45,000	21,348	280,000	39,329
2008	40,000	19,440	50,000	19,210	295,000	30,929
2009-2013	365,000	60,820	270,000	58,723	620,000	33,050
2014	-	-	65,000	3,347	-	-
	<u>\$ 515,000</u>	<u>\$ 148,635</u>	<u>\$ 515,000</u>	<u>\$ 151,328</u>	<u>\$ 1,730,000</u>	<u>\$ 203,590</u>

The Series 1999 capital loan notes require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the notes are in a range between 4.6% and 5.5%. The debt is secured by the future net revenues of the Utility.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(5) Noncurrent Liabilities, Continued

The total debt service obligations over the remaining term of the notes are as follows:

<u>Year</u>	<u>Principal Amount</u>	<u>Interest Amount</u>
2005	\$ 245,000	\$ 159,048
2006	255,000	147,532
2007	270,000	135,293
2008	285,000	122,062
2009	295,000	107,813
2010-2013	1,345,000	269,630
2014	380,000	20,900
	<u>\$3,075,000</u>	<u>\$ 962,278</u>

The bond resolution provides certain covenants relating to the collection, segregation and distribution of revenues from customers; places certain restrictions on future borrowing and leasing or disposition of assets; and requires that minimum insurance coverage be maintained.

The Board of Trustees of the Municipal Electric Utility authorized a loan to be extended to the Utility under Resolutions No. 2759, 2840, 2939, 2994, and 3086. The December 31, 2004 and 2003 outstanding balances on this loan were \$2,218,090 and \$2,403,090, respectively, bearing interest at 3.1%. The Board of Trustees of the Municipal Electric Utility approved a loan be extended to the Utility under Resolution No. 3497. The December 31, 2004 and 2003 outstanding balances on this loan were \$875,000 and \$1,000,000, respectively, bearing interest at 3.1%. Semiannual debt service payments are required on January 1 and July 1. Total debt service requirements are as follows:

<u>Year</u>	<u>Principal Amount</u>	<u>Interest Amount</u>
2005	\$ 310,000	\$ 98,151
2006	310,000	88,680
2007	310,000	79,070
2008	310,000	69,552
2009-2013	1,300,000	206,940
2014-2016	553,090	43,840
	<u>\$3,093,090</u>	<u>\$586,233</u>

(6) Pension Plan

The Utility contributes to the Iowa Public Employees Retirement System (IPERS), 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 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 Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2004, 2003, and 2002 were \$63,318; \$67,282; and \$45,677; respectively, equal to the required contributions for each year.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(7) Income Tax Status

The Utility is exempt from federal and state income taxes under the applicable tax codes.

(8) Related Party Transactions

The Utility uses a pooled cash account with affiliated utilities. Activity between utilities that are representative of lending/borrowing arrangements due to cash overdrafts in certain affiliated utilities at the end of the year are referred as "due to/due from affiliated utilities". At December 31, 2004 and 2003, the Utility had a due to affiliated utilities of \$-0- and \$181,779, respectively, under this agreement.

The Utility provides communications service to the City. Operating revenues from the service provided amounted to \$39,010 and \$38,740 in 2004 and 2003, respectively.

Outstanding loan balances from the Municipal Electric Utility are \$3,093,090, and \$3,403,090 as of December 31, 2004, and 2003, respectively. Interest accrues on the loan at 3.1%, and is paid semi-annually during January and July. Annual principal payments continue through 2016 (see note 5). Accrued interest payable was \$50,606 and \$55,585 at December 31, 2004 and 2003, respectively.

The Utility pays the Municipal Electric Utility, the Municipal Gas Utility and the Municipal Water Utility a management fee for administration, finance, human resources and legal services as part of the program to equitably allocate Communications costs. For the years ended December 31, 2004 and 2003, the Utility recorded a management fee to the Municipal Electric Utility of \$67,510, the Municipal Gas Utility of \$20,800, and the Municipal Water Utility of \$1,690.

See note 5 for description of debt with the City. The interest paid to the City was \$112,666 and \$135,126 for the years ended December 31, 2004 and 2003, respectively. The accrued interest related to this debt was \$8,582 and \$9,389 at December 31, 2004 and 2003, respectively.

(9) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,013,300 in aggregate for all participants and have insurance for claims above this amount.

Liabilities of the risk management account are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an estimated amount for claims that have been incurred but not reported (IBNR) which represent estimates of the eventual loss on claims arising prior to year-end. Changes in the balances of claims liabilities during the past two years are as follows:

	<u>2004</u>	<u>2003</u>
Unpaid claims, beginning of year	\$ 112,350	\$ 181,700
Current year claims and changes in estimates	1,593,270	1,149,399
Claim payments	<u>(1,543,395)</u>	<u>(1,218,749)</u>
Unpaid claims, end of year	<u>\$ 162,225</u>	<u>\$ 112,350</u>

(Continued)

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)

Notes to Financial Statements

December 31, 2004 and 2003

(9) Risk Management, Continued

The Utility has recorded \$19,467 and \$11,235 in accounts payable for its share of these unpaid claims at December 31, 2004 and 2003, respectively.

The Utilities are a member of the Iowa Municipalities Workers' Compensation Association (the Association), which was established to provide members a group self-insurance program for their workers' compensation liabilities. Approximately 470 governmental entities participate in the Association. A board of trustees consisting of seven members is elected by the members participating in the Association to manage and conduct the business and affairs of the Association.

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2004.

Cash and cash equivalents and investments	\$22,960,768
Receivables	814,103
Other assets	668,545
Total assets	<u>\$24,443,416</u>
Total liabilities	18,559,769
Total equity	5,883,647
Total liabilities and equity	<u>\$24,443,416</u>
Total revenues	663,637
Total expenses	2,425,524
Distribution to members	-
Net decrease in equity	<u>\$(1,761,887)</u>

There have been no instances where the amount of settlement has exceeded available coverage in the past three years. There has been no significant reduction in insurance coverage from coverage in the prior year.

10. Subsequent Event

Effective January 1, 2005, the Board of Trustees approved a Cable TV rate increase. The average rate increase is approximately 9.0% for all Basic Cable TV customers, approximately 10.0 % for all Basic Plus Cable TV customers, and approximately 15.0% for Digital Cable TV customers. The Digital Cable TV rates were also restructured.



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 Board of Trustees
Cedar Falls Utilities – Municipal Communications Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Communications Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2004 and 2003, and have issued our report thereon dated March 30, 2005. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted a certain immaterial instance of non-compliance that is described in Part II of the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2004, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the 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.

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Utility in a separate letter dated March 30, 2005. There were no prior year reportable conditions.

This report, a public record by law, is intended solely for the information and use of the officials, employees, and the customers of the Utility and other parties to whom the Utility 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 Utility 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.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Dubuque, Iowa
March 30, 2005

**CEDAR FALLS UTILITIES – MUNICIPAL COMMUNICATIONS UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

Part I: Summary of the Independent Auditor's Results:

- (a) An unqualified opinion was issued on the financial statements.
- (b) No material weaknesses in internal control over financial reporting were noted.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

Part II: Other Findings Related to Statutory Reporting:

- II-A-04 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2004.
- II-B-04 Certified Budget - Disbursements during the year ended December 31, 2004, did not exceed the amounts budgeted.
- II-C-04 Questionable Expenditures - We noted no expenditures that we believe may 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 Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-04 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-04 Bond Coverage - Surety bond coverage of Utility 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 Board Minutes - No transactions were found that we believe should have been approved in the Board 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 Utility's investment policy were noted.
- II-I-04 Revenue Bonds - We noted no instances of non-compliance with the provisions of the Utility's revenue bond resolutions.

**CEDAR FALLS UTILITIES – MUNICIPAL COMMUNICATIONS UTILITY
CEDAR FALLS, IOWA
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004**

II-J-04 Notice of Public Hearing – Notice of public hearing for public improvements with a total cost to the Utility of \$25,000 or more is to be published not less than four nor more than twenty days prior to the public hearing in accordance with Chapters 384.102 and 362.3 of the Code of Iowa. We noted several notices of public hearing that were published more than twenty days prior to the public hearing.

Recommendation – We recommend that the Utility examine the procedures in place regarding publication of notice of public hearing to ensure that they are in compliance with the requirements of the Code of Iowa in the future.

Response – We will change the process we have been using of counting clear days for notices. Going forward, we will count calendar days but not include the day of publication.

Conclusion – Response accepted.



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INDEPENDENT AUDITORS' REPORT ON SUPPLEMENTARY INFORMATION

The Board of Trustees
Cedar Falls Utilities – Municipal Electric, Gas, Water, and Communications Utilities

We have audited and reported separately herein on the financial statements of Cedar Falls Utilities – Municipal Electric, Gas, Water, and Communications Utilities as of and for the years ended December 31, 2004 and 2003.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Cedar Falls Utilities – Municipal Electric, Gas, Water, and Communications Utilities taken as a whole. The supplementary information in the schedules noted on the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in our audit of the basic financial statements, and accordingly, we express no opinion on it.

Eide Bailly LLP

March 30, 2005
Dubuque, Iowa

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MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

Schedule of Insurance Coverage

(Unaudited-See accompanying accountants' report)

December 31, 2004

Schedule 1

Insurer and Policy Information

Coverage

Iowa Municipalities Workers Compensation Association

Worker's Compensation	\$ 1,000,000/accident
Member No. 0480	1,000,000/employee
Term 07-01-04/07-01-05	

Acuity

Commercial Auto Liability	\$ 250,000
Policy No. F89834	
Term 01-01-05/01-01-06	

Associated Electric & Gas Insurance Services Limited

Fiduciary & Employee Benefit Liability	\$10,000,000
Policy No. FO432A1A05	
Term 01-01-05/01-01-06	
Includes a \$200,000/occurrence self-retention	
Excess General Liability	\$25,000,000/occurrence
Policy No. XO432A1A05	
Term 01-01-05/01-01-06	
Public Officials' Errors & Omissions Liability	\$10,000,000/occurrence
Policy No. D0432A1A05	
Term 01-01-05/01-01-06	

West Bend Mutual Insurance Company

Commercial Property (2 Booster Stations)	\$ 226,000
Policy No. CPI044166804	
Term 09-01-04/09-01-05	

(Continued)

MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

Schedule of Insurance Coverage

(Unaudited-See accompanying accountants' report)

December 31, 2004

Schedule 1

<u>Insurer and Policy Information</u>	<u>Coverage</u>
<u>The Hartford Steam Boiler Inspection and Insurance Co</u>	
Property	\$98,448,988
Inland Marine/Contractors Equipment	1,439,585
Policy No. STA4102045	
Term 01-01-05/01-01-06	
<u>National Union Fire Insurance Co of Pittsburgh, PA</u>	
Crime	\$ 500,000/occurrence
Policy No. 009782599	
Term 01-01-05/01-01-06	
<u>Zurich</u>	
Builders Risk (125 x 125 Building)	\$ 1,500,000
Policy No. BR59817793	
Term 08-01-04/08-01-05	
<u>Iowa Comprehensive Petroleum Underground Storage Tank Financial Responsibility Program</u>	
Underground Storage Tanks	\$ 500,000/occurrence
Policy No. 8600572	1,000,000/aggregate
Term 10-17-04/10-16-05	

Management believes the current insurance program is adequate to protect bondholders from losses, which can reasonably be anticipated. The schedule includes insurance coverage for the Electric, Gas, Water, and Communications Utilities.

(Continued)

MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

Schedule of Insurance Coverage

(Unaudited-See accompanying accountants' report)

December 31, 2004

Schedule 2

Electric Utility

Rates of the Electric Utility, as a municipal system, are not subject to Iowa Utilities Board regulation. Rates are established by a Board of Trustees, currently consisting of Mark W. Baldwin, Chair; Pamela L. Taylor, Vice Chair; Richard A. Eades, Secretary; Roger A. Kueter, member; Vilas L. Morris, member. The current electric rate tariff provides for an energy cost adjustment factor, which reflects changes in the price of fuel used to generate electricity and purchased power. Following are the basic monthly rates for electric service in effect for 2004.

Residential (Except Heating)

Customer charge	\$6.00
First 800 KWH	0.0660¢ per KWH
All over 800 KWH	0.0500¢ per KWH (Oct - May)
All over 800 KWH	0.0600¢ per KWH (June - Sept)
Minimum	\$6.00

Residential All-Electric Service

Customer charge	\$6.00
First 800 KWH	0.0650¢ per KWH
All over 800 KWH	0.0341¢ per KWH (Oct - May)
All over 800 KWH	0.0650¢ per KWH (June - Sept)
Minimum	\$6.00

Farm/Agricultural Service

Customer charge	\$8.00
First 50 KWH	0.1460¢ per KWH
Next 150 KWH	0.0970¢ per KWH
Next 500 KWH	0.0720¢ per KWH
All over 700 KWH	0.0550¢ per KWH
Minimum	\$8.00

Demand Space Heating Service

Customer charge	\$20.00
Demand charge	
All KW of billing demand	\$ 3.30 per KWH
Energy charge	
First 180 hours use per month per KW of billing demand	\$0.041¢ per KWH
Next 180 hours of use per month per KW of billing demand	0.032¢ per KWH
All over 360 hours use per month per KW of billing demand	0.032¢ per KWH (June-Sept)
All over 360 hours use per month per KW of billing demand	0.026¢ per KWH (Oct-May)
Minimum	the demand & customer charge

(Continued)

MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2004

Small Space Heating Service

Customer charge	\$6.00
All KWH	0.0345¢ per KWH
Minimum	\$6.00

General Service

Customer charge	\$20.00
First 4,000 KWH	0.0662¢ per KWH
Next 6,000 KWH	0.0500¢ per KWH
All over 10,000 KWH	0.0427¢ per KWH

Large-Volume Power Service

Customer charge	\$100.00
Demand charge	
First 1,000 KW of billing demand	\$ 3.90/KW/month
All over 1,000 KW of billing demand	\$ 2.50/KW/month
Energy charge	
First 250 hours use per month per KW of billing demand	\$ 0.040¢ per KWH
Next 110 hours use per month per KW of billing demand	0.033¢ per KWH
Over 360 hours use per month per KW of billing demand	0.027¢ per KWH
Minimum	\$275.00

Non-Profit/Governmental and Interdepartmental

Customer charge	\$10.00
All KWH	0.0531¢ per KWH
Minimum	\$10.00
No sales tax	

(1) The Board of Trustees at their June 2, 1987, meeting approved an electric revenue adjustment credit of 0.6¢/KWH for this rate step for the billing months of October through May. This credit will remain applicable until further action is taken by the Board of Trustees.

(2) The Board of Trustees at their June 2, 1987, meeting approved an electric revenue adjustment credit of 0.3¢/KWH for each energy block of this rate. This credit will continue until further action is taken by the Board of Trustees.

At December 31, 2004 and 2003 the number of customer accounts was 16,970 and 16,738, respectively.

(Continued)

MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2004

Gas Utility

Rates of the Gas Utility, as a municipal system, are not subject to Iowa Utilities Board regulation. Rates are established by a Board of Trustees, currently consisting of Mark W. Baldwin, Chair; Pamela L. Taylor, Vice Chair; Richard A. Eades, Secretary; Roger A. Kueter, member; Vilas L. Morris, member. The current gas rate tariff provides for a purchased gas adjustment factor, which reflects changes in the price of fuel purchased. Following are the basic monthly rates for gas service in effect for 2004.

Residential Firm Service

Customer charge	\$10.00
First 2 MCF	6.85 per MCF
All over 2 MCF	4.00 per MCF
Minimum	\$10.00

Small-Volume Firm Service

Customer charge	\$15.75
First 5 MCF	5.50 per MCF
All over 5 MCF	4.40 per MCF
Minimum	\$15.75

Large-Volume Firm Service

Customer charge	\$15.75
First 5 MCF	5.00 per MCF
All over 5 MCF	4.30 per MCF
Minimum	\$15.75

Interruptible Commercial Service

Customer charge	\$27.64
All MCF	4.00 per MCF
Minimum	\$27.64

Large-Volume/High Load Factor Firm Service

Customer charge	\$109.49
All MCF	3.41 per MCF
Minimum	\$109.49

Industrial Interruptible Service (Large-Volume)

Customer charge	\$109.49
All MCF	3.35 per MCF
Minimum	\$109.49

Large-Volume Competitive Fuel Service

All MCF

Variable with market

MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2004

No minimum
Purchased gas adjustment to applicable

Tax Supported/Non Profit Institutional Service

Customer charge	\$27.05
All MCF	4.25 per MCF
Minimum	\$27.05

Interdepartmental Service

Customer charge	\$ 2.34
All MCF	3.62
Minimum	\$ 2.34

Large-Volume Interruptible Service

Part 1-Transportation cost	\$1,187.50/month
Part 2-Commodity cost	Ventura Index Price
Part 3-Broker cost	\$ 0.35/MCF
Minimum	\$1,187.50
Sales tax not applicable	

Electric Generation & Steam Boiler Interruptible Service

All MCF billed at the current CFU gas acquisition cost, plus \$0.10 per MCF	
Minimum	\$ 0.00
Sales tax not applicable	

Large-Volume Transportation Service

Customer charge	\$100.00
All volumes delivered	0.92 per MCF
Minimum	0.00

At December 31, 2004 and 2003, the number of customer accounts was 12,456 and 12,246, respectively.

Water Utility

Rates of the Water Utility, as a municipal system, are not subject to Iowa Utilities Board regulation. Rates are established by a Board of Trustees, currently consisting of Mark W. Baldwin, Chair; Pamela L. Taylor, Vice Chair; Richard A. Eades, Secretary; Roger A. Kueter, member; Vilas L. Morris, member.

At December 31, 2004 and 2003 the number of customer accounts was 11,407 and 11,133, respectively.

(Continued)

MUNICIPAL ELECTRIC, GAS, WATER AND COMMUNICATIONS UTILITIES
OF THE CITY OF CEDAR FALLS, IOWA

(Component Units of the City of Cedar Falls, Iowa)

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2004

Communications Utility

Rates of the Communications Utility, as a municipal system, are not subject to Iowa Utilities Board regulation. Rates are established by a Board of Trustees, currently consisting of Mark W. Baldwin, Chair; Pamela L. Taylor, Vice Chair; Richard A. Eades, Secretary; Roger A. Kueter, member; Vilas L. Morris, member.

At December 31, 2004 and 2003 the number of customer accounts was as follows:

	<u>2004</u>	<u>2003</u>
Cable television	7,977	7,890
Cable modem service	6,288	5,926
Commercial data service	13	12



To the Board of Trustees
Cedar Falls Utilities – Municipal Electric, Gas, Water, and Communications Utilities

We have audited the financial statements of Cedar Falls Utilities – Municipal Electric, Gas, Water, and Communications Utilities (the Utilities) for the year ended December 31, 2004, and have issued our report thereon dated March 30, 2005. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Auditing Standards Generally Accepted in the United States of America and *Government Auditing Standards*

As stated in our engagement letter dated January 13, 2005, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with auditing standards generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of the Utilities. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Utilities' compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

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 Utilities 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 2004. We noted no transactions entered into by the Utilities during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

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 most sensitive estimate affecting the financial statements was unbilled service revenue.

Management's estimate of the unbilled service revenue is based on past history and billings generated after year end. We evaluated the key factors and assumptions used to develop the unbilled service revenue estimate in determining that it is reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Utilities' financial reporting process (that is, cause future financial statements to be materially misstated). Audit adjustments were made to adjust the receivables for unbilled service revenue in the Electric and Gas Utilities and to record an allowance for funds used during construction in the Electric Utility.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter 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.

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 governmental unit'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.

Issues Discussed Prior to Retention of Independent Auditors

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 Utilities' auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

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

Other Comments

We have included additional comments regarding the financial statements and operations. These comments are not a result of in-depth study of any specific areas but are based on observations made during the course of our audit. Our observations indicate that overall financial operations of the Utilities continue to be conducted in an efficient and effective manner.

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

As always, we will be happy to discuss these or any other topics at your convenience. We would like to take this opportunity to express our appreciation to you and your staff for the fine cooperation that we received during the course of the audit. We look forward to many years of continued service to Cedar Falls Utilities.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Dubuque, Iowa
March 30, 2005

CEDAR FALLS UTILITIES

DECEMBER 31, 2004

OTHER COMMENTS

Travel and Expense Reimbursement

During our review of expense reimbursement to employees and expenses charged to procurement cards owned by Cedar Falls Utilities, it was noted that employees are not always following the Utilities' travel policy requiring all expenses be supported by detailed receipts. In many instances, documentation supplied for meals consisted of only a signed credit card receipt showing the total charge rather than a detail of the costs.

The policy also states that if an employee does not present receipts in support of an expense reimbursement request or a charge to a procurement card that the employee must pay for the expense personally. We noted at least one instance when an expense had no receipts to support it, but the cost was not reimbursed by the employee.

Also, in this time of increased public scrutiny, it is especially important that a municipal entity monitor all of its expenditures to ensure that they meet the criteria of public purpose. Areas that seem to be highly susceptible to this scrutiny include things such as travel and training expenses, reimbursement for meals incurred when not traveling out-of-town, expenses incurred under the heading of employee recognition and morale, and food purchased for consumption within the place of business.

We recommend that the Utilities develop some form of communication and/or education for all employees and board members informing them of the need to follow the existing travel and reimbursement policies. This education should also include information regarding the public purpose criteria for all expenditures and the importance of documenting that public purpose.

New Pronouncements

The Governmental Accounting Standards Board (GASB) has issued five statements not yet implemented by Cedar Falls Utilities. The statements, which might impact the Utilities, are as follows:

Statement No. 40, *Deposit and Investment Risk Disclosures*, issued March 2003, will be effective for the Utilities for the year ending December 31, 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 Utilities for the year ending December 31, 2005. 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 Utilities for the year ending December 31, 2007. 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.

CEDAR FALLS UTILITIES

DECEMBER 31, 2004

OTHER COMMENTS

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, issued June 2004, will be effective for the Utilities for the year ending December 31, 2008. 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 in the financial reports of state and local governmental employers.

Statement No. 46, *Net Assets Restricted by Enabling Legislation*, issued December 2004, will be effective for the Utilities for the year ending December 31, 2006. This statement clarifies the definition of a legally enforceable enabling legislation restriction. It also specifies the accounting and financial reporting requirements for the restrictions and for any changes in them.

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