

**SPENCER MUNICIPAL UTILITIES  
FINANCIAL STATEMENTS  
FOR THE YEAR ENDED  
DECEMBER 31, 2004 AND  
INDEPENDENT AUDITORS' REPORT**

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SPENCER MUNICIPAL UTILITIES

OFFICIALS

DECEMBER 31, 2004

<u>Board of Trustees</u>		<u>Term Expires</u>
Murray Hart	Treasurer	6-30-2007
Tom Howe	Trustee	6-30-2008
Dave Hultgren	Vice-Chairman	6-30-2005
Bruce Tamisiea	Chairman	6-30-2010
Gary Tolzmann	Secretary	6-30-2006

Management

Leon Rodas	General Manager
Steven Pick	Finance Supervisor

**SPENCER MUNICIPAL UTILITIES**

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA

**WINTHER, STAVE & CO., LLP**  
*Certified Public Accountants*

1316 West 18th Street  
P.O. Box 175  
Spencer, Iowa 51301-0175  
Phone 712-262-3117  
FAX 712-262-3159

1004 21st Street #4  
P.O. Box 187  
Milford, Iowa 51351  
Phone 712-338-2488  
FAX 712-338-2510

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INDEPENDENT AUDITORS' REPORT

Board of Trustees  
Spencer Municipal Utilities - Municipal Electric Utility  
Spencer, IA 51301

We have audited the accompanying balance sheet of the Municipal Electric Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2004 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year 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 audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards, 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 audit provides 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 the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 23, 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 4 through 7 and 25 through 27 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Winter, Stone & Co LLP*

February 23, 2005

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of management's discussion and analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Electric Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2004.

The following information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

The Utility is implementing Government Accounting Standards Board Statement #34 (GASB 34) as required by the Governmental Accounting Standards Board. Because of these new reporting standards for this year with significant changes in content and structure, much of the information is not easily comparable to prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the Utility's financial position and results of operations.

### **2004 Financial Highlights**

The Utility delivered approximately 152,289,000 kilowatt hours (kWh) of electricity to its retail customers in 2004 compared to approximately 151,045,000 (kWh) in 2003.

The Utility's net assets increased \$143,561 to \$45,034,436 as a result of operations for the year ended December 31, 2004.

### **Overview of the Financial Statements**

The balance sheet includes the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities).

The statement of revenues, expenses and changes in net assets report all revenues and expenses incurred during the fiscal year.

The statement of cash flows present cash receipts, cash disbursements, and net changes in cash resulting from operations, non capital financing activities, capital and related financing activities and investing activities.

The notes to the financial statements provide the required disclosures and other information that is necessary to give the reader a complete understanding of the data provided in the statements. The notes present information about the Utility's accounting policies, material risks, obligations, commitments, contingencies and subsequent events.

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

**Condensed Financial Information**

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

<u>Condensed Balance Sheet</u>		
	<u>2004</u>	<u>2003</u>
Current assets .....	\$16,375,395	\$17,839,192
Capital assets - net of depreciation .....	26,974,973	24,683,355
Noncurrent assets .....	17,735,532	9,984,758
Deferred costs .....	<u>182,884</u>	<u>94,758</u>
Total assets	<u>\$61,268,784</u>	<u>\$52,602,063</u>
Current liabilities .....	\$ 1,954,348	\$ 1,260,018
Long-term debt .....	<u>14,280,000</u>	<u>6,450,000</u>
Total liabilities	<u>16,234,348</u>	<u>7,710,018</u>
Investments in capital assets - net of related debt .....	11,957,857	17,911,943
Restricted .....	8,467,937	1,618,343
Unrestricted .....	<u>24,608,642</u>	<u>25,360,589</u>
Total net assets	<u>45,034,436</u>	<u>44,890,875</u>
Total liabilities and net assets	<u>\$61,268,784</u>	<u>\$52,602,063</u>

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Sales of electricity .....	\$ 7,456,330	\$ 7,047,828
Other .....	<u>207,941</u>	<u>150,466</u>
Total operating revenue	<u>7,664,271</u>	<u>7,198,294</u>
Power supply costs .....	4,668,272	4,409,441
Distribution system maintenance .....	1,013,513	945,003
Depreciation and amortization .....	1,601,919	1,608,712
Customer service and administration .....	<u>939,922</u>	<u>873,153</u>
Total operating expenses	<u>8,223,626</u>	<u>7,836,309</u>
Operating income (loss)	(559,355)	(638,015)
Interest income .....	608,605	591,373
Interest expense .....	(380,587)	(404,607)
Other income (expenses) - net .....	<u>474,898</u>	<u>454,956</u>
Total non-operating revenues	<u>702,916</u>	<u>641,722</u>
Change in net assets	143,561	3,707
Net assets - beginning of year .....	<u>44,890,875</u>	<u>44,887,168</u>
Net assets - end of year	<u>\$45,034,436</u>	<u>\$44,890,875</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

### **Financial Analysis**

The Utility's total assets increased by approximately \$8.5 million, of which approximately \$6.8 million is related to the 2004 bond sale.

The Utility's gross revenues increased by approximately \$460,000 or 6.40%.

Power supply costs have increased by approximately \$260,000. Other operating expenses increased by approximately \$145,000 due to increased expenses related to distribution maintenance, customer service and metering.

Total operating loss generated in 2004 was \$559,000 compared to \$623,000 in 2003.

Utility non-operating income (expense) resulted in an additional \$76,000 of income in 2004 over 2003 due to additional leases of utility facilities.

Total net income increased from \$3,700 in 2003 to \$143,000 in 2004.

### **Capital Assets and Debt Administration**

Net capital assets increased by approximately \$2,380,000 due to the construction of the Shine substation, significant upgrades to the West substation, construction work in progress related to the Council Bluffs Energy Center Unit 4 (CBEC #4), and distribution construction.

During August of 2002, the Board of Trustees entered a joint ownership agreement for the construction of the Council Bluffs Energy Center Unit 4. The Utility will become a 1.07% owner which is 8.453 megawatts. The Utility's total ownership interest is estimated at \$13,600,000. The Utility's construction work in progress totaled approximately \$2,400,000 at year end.

On February 1, 2004, the Board of Trustees authorized the issuance of \$8,750,000 in Electric Revenue Bonds, Series 2004. The proceeds from these bonds will be used to finance a portion of the construction of the Council Bluffs Energy Center Unit 4 discussed above.

### **Economic Factors**

The Utility continues to experience positive growth in retail sales; however, power supply costs are increasing at a greater rate because of several factors. They include reductions in electricity delivered and increased costs from Western Area Power Administration (WAPA), and increased purchased power costs from NIMECA. In order to address these issues, the Board of Trustees has entered into a joint ownership agreement for the construction of the CBEC #4 and has signed a letter of intent to become a 6.25% participant of the Wisdom 2 combustion turbine generator.

The Utility is also adversely affected by the low interest rates currently being received on invested funds.

The Utility completed a Cost of Service Study during 2004. The purpose of the study was to assign operating and capital costs to the various rate classes and verify that rates were adequate to cover those costs. The Board of Trustees adopted rate adjustments based on the study effective March 1, 2005. The annual increase in revenue should approximate 10%.

## MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

### **Contacting the Utility's Financial Management**

This financial report is designed to present our citizens, customers, and creditors with a general overview of the Utility's finances and operating activities. If you have any questions or require additional information please contact the Finance Supervisor, 712 Grand Ave, PO Box 222, Spencer, Iowa 51301.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET  
DECEMBER 31, 2004

ASSETS

CAPITAL ASSETS (Note 4):		
Plant in service .....	\$48,105,329	
Less accumulated depreciation .....	<u>23,797,937</u>	
Plant in service - net .....	24,307,392	
Construction work in progress .....	<u>2,667,581</u>	
CAPITAL ASSETS - NET .....		\$26,974,973
NONCURRENT ASSETS:		
Noncurrent investments:		
Board designated (Notes 2 and 3) .....	3,815,283	
Restricted (Notes 2 and 9) .....	6,816,999	
Note receivable - City of Spencer (Note 7) .....	53,250	
Note receivable - Municipal Communications Utility (Note 8) .....	<u>7,050,000</u>	
TOTAL NONCURRENT ASSETS .....		17,735,532
CURRENT ASSETS:		
Cash and cash equivalents:		
Unrestricted (Note 2) .....	1,051,516	
Board designated (Notes 2 and 3) .....	11,191,566	
Restricted (Notes 2 and 9) .....	1,650,938	
Consumer deposits .....	20,727	
Accounts receivable - net of allowance for doubtful accounts of \$42,609 .....	892,348	
Unbilled usage .....	363,600	
Materials and supplies inventory .....	627,654	
Fuel inventory .....	162,570	
Prepayments .....	65,841	
Accrued interest receivable (Note 8) .....	313,578	
Note receivable - electric heat (Note 6) .....	482	
Note receivable - City of Spencer (Note 7) .....	26,625	
Notes receivable - employees (Note 5) .....	<u>7,950</u>	
TOTAL CURRENT ASSETS .....		16,375,395
DEFERRED COSTS:		
Unamortized bond issue costs .....		<u>182,884</u>
TOTAL ASSETS .....		<u>\$61,268,784</u>

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET - Continued  
DECEMBER 31, 2004

LIABILITIES

NONCURRENT LIABILITIES:  
Revenue bonds payable - less current installments (Note 9)..... \$14,280,000

CURRENT LIABILITIES:  
Current installments of revenue bonds payable (Note 9) ..... \$ 920,000  
Accounts payable ..... 665,967  
Accrued wages, vacations, and benefits ..... 227,235  
Accrued interest ..... 55,380  
Consumer deposits ..... 20,644  
Accrued expenses ..... 65,122  
TOTAL CURRENT LIABILITIES 1,954,348

COMMITMENTS AND CONTINGENCIES (Notes 15 and 17) ..... \_\_\_\_\_  
TOTAL LIABILITIES 16,234,348

NET ASSETS

Invested in capital assets - net of related debt ..... 11,957,857  
Restricted - bond funds (Note 9) ..... 8,467,937  
Unrestricted ..... 24,608,642  
TOTAL NET ASSETS 45,034,436

TOTAL LIABILITIES AND NET ASSETS \$61,268,784

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
FOR THE YEAR ENDED DECEMBER 31, 2004

OPERATING REVENUES:		
Residential .....	\$ 2,827,047	
Commercial .....	3,875,697	
Public authorities .....	650,466	
Sales for resale .....	161,845	
Interdepartmental .....	103,120	
Penalties .....	10,899	
Rental income .....	20,334	
Miscellaneous .....	<u>14,863</u>	
TOTAL OPERATING REVENUES		\$ 7,664,271
OPERATING EXPENSES:		
Generation and transmission:		
Neal #4 fuel and generation .....	830,751	
Purchased power .....	3,759,376	
Other .....	78,145	
Distribution .....	1,013,513	
Depreciation and amortization .....	1,601,919	
Customer operations .....	219,496	
General and administrative .....	<u>720,426</u>	
TOTAL OPERATING EXPENSES		<u>8,223,626</u>
LOSS FROM OPERATIONS		(559,355)
NON-OPERATING INCOME (EXPENSE) AND TRANSFERS:		
Interest income on investments .....	283,121	
Interest income from Municipal Communication Utility (Note 8) ...	325,484	
Economic development payments .....	(188,040)	
Leased facilities (Note 12) .....	997,680	
Interest expense .....	(380,567)	
Gain on plant retirements .....	14,094	
Transfers to City - in lieu of property taxes (Note 7) .....	<u>(348,836)</u>	
TOTAL NON-OPERATING INCOME (EXPENSE) AND TRANSFERS - NET		<u>702,916</u>
NET INCOME		143,561
NET ASSETS - BEGINNING OF YEAR .....		<u>44,890,875</u>
NET ASSETS - END OF YEAR		<u>\$45,034,436</u>

See Accompanying Notes to Financial Statements

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2004

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Cash received from customers .....	\$ 7,621,920
Cash paid to suppliers .....	(5,182,201)
Cash paid to employees .....	<u>(1,333,195)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>1,106,524</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
Contributions paid for economic development .....	(188,040)
Transfer to City - in lieu of property tax .....	<u>(348,836)</u>
NET CASH USED IN NONCAPITAL FINANCING ACTIVITIES	<u>(536,876)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
Acquisition and construction of capital assets .....	(3,903,606)
Proceeds received from sale of capital assets .....	37,948
Proceeds received from issuance of revenue bonds .....	8,750,000
Revenue bond principal repayment .....	(415,000)
Cost of revenue bond issuance .....	(103,081)
Payments received from leasing of facilities .....	987,408
Interest paid .....	<u>(358,859)</u>
NET CASH PROVIDED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>4,994,810</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Payments received on note receivable - City of Spencer .....	26,625
Payments received on notes receivable - employees .....	7,234
Payments received on note receivable - electric heat .....	635
Loan advances for notes receivable - employees .....	(9,575)
Payments received on note receivable - Communications Utility .....	300,000
Proceeds from redemption of investments .....	1,903,883
Purchase of investments .....	(9,941,496)
Interest income on investments .....	243,335
Interest income from note receivable - Communications Utility .....	<u>521,079</u>
NET CASH USED BY INVESTING ACTIVITIES	<u>(6,948,280)</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	(1,383,822)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR .....	<u>15,277,842</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$13,894,020</u>

MUNICIPAL ELECTRIC UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 STATEMENT OF CASH FLOWS - Continued  
 FOR THE YEAR ENDED DECEMBER 31, 2004

<b>RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	
Loss from operations .....	\$ <u>(559,355)</u>
Adjustments to reconcile income from operations to net cash provided by operating activities:	
Depreciation .....	1,588,134
Amortization .....	13,785
(Increase) decrease in:	
Consumer deposits .....	(1,105)
Accounts receivable .....	(49,568)
Unbilled usage .....	7,300
Materials and supplies inventory .....	(98,435)
Fuel inventory .....	55,430
Prepayments .....	(17,264)
Increase (decrease) in:	
Accounts payable .....	85,472
Accrued wages, vacations, and benefits .....	39,825
Consumer deposits .....	1,022
Accrued expenses .....	<u>41,283</u>
Total adjustments .....	<u>1,665,879</u>
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 <u>\$ 1,106,524</u>

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

The Municipal Electric Utility of the City of Spencer, Iowa (Electric Utility or Utility) operates as an independent unit of the City of Spencer and is managed, along with the Municipal Water Utility and the Municipal Communication Utility of the City of Spencer, Iowa, by a five member Board of Trustees.

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.

For financial reporting purposes, the Utility has included all funds. The Utility has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Utility. It was determined that the Utility has no component units.

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2004 has been completed and is filed under separate cover.

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

In reporting the financial activity of its enterprise fund, the Utility applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**B. Capital Assets and Depreciation**

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new electric facilities. In addition, net interest costs on construction debt are capitalized. During 2004, the Utility capitalized interest expense of \$155,455, which equals total interest expense of \$266,426 less interest income from invested proceeds of \$110,971.

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.215% undivided interest in a 640 MW electric generation station known as George Neal Generating Station Unit No. 4. The Electric Utility's 1.215% ownership interest in this plant represents a total investment of \$4,723,691 included in utility plant in service with \$3,318,446 included in accumulated depreciation. Operating costs associated with this plant and depreciation are reflected in the statement of income.

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.07% undivided interest in an electric generation station known as Council Bluffs 4, which is currently under construction with expected completion in 2007. Additional information is included in Note 17.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred.

Depreciation is provided on a straight-line basis. Current depreciation expense is approximately 3.30% of the original cost of depreciable electric plant in service.

The estimated useful lives used to depreciate assets by class are as follows:

Infrastructure	20 - 33 years
Buildings and improvements	20 years
Equipment	5 years

**C. Accounts Receivable**

Accounts receivable are stated at the amount the Utility expects to collect from outstanding balances. The Utility provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after the Utility has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements.

**D. Inventories**

Inventories are valued at the lower of cost or market. The average cost method is used for determining the cost of materials and supplies inventory. Inventories are recorded as an expenditure when consumed.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**E. Unamortized Bond Issue Costs**

Unamortized debt issue costs are amortized over the life of the debt on a straight-line basis which approximates the effective interest method.

**F. 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 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.

**G. Income Taxes**

The Electric Utility is exempt from federal and state income taxes because it is a governmental entity organized under the provisions of Chapter 388 of the Code of Iowa.

**H. Revenues and Unbilled Usage**

Revenues are based on billing rates, which are applied to customers' consumption of electricity. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2004, totaled \$363,600.

**I. Estimates**

The preparation of the financial statements in conformity with U.S. generally accepted accounting principals 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. CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS**

The Utility's deposits at December 31, 2004 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Utility is authorized by statute and Board of Trustees' approval to invest in obligations of the United States government, its agencies, and instrumentalities; certificates of deposit and other evidences of deposit at federally insured Iowa depository institutions; and the Iowa Public Agency Investment Trust.

MUNICIPAL ELECTRIC UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 NOTES TO FINANCIAL STATEMENTS - Continued  
 DECEMBER 31, 2004

**2. CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS -**  
 Continued

The Utility had no investments that are subject to risk categorization. The Utility had investments in Iowa Public Agency Investment Trust which are valued at an amortized cost of \$6,787,680 pursuant to Rule 2a-7 under the Investment Company Act of 1940 that also are not subject to risk categorization.

The Utility considers all highly liquid investments with an original maturity of three months or less to be cash equivalents for purposes of the statement of cash flows.

Investments are recorded at cost which approximates market. Adjustments are made to cost for any premium or discount, which is amortized over the maturity of the investment. Adjustments are also made to account for the change in accrued interest on respective investments.

Reconciliation of the Utility's cash and cash equivalents and noncurrent investments is as follows:

Cash and cash equivalents:	
Board designated .....	\$11,191,566
Restricted .....	1,650,938
Unrestricted .....	<u>1,051,516</u>
Total cash and cash equivalents	<u>13,894,020</u>
Noncurrent investments:	
Board designated .....	3,815,283
Restricted .....	<u>6,816,999</u>
Total noncurrent investments	<u>10,632,282</u>
 Total cash and cash equivalents and noncurrent investments	 <u>\$24,526,302</u>

**3. BOARD DESIGNATED FUNDS**

The Board of Trustees of the Utility has designated certain funds to be placed in a contingency reserve account. These funds, which are from unrestricted net assets, are being designated for contingencies such as a natural disaster and cannot be expended without Board approval.

The Board of Trustees of the Utility has designated certain funds to be placed in a replacement and construction reserve account. These funds, which are from unrestricted net assets, are being designated for replacement of property, plant, and equipment and for new construction. These funds cannot be expended without Board approval.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**3. BOARD DESIGNATED FUNDS - Continued**

Assets of the funds as of December 31, 2004 are summarized as follows:

	<u>Contingency Reserve</u>	<u>Replacement and Construction Reserve</u>	<u>Total</u>
Cash and cash equivalents .....	\$1,225,849	\$ 9,965,717	\$11,191,566
Noncurrent investments .....	<u>                    </u>	<u>3,815,283</u>	<u>3,815,283</u>
Total	<u>\$1,225,849</u>	<u>\$13,781,000</u>	<u>\$15,006,849</u>

**4. CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2004 was as follows:

	<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 .....	\$ 86,092			\$ 86,092
Construction in progress .....	<u>857,109</u>	<u>\$1,810,472</u>	<u>                    </u>	<u>2,667,581</u>
Total capital assets not being depreciated	<u>943,201</u>	<u>1,810,472</u>	<u>                    </u>	<u>2,753,673</u>
Capital assets being depreciated:				
Infrastructure .....	40,279,321	1,809,238	\$ (2,856)	42,085,703
Buildings and improvements ....	738,706	2,775		741,481
Equipment .....	<u>5,080,207</u>	<u>270,667</u>	<u>(158,821)</u>	<u>5,192,053</u>
Total capital assets being depreciated	<u>46,098,234</u>	<u>2,082,680</u>	<u>(161,677)</u>	<u>48,019,237</u>
Less accumulated depreciation ...	<u>22,358,080</u>	<u>1,588,134</u>	<u>(148,277)</u>	<u>23,797,937</u>
Total capital assets being depreciated - net .....	<u>23,740,154</u>	<u>494,546</u>	<u>(13,400)</u>	<u>24,221,300</u>
<b>CAPITAL ASSETS - NET</b>	<u>\$24,683,355</u>	<u>\$2,305,018</u>	<u>\$(13,400)</u>	<u>\$26,974,973</u>

**5. NOTES RECEIVABLE - EMPLOYEES**

The Board of Trustees has authorized the Electric Utility to purchase personal computers for interested employees. The employees repay the Utility through payroll withholding over a maximum of 24 months. No interest is charged on the unpaid balance.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**6. NOTE RECEIVABLE - ELECTRIC HEAT**

The Board of Trustees determined that the operations of the Steam Heat Utility would be suspended as of May 1989, and the Electric Utility would provide financial assistance to the present steam heat customers converting to electric heat. At December 31, 1989, all of the customers had converted from the steam heat system. The \$482 balance is due from one customer. The note bears a variable interest rate that is adjusted annually. The rate at December 31, 2004 was 3.25%. The note is payable in monthly installments over a 15-year period and is secured by the equipment installed and by a personal guarantee.

**7. TRANSFERS IN LIEU OF PROPERTY TAXES/NOTE RECEIVABLE - CITY OF SPENCER**

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Currently, transfers approximate 5% of gross sales, less actual property taxes paid (on the George Neal Generating Station Unit No. 4) and returned to the City of Spencer, Iowa. Additionally, funds declared to be surplus can be, and have been, transferred to the City.

During 1996, the Utility advanced the City \$355,000, of which \$266,250 was a loan, to perform public improvements in the area of West 11<sup>th</sup> Street in Spencer. The City reimburses the Utility in equal payments of \$26,625 without interest, payable annually on July 1. The balance of this note at December 31, 2004 was \$79,875.

**8. NOTE RECEIVABLE - MUNICIPAL COMMUNICATIONS UTILITY**

The Board of Trustees has approved an \$8,000,000 line of credit for the Municipal Communications Utility for use in start-up and construction costs related to bringing the Communications Utility into operation. At December 31, 2004, \$8,000,000 has been advanced and \$7,050,000 remains outstanding. Outstanding balances bear interest at a rate of 4.5% per annum. Accrued interest receivable was \$313,578 at December 31, 2004.

**9. NONCURRENT LIABILITIES**

Noncurrent liabilities activity for the year ended December 31, 2004 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Series 2000 revenue bonds .....	\$6,865,000		\$415,000	\$ 6,450,000	\$440,000
Series 2004 revenue bonds .....	<u>                    </u>	<u>\$8,750,000</u>	<u>                    </u>	<u>8,750,000</u>	<u>480,000</u>
Total revenue bonds	6,865,000	8,750,000	415,000	15,200,000	<u>\$920,000</u>
Current installments of revenue bonds payable .....	<u>(415,000)</u>	<u>(505,000)</u>	<u>                    </u>	<u>(920,000)</u>	
Revenue bonds payable - less current installments .....	<u>\$6,450,000</u>	<u>\$8,245,000</u>	<u>\$415,000</u>	<u>\$14,280,000</u>	

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**9. NONCURRENT LIABILITIES - Continued**

During 2004, the Utility issued \$8,750,000 Series 2004 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 2019 and interest rates throughout the term of the bonds range between 1.4% and 4.4%.

The Series 2000 and 2004 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 range between 1.4% and 5.75%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

	<u>Series 2000</u>		<u>Series 2004</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2005 .....	\$ 440,000	\$ 359,068	\$ 480,000	\$ 291,258
2006 .....	465,000	334,867	490,000	284,537
2007 .....	490,000	309,292	495,000	275,963
2008 .....	515,000	282,342	510,000	265,567
2009 .....	545,000	254,018	520,000	253,583
2010 - 2014 .....	3,230,000	782,765	2,840,000	1,024,672
2015 - 2019 .....	<u>765,000</u>	<u>43,987</u>	<u>3,415,000</u>	<u>450,215</u>
	<u>\$6,450,000</u>	<u>\$2,366,339</u>	<u>\$8,750,000</u>	<u>\$2,845,795</u>

The bond resolutions provide 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.

**Restricted Funds**

Outstanding Electric Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. The Utility is in compliance with all significant financial requirements as of December 31, 2004, except that the Series 2004 bond sinking fund was underfunded by approximately \$10,000 at December 31, 2004.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**9. NONCURRENT LIABILITIES - Continued**

At December 31, 2004, the special funds consisted of the following:

	Cash and Cash Equivalents	Noncurrent Investments	Total
Bond Sinking Fund .....	\$ 121,394		\$ 121,394
Bond Reserve Fund .....		\$1,582,718	1,582,718
Bond Improvement Fund .....		751,980	751,980
Unexpended bond proceeds .....	<u>1,529,544</u>	<u>4,482,301</u>	<u>6,011,845</u>
 Total	 <u>\$1,650,938</u>	 <u>\$6,816,999</u>	 <u>\$8,467,937</u>

Monthly deposits into two bond sinking funds are required to establish the amount necessary to pay the next installments of principal and interest on the 2000 and 2004 Electric Revenue Bonds. Bond reserve funds for the 2000 and 2004 Electric Revenue Bonds equaled the required balance at December 31, 2004; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

The bond improvement fund balance at December 31, 2004 equaled the minimum balance required; therefore monthly deposits into the fund are not currently required. These funds are to be used first for principal and interest payments when insufficient funds are available in the sinking and reserve funds and second for extraordinary unbudgeted maintenance expenses or system repairs, renewals and replacements.

**10. RATE MATTERS**

Rates of the Utility are established by the Board of Trustees and, as a municipal system, are not subject to the regulation of the Utilities Division of the Department of Commerce of the State of Iowa. On January 12, 2005, the Utility approved a rate increase for all consumption beginning on March 1, 2005.

**11. NUMBER OF METER CONNECTIONS**

The number of meter connections totaled 5,867 at December 31, 2004.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**12. LEASES**

The Utility leases electrical generation capacity of a jet turbine generator and its share of the Neal 4 plant under operating leases to other utilities or their associations. The revenues from such leases are classified as leased facilities. The Utility's investment in these facilities is included in capital assets in service and is set forth as follows:

Jet turbine generator .....	\$2,294,741
Neal 4 plant .....	<u>4,723,691</u>
Total	7,018,432
Less accumulated depreciation .....	<u>5,456,204</u>
Net investment	<u>\$1,562,228</u>

The lease of the Neal 4 plant is a long-term commitment based on capacity. The amount is determined by formula based on usage and totaled \$287,545 in 2004. The leases of the jet turbine generator are both by noncancelable lease and a variable lease determined by capacity and totaled \$155,532 in 2004. The following is a schedule of future minimum rentals on noncancelable operating leases on the jet turbine generator as of December 31, 2004:

2005 .....	\$ 65,000
2006 .....	65,000
2007 .....	65,000
2008 .....	65,000
2009 .....	<u>65,000</u>
Total minimum lease payment receivable	<u>\$325,000</u>

The Utility leases bandwidth, property, and building space to the Water Utility and Communications Utility. The revenues from such leases are classified as leased facilities. The leases are 20-year variable leases based on bandwidth and space utilized. Lease income totaled \$409,479 in 2004, of which \$373,740 is included in accounts receivable at December 31, 2004.

The Utility leases building space from the Water Utility. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized. Lease expense totaled \$7,337 in 2004, of which \$667 is included in accounts payable at December 31, 2004.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**13. RETIREMENT SYSTEM**

**IPERS**

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

Plan members are required to contribute 3.70% of their annual 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 to IPERS for the years ended December 31, 2004, 2003, and 2002 were \$75,592, \$75,874, and \$75,141, respectively, equal to the required contributions for each year.

**Employees Pension Plan**

All full-time employees of the Electric Utility who have completed six months of continuous employment and are 21 years of age are eligible to participate in a Money Accumulation Pension Plan administered by Copeland Plan Services. The Plan is a defined contribution plan of the money purchase type, intended to qualify under Internal Revenue Service Code Section 401(a), funded by a combination of employee and employer contributions. Employees electing to participate are required to contribute 2% of their compensation, and they may contribute an additional amount of not less than 1% and not more than 10% of their compensation. The Utility contributes 8% of the employees' compensation for all employees electing to participate.

The Electric Utility's contribution to the Money Accumulation Pension Plan for 2004 totaled \$105,485.

**14. RISK MANAGEMENT**

The Electric Utility is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. The Utility assumes liability for any deductible and claims in excess of coverage limitations. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The Utility, as is typical in the electric power industry, does not insure its transmission lines due to the high cost of such coverage.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**15. CONTINGENT LIABILITY**

During 2000, the Electric Utility was named in two lawsuits by Mediacom, Iowa LLC, the competing cable television provider in Spencer, and a taxpayer (plaintiffs). Both of these cases arise out of the establishment and operation of a communication utility governed by the Spencer Municipal Utilities Board of Trustees. Both cases are currently in the discovery stage and are consolidated for trial. A trial date has been set in the fall of 2005. Plaintiffs' motions for preliminary injunction in each case were denied by the court. The court ruled there was not a reasonable likelihood that Plaintiffs would be successful on the merits. The present actions seek to block the operation of the entire system. Spencer Municipal Utilities' insurer has agreed to defend the cases under a reservation of rights pending further action. Should the insurance company ultimately decline coverage, the Spencer Municipal Utilities would be responsible for attorney fees in defending the cases. Spencer Municipal Utilities will continue to aggressively defend its action, if necessary. However, at this time, an estimate or range of loss, if any, is unknown. While Spencer Municipal Utilities believes the remaining claims will be successfully defended, this litigation does present the possibility of very significant financial exposure for Spencer Municipal Utilities.

**16. RELATED PARTY**

The Electric Utility, Water Utility, and Communications Utility of the City of Spencer, Iowa exchange services in the normal course of business.

Two members of the Board of Trustees hold non-controlling interests in a financial institution where the Utility maintains cash balances.

Additional related party items are included in Notes 8 and 12.

**17. COMMITMENTS**

During 2003, the Electric Utility entered into an agreement to purchase a 1.07% ownership in the generating facilities at Council Bluffs 4. The plant is expected to be in production in 2007. The commitment of Spencer Municipal Utilities in order to maintain its percentage of ownership is expected to approximate \$13,600,000. Approximately \$2,416,181 had been paid or accrued resulting in a future commitment of approximately \$11,183,819. Future payments by the Utility would be required as construction progresses.

During 2004, the Electric Utility entered into negotiations to purchase a 6.25% ownership in the generating facilities at Wisdom 2. The Spencer Municipal Utilities' commitment is expected to approximate \$2,400,000. Based on a letter of intent to acquire this ownership, leased facilities revenues of approximately \$124,600 were allocated to and realized by the Utilities in 2004.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**18. ACCOUNTING CHANGE**

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments*; Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*; Statement No. 38, *Certain Financial Statement Note Disclosures*; and Statement no. 41, *Budgetary Comparison Schedule - Perspective Differences*, were implemented for the year ended December 31, 2004. The statements create new basic financial statements for reporting the Utility's financial activities.

**REQUIRED SUPPLEMENTARY INFORMATION**

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, DISBURSEMENTS AND  
CHANGES IN NET ASSETS - BUDGET AND ACTUAL (CASH BASIS)

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2004

	<u>Actual</u>	<u>Budgeted Amounts Original/Final</u>	<u>Final to Actual Variance</u>
Receipts, including bond proceeds:			
Municipal Electric Utility .....	\$18,496,184		
Municipal Water Utility .....	956,317		
Municipal Communications Utility .....	<u>4,881,192</u>		
Combined receipts, including bond proceeds	<u>24,333,693</u>	<u>\$24,163,000</u>	<u>\$ 170,693</u>
Disbursements, including capital outlay:			
Municipal Electric Utility .....	11,842,393		
Municipal Water Utility .....	1,000,605		
Municipal Communications Utility .....	<u>4,305,807</u>		
Combined disbursements, including capital outlay	<u>17,148,805</u>	<u>12,839,105</u>	<u>(4,309,700)</u>
Transfers in .....		1,400,000	(1,400,000)
Transfers out .....		<u>(1,400,000)</u>	<u>1,400,000</u>
Transfers in - net			
Combined excess (deficit) of receipts over disbursements	7,184,888	11,323,895	(4,139,007)
Combined beginning net assets .....	<u>22,619,451</u>	<u>31,047,036</u>	<u>(8,427,585)</u>
<b>COMBINED ENDING NET ASSETS</b>	<u><b>\$29,804,339</b></u>	<u><b>\$42,370,931</b></u>	<u><b>\$(12,566,592)</b></u>

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGET TO GAAP RECONCILIATION

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2004

	<u>Cash Basis</u>	<u>Accrual Adjustments</u>	<u>Accrual Basis</u>
Revenues:			
Municipal Electric Utility .....	\$ 9,746,184	\$ (461,534)	\$ 9,284,650
Municipal Water Utility .....	956,317	39,208	995,525
Municipal Communications Utility .....	<u>4,881,192</u>	<u>105,268</u>	<u>4,986,460</u>
Combined revenues	<u>15,583,693</u>	<u>(317,058)</u>	<u>15,266,635</u>
Expenditures/expenses:			
Municipal Electric Utility .....	11,842,393	(2,701,304)	9,141,089
Municipal Water Utility .....	1,000,605	107,583	1,108,188
Municipal Communications Utility .....	<u>4,305,807</u>	<u>(346,653)</u>	<u>3,959,154</u>
Combined expenditures/expenses	<u>17,148,805</u>	<u>(2,940,374)</u>	<u>14,208,431</u>
Net	(1,565,112)	2,623,316	1,058,204
Combined other financing sources - net .....	8,750,000	(8,750,000)	
Combined beginning net assets .....	<u>22,619,451</u>	<u>28,139,778</u>	<u>50,759,229</u>
 COMBINED ENDING NET ASSETS	 <u>\$29,804,339</u>	 <u>\$22,013,094</u>	 <u>\$51,817,433</u>

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING  
YEAR ENDED DECEMBER 31, 2004

**NOTE 1**

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa following required public notice and hearing. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized and appropriations lapse at year-end.

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

**NOTE 2**

The receipts, including bond proceeds, and disbursements, including capital outlays, on the cash basis for each Utility is summarized as follows:

	Municipal Electric Utility	Municipal Water Utility	Municipal Communications Utility	Combined
Receipts, including bond proceeds .....	\$18,496,184	\$ 956,317	\$ 4,881,192	\$24,333,693
Disbursements, including capital outlay ..	<u>11,842,393</u>	<u>1,000,605</u>	<u>4,305,807</u>	<u>17,148,805</u>
Excess (deficit) of receipts over disbursements	6,653,791	(44,288)	575,385	7,184,888
Beginning net assets .....	<u>17,872,511</u>	<u>4,154,037</u>	<u>592,903</u>	<u>22,619,451</u>
<b>ENDING NET ASSETS</b>	<b><u>\$24,526,302</u></b>	<b><u>\$ 4,109,749</u></b>	<b><u>\$ 1,168,288</u></b>	<b><u>\$29,804,339</u></b>

**WINTHER, STAVE & CO., LLP**  
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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING**

Board of Trustees  
Spencer Municipal Utilities - Municipal Electric Utility  
Spencer, IA 51301

We have audited the financial statements of the Municipal Electric Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2004, and have issued our report thereon dated February 23, 2005. We conducted our audit in accordance with generally accepted auditing standards, 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**

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 grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Governmental Auditing Standards*.

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.

**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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of

one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. 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 and employees of Spencer Municipal Utilities, the citizens of the City of Spencer and other parties to whom Spencer Municipal Utilities may report. This report is not intended to be and should not be used by anyone other than these specified parties.

*Winter, Stone & Co LLP*

February 23, 2005

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part I: Findings Related to the Financial Statements**

No matters were noted.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part II: Other Findings Related to Required Statutory Reporting**

II-A-04 Official Depositories - A resolution naming official depositories has been adopted by the Board. 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 exceeded the amounts budgeted in the business type activities function. Chapter 384.20 of the Code of Iowa states in part that public monies may not be expended or encumbered except under an annual or continuing appropriation.

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

Response - The budget will be amended in the future, if applicable.

Conclusion - Response accepted.

II-C-04 Questionable Expenditures - No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-D-04 Travel Expenses - No expenditures of Utilities' money for travel expenses of spouses of Utilities' officials or employees were noted.

II-E-04 Business Transactions - Business transactions between Spencer Municipal Utilities and Spencer Municipal Utilities' employees are detailed as follows:

<u>Name, Title and Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
Rachel and Ryan Florke, children of employee	Cleaning Services	\$ 1,800

In accordance with Chapter 362.5(10) of the Code of Iowa, the transactions for cleaning services do not appear to represent conflicts of interest since total transactions with each individual were less than \$1,500 during the year.

II-F-04 Bond Coverage - Surety bond coverage of Spencer Municipal Utilities' 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.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part II: Other Findings Related to Required Statutory Reporting**

II-H-04 Revenue Bonds - As of December 31, 2004, the Utility had complied with all significant financial requirements related to its Electric Revenue Bonds, Series 2000, and Electric Revenue Bond, Series 2004, except that the Series 2004 bond sinking fund was under funded by approximately \$10,000.

Recommendation - The utility should make transfers to the Series 2004 bond sinking fund necessary to bring the balance into compliance with bond resolution requirements.

Response - We will make the necessary transfers to the bond sinking fund necessary to bring the balance into compliance with bond resolution requirements.

Conclusion - Response accepted.

II-I-04 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utilities' investment policy were noted.

II-J-04 Economic Development - During the year ended December 31, 2004, the Utility paid \$142,500 to Spencer Area Jobs Trust for economic development. According to Chapter 15A of the Code of Iowa and an Attorney General's opinion dated August 28, 1986, government financing of economic development may, in appropriate circumstances, serve a public purpose. The opinion advises the governing body to evaluate the public benefits to be obtained and discusses specific criteria to be considered in documenting the public purpose.

Recommendation - The public benefit to be derived by economic development expenditures should be more clearly documented. The Board should evaluate and document the public purpose served by the expenditure before authorizing payment and should verify that the funds were spent as intended to accomplish economic development activities.

Response - We will adopt a resolution regarding use of surplus utility funds for economic development expenditures which serve a public purpose. The Board will evaluate and document the public purpose served by economic development expenditure before authorizing payment and will verify how the funds were used to accomplish economic development activities.

Conclusion - Response accepted.

**SPENCER MUNICIPAL UTILITIES**

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA

**WINTHER, STAVE & CO., LLP**  
*Certified Public Accountants*

1316 West 18th Street  
P.O. Box 175  
Spencer, Iowa 51301-0175  
Phone 712-262-3117  
FAX 712-262-3159

1004 21st Street #4  
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Milford, Iowa 51351  
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INDEPENDENT AUDITORS' REPORT

Board of Trustees  
Spencer Municipal Utilities - Municipal Water Utility  
Spencer, IA 51301

We have audited the accompanying balance sheet of the Municipal Water Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2004 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year 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 audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards, 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 audit provides 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 the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 23, 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 35 through 37 and 52 through 54 are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Winter, Stone & Co LLP*

February 23, 2005

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of management's discussion and analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Water Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2004.

The following information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

The Utility is implementing Government Accounting Standards Board Statement #34 (GASB 34) as required by the Governmental Accounting Standards Board. Because of these new reporting standards for this year with significant changes in content and structure, much of the information is not easily comparable to prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the Utility's financial position and results of operations.

### **2004 Financial Highlights**

The Utility delivered approximately 458,580,000 gallons of water to its retail customers in 2004 compared to approximately 496,769,000 gallons in 2003.

The Utility's net assets decreased by \$112,663 to \$6,939,382 as a result of operations for the year ended December 31, 2004.

### **Overview of the Financial Statements**

The balance sheet includes the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities).

The statement of revenues, expenses and changes in net assets report all revenues and expenses incurred during the fiscal year.

The statement 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.

The notes to the financial statements provide the required disclosures and other information that is necessary to give the reader a complete understanding of the data provided in the statements. The notes present information about the Utility's accounting policies, material risks, obligations, commitments, contingencies and subsequent events.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Condensed Financial Information

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

<u>Condensed Balance Sheet</u>		
	<u>2004</u>	<u>2003</u>
Current assets .....	\$ 3,449,187	\$ 3,477,740
Capital assets - net of depreciation .....	4,208,924	4,381,793
Noncurrent assets .....	<u>1,017,350</u>	<u>1,017,156</u>
Total assets	<u>\$ 8,675,461</u>	<u>\$ 8,876,689</u>
Current liabilities .....	\$ 456,079	\$ 486,644
Long-term debt .....	<u>1,280,000</u>	<u>1,338,000</u>
Total liabilities	<u>1,736,079</u>	<u>1,824,644</u>
Investments in capital assets - net of related debt .....	2,886,468	3,007,623
Restricted .....	192,696	190,759
Unrestricted .....	<u>3,860,218</u>	<u>3,853,663</u>
Total net assets	<u>6,939,382</u>	<u>7,052,045</u>
Total liabilities and net assets	<u>\$ 8,675,461</u>	<u>\$ 8,876,689</u>

### Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Sales of water .....	\$ 850,090	\$ 906,955
Other .....	<u>32,202</u>	<u>22,948</u>
Total operating revenue .....	<u>882,292</u>	<u>929,903</u>
System operation and maintenance .....	552,210	490,427
Depreciation and amortization .....	266,184	257,208
Customer service and administration .....	<u>164,668</u>	<u>162,285</u>
Total operating expenses	<u>983,062</u>	<u>909,920</u>
Operating income (loss)	<u>(100,770)</u>	<u>19,983</u>
Interest income .....	54,370	65,082
Interest expense .....	(53,690)	(55,182)
Other income (expense) - net .....	<u>(12,573)</u>	<u>28,673</u>
Total non-operating revenues (expense)	<u>(11,893)</u>	<u>38,573</u>
Change in net assets	(112,663)	58,556
Net assets - beginning of year .....	<u>7,052,045</u>	<u>6,993,489</u>
Net assets - end of year	<u>\$ 6,939,382</u>	<u>\$ 7,052,045</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### **Financial Analysis**

The Utility's total assets decreased by approximately \$148,000.

The Utility's gross revenues decreased by approximately \$48,000 or 5.12%.

Total operating expenses increased by approximately \$73,000 due to increased expenses related to system operation and maintenance and well maintenance.

Total operating loss generated in 2004 was \$101,000 compared to an operating profit of \$19,000 in 2003.

Utility non-operating income (expense) resulted in additional expenses of \$92,325 during the year ended December 31, 2004.

The Utility had a net loss of \$112,663 for the year ended December 31, 2004 compared to a net income of 58,556 for the year ended December 31, 2003.

### **Capital Assets and Debt Administration**

Net capital assets decreased by approximately \$121,000 due to depreciation expense being greater than capital purchases for the year ended December 31, 2004.

### **Economic Factors**

During the year ended December 31, 2004, the Utility experienced a net loss. We believe the factors that led to the loss were decreased consumption due to the cooler summer, increased distribution costs related to the downtown storm sewer project, increased motor vehicle maintenance, increased meter testing and replacement costs, and increased lieu of tax payments to the City of Spencer. The Utility also received less contributions in aid of construction for the year because of less construction projects being completed during the year.

### **Contacting the Utility's Financial Management**

This financial report is designed to present our citizens, customers, and creditors with a general overview of the Utility's finances and operating activities. If you have any questions or require additional information please contact the Finance Supervisor, 712 Grand Ave, PO Box 222, Spencer, Iowa 51301.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET  
DECEMBER 31, 2004

ASSETS

CAPITAL ASSETS (Note 4):		
Plant in service .....	\$ 9,214,826	
Less accumulated depreciation .....	<u>5,005,902</u>	
CAPITAL ASSETS - NET		\$ 4,208,924
NONCURRENT ASSETS:		
Noncurrent investments:		
Board designated (Notes 2 and 3) .....		1,001,806
CURRENT ASSETS:		
Cash and cash equivalents:		
Unrestricted (Note 2) .....	971,211	
Board designated (Notes 2 and 3) .....	1,944,036	
Restricted (Notes 2 and 7) .....	192,696	
Accounts receivable - net of allowance for doubtful accounts of \$6,756 .....	248,452	
Unbilled usage .....	33,800	
Materials and supplies inventory .....	53,436	
Prepayments .....	<u>5,556</u>	
TOTAL CURRENT ASSETS		3,449,187
DEFERRED COSTS:		
Unamortized bond issue costs .....		<u>15,544</u>
TOTAL ASSETS		<u>\$ 8,675,461</u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET - Continued  
DECEMBER 31, 2004

LIABILITIES

NONCURRENT LIABILITIES:

Revenue bonds payable - less current installments (Note 7).....	\$ 1,280,000
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CURRENT LIABILITIES:

Current installments of revenue bonds payable (Note 7) .....	\$ 58,000	
Accounts payable .....	350,614	
Accrued wages, vacations, and benefits .....	27,918	
Accrued interest .....	10,639	
Accrued expenses .....	<u>8,908</u>	
TOTAL CURRENT LIABILITIES		<u>456,079</u>

TOTAL LIABILITIES	<u>1,736,079</u>
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NET ASSETS

Invested in capital assets - net of related debt .....	2,886,468	
Restricted - bond funds (Note 7) .....	192,696	
Unrestricted .....	<u>3,860,218</u>	
TOTAL NET ASSETS		<u>6,939,382</u>

TOTAL LIABILITIES AND NET ASSETS	<u>\$ 8,675,461</u>
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MUNICIPAL WATER UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
 FOR THE YEAR ENDED DECEMBER 31, 2004

OPERATING REVENUES:	
Residential and commercial .....	\$ 849,251
Interdepartmental .....	839
Service permits .....	20,429
Rental income .....	9,950
Miscellaneous .....	<u>1,823</u>
TOTAL OPERATING REVENUES	\$ 882,292
OPERATING EXPENSES:	
Treatment .....	260,666
Distribution .....	291,544
Depreciation and amortization .....	266,184
Customer operations .....	50,680
General and administrative .....	<u>113,988</u>
TOTAL OPERATING EXPENSES	<u>983,062</u>
LOSS FROM OPERATIONS	(100,770)
NON-OPERATING INCOME (EXPENSE) AND TRANSFERS:	
Interest income on investments .....	54,370
Contributions from developers .....	29,654
Leased facilities (Note 10) .....	9,141
Interest expense .....	(53,690)
Gain on plant retirements .....	20,068
Transfers to City - in lieu of property taxes (Note 6) .....	<u>(71,436)</u>
TOTAL NON-OPERATING INCOME (EXPENSE) AND TRANSFERS - NET	<u>(11,893)</u>
NET LOSS	(112,663)
NET ASSETS - BEGINNING OF YEAR .....	<u>7,052,045</u>
NET ASSETS - END OF YEAR	<u>\$ 6,939,382</u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2004

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Cash received from customers .....	\$ 871,160
Cash paid to suppliers .....	(469,976)
Cash paid to employees .....	<u>(233,198)</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b><u>167,986</u></b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
Transfer to City - in lieu of property tax .....	<u>(71,436)</u>
<b>NET CASH USED IN NONCAPITAL FINANCING ACTIVITIES</b>	<b><u>(71,436)</u></b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
Acquisition and construction of capital assets .....	(117,540)
Proceeds received from sale of capital assets .....	22,233
Revenue bond principal repayment .....	(56,000)
Payments received from leasing of facilities .....	9,972
Interest paid .....	<u>(52,455)</u>
<b>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<b><u>(193,790)</u></b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Proceeds from redemption of investments .....	1,000,000
Purchase of investments .....	(1,000,000)
Interest income on investments .....	<u>52,952</u>
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b><u>52,952</u></b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(44,288)</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR</b> .....	<b><u>3,152,231</u></b>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<b><u>\$ 3,107,943</u></b>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2004

RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY  
OPERATING ACTIVITIES

Loss from operations .....	\$ (100,770)
Adjustments to reconcile loss from operations to net cash provided by operating activities:	
Depreciation .....	264,960
Amortization .....	1,224
(Increase) decrease in:	
Accounts receivable .....	(15,132)
Unbilled usage .....	4,000
Materials and supplies inventory .....	(4,555)
Prepayments .....	(879)
Increase (decrease) in:	
Accounts payable .....	3,261
Accrued wages, vacations, and benefits .....	10,328
Accrued expenses .....	5,549
Total adjustments .....	<u>268,756</u>
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 <u>\$ 167,986</u>

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING, CAPITAL,  
AND RELATED FINANCING ACTIVITIES:

Acquisition and construction of capital assets .....	\$ 94,256
Decrease in retainage and contracts payable .....	52,938
Contributions from developers .....	<u>(29,654)</u>
 Cash paid to acquire and construct capital assets	 <u>\$ 117,540</u>

See Note 2 for reconciliation of statement of cash flows to balance sheet.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

The Municipal Water Utility of the City of Spencer, Iowa (Water Utility or Utility) operates as an independent unit of the City of Spencer and is managed, along with the Municipal Electric Utility and the Municipal Communication Utility of the City of Spencer, Iowa, by a five member Board of Trustees.

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.

For financial reporting purposes, the Utility has included all funds. The Utility has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Utility. It was determined that the Utility has no component units.

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2004 has been completed and is filed under separate cover.

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

In reporting the financial activity of its enterprise fund, the Utility applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

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

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**B. Capital Assets and Depreciation**

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new water facilities. In addition, net interest costs on construction debt are capitalized.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred.

Depreciation is provided on a straight-line basis. Current depreciation expense is approximately 2.88% of the original cost of depreciable water plant in service.

The estimated useful lives used to depreciate assets by class are as follows:

Infrastructure	40 years
Buildings and equipment	5 - 20 years
Vehicles	5 years

**C. Accounts Receivable**

Accounts receivable are stated at the amount the Utility expects to collect from outstanding balances. The Utility provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after the Utility has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements.

**D. Inventories**

Inventories are valued at the lower of cost or market. The average cost method is used for determining the cost of materials and supplies inventory.

**E. Unamortized Bond Issue Costs**

Unamortized debt issue costs are amortized over the life of the debt on a straight-line basis which approximates the effective interest method.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**F. 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 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.

**G. Income Taxes**

The Water Utility is exempt from federal and state income taxes because it is a governmental entity organized under the provisions of Chapter 388 of the Code of Iowa.

**H. Revenues and Unbilled Usage**

Revenues 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 at December 31, 2004, totaled \$33,800.

**I. Estimates**

The preparation of the financial statements in conformity with U.S. generally accepted accounting principals 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. CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS**

The Utility's deposits at December 31, 2004 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Utility is authorized by statute and Board of Trustees' approval to invest in obligations of the United States government, its agencies, and instrumentalities; certificates of deposit and other evidences of deposit at federally insured Iowa depository institutions; and the Iowa Public Agency Investment Trust.

The Utility had no investments that are subject to risk categorization. The Utility had investments in Iowa Public Agency Investment Trust which are valued at an amortized cost of \$1,274,930 pursuant to Rule 2a-7 under the Investment Company Act of 1940 that also are not subject to risk categorization.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**2. CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS -**  
Continued

The Utility considers all highly liquid investments with an original maturity of three months or less to be cash equivalents for purposes of the statement of cash flows.

Investments are recorded at cost which approximates market. Adjustments are made to cost for any premium or discount, which is amortized over the maturity of the investment. Adjustments are also made to account for the change in accrued interest on respective investments.

Reconciliation of the Utility's cash and cash equivalents and noncurrent investments is as follows:

Cash and cash equivalents:	
Board designated .....	\$ 1,944,036
Restricted .....	192,696
Unrestricted .....	<u>971,211</u>
Total cash and cash equivalents	<u>3,107,943</u>
Noncurrent investments:	
Board designated .....	<u>1,001,806</u>
Total noncurrent investments	<u>1,001,806</u>
 Total cash and cash equivalents and noncurrent investments	 <u>\$ 4,109,749</u>

**3. BOARD DESIGNATED FUNDS**

The Board of Trustees of the Utility has designated certain funds to be placed in a contingency reserve account. These funds, which are from unrestricted net assets, are being designated for contingencies such as a natural disaster and cannot be expended without Board approval.

The Board of Trustees of the Utility has designated certain funds to be placed in a replacement and construction reserve account. These funds, which are from unrestricted net assets, are being designated for replacement of property, plant, and equipment and for new construction. These funds cannot be expended without Board approval.

Assets of the funds as of December 31, 2004 are summarized as follows:

	Contingency <u>Reserve</u>	Replacement and Construction <u>Reserve</u>	<u>Total</u>
Cash and cash equivalents .....	\$ 469,106	\$ 1,474,930	\$ 1,944,036
Noncurrent investments .....	<u>          </u>	<u>1,001,806</u>	<u>1,001,806</u>
Total	<u>\$ 469,106</u>	<u>\$ 2,476,736</u>	<u>\$ 2,945,842</u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**4. CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2004 was as follows:

	<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 .....	\$ 261,509	_____	\$ 2,165	\$ 259,344
Total capital assets not being depreciated	<u>261,509</u>	_____	<u>2,165</u>	<u>259,344</u>
Capital assets being depreciated:				
Infrastructure .....	4,992,708	\$ 111,707		5,104,415
Buildings and equipment .....	3,692,841	7,312		3,700,153
Vehicles .....	<u>122,739</u>	<u>28,175</u>	_____	<u>150,914</u>
Total capital assets being depreciated	<u>8,808,288</u>	<u>147,194</u>	_____	<u>8,955,482</u>
Less accumulated depreciation ...	<u>4,740,942</u>	<u>264,960</u>	_____	<u>5,005,902</u>
Total capital assets being depreciated - net .....	<u>4,067,346</u>	<u>(117,766)</u>	_____	<u>3,949,580</u>
<b>CAPITAL ASSETS - NET</b>	<u>\$ 4,328,855</u>	<u>\$ (117,766)</u>	<u>\$ 2,165</u>	<u>\$ 4,208,924</u>

**5. SEWER, STORM WATER, AND SOLID WASTE**

The Electric utility bills and collects sewer, storm water, and solid waste revenues for the City of Spencer. The resulting receivable and corresponding payable are recorded under the Water Utility. The City of Spencer reimburses the Electric Utility for these services.

**6. TRANSFERS IN LIEU OF PROPERTY TAXES**

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Currently, transfers approximate 5% of gross sales. Additionally, funds declared to be surplus can be, and have been, transferred to the City.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**7. NONCURRENT LIABILITIES**

Noncurrent liabilities activity for the year ended December 31, 2004 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Series 2001 revenue bonds .....	\$1,394,000	_____	\$ 56,000	\$ 1,338,000	\$ 58,000
Total revenue bonds	1,394,000			1,338,000	<u>\$ 58,000</u>
Current installments of revenue bonds payable .....	<u>(56,000)</u>	<u>\$ (2,000)</u>	_____	<u>(58,000)</u>	
Revenue bonds payable - less current installments .....	<u>\$1,338,000</u>	<u>\$ (2,000)</u>	<u>\$ 56,000</u>	<u>\$ 1,280,000</u>	

The Series 2001 revenue bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rate throughout the term of the bonds is 3.84%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

	<u>Series 2001</u>	
	<u>Principal</u>	<u>Interest</u>
2005 .....	\$ 58,000	\$ 51,226
2006 .....	61,000	48,941
2007 .....	63,000	46,560
2008 .....	65,000	44,102
2009 .....	68,000	41,549
2010 - 2014 .....	380,000	165,890
2015 - 2019 .....	459,000	85,539
2020 - 2021 .....	<u>184,000</u>	<u>8,083</u>
	<u>\$1,338,000</u>	<u>\$ 491,890</u>

The bond resolutions provide 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.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**7. NONCURRENT LIABILITIES - Continued**

**Restricted Funds**

Outstanding Water Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. The Utility is in compliance with all significant financial requirements as of December 31, 2004.

At December 31, 2004, the special funds consisted of the following:

	<u>Total</u>
Bond Sinking Fund .....	\$ 77,696
Bond Reserve Fund .....	<u>115,000</u>
 Total	 <u>\$ 192,696</u>

Monthly deposits into the bond sinking fund are required to establish the amount necessary to pay the next installments of principal and interest. The bond reserve fund at December 31, 2004 equaled the required balance; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

The bond improvement fund balance at December 31, 2004 equaled the minimum balance required; therefore monthly deposits into the fund are not currently required. These funds are to be used first for principal and interest payments when insufficient funds are available in the sinking and reserve funds and second for extraordinary unbudgeted maintenance expenses or system repairs, renewals and replacements.

**8. RATE MATTERS**

Rates of the Utility are established by the Board of Trustees and, as a municipal system, are not subject to the regulation of the Utilities Division of the Department of Commerce of the State of Iowa.

**9. NUMBER OF METER CONNECTIONS**

The number of meter connections totaled 5,509 at December 31, 2004.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**10. LEASES**

The Utility leases bandwidth and building space from the Electric Utility. The expense from such leases is classified as operating expense. The lease is a 20-year variable lease based on bandwidth and space utilized. Lease expense totaled \$22,980 in 2004, of which \$1,915 is included in accounts payable at December 31, 2004.

The Utility leases building space to the Electric Utility and Communication utility. The revenues from such leases are classified as leased facilities. The leases are monthly leases based on building space utilized. Lease income totaled \$9,141 in 2004, of which \$831 is included in accounts receivable at December 31, 2004.

**11. RETIREMENT SYSTEM**

**IPERS**

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

Plan members are required to contribute 3.70% of their annual 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 to IPERS for the years ended December 31, 2004, 2003, and 2002 were \$12,341, \$10,195, and \$9,659, respectively, equal to the required contributions for each year.

**Employees Pension Plan**

All full-time employees of the Water Utility who have completed six months of continuous employment and are 21 years of age are eligible to participate in a Money Accumulation Pension Plan administered by Copeland Plan Services. The Plan is a defined contribution plan of the money purchase type, intended to qualify under Internal Revenue Service Code Section 401(a), funded by a combination of employee and employer contributions. Employees electing to participate are required to contribute 2% of their compensation, and they may contribute an additional amount of not less than 1% and not more than 10% of their compensation. The Utility contributes 8% of the employees' compensation for all employees electing to participate.

The Water Utility's contribution to the Money Accumulation Pension Plan for 2004 totaled \$17,133.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**12. RISK MANAGEMENT**

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

**13. RELATED PARTY**

The Electric Utility, Water Utility, and Communications Utility of the City of Spencer, Iowa exchange services in the normal course of business.

Two members of the Board of Trustees hold non-controlling interests in a financial institution where the Utility maintains cash balances.

Additional related party items are included in Note 10.

**14. ACCOUNTING CHANGE**

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - Management's Discussion and Analysis - for State and Local Governments*; Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*; Statement No. 38, *Certain Financial Statement Note Disclosures*; and Statement no. 41, *Budgetary Comparison Schedule - Perspective Differences*, were implemented for the year ended December 31, 2004. The statements create new basic financial statements for reporting the Utility's financial activities.

**REQUIRED SUPPLEMENTARY INFORMATION**

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, DISBURSEMENTS AND  
CHANGES IN NET ASSETS - BUDGET AND ACTUAL (CASH BASIS)

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2004

	<u>Actual</u>	<u>Budgeted Amounts Original/Final</u>	<u>Final to Actual Variance</u>
Receipts, including bond proceeds:			
Municipal Electric Utility .....	\$18,496,184		
Municipal Water Utility .....	956,317		
Municipal Communications Utility .....	<u>4,881,192</u>		
Combined receipts, including bond proceeds	<u>24,333,693</u>	<u>\$24,163,000</u>	<u>\$ 170,693</u>
Disbursements, including capital outlay:			
Municipal Electric Utility .....	11,842,393		
Municipal Water Utility .....	1,000,605		
Municipal Communications Utility .....	<u>4,305,807</u>		
Combined disbursements, including capital outlay	<u>17,148,805</u>	<u>12,839,105</u>	<u>(4,309,700)</u>
Transfers in .....		1,400,000	(1,400,000)
Transfers out .....		<u>(1,400,000)</u>	<u>1,400,000</u>
Transfers in - net			
Combined excess (deficit) of receipts over disbursements	7,184,888	11,323,895	(4,139,007)
Combined beginning net assets .....	<u>22,619,451</u>	<u>31,047,036</u>	<u>(8,427,585)</u>
<b>COMBINED ENDING NET ASSETS</b>	<u><b>\$29,804,339</b></u>	<u><b>\$42,370,931</b></u>	<u><b>\$(12,566,592)</b></u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGET TO GAAP RECONCILIATION

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2004

	<u>Cash Basis</u>	<u>Accrual Adjustments</u>	<u>Accrual Basis</u>
<b>Revenues:</b>			
Municipal Electric Utility .....	\$ 9,746,184	\$ (461,534)	\$ 9,284,650
Municipal Water Utility .....	956,317	39,208	995,525
Municipal Communications Utility .....	<u>4,881,192</u>	<u>105,268</u>	<u>4,986,460</u>
Combined revenues	<u>15,583,693</u>	<u>(317,058)</u>	<u>15,266,635</u>
<b>Expenditures/expenses:</b>			
Municipal Electric Utility .....	11,842,393	(2,701,304)	9,141,089
Municipal Water Utility .....	1,000,605	107,583	1,108,188
Municipal Communications Utility .....	<u>4,305,807</u>	<u>(346,653)</u>	<u>3,959,154</u>
Combined expenditures/expenses	<u>17,148,805</u>	<u>(2,940,374)</u>	<u>14,208,431</u>
<b>Net</b>	(1,565,112)	2,623,316	1,058,204
Combined other financing sources - net .....	8,750,000	(8,750,000)	
Combined beginning net assets .....	<u>22,619,451</u>	<u>28,139,778</u>	<u>50,759,229</u>
<b>COMBINED ENDING NET ASSETS</b>	<u>\$29,804,339</u>	<u>\$22,013,094</u>	<u>\$51,817,433</u>

MUNICIPAL WATER UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING  
 YEAR ENDED DECEMBER 31, 2004

**NOTE 1**

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa following required public notice and hearing. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized and appropriations lapse at year-end.

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

**NOTE 2**

The receipts, including bond proceeds, and disbursements, including capital outlays, on the cash basis for each Utility is summarized as follows:

	Municipal Electric Utility	Municipal Water Utility	Municipal Communications Utility	Combined
Receipts, including bond proceeds .....	\$18,496,184	\$ 956,317	\$ 4,881,192	\$24,333,693
Disbursements, including capital outlay ..	<u>11,842,393</u>	<u>1,000,605</u>	<u>4,305,807</u>	<u>17,148,805</u>
Excess (deficit) of receipts over disbursements	6,653,791	(44,288)	575,385	7,184,888
Beginning net assets .....	<u>17,872,511</u>	<u>4,154,037</u>	<u>592,903</u>	<u>22,619,451</u>
<b>ENDING NET ASSETS</b>	<b><u>\$24,526,302</u></b>	<b><u>\$ 4,109,749</u></b>	<b><u>\$ 1,168,288</u></b>	<b><u>\$29,804,339</u></b>

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING

Board of Trustees  
Spencer Municipal Utilities - Municipal Water Utility  
Spencer, IA 51301

We have audited the financial statements of the Municipal Water Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2004, and have issued our report thereon dated February 23, 2005. We conducted our audit in accordance with generally accepted auditing standards, 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**

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 grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Governmental Auditing Standards*.

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.

**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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of

one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. 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 and employees of Spencer Municipal Utilities, the citizens of the City of Spencer and other parties to whom Spencer Municipal Utilities may report. This report is not intended to be and should not be used by anyone other than these specified parties.

*Wischer, Steve R. CPA*

February 23, 2005

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL WATER UTILITY  
SCHEDULE OF FINDINGS  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part I: Findings Related to the Financial Statements**

No matters were noted.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL WATER UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part II: Other Findings Related to Required Statutory Reporting**

II-A-04 Official Depositories - A resolution naming official depositories has been adopted by the Board. 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 exceeded the amounts budgeted in the business type activities function. Chapter 384.20 of the Code of Iowa states in part that public monies may not be expended or encumbered except under an annual or continuing appropriation.

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

Response - The budget will be amended in the future, if applicable.

Conclusion - Response accepted.

II-C-04 Questionable Expenditures - We noted no expenditures that we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-D-04 Travel Expenses - No expenditures of Utilities' money for travel expenses of spouses of Utilities' 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 Spencer Municipal Utilities' 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 Revenue Bonds - As of December 31, 2004, the Utility is in compliance with all significant financial requirements related to its Water Revenue Bond, Series 2001.

II-I-04 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utilities' investment policy were noted.

**SPENCER MUNICIPAL UTILITIES**  
**MUNICIPAL COMMUNICATIONS UTILITY**  
**OF THE CITY OF SPENCER, IOWA**

**WINTHER, STAVE & CO., LLP**  
*Certified Public Accountants*

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INDEPENDENT AUDITORS' REPORT

Board of Trustees  
Spencer Municipal Utilities - Municipal Communications Utility  
Spencer, IA 51301

We have audited the accompanying balance sheet of the Municipal Communications Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2004 and the related statements of revenues, expenses, and changes in net assets (deficit) and cash flows for the year 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 audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards, 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 audit provides 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 the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 23, 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 grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages 61 through 63 and 75 through 77 are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Winter, Stone & Co LLP*

February 23, 2005

## MANAGEMENT DISCUSSION AND ANALYSIS

The purpose of management's discussion and analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Communications Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2004.

The following information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

The Utility is implementing Government Accounting Standards Board Statement #34 (GASB 34) as required by the Governmental Accounting Standards Board. Because of these new reporting standards for this year with significant changes in content and structure, much of the information is not easily comparable to prior years. However, in future years, comparisons will be more meaningful and will go further in explaining the Utility's financial position and results of operations.

### **2004 Financial Highlights**

Total assets increased by approximately \$684,000 which was primarily attributable to an increase in the cash balances and an increase in the accounts receivable balances related to increased telephone traffic and larger Carrier Access Billings. Total liabilities decreased by approximately \$343,000 due to payments on debt service.

Total net assets increased by \$1,027,000, as a result of the utility operations.

### **Overview of the Financial Statements**

The balance sheet includes the Utility's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities).

The statement of revenues, expenses and changes in net assets report all revenues and expenses incurred during the fiscal year.

The statement 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.

The notes to the financial statements provide the required disclosures and other information that is necessary to give the reader a complete understanding of the data provided in the statements. The notes present information about the Utility's accounting policies, material risks, obligations, commitments, contingencies and subsequent events.

## MANAGEMENT DISCUSSION AND ANALYSIS

### Condensed Financial Information

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

<u>Condensed Balance Sheet</u>		
	<u>2004</u>	<u>2003</u>
Current assets .....	\$ 1,958,590	\$ 1,167,508
Capital assets - net of depreciation .....	6,072,126	6,184,421
Noncurrent assets .....	<u>34,773</u>	<u>29,434</u>
Total assets	<u>\$ 8,065,489</u>	<u>\$ 7,381,363</u>
Current liabilities .....	\$ 1,171,874	\$ 1,215,054
Long-term debt .....	<u>7,050,000</u>	<u>7,350,000</u>
Total liabilities	<u>8,221,874</u>	<u>8,565,054</u>
Investments in capital assets - net of related debt .....	(943,101)	(836,145)
Unrestricted .....	<u>786,716</u>	<u>(347,546)</u>
Total net assets	<u>(156,385)</u>	<u>(1,183,691)</u>
Total liabilities and net assets	<u>\$ 8,065,489</u>	<u>\$ 7,381,363</u>

### Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>
Cable television revenue .....	\$ 806,118	\$ 747,116
Telephone revenue .....	3,662,453	3,193,117
Data services revenue .....	<u>432,499</u>	<u>278,617</u>
Total operating revenue	<u>4,901,070</u>	<u>4,218,850</u>
System operation and maintenance .....	2,064,225	2,011,895
Depreciation and amortization .....	775,268	713,066
Customer service and administration .....	<u>714,577</u>	<u>746,068</u>
Total operating expenses	<u>3,554,070</u>	<u>3,471,029</u>
Operating income	<u>1,347,000</u>	<u>747,821</u>
Interest income .....	12,685	7,974
Interest expense .....	(325,484)	(347,212)
Other income (expense) - net .....	<u>(6,895)</u>	<u>18,061</u>
Total non-operating expenses	<u>(319,694)</u>	<u>(321,177)</u>
Change in net assets	1,027,306	426,644
Net assets, beginning of year .....	<u>(1,183,691)</u>	<u>(1,610,335)</u>
Net assets, end of year	<u>\$ (156,385)</u>	<u>\$ (1,183,691)</u>

## MANAGEMENT DISCUSSION AND ANALYSIS

### **Financial Analysis**

The Utility's total assets increased by approximately \$684,000.

The Utility's gross revenues increased by approximately \$660,000 or 15.55%.

Total operating expenses increased by approximately \$102,000 in 2004 over 2003 because of increased expenses for cable programming, telephone operations and customer service due to an increase in the number of subscribers.

Total operating income generated in 2004 was \$1,347,000 compared to \$880,000 in 2003.

The Utility had a net income of \$1,027,306 for the year ended December 31, 2004 compared to a net income of 426,644 for the year ended December 31, 2003.

### **Capital Assets and Debt Administration**

Net capital assets decreased by approximately \$77,000 due to depreciation expense being greater than capital purchases for the year ended December 31, 2004.

### **Economic Factors**

The Utility continues to see positive growth in subscriber base and also net income. The Utility will be faced with increased costs of operating due to cable programming contracts. The Utility will be challenged to continue the strong growth pattern because of competition from incumbent providers.

### **Contacting the Utility's Financial Management**

This financial report is designed to present our citizens, customers, and creditors with a general overview of the Utility's finances and operating activities. If you have any questions or require additional information please contact the Finance Supervisor, 712 Grand Ave, PO Box 222, Spencer, Iowa 51301.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET  
DECEMBER 31, 2004

ASSETS

CURRENT ASSETS:

Cash and cash equivalents (Note 2) .....	\$ 1,168,288	
Accounts receivable - net of allowance for doubtful accounts of \$55,000 .....	387,630	
Consumer deposits .....	32,983	
Materials and supplies inventory .....	21,264	
Prepayments .....	139,633	
Unbilled usage .....	<u>208,792</u>	
TOTAL CURRENT ASSETS		\$ 1,958,590

UNAMORTIZED DEFERRED COSTS .....		34,773
----------------------------------	--	--------

CAPITAL ASSETS (Note 3):

Plant in service .....	8,319,899	
Less accumulated depreciation .....	<u>2,247,773</u>	
CAPITAL ASSETS - NET		<u>6,072,126</u>

TOTAL ASSETS		<u>\$ 8,065,489</u>
--------------	--	---------------------

LIABILITIES AND NET ASSETS (DEFICIT)

CURRENT LIABILITIES:

Accounts payable .....	\$ 750,152	
Accrued interest payable (Note 5) .....	313,578	
Accrued wages, vacations, and benefits .....	42,563	
Consumer deposits .....	32,796	
Accrued expenses .....	<u>32,785</u>	
TOTAL CURRENT LIABILITIES		\$ 1,171,874

NONCURRENT LIABILITIES:

Long-term debt (Note 5) .....		<u>7,050,000</u>
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TOTAL LIABILITIES		<u>8,221,874</u>
-------------------	--	------------------

NET ASSETS (DEFICIT):

Invested in capital assets - net of related debt .....	(943,101)	
Unrestricted .....	<u>786,716</u>	
TOTAL NET ASSETS (DEFICIT)		<u>(156,385)</u>

TOTAL LIABILITIES AND NET ASSETS (DEFICIT)		<u>\$ 8,065,489</u>
--	--	---------------------

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT)  
FOR THE YEAR ENDED DECEMBER 31, 2004

REVENUE:	
Cable system revenue .....	\$ 806,118
Telephone system revenue .....	3,662,453
Data services revenue .....	<u>432,499</u>
TOTAL REVENUES	\$ 4,901,070
OPERATING EXPENSES:	
Plant specific and programming .....	2,064,225
Depreciation and amortization .....	775,268
Customer services and marketing .....	314,700
General and administrative .....	<u>399,877</u>
TOTAL OPERATING EXPENSES	<u>3,554,070</u>
INCOME FROM OPERATIONS	1,347,000
NON-OPERATING INCOME (EXPENSE):	
Miscellaneous income .....	72,705
Economic development payments .....	(75,000)
Transfers to City in lieu of property taxes .....	(4,600)
Interest income .....	12,685
Interest expense .....	<u>(325,484)</u>
TOTAL NON-OPERATING INCOME (EXPENSE) - NET	<u>(319,694)</u>
NET INCOME	1,027,306
NET ASSETS (DEFICIT) - DECEMBER 31, 2003 .....	<u>(1,183,691)</u>
NET ASSETS (DEFICIT) - DECEMBER 31, 2004	<u>\$ (156,385)</u>

MUNICIPAL COMMUNICATIONS UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 STATEMENT OF CASH FLOWS  
 FOR THE YEAR ENDED DECEMBER 31, 2004

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Cash received from customers .....	\$ 4,795,802
Cash paid to suppliers .....	(2,142,162)
Cash paid to employees .....	<u>(565,220)</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u><b>2,088,420</b></u>
 <b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
Contributions paid for economic development .....	(75,000)
Transfer to City - in lieu of property tax .....	<u>(4,600)</u>
<b>NET CASH USED IN NONCAPITAL FINANCING ACTIVITIES</b>	<u><b>(79,600)</b></u>
 <b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
Acquisition and construction of capital assets .....	(697,746)
Payments received from leasing of facilities .....	72,705
Repayment of long-term debt .....	(300,000)
Interest paid .....	<u>(521,079)</u>
<b>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<u><b>(1,446,120)</b></u>
 <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Interest income on investments .....	<u>12,685</u>
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<u><b>12,685</b></u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>575,385</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR</b> .....	<u><b>592,903</b></u>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<u><b>\$ 1,168,288</b></u>

MUNICIPAL COMMUNICATIONS UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 STATEMENT OF CASH FLOWS - Continued  
 FOR THE YEAR ENDED DECEMBER 31, 2004

<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	
Income from operations .....	<u>\$ 1,347,000</u>
Adjustments to reconcile income from operations to net cash provided by operating activities:	
Depreciation .....	770,472
Amortization .....	4,796
(Increase) decrease in:	
Consumer deposits .....	(3,549)
Accounts receivable .....	(71,898)
Unbilled usage .....	(33,183)
Materials and supplies inventory .....	19,855
Prepayments .....	(97,488)
Increase (decrease) in:	
Accounts payable .....	128,574
Accrued wages, vacations, and benefits .....	2,591
Consumer deposits .....	3,362
Accrued expenses .....	<u>17,888</u>
Total adjustments	<u>741,420</u>
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 <u>\$ 2,088,420</u>

See Note 2 for reconciliation of statement of cash flows to balance sheet.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

The Municipal Communications Utility of the City of Spencer, Iowa (Communications Utility or Utility) operates as an independent unit of the City of Spencer and is managed, along with the Municipal Electric Utility and the Municipal Water Utility of the City of Spencer, Iowa, by a five member Board of Trustees. 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, telephone, and high-speed data communications. The Utility's rates are set by its governing board.

For financial reporting purposes, the Utility has included all funds. The Utility has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Utility. It was determined that the Utility has no component units.

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2004 has been completed and is filed under separate cover.

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

In reporting the financial activity of its enterprise fund, the Utility applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

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

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**B. Capital Assets and Depreciation**

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new communications facilities. In addition, net interest costs on construction debt are capitalized.

Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred.

Depreciation is calculated on the straight-line basis. Current depreciation expense is approximately 9.29% of the original cost of depreciable communication plant in service.

The estimated useful lives used to depreciate assets by class are as follows:

Infrastructure	10 - 15 years
Buildings and improvements	20 years
Equipment	5 - 7 years

**C. Accounts Receivable**

Accounts receivable are stated at the amount the Utility expects to collect from outstanding balances. The Utility provides for probable uncollectible amounts through a charge to earnings and a credit to a valuation allowance based on its assessment of the current status of individual accounts. Balances that are still outstanding after the Utility has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable. Changes in the valuation allowance have not been material to the financial statements.

**D. Inventories**

Inventories are valued at the lower of cost or market. The average cost method is used for determining the cost of materials and supplies inventory.

**E. Unamortized Deferred Costs**

Cable television system costs allocated during construction of the system are being amortized using the straight-line method over the expected life of the cable television plant.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued**

**F. Net Assets (Deficit)**

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 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 had a deficit in net assets of \$156,385 at December 31, 2004. The utility intends to eliminate the deficit through future earnings of the Utility.

**G. Income Taxes**

The Communications Utility is exempt from federal and state income taxes because it is a governmental entity organized under the provisions of Chapter 388 of the Code of Iowa.

**H. Revenues and Unbilled Usage**

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 yet billed at December 31, 2004, totaled \$208,792.

**I. Estimates**

The preparation of the financial statements in conformity with U.S. generally accepted accounting principals 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. CASH AND CASH EQUIVALENTS**

The utility's deposits at December 31, 2004 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Utility is authorized by statute and Board of Trustees' approval to invest in obligations of the United States government, its agencies, and instrumentalities; certificates of deposit and other evidences of deposit at federally insured Iowa depository institutions; and the Iowa Public Agency Investment Trust. The Utility had no investments that are subject to risk categorization.

The Utility considers all highly liquid investments with an original maturity of three months or less to be cash equivalents for purposes of the statement of cash flows.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**3. CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2004 was as follows:

	<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 .....	\$ 10,342	_____	_____	\$ 10,342
Total capital assets not being depreciated	<u>10,342</u>	_____	_____	<u>10,342</u>
Capital assets being depreciated:				
Infrastructure .....	6,843,397	\$ 656,354		7,499,751
Buildings and improvements ...	5,271	3,013		8,284
Equipment .....	<u>763,143</u>	<u>38,379</u>		<u>801,522</u>
Total capital assets being depreciated	<u>7,611,811</u>	<u>697,746</u>		<u>8,309,557</u>
Less accumulated depreciation ...	<u>1,477,301</u>	<u>770,472</u>		<u>2,247,773</u>
Total capital assets being depreciated - net .....	<u>6,134,510</u>	<u>(72,726)</u>		<u>6,061,784</u>
<b>CAPITAL ASSETS - NET</b>	<b><u>\$ 6,144,852</u></b>	<b><u>\$ (72,726)</u></b>	<b><u>\$ _____</u></b>	<b><u>\$ 6,072,126</u></b>

**4. TRANSFERS IN LIEU OF PROPERTY TAXES**

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Funds totaling \$4,600 were transferred to the City during 2004.

**5. NONCURRENT LIABILITIES**

Noncurrent liabilities activity for the year ended December 31, 2004 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Note payable - Municipal Electric Utility .....	<u>\$7,350,000</u>	_____	<u>\$300,000</u>	<u>\$ 7,050,000</u>	<u>\$ 0</u>

The Board of Trustees of the Municipal Electric Utility adopted a resolution on June 14, 1999, pursuant to Section 384.89 City Code of Iowa and Rule 2.5(5) of the rules promulgated by the City Finance Committee, allowing for the advance of funds not to exceed \$8,000,000 to the Municipal Communications Utility to be utilized for the construction and development of the communication system. These funds are to be repaid upon demand and bear a 4.5% per annum interest rate. Accrued interest payable was \$313,578 at December 31, 2004.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**6. LEASES**

The Utility leases building space from the Water Utility. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized. Lease expense totaled \$1,804 in 2004, of which \$164 is included in accounts payable at December 31, 2004.

The Utility leases bandwidth, property, and building space from the Electric Utility. The expense from the lease is classified as operating expenses. The lease is a 20-year variable lease based on bandwidth and space utilized. Lease expense totaled \$386,499 in 2004, of which \$371,825 is included in accounts payable At December 31, 2004.

**7. RETIREMENT SYSTEM**

**IPERS**

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

Plan members are required to contribute 3.70% of their annual 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 to IPERS for the years ended December 31, 2004, 2003, and 2002 were \$32,050, \$26,291, and \$25,739, respectively, equal to the required contributions for each year.

**Employees Pension Plan**

All full-time employees of the Communications Utility who have completed six months of continuous employment and are 21 years of age are eligible to participate in a Money Accumulation Pension Plan administered by Copeland Plan Services. The Plan is a defined contribution plan of the money purchase type, intended to qualify under Internal Revenue Service Code Section 401(a), funded by a combination of employee and employer contributions. Employees electing to participate are required to contribute 2% of their compensation, and they may contribute an additional amount of not less than 1% and not more than 10% of their compensation. The Utility contributes 8% of the employees' compensation for all employees electing to participate.

The Communications Utility's contribution to the Money Accumulation Pension Plan for 2004 totaled \$43,593.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**8. RISK MANAGEMENT**

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

**9. CONTINGENT LIABILITY**

During 2000, the Electric Utility was named in two lawsuits by Mediacom, Iowa LLC, the competing cable television provider in Spencer, and a taxpayer (plaintiffs). Both of these cases arise out of the establishment and operation of a communication utility governed by the Spencer Municipal Utilities Board of Trustees. Both cases are currently in the discovery stage and are consolidated for trial. A trial date has been set in the fall of 2005. Plaintiffs' motions for preliminary injunction in each case were denied by the court. The court ruled there was not a reasonable likelihood that Plaintiffs would be successful on the merits. The present actions seek to block the operation of the entire system. Spencer Municipal Utilities' insurer has agreed to defend the cases under a reservation of rights pending further action. Should the insurance company ultimately decline coverage, the Spencer Municipal Utilities would be responsible for attorney fees in defending the cases. Spencer Municipal Utilities will continue to aggressively defend its action, if necessary. However, at this time, an estimate or range of loss, if any, is unknown. While Spencer Municipal Utilities believes the remaining claims will be successfully defended, this litigation does present the possibility of very significant financial exposure for Spencer Municipal Utilities.

**10. RELATED PARTY**

The Electric Utility, Water Utility, and Communications Utility of the City of Spencer, Iowa exchange services in the normal course of business.

Two members of the Board of Trustees hold non-controlling interests in a financial institution where the Utility maintains cash balances.

Additional related party items are included in Note 6.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2004

**11. ACCOUNTING CHANGE**

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

**12. JOINT VENTURE**

During December 2003, the Utility entered into an agreement with Northern Iowa Communications Partners, L.L.C. (NICP), an Iowa limited liability company, to form an organization pursuant to the provisions of Chapter 28E of the Code of Iowa. Under this agreement, the Utility, along with other members of NICP, agrees to pay for the use of a shared switch for routing certain telecommunications traffic at rates adopted by NICP. The Utility will share in profits generated by or be responsible for shortfalls incurred through the 28E agreement. An NICP member will be responsible for maintaining the financial records for the 28E entity.

**13. SUBSEQUENT EVENTS**

On January 11, 2005, the citizens of Fostoria approved granting a nonexclusive cable television franchise to Spencer Municipal Utilities.

**REQUIRED SUPPLEMENTARY INFORMATION**

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, DISBURSEMENTS AND  
CHANGES IN NET ASSETS - BUDGET AND ACTUAL (CASH BASIS)

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2004

	<u>Actual</u>	<u>Budgeted Amounts Original/Final</u>	<u>Final to Actual Variance</u>
Receipts, including bond proceeds:			
Municipal Electric Utility .....	\$18,496,184		
Municipal Water Utility .....	956,317		
Municipal Communications Utility .....	<u>4,881,192</u>		
Combined receipts, including bond proceeds	<u>24,333,693</u>	<u>\$24,163,000</u>	<u>\$ 170,693</u>
Disbursements, including capital outlay:			
Municipal Electric Utility .....	11,842,393		
Municipal Water Utility .....	1,000,605		
Municipal Communications Utility .....	<u>4,305,807</u>		
Combined disbursements, including capital outlay	<u>17,148,805</u>	<u>12,839,105</u>	<u>(4,309,700)</u>
Transfers in .....		1,400,000	(1,400,000)
Transfers out .....		<u>(1,400,000)</u>	<u>1,400,000</u>
Transfers in - net			
Combined excess (deficit) of receipts over disbursements	7,184,888	11,323,895	(4,139,007)
Combined beginning net assets .....	<u>22,619,451</u>	<u>31,047,036</u>	<u>(8,427,585)</u>
<b>COMBINED ENDING NET ASSETS</b>	<u><b>\$29,804,339</b></u>	<u><b>\$42,370,931</b></u>	<u><b>\$(12,566,592)</b></u>

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGET TO GAAP RECONCILIATION

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2004

	<u>Cash Basis</u>	<u>Accrual Adjustments</u>	<u>Accrual Basis</u>
Revenues:			
Municipal Electric Utility .....	\$ 9,746,184	\$ (461,534)	\$ 9,284,650
Municipal Water Utility .....	956,317	39,208	995,525
Municipal Communications Utility .....	<u>4,881,192</u>	<u>105,268</u>	<u>4,986,460</u>
Combined revenues	<u>15,583,693</u>	<u>(317,058)</u>	<u>15,266,635</u>
Expenditures/expenses:			
Municipal Electric Utility .....	11,842,393	(2,701,304)	9,141,089
Municipal Water Utility .....	1,000,605	107,583	1,108,188
Municipal Communications Utility .....	<u>4,305,807</u>	<u>(346,653)</u>	<u>3,959,154</u>
Combined expenditures/expenses	<u>17,148,805</u>	<u>(2,940,374)</u>	<u>14,208,431</u>
Net	(1,565,112)	2,623,316	1,058,204
Combined other financing sources - net .....	8,750,000	(8,750,000)	
Combined beginning net assets .....	<u>22,619,451</u>	<u>28,139,778</u>	<u>50,759,229</u>
 COMBINED ENDING NET ASSETS	 <u>\$29,804,339</u>	 <u>\$22,013,094</u>	 <u>\$51,817,433</u>

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING  
YEAR ENDED DECEMBER 31, 2004**

**NOTE 1**

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa following required public notice and hearing. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized and appropriations lapse at year-end.

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

**NOTE 2**

The receipts, including bond proceeds, and disbursements, including capital outlays, on the cash basis for each Utility is summarized as follows:

	Municipal Electric Utility	Municipal Water Utility	Municipal Communications Utility	Combined
Receipts, including bond proceeds .....	\$18,496,184	\$ 956,317	\$ 4,881,192	\$24,333,693
Disbursements, including capital outlay ..	<u>11,842,393</u>	<u>1,000,605</u>	<u>4,305,807</u>	<u>17,148,805</u>
Excess (deficit) of receipts over disbursements	6,653,791	(44,288)	575,385	7,184,888
Beginning net assets .....	<u>17,872,511</u>	<u>4,154,037</u>	<u>592,903</u>	<u>22,619,451</u>
<b>ENDING NET ASSETS</b>	<b><u>\$24,526,302</u></b>	<b><u>\$ 4,109,749</u></b>	<b><u>\$ 1,168,288</u></b>	<b><u>\$29,804,339</u></b>

**WINTHER, STAVE & CO., LLP**  
*Certified Public Accountants*

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING**

Board of Trustees  
Spencer Municipal Utilities - Municipal Communications Utility  
Spencer, IA 51301

We have audited the financial statements of the Municipal Communications Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2004, and have issued our report thereon dated February 23, 2005. We conducted our audit in accordance with generally accepted auditing standards, 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**

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 grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Governmental Auditing Standards*.

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.

**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 assurance 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 over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or

operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. 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 and employees of Spencer Municipal Utilities, the citizens of the City of Spencer and other parties to whom Spencer Municipal Utilities may report. This report is not intended to be and should not be used by anyone other than these specified parties.

*Winter, Steve & G L H*

February 23, 2005

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL COMMUNICATIONS UTILITY  
SCHEDULE OF FINDINGS  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part I: Findings Related to the Financial Statements**

No matters were noted.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL COMMUNICATIONS UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part II: Other Findings Related to Required Statutory Reporting**

II-A-04 Official Depositories - A resolution naming official depositories has been adopted by the Board. 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 exceeded the amounts budgeted in the business type activities function. Chapter 384.20 of the Code of Iowa states in part that public monies may not be expended or encumbered except under an annual or continuing appropriation.

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

Response - The budget will be amended in the future, if applicable.

Conclusion - Response accepted.

II-C-04 Questionable Expenditures - No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-D-04 Travel Expenses - No expenditures of Utilities' money for travel expenses of spouses of Utilities' officials or employees were noted.

II-E-04 Business Transactions - Business transactions between Spencer Municipal Utilities and a board member are detailed as follows:

<u>Name, Title and Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
Tom Howe, Board Member, Part-owner of H & N Chevrolet	Maintenance and repairs	\$ 422

In accordance with Chapter 362.5(10) of the Code of Iowa, the transactions with the Board Member do not appear to represent conflicts of interest since competitive bids were accepted in regard to maintenance and repairs and since the total transactions were less than \$1,500 during the year.

II-F-04 Bond Coverage - Surety bond coverage of Spencer Municipal Utilities' 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.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL COMMUNICATIONS UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2004

**Part II: Other Findings Related to Required Statutory Reporting**

II-H-04 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utilities' investment policy were noted.

II-I-04 Economic Development - During the year ended December 31, 2004, the Utility paid \$75,000 to Spencer Area Jobs Trust for economic development. According to Chapter 15A of the Code of Iowa and an Attorney General's opinion dated August 28, 1986, government financing of economic development may, in appropriate circumstances, serve a public purpose. The opinion advises the governing body to evaluate the public benefits to be obtained and discusses specific criteria to be considered in documenting the public purpose.

Recommendation - The public benefit to be derived by economic development expenditures should be more clearly documented. The Board should evaluate and document the public purpose served by the expenditure before authorizing payment and should verify that the funds were spent as intended to accomplish economic development activities.

Response - We will adopt a resolution regarding use of surplus utility funds for economic development expenditures which serve a public purpose. The Board will evaluate and document the public purpose served by economic development expenditure before authorizing payment and will verify how the funds were used to accomplish economic development activities.

Conclusion - Response accepted.