

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTIC UTILITY

INDEPENDENT AUDITORS' REPORTS  
BASIC FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION  
SCHEDULE OF FINDINGS

DECEMBER 31, 2004

## Table of Contents

	<u>PAGE</u>
Independent Auditors' Report	4-5
Management's Discussion and Analysis	7-10
Basic Financial Statements:	<u>Exhibit</u>
Statement of Net Assets	A           13
Statement of Revenues, Expenses and Changes in Net Assets	B           14-16
Statement of Cash Flows	C           17
Notes to Financial Statements	18-28
Other Supplementary Information:	<u>Schedule</u>
Schedule of Statistical Data	1           30
Operational Analysis	2           31
Independent Auditors' Report on Compliance and on Internal Control over Financial Reporting	34-35
Schedule of Findings	36-37

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTRIC UTILITY

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## Independent Auditors' Report

Honorable Mayor and City Council  
City of Estherville, Iowa

We have audited the accompanying financial statements of the Municipal Electric Utility, City of Estherville, Iowa as of and for the year ended December 31, 2004. These financial statements are the responsibility of the City of Estherville's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statements presentation. We believe our audit provides a reasonable basis for our opinion.

Management has excluded from inventory in the accompanying statement of net assets items that, in our opinion, should be included to conform to accounting principles generally accepted in the United States of America. Accounting principles generally accepted in the United States of America require that inventory reflect a complete listing of materials and supplies owned by the Municipal Electric Utility, City of Estherville, Iowa. The distribution plant inventory of the Municipal Electric Utility, City of Estherville, Iowa does not include all materials and supplies. The amount by which this departure would affect the basic financial statements is not reasonably determinable.

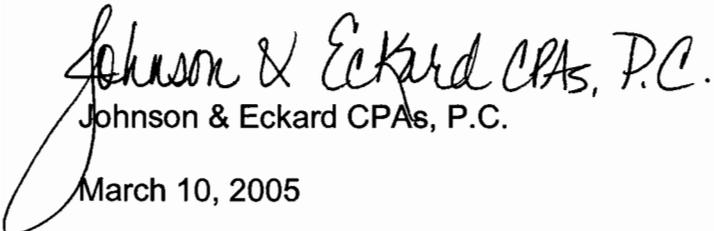
In our opinion, except for the effects of an incomplete inventory, as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Municipal Electric Utility, City of Estherville, Iowa as of December 31, 2004, and the respective changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13, during the year ended December 31, 2004, the Municipal Electric Utility, City of Estherville, Iowa adopted Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments; Statement No. 37, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus; and Statement No. 38, Certain Financial Statement Note Disclosures.

In accordance with Government Auditing Standards, we have also issued our report dated March 10, 2005 on our consideration of the Municipal Electric Utility, City of Estherville, Iowa’s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. 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.

Management’s Discussion and Analysis on pages 7 through 11 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion thereon.

The supplementary information on pages 31 and 32 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

  
Johnson & Eckard CPAs, P.C.

March 10, 2005

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTRIC UTILITY

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

This narrative overview and analysis of the financial activities of the Electric Utility is for the calendar year ending December 31, 2004. We encourage readers to consider the information in conjunction with the financial statements.

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

### **2004 FINANCIAL HIGHLIGHTS**

Operating revenue of the Electric Utility decreased 1.63% or \$61,247 from 2003 to 2004. The primary reason for the decline was a decrease in energy sales.

Operating expenses increased 6.67% or \$199,832 from 2003 to 2004. The majority of this increase, \$152,551, was related to the increased cost of wholesale energy.

The Electric Utility's net assets increased \$329,595 or 6.38% from 2003 to 2004.

### **USING THIS ANNUAL REPORT**

The annual report consists of a series of financial statements and other information as required by Governmental Accounting Standard Board Statement No. 34. The required information is:

Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the City's financial activities.

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

The Statement of Revenues, Expenses, and Changes in Net Assets presents information showing how the Electric Utility's net assets changed during the most recent fiscal year.

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents. It provides answers to such questions as where did cash come from, what cash was used for and what was the change in cash and cash equivalents during the reporting year.

Notes to financial statements provide additional information essential to a full understanding of the data provided in the basic financial statements.

Supplementary information further explains and supports the financial statements.

## FINANCIAL ANALYSIS

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

Net Assets December 31, 2004	
Current Assets & Other Assets	\$3,090,846
Capital Assets	<u>2,691,061</u>
Total Assets	<u>\$5,781,907</u>
Long Term Liabilities	\$ -0-
Current Liabilities	<u>288,301</u>
Total Liabilities	<u>\$ 288,301</u>
Net Assets:	
Invested in Capital Assets	\$2,655,146
Unrestricted	<u>2,838,460</u>
Total Net Assets	<u>\$5,493,606</u>

Net assets increased from 2003 by approximately \$330,000, or 6.4%. The largest portion of the net assets is the investment in capital assets (e.g., land, infrastructure, buildings, and equipment). Unrestricted net assets is the part of net assets that can be used to finance day-to-day operations without constraints.

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**Changes in Net Assets**  
**Year Ended December 31, 2004**

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<b>Revenues:</b>	
<b>Operating Revenues:</b>	
Charges for service, sales, and rent	\$3,697,501
<b>Non-operating revenues:</b>	
Investment earnings	<u>27,847</u>
<b>Total revenues</b>	<b><u>\$3,725,348</u></b>
 <b>Operating expenses:</b>	
Generation	\$1,765,007
Distribution	558,708
General and administration	872,208
<b>Non-operating expenses:</b>	
Interest expense	2,972
Other non-operating expense	138,589
Transfers, net	<u>58,269</u>
<b>Total expense and transfers</b>	<b><u>\$3,395,753</u></b>
 Increase in net assets	 \$ 329,595
 Net assets beginning of year	 <u>\$5,164,011</u>
 Net assets end of year	 <u>\$5,493,606</u>

Since this is the first year to report activities using the new GASB 34 approach, a comparison to the prior year is not possible. However, in next year's discussion, this section will show a condensed financial comparison of revenues and expenses and provide explanations for significant differences.

## **CAPITAL ASSETS AND DEBT ADMINISTRATION**

### **Capital Assets**

The Electric Utilities capital assets include land, buildings and improvements, and equipment. Capital assets totaled \$2,691,062 (net of accumulated depreciation) at December 31, 2004. See note 7 to the financial statements for more information about the capital assets.

### **Debt Administration**

The Electric Utility has no long-term debt outstanding. The utility does hold customer deposits totaling \$65,244.

### **ECONOMIC FACTORS BEARING ON THE ELECTRIC UTILITY'S FUTURE**

The Electric Utility has not made any rate changes since 1984 and does not expect any significant changes in the near future.

For the upcoming fiscal year the Electric Utility's budget is fairly consistent with the current year.

### **CONTACTING THE ELECTRIC UTILITY'S FINANCIAL MANAGEMENT**

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Electric Utility's finances and to show the Electric Utility's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Vaughn Brua, City Clerk, 2 North 7<sup>th</sup> Street, Estherville, Iowa 51334 or telephone (712)362-7771.

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTRIC UTILITY

## Basic Financial Statements

City of Estherville, Iowa  
Municipal Electric Utility  
Statement of Net Assets  
December 31, 2004

Exhibit A

**Assets**

Current Assets:

Cash and Cash Equivalents	\$1,500,155
Appropriated Cash - Equipment Sinking Fund	73,932
Designated Cash	76,951
Receivables:	
Accounts	288,349
Accounts - City of Estherville	17,198
Accrued Interest	1,223
Fuel and Lube Oil Inventory	17,338
Distribution Plant Inventory	458,866
Prepaid Insurance	<u>26,968</u>
Total Current Assets	2,460,980

Noncurrent Assets:

Designated Investments	514,840
Investment in Joint Venture	115,026
Capital Assets (Net of Accumulated Depreciation)	<u>2,691,061</u>
Total Noncurrent Assets	<u>3,320,927</u>

<b>Total Assets</b>	<b><u>5,781,907</u></b>
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**Liabilities**

Current Liabilities:

Accounts Payable	195,950
Customer Deposits	65,244
Accrued Payroll	17,411
Accrued Sales and Use Tax	<u>9,696</u>

<b>Total Liabilities</b>	<b><u>288,301</u></b>
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**Net Assets**

Invested in Capital Assets	2,655,146
Unrestricted	<u>2,838,460</u>

<b>Total Net Assets</b>	<b><u>\$5,493,606</u></b>
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See notes to financial statements.

City of Estherville, Iowa  
Municipal Electric Utility  
Statement of Revenues, Expenses and Changes in Net Assets  
Year Ended December 31, 2004

Exhibit B

Operating Revenues:

Sales of Electricity to Customers	
Residential Sales	\$1,410,783
Commerical Sales - Large	1,065,661
Commerical Sales - Small	547,776
Industrial Sales	294,820
Customer Service and Other Sales	<u>109,469</u>
Total Sales to Customers	<u>3,428,509</u>
Service to City	
Various Departments	<u>253,170</u>
Other Operating Revenues	
Sales of Service Work, Material and Miscellaneous	15,802
Rent and Sales of Property	<u>20</u>
Total Other Operating Revenues	<u>15,822</u>
Total Operating Revenues	3,697,501

Operating Expenses:

Generation Expense	
Purchased Power - Net	1,467,350
Salaries	133,571
Utilities	42,789
Depreciation	37,014
Employee Insurance	32,747
Payroll Taxes and IPERS	17,148
Repairs and Maintenance	9,491
Fuel Oil	8,467
Natural Gas Fuel	7,189
Operating Supplies and Expense	3,529
Building and Structures	3,071
Transportation and Vehicle Expense	2,082
Lube Oil	<u>559</u>
Total Generation Expense	<u>1,765,007</u>

See notes to financial statements.

City of Estherville, Iowa  
Municipal Electric Utility  
Statement of Revenues, Expenses and Changes in Net Assets  
Year Ended December 31, 2004

Exhibit B

Operating Expenses - Continued

Distribution Expense

Salaries	\$ 325,322
Depreciation	91,978
Employee Insurance	49,119
Payroll Taxes and IPERS	41,863
Transportation and Vehicle Expense	30,114
Utilities	8,481
Operating Supplies and Expense	6,250
Capital Utility Improvements	3,485
Building and Structures	856
Equipment Repair	698
Maintenance of Lines & Supplies	387
Maintenance of Street and Traffic Lights & Supplies	<u>155</u>
Total Distribution Expense	<u>558,708</u>

Accounting and Collection Expenses

Reimbursement to City for Expense	328,100
Meter Supplies	<u>215</u>
Total Accounting and Collection Expense	<u>328,315</u>

Administration and General Expenses

Payment in Lieu of Taxes	426,739
Professional Services	41,893
Insurance	38,987
Dues and Other Expenses	<u>36,274</u>
Total Administration and Collection Expense	<u>543,893</u>

Total Operating Expense 3,195,923

Net Operating Income 501,578

See notes to financial statements.

City of Estherville, Iowa  
Municipal Electric Utility  
Statement of Revenues, Expenses and Changes in Net Assets  
Year Ended December 31, 2004

Exhibit B

Non-Operating Revenues (Expenses):	
Interest Income	\$ 27,847
Interest Expense	(2,972)
Loss on Wind Generation Project	(3,589)
Donation - Regional Wellness Center	<u>(135,000)</u>
Net Non-Operating Expenses	<u>(113,714)</u>
Change in Net Assets	387,864
Net Assets Beginning of Year, As Restated	5,164,011
Add: Transfers From Other City Funds - Net	19,003
Less: Transfers To Other City Funds - Net	<u>(77,272)</u>
Net Assets End of Year	<u><u>\$5,493,606</u></u>

See notes to financial statements.

City of Estherville, Iowa  
Municipal Electric Utility  
Statement of Cash Flows  
Year Ended December 31, 2004

Exhibit C

<b>Cash Flows From Operating Activities:</b>	
Cash Received From Sales of Electricity to Customers	3,440,182
Cash Received From Service to City	257,488
Cash Received From Other Operating Revenues	21,818
Cash Paid to Suppliers for Goods and Services	(1,778,463)
Cash Paid to Employees for Services	(455,181)
Cash Paid to City for Payments in Lieu of Taxes	(426,739)
Cash Paid to City for Reimbursement of Expense	<u>(328,100)</u>
Net Cash Provided By Operating Activities	<u>731,005</u>
<b>Cash Flows From Noncapital Financing Activities:</b>	
Transfers from Other Funds	19,003
Transfers to Other Funds	<u>(77,272)</u>
Net Cash Used By Noncapital Financing Activities	<u>(58,269)</u>
<b>Cash Flows From Capital and Related Financing Activities:</b>	
Purchase of Capital Assets - Distribution	(259,086)
Purchase of Capital Assets - Generation	<u>(98,847)</u>
Net Cash Used By Capital and Related Financing Activities	<u>(357,933)</u>
<b>Cash Flows From Investing Activities:</b>	
Interest Income	27,433
Interest Expense	(2,054)
Loss on Wind Generation Project	(4,209)
Donation - Regional Wellness Center	<u>(135,000)</u>
Net Cash Used By Investing Activities	<u>(113,830)</u>
Net Increase in Cash and Cash Equivalents	200,973
Cash and Cash Equivalents Beginning of Year	<u>1,450,065</u>
Cash and Cash Equivalents End of Year	<u>\$1,651,038</u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>	
Operating Income	<u>\$ 501,578</u>
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	128,992
Changes in Assets and Liabilities:	
Decrease in Accounts Receivable	21,987
(Increase) in Inventory	(1,197)
Decrease in Prepaid Insurance	40
Increase in Accounts Payable	66,662
Increase in Customer Deposits Payable	10,285
Increase in Accrued Payroll	3,712
(Decrease) in Sales and Use Tax Payable	<u>(1,054)</u>
Total Adjustments	<u>229,427</u>
Net Cash Provided By Operating Activities	<u>\$ 731,005</u>

See notes to financial statements.

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**(1) Summary of Significant Accounting Policies**

The Municipal Electric Utility, City of Estherville, Iowa's financial statements are prepared in conformity with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board.

A. Reporting Entity

For financial reporting purposes, Municipal Electric Utility, City of Estherville, Iowa has included all funds, organizations, agencies, boards, commissions and authorities. 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. Municipal Electric Utility, City of Estherville, Iowa has no component units which meet the Governmental Accounting Standards Board criteria.

B. Basis of Presentation

The accounts of the Municipal Electric Utility, City of Estherville, Iowa are organized as an Enterprise Fund. Enterprise Funds are used to account for operations (a) financed and operated in a manner similar to private business enterprises, where the intent of the governing body is the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

C. Measurement Focus and Basis of Accounting

The 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. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

Measurement Focus and Basis of Accounting – Continued

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. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

D. Assets, Liabilities and Net Investments

The following accounting policies are followed in preparing the Statement of Net Assets:

Cash, Investments and Cash Equivalents – The Utility considers all short-term investments that are highly liquid to be cash equivalents. Cash equivalents are readily convertible to known amounts of cash and, at the day of purchase, have a maturity date no longer than three months. Cash investments not meeting the definition of cash equivalents at December 31, 2004 include certificates of deposit of \$514,840.

Designated Investments – Funds set aside for repurchase of the 69KV portion of substation, 69KV transmission lines No. 1 & No. 2 and backup transformer are classified as designated.

Capital Assets – Capital assets purchased prior to January 1, 1963 are accounted for at appraised values with subsequent additions accounted for at historical cost. Depreciation of all exhaustible capital assets is charged as an expense against operations. The cost of repair and maintenance is charged to expense, while the cost of renewals or substantial betterments is capitalized. The cost and accumulated depreciation of assets disposed of are deleted, with any gain or loss recorded in current operations.

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

Capital Assets - Continued

Capital assets of the Utility are depreciated using the straight line method over the following estimated useful lives:

Asset Class	Estimated Useful Lives (In Years)
Buildings	40
Building Improvements	40
Equipment and Vehicles	10-50

Interest is capitalized on qualified assets acquired with certain tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project with interest earned on invested proceeds over the same period. There were no qualifying assets acquired during the year ended December 31, 2004.

Compensated Absences – Utility employees accumulate a limited amount of earned but unused vacation hours for subsequent use or for payment upon termination, death or retirement. The Utility had no vacation payable at December 31, 2004.

Accounts Receivable – Bad debts are charged to operations in the year in which the account is determined uncollectible. If the reserve method of accounting for uncollectible accounts were used, it would not have a material effect on the financial statements. The City carries accounts receivable on the majority of its sales. The City's sales are made to local businesses and residents.

Inventory – Inventory is valued at cost (first-in, first-out method).

## **(2) Cash and Investments**

The Utility's deposits in banks 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 depositories to insure there will be no loss of public funds.

The Utility is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Utility; prime eligible bankers acceptances; certain high rated

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**(2) Cash and Investments - Continued**

commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The Utility had no investments meeting the disclosure requirements of Governmental Accounting Standards Board Statement No. 3.

Investment in Joint Venture – On November 4, 1997, the City entered into a joint venture agreement pursuant to the provisions of Chapter 390 of the Code of Iowa with the Municipal Electric Utility of the City of Cedar Falls, Algona Municipal Utilities, the City of Ellsworth, Westfield Municipal Utilities, Montezuma Light and Power, and the City of Fonda. This joint agreement is a collaborative effort of the parties above, the U.S. Department of Energy (“DOE”), and the Electric Power Research Institute (“EPRI”) to develop, construct and operate a wind-powered electric generation facility (Iowa Distributed Wind Generation Project – “IDWGP”). The project is partially funded by a grant from EPRI consisting of 47.42% of construction and operating expenses for 1999 and 2000 funded by EPRI.

The City of Estherville owns an 8% interest in the project and at December 31, 2004 and 2003 had a net investment of \$115,026. At this time, the City does not anticipate a need for much additional financial investment. The energy produced by the IDWGP will be apportioned among the parties based on their percentages of ownership. On November 19, 1998, the City entered into a two year agreement to sell its share of the generation from the IDWGP to Cedar Falls Utilities. The City was to receive payments for its generation on a semiannual basis as follows: Annual Payment = (Actual Operating Costs) + (Net Capital Cost) x (8.72%). This agreement has not been fulfilled as Cedar Falls Utilities has found the cost to deliver this energy to them is too high. Currently, Algona Municipal Utilities is purchasing the generated power at their avoided cost which has been determined to be \$.01213/KWH and \$.01394/KWH at December 31, 2004 and 2003 respectively. It has not been determined how long this arrangement will continue.

**(3) Equipment Sinking Fund**

City officials have established an “Equipment Sinking Fund”. This fund is increased by monthly deposits from various city departments; with purchases being made from the fund for vehicles and equipment. The Utility department’s 2004 balances and transactions are as follows:

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**(3) Equipment Sinking Fund - Continued**

	<u>Generation Plant</u>	<u>Distribution Department</u>	<u>Total</u>
Balance December 31, 2003	\$ 4,200	\$ 7,771	\$ 11,971
Deposits to Fund 2004	-	76,966	76,966
Disbursements 2004	<u>-</u>	<u>(15,005)</u>	<u>(15,005)</u>
Balance December 31, 2004	<u>\$ 4,200</u>	<u>\$ 69,732</u>	<u>\$ 73,932</u>

**(4) Pension and Retirement Benefits**

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

Plan members are required to contribute 3.70% of their annual covered salary and the City is required to contribute 5.75% of annual covered payroll for the years ended December 31, 2004, 2003 and 2002. Contribution requirements are established by state statute. The City's contributions to IPERS for years ended December 31, 2004, 2003 and 2002 were \$25,791, \$24,030 and \$23,565, respectively, for the Municipal Electric Utility.

**(5) Designated Cash**

Designated cash consists of customer security deposits collected and held by the Utility. The Utility pays interest of 5% per annum when the money is refunded.

**(6) Reimbursement to City for Accounting, Collection, and Administration Expenses**

City officials and employees have estimated the Utility's share of accounting and collection expenses to be \$328,100 in 2004.

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**(7) Capital Assets**

A summary of capital assets at December 31, 2004 is as follows:

	Balance Beginning of Year as restated (Note 15)	Increases	Decreases	Balance End of Year
Capital assets not being depreciated:				
Generation – Land	\$ 46,041	\$ -	\$ -	\$ 46,041
Distribution – Land and Easement	8,324	-	-	8,324
Total capital assets not being depreciated	54,365	-	-	54,365
Capital assets being depreciated:				
Office Equipment	105,849	-	-	105,849
Generation	4,594,872	98,847	-	4,693,719
Distribution	6,420,100	259,086	-	6,679,186
Total capital assets being depreciated	11,120,821	357,933	-	11,478,754
Less accumulated depreciation for:				
Office Equipment	105,849	-	-	105,849
Generation	4,024,883	37,014	-	4,061,897
Distribution	4,582,333	91,978	-	4,674,311
Total accumulated depreciation	8,713,065	128,992	-	8,842,057
Total capital assets being depreciated, net	2,407,756	228,941	-	2,636,697
Total capital assets, net	\$ 2,462,121	\$ 228,941	\$ -	\$ 2,691,062

**(8) Commitments – Agreement with Corn Belt Power Cooperative**

On May 29, 1998, the City entered into a “Wholesale Electric Service Agreement” with Corn Belt Power Cooperative and Iowa Lakes Electric Cooperative, agent for Corn Belt Power Cooperative.

Some of the more significant covenants of the current agreement are as follows:

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**Commitments – Agreement with Corn Belt Power Cooperative - Continued**

1. The City agrees to purchase from Corn Belt all of its purchased electrical energy in excess of that which is available to the City from Western Area Power Administration, Iowa Distributed Wind Generation Project, and that power which the City generates upon request.
2. Corn Belt Power Cooperative will provide the necessary equipment (including the installation of a backup transformer) to the point of delivery. The City will provide the necessary equipment for the distribution system.
3. The energy rate will be equal to 24.50 mills per KWH (the “Base Rate”) from the date of this agreement until December 31, 2001. Beginning January 1, 2002 and January 1 of each year thereafter, Corn Belt may make adjustments to the energy rate. The adjustment shall be no greater than the cumulative percentage increase in the Bureau of Labor Statistics Consumer Price Index, U.S. City Average, Urban Wage Earners and Clerical workers from October 1998 to the October preceding the rate adjustment. There was no adjustment to the energy rate for the years ended 2001, 2002 or 2003. As of January 1, 2004, the energy rate was increased to 27.33 mills per KWH. As of January 1, 2005, the energy rate was increased to 28.33 mills per KWH. Corn Belt Power Cooperative will also make available to the City up to 5,000 KW of peaking capacity during the months of May to October and the City will pay the following rate each month for the amount specified:

1998	\$4.62 per KW
1999	4.77 per KW
2000	4.92 per KW
2001 – 2004	Priced at Market

The City did not require the use of the 5,000 KW of peaking capacity in 2001 - 2004 so no rate was set.

4. The initial term of this agreement is for a period of five (5) years and will continue from year to year with no further action by either party. On or after the fourth anniversary of the effective date of this agreement, it may be terminated by either party by giving one year’s written notice.
5. Corn Belt Power Cooperative purchased from Mid American Energy Company, the 69 KV portion of substation, 69KV transmission lines No. 1 & No. 2 for an amount equal to their original cost less accumulated depreciation. Upon termination of this agreement, the City shall purchase said facilities and the backup transformer at a price equal to Corn Belt Power Cooperative’s original cost less accumulated depreciation as of the

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**Commitments – Agreement with Corn Belt Power Cooperative - Continued**

date of termination. The City has set aside a certificate of deposit in the amount of \$514,840 in anticipation of these repurchase requirements.

6. The effective date of this agreement was June 1, 1998.
7. The net cost of power purchased during 2004 under this agreement was \$1,192,052.

**(9) Commitments – Agreement with Western Area Power Administration**

On May 1, 1998, the City entered into a “Service Agreement” with the United States Department of Energy, acting through the Administrator, Western Area Power Administrative (WAPA).

Some of the more significant covenants of the current agreement are as follows:

1. WAPA agreed to supply the City electrical energy not to exceed 2,814 KW in the winter season and 2,743 KW in the summer season through December 31, 2005, at which point the contract rate of delivery will be adjusted. The estimated cost of power from WAPA is 1.54 cents per KWH not including the cost of transmission.
2. WAPA makes delivery of energy through Corn Belt Power Cooperative, the City’s primary energy provider with whom the City has entered into an agreement dated November 1, 2000 for the delivery of this energy at an estimated rate of .462 cents per KWH. This transmission agreement was in effect January 1, 2001 through December 31, 2003.

On January 1, 2004, the City entered into a new transmission agreement effective January 1, 2004 through December 31, 2009. The terms of this agreement did not change from the prior transmission agreement. The net delivery cost during 2004 under this agreement was \$56,213.

3. The initial term of this agreement with WAPA is for a period of twenty (20) years with service to begin on January 1, 2001.
4. The net cost of power purchased during 2004 under this agreement was \$219,085.

**(10) Commitments – Agreement with Iowa Lakes Community College**

On September 21, 2004, the City entered into an “Interconnection Agreement” with Iowa Lakes Community College (ILCC) for interconnection and operation of a

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**Commitments – Agreement with Iowa Lakes Community College - Continued**

wind turbine generator (WTG).

Some of the more significant covenants of the current agreement are as follows:

1. The City and ILCC agree that the WTG may be interconnected to and operated in parallel with the City's system.
2. ILCC will provide and maintain the necessary equipment for interconnection and operation of the WTG.
3. The City will have the right to inspect, at its own expense and upon reasonable notice to ILCC, any interconnection equipment for the WTG.
4. The agreement is for a period of 20 years from the commercial date of operation of the WTG. It may be terminated by ILCC at any time by giving the City two (2) years written notice. The City may terminate upon failure by ILCC to generate energy from the WTG by the later of two (2) years from the date of this agreement or twelve (12) months after completion of the interconnection. Either party may terminate by giving the other party at least sixty days' prior written notice that the other party is in default of any of the material terms and conditions of the agreement.
5. The City connected to the WTG on February 15, 2005.

**(11) Commitments – Agreement with Iowa Lakes Community College**

On September 21, 2004, the City entered into a "Power Purchase Agreement" with Iowa Lakes Community College (ILCC) to purchase power from the wind turbine generator (WTG).

Some of the more significant covenants of the current agreement are as follows:

1. The City agrees to purchase all of the output of the WTG delivered to the Interconnection Point. There are no minimum or maximum output requirements.
2. Payment will be calculated by multiplying the metered output by the avoided cost rate. Initially the avoided cost rate will be about 2.73 cents per KWH. The avoided cost rate may change from month to month to track the City's actual avoided costs.
3. The agreement is for a period of 20 years from the commercial date of operation of the WTG. It may be terminated by ILCC at any time by giving the City two (2) years written notice. Either party may terminate by giving

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**Commitments – Agreement with Iowa Lakes Community College - Continued**

the other party at least sixty days' prior written notice that the other party is in default of any of the material terms and conditions of the agreement. Either party may terminate by giving the other party at least sixty days' prior written notice if the Interconnection Agreement is terminated.

4. The City began receiving power from the WTG on February 15, 2005.

**(12) Risk Management**

The 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. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The City assumes liability for any deductibles and claims in excess of coverage limitations.

**(13) Accounting Change**

For the year ended December 31, 2004, the Utility implemented Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments; Statement No. 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus; and Statement No. 38, Certain Financial Statement Note Disclosures.

Implementation of these statements had no effect on the beginning balances of the Utility.

**(14) Commitments**

In conjunction with the application for a Vision Iowa grant for the Regional Wellness Center, the City guaranteed pledges of \$2,000,000 from the area-wide fund-raising campaign for the Regional Wellness Center.

On November 6, 2003, the City approved a challenge grant to the Regional Wellness Center of up to \$135,000 to match other donations for RWC equipment. The City paid \$135,000 from the Utility in satisfaction of the challenge grant during the year ended December 31, 2004.

**(15) Prior Period Adjustment to Retained Earnings**

Previously reported distribution inventories were discovered to be understated and previously reported distribution plant assets were discovered to be overstated during the current year. Accordingly, an adjustment of \$283,919 was

City of Estherville, Iowa  
Municipal Electric Utility  
Notes to Financial Statements - Continued  
December 31, 2004

**Prior Period Adjustment to Retained Earnings – Continued**

made during 2004 to increase the beginning balance of distribution inventories and decrease the beginning balance of distribution plant assets. A corresponding entry was made to increase previously reported unappropriated net assets and decrease accumulated depreciation by \$14,571 to reverse the depreciation expense deducted on these assets in prior periods. The effect of the restatement of net assets is an increase to beginning net assets in the amount of \$14,571.

**(16) Related Party Transactions**

The Municipal Electric Utility, City of Estherville, Iowa had sales of electric power to the City of Estherville of \$253,170 during the year ended December 31, 2004. The Utility paid \$328,100 for accounting and collection and \$426,739 for payment in lieu of taxes to the City of Estherville during the year ended December 31, 2004. The City of Estherville owed \$17,198 to the Utility at December 31, 2004.

The Utility is a fund of the City of Estherville.

## Other Supplementary Information

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF STATISTICAL DATA  
YEAR ENDED DECEMBER 31, 2004

Schedule 1

UNAUDITED

	<u>KWH Sold</u>	<u>Amount Billed</u>	<u>Average Unit Revenue Per KWH</u>	<u>Percent of Revenue To Total</u>	<u>Percent of KWH To Total</u>	<u>Number of Meters In Service</u>
Service to Customers						
Residential	19,646,374	\$ 1,406,949	7.16	39.44 %	36.58 %	2,757
Small Commercial	7,766,398	547,035	7.04	15.33	14.46	417
Large Commercial	16,432,037	1,065,571	6.48	29.87	30.59	44
Industrial	5,603,008	294,820	5.26	8.26	10.43	1
Total Service to Customers	49,447,817	3,314,375	6.70	92.90	92.06	3,219
Service to City	4,261,801	253,170	5.94	7.10	7.94	38
Total	<u>53,709,618</u>	<u>\$ 3,567,545</u>		<u>100.00 %</u>	<u>100.00 %</u>	<u>3,257</u>

Analysis of Kilowatt Hours Generated and Purchased

Total Kilowatt Hours Generated - 2004	144,200
Kilowatt Hours Purchased - Net 2004	<u>57,825,000</u>
	57,969,200
Less: Station Power Consumption	<u>(793,700)</u>
Total to Feeders	57,175,500
Kilowatt Hours Sold on Line	
Service to Customers	49,447,817
Service to City	4,261,801
Kilowatt Hours Used For	
Security/Traffic Lights	<u>638,331</u>
Line Loss and Excess Generator 4.95%	<u>2,827,551</u>

See Independent Auditors' Report

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTRIC UTILITY  
OPERATIONAL ANALYSIS  
YEAR ENDED DECEMBER 31, 2004

Schedule 2

UNAUDITED

REVENUE

Sales of electrical energy decreased in 2004 to 53,709,618 kilowatt hours from 54,050,269 in 2003, a decrease of .63%. Operating revenues from energy sales decreased to \$3,681,679 down \$63,077 from the previous year. Other operating revenues increased \$1,830. Total operating revenues for 2004 were \$3,697,501 a decrease of \$61,247 from the previous year.

OPERATION AND MAINTENANCE EXPENSE

Operating expenses in 2004 increased to \$3,195,923 up from \$2,996,091 in 2003 for an increase of \$199,832. Energy purchases continue to be the largest single item of operating expense and totaled \$1,467,350 up from \$1,314,799 in 2003. The cost of purchased power, natural gas and fuel oil represented approximately 46.40% of the total operating costs in 2004 and 44.13% in 2003.

NET INCOME

Net operating income before interest totaled \$501,578 in 2004, compared to \$762,657 for the prior year, a decrease of \$261,079. Depreciation expense decreased \$69,311 for the current year, and interest expense increased \$438. Interest income decreased \$4,855 in 2004 when compared to 2003.

Net income of \$387,864 was realized for 2004 compared to \$456,867 for 2003, a decrease of \$69,003.

See Independent Auditors' Report

Independent Auditors' Report on Compliance and on  
Internal Control Over Financial Reporting

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTIC UTILITY

# Johnson & Eckard CPAs, P.C.

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## Independent Auditors' Report on Compliance and on Internal Control over Financial Reporting

Honorable Mayor and City Council  
City of Estherville, Iowa

We have audited the financial statements of Municipal Electric Utility, City of Estherville, Iowa as of and for the year ended December 31, 2004, and have issued our report thereon dated March 10, 2005. 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.

### Compliance

As part of obtaining reasonable assurance about whether the Municipal Electric Utility, City of Estherville, Iowa's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance required to be reported under Government 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.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered Municipal Electric Utility, City of Estherville'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. However, we noted certain matters involving the internal control over financial reporting

and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Municipal Electric Utility, City of Estherville, Iowa's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Part II of the accompanying Schedule of Findings.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe item II-A-04, the reportable condition described above, is a material weakness.

This report, a public record by law, is intended solely for the information and use of the members and customers of the Municipal Electric Utility, City of Estherville, Iowa and other parties to whom the Utility may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the Municipal Electric Utility, City of Estherville, Iowa during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.



JOHNSON & ECKARD CPAs, P.C.

March 10, 2005

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2004

Part I: Summary of the Independent Auditors' Results:

- (a) The auditors' report expresses a qualified opinion on the financial statements of the Municipal Electric Utility, City of Estherville, Iowa.
- (b) A reportable condition in internal control over financial reporting was disclosed by the audit of the financial statements, including a material weakness.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

CITY OF ESTHERVILLE, IOWA  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2004

Part II: Findings Related to the Financial Statements:

INSTANCES OF NON-COMPLIANCE:

No matters were noted.

REPORTABLE CONDITIONS:

II-A-04 Segregation of Duties - One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. We noted that employees who handle cash receipts are also involved with the preparation of bank reconciliations.

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

Response – The City will make every effort to comply.

Conclusion - Response accepted.

Part III: Other Findings Related to the Statutory Reporting:

III-A-04 Official Depositories - A resolution naming official depositories has been approved by the City. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2004.

III-B-04 Questionable Disbursements - No disbursements that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979 were noted.

III-C-04 Travel Expense - No disbursements of City money for travel expenses of spouses of City officials or employees were noted.

III-D-04 Council Minutes – No transactions were found that we believe should have been approved in the Council minutes but were not.

III-E-04 Deposits and Investments – We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the City's investment policy.