



# **Cedar Falls Utilities**

Electric • Gas • Water • Communications

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**Financial Statements and  
Supplementary Information  
for the Years Ended  
December 31, 2005 and 2004**

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

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

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## INDEPENDENT AUDITORS' REPORT

The Board of Trustees  
Cedar Falls Utilities – Municipal Electric Utility

We have audited the accompanying balance sheets of the Municipal Electric Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006, on our consideration of the Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Eide Bailly LLP".

March 24, 2006  
Dubuque, Iowa

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

Management Discussion and Analysis

December 31, 2005 and 2004

Our discussion and analysis of the Municipal Electric Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2005 and 2004. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased as a result of this year's operations. Total assets at year-end were \$122,207,655 and total liabilities were \$50,607,915 resulting in net assets of \$71,599,740. In 2004, total assets were \$89,839,916 and total liabilities were \$24,568,083 resulting in net assets of \$65,271,833.
- Operating revenues increased 18.7 percent to \$30,429,628 from 25,633,884 in 2004 while operating expenses increased 13.2 percent to \$25,723,745 from 22,732,913 in 2004.
- During the year, the Utility had operating income of \$4,705,883. This compares to last year, when the Utility had operating income of \$2,900,971.
- The Utility delivered approximately 419,700,000 kilowatt hours (kWh) of electricity to its retail customers in 2005 as compared to approximately 399,900,000 kWh in 2004.

**Overview of the Financial Statements**

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

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

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

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

Management Discussion and Analysis

December 31, 2005 and 2004

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

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

**Condensed Financial Information**

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

**Condensed Balance Sheet Information**

	<u>2005</u>	<u>2004</u>
Current assets	\$25,345,704	\$18,331,471
Capital assets, net	68,011,047	53,065,285
Other non-current assets	28,850,904	18,443,160
Total assets	<u>\$122,207,655</u>	<u>\$89,839,916</u>
Current liabilities	7,560,768	5,960,342
Non-current liabilities	5,433,937	4,254,365
Long-term debt	37,613,210	14,353,376
Total liabilities	<u>\$50,607,915</u>	<u>\$24,568,083</u>
Invested in capital assets, net of related debt	44,182,925	42,826,327
Restricted	4,235,500	2,440,910
Unrestricted	23,181,315	20,004,596
Total net assets	<u>\$71,599,740</u>	<u>\$65,271,833</u>

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

Management Discussion and Analysis

December 31, 2005 and 2004

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2005</u>	<u>2004</u>
Sales of electricity	\$29,052,465	\$24,344,499
Other	<u>1,377,163</u>	<u>1,289,385</u>
Total operating revenues	<u>30,429,628</u>	<u>25,633,884</u>
System operation and maintenance	17,014,840	13,744,661
Depreciation and amortization	2,647,776	2,514,784
Service and administrative	<u>6,061,129</u>	<u>6,473,468</u>
Total operating expenses	<u>25,723,745</u>	<u>22,732,913</u>
Operating income	<u>4,705,883</u>	<u>2,900,971</u>
Interest income	1,175,682	711,606
Other, net	<u>446,342</u>	<u>(146,018)</u>
Total non-operating revenues (expenses)	<u>1,622,024</u>	<u>565,588</u>
Change in net assets	6,327,907	3,466,559
Net assets, beginning of year	<u>65,271,833</u>	<u>61,805,274</u>
Net assets, end of year	<u>\$71,599,740</u>	<u>\$65,271,833</u>

**Financial Analysis**

Current assets increased 38.9 percent in 2005 primarily as a result of an increase in unrestricted cash and cash equivalents of \$3,582,212 from operations; an increase in customer accounts of approximately \$1,321,000; an increase in local fuel inventory of \$701,897 due to a 63.9 percent increase in coal purchases over 2004 and an increase in the average cost per ton of \$16.83.

Other non-current assets increased 56.4 percent in 2005 primarily due to investments made from the 2005 revenue bond issue in the construction fund maturing and being used to invest in the Council Bluffs #4 (CB4) generation construction project. Other noncurrent assets also include the long-term note receivable from the Municipal Communication Utility. The total outstanding balance at December 31, 2005 was \$2,783,090.

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

Management Discussion and Analysis

December 31, 2005 and 2004

Current liabilities increased 26.9 percent in 2005 primarily as a result of the following: accounts payable increased approximately \$916,000 due primarily to increased material purchases for projects and outstanding construction projects and CB4 construction.

Non-current liabilities increased 27.7 percent in 2005 primarily due to the \$955,446 additional retainage held on the long-term construction project of CB4, in which the Utility is a 2.02 percent owner; and an increase of approximately \$167,400 in customer advances for construction and an increase of \$56,725 in accrued severance that employees are entitled to receive upon retirement with 20 years of continuous service.

Long-term debt increased 162.1 percent primarily due to the issuance of \$24,975,000 in revenue bonds in 2005. The proceeds of which are being used to fund local transmission projects and the construction of CB4.

Sales of electricity increased 19.3 percent in 2005 primarily due to the impact of the general rate increase effective January 2005 of approximately 5 percent. Sales for resale were also a contributing factor to the total increase in sales of electricity. Sales for resale increased approximately \$432,800 or 24.1 percent. Due to the market price of electricity being relatively high, the Utility ran our local units resulting in excess generation available to sell on the market.

Other operating revenues increased 6.3 percent in 2005 primarily as a result of increased rates for pole rental. Forfeited Discounts, which are charges assessed to customers who pay their bills late, increased 33.5 percent in 2005.

System operation and maintenance increased 23.7 percent in 2005 due to several factors. As mentioned previously, due to the market price of electricity being relatively high, the Utility ran our local units. The Utility purchased nearly 22,000 tons of coal more during 2005 than in 2004. This represents an increase of 27.1 percent. The corresponding increase in the cost of the coal used is approximately \$1,407,000 or a 28.5 percent increase over 2004. Due to the increase in coal used, the associated costs of allowances, fuel handling, and ash disposal increased approximately \$396,968. The change in the fuel cost to be recovered from customers represents an additional expense or reduction in expense. The amount of the change in fuel cost to be recovered from December 31, 2004 to December 31, 2005 is a decrease in expense of approximately \$334,580.

Administrative and general expenses decreased 4.6 percent in 2005 primarily due decreases of approximately \$145,000 in employee insurance and benefit costs and \$24,200 in property insurance.

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

December 31, 2005 and 2004

Other non-operating revenues increased 77.8 percent in 2005 primarily due to a \$425,000 increase in interest income related to the investment of the proceeds from the 2005 Electric Revenue Bonds and \$746,500 increase in Miscellaneous Non-Operating Income largely from the receipt of \$772,903 in TIF monies from the City of Cedar Falls.

**Capital Assets and Debt Administration**

Net capital assets represent 55.6 percent of total assets for the Utility. Net capital assets increased 28.2 percent from the prior year due to distribution system additions and Council Bluffs Energy Center Unit 4 construction work in progress. Additional detail on the change in capital assets can be found in Note 4.

During 2002, the Board of Trustees approved the joint ownership agreement for the construction and operation of the Council Bluffs Energy Center Unit 4. The Utility will become a 2.02 percent owner which is approximately 16 megawatts. Our total estimated cost to construct is approximately \$25,000,000 and operation is expected to begin in 2007. Construction work in progress related to this project at December 31, 2005 is approximately \$16,391,000.

The Board of Trustees authorized the issuance of revenue bonds in an amount not to exceed \$35,000,000 for electric system improvements and extensions, including the construction of generation and transmission assets. On December 18, 2003 \$10,000,000 of revenue bonds were issued for the first phases of the projects. On July 13, 2005 \$24,975,000 of revenue bonds were issued for the final phases of the electric system improvements and extensions and the construction of generation and transmission assets. Additional detail on the issuance of revenue bonds can be found in Note 5.

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

Balance Sheets

December 31, 2005 and 2004

<u>Assets</u>	<u>2005</u>	<u>2004</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 106,257,062	\$ 100,548,512
Less accumulated depreciation	<u>60,821,685</u>	<u>58,601,755</u>
	45,435,377	41,946,757
Construction work in progress	<u>22,575,670</u>	<u>11,118,528</u>
Net capital assets (note 8)	<u>68,011,047</u>	<u>53,065,285</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Restricted (note 2)	17,022,250	5,622,994
Unrestricted	8,950,390	9,751,592
Note receivable (note 9)	<u>2,473,090</u>	<u>2,783,090</u>
Total noncurrent assets	<u>28,445,730</u>	<u>18,157,676</u>
Current assets:		
Cash and cash equivalents (note 1)	5,692,717	2,110,505
Investments (note 3)	7,952,227	7,579,469
Receivables:		
Customer accounts, less allowance for doubtful		
accounts of \$33,992 in 2005 and \$34,256 in 2004	3,794,093	2,472,660
Interest (note 9)	477,615	328,764
Current installment of note receivable (note 9)	310,000	310,000
Other	778,890	561,290
Inventories:		
Fuel	2,507,631	1,805,734
Material and supplies	864,436	760,175
Prepayments and other	434,468	623,998
Restricted - cash (note 2)	<u>2,533,627</u>	<u>1,778,876</u>
Total current assets	<u>25,345,704</u>	<u>18,331,471</u>
Deferred costs:		
Deferred costs	<u>405,174</u>	<u>285,484</u>
Total assets	<u>\$ 122,207,655</u>	<u>\$ 89,839,916</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2005</u>	<u>2004</u>
Long-term debt, less current installments (note 5)	\$ 37,613,210	14,353,376
Current liabilities:		
Accounts payable	4,209,637	3,293,274
Reserve for surplus declaration (note 9)	1,200,000	1,200,000
Accrued wages and vacations	462,703	441,030
Accrued interest	152,855	82,594
Other accrued expenses	140,573	158,444
Current installments of long-term debt (note 5)	1,395,000	785,000
Total current liabilities	<u>7,560,768</u>	<u>5,960,342</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	295,350	127,950
Other liabilities (note 5)	5,138,587	4,126,415
Total noncurrent liabilities	<u>5,433,937</u>	<u>4,254,365</u>
 Total liabilities	 <u>50,607,915</u>	 <u>24,568,083</u>
 <u>Net Assets</u>		
Invested in captial assets, net of related debt	44,182,925	42,826,327
Restricted - bond indentures (note 2)	4,235,500	2,440,910
Unrestricted	23,181,315	20,004,596
Total net assets	<u>71,599,740</u>	<u>65,271,833</u>
 Total liabilities and net assets	 \$ <u>122,207,655</u>	 <u>89,839,916</u>

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

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues: (note 5)		
Sales of electricity:		
Residential	\$ 11,717,764	\$ 10,070,822
Large industrial & commercial	1,861,720	1,574,962
Small industrial & commercial	10,222,036	8,489,530
Governmental (note 9)	2,851,303	2,274,275
Sales for resale	2,225,304	1,792,504
Interdepartmental	174,338	142,406
Total sales of electricity	<u>29,052,465</u>	<u>24,344,499</u>
Other operating revenues	1,377,163	1,289,385
Total operating revenues	<u>30,429,628</u>	<u>25,633,884</u>
Operating expenses:		
Production and generation:		
Fuel	6,576,700	5,182,276
Purchased power	4,379,786	2,660,981
Other	3,381,122	3,300,487
Transmission	767,364	800,577
Distribution	1,909,868	1,800,340
Depreciation and amortization	2,647,776	2,514,784
Customer accounts	589,551	647,114
Customer service and information expenses	363,463	365,479
Sales	73,473	70,063
Administrative and general (note 9)	4,361,287	4,571,719
Taxes other than income taxes	673,355	819,093
Total operating expenses	<u>25,723,745</u>	<u>22,732,913</u>
Operating income	<u>4,705,883</u>	<u>2,900,971</u>
Nonoperating revenues (expenses):		
Interest income (note 9)	1,175,682	711,606
Net increase (decrease) in the fair value of investments	(159,166)	(119,609)
Miscellaneous revenue (expense), net (note 9)	966,826	503,586
Interest expense on long-term debt	(364,621)	(525,051)
Interest income (expense) on security deposits	3,303	(4,944)
Total nonoperating revenues (expenses)	<u>1,622,024</u>	<u>565,588</u>
Change in net assets	<u>6,327,907</u>	<u>3,466,559</u>
Net assets, beginning of year	<u>65,271,833</u>	<u>61,805,274</u>
Net assets, end of year	<u>\$ 71,599,740</u>	<u>\$ 65,271,833</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from customers	\$ 29,893,733	\$ 25,548,031
Cash paid to suppliers	(17,377,146)	(12,043,228)
Cash paid to employees	(2,927,097)	(2,686,399)
Payment in lieu of taxes to the City of Cedar Falls	(1,200,000)	(1,400,000)
Property tax paid	(333,369)	(370,108)
	<hr/>	<hr/>
Net cash provided by operating activities	8,056,121	9,048,296
Cash flows from noncapital financing activities:		
Proceeds from affiliated utility	-	181,779
Interest paid	(5,185)	(3,795)
	<hr/>	<hr/>
Net cash provided by (used in) noncapital financing activities	(5,185)	177,984
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(785,000)	(745,000)
Proceeds from issuance of revenue bonds	24,623,703	-
Cost of issuance of revenue bonds	(100,945)	-
Proceeds from customer advances for construction	332,500	234,450
Refunds of customer advances for construction	(165,100)	(240,444)
Acquisition, construction and removal cost of capital assets	(16,973,200)	(13,183,137)
Proceeds from sale of capital assets	168,376	20,597
Reimbursement of utility construction costs	46,289	188,353
Interest paid	(1,067,449)	(762,517)
	<hr/>	<hr/>
Net cash provided by (used in) capital and related financing activities	6,079,174	(14,487,698)
Cash flows from investing activities:		
Proceeds from repayment of loan by associated utility	310,000	471,500
Proceeds from maturities of investment securities	21,293,211	18,486,000
Purchase of investment securities	(32,423,189)	(14,839,927)
Interest received	1,026,831	652,578
	<hr/>	<hr/>
Net cash provided by (used in) investing activities	(9,793,147)	4,770,151
Net increase (decrease) in cash and cash equivalents	4,336,963	(491,267)
Cash and cash equivalents, beginning of year	3,889,381	4,380,648
Cash and cash equivalents, end of year (note 1)	<u>\$ 8,226,344</u>	<u>\$ 3,889,381</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 4,705,883	\$ 2,900,971
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization of capital assets	2,647,776	2,514,784
Other income (expense) related to operating activities	966,826	503,586
Increase in accounts receivable	(1,539,033)	(629,594)
Increase in inventories	(806,158)	(578,018)
(Increase) decrease in prepayments and other	189,530	(506,354)
(Increase) decrease in other assets	(41,040)	26,862
Increase in accounts payable	916,363	1,962,493
Increase in accrued wages and vacation	21,673	82,191
Decrease in reserve for surplus declaration	-	(200,000)
Increase (decrease) in other accrued expenses	(17,871)	12,845
Increase in other liabilities	<u>1,012,172</u>	<u>2,958,530</u>
Net cash provided by operating activities	<u>\$ 8,056,121</u>	<u>\$ 9,048,296</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

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

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

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

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

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 4.63% in 2005 and 2004. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets.

The range of estimated service lives for the classes of capital assets are as follows: land improvements - 30 years, infrastructure - 10 to 150 years, buildings and improvements - 20 to 55 years, and equipment - 5 to 25 years. The depreciation provisions were equivalent to an overall composite rate of 2.6% and 2.8% of depreciable assets for 2005 and 2004, respectively.

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

(c) Cash and Investments

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

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

The Utility considers all highly liquid investments with maturity of three months or less at purchase to be cash equivalents for purposes of the statements of cash flows. Included in cash and cash equivalents at December 31, 2005 was \$500,000 for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(d) Inventories

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

(e) Operating Revenues and Expenses

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

Revenues from the sale of electricity are based on billing rates, which are applied to customers' consumption of electricity. The Utility records estimated unbilled revenue, including amounts to be billed under a fuel adjustment clause, at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2005 and 2004, were \$1,053,855, and \$805,822, respectively, and are recorded in customer accounts receivable. The Utility uses a fuel adjustment clause whereby increases or decreases in fuel costs are billed to customers and included in operating revenue without changing base rates charged to its customers.

(f) Bond Issue Costs

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

(g) Net Assets

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

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

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

(h) Estimates

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

(i) Budgetary Information

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on the cash basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribe procedures. Encumbrances are not recognized on the cash basis budget and appropriations lapse at year end.

Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year, one budget amendment increased budgeted disbursements by \$6,179,500. This budget amendment is reflected in the final budgeted amounts.

(2) Restricted Assets

Restricted assets represent monies set aside under the terms of the bond resolutions relating to the Series 1999A, 1999B, 2003, and 2005 revenue bonds. In accordance with the covenants of the bond resolutions, monies are also segregated into various funds. The composition of these funds as of December 31 was as follows:

	<u>2005</u>	<u>2004</u>
Current assets - restricted:		
Bond reserve fund	\$ 1,500	\$ 1,500
Bond and interest fund	256,538	126,957
Construction fund	<u>2,275,589</u>	<u>1,650,419</u>
Restricted-cash	<u>2,533,627</u>	<u>1,778,876</u>
Noncurrent assets - restricted:		
Improvement and extension fund	1,000,000	1,000,000
Bond reserve fund	3,117,750	1,373,994
Construction fund	<u>12,904,500</u>	<u>3,249,000</u>
Restricted noncurrent investments	<u>17,022,250</u>	<u>5,622,994</u>
Total restricted assets	<u>\$19,555,877</u>	<u>\$ 7,401,870</u>

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

(3) Cash on Hand, Deposits, and Investments

Cash on Hand - Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2005 and 2004 was \$493.

Deposits - At December 31, 2005, the Utility's carrying amount of deposits, including \$9,943,756 of certificates of deposits and \$4,297,171 of money market accounts, was \$17,669,608. At December 31, 2004, the Utility's carrying amount of deposits, including \$11,734,000 of certificates of deposits, was \$15,122,888.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(3) Cash on Hand, Deposits, and Investments, continued

Investments - The utility is authorized by statute to invest public funds not currently needed for operating expenses in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

As of December 31, 2005, the Utility had the following investments and maturities. (The Utility assumes callable bonds will not be called):

<u>2005</u> <u>Investment Type</u>	<u>Investment Maturities (In Years)</u>		
	<u>Less than 1</u>	<u>1 to 3</u>	<u>Total</u>
Federal Agency Obligations	<u>\$ 8,727,609</u>	<u>\$15,253,501</u>	<u>\$23,981,110</u>

As of December 31, 2004, the Utility had the following investments and maturities. (The Utility assumes callable bonds will not be called):

<u>2004</u> <u>Investment Type</u>	<u>Investment Maturities (In Years)</u>		
	<u>Less than 1</u>	<u>1 to 3</u>	<u>Total</u>
Federal Agency Obligations	<u>\$ -</u>	<u>\$11,220,055</u>	<u>\$11,220,055</u>

In addition, the Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$500,000 at December 31, 2005 and 2004, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk. The Utility's investment policy limits the investments of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in instruments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

Credit Risk. The Utility's investment policy limits investments in commercial paper and other corporate debt to the top two highest classifications. The Utility did not invest in any commercial paper or other corporate debt during the year. The Utility's investment in the Iowa Public Agency Investment Trust is unrated.

Concentration of Credit Risk. The Utility's investment policy does not allow for a prime bankers' acceptance or commercial paper and other corporate debt balances to be greater than ten percent of its total deposits and investments. The policy also limits the amount that can be invested in a single issue to five percent of its total deposits and investments. The Utility held no such investments during the year.

Custodial Credit Risk - Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are 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.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(3) Cash on Hand, Deposits, and Investments, continued

Custodial Credit Risk - Investments. For an investment, this is the risk that, in the event of the failure of the counterparty, the Utility will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Utility had no custodial risk with regards to investments, since all investments were held by the Utility or its agent in the Utility's name.

A reconciliation of the Utility's cash and cash equivalents and investments as shown on the balance sheets follows:

	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 493	\$ 493
Carrying amount of deposits	17,669,608	15,122,888
Carrying amount of federal agency obligations	23,981,110	11,220,055
Carrying amount of Iowa Public Agency Investment Trust	<u>500,000</u>	<u>500,000</u>
Total	<u>\$42,151,211</u>	<u>\$26,843,436</u>
Current Assets		
Cash and cash equivalents	\$ 5,692,717	\$ 2,110,505
Investments	7,952,227	7,579,469
Restricted - cash	2,533,627	1,778,876
Noncurrent investments		
Restricted	17,022,250	5,622,994
Unrestricted	<u>8,950,390</u>	<u>9,751,592</u>
Total	<u>\$42,151,211</u>	<u>\$26,843,436</u>

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2005 and 2004 follows:

2005	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 991,703	\$ -	\$ -	\$ 991,703
Construction work in progress	<u>11,118,528</u>	<u>17,932,702</u>	<u>6,475,560</u>	<u>22,575,670</u>
Total capital assets, not being depreciated	<u>12,110,231</u>	<u>17,932,702</u>	<u>6,475,560</u>	<u>23,567,373</u>
Capital assets, being depreciated:				
Land improvements	4,683	-	-	4,683
Infrastructure	74,248,082	4,011,383	310,240	77,949,225
Buildings and improvements	10,883,742	1,422,510	3,152	12,303,100
Equipment	<u>14,420,302</u>	<u>1,042,244</u>	<u>454,195</u>	<u>15,008,351</u>
Total capital assets, being depreciated	<u>99,556,809</u>	<u>6,476,137</u>	<u>767,587</u>	<u>105,265,359</u>
Less accumulated depreciation	<u>(58,601,755)</u>	<u>(2,935,418)</u>	<u>(715,488)</u>	<u>(60,821,685)</u>
Total capital assets, being depreciated, net	<u>40,955,054</u>	<u>3,540,719</u>	<u>52,099</u>	<u>44,443,674</u>
Capital assets, net	<u>\$53,065,285</u>	<u>\$21,473,421</u>	<u>\$6,527,659</u>	<u>\$68,011,047</u>
2004	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 830,431	\$ 201,251	\$ 39,979	\$ 991,703
Construction work in progress	<u>2,192,830</u>	<u>13,617,734</u>	<u>4,692,036</u>	<u>11,118,528</u>
Total capital assets, not being depreciated	<u>3,023,261</u>	<u>13,818,985</u>	<u>4,732,015</u>	<u>12,110,231</u>
Capital assets, being depreciated:				
Land improvements	4,683	-	-	4,683
Infrastructure	71,702,410	2,856,219	310,547	74,248,082
Buildings and improvements	10,799,268	93,100	8,626	10,883,742
Equipment	<u>13,227,578</u>	<u>1,541,466</u>	<u>348,742</u>	<u>14,420,302</u>
Total capital assets, being depreciated	<u>95,733,939</u>	<u>4,490,785</u>	<u>667,915</u>	<u>99,556,809</u>
Less accumulated depreciation	<u>(56,422,028)</u>	<u>(2,775,705)</u>	<u>(595,978)</u>	<u>(58,601,755)</u>
Total capital assets, being depreciated, net	<u>39,311,911</u>	<u>1,715,080</u>	<u>71,937</u>	<u>40,955,054</u>
Capital assets, net	<u>\$42,335,172</u>	<u>\$15,534,065</u>	<u>\$4,803,952</u>	<u>\$53,065,285</u>

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2005 and 2004 was as follows:

2005	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 1999A revenue bonds	\$ 3,600,000	\$ -	\$ 350,000	\$ 3,250,000	\$375,000
Series 1999B revenue bonds	1,890,000	-	195,000	1,695,000	205,000
Series 2003 revenue bonds	9,765,000	-	240,000	9,525,000	245,000
Series 2005 revenue bonds	-	24,975,000	-	24,975,000	570,000
Unamortized premium on revenue bonds	-	167,843	6,591	161,252	
Unamortized discount on revenue bonds	(116,623)	(519,140)	(37,721)	(598,041)	-
	\$15,138,376	24,623,703	753,870	\$39,008,211	\$1,395,000
Current installments of long-term debt	(785,000)	(610,000)	-	(1,395,000)	
Long-term debt, less current installments	14,353,376	24,013,703	753,870	37,613,211	
Customer advances for construction	127,950	332,500	165,100	295,350	
Other liabilities:					
Landfill closure	477,819	-	8,902	468,917	
Severance	572,944	75,304	18,579	629,669	
Contract payable	3,075,652	964,348	-	4,040,000	
Noncurrent liabilities	4,254,365	1,372,152	192,581	5,433,936	
Total noncurrent liabilities	\$18,607,741	\$25,385,855	\$ 946,451	\$43,047,147	

2004	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 1999A revenue bonds	\$3,925,000	\$ -	\$ 325,000	\$ 3,600,000	\$350,000
Series 1999B revenue bonds	2,075,000	-	185,000	1,890,000	195,000
Series 2003 revenue bonds	10,000,000	-	235,000	9,765,000	240,000
Unamortized discount on revenue bonds	(133,621)	-	(16,997)	(116,624)	-
	15,866,379	-	728,003	15,138,376	\$785,000
Current installments of long-term debt	(745,000)	(40,000)	-	(785,000)	
Long-term debt, less current installments	15,121,379	(40,000)	728,003	14,353,376	
Customer advances for construction	133,944	234,450	240,444	127,950	
Other liabilities:					
Landfill closure	477,819	-	-	477,819	
Severance	294,146	278,798	-	572,944	
Contract payable	395,920	2,679,732	-	3,075,652	
Noncurrent liabilities	1,301,829	3,192,980	240,444	4,254,365	
Total noncurrent liabilities	\$16,423,208	\$ 3,152,980	\$ 968,447	\$18,607,741	

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities, Continued

During 2005, the Utility issued \$24,975,000 of Series 2005 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 2024 and interest rates throughout the term of the bonds are in a range between 3.00% and 4.25%.

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

The Series 1999A, 1999B, 2003 and 2005 revenue bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds are in a range between 3.25% and 7.125%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

Year	Series 1999A		Series 1999B	
	Principal Amount	Interest Amount	Principal Amount	Interest Amount
2006	375,000	231,024	205,000	83,200
2007	400,000	204,399	215,000	73,463
2008	430,000	175,999	225,000	63,142
2009	460,000	145,468	240,000	52,230
2010	490,000	112,809	255,000	40,530
2011-2015	1,095,000	118,275	555,000	42,570
	<u>\$3,250,000</u>	<u>\$987,974</u>	<u>\$1,695,000</u>	<u>\$ 335,135</u>

  

Year	Series 2003		Series 2005	
	Principal Amount	Interest Amount	Principal Amount	Interest Amount
2006	245,000	382,350	570,000	986,888
2007	250,000	374,388	595,000	969,788
2008	255,000	366,262	615,000	951,938
2009	265,000	357,975	630,000	933,488
2010	270,000	349,363	655,000	911,438
2011-2015	2,310,000	1,567,337	5,630,000	4,108,237
2016-2020	3,440,000	999,318	8,335,000	2,714,874
2021-2024	2,490,000	226,080	7,945,000	857,005
	<u>\$9,525,000</u>	<u>\$4,623,073</u>	<u>\$24,975,000</u>	<u>\$12,433,656</u>

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

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities, Continued

Iowa Administrative Code rule 567-103.2(13) requires the Utility to place a final cover on its Leverssee Road ash landfill site when it is closed and thereupon to have in place surveying monuments and an approved groundwater monitoring system. Iowa Administrative Code rule 567-103.2(14) requires the Utility to maintain the final cover, monitor ground water, and file reports with the Iowa Department of Natural Resources for thirty years following closure of the site. Although closure and post closure costs are paid only near or after the date that the landfill is closed, the Utility reports a portion of these closure and post closure costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. The \$468,917 reported as landfill closure and post closure care liability at December 31, 2005, represents the cumulative amount reported to date based on the use of 100% of the estimated capacity of the landfill. This is based on what it would cost to perform all closure and post closure care in 2006. The Utility expects to close the landfill no earlier than the year 2006. Actual costs may be higher due to inflation, changes in technology, or changes in regulations.

(6) Pension and Retirement Benefits

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

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2005, 2004, and 2003 were \$292,729; \$272,558; and \$248,500; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Contractually, qualifying employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age may convert their accrued sick leave value into paid health insurance premiums upon retirement. The Utility recognized liability of \$253,754 and \$229,167; respectively, for the years ended December 31, 2005 and 2004.

(7) Income Tax Status

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

(8) Jointly-Owned Capital Assets

The Utility's share of jointly owned electric facilities at December 31, 2005 and 2004 is reflected in the following table. These facilities provide approximately 27% of the Utility's total generating capacity. The Utility is required to provide financing for its share of the facilities. The Utility's share of expenses associated with these facilities is included with the appropriate operating expenses in the statements of revenues, expenses and changes in net assets.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(8) Jointly-Owned Capital Assets, continued

Facility	Capital Assets, Net			
	Percentage Capacity ownership	MW	2005	2004
Council Bluffs #3	3.1%	20.9	\$3,968,389	\$4,064,829
Neal #4	2.5	15.6	2,097,267	2,233,048
Iowa Distributed Wind Generation Project	65.8	1.5	874,815	917,916

(9) Related Party Transactions

The Utility makes payments in lieu of taxes upon approval by the Board of Trustees to the City of Cedar Falls, Iowa. Expenses for 2005 and 2004 were \$1,200,000 and \$1,200,000, respectively, which were recorded in administrative and general expenses. Subsequent to December 31, 2005, the Utility's Board of Trustees approved a payment of \$1,200,000 related to payments in lieu of taxes for 2005.

In addition, the Utility provides electric service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$476,441 and \$571,764 in 2005 and 2004, respectively.

The Electric Utility has extended a loan to the Municipal Communications Utility of the City of Cedar Falls (Communications Utility), with an outstanding balance of \$2,783,090 and \$3,093,090 as of December 31, 2005 and 2004, respectively. Interest accrues on the loan at 3.10% and is paid semi-annually during January and July. Semi-annual principal payments continue through 2016. Accrued interest receivable was \$46,040 and \$50,606 at December 31, 2005 and 2004, respectively. Interest income for the years ended December 31, 2005 and 2004 was \$93,585 and \$103,066 respectively.

During 2003, the Electric Utility extended a loan to the Municipal Gas Utility of the City of Cedar Falls (Gas Utility). Principal and interest were paid at maturity, July 2004. Interest accrued on the loan at 3.10%. Interest income for the years ended December 31, 2005 and 2004 was \$ -0- and \$2,496, respectively.

For the years ended December 31, 2005 and 2004, the Utility earned a management fee of \$67,510 from the Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous nonoperating revenue.

(10) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and the participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,198,758 in aggregate for all participants and have insurance for claims above this amount.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(10) Risk Management, continued

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

	<u>2005</u>	<u>2004</u>
Unpaid claims, beginning of year	\$ 162,225	\$ 112,350
Current year claims and changes in estimates	1,566,575	1,593,270
Claim payments	<u>(1,561,325)</u>	<u>(1,543,395)</u>
Unpaid claims, end of year	<u>\$ 167,475</u>	<u>\$ 162,225</u>

The Utility has recorded \$97,135 and \$94,090 in accounts payable for its share of these unpaid claims at December 31, 2005 and 2004, respectively.

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

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2005.

Cash and cash equivalents and investments	\$27,182,058
Receivables	1,141,735
Other assets	685,439
Total assets	<u>\$29,009,232</u>
Total liabilities	17,667,247
Total equity	<u>11,341,985</u>
Total liabilities and equity	<u>\$29,009,232</u>
Total revenues	8,251,594
Total expenses	2,793,256
Distribution to members	-
Net increase in equity	<u>\$ 5,458,338</u>

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

(11) Commitments and Contingencies

The Utility jointly owns the Council Bluffs #3 generating unit and the Neal #4 generating unit (see note 8). Coal procurements are made by the agent for the joint owners on a system portfolio basis, which are a mix of 1, 2, and 3-year purchases to minimize risk. The Utility is obligated to purchase at least the annual amount of coal to operate the Utility's share at minimum load. The Utility's share of coal purchases for the years 2005 and 2004 were \$2,043,851 and \$1,995,851, respectively.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(11) Commitments and Contingencies, continued

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

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

As of December 31, 2005, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$4,480,800. Additionally, the Council Bluffs Energy Center Unit 4 project has an estimated cost to complete of approximately \$8,609,000.



CPAs & BUSINESS ADVISORS

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

To the Board of Trustees  
Cedar Falls Utilities – Municipal Electric Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Electric Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2005 and 2004, and have issued our report thereon dated March 24, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

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Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2005, 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.

We noted certain matters that we reported to management of the Utility in a separate letter dated March 24, 2006.

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

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

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

Dubuque, Iowa  
March 24, 2006

**CEDAR FALLS UTILITIES – MUNICIPAL ELECTRIC UTILITY  
CEDAR FALLS, IOWA  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2005**

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

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

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

- II-A-05 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2005.
- II-B-05 Certified Budget - Disbursements during the year ended December 31, 2005, did not exceed the amounts budgeted.
- II-C-05 Questionable Expenditures - We noted no expenditures that we believe may fail to meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- II-D-05 Travel Expense - No expenditures of Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-05 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-05 Bond Coverage - Surety bond coverage of Utility officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- II-G-05 Board Minutes - No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-H-05 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Utility's investment policy were noted.
- II-I-05 Revenue Bonds - We noted no instances of non-compliance with the provisions of the Utility's revenue bond resolutions.



CPAs & BUSINESS ADVISORS

## INDEPENDENT AUDITORS' REPORT

The Board of Trustees  
Cedar Falls Utilities – Municipal Gas Utility

We have audited the accompanying balance sheets of the Municipal Gas Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006, on our consideration of the Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 4 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

March 24, 2006  
Dubuque, Iowa

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

Management Discussion and Analysis

December 31, 2005 and 2004

Our discussion and analysis of the Municipal Gas Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2005 and 2004. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased as a result of operations in 2005 and 2004. At December 31, 2005 and 2004, total assets were \$21,179,569 and \$20,266,152, respectively, and total liabilities were \$5,476,024 and \$5,302,085, respectively, resulting in net assets of \$15,703,545 and \$14,964,067, respectively.
- Operating revenues increased 18.8 percent to \$17,677,347 while operating expenses increased 17.2 percent to \$17,321,346 in 2005. Operating revenues decreased 2.6 percent to \$14,883,766 while operating expenses increased 6.7 percent to \$14,779,740 in 2004.
- During the year, the Utility had operating income of \$356,001. This compares to last year, when the Utility had operating income of \$104,026.

**Overview of the Financial Statements**

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

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

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

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

Management Discussion and Analysis

December 31, 2005 and 2004

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

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

**Condensed Financial Information**

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

**Condensed Balance Sheet Information**

	<u>2005</u>	<u>2004</u>
Current assets	\$ 9,757,391	\$ 8,260,068
Capital assets, net	11,161,092	10,800,847
Other noncurrent assets	<u>261,086</u>	<u>1,205,237</u>
Total assets	<u>\$21,179,569</u>	<u>\$20,266,152</u>
Current liabilities	4,130,134	3,198,925
Noncurrent liabilities	352,875	283,935
Long-term debt	<u>993,015</u>	<u>1,819,225</u>
Total liabilities	<u>\$ 5,476,024</u>	<u>\$ 5,302,085</u>
Invested in capital assets, net of related debt	9,608,077	8,481,622
Restricted	280,000	1,199,431
Unrestricted	<u>5,815,468</u>	<u>5,283,014</u>
Total net assets	<u>\$15,703,545</u>	<u>\$14,964,067</u>

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

Management Discussion and Analysis

December 31, 2005 and 2004

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2005</u>	<u>2004</u>
Sales of gas	\$17,648,432	\$14,856,834
Other	28,915	26,932
Total operating revenues	<u>17,677,347</u>	<u>14,883,766</u>
System operation and maintenance	14,520,496	12,105,153
Depreciation	620,095	600,068
Service and administrative	<u>2,180,755</u>	<u>2,074,519</u>
Total operating expenses	<u>17,321,346</u>	<u>14,779,740</u>
Operating income	<u>356,001</u>	<u>104,026</u>
Interest income	199,009	69,521
Other, net	<u>184,468</u>	<u>(93,155)</u>
Total non-operating revenues (expenses)	<u>383,477</u>	<u>(23,634)</u>
Change in net assets	739,478	80,392
Net assets, beginning of year	<u>14,964,067</u>	<u>14,883,675</u>
Net assets, end of year	<u>\$15,703,545</u>	<u>\$14,964,067</u>

**Financial Analysis**

Current assets increased 18.1 percent in 2005 primarily as the result of the following: cash and investments increased 14.7 percent as a result of approximately \$403,348 more cash provided by operating activities and \$368,931 increase in current investments; increase of customer accounts receivable of 26.7 due to high gas prices, increased customers and increased usage.

Long-term debt decreased by 45.4 percent due to a 2005 refunding of the 1992 Gas Revenue Bonds with issuance of 2005 Gas Capital Loan Notes.

Non-current liabilities increased 24.3 percent in 2005 primarily due to the 71.1 percent increase in Customer Advances for Constructions and 6.4 percent increase in the recording of accrued retirement insurance benefits.

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

Management Discussion and Analysis

December 31, 2005 and 2004

Sales of gas increased 18.8 percent in 2005 primarily due to the cost of gas and the PGA. The average PGA was \$6.17 per mcf and \$4.23 per mcf during 2005 and 2004, respectively, an increase of \$1.94 per mcf.

System operation and maintenance expenses increased 20 percent in 2005 primarily due to the increase in wholesale gas costs. This is reflected in the \$1.94 per mcf increase in the average PGA from 2004 to 2005 and the increase in natural gas purchased of \$2,227,345. System operation and maintenance expenses also increased due to the change in the fuel cost to be recovered from customers. The change in fuel cost to be recovered represents an additional expense or reduction in expense. The amount of the change in fuel cost to be recovered from December 31, 2004 to December 31, 2005 is an increase in expense of approximately \$134,860.

Interest income increased 189.3 percent in 2005 primarily due to the increase in cash and cash equivalents that resulted in an increase in checking interest income and the increase in investments at improved rates of interest.

Miscellaneous non-operating revenues and expenses, net increased \$241,053 in 2005 primarily due to the receipt of \$297,742 of TIF monies from the City of Cedar Falls. Interest expense decreased 25.7 percent from 2004 to 2005 due to the redemption of the 1992 Gas Revenue Bonds with the refunding issue of Gas Capital Loan Notes.

**Capital Assets and Debt Administration**

Net capital assets represent 52.7 percent of total assets for the Utility. Net capital assets increased 3.3 percent from the prior year primarily due to the completion of several large projects. Additional detail on the change in capital assets can be found in Note 4.

On July 1, 2005, the Utility expended \$2,325,000 for the redemption of the outstanding series 1992 revenue bonds. The Utility used their own funds and \$1,551,000 in proceeds from the issue of Gas Capital Loan Notes to extinguish the debt. Additional detail on the redemption can be found in Note 5.

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

Balance Sheets

December 31, 2005 and 2004

<u>Assets</u>	<u>2005</u>	<u>2004</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 17,658,175	\$ 16,473,574
Less accumulated depreciation	<u>6,589,522</u>	<u>6,102,294</u>
	11,068,653	10,371,280
Construction work in progress	<u>92,439</u>	<u>429,567</u>
Net capital assets	<u>11,161,092</u>	<u>10,800,847</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Restricted (note 2)	-	949,431
Unrestricted	<u>243,850</u>	<u>248,575</u>
Total noncurrent investments	<u>243,850</u>	<u>1,198,006</u>
Current assets:		
Cash and cash equivalents (note 3)	3,789,202	3,885,854
Investments (note 3)	1,635,000	766,069
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$29,737 in 2005 and \$20,232 in 2004	3,829,917	3,025,508
Trade	18,715	65,234
Interest	42,150	22,257
Inventories:		
Material and supplies	136,811	131,395
Prepayments and other	25,596	41,035
Restricted - cash (note 2)	<u>280,000</u>	<u>322,716</u>
Total current assets	<u>9,757,391</u>	<u>8,260,068</u>
Deferred costs:		
Deferred costs	<u>17,236</u>	<u>7,231</u>
Total assets	<u>\$ 21,179,569</u>	<u>\$ 20,266,152</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2005</u>	<u>2004</u>
Long-term debt, less current installments (note 5)	\$ 993,015	\$ 1,819,225
Current liabilities:		
Accounts payable	3,150,023	2,201,795
Reserve for surplus declaration (note 9)	200,000	200,000
Accrued wages and vacations	156,854	161,671
Accrued interest	-	72,716
Other accrued expenses	63,257	62,743
Current installments of long-term debt (note 5)	560,000	500,000
Total current liabilities	<u>4,130,134</u>	<u>3,198,925</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	134,541	78,651
Other liabilities	218,334	205,284
Total noncurrent liabilities	<u>352,875</u>	<u>283,935</u>
 Total liabilities	 <u>5,476,024</u>	 <u>5,302,085</u>

<u>Net Assets</u>		
Invested in captial assets, net of related debt	9,608,077	8,481,622
Restricted - bond indentures (note 2)	280,000	1,199,431
Unrestricted	5,815,468	5,283,014
Total net assets	<u>15,703,545</u>	<u>14,964,067</u>

Total liabilities and net assets	\$ <u>21,179,569</u>	\$ <u>20,266,152</u>
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MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues: (note 5)		
Sales of gas:		
Residential	\$ 10,210,682	\$ 8,693,179
Industrial	1,979,729	1,583,616
Commercial	4,313,326	3,574,998
Governmental (note 8)	988,941	873,009
Interdepartmental	155,754	132,032
Total sales of gas	<u>17,648,432</u>	<u>14,856,834</u>
Other operating revenues	28,915	26,932
Total operating revenues	<u>17,677,347</u>	<u>14,883,766</u>
 Operating expenses:		
Production:		
Natural gas purchased for resale	13,506,745	11,144,540
Other	4,898	26,780
Distribution	1,008,853	933,833
Depreciation	620,095	600,068
Customer accounts	425,580	375,138
Customer service and information expenses	40,223	44,680
Sales	21,661	21,063
Administrative and general (note 8)	1,572,784	1,524,114
Taxes other than income taxes	120,507	109,524
Total operating expenses	<u>17,321,346</u>	<u>14,779,740</u>
 Operating income	<u>356,001</u>	<u>104,026</u>
 Nonoperating revenues (expenses):		
Interest income	199,009	69,521
Net increase (decrease) in the fair value of investments	(4,725)	(2,363)
Miscellaneous revenue (expense), net (note 8)	301,756	60,703
Interest expense on long-term debt	(112,563)	(151,495)
Total nonoperating revenues (expenses)	<u>383,477</u>	<u>(23,634)</u>
 Change in net assets	739,478	80,392
 Net assets, beginning of year	<u>14,964,067</u>	<u>14,883,675</u>
 Net assets, end of year	<u>\$ 15,703,545</u>	<u>\$ 14,964,067</u>

See accompanying notes to financial statement.

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

Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from customers	\$ 17,259,014	\$ 16,696,834
Cash paid to suppliers	(14,527,780)	(13,936,662)
Cash paid to employees	(1,044,275)	(938,313)
Payment in lieu of taxes to the City of Cedar Falls	(200,000)	-
	<u>1,486,959</u>	<u>1,821,859</u>
Net cash provided by operating activities		
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(2,325,000)	(186,500)
Proceeds from issuance of revenue debt	1,551,890	-
Cost of issuance of revenue debt	(27,000)	-
Proceeds from customer advances for construction	110,490	61,005
Refunds of customer advances for construction	(54,600)	(54,657)
Acquisition, construction and removal cost of capital assets	(1,031,322)	(934,675)
Proceeds from sale of capital assets	58,054	1,054
Reimbursement of utility construction costs	7,830	4,876
Interest paid	(176,285)	(172,265)
	<u>(1,885,943)</u>	<u>(1,281,162)</u>
Net cash used in capital and related financing activities		
Cash flows from investing activities:		
Proceeds from maturities of investment securities	3,267,390	1,977,186
Purchase of investment securities	(3,186,890)	(2,057,019)
Interest received	179,116	79,937
	<u>259,616</u>	<u>104</u>
Net cash provided by investing activities		
Net increase (decrease) in cash and cash equivalents	(139,368)	540,801
Cash and cash equivalents, beginning of year	<u>4,208,570</u>	<u>3,667,769</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 4,069,202</u>	<u>\$ 4,208,570</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 356,001	\$ 104,026
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	620,095	600,068
Other expense related to operating activities	301,756	60,703
(Increase) decrease in accounts receivable	(757,890)	1,695,152
Increase in inventories	(5,416)	(6,558)
Decrease in prepayments and other	15,439	57,498
Increase (decrease) in accounts payable	948,228	(1,010,233)
Increase (decrease) in accrued wages and vacation	(4,817)	31,806
Increase in reserve for surplus declaration	-	200,000
Increase (decrease) in accrued expenses	513	(2,754)
Increase in other liabilities	13,050	92,151
Net cash provided by operating activities	<u>\$ 1,486,959</u>	<u>\$ 1,821,859</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

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

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

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

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 5.74% in 2005 and 2004. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated services and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 15 to 65 years, buildings and improvements - 30 to 45 years, and equipment - 20 to 85 years. The depreciation provisions were equivalent to an overall composite rate of 3.7% and 3.8% of depreciable assets for 2005 and 2004, respectively.

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

(c) Cash and Investments

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

The Utility considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents for purposes of the statement of cash flows. Included in cash and cash equivalents at December 31, 2005 and 2004 was \$500,000, respectively for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

(d) Inventories

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

(e) Natural Gas Commodity Purchases

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

(f) Operating Revenues and Expenses

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

Revenues from the sale of gas are based on billing rates, which are applied to customers' consumption of gas. The Utility records estimated unbilled revenue, including amounts to be billed under a purchased gas adjustment clause, at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2005 and 2004 were \$1,761,868 and \$1,509,415, respectively, and are recorded in customer accounts receivable. The Utility uses a purchased gas adjustment clause whereby increases and decreases in fuel costs are billed to customers and included in operating revenue without changing base rates charged to its customers.

(g) Debt Discount and Bond Issue Costs

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

(h) Net Assets

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

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

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

(i) Estimates

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

(j) Budgetary Information

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on the cash basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribe procedures. Encumbrances are not recognized on the cash basis budget and appropriations lapse at year end.

Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year, one budget amendment increased budgeted disbursements by \$6,179,500. This budget amendment is reflected in the final budgeted amounts.

(2) Restricted Assets

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

	<u>2005</u>	<u>2004</u>
Current assets - restricted:		
Bond and interest fund	280,000	322,716
Restricted - cash	<u>280,000</u>	<u>322,716</u>
Noncurrent assets - restricted:		
Bond reserve fund	-	629,431
Improvement and extension fund	-	320,000
Restricted noncurrent investments	-	949,431
Total restricted assets	<u>\$ 280,000</u>	<u>\$1,272,147</u>

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

(3) Cash on Hand, Deposits, and Investments

Cash on Hand - Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2005 and 2004 was \$165.

Deposits - At December 31, 2005, the Utility's carrying amount of deposits, including \$1,635,000 of certificates of deposits as \$5,204,037. At December 31, 2004, the Utility's carrying amount of deposits, including \$1,715,500 of certificates of deposits, was \$5,423,905.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(3) Cash on Hand, Deposits, and Investments, continued

Investments - The utility is authorized by statute to invest public funds not currently needed for operating expenses in obligations of the United State government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

As of December 31, 2005, the Utility had the following investments and maturities. (The Utility assumes callable bonds will not be called):

<u>2005</u> <u>Investment Type</u>	<u>Investment Maturities (In Years)</u>		
	<u>Less than 1</u>	<u>1 to 3</u>	<u>Total</u>
Federal Agency Obligations	\$ -	\$ 243,850	\$ 243,850

As of December 31, 2004, the Utility had the following investments and maturities. (The Utility assumes callable bonds will not be called):

<u>2004</u> <u>Investment Type</u>	<u>Investment Maturities (In Years)</u>		
	<u>Less than 1</u>	<u>1 to 3</u>	<u>Total</u>
Federal Agency Obligations	\$ -	\$ 248,575	\$ 248,575

In addition, the Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$500,000 at December 31, 2005 and 2004, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk. The Utility's investment policy limits the investments of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in instruments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

Credit Risk. The Utility's investment policy limits investments in commercial paper and other corporate debt to the top two highest classifications. The Utility did not invest in any commercial paper or other corporate debt during the year. The Utility's investment in the Iowa Public Agency Investment Trust is unrated.

Concentration of Credit Risk. The Utility's investment policy does not allow for a prime bankers' acceptance or commercial paper and other corporate debt balances to be greater than ten percent of its total deposits and investments. The policy also limits the amount that can be invested in a single issue to five percent of its total deposits and investments. The Utility held no such investments during the year.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(3) Cash on Hand, Deposits, and Investments, continued

Custodial Credit Risk - Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are 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.

Custodial Credit Risk - Investments. For an investment, this is the risk that, in the event of the failure of the counterparty, the Utility will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Utility had no custodial risk with regards to investments, since all investments were held by the Utility or its agent in the Utility's name.

A reconciliation of the Utility's cash and cash equivalents and investments as shown on the balance sheets follows:

	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 165	\$ 165
Carrying amount of deposits	5,204,037	5,423,905
Carrying amount of federal agency obligations	243,850	248,575
Carrying amount of Iowa Public Agency Investment Trust	<u>500,000</u>	<u>500,000</u>
Total	<u>\$ 5,948,052</u>	<u>\$ 6,172,645</u>
Current Assets		
Cash and cash equivalents	\$ 3,789,202	\$ 3,885,854
Investments	1,635,000	766,069
Restricted - cash	280,000	322,716
Noncurrent investments		
Restricted	-	949,431
Unrestricted	<u>243,850</u>	<u>248,575</u>
Total	<u>\$ 5,948,052</u>	<u>\$ 6,172,645</u>

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2005 and 2004 follows:

<u>2005</u>	<u>Beginning Balance</u>	<u>Additions and Transfers In</u>	<u>Deletions and Transfers Out</u>	<u>Ending Balance</u>
Capital assets, not being depreciated:				
Land	\$ 41,350	\$ -	\$ -	\$ 41,350
Construction work in progress	<u>429,567</u>	<u>969,884</u>	<u>1,307,012</u>	<u>92,439</u>
Total capital assets, not being depreciated	<u>470,917</u>	<u>969,884</u>	<u>1,307,012</u>	<u>133,789</u>

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(4) Capital Assets, continued

Capital assets, being depreciated:				
Infrastructure	15,211,173	728,513	121,464	15,818,222
Buildings and improvements	677,743	481,860	-	1,159,603
Equipment	543,308	97,348	1,655	639,001
Total capital assets being depreciated	<u>16,432,224</u>	<u>1,307,721</u>	<u>123,119</u>	<u>17,616,826</u>
Less accumulated depreciation	<u>(6,102,294)</u>	<u>(620,095)</u>	<u>(132,866)</u>	<u>(6,589,523)</u>
Total capital assets, being depreciated, net	<u>10,329,930</u>	<u>687,626</u>	<u>(9,747)</u>	<u>11,027,303</u>
Capital assets, net	<u>\$10,800,847</u>	<u>\$1,657,510</u>	<u>\$1,297,265</u>	<u>\$11,161,092</u>

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

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities

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

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
<u>2005</u>					
Series 1992 revenue bonds	\$2,325,000	\$ -	\$2,325,000	\$ -	\$ -
Series 2005 gas refunding capital loan notes	-	1,555,000	-	1,555,000	560,000
Unamortized discount on revenue bonds	(5,775)	(3,110)	(6,899)	(1,986)	-
	<u>2,319,225</u>	<u>1,551,890</u>	<u>2,218,101</u>	<u>1,553,014</u>	<u>\$560,000</u>
Current installments of long-term debt	(500,000)	(60,000)	-	(560,000)	
Long-term debt, less current installments	<u>1,819,225</u>	<u>1,491,890</u>	<u>2,318,101</u>	<u>993,014</u>	
Customer advances for construction	78,651	110,490	54,600	134,541	
Severance	<u>205,284</u>	<u>23,011</u>	<u>9,961</u>	<u>218,334</u>	
Other noncurrent liabilities	<u>283,935</u>	<u>133,501</u>	<u>64,561</u>	<u>352,875</u>	
Total noncurrent liabilities	<u>\$2,103,160</u>	<u>\$1,625,391</u>	<u>\$2,382,662</u>	<u>\$1,345,889</u>	
<u>2004</u>					
Series 1992 revenue bonds	2,350,000	-	25,000	2,325,000	\$ 500,000
Unamortized discount on revenue bonds	(10,107)	-	(4,332)	(5,775)	-
	<u>2,339,893</u>	<u>-</u>	<u>20,668</u>	<u>2,319,225</u>	<u>\$ 500,000</u>
Current installments of long-term debt	(25,000)	(475,000)	-	(500,000)	
Long-term debt, less current installments	<u>2,314,893</u>	<u>(475,000)</u>	<u>20,668</u>	<u>1,819,225</u>	
Customer advances for construction	72,303	61,005	54,657	78,651	
Severance	<u>113,133</u>	<u>92,151</u>	<u>-</u>	<u>205,284</u>	
Other Noncurrent liabilities	<u>185,436</u>	<u>153,156</u>	<u>54,657</u>	<u>283,935</u>	
Total noncurrent liabilities	<u>\$2,500,329</u>	<u>\$(321,844)</u>	<u>\$ 75,325</u>	<u>\$2,103,160</u>	

The Series 2005 revenue capital loan notes require annual principal payments, due July 1, and semiannual interest payments, due January 1 and July 1. Interest rates throughout the term of the capital loan notes are in a range between 2.6% and 3.0%. The capital loan notes are secured by the future net revenues of the Utility. The capital loan notes mature and bear interest as follows:

Year	Series 2005	
	Principal Amount	Interest Amount
2006	560,000	52,464
2007	595,000	28,660
2008	400,000	12,000
	<u>\$1,555,000</u>	<u>\$93,124</u>

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities, continued

On March 9, 2005, the Utility issued \$1,555,000 Gas Utility Revenue Refunding Capital Loan Notes, Series 2005. The proceeds of the Notes, as well as, the Utility's own funds were used for the redemption of the outstanding Series 1992 revenue bonds. The Utility expended \$1,825,000 to extinguish the debt.

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

(6) Pension and Retirement Benefits

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

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2005, 2004, and 2003 were \$103,146; \$93,064; and \$90,526; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Contractually, qualifying employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age may convert their accrued sick leave value into paid health insurance premiums upon retirement. The Utility recognized liability of \$79,038 and \$71,380; respectively, for the years ended December 31, 2005 and 2004.

(7) Income Tax Status

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

(8) Related Party Transactions

The Utility provides gas service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$116,049 and \$132,216 in 2005 and 2004, respectively.

The Utility makes payments in lieu of taxes upon approval by the Board of Trustees to the City of Cedar Falls, Iowa. Expenses were \$200,000 for 2005 and 2004, respectively, which were recorded in administrative and general expenses. Subsequent to December 31, 2005, the Utility's Board of Trustees approved a payment of \$200,000 related to payments in lieu of taxes for 2005.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(8) Related Party Transactions, continued

For the years ended December 31, 2005 and 2004, the Utility earned a management fee of \$20,800 from the Municipal Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous nonoperating revenue.

During 2003, the Electric Utility extended a loan to the Municipal Gas Utility of the City of Cedar Falls (Gas Utility). Principal and interest were paid at maturity, July 2004. Interest accrued on the loan at 3.10%. Interest income for the years ended December 31, 2005 and 2004 was \$ -0- and \$2,496, respectively.

(9) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,198,758 in aggregate for all participants and have insurance for claims above this amount.

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

	<u>2005</u>	<u>2004</u>
Unpaid claims, beginning of year	\$ 162,225	\$ 112,350
Current year claims and changes in estimates	1,566,575	1,593,270
Claim payments	<u>(1,561,325)</u>	<u>(1,543,395)</u>
Unpaid claims, end of year	<u>\$ 167,475</u>	<u>\$ 162,225</u>

The Utility has recorded \$35,170 and \$34,067 in accounts payable for its share of these unpaid claims at December 31, 2005 and 2004, respectively.

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

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(9) Risk Management, continued

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2005.

Cash and cash equivalents and investments	\$27,182,058
Receivables	1,141,735
Other assets	685,439
Total assets	<u>\$29,009,232</u>
Total liabilities	17,667,247
Total equity	11,341,985
Total liabilities and equity	<u>\$29,009,232</u>
Total revenues	17,667,247
Total expenses	11,341,985
Net increase in equity	<u>\$ 5,458,338</u>

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

(10) Commitments and Contingencies

The Utility has a natural gas transportation contract with a pipeline, which expires in 2025. Total payments include transportation charges and commodity charges. Minimum transportation payments for 2006 are expected to be approximately \$542,541 at current rates.



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

To the Board of Trustees  
Cedar Falls Utilities – Municipal Gas Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Gas Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2005 and 2004, and have issued our report thereon dated March 24, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

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Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2005, 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.

We noted certain matters that we reported to management of the Utility in a separate letter dated March 24, 2006.

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

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

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

Dubuque, Iowa  
March 24, 2006

**CEDAR FALLS UTILITIES – MUNICIPAL GAS UTILITY  
CEDAR FALLS, IOWA  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2005**

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

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

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

- II-A-05 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2005.
- II-B-05 Certified Budget - Disbursements during the year ended December 31, 2005, did not exceed the amounts budgeted.
- II-C-05 Questionable Expenditures - We noted no expenditures that we believe may fail to meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- II-D-05 Travel Expense - No expenditures of Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-05 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-05 Bond Coverage - Surety bond coverage of Utility officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- II-G-05 Board Minutes - No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-H-05 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Utility's investment policy were noted.
- II-I-05 Revenue Bonds - We noted no instances of non-compliance with the provisions of the Utility's revenue bond resolutions.



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## INDEPENDENT AUDITORS' REPORT

The Board of Trustees  
Cedar Falls Utilities – Municipal Water Utility

We have audited the accompanying balance sheets of the Municipal Water Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006, on our consideration of the Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 4 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Eide Bailly LLP".

March 24, 2006  
Dubuque, Iowa

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

Management Discussion and Analysis

December 31, 2005 and 2004

Our discussion and analysis of the Municipal Water Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2005 and 2004. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased as a result of operations. At December 31, 2005 and 2004, total assets were \$17,402,621 and \$15,428,866, respectively, and total liabilities were \$731,718 and \$632,114, respectively, resulting in net assets of \$16,670,903 and \$14,796,752, respectively.
- A water rate increase effective 01/01/05 contributed to the 2005 increase in revenues as did an increase in customers.
- Operating revenues increased 13.9 percent to \$2,017,465 while operating expenses increased 5.3 percent to \$2,241,511 in 2005. Operating revenues decreased 2.2 percent to \$1,770,841 while operating expenses increased 10.4 percent to \$2,127,701 in 2004.
- During the year, the Utility had an operating loss of \$224,046. This compares to last year, when the Utility had operating losses of \$356,860.

**Overview of the Financial Statements**

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

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

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

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

Management Discussion and Analysis

December 31, 2005 and 2004

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

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

**Condensed Financial Information**

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

**Condensed Balance Sheet Information**

	<u>2005</u>	<u>2004</u>
Current assets	\$ 2,868,268	\$ 2,808,242
Capital assets, net	13,578,053	11,645,324
Other noncurrent assets	956,300	975,300
Total assets	<u>\$17,402,621</u>	<u>\$15,428,866</u>
Current liabilities	408,468	228,574
Noncurrent liabilities	323,250	403,540
Long-term debt	-	-
Total liabilities	<u>\$ 731,718</u>	<u>\$ 632,114</u>
Net assets:		
Invested in capital assets, net of related debt	13,578,053	11,645,324
Restricted	-	-
Unrestricted	<u>3,092,850</u>	<u>3,151,428</u>
Total net assets	<u>\$16,670,903</u>	<u>\$14,796,752</u>

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

Management Discussion and Analysis

December 31, 2005 and 2004

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2005</u>	<u>2004</u>
Sales of water	\$ 1,951,943	\$ 1,719,548
Other	<u>65,522</u>	<u>51,293</u>
Total operating revenues	<u>2,017,465</u>	<u>1,770,841</u>
System operation and maintenance	953,126	874,180
Depreciation	402,299	374,758
Service and administrative	<u>886,086</u>	<u>878,763</u>
Total operating expenses	<u>2,241,511</u>	<u>2,127,701</u>
Operating income (loss)	<u>(224,046)</u>	<u>(356,860)</u>
Interest income	103,794	30,965
Other, net	<u>445,606</u>	<u>112,695</u>
Total non-operating revenues (expenses)	<u>549,400</u>	<u>143,660</u>
Income (loss) before contributions	<u>325,354</u>	<u>(213,200)</u>
Capital contributions	<u>1,548,797</u>	<u>548,073</u>
Change in net assets	1,874,151	334,873
Net assets, beginning of year	<u>14,796,752</u>	<u>14,461,879</u>
Net assets, end of year	<u>\$16,670,903</u>	<u>\$14,796,752</u>

Financial Analysis

Current assets increased 2.1 percent in 2005 primarily due to the following factors: an increase in customer accounts receivable of 33.2 percent; and a 62.8 percent increase in interest receivable, and a decrease in Prepaid and Other of 17.3 percent. Customer accounts receivable increased 33.2 percent due to a 01/01/05 water rate increase and an increase in customers and usage. 2005 collections improved, reducing the Allowance for Doubtful Accounts by 51.8 percent over 2004. Materials & supplies increased 6.4 percent due to an 11.4 percent capital investment in infrastructure and an 83 percent increase in capital improvements of structures.

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

Management Discussion and Analysis

December 31, 2005 and 2004

Current liabilities increased 78.7 percent in 2005 primarily due to 76.8 percent increase in all accounts payable. The accounts payable open items increased 102.5 percent primarily due to an increase in purchases related to projects resulting from residential and commercial development.

Noncurrent liabilities decreased 19.9 percent in 2005 due to the payout of severance benefits of \$80,290 resulting from several retirements in the water utility during 2005.

System operation and maintenance expenses increased 9 percent in 2005 primarily due to the increase in Pumping and Power Expense of over 20 percent resulting from an increase in pumpage and the Municipal Electric Utility rate increase in January 2005.

Service and administrative expenses increased 0.8 percent in 2005 primarily due to a 59.0 percent decrease of approximately \$27,000 in customer rebates related to the demand side management program, and an increase of approximately \$27,500 in depreciation expense.

Interest income increased 188.6 percent in 2005 primarily due to the increase in investment interest rates. Miscellaneous revenue increased 392 percent primarily due to \$213,343 in TIF monies received from the City of Cedar Falls during 2005 and \$172,295 received from the Iowa Underground Storage Tank Fund for reimbursement of corrective action costs.

Capital contributions increased 182.6 percent in 2005 due to capital contributions being based on new developments requiring distribution extensions.

**Capital Assets and Debt Administration**

Net capital assets represent 78 percent of total assets for the Utility. Net capital assets increased 16.6 percent from the prior year primarily due to distribution extensions in 2005. Additional detail on the change in capital assets can be found in Note 4.

The Utility has no outstanding debt as of December 31, 2005.

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

Balance Sheets

December 31, 2005 and 2004

<u>Assets</u>	<u>2005</u>	<u>2004</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 19,398,828	\$ 17,276,291
Less accumulated depreciation	<u>6,150,127</u>	<u>5,766,778</u>
	13,248,701	11,509,513
Construction work in progress	<u>329,352</u>	<u>135,811</u>
Net capital assets	<u>13,578,053</u>	<u>11,645,324</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Unrestricted	<u>956,300</u>	<u>975,300</u>
Current assets:		
Cash and cash equivalents (note 1)	604,519	612,855
Investments (note 2)	1,850,000	1,850,000
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$1,699 in 2005 and \$3,528 in 2004	233,137	175,040
Interest	62,342	38,301
Other	7,322	23,077
Material and supplies	93,395	87,741
Prepayments and other	<u>17,553</u>	<u>21,228</u>
Total current assets	<u>2,868,268</u>	<u>2,808,242</u>
 Total assets	 <u>\$ 17,402,621</u>	 <u>\$ 15,428,866</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2005</u>	<u>2004</u>
Current liabilities:		
Accounts payable	262,104	148,216
Accrued wages and vacations	83,227	74,056
Other accrued expenses	63,137	6,302
Total current liabilities	<u>408,468</u>	<u>228,574</u>
Noncurrent liabilities: (note 4)		
Deferred credits	300,000	300,000
Other liabilities	23,250	103,540
Total noncurrent liabilities	<u>323,250</u>	<u>403,540</u>
 Total liabilities	 <u>731,718</u>	 <u>632,114</u>
 <u>Net Assets</u>		
Invested in capital assets, net of related debt	13,578,053	11,645,324
Unrestricted	3,092,850	3,151,428
Total net assets	<u>16,670,903</u>	<u>14,796,752</u>
 Total liabilities and net assets	 \$ <u>17,402,621</u>	 \$ <u>15,428,866</u>

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

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues: (note 5)		
Sales of water:		
Residential	\$ 1,424,411	\$ 1,269,924
Industrial	29,094	26,770
Commercial	356,876	293,922
Governmental (note 8)	100,077	101,467
Interdepartmental	41,485	27,465
Total sales of water	<u>1,951,943</u>	<u>1,719,548</u>
Other operating revenues	65,522	51,293
Total operating revenues	<u>2,017,465</u>	<u>1,770,841</u>
 Operating expenses		
Production:		
Purchased power from affiliated utility	124,833	107,198
Other	227,581	185,623
Distribution	600,712	581,359
Depreciation	402,299	374,758
Customer accounts	174,666	174,664
Customer service and information expenses	18,851	45,965
Sales	15,207	14,183
Administrative and general	613,559	583,062
Taxes other than income taxes	63,803	60,889
Total operating expenses	<u>2,241,511</u>	<u>2,127,701</u>
 Operating loss	<u>(224,046)</u>	<u>(356,860)</u>
 Nonoperating revenues (expenses):		
Interest income	103,794	30,965
Net increase (decrease) in the fair value of investments	(19,000)	(1,580)
Miscellaneous revenue (expense), net (note 8)	464,606	94,379
Interest expense on long-term debt	-	19,896
Total nonoperating revenues (expenses)	<u>549,400</u>	<u>143,660</u>
 Income (loss) before contributions	<u>325,354</u>	<u>(213,200)</u>
 Capital contributions	<u>1,548,797</u>	<u>548,073</u>
 Change in net assets	1,874,151	334,873
 Net assets, beginning of year	<u>14,796,752</u>	<u>14,461,879</u>
 Net assets, end of year	<u>\$ 16,670,903</u>	<u>\$ 14,796,752</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from customers	\$ 2,444,208	\$ 1,868,585
Cash paid to suppliers	(1,194,378)	(1,131,768)
Cash paid to employees	(551,687)	(525,447)
	<u>698,143</u>	<u>211,370</u>
Net cash provided by operating activities		
Cash flows from capital and related financing activities:		
Contributions from contractors	22,233	7,560
Acquisition, construction and removal cost of capital assets	(986,784)	(650,900)
Proceeds from sale of capital assets	3,549	124,991
Reimbursement of utility construction costs	174,770	3,187
Proceeds from grant for capital construction	-	300,000
Interest paid	-	(38,153)
	<u>(786,232)</u>	<u>(253,315)</u>
Net cash used in capital and related financing activities		
Cash flows from investing activities:		
Proceeds from maturities of investment securities	1,850,000	1,850,000
Purchase of investment securities	(1,850,000)	(1,850,000)
Interest received	79,753	66,378
	<u>79,753</u>	<u>66,378</u>
Net cash provided by investing activities		
Net increase (decrease) in cash and cash equivalents	(8,336)	24,433
Cash and cash equivalents, beginning of year	<u>612,855</u>	<u>588,422</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 604,519</u>	<u>\$ 612,855</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued

Years Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Reconciliation of operating loss to net cash provided by operating activities		
Operating loss	\$ (224,046)	\$ (356,860)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation of capital assets	402,299	374,758
Other income related to operating activities	464,606	94,379
Increase in accounts receivable	(42,342)	(7,040)
(Increase) decrease in materials and supplies	(5,653)	3,315
(Increase) decrease in prepayments and other	3,675	(2,460)
Increase in accounts payable	113,888	47,400
Increase in accrued wages and vacation	9,171	4,145
Increase (decrease) in other accrued expenses	56,835	(4,554)
Increase (decrease) in accrued severance	<u>(80,290)</u>	<u>58,287</u>
Net cash provided by operating activities	<u>\$ 698,143</u>	<u>\$ 211,370</u>

Noncash investing, capital and financing activities:

Contributions from contractors in aid of construction	<u>\$ 1,526,564</u>	<u>\$ 540,513</u>
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See accompanying notes to financial statements.

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

Notes to Financial Statements  
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

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

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

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

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 5.88% in 2005 and 2004. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 20 to 70 years, buildings and improvements - 30 to 45 years, and equipment - 20 to 85 years. The depreciation provisions were equivalent to an overall composite rate of 2.3% of depreciable assets for 2005 and 2004.

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

(c) Cash and Investments

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

The Utility considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents for purposes of the statement of cash flows. Included in cash and cash equivalents at December 31, 2005 and 2004 was \$250,000 for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(d) Inventories

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

(Continued)

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

Notes to Financial Statements  
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

(e) Operating Revenues and Expenses

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

Revenues from the sale of water are based on billing rates, which are applied to customers' consumption of water. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed as of December 31, 2005 and 2004, were \$76,388 and \$69,267, respectively, and are recorded in customer accounts receivable.

(f) Bond Issue Costs

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

(g) Capital Contributions

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

(h) Net Assets

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

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

(i) Estimates

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

(Continued)

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

Notes to Financial Statements  
December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

(j) Budgetary Information

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on the cash basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized on the cash basis budget and appropriations lapse at year end.

Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year, one budget amendment increased budgeted disbursements by \$6,179,500. This budget amendment is reflected in the final budgeted amounts.

(2) Cash on Hand, Deposits, and Investments

Cash on Hand - Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2005 and 2004 was \$68.

Deposits - At December 31, 2005, the Utility's carrying amount of deposits, including \$1,850,000 of certificates of deposits, was \$2,204,451. At December 31, 2004, the Utility's carrying amount of deposits, including \$1,850,000 of certificates of deposits, was \$2,212,787.

Investments - The utility is authorized by statute to invest public funds not currently needed for operating expenses in obligations of the United State government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

As of December 31, 2005, the Utility had the following investments and maturities. (The Utility assumes callable bonds will not be called):

<u>2005</u> <u>Investment Type</u>	<u>Investment Maturities (In Years)</u>		
	<u>Less than 1</u>	<u>1 to 3</u>	<u>Total</u>
Federal Agency Obligations	\$ -	\$ 956,300	\$ 956,300

As of December 31, 2004, the Utility had the following investments and maturities. (The Utility assumes callable bonds will not be called):

<u>2004</u> <u>Investment Type</u>	<u>Investment Maturities (In Years)</u>		
	<u>Less than 1</u>	<u>1 to 3</u>	<u>Total</u>
Federal Agency Obligations	\$ -	\$ 975,300	\$ 975,300

In addition, the Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$250,000 at December 31, 2005 and 2004, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

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

Notes to Financial Statements  
December 31, 2005 and 2004

(2) Cash on Hand, Deposits, and Investments, continued

Interest Rate Risk. The Utility's investment policy limits the investments of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in instruments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

Credit Risk. The Utility's investment policy limits investments in commercial paper and other corporate debt to the top two highest classifications. The Utility did not invest in any commercial paper or other corporate debt during the year. The Utility's investment in the Iowa Public Agency Investment Trust is unrated.

Concentration of Credit Risk. The Utility's investment policy does not allow for a prime bankers' acceptance or commercial paper and other corporate debt balances to be greater than ten percent of its total deposits and investments. The policy also limits the amount that can be invested in a single issue to five percent of its total deposits and investments. The Utility held no such investments during the year.

Custodial Credit Risk - Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are 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.

Custodial Credit Risk - Investments. For an investment, this is the risk that, in the event of the failure of the counterparty, the Utility will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Utility had no custodial risk with regards to investments, since all investments were held by the Utility or its agent in the Utility's name.

A reconciliation of the Utility's cash and cash equivalents and investments as shown on the balance sheets follows:

	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 68	\$ 68
Carrying amount of deposits	2,204,451	2,212,787
Carrying amount of federal agency obligations	956,300	975,300
Carrying amount of Iowa Public Agency Investment Trust	<u>250,000</u>	<u>250,000</u>
Total	<u>\$ 3,410,819</u>	<u>\$ 3,438,155</u>
Current Assets		
Cash and cash equivalents	\$ 604,519	\$ 612,855
Investments	1,850,000	1,850,000
Noncurrent investments		
Unrestricted	<u>956,300</u>	<u>975,300</u>
Total	<u>\$ 3,410,819</u>	<u>\$ 3,438,155</u>

(Continued)

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

Notes to Financial Statements  
December 31, 2005 and 2004

(3) Capital Assets

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

2005	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
<u>Capital assets, not being depreciated:</u>				
Land	\$ 63,581	\$ -	\$ -	\$ 63,581
Construction work in progress	135,811	2,343,345	2,149,804	329,352
Total capital assets, not being depreciated	<u>199,392</u>	<u>2,343,345</u>	<u>2,149,804</u>	<u>392,933</u>
<u>Capital assets, being depreciated:</u>				
Infrastructure	16,607,886	1,927,925	21,919	18,513,892
Buildings and improvements	235,364	194,774	-	430,138
Equipment	369,460	22,337	580	391,217
Total capital assets being depreciated	<u>17,212,710</u>	<u>2,145,036</u>	<u>22,499</u>	<u>19,335,247</u>
Less accumulated depreciation	<u>(5,766,778)</u>	<u>(402,299)</u>	<u>(18,950)</u>	<u>(6,150,127)</u>
Total capital assets, being depreciated, net	<u>11,445,932</u>	<u>1,742,737</u>	<u>3,549</u>	<u>13,185,120</u>
Capital assets, net	<u>\$11,645,324</u>	<u>\$4,086,082</u>	<u>\$2,153,353</u>	<u>\$13,578,053</u>
<u>2004</u>				
<u>Capital assets, not being depreciated:</u>				
Land	\$ 63,581	\$ -	\$ -	\$ 63,581
Construction work in progress	382,114	1,011,862	1,258,165	135,811
Total capital assets, not being depreciated	<u>445,695</u>	<u>1,011,862</u>	<u>1,258,165</u>	<u>199,392</u>
<u>Capital assets, being depreciated:</u>				
Infrastructure	15,430,976	1,206,743	29,833	16,607,886
Buildings and improvements	229,211	6,871	718	235,364
Equipment	324,908	44,552	-	369,460
Total capital assets being depreciated	<u>15,985,095</u>	<u>1,258,166</u>	<u>30,551</u>	<u>17,212,710</u>
Less accumulated depreciation	<u>(5,493,839)</u>	<u>(374,758)</u>	<u>(101,820)</u>	<u>(5,766,778)</u>
Total capital assets, being depreciated, net	<u>10,491,256</u>	<u>883,408</u>	<u>(71,268)</u>	<u>11,445,932</u>
Capital assets, net	<u>\$10,936,951</u>	<u>\$1,895,270</u>	<u>\$1,186,897</u>	<u>\$11,645,324</u>

(Continued)

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

Notes to Financial Statements  
December 31, 2005 and 2004

(4) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2005 and 2004 was as follows:

	Beginning	Additions	Reductions	Ending	Amounts
2005	Balance			Balance	Due Within
					One Year
Accrued severance	\$ 103,540	\$ 15,242	\$ 95,532	\$ 23,250	\$ -
Deferred credits	300,000	-	-	300,000	-
Noncurrent liabilities	<u>\$ 403,540</u>	<u>\$ 15,242</u>	<u>\$ 95,532</u>	<u>\$ 323,250</u>	<u>\$ -</u>
2004					
Accrued severance	\$ 45,253	\$ 58,287	-	\$ 103,540	\$ -
Deferred credits	-	300,000	-	300,000	-
Noncurrent liabilities	<u>\$ 45,253</u>	<u>\$ 385,287</u>	<u>\$ -</u>	<u>\$ 403,540</u>	<u>\$ -</u>

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

(5) Pension and Retirement Benefits

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

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2005, 2004 and 2003, were \$51,924; \$50,737; and \$46,444; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Contractually, qualifying employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age may convert their accrued sick leave value into paid health insurance premiums upon retirement. The Utility recognized liability of \$49,919 and \$45,082; respectively, for the years ended December 31, 2005 and 2004.

(6) Income Tax Status

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

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

Notes to Financial Statements  
December 31, 2005 and 2004

(7) Related Party Transactions

The Utility provides water service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$53,469 and \$23,808 in 2005 and 2004, respectively.

The Utility also provides billing and collection services to the City for the City's sanitary sewer system and garbage and refuse service. Revenues from the service provided amounted to \$87,600 in 2005 and 2004, and are recorded in miscellaneous nonoperating revenue.

For the years ended December 31, 2005 and 2004, the Utility earned a management fee of \$1,690 from the Municipal Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous nonoperating revenue.

(8) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,198,758 in aggregate for all participants and have insurance for claims above this amount.

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

	<u>2005</u>	<u>2004</u>
Unpaid claims, beginning of year	\$ 162,225	\$ 112,350
Current year claims and changes in estimates	1,566,575	1,593,270
Claim payments	<u>(1,561,325)</u>	<u>(1,543,395)</u>
Unpaid claims, end of year	<u>\$ 167,475</u>	<u>\$ 162,225</u>

The Utility has recorded \$15,073 and \$14,600 in accounts payable for its share of these unpaid claims at December 31, 2005 and 2004, respectively.

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

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

Notes to Financial Statements  
December 31, 2005 and 2004

(8) Risk Management, continued

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2005.

Cash and cash equivalents and investments	\$27,182,058
Receivables	1,141,735
Other assets	<u>685,439</u>
Total assets	<u>\$29,009,232</u>
Total liabilities	17,667,247
Total equity	<u>11,341,985</u>
Total liabilities and equity	<u>\$29,009,232</u>
Total revenues	8,251,594
Total expenses	2,793,256
Distribution to members	-
Net increase in equity	<u>\$ 5,458,338</u>

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

(9) Commitments and Contingencies

As of December 31, 2005, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$92,600.



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

To the Board of Trustees  
Cedar Falls Utilities – Municipal Water Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Water Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2005 and 2004, and have issued our report thereon dated March 24, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

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Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2005, 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.

We noted certain matters that we reported to management of the Utility in a separate letter dated March 24, 2006.

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

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

*Eide Bailly LLP*

Dubuque, Iowa  
March 24, 2006

**CEDAR FALLS UTILITIES – MUNICIPAL WATER UTILITY  
CEDAR FALLS, IOWA  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2005**

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

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

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

- II-A-05 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2005.
- II-B-05 Certified Budget - Disbursements during the year ended December 31, 2005, did not exceed the amounts budgeted.
- II-C-05 Questionable Expenditures - We noted no expenditures that we believe may fail to meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- II-D-05 Travel Expense - No expenditures of Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-05 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-05 Bond Coverage - Surety bond coverage of Utility officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- II-G-05 Board Minutes - No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-H-05 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Utility's investment policy were noted.



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## INDEPENDENT AUDITORS' REPORT

The Board of Trustees  
Cedar Falls Utilities – Municipal Communications Utility

We have audited the accompanying balance sheets of the Municipal Communications Utility of Cedar Falls, Iowa (the Utility) (a component unit of the City of Cedar Falls, Iowa) as of December 31, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 24, 2006, on our consideration of the Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 5 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

March 24, 2006  
Dubuque, Iowa

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

Management Discussion and Analysis

December 31, 2005 and 2004

Our discussion and analysis of the Municipal Communications Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2005 and 2004. Please read this information in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased as a result of operations. At December 31, 2005 and 2004, total assets were \$9,964,120 and \$9,637,851, respectively, and total liabilities were \$8,739,216 and \$9,668,458, respectively, resulting in surplus net assets of \$1,224,904 in 2005 and deficit net assets of \$30,607 in 2004.
- Operating revenues increased 12 percent to \$7,893,571 while operating expenses increased 8 percent to \$6,308,337 in 2005. Operating revenues increased 9.1 percent to \$7,047,702 while operating expenses increased 15.1 percent to \$5,838,527 in 2004.
- During the year, the Utility had operating income of \$1,585,234. This compares to last year, when the Utility had operating income of \$1,209,175.

**Overview of the Financial Statements**

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

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

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

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

Management Discussion and Analysis

December 31, 2005 and 2004

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

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

**Condensed Financial Information**

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

**Condensed Balance Sheet Information**

	<u>2005</u>	<u>2004</u>
Current assets	\$ 1,751,044	\$ 1,347,447
Capital assets, net	7,275,276	7,335,051
Other noncurrent assets	<u>937,800</u>	<u>955,353</u>
Total assets	<u>\$ 9,964,120</u>	<u>\$ 9,637,851</u>
Current liabilities	\$ 1,550,297	\$ 1,566,983
Noncurrent liabilities	75,395	66,178
Long-term debt	<u>7,113,524</u>	<u>8,035,297</u>
Total liabilities	<u>\$ 8,739,216</u>	<u>\$ 9,668,458</u>
Invested in capital assets, net of related debt	\$ (758,247)	\$ (1,590,247)
Restricted	953,833	951,333
Unrestricted	<u>1,029,318</u>	<u>608,307</u>
Total net assets (deficit)	<u>\$ 1,224,904</u>	<u>\$ (30,607)</u>

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

December 31, 2005 and 2004

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2005</u>	<u>2004</u>
Cable television	\$ 4,019,602	\$ 3,415,155
High speed data communications	<u>3,873,969</u>	<u>3,632,547</u>
Total operating revenues	<u>7,893,571</u>	<u>7,047,702</u>
System operation and maintenance	3,747,347	3,282,640
Depreciation	1,201,525	1,110,541
Service and administrative	<u>1,359,465</u>	<u>1,445,346</u>
Total operating expenses	<u>6,308,337</u>	<u>5,838,527</u>
Operating income	<u>1,585,234</u>	<u>1,209,175</u>
Interest expense	(360,340)	(396,920)
Other, net	<u>30,617</u>	<u>220,689</u>
Total non-operating revenues (expenses)	<u>(329,723)</u>	<u>(176,231)</u>
Change in net assets	1,255,511	1,032,944
Net assets (deficit), beginning of year	<u>( 30,607)</u>	<u>(1,063,551)</u>
Net assets (deficit), end of year	<u>\$ 1,224,904</u>	<u>\$ (30,607)</u>

**Financial Analysis**

Current liabilities decreased 1.3 percent in 2005 primarily from the \$28,200 decrease in accrued cable TV programming fees payable and a \$6,300 decrease in interest payable.

Non-current liabilities decreased 11 percent in 2005 primarily due to a reduction of long term debt, less current installments. Customer Advances for Construction did not change during 2005.

Total net assets increased to \$1,224,904 in 2005 from a deficit of (\$30,607) in 2004, primarily due to the 2005 total change in net assets of \$1,255,511, which was due primarily to increases in

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

Management Discussion and Analysis

December 31, 2005 and 2004

the number of subscribers. Invested in capital assets, net of related debt is a deficit balance due to capital assets being funded by debt. Capital assets are depreciated between 7 to 20 years and the debt repayment is scheduled through 2016. Capital assets are depreciating at a larger proportion than the debt repayment schedule. Unrestricted net assets is a positive balance as a reflection of the Utility's net income during 2004 and 2005. The Utility increased rates in our product lines, adjusted product lines and implemented cost cutting measures throughout 2003, 2004 and 2005 which is reflective in the increase in net assets for 2005.

Cable television operating revenues increased 18 percent in 2005. An increase in the number of subscribers and a general rate increase effective 01/01/05 primarily account for the increase in cable television operating revenues.

High speed data communications operating revenues increased 7 percent in 2005. An increase in the number of subscribers accounts for the increase. In January 2004 the discount provided to customers with bundled communication services and previously charged against high speed data communications revenues was reclassified as a cable TV discount and is now charged against basic revenues, this also accounts for the increase in 2004 high speed data revenues. Basic Service revenues increased 12 percent in 2005 primarily due to a rate increase effective 01/01/05 and an increase in subscribers. Also, high speed data communications revenues billed to other communities for transport and access has decreased approximately \$25,412 due to the loss of customers. However, Bulk Account revenues increased by \$22,800 during 2005.

System operation and maintenance expenses increased 14 percent in 2005 primarily due to Cable TV programming costs increases of \$263,361 or 13%, Network Administration expense increases of nearly \$20,000 or 49%, and an increase in pole rental expenses of \$28,000 or 165%. The rise in cable programming costs is driven by increased customers being served and the continuing increase of programming costs which recently have been increasing at a rate of 8 – 15 percent annually. Customer premise wiring expense increased primarily due to an increase in payroll being assigned to this account. The increase in customers drives the growth in payroll costs associated with customer premise wiring. Telecommunications – Corporate Operation decreased over \$81,000 in 2005 primarily due to a decrease of \$83,164 in Research and Development resulting from the 2004 cost of conducting both a feasibility study and market research study on Voice Over Internet Protocol. Interest income increased nearly 117% in 2005 due to improved interest rates being received on investments. Interest expense decreased 9.2 percent in 2005 primarily due to higher principal payments on long-term debt and less interest paid in 2005. Other non-operating income decreased by \$214,551 during 2005 primarily due to no TIF monies being received in 2005 from the City of Cedar Falls.

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

Management Discussion and Analysis

December 31, 2005 and 2004

**Capital Assets and Debt Administration**

Capital assets represent 73 percent of total assets for the Utility. Net capital assets decreased 0.8 percent from the prior year primarily due to higher depreciation than additions of infrastructure. Additional detail on the change in capital assets can be found in Note 4.

The Utility's total debt service in 2005, excluding the outstanding loan with the Municipal Electric Utility, was \$842,036 compared to \$847,641 during 2004.

The Utility has an outstanding loan with the Municipal Electric Utility totaling \$2,783,090 and \$3,093,090 at December 31, 2005 and 2004 respectively. Additional detail on the outstanding loan can be found in Note 5.

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

Balance Sheets

December 31, 2005 and 2004

<u>Assets</u>	<u>2005</u>	<u>2004</u>
Current assets:		
Cash and short-term investments	\$ 237,391	\$ 44,293
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$19,527 in 2005 and \$22,011 in 2004	1,048,681	866,438
Interest	27,492	14,407
Other	85,179	83,475
Material and supplies	265,722	242,291
Prepayments and other	15,691	26,373
Restricted - cash (note 2)	70,888	70,170
Total current assets	<u>1,751,044</u>	<u>1,347,447</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Restricted (note 2)	<u>903,000</u>	<u>903,000</u>
Capital assets: (note 4)		
Capital assets, in service	14,149,608	13,466,271
Less accumulated depreciation	<u>7,007,987</u>	<u>6,197,308</u>
	7,141,621	7,268,963
Construction work in progress	<u>133,655</u>	<u>66,088</u>
Net captial assets	<u>7,275,276</u>	<u>7,335,051</u>
Deferred costs, net of amortization	<u>34,800</u>	<u>52,353</u>
Total noncurrent assets	<u>8,213,076</u>	<u>8,290,404</u>
 Total assets	 <u>\$ 9,964,120</u>	 <u>\$ 9,637,851</u>

See accompanying notes to financial statements.

<u>Liabilities</u>	<u>2005</u>	<u>2004</u>
Current liabilities:		
Accounts payable	\$ 390,412	\$ 382,964
Advance lease payments (note 5)	-	26,425
Accrued wages and vacation	97,902	90,980
Accrued interest	66,095	72,443
Other accrued liabilities	75,888	104,171
Current installments of long-term debt (note 5)	920,000	890,000
Total current liabilities	<u>1,550,297</u>	<u>1,566,983</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	30,939	30,939
Other noncurrent liabilities	44,456	35,239
Long-term debt, less current installments	7,113,524	8,035,297
Total noncurrent liabilities	<u>7,188,919</u>	<u>8,101,475</u>
Total liabilities	<u>8,739,216</u>	<u>9,668,458</u>
<u>Net Assets</u>		
Invested in capital assets, net of related debt	(758,247)	(1,590,247)
Restricted - bond indentures (note 2)	953,833	951,333
Unrestricted	1,029,318	608,307
Total net assets (deficit)	<u>1,224,904</u>	<u>(30,607)</u>
Total liabilities and net assets	<u>\$ 9,964,120</u>	<u>\$ 9,637,851</u>

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

Statements of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues: (note 5)		
Cable system revenues	\$ 4,019,602	\$ 3,415,155
Local private line revenue	150,994	140,775
Data services revenue	3,491,726	3,321,158
Network access revenue	231,249	170,614
Total operating revenues	<u>7,893,571</u>	<u>7,047,702</u>
Operating expenses:		
Plant specific and programming	3,034,577	2,632,520
Depreciation	1,201,525	1,110,541
Plant nonspecific	712,770	650,120
Customer operations	427,484	410,621
Sales	217,298	250,554
Corporate operations (note 8)	714,683	784,171
Total operating expenses	<u>6,308,337</u>	<u>5,838,527</u>
Operating income (loss)	<u>1,585,234</u>	<u>1,209,175</u>
Nonoperating revenues (expenses):		
Interest income	45,270	20,791
Miscellaneous revenue (expense), net	(14,653)	199,898
Interest expense on long-term debt (note 5)	(266,755)	(293,854)
Interest expense on affiliated note payable (note 5 and 8)	(93,585)	(103,066)
Total nonoperating revenues (expenses)	<u>(329,723)</u>	<u>(176,231)</u>
Change in net assets	1,255,511	1,032,944
Net assets (deficit), beginning of year	<u>(30,607)</u>	<u>(1,063,551)</u>
Net assets (deficit), end of year	<u>\$ 1,224,904</u>	<u>\$ (30,607)</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash received from customers	\$ 7,668,546	\$ 7,133,568
Cash paid to suppliers	(4,385,474)	(4,042,627)
Cash paid to employees	(738,782)	(669,377)
Net cash provided by operating activities	<u>2,544,290</u>	<u>2,421,564</u>
Cash flows from noncapital financing activities:		
Payments on advance from affiliated utility	<u>-</u>	<u>(181,779)</u>
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(890,000)	(875,000)
Proceeds from customer advances for construction	-	36,339
Refunds of customer advances for construction	-	(5,400)
Acquisition, construction and removal cost of capital assets	(1,173,183)	(1,089,623)
Proceeds from sale of capital assets	1,583	200
Reimbursement of utility construction costs	39,128	110,908
Interest paid	(360,187)	(390,687)
Net cash used in capital and related financing activities	<u>(2,382,659)</u>	<u>(2,213,263)</u>
Cash flows from investing activities:		
Proceeds from maturities of investment securities	903,000	903,000
Purchase of investment securities	(903,000)	(903,000)
Interest received	32,185	17,304
Net cash provided by investing activities	<u>32,185</u>	<u>17,304</u>
Net increase in cash and cash equivalents	193,816	43,826
Cash and cash equivalents, beginning of year	<u>114,463</u>	<u>70,637</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 308,279</u>	<u>\$ 114,463</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 1,585,234	\$ 1,209,175
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	1,201,525	1,110,541
Other income (expense) related to operating activities	(14,653)	199,898
Amortization of advance lease payments	(26,425)	(29,587)
Increase in accounts receivable	(183,947)	(84,445)
Increase in materials and supplies	(23,431)	(28,199)
(Increase) decrease in prepayments and other	10,682	(6,433)
Increase in accounts payable	7,448	41,688
Increase (decrease) in accrued wages and vacation	6,922	(5,839)
Decrease in other accrued liabilities	(28,282)	(20,474)
Increase in accrued severance	9,217	35,239
Net cash provided by operating activities	<u>\$ 2,544,290</u>	<u>\$ 2,421,564</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

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

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

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

(b) Cash and Investments

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

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

(c) Inventories

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

(d) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 4.92% in 2005 and 2004. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 7 to 20 years and equipment - 20 years. The depreciation provision was equivalent to an overall composite rate of 8.8% and 8.6% of depreciable assets for 2005 and 2004, respectively.

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

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(1) Summary of Significant Accounting Policies, Continued

(e) Operating Revenues and Expenses

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

Revenues are based on billing rates, which are applied to customers' consumption of communications services. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not billed at December 31, 2005 and 2004, were \$364,812 and \$331,018, respectively. Advance local private line operating lease rental payments received are deferred and recognized on a straight-line basis over the period of service.

(f) Deferred Costs

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

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

(g) Net Assets

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

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

(h) Estimates

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

(i) Budgetary Information

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on the cash basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribe procedures. Encumbrances are not recognized on the cash basis budget and appropriations lapse at year end.

Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year, one budget amendment increased budgeted disbursements by \$6,179,500. This budget amendment is reflected in the final budgeted amounts.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(2) Restricted Assets

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

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

	<u>2005</u>	<u>2004</u>
Current assets - restricted:		
Bond and interest fund	\$ <u>70,888</u>	\$ <u>70,170</u>
Restricted - cash	<u>70,888</u>	<u>70,170</u>
Noncurrent assets - restricted:		
Bond reserve fund	403,000	403,000
Improvement and extension fund	<u>500,000</u>	<u>500,000</u>
Restricted noncurrent investments	<u>903,000</u>	<u>903,000</u>
Total restricted assets	<u>\$973,888</u>	<u>\$973,170</u>

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

(3) Cash on Hand, Deposits, and Investments

Cash on Hand - Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2005 and 2004 was \$75.

Deposits - At December 31, 2005, the Utility's carrying amount of deposits, including \$903,000 of certificates of deposits, was \$1,211,204. At December 31, 2004, the Utility's carrying amount of deposits, including \$903,000 of certificates of deposits, was \$1,017,389.

Investments - The utility is authorized by statute to invest public funds not currently needed for operating expenses in obligations of the United State government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

As of December 31, 2005 and 2004, respectively, the Utility had no Federal Agency Obligations.

Interest Rate Risk. The Utility's investment policy limits the investments of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in instruments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

Credit Risk. The Utility's investment policy limits investments in commercial paper and other corporate debt to the top two highest classifications. The Utility did not invest in any commercial paper or other corporate debt during the year. The Utility's investment in the Iowa Public Agency Investment Trust is unrated.

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

Notes to Financial Statements

December 31, 2005 and 2004

(3) Cash on Hand, Deposits, and Investments, continued

Concentration of Credit Risk. The Utility's investment policy does not allow for a prime bankers' acceptance or commercial paper and other corporate debt balances to be greater than ten percent of its total deposits and investments. The policy also limits the amount that can be invested in a single issue to five percent of its total deposits and investments. The Utility held no such investments during the year.

Custodial Credit Risk - Deposits. In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are 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.

Custodial Credit Risk - Investments. For an investment, this is the risk that, in the event of the failure of the counterparty, the Utility will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Utility had no custodial risk with regards to investments, since all investments were held by the Utility or its agent in the Utility's name.

A reconciliation of the Utility's cash and cash equivalents and investments as shown on the balance sheets follows:

	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 75	\$ 75
Carrying amount of deposits	<u>1,211,204</u>	<u>1,017,389</u>
Total	<u>\$ 1,211,279</u>	<u>\$ 1,017,464</u>
Current Assets		
Cash and cash equivalents	\$ 237,391	\$ 44,294
Restricted - cash	70,888	70,170
Noncurrent investments		
Restricted	<u>903,000</u>	<u>903,000</u>
Total	<u>\$ 1,211,279</u>	<u>\$ 1,017,464</u>

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

Notes to Financial Statements

December 31, 2005 and 2004

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2005 and 2004 follows:

2005	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:				
Construction work in progress	\$ 66,088	\$1,163,134	\$1,095,567	\$ 133,655
Capital assets, being depreciated:				
Infrastructure	13,224,421	1,088,749	412,228	13,900,942
Equipment	241,850	6,816	-	248,666
Total capital assets being depreciated	13,466,271	1,095,565	412,228	14,149,608
Less accumulated depreciation	(6,197,308)	(1,201,525)	(390,846)	(7,007,987)
Total capital assets, being depreciated, net	7,268,963	(105,959)	21,382	7,141,621
Capital assets, net	<u>\$ 7,335,051</u>	<u>\$1,057,174</u>	<u>\$1,116,949</u>	<u>\$ 7,275,276</u>
2004				
Capital assets, not being depreciated:				
Construction work in progress	\$ 84,553	\$ 989,313	\$1,007,778	\$ 66,088
Capital assets, being depreciated:				
Infrastructure	12,410,597	989,264	175,440	13,224,421
Equipment	223,336	18,514	-	241,850
Total capital assets being depreciated	12,633,933	1,007,778	175,440	13,466,271
Less accumulated depreciation	(5,258,759)	(1,110,438)	(171,889)	(6,197,308)
Total capital assets, being depreciated, net	7,375,174	(102,660)	3,551	7,268,963
Capital assets, net	<u>\$ 7,459,727</u>	<u>\$ 886,653</u>	<u>\$1,011,329</u>	<u>\$ 7,335,051</u>

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2005 and 2004 was as follows:

2005	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 1998 G.O. bonds	\$ 515,000	\$ -	\$ 35,000	\$ 480,000	\$ 35,000
Series 1999 G.O. bonds	515,000	-	40,000	475,000	45,000
Series 2002 G.O. bonds	1,730,000	-	260,000	1,470,000	275,000
Note payable to the Municipal Electric Utility	3,093,090	-	310,000	2,783,090	310,000
Series 1999 capital loan notes	3,075,000	-	245,000	2,830,000	255,000
Unamortized discount on debt	(4,974)	-	(1,083)	(3,891)	-
Unamortized premium on debt	2,181	-	2,856	(675)	-
	<u>8,925,297</u>	<u>-</u>	<u>891,773</u>	<u>8,033,524</u>	<u>920,000</u>
Current installments of long-term debt	(890,000)	(30,000)	-	(920,000)	
Long-term debt, less current installments	<u>8,035,297</u>	<u>(30,000)</u>	<u>891,773</u>	<u>7,113,524</u>	
Advance lease payments	26,425	-	26,425	-	
Current advance lease payments	(26,425)	-	(26,425)	-	
Customer advances for Construction	30,939	-	-	30,939	
Accrued Severance Benefits	<u>35,239</u>	<u>9,217</u>	<u>-</u>	<u>44,456</u>	
Total noncurrent liabilities	<u>\$ 8,101,475</u>	<u>\$ (20,783)</u>	<u>\$ 891,773</u>	<u>\$ 7,188,918</u>	<u>\$ 920,000</u>
2004					
Series 1998 G.O. bonds	\$ 550,000	\$ -	\$ 35,000	\$ 515,000	\$ 35,000
Series 1999 G.O. bonds	555,000	-	40,000	515,000	40,000
Series 2002 G.O. bonds	1,985,000	-	255,000	1,730,000	260,000
Note payable to the Municipal Electric Utility	3,403,090	-	310,000	3,093,090	310,000
Series 1999 capital loan notes	3,310,000	-	235,000	3,075,000	245,000
Unamortized discount on debt	(6,261)	-	(1,287)	(4,974)	-
Unamortized premium on debt	6,690	-	4,509	2,181	-
	<u>9,803,519</u>	<u>-</u>	<u>878,222</u>	<u>8,925,297</u>	<u>890,000</u>
Current installments of long-term debt	(875,000)	(15,000)	-	(890,000)	
Long-term debt, less current installments	<u>8,928,519</u>	<u>(15,000)</u>	<u>878,222</u>	<u>8,035,297</u>	
Advance lease payments	56,012	-	29,587	26,425	26,425
Current advance lease payments	(29,587)	-	(3,162)	(26,425)	
Noncurrent advance lease payments	26,425	-	26,425	-	
Customer advances for construction	-	36,339	5,400	30,939	
Accrued severance benefits	<u>-</u>	<u>35,239</u>	<u>-</u>	<u>35,239</u>	
Total noncurrent liabilities	<u>\$ 8,954,944</u>	<u>\$ 56,578</u>	<u>\$ 910,047</u>	<u>\$ 8,101,475</u>	<u>\$ 916,425</u>

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities, continued

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

Year	Series 1998		Series 1999		Series 2002	
	Principal Amount	Interest Amount	Principal Amount	Interest Amount	Principal Amount	Interest Amount
2006	35,000	22,797	45,000	23,440	275,000	46,891
2007	40,000	21,240	45,000	21,348	280,000	39,329
2008	40,000	19,440	50,000	19,210	295,000	30,929
2009	40,000	17,600	50,000	16,810	305,000	21,710
2010	45,000	15,720	50,000	14,385	315,000	11,340
2011-2015	280,000	27,500	235,000	30,875	-	-
	<u>\$ 480,000</u>	<u>\$124,297</u>	<u>\$475,000</u>	<u>\$126,068</u>	<u>\$1,470,000</u>	<u>\$150,199</u>

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

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

Year	Principal Amount	Interest Amount
2006	255,000	147,532
2007	270,000	135,293
2008	285,000	122,062
2009	295,000	107,813
2010	310,000	92,768
2011-2014	1,415,000	197,763
	<u>\$2,830,000</u>	<u>\$ 803,231</u>

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

The Board of Trustees of the Municipal Electric Utility authorized a loan to be extended to the Utility under Resolutions No. 2759, 2840, 2939, 2994, and 3086. The December 31, 2005 and 2004 outstanding balances on this loan were \$2,033,090 and \$2,218,090, respectively, bearing interest at 3.1%. The Board of Trustees of the Municipal Electric Utility approved a loan to be extended to the Utility under Resolution No. 3497. The December 31, 2005 and 2004 outstanding balances on this loan were \$750,000 and \$875,000, respectively, bearing interest at 3.1%. Semiannual debt service payments are required on January 1 and July 1. Total debt service requirements are as follows:

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(5) Noncurrent Liabilities, continued

<u>Year</u>	<u>Principal Amount</u>	<u>Interest Amount</u>
2006	310,000	88,680
2007	310,000	79,070
2008	310,000	69,552
2009	310,000	59,764
2010	310,000	50,240
2011-2015	1,050,000	130,300
2016	183,090	10,476
	<u>\$2,783,090</u>	<u>\$488,082</u>

(6) Pension and Retirement Benefits

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

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2005, 2004, and 2003, were \$67,804; \$63,318; and \$67,282, respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Contractually, qualifying employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age may convert their accrued sick leave value into paid health insurance premiums upon retirement. The Utility recognized liability of \$33,279 and \$30,055; respectively, for the years ended December 31, 2005 and 2004.

(7) Income Tax Status

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

(8) Related Party Transactions

The Utility provides communications service to the City. Operating revenues from the service provided amounted to \$37,559 and \$39,010 in 2005 and 2004, respectively.

Outstanding loan balances from the Municipal Electric Utility are \$2,783,090, and \$3,093,090 as of December 31, 2005, and 2004, respectively. Interest accrues on the loan at 3.1%, and is paid semi-annually during January and July. Annual principal payments continue through 2016 (see note 5). Accrued interest payable was \$46,040 and \$50,606 at December 31, 2005 and 2004, respectively.

(Continued)

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

Notes to Financial Statements

December 31, 2005 and 2004

(8) Related Party Transactions, continued

The Utility pays the Municipal Electric Utility, the Municipal Gas Utility and the Municipal Water Utility a management fee for administration, finance, human resources and legal services as part of the program to equitably allocate communications costs. For the years ended December 31, 2005 and 2004, the Utility recorded a management fee to the Municipal Electric Utility of \$67,510, the Municipal Gas Utility of \$20,800, and the Municipal Water Utility of \$1,690.

See note 5 for description of debt with the City. The interest paid to the City was \$102,989 and \$112,666 for the years ended December 31, 2005 and 2004, respectively. The accrued interest related to this debt was \$7,761 and \$8,582 at December 31, 2005 and 2004, respectively.

(9) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks. The Utilities maintain a risk management account to account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and \$2,198,758 in aggregate for all participants and have insurance for claims above this amount.

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

	<u>2005</u>	<u>2004</u>
Unpaid claims, beginning of year	\$ 162,225	\$ 112,350
Current year claims and changes in estimates	1,566,575	1,593,270
Claim payments	<u>(1,561,325)</u>	<u>(1,543,395)</u>
Unpaid claims, end of year	<u>\$ 167,475</u>	<u>\$ 162,225</u>

The Utility has recorded \$20,097 and \$19,467 in accounts payable for its share of these unpaid claims at December 31, 2005 and 2004, respectively.

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

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

Notes to Financial Statements

December 31, 2005 and 2004

(9) Risk Management, continued

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2005.

Cash and cash equivalents and investments	\$27,182,058
Receivables	1,141,735
Other assets	685,439
Total assets	<u>\$29,009,232</u>
Total liabilities	17,667,247
Total equity	<u>11,341,985</u>
Total liabilities and equity	<u>\$29,009,232</u>
Total revenues	8,251,594
Total expenses	2,793,256
Distribution to members	-
Net decrease in equity	<u>\$ 5,458,338</u>

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



CPAs & BUSINESS ADVISORS

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

To the Board of Trustees  
Cedar Falls Utilities – Municipal Communications Utility

We have audited the financial statements of Cedar Falls Utilities – Municipal Communications Utility of Cedar Falls, Iowa (the Utility), as of and for the years ended December 31, 2005 and 2004, and have issued our report thereon dated March 24, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

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Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2005, 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.

We noted certain matters that we reported to management of the Utility in a separate letter dated March 24, 2006.

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

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

*Eide Bailly LLP*

Dubuque, Iowa  
March 24, 2006

**CEDAR FALLS UTILITIES – MUNICIPAL COMMUNICATIONS UTILITY  
CEDAR FALLS, IOWA  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2005**

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

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

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

- II-A-05 Official Depositories - A resolution naming official depositories has been approved by the Utility's Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2005.
- II-B-05 Certified Budget - Disbursements during the year ended December 31, 2005, did not exceed the amounts budgeted.
- II-C-05 Questionable Expenditures - We noted no expenditures that we believe may fail to meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- II-D-05 Travel Expense - No expenditures of Utility money for travel expenses of spouses of Utility officials or employees were noted.
- II-E-05 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-F-05 Bond Coverage - Surety bond coverage of Utility officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- II-G-05 Board Minutes - No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-H-05 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Utility's investment policy were noted.
- II-I-05 Revenue Bonds - We noted no instances of non-compliance with the provisions of the Utility's revenue bond resolutions.
- II-J-05 Telecommunication Services - No instances of non-compliance with Chapter 388.10 of the Iowa Code were noted.

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

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

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2005

Schedule 1

Insurer and Policy Information

Coverage

Iowa Municipalities Workers Compensation Association

Worker's Compensation	\$ 1,000,000/accident
Member No. 0480	1,000,000/employee
Term 07-01-05/07-01-06	

Acuity

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

Associated Electric & Gas Insurance Services Limited

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

West Bend Mutual Insurance Company

Commercial Property (2 Booster Stations)	\$ 226,000
Policy No. CPI044166805	
Term 09-01-05/09-01-06	

(Continued)

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

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

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2005

Schedule 1

Insurer and Policy Information

Coverage

The Hartford Steam Boiler Inspection and Insurance Co

Property	\$102,591,995
Inland Marine/Contractors Equipment	2,178,233
Coal Unloading Equipment	365,000
Policy No. STA4102045	
Term 01-01-05/01-01-06	

National Union Fire Insurance Co of Pittsburgh, PA

Crime	\$ 500,000/occurrence
Policy No. 009782599	
Term 01-01-05/01-01-06	

Zurich

Builders Risk (Phase II Remodeling)	\$ 2,000,000
Policy No. BR62806890	
Term 08-01-04/08-01-05	

Iowa Comprehensive Petroleum Underground Storage Tank  
Financial Responsibility Program

Underground Storage Tanks	\$ 500,000/occurrence
Policy No. 8600572	1,000,000/aggregate
Term 10-17-05/10-16-06	

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

(Continued)

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

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

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2005

Schedule 2

Electric Utility

Rates of the Electric Utility, as a municipal system, are not subject to Iowa Utilities Board regulation. Rates are established by a Board of Trustees, currently consisting of Pamela L. Taylor, Chair; Richard A. Eades, Vice Chair; Vilas L. Morris, Jr., Secretary; Roger A. Kueter, member; Johnny A. Dickinson, member. The current electric rate tariff provides for an energy cost adjustment factor, which reflects changes in the price of fuel used to generate electricity and purchased power. Following are the basic monthly rates for electric service in effect for 2005.

Residential (Except Heating)

Customer charge	\$6.30
First 800 KWH	0.0690¢ per KWH
All over 800 KWH	0.0530¢ per KWH (Oct - May)
All over 800 KWH	0.0690¢ per KWH (June - Sept)
Minimum	\$6.30

Residential All-Electric Service

Customer charge	\$6.30
First 800 KWH	0.0680¢ per KWH
All over 800 KWH	0.0360¢ per KWH (Oct - May)
All over 800 KWH	0.0680¢ per KWH (June - Sept)
Minimum	\$6.30

Farm/Agricultural Service

Customer charge	\$8.40
First 50 KWH	0.1530¢ per KWH
Next 150 KWH	0.1020¢ per KWH
Next 500 KWH	0.0760¢ per KWH
All over 700 KWH	0.0580¢ per KWH
Minimum	\$8.40

Demand Space Heating Service

Customer charge	\$21.00
Demand charge	
All KW of billing demand	\$ 3.47 per KWH
Energy charge	
First 180 hours use per month per KW of billing demand	\$0.043¢ per KWH
Next 180 hours of use per month per KW of billing demand	0.034¢ per KWH
All over 360 hours use per month per KW of billing demand	0.034¢ per KWH (June-Sept)
All over 360 hours use per month per KW of billing demand	0.027¢ per KWH (Oct-May)
Minimum	the demand & customer charge

(Continued)

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

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

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2005

Small Space Heating Service

Customer charge	\$6.30
All KWH	0.0360¢ per KWH
Minimum	\$6.30

General Service

Customer charge	\$15.00
First 4,000 KWH	0.0720¢ per KWH
Next 6,000 KWH	0.0530¢ per KWH
All over 10,000 KWH	0.0450¢ per KWH

Large-Volume Power Service

Customer charge	\$105.00
<b>Demand charge</b>	
First 1,000 KW of billing demand	\$ 4.10/KW/month
All over 1,000 KW of billing demand	\$ 2.63/KW/month
<b>Energy charge</b>	
First 250 hours use per month per KW of billing demand	\$ 0.042¢ per KWH
Next 110 hours use per month per KW of billing demand	0.035¢ per KWH
Over 360 hours use per month per KW of billing demand	0.028¢ per KWH
Minimum	\$275.00

Non-Profit/Governmental and Interdepartmental

Customer charge	\$10.50
All KWH	0.0560¢ per KWH
Minimum	\$15.00
No sales tax	

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

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

At December 31, 2005 and 2004 the number of customer accounts was 17,231 and 16,970, respectively.

(Continued)

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

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

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2005

Gas Utility

Rates of the Gas Utility, as a municipal system, are not subject to Iowa Utilities Board regulation. Rates are established by a Board of Trustees, currently consisting of Pamela L. Taylor, Chair; Richard A. Eades, Vice Chair; Vilas L. Morris, Jr., Secretary; Roger A. Kueter, member; Johnny A. Dickinson, member. The current gas rate tariff provides for a purchased gas adjustment factor, which reflects changes in the price of fuel purchased. Following are the basic monthly rates for gas service in effect for 2005.

Residential Firm Service

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

Small-Volume Firm Service

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

Large-Volume Firm Service

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

Interruptible Commercial Service

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

Large-Volume/High Load Factor Firm Service

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

Industrial Interruptible Service (Large-Volume)

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

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

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

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2005

Large-Volume Competitive Fuel Service

All MCF Variable with market  
No minimum  
Purchased gas adjustment to applicable

Tax Supported/Non Profit Institutional Service

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

Interdepartmental Service

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

Large-Volume Interruptible Service

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

Electric Generation & Steam Boiler Interruptible Service

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

Large-Volume Transportation Service

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

At December 31, 2005 and 2004, the number of customer accounts was 12,714 and 12,456, respectively.

Water Utility

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

At December 31, 2005 and 2004 the number of customer accounts was 11,682 and 11,407, respectively.

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

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

Rate Matters

(Unaudited-See accompanying accountants' report)

December 31, 2005

Communications Utility

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

At December 31, 2005 and 2004 the number of customer accounts was as follows:

	<u>2005</u>	<u>2004</u>
Cable television	8,146	7,977
Cable modem service	6,845	6,288
Commercial data service	17	13



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

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We have audited the financial statements of Cedar Falls Utilities – Municipal Electric, Gas, Water, and Communications Utilities (the Utilities) for the year ended December 31, 2005, and have issued our report thereon dated March 24, 2006. Professional standards require that we provide you with the following information related to our audit.

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

As stated in our engagement letter dated January 6, 2006, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

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

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

### **Significant Accounting Policies**

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Utilities are described in Note 1 to the financial statements. No new accounting policies were adopted, and the application of existing policies was not changed during 2005. We noted no transactions entered into by the Utilities during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

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## **Accounting Estimates**

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements are unbilled service revenue and depreciation.

Management's estimate of the unbilled service revenue is based on past history and billings generated after year end. Management's estimate of depreciation is calculated on a composite straight-line method at rates based on estimated services and salvage values. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

## **Audit Adjustments**

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Utilities' financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by the Utilities, either individually or in the aggregate, indicate matters that could have a significant effect on the Utilities' financial reporting process.

## **Disagreements with Management**

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

## **Consultations with Other Independent Accountants**

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

## **Issues Discussed Prior to Retention of Independent Auditors**

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Utilities' auditors. However, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

## **Difficulties Encountered in Performing the Audit**

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

## Other Comments

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

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

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

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

Dubuque, Iowa  
March 24, 2006

**CEDAR FALLS UTILITIES**  
**DECEMBER 31, 2005**  
**OTHER COMMENTS**

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## **Travel and Expense Reimbursement**

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

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

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

## **New Pronouncements**

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

Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, issued April 2004, will be effective for the Utilities for the year ending December 31, 2007. This statement establishes uniform financial reporting standards for other postemployment benefit (OPEB) plans and supersedes the interim guidance included in Statement No. 26. This statement affects reporting by administrators or trustees of OPEB plan assets or by employers or sponsors that include OPEB plan assets as trust or agency funds in their financial reports.

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, issued June 2004, will be effective for the Utilities for the year ending December 31, 2008. This statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

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

Statement No. 47, *Accounting for Termination Benefits*, issued June 2005, establishes accounting standards for termination benefits. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this statement should be implemented simultaneously with the requirements of Statement No. 45. For all other termination benefits, this statement is effective for the fiscal year ending December 31, 2006.

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