

**SPENCER MUNICIPAL UTILITIES  
FINANCIAL STATEMENTS  
FOR THE YEAR ENDED  
DECEMBER 31, 2005 AND  
INDEPENDENT AUDITORS' REPORT**

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SPENCER MUNICIPAL UTILITIES

OFFICIALS

DECEMBER 31, 2005

<u>Board of Trustees</u>		<u>Term Expires</u>
Murray Hart	Treasurer	6-30-2007
Tom Howe	Trustee	6-30-2008
Dave Hultgren	Vice-Chairman	6-30-2011
Bruce Tamisiea	Chairman	6-30-2010
Gary Tolzmann	Secretary	6-30-2006

Management

Leon Rodas	General Manager
Steven Pick	Finance Supervisor

**SPENCER MUNICIPAL UTILITIES**

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA**

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

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

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

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheet of the Municipal Electric Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2005 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards 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 audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2006 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 4 through 7 and 24 through 26 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Wentcher, Stone & Co. LLP*

March 20, 2006

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of Management's Discussion and Analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Electric Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2005.

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

### **2005 Financial Highlights**

The Utility delivered approximately 159,258,000 kilowatt hours (kWh) of electricity to its retail customers in 2005 compared to approximately 152,289,000 kWh in 2004.

The Utility's net assets decreased \$453,462 to \$44,580,974 as a result of operations for the year ended December 31, 2005.

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

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

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

The statement of cash flows presents cash receipts, cash disbursements, and net changes in cash resulting from operating, noncapital financing, capital and related financing and investing activities.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

**Condensed Financial Information**

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

Condensed Balance Sheets

	<u>2005</u>	<u>2004</u>
Current assets .....	\$13,772,356	\$16,375,395
Capital assets - net of depreciation .....	31,502,348	26,974,973
Noncurrent assets .....	14,833,523	17,735,532
Deferred costs .....	<u>168,559</u>	<u>182,884</u>
Total assets	<u>\$60,276,786</u>	<u>\$61,268,784</u>
Current liabilities .....	\$ 2,370,812	\$ 1,954,348
Long-term debt .....	<u>13,325,000</u>	<u>14,280,000</u>
Total liabilities	<u>15,695,812</u>	<u>16,234,348</u>
Investments in capital assets - net of related debt .....	19,502,542	17,969,702
Restricted .....	2,467,350	2,456,092
Unrestricted .....	<u>22,611,082</u>	<u>24,608,642</u>
Total net assets	<u>44,580,974</u>	<u>45,034,436</u>
Total liabilities and net assets	<u>\$60,276,786</u>	<u>\$61,268,784</u>

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2005</u>	<u>2004</u>
Sales of electricity .....	\$ 8,726,584	\$ 7,456,330
Other .....	<u>153,923</u>	<u>207,941</u>
Total operating revenue	<u>8,880,507</u>	<u>7,664,271</u>
Power supply costs .....	6,542,381	4,668,272
Distribution system maintenance .....	1,417,250	1,013,513
Depreciation and amortization .....	1,726,613	1,601,919
Customer service and administration .....	<u>724,907</u>	<u>939,922</u>
Total operating expenses	<u>10,411,151</u>	<u>8,223,626</u>
Operating income (loss)	(1,530,644)	(559,355)
Interest income .....	830,385	608,605
Interest expense .....	(356,410)	(380,587)
Other income (expenses) - net .....	<u>603,207</u>	<u>474,898</u>
Total non-operating income	<u>1,077,182</u>	<u>702,916</u>
Change in net assets	(453,462)	143,561
Net assets - beginning of year .....	<u>45,034,436</u>	<u>44,890,875</u>
Net assets - end of year	<u>\$44,580,974</u>	<u>\$45,034,436</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

### **Financial Analysis**

The Utility's total assets decreased by approximately \$992,000 during 2005.

The Utility's gross revenues increased in 2005 compared to 2004 by approximately \$1,216,000 or 15.81%.

Power supply costs have increased in 2005 compared to 2004 by approximately \$1,874,000. Total operating expenses increased by approximately \$189,000 due to increased expenses related to distribution maintenance. Depreciation and amortization also increased by approximately \$125,000. Customer service and administration expense was lower due to payroll overheads being charged to the respective payroll account instead of administration expense.

Total operating loss generated in 2005 was \$1,530,644 compared to \$559,355 in 2004.

Utility non-operating income (expense) in 2005 resulted in an additional \$374,266 of income compared to 2004 due to additional leases of utility facilities and a higher rate of return on invested funds.

The Utility's net assets decreased \$453,462 for the year ended December 31, 2005 compared to an increase of \$143,560 for the year ended December 31, 2004.

### **Budgetary Highlights**

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa.

The original adopted combined budget for 2005 was approximately \$25,500,000. This was an increase of \$12,600,000 over the previous year budget. The budget was amended once during 2005 to allow for increased expenditures of approximately \$2,200,000.

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

Net capital assets increased by approximately \$5,264,000 due to construction work in progress related to the Council Bluffs Energy Center Unit 4 (CBEC #4), and distribution construction.

During August of 2002, the Board of Trustees entered a joint ownership agreement for the construction of the Council Bluffs Energy Center Unit 4. The Utility will become a 1.07% owner which is 8.453 megawatts. The Utility's total ownership interest is estimated at \$13,600,000. The Utility's construction work in progress totaled approximately \$7,017,000 at year end.

On February 1, 2004, the Board of Trustees authorized the issuance of \$8,750,000 in Electric Revenue Bonds, Series 2004 of which \$8,270,000 was outstanding at December 31, 2005. The proceeds from these bonds will be used to finance a portion of the construction of the Council Bluffs Energy Center Unit 4 discussed above. The balance of the bond proceeds fund at December 31, 2005 was approximately \$2,112,000. In addition, \$6,010,000 remained outstanding at December 31, 2005 from Electric Revenue Bonds, Series 2000.

## MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

### **Economic Factors**

The Utility continues to experience positive growth in retail sales; however, power supply costs have increased at a greater rate during 2005. The primary reason for the increase in power supply costs is the conversion to market based pricing between NIMECA and MidAmerican Energy Company. In order to cover more of its baseload capacity, the Board of Trustees has entered into a joint ownership agreement for the construction of the CBEC #4. It has also signed a letter of intent to become a 6.25% participant of the Wisdom 2 combustion turbine generator.

The Utility completed a Cost of Service Study during 2004. The purpose of the study was to assign operating and capital costs to the various rate classes and verify that rates were adequate to cover those costs. The Board of Trustees adopted rate adjustments based on the study effective March 1, 2005. The utility also adopted an Energy Cost Adjustment (ECA) for all consumption beginning September 7, 2005. The ECA is calculated monthly and is designed to recoup the additional costs of power supply from the consumer.

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

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET  
DECEMBER 31, 2005

ASSETS

CAPITAL ASSETS (Note 4):		
Plant in service .....	\$49,707,183	
Less accumulated depreciation .....	<u>25,457,420</u>	
Plant in service - net	24,249,763	
Construction work in progress .....	<u>7,252,585</u>	
<b>CAPITAL ASSETS - NET</b>		<b>\$31,502,348</b>
NONCURRENT ASSETS:		
Noncurrent investments:		
Board designated (Notes 2 and 3) .....	3,813,114	
Restricted (Notes 2 and 8) .....	4,447,784	
Note receivable - City of Spencer (Note 6) .....	26,625	
Note receivable - Municipal Communications Utility (Note 7) .....	<u>6,546,000</u>	
<b>TOTAL NONCURRENT ASSETS</b>		<b>14,833,523</b>
CURRENT ASSETS:		
Cash and cash equivalents:		
Unrestricted (Note 2) .....	1,181,598	
Board designated (Notes 2 and 3) .....	10,304,700	
Restricted (Notes 2 and 8) .....	131,201	
Consumer deposits .....	19,510	
Accounts receivable - net of allowance for doubtful accounts of \$27,000 .....	880,128	
Unbilled usage .....	445,265	
Materials and supplies inventory .....	575,137	
Fuel inventory .....	134,270	
Prepayments .....	69,041	
Note receivable - City of Spencer (Note 6) .....	26,625	
Notes receivable - employees (Note 5) .....	<u>4,881</u>	
<b>TOTAL CURRENT ASSETS</b>		<b>13,772,356</b>
DEFERRED COSTS:		
Unamortized bond issue costs .....		<u>168,559</u>
<b>TOTAL ASSETS</b>		<b><u>\$60,276,786</u></b>

See Accompanying Notes to Financial Statements

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET - Continued  
DECEMBER 31, 2005

LIABILITIES

NONCURRENT LIABILITIES:

Revenue bonds payable - less current installments (Note 8).....	\$13,325,000
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CURRENT LIABILITIES:

Current installments of revenue bonds payable (Note 8) .....	\$ 955,000	
Accounts payable .....	1,064,261	
Accrued wages, vacations, and benefits .....	235,784	
Accrued interest .....	51,627	
Consumer deposits .....	19,510	
Accrued expenses .....	<u>44,630</u>	
TOTAL CURRENT LIABILITIES		2,370,812

COMMITMENTS AND CONTINGENCIES (Note 15) .....	<u>                    </u>
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TOTAL LIABILITIES	15,695,812
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NET ASSETS

Invested in capital assets - net of related debt .....	19,502,542	
Restricted - bond funds (Note 8) .....	2,467,350	
Unrestricted .....	<u>22,611,082</u>	
TOTAL NET ASSETS		<u>44,580,974</u>

TOTAL LIABILITIES AND NET ASSETS	<u>\$60,276,786</u>
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MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
FOR THE YEAR ENDED DECEMBER 31, 2005

OPERATING REVENUES:		
Residential .....	\$ 3,411,516	
Commercial .....	4,711,413	
Public authorities .....	485,530	
Sales for resale .....	131,646	
Interdepartmental .....	118,125	
Penalties .....	14,467	
Miscellaneous .....	<u>7,810</u>	
TOTAL OPERATING REVENUES		\$ 8,880,507
OPERATING EXPENSES:		
Generation and transmission:		
Neal #4 fuel and generation .....	859,868	
Purchased power .....	5,623,356	
Other .....	59,157	
Distribution .....	1,417,250	
Depreciation and amortization .....	1,726,613	
Customer operations .....	248,886	
General and administrative .....	<u>476,021</u>	
TOTAL OPERATING EXPENSES		<u>10,411,151</u>
LOSS FROM OPERATIONS		(1,530,644)
NON-OPERATING INCOME (EXPENSE) AND TRANSFERS:		
Interest income on investments .....	516,258	
Interest income from Municipal Communication Utility (Note 7) ...	314,127	
Economic development payments .....	(138,209)	
Leased facilities (Notes 11 and 15) .....	1,117,688	
Interest expense .....	(356,410)	
Loss on plant retirements .....	(2,192)	
Transfers to City - in lieu of property taxes (Note 6) .....	<u>(374,080)</u>	
TOTAL NON-OPERATING INCOME (EXPENSE) AND TRANSFERS - NET		<u>1,077,182</u>
CHANGE IN NET ASSETS		(453,462)
NET ASSETS - BEGINNING OF YEAR .....		<u>45,034,436</u>
NET ASSETS - END OF YEAR		<u>\$44,580,974</u>

See Accompanying Notes to Financial Statements

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2005

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Cash received from customers .....	\$ 8,440,573
Cash paid to suppliers .....	(6,808,630)
Cash paid to employees .....	<u>(1,411,940)</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b><u>220,003</u></b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
Contributions paid for economic development .....	(138,209)
Transfer to City - in lieu of property tax .....	<u>(374,080)</u>
<b>NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES</b>	<b><u>(512,289)</u></b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
Acquisition and construction of capital assets .....	(6,241,855)
Revenue bond principal repayment .....	(920,000)
Payments received from leasing of facilities .....	1,488,260
Interest paid .....	<u>(360,163)</u>
<b>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<b><u>(6,033,758)</u></b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Payments received on note receivable - City of Spencer .....	26,625
Payments received on notes receivable - employees .....	8,421
Payments received on note receivable - electric heat .....	482
Loan advances for notes receivable - employees .....	(5,352)
Payments received on note receivable - Communications Utility .....	504,000
Proceeds from redemption of investments .....	6,757,714
Purchase of investments .....	(4,386,330)
Interest received from investments .....	516,258
Interest received from note receivable - Communications Utility .....	<u>627,705</u>
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b><u>4,049,523</u></b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>(2,276,521)</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR</b> .....	<b><u>13,894,020</u></b>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<b><u>\$11,617,499</u></b>

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2005

<b>RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	
Loss from operations .....	<u>\$ (1,530,644)</u>
Adjustments to reconcile income from operations to net cash provided by operating activities:	
Depreciation .....	1,712,288
Amortization .....	14,325
(Increase) decrease in:	
Consumer deposits .....	1,217
Accounts receivable .....	(358,352)
Unbilled usage .....	(81,665)
Materials and supplies inventory .....	52,517
Fuel inventory .....	28,300
Prepayments .....	(3,200)
Increase (decrease) in:	
Accounts payable .....	398,294
Accrued wages, vacations, and benefits .....	8,549
Consumer deposits .....	(1,134)
Accrued expenses .....	(20,492)
Total adjustments .....	<u>1,750,647</u>
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 <u>\$ 220,003</u>

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

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

The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

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

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2005 has been completed and is filed under separate cover.

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

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

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

**B. Capital Assets and Depreciation**

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new electric facilities. In addition, net interest costs on construction debt are capitalized. During 2005, the Utility capitalized interest expense of \$192,880, which equals total interest expense of \$291,264 less interest income from invested proceeds of \$98,384.

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.215% undivided interest in a 640 MW electric generation station known as George Neal Generating Station Unit No. 4. The Electric Utility's 1.215% ownership interest in this plant represents a total investment of \$4,892,420 included in utility plant in service with \$3,458,023 included in accumulated depreciation. Operating costs associated with this plant and depreciation are reflected in the statement of income.

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.07% undivided interest in an electric generation station known as Council Bluffs 4, which is currently under construction with expected completion in 2007. Additional information is included in Note 15.

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

Depreciation is provided on a straight-line basis. Current depreciation expense is approximately 3.44% of the original cost of depreciable electric plant in service.

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

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

**C. Accounts Receivable**

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

**D. Inventories**

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

**E. Unamortized Bond Issue Costs**

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

**F. Net Assets**

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets and increased by unspent proceeds. 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.

**G. Income Taxes**

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

**H. Revenues and Unbilled Usage**

Revenues are based on billing rates, which are applied to customers' consumption of electricity. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2005, totaled \$445,265.

**I. Estimates**

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

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

The Utility's deposits in banks at December 31, 2005 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

The Utility had investments in Iowa Public Agency Investment Trust which are valued at an amortized cost of \$6,973,624 pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk - The Utility's investment policy limits the investment 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 investments 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 in the Iowa Public Agency Investment Trust is unrated.

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

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

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

Cash and cash equivalents:	
Board designated .....	\$10,304,700
Restricted .....	131,201
Unrestricted .....	<u>1,181,598</u>
Total cash and cash equivalents	<u>11,617,499</u>
Noncurrent investments:	
Board designated .....	3,813,114
Restricted .....	<u>4,447,784</u>
Total noncurrent investments	<u>8,260,898</u>
Total cash and cash equivalents and noncurrent investments	<u>\$19,878,397</u>

**3. BOARD DESIGNATED FUNDS**

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**3. BOARD DESIGNATED FUNDS - Continued**

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

Assets of the funds as of December 31, 2005 are summarized as follows:

	Contingency Reserve	Replacement and Construction Reserve	Total
Cash and cash equivalents .....	\$1,236,814	\$9,067,886	\$10,304,700
Noncurrent investments .....		3,813,114	3,813,114
<b>Total</b>	<b><u>\$1,236,814</u></b>	<b><u>\$12,881,000</u></b>	<b><u>\$14,117,814</u></b>

**4. CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2005 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
<b>Capital assets not being depreciated:</b>				
Land .....	\$ 86,092			\$ 86,092
Construction in progress .....	2,667,581	\$4,865,303	\$ (280,299)	7,252,585
Total capital assets not being depreciated	<u>2,753,673</u>	<u>4,865,303</u>	<u>(280,299)</u>	<u>7,338,677</u>
<b>Capital assets being depreciated:</b>				
Infrastructure .....	42,085,703	1,580,250	(20,596)	43,645,357
Buildings and improvements ...	741,481	24,395		765,876
Equipment .....	5,192,053	52,206	(34,401)	5,209,858
Total capital assets being depreciated	<u>48,019,237</u>	<u>1,656,851</u>	<u>(54,997)</u>	<u>49,621,091</u>
Less accumulated depreciation ...	<u>23,797,937</u>	<u>1,712,288</u>	<u>(52,805)</u>	<u>25,457,420</u>
Total capital assets being depreciated - net .....	<u>24,221,300</u>	<u>(55,437)</u>	<u>(2,192)</u>	<u>24,163,671</u>
<b>Capital assets - net</b>	<b><u>\$26,974,973</u></b>	<b><u>\$4,809,866</u></b>	<b><u>\$ (282,491)</u></b>	<b><u>\$31,502,348</u></b>

**5. NOTES RECEIVABLE - EMPLOYEES**

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

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

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

During 1996, the Utility advanced the City \$355,000, of which \$266,250 was a loan, to perform public improvements in the area of West 11<sup>th</sup> Street in Spencer. The City reimburses the Utility in equal payments of \$26,625 without interest, payable annually on July 1. The balance of this note at December 31, 2005 was 53,250.

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

The Board of Trustees has approved an \$8,000,000 line of credit for the Municipal Communications Utility for use in start-up and construction costs related to bringing the Communications Utility into operation. At December 31, 2005, \$8,000,000 has been advanced and \$6,546,000 remains outstanding. Outstanding balances bear interest at a rate of 4.5% per annum.

**8. NONCURRENT LIABILITIES**

Noncurrent liabilities activity for the year ended December 31, 2005 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 2000 revenue bonds .....	\$ 6,450,000		\$440,000	\$ 6,010,000	\$465,000
Series 2004 revenue bonds .....	<u>8,750,000</u>		<u>480,000</u>	<u>8,270,000</u>	<u>490,000</u>
Total revenue bonds	15,200,000		920,000	14,280,000	<u>\$955,000</u>
Current installments of revenue bonds payable .....	<u>(920,000)</u>	<u>\$(35,000)</u>		<u>(955,000)</u>	
Revenue bonds payable - less current installments	<u>\$14,280,000</u>	<u>\$(35,000)</u>	<u>\$920,000</u>	<u>\$13,325,000</u>	

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**8. NONCURRENT LIABILITIES - Continued**

The Series 2000 and 2004 revenue bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds range between 1.4% and 5.75%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

	Series 2000		Series 2004	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2006 .....	\$ 465,000	\$ 334,867	\$ 490,000	\$ 284,537
2007 .....	490,000	309,292	495,000	275,963
2008 .....	515,000	282,342	510,000	265,567
2009 .....	545,000	254,018	520,000	253,583
2010 .....	575,000	224,042	535,000	239,802
2011 - 2015 .....	3,420,000	602,710	2,935,000	928,600
2016 - 2019 .....	<u>                    </u>	<u>                    </u>	<u>2,785,000</u>	<u>306,485</u>
Total	<u>\$6,010,000</u>	<u>\$2,007,271</u>	<u>\$8,270,000</u>	<u>\$2,554,537</u>

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

**Restricted Funds**

Outstanding Electric Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. The Utility is in compliance with all significant financial requirements as of December 31, 2005.

At December 31, 2005, the special funds consisted of the following:

	Cash and Cash <u>Equivalents</u>	Noncurrent <u>Investments</u>	<u>Total</u>
Bond Sinking Fund .....	\$ 131,201		\$ 131,201
Bond Reserve Fund .....		\$1,584,191	1,584,191
Bond Improvement Fund .....		<u>751,958</u>	<u>751,958</u>
Restricted - bond funds	131,201	2,336,149	2,467,350
Unexpended bond proceeds .....		<u>2,111,635</u>	<u>2,111,635</u>
Total	<u>\$ 131,201</u>	<u>\$4,447,784</u>	<u>\$4,578,985</u>

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**8. NONCURRENT LIABILITIES - Continued**

Monthly deposits into two bond sinking funds are required to establish the amount necessary to pay the next installments of principal and interest on the 2000 and 2004 Electric Revenue Bonds. Bond reserve funds for the 2000 and 2004 Electric Revenue Bonds equaled the required balance at December 31, 2005; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

The bond improvement fund balance at December 31, 2005 equaled the minimum balance required; therefore monthly deposits into the fund are not currently required. These funds are to be used first for principal and interest payments when insufficient funds are available in the sinking and reserve funds and second for extraordinary unbudgeted maintenance expenses or system repairs, renewals and replacements.

**9. RATE MATTERS**

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

**10. NUMBER OF METER CONNECTIONS**

The number of meter connections totaled 5,866 at December 31, 2005.

**11. LEASES**

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

Jet turbine generator .....	\$2,522,868
Neal 4 plant .....	<u>4,892,420</u>
Total	7,415,288
Less accumulated depreciation .....	<u>5,620,592</u>
Net investment	<u>\$1,794,696</u>

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**11. LEASES - Continued**

The lease of the Neal 4 plant is a long-term commitment based on capacity. The amount is determined by formula based on usage and totaled \$308,092 in 2005. The leases of the jet turbine generator are both by noncancelable lease and a variable lease determined by capacity and totaled \$155,953 in 2005. The following is a schedule of future minimum rentals on noncancelable operating leases on the jet turbine generator as of December 31, 2005:

2006 .....		\$	65,000
2007 .....			65,000
2008 .....			65,000
2009 .....			65,000
2010 .....			<u>65,000</u>
Total minimum lease payment receivable			<u>\$ 325,000</u>

The Utility leases bandwidth, property, and building space to the Water Utility and Communications Utility. The revenues from such leases are classified as leased facilities and totaled \$409,421 in 2005. The leases are 20-year variable leases based on bandwidth and space utilized. There is no amount receivable at December 31, 2005.

The Utility leases building space from the Water Utility. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized and totaled \$8,000 in 2005. There is no amount payable at December 31, 2005.

**12. RETIREMENT SYSTEM**

**IPERS**

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

Plan members are required to contribute 3.70% of their annual 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 to IPERS for the years ended December 31, 2005, 2004, and 2003 were \$85,741, \$75,592, and \$75,874, respectively, equal to the required contributions for each year.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**12. RETIREMENT SYSTEM - Continued**

**Employees Pension Plan**

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

The Electric Utility's contribution to the Money Accumulation Pension Plan for 2005 totaled \$117,913.

**13. RISK MANAGEMENT**

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

**14. RELATED PARTIES**

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

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

Additional related party items are included in Notes 7 and 11.

MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**15. COMMITMENTS**

During 2003, the Electric Utility entered into an agreement to purchase a 1.07% ownership in the generating facilities at Council Bluffs 4. The plant is expected to be in production in 2007. The commitment of Spencer Municipal Utilities in order to maintain its percentage of ownership is expected to approximate \$13,600,000. Approximately \$7,017,198 had been paid or accrued resulting in a future commitment of approximately \$6,582,802. Future payments by the Utility would be required as construction progresses.

During 2004, the Electric Utility entered into negotiations to purchase a 6.25% ownership in the generating facilities at Wisdom 2. The Spencer Municipal Utilities' commitment is expected to approximate \$2,400,000. Based on a letter of intent to acquire this ownership, leased facilities revenues of \$197,111 were allocated to and realized by the Utilities in 2005.

During 2005, the Electric Utility provided a letter of support to continue funding Iowa Great Lakes Corridor of Opportunity at a level of \$12,500 per year for four years.

**REQUIRED SUPPLEMENTARY INFORMATION**

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

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2005

	<u>Actual</u>	Budgeted Amounts <u>Final</u>	Final to Actual <u>Variance</u>
Receipts:			
Municipal Electric Utility .....	\$11,612,324		
Municipal Water Utility .....	1,094,784		
Municipal Communications Utility .....	<u>5,464,667</u>		
Combined receipts	<u>18,171,775</u>	\$17,837,918	\$ 333,857
Disbursements, including capital outlay:			
Municipal Electric Utility .....	16,260,229		
Municipal Water Utility .....	1,106,739		
Municipal Communications Utility .....	<u>4,885,445</u>		
Combined disbursements, including capital outlay	<u>22,252,413</u>	27,692,992	5,440,579
Transfers in .....		1,700,000	(1,700,000)
Transfers out .....	<u>                    </u>	<u>(1,700,000)</u>	<u>1,700,000</u>
Transfers - net	<u>                    </u>	<u>                    </u>	<u>                    </u>
Combined excess (deficit) of receipts over disbursements	(4,080,638)	(9,855,074)	5,774,436
Combined beginning net assets .....	<u>29,804,339</u>	<u>32,449,450</u>	<u>(2,645,111)</u>
<b>COMBINED ENDING NET ASSETS</b>	<b><u>\$25,723,701</u></b>	<b><u>\$22,594,376</u></b>	<b><u>\$ 3,129,325</u></b>
	<u>Original</u>	<u>Final</u>	
	<u>Budget</u>	<u>Budget</u>	
Total revenues and transfers in .....	\$18,291,830	\$19,537,918	
Total expenditures and transfers out .....	<u>27,194,185</u>	<u>29,392,992</u>	
Excess (deficit) of receipts over disbursements	(8,902,355)	(9,855,074)	
Beginning balance - January 1 .....	<u>32,449,450</u>	<u>32,449,450</u>	
Ending balance - December 31	<u>\$23,547,095</u>	<u>\$22,594,376</u>	

See Accompanying Independent Auditors' Report

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

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2005

	<u>Cash Basis</u>	<u>Accrual Adjustments</u>	<u>Accrual Basis</u>
<b>Revenues:</b>			
Municipal Electric Utility .....	\$11,612,324	\$ (783,744)	\$10,828,580
Municipal Water Utility .....	1,094,784	190,966	1,285,750
Municipal Communications Utility .....	<u>5,464,667</u>	<u>842,210</u>	<u>6,306,877</u>
Combined revenues	<u>18,171,775</u>	<u>249,432</u>	<u>18,421,207</u>
<b>Expenditures/expenses:</b>			
Municipal Electric Utility .....	16,260,229	(4,978,187)	11,282,042
Municipal Water Utility .....	1,106,739	(24,405)	1,082,334
Municipal Communications Utility .....	<u>4,885,445</u>	<u>(558,845)</u>	<u>4,326,600</u>
Combined expenditures/expenses	<u>22,252,413</u>	<u>(5,561,437)</u>	<u>16,690,976</u>
Net	(4,080,638)	5,810,869	1,730,231
Combined beginning net assets .....	<u>29,804,339</u>	<u>22,013,094</u>	<u>51,817,433</u>
<b>COMBINED ENDING NET ASSETS</b>	<b><u>\$25,723,701</u></b>	<b><u>\$27,823,963</u></b>	<b><u>\$53,547,664</u></b>

See Accompanying Independent Auditors' Report

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING**

**YEAR ENDED DECEMBER 31, 2005**

**NOTE 1**

The budgetary comparison is presented as Required Supplementary Information in accordance with Government Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for each individual utility.

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

Formal and legal budgetary control is based upon nine major classes of disbursements, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business type activities. All Utility disbursements are included in business type activities function and are required to be budgeted. During the year, one budget amendment increased budgeted disbursements by \$2,198,807. This budget amendment is reflected in the final budgeted amounts.

**NOTE 2**

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

	Municipal Electric Utility	Municipal Water Utility	Municipal Communications Utility	Combined
Receipts .....	\$11,612,324	\$ 1,094,784	\$ 5,464,667	\$18,171,775
Disbursements, including capital outlay ..	<u>16,260,229</u>	<u>1,106,739</u>	<u>4,885,445</u>	<u>22,252,413</u>
Excess (deficit) of receipts over disbursements	(4,647,905)	(11,955)	579,222	(4,080,638)
Beginning net assets .....	<u>24,526,302</u>	<u>4,109,749</u>	<u>1,168,288</u>	<u>29,804,339</u>
<b>ENDING NET ASSETS</b>	<u><b>\$19,878,397</b></u>	<u><b>\$ 4,097,794</b></u>	<u><b>\$ 1,747,510</b></u>	<u><b>\$25,723,701</b></u>

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

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**INDEPENDENT AUDITORS' 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**

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

We have audited the financial statements of the Municipal Electric Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2005, and have issued our report thereon dated March 20, 2006. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 over financial reporting 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, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards*.

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

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

*Winter, Steve Ho. L.L.P.*

March 20, 2006

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS  
FOR THE YEAR ENDED DECEMBER 31, 2005

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

No matters were noted.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2005

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

II-A-05 Official Depositories - A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2005.

II-B-05 Certified Budget - Disbursements during the year ended December 31, 2005 did not exceed the amounts budgeted in the business type activities function.

II-C-05 Questionable Expenditures - No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-D-05 Travel Expenses - No expenditures of Utility's money for travel expenses of spouses of Utility's officials or employees were noted.

II-E-05 Business Transactions - Business transactions between the Utility and Utility officials and employees are detailed as follows:

<u>Name, Title and Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
Tom Howe, Board Member Part owner of H & N Chevrolet	Maintenance & Repairs	\$ 2,035
Dave Hultgren, Board Member Owner, Northwest Equipment	Maintenance & Repairs	\$ 451
Rachel, Rebecca, and Ryan Florke Children of employee	Cleaning Services	\$ 1,725

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

II-F-05 Bond Coverage - Surety bond coverage of Spencer Municipal Utilities' officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

II-G-05 Board Minutes - No transactions were found that we believe should have been approved in the Board minutes but were not.

II-H-05 Revenue Bonds - As of December 31, 2005, the Utility had complied with all significant financial requirements related to its Electric Revenue Bonds, Series 2000, and Electric Revenue Bonds, Series 2004.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2005

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

- II-I-05 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility's investment policy were noted.

**SPENCER MUNICIPAL UTILITIES**

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA**

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheet of the Municipal Water Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2005 and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards 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 audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2006 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 34 through 36 and 51 through 53 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Winter, Stone & Co. LLP*

March 20, 2006

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of Management's Discussion and Analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Water Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2005.

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

### **2005 Financial Highlights**

The Utility delivered approximately 460,302,000 gallons of water to its retail customers in 2005 compared to approximately 458,580,000 gallons in 2004.

The Utility's net assets increased by \$203,416 to \$7,142,798 as a result of operations for the year ended December 31, 2005.

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

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

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

The statement of cash flows presents cash receipts, cash disbursements, and net changes in cash resulting from operating, noncapital financing, capital and related financing and investing activities.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

**Condensed Financial Information**

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

<u>Condensed Balance Sheets</u>		
	<u>2005</u>	<u>2004</u>
Current assets .....	\$ 3,390,846	\$ 3,449,187
Capital assets - net of depreciation .....	4,607,674	4,208,924
Noncurrent assets and deferred costs .....	<u>1,014,320</u>	<u>1,017,350</u>
Total assets	<u>\$ 9,012,840</u>	<u>\$ 8,675,461</u>
Current liabilities .....	\$ 651,042	\$ 456,079
Long-term debt .....	<u>1,219,000</u>	<u>1,280,000</u>
Total liabilities	<u>1,870,042</u>	<u>1,736,079</u>
Investments in capital assets - net of related debt .....	3,341,994	2,886,468
Restricted .....	194,108	192,696
Unrestricted .....	<u>3,606,696</u>	<u>3,860,218</u>
Total net assets	<u>7,142,798</u>	<u>6,939,382</u>
Total liabilities and net assets	<u>\$ 9,012,840</u>	<u>\$ 8,675,461</u>

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2005</u>	<u>2004</u>
Sales of water .....	\$ 865,532	\$ 850,090
Other .....	<u>38,022</u>	<u>32,202</u>
Total operating revenue	<u>903,554</u>	<u>882,292</u>
System operation and maintenance .....	611,618	552,210
Depreciation and amortization .....	264,258	266,184
Customer service and administration .....	<u>114,187</u>	<u>164,668</u>
Total operating expenses	<u>990,063</u>	<u>983,062</u>
Operating income (loss)	<u>(86,509)</u>	<u>(100,770)</u>
Interest income .....	122,255	54,370
Interest expense .....	(47,979)	(53,690)
Other income (expense) - net .....	<u>215,649</u>	<u>(12,573)</u>
Total non-operating income (expense)	<u>289,925</u>	<u>(11,893)</u>
Change in net assets	203,416	(112,663)
Net assets - beginning of year.....	<u>6,939,382</u>	<u>7,052,045</u>
Net assets - end of year	<u>\$ 7,142,798</u>	<u>\$ 6,939,382</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

### **Financial Analysis**

The Utility's total assets increased by approximately \$337,000 during 2005.

The Utility's gross revenues increased in 2005 compared to 2004 by approximately \$21,000 or 2.40%.

Total operating expenses increased in 2005 compared to 2004 by approximately \$6,000 due to increased expenses related to the water plant operation and maintenance. Customer service and administration expense was lower due to payroll overheads being charged to the respective payroll account instead of administration expense.

Total operating loss generated in 2005 was \$86,509 compared to \$100,770 in 2004.

Utility non-operating income (expense) resulted in additional income of \$300,594 during the year ended December 31, 2005 compared to 2004. Contributions in aid of construction totaled \$249,138 for the year ended December 31, 2005 compared to \$29,654 for the year ended December 31, 2004.

The Utility's net assets increased \$203,416 for the year ended December 31, 2005 compared to a decrease of \$112,663 for the year ended December 31, 2004.

### **Budgetary Highlights**

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa.

The original adopted combined budget for 2005 was approximately \$25,500,000. This was an increase of \$12,600,000 over the previous year budget. The budget was amended once during 2005 to allow for increased expenditures of approximately \$2,200,000.

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

Net capital assets increased by approximately \$399,000 due to construction of water mains during the year ended December 31, 2005.

\$1,280,000 remained outstanding at December 31, 2005 from Water Revenue Bonds, Series 2001. The bonds mature in 2021.

### **Economic Factors**

During the year ended December 31, 2005, the Utility experienced a net income due to significant contributions in aid of construction. Because of the net operating loss, the Board of Trustees adopted a rate adjustment effective with consumption beginning February 28, 2006. This rate adjustment will increase annual revenues by approximately \$115,000.

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

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

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET  
DECEMBER 31, 2005

ASSETS

CAPITAL ASSETS (Note 4):		
Plant in service .....	\$ 9,873,618	
Less accumulated depreciation .....	<u>5,268,936</u>	
PLANT IN SERVICE - NET	4,604,682	
Construction work in progress .....	<u>2,992</u>	
CAPITAL ASSETS - NET		\$ 4,607,674
NONCURRENT ASSETS:		
Noncurrent investments:		
Board designated (Notes 2 and 3) .....		1,000,000
CURRENT ASSETS:		
Cash and cash equivalents:		
Unrestricted (Note 2) .....	805,580	
Board designated (Notes 2 and 3) .....	2,098,106	
Restricted (Notes 2 and 7) .....	194,108	
Accounts receivable - net of allowance for doubtful accounts of \$4,000 .....	190,069	
Unbilled usage .....	34,011	
Materials and supplies inventory .....	61,787	
Prepayments .....	<u>7,185</u>	
TOTAL CURRENT ASSETS		3,390,846
DEFERRED COSTS:		
Unamortized bond issue costs .....		<u>14,320</u>
 TOTAL ASSETS		 <u>\$ 9,012,840</u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET - Continued  
DECEMBER 31, 2005

LIABILITIES

NONCURRENT LIABILITIES:		
Revenue bonds payable - less current installments (Note 7).....		\$ 1,219,000
CURRENT LIABILITIES:		
Current installments of revenue bonds payable (Note 7) .....	\$ 61,000	
Accounts payable .....	544,317	
Accrued wages, vacations, and benefits .....	30,165	
Accrued interest .....	8,352	
Accrued expenses .....	<u>7,208</u>	
TOTAL CURRENT LIABILITIES		<u>651,042</u>
COMMITMENTS AND CONTINGENCIES (Note 14) .....		
TOTAL LIABILITIES		<u>1,870,042</u>
NET ASSETS		
Invested in capital assets - net of related debt .....	3,341,994	
Restricted - bond funds (Note 7) .....	194,108	
Unrestricted .....	<u>3,606,696</u>	
TOTAL NET ASSETS		<u>7,142,798</u>
TOTAL LIABILITIES AND NET ASSETS		<u>\$ 9,012,840</u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
FOR THE YEAR ENDED DECEMBER 31, 2005

OPERATING REVENUES:		
Residential and commercial .....	\$ 865,532	
Rental income .....	32,400	
Miscellaneous .....	<u>5,622</u>	
TOTAL OPERATING REVENUES		\$ 903,554
OPERATING EXPENSES:		
Treatment .....	350,868	
Distribution .....	260,750	
Depreciation and amortization .....	264,258	
Customer operations .....	48,670	
General and administrative .....	<u>65,517</u>	
TOTAL OPERATING EXPENSES		<u>990,063</u>
LOSS FROM OPERATIONS		(86,509)
NON-OPERATING INCOME (EXPENSE) AND TRANSFERS:		
Interest income on investments .....	122,255	
Contributions from developers .....	249,138	
Leased facilities (Note 10) .....	10,803	
Interest expense .....	(47,979)	
Transfers to City - in lieu of property taxes (Note 6) .....	<u>(44,292)</u>	
TOTAL NON-OPERATING INCOME (EXPENSE) AND TRANSFERS - NET		<u>289,925</u>
CHANGE IN NET ASSETS		203,416
NET ASSETS - BEGINNING OF YEAR .....		<u>6,939,382</u>
NET ASSETS - END OF YEAR		<u>\$ 7,142,798</u>

MUNICIPAL WATER UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 STATEMENT OF CASH FLOWS  
 FOR THE YEAR ENDED DECEMBER 31, 2005

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Cash received from customers .....	\$ 961,726
Cash paid to suppliers .....	(290,377)
Cash paid to employees .....	(251,158)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>420,191</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>	
Transfer to City - in lieu of property tax .....	<u>(44,292)</u>
<b>NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES</b>	<u>(44,292)</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>	
Acquisition and construction of capital assets .....	(412,646)
Revenue bond principal repayment .....	(58,000)
Payments received from leasing of facilities .....	10,803
Interest paid .....	<u>(50,266)</u>
<b>NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<u>(510,109)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Proceeds from redemption of investments .....	1,001,806
Purchase of investments .....	(1,000,000)
Interest received from investments .....	<u>122,255</u>
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<u>124,061</u>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	(10,149)
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR</b>	<u>3,107,943</u>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<u>\$ 3,097,794</u>

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

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2005

RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Loss from operations .....	\$ (86,509)
Adjustments to reconcile loss from operations to net cash provided by operating activities:	
Depreciation .....	263,034
Amortization .....	1,224
(Increase) decrease in:	
Accounts receivable .....	58,383
Unbilled usage .....	(211)
Materials and supplies inventory .....	(8,351)
Prepayments .....	(1,629)
Increase (decrease) in:	
Accounts payable .....	193,703
Accrued wages, vacations, and benefits .....	2,247
Accrued expenses .....	(1,700)
Total adjustments .....	<u>506,700</u>
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 <u>\$ 420,191</u>

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

Acquisition and construction of capital assets .....	\$ (661,784)
Contributions from developers .....	<u>249,138</u>
 Cash paid to acquire and construct capital assets	 <u>\$ (412,646)</u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

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

The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

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

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2005 has been completed and is filed under separate cover.

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

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

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

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

**B. Capital Assets and Depreciation**

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

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

Depreciation is provided on a straight-line basis. Current depreciation expense is approximately 2.66% of the original cost of depreciable water plant in service.

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

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

**C. Accounts Receivable**

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

**D. Inventories**

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

**E. Unamortized Bond Issue Costs**

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

**F. Net Assets**

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

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

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

**G. Income Taxes**

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

**H. Revenues and Unbilled Usage**

Revenues are based on billing rates, which are applied to customers' consumption of water. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2005, totaled \$34,011.

**I. Estimates**

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

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

The Utility's deposits in bank at December 31, 2005 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

The Utility had investments in Iowa Public Agency Investment Trust which are valued at an amortized cost of \$1,309,859 pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk - The Utility's investment policy limits the investment 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 investments 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 in the Iowa Public Agency Investment Trust is unrated.

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

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

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

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

Cash and cash equivalents:	
Board designated .....	\$ 2,098,106
Restricted .....	194,108
Unrestricted .....	<u>805,580</u>
Total cash and cash equivalents	<u>3,097,794</u>
Noncurrent investments:	
Board designated .....	<u>1,000,000</u>
Total noncurrent investments	<u>1,000,000</u>
 Total cash and cash equivalents and noncurrent investments	 <u>\$ 4,097,794</u>

**3. BOARD DESIGNATED FUNDS**

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

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

Assets of the funds as of December 31, 2005 are summarized as follows:

	Contingency <u>Reserve</u>	Replacement and Construction <u>Reserve</u>	<u>Total</u>
Cash and cash equivalents .....	\$ 469,106	\$1,629,000	\$2,098,106
Noncurrent investments .....	<u>                    </u>	<u>1,000,000</u>	<u>1,000,000</u>
Total	<u>\$ 469,106</u>	<u>\$2,629,000</u>	<u>\$3,098,106</u>

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**4. CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2005 was as follows:

	<u>Beginning Balance</u>	<u>Additions and Transfers In</u>	<u>Deletions and Transfers Out</u>	<u>Ending Balance</u>
Capital assets not being depreciated:				
Land .....	\$ 259,344			\$ 259,344
Construction in progress .....		\$ 2,992		2,992
Total capital assets not being depreciated	<u>259,344</u>	<u>2,992</u>		<u>262,336</u>
Capital assets being depreciated:				
Infrastructure .....	5,104,415	625,291		5,729,706
Buildings and equipment .....	3,700,153	33,501		3,733,654
Vehicles .....	150,914			150,914
Total capital assets being depreciated	<u>8,955,482</u>	<u>658,792</u>		<u>9,614,274</u>
Less accumulated depreciation ...	<u>5,005,902</u>	<u>263,034</u>		<u>5,268,936</u>
Total capital assets being depreciated - net .....	<u>3,949,580</u>	<u>395,758</u>		<u>4,345,338</u>
Capital assets - net	<u>\$ 4,208,924</u>	<u>\$ 398,750</u>		<u>\$4,607,674</u>

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

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

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

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

MUNICIPAL WATER UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 NOTES TO FINANCIAL STATEMENTS - Continued  
 DECEMBER 31, 2005

**7. NONCURRENT LIABILITIES**

Noncurrent liabilities activity for the year ended December 31, 2005 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Series 2001 revenue bonds .....	\$1,338,000	_____	\$ 58,000	\$1,280,000	\$61,000
Total revenue bonds	1,338,000		58,000	1,280,000	<u>\$61,000</u>
Current installments of revenue bonds payable .....	<u>(58,000)</u>	<u>\$ (3,000)</u>	_____	<u>(61,000)</u>	
Revenue bonds payable - less current installments .....	<u>\$1,280,000</u>	<u>\$ (3,000)</u>	<u>\$ 58,000</u>	<u>\$1,219,000</u>	

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

	<u>Series 2001</u>	
	<u>Principal</u>	<u>Interest</u>
2006 .....	\$ 61,000	\$ 48,941
2007 .....	63,000	46,560
2008 .....	65,000	44,102
2009 .....	68,000	41,549
2010 .....	70,000	38,900
2011 - 2015 .....	395,000	151,010
2016 - 2020 .....	477,000	67,567
2021 .....	<u>81,000</u>	<u>2,035</u>
Total	<u>\$1,280,000</u>	<u>\$ 440,664</u>

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

MUNICIPAL WATER UTILITY  
 OF THE CITY OF SPENCER, IOWA  
 NOTES TO FINANCIAL STATEMENTS - Continued  
 DECEMBER 31, 2005

**7. NONCURRENT LIABILITIES - Continued**

**Restricted Funds**

Outstanding Water Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. The Utility is in compliance with all significant financial requirements as of December 31, 2005.

At December 31, 2005, the special funds consisted of the following:

	<u>Total</u>
Bond Sinking Fund .....	\$ 79,108
Bond Reserve Fund .....	<u>115,000</u>
 Total	 <u>\$ 194,108</u>

Monthly deposits into the bond sinking fund are required to establish the amount necessary to pay the next installments of principal and interest. The bond reserve fund at December 31, 2005 equaled the required balance; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

**8. RATE MATTERS**

Rates of the Utility are established by the Board of Trustees and, as a municipal system, are not subject to the regulation of the Utilities Division of the Department of Commerce of the State of Iowa. On January 11, 2006, the Utility approved a rate increase for all consumption beginning on February 28, 2006.

**9. NUMBER OF METER CONNECTIONS**

The number of meter connections totaled 5,570 at December 31, 2005.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**10. LEASES**

The Utility leases building space to the Electric Utility and Communication Utility. The revenues from such leases are classified as leased facilities. The leases are monthly leases based on building space utilized and totaled \$9,974 in 2005. No amount is receivable at December 31, 2005.

The Utility leases bandwidth and building space from the Electric Utility. The expense from such leases is classified as operating expense. The lease is a 20-year variable lease based on bandwidth and space utilized and totaled \$23,035 in 2005. No amount is payable at December 31, 2005.

**11. RETIREMENT SYSTEM**

**IPERS**

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

Plan members are required to contribute 3.70% of their annual 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 to IPERS for the years ended December 31, 2005, 2004, and 2003 were \$14,133, \$12,341, and \$10,195, respectively, equal to the required contributions for each year.

**Employees Pension Plan**

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

The Water Utility's contribution to the Money Accumulation Pension Plan for 2005 totaled \$19,222.

MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**12. RISK MANAGEMENT**

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

**13. RELATED PARTIES**

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

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

Additional related party items are included in Note 10.

**14. COMMITMENTS**

During 2005, the Water Utility entered into a construction contract totaling approximately \$322,000 for maintenance to the distribution system to be completed in 2006. No amounts have been paid or accrued as of December 31, 2005.

REQUIRED SUPPLEMENTARY INFORMATION

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

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2005

	<u>Actual</u>	Budgeted Amounts <u>Final</u>	Final to Actual <u>Variance</u>
<b>Receipts:</b>			
Municipal Electric Utility .....	\$11,612,324		
Municipal Water Utility .....	1,094,784		
Municipal Communications Utility .....	<u>5,464,667</u>		
Combined receipts	<u>18,171,775</u>	\$17,837,918	\$ 333,857
<b>Disbursements, including capital outlay:</b>			
Municipal Electric Utility .....	16,260,229		
Municipal Water Utility .....	1,106,739		
Municipal Communications Utility .....	<u>4,885,445</u>		
Combined disbursements, including capital outlay	<u>22,252,413</u>	27,692,992	5,440,579
Transfers in .....		1,700,000	(1,700,000)
Transfers out .....	<u>                    </u>	<u>(1,700,000)</u>	<u>1,700,000</u>
Transfers - net	<u>                    </u>	<u>                    </u>	<u>                    </u>
Combined excess (deficit) of receipts over disbursements	(4,080,638)	(9,855,074)	5,774,436
Combined beginning net assets .....	<u>29,804,339</u>	<u>32,449,450</u>	<u>(2,645,111)</u>
<b>COMBINED ENDING NET ASSETS</b>	<b><u>\$25,723,701</u></b>	<b><u>\$22,594,376</u></b>	<b><u>\$ 3,129,325</u></b>
	<u>Original</u>	<u>Final</u>	
	<u>Budget</u>	<u>Budget</u>	
Total revenues and transfers in .....	\$18,291,830	\$19,537,918	
Total expenditures and transfers out .....	<u>27,194,185</u>	<u>29,392,992</u>	
Excess (deficit) of receipts over disbursements	(8,902,355)	(9,855,074)	
Beginning balance - January 1 .....	<u>32,449,450</u>	<u>32,449,450</u>	
Ending balance - December 31	<u>\$23,547,095</u>	<u>\$22,594,376</u>	

See Accompanying Independent Auditors' Report

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

**REQUIRED SUPPLEMENTARY INFORMATION**

YEAR ENDED DECEMBER 31, 2005

	<u>Cash Basis</u>	<u>Accrual Adjustments</u>	<u>Accrual Basis</u>
<b>Revenues:</b>			
Municipal Electric Utility .....	\$11,612,324	\$ (783,744)	\$10,828,580
Municipal Water Utility .....	1,094,784	190,966	1,285,750
Municipal Communications Utility .....	<u>5,464,667</u>	<u>842,210</u>	<u>6,306,877</u>
Combined revenues	<u>18,171,775</u>	<u>249,432</u>	<u>18,421,207</u>
<b>Expenditures/expenses:</b>			
Municipal Electric Utility .....	16,260,229	(4,978,187)	11,282,042
Municipal Water Utility .....	1,106,739	(24,405)	1,082,334
Municipal Communications Utility .....	<u>4,885,445</u>	<u>(558,845)</u>	<u>4,326,600</u>
Combined expenditures/expenses	<u>22,252,413</u>	<u>(5,561,437)</u>	<u>16,690,976</u>
Net	(4,080,638)	5,810,869	1,730,231
Combined beginning net assets .....	<u>29,804,339</u>	<u>22,013,094</u>	<u>51,817,433</u>
<b>COMBINED ENDING NET ASSETS</b>	<u><b>\$25,723,701</b></u>	<u><b>\$27,823,963</b></u>	<u><b>\$53,547,664</b></u>

See Accompanying Independent Auditors' Report

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING**

YEAR ENDED DECEMBER 31, 2005

**NOTE 1**

The budgetary comparison is presented as Required Supplementary Information in accordance with Government Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for each individual utility.

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

Formal and legal budgetary control is based upon nine major classes of disbursements, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business type activities. All Utility disbursements are included in business type activities function and are required to be budgeted. During the year, one budget amendment increased budgeted disbursements by \$2,198,807. This budget amendment is reflected in the final budgeted amounts.

**NOTE 2**

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

	Municipal Electric Utility	Municipal Water Utility	Municipal Communications Utility	Combined
Receipts .....	\$11,612,324	\$ 1,094,784	\$ 5,464,667	\$18,171,775
Disbursements, including capital outlay ..	<u>16,260,229</u>	<u>1,106,739</u>	<u>4,885,445</u>	<u>22,252,413</u>
Excess (deficit) of receipts over disbursements	(4,647,905)	(11,955)	579,222	(4,080,638)
Beginning net assets .....	<u>24,526,302</u>	<u>4,109,749</u>	<u>1,168,288</u>	<u>29,804,339</u>
<b>ENDING NET ASSETS</b>	<b><u>\$19,878,397</u></b>	<b><u>\$ 4,097,794</u></b>	<b><u>\$ 1,747,510</u></b>	<b><u>\$25,723,701</u></b>

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

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INDEPENDENT AUDITORS' 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

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

We have audited the financial statements of the Municipal Water Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2005, and have issued our report thereon dated March 20, 2006. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 over financial reporting 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, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards*.

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

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

*Wischer, Steve CG LHP*

March 20, 2006

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL WATER UTILITY  
SCHEDULE OF FINDINGS  
FOR THE YEAR ENDED DECEMBER 31, 2005

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

No matters were noted.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL WATER UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2005

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

- II-A-05 Official Depositories - A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2005.
- II-B-05 Certified Budget - Disbursements during the year ended December 31, 2005 did not exceed the amounts budgeted in the business type activities function.
- II-C-05 Questionable Expenditures - We noted no expenditures that we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- II-D-05 Travel Expenses - No expenditures of Utility's money for travel expenses of spouses of Utility's 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 Spencer Municipal Utilities' officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- II-G-05 Board Minutes - No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-H-05 Revenue Bonds - As of December 31, 2005, the Utility is in compliance with all significant financial requirements related to its Water Revenue Bond, Series 2001.
- II-I-05 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility's investment policy were noted.

**SPENCER MUNICIPAL UTILITIES**

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

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

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheet of the Municipal Communications Utility of the City of Spencer, Iowa (the Utility) as of December 31, 2005 and the related statements of revenues, expenses, and changes in net assets (deficit) and cash flows for the year then ended. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards 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 audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 20, 2006 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 60 through 62 and 73 through 75 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Winter, Stone & Co LLP*

March 20, 2006

## MANAGEMENT DISCUSSION AND ANALYSIS

The purpose of Management's Discussion and Analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Communications Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the year ended December 31, 2005.

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

### **2005 Financial Highlights**

Total assets increased by approximately \$950,000 which was primarily attributable to an increase in the cash balance, an increase in the accounts receivable balances related to increased telephone traffic, and larger carrier access billings. Total liabilities decreased by approximately \$1,030,000 due to payments on debt service and the timing of other accounts payable.

Total net assets increased by \$1,980,277, the result of the utility operations.

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

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

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

The statement of cash flows presents cash receipts, cash disbursements, and net changes in cash resulting from operating, noncapital financing, capital and related financing and investing activities.

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

MANAGEMENT DISCUSSION AND ANALYSIS - Continued

**Condensed Financial Information**

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

	<u>Condensed Balance Sheets</u>	
	<u>2005</u>	<u>2004</u>
Current assets .....	\$ 3,179,644	\$ 1,958,590
Capital assets - net of depreciation .....	5,628,596	6,072,126
Noncurrent assets .....	<u>207,705</u>	<u>34,773</u>
Total assets	<u>\$ 9,015,945</u>	<u>\$ 8,065,489</u>
Current liabilities .....	\$ 646,053	\$ 1,171,874
Long-term debt .....	<u>6,546,000</u>	<u>7,050,000</u>
Total liabilities	<u>7,192,053</u>	<u>8,221,874</u>
Investments in capital assets - net of related debt .....	(887,427)	(943,101)
Unrestricted .....	<u>2,711,319</u>	<u>786,716</u>
Total net assets (deficit)	<u>1,823,892</u>	<u>(156,385)</u>
Total liabilities and net assets	<u>\$ 9,015,945</u>	<u>\$ 8,065,489</u>

Condensed Statements of Revenues, Expenses and Changes in Net Assets (Deficit)

	<u>2005</u>	<u>2004</u>
Cable television revenue .....	\$ 896,456	\$ 806,118
Telephone revenue .....	4,414,616	3,662,453
Data services revenue .....	<u>597,168</u>	<u>432,499</u>
Total operating revenue	<u>5,908,240</u>	<u>4,901,070</u>
System operation and maintenance .....	2,477,795	2,064,225
Depreciation and amortization .....	905,617	775,268
Customer service and administration .....	<u>569,579</u>	<u>714,577</u>
Total operating expenses	<u>3,952,991</u>	<u>3,554,070</u>
Operating income	<u>1,955,249</u>	<u>1,347,000</u>
Interest income .....	51,064	12,685
Interest expense .....	(314,127)	(325,484)
Other income (expense) - net .....	<u>288,091</u>	<u>(6,895)</u>
Total non-operating income (expense)	<u>25,028</u>	<u>(319,694)</u>
Change in net assets	1,980,277	1,027,306
Net assets (deficit), beginning of year .....	<u>(156,385)</u>	<u>(1,183,691)</u>
Net assets (deficit), end of year	<u>\$ 1,823,892</u>	<u>\$ (156,385)</u>

## MANAGEMENT DISCUSSION AND ANALYSIS - Continued

### **Financial Analysis**

The Utility's total assets increased by approximately \$950,000 during 2005.

The Utility's gross revenues increased in 2005 compared to 2004 by approximately \$1,007,000 or 20.53%.

Total operating expenses increased in 2005 compared to 2004 by approximately \$399,000 because of increased expenses for cable programming, telephone long distance and due to an increase in the number of subscribers. Depreciation and amortization expense also increased by approximately \$130,000. Customer service and administration expense was lower due to payroll overheads being charged to the respective payroll account instead of administration expense.

Total operating income generated in 2005 was approximately \$1,955,000 compared to approximately \$1,347,000 in 2004.

The Utility's net assets increased \$1,980,277 for the year ended December 31, 2005 compared to an increase of \$1,027,306 for the year ended December 31, 2004.

### **Budgetary Highlights**

In accordance with the Code of Iowa, Spencer Municipal Utilities annually adopts a combined budget on the cash basis for the Municipal Electric Utility, Municipal Water Utility, and Municipal Communications Utility of the City of Spencer, Iowa.

The original adopted combined budget for 2005 was approximately \$25,500,000. This was an increase of \$12,600,000 over the previous year budget. The budget was amended once during 2005 to allow for increased expenditures of approximately \$2,200,000.

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

Net capital assets decreased by approximately \$448,000 due to depreciation expense being greater than capital purchases for the year ended December 31, 2005.

During 2005, principal of \$504,000 was repaid on a note payable to the Municipal Electric Utility, resulting in a balance of \$6,546,000 at December 31, 2005.

### **Economic Factors**

The Utility continues to see positive growth in subscriber base and also net income. The Utility will be faced with increased costs of operating due to cable programming contracts.

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

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

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
BALANCE SHEET  
DECEMBER 31, 2005

ASSETS

CURRENT ASSETS:	
Cash and cash equivalents (Note 2) .....	\$ 1,747,510
Accounts receivable - net of allowance for doubtful accounts of \$25,000 .....	995,036
Consumer deposits .....	34,034
Materials and supplies inventory .....	45,614
Prepayments .....	91,395
Unbilled usage .....	<u>266,055</u>
TOTAL CURRENT ASSETS	\$ 3,179,644
UNAMORTIZED DEFERRED COSTS .....	29,977
CAPITAL ASSETS (Note 3):	
Plant in service .....	8,777,190
Less accumulated depreciation .....	<u>3,148,594</u>
CAPITAL ASSETS - NET	5,628,596
LONG-TERM RECEIVABLE - NICP (Note 5) .....	<u>177,728</u>
TOTAL ASSETS	<u>\$ 9,015,945</u>

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES:	
Accounts payable .....	\$ 546,068
Accrued wages, vacations, and benefits .....	51,865
Consumer deposits .....	34,034
Accrued expenses .....	<u>14,086</u>
TOTAL CURRENT LIABILITIES	\$ 646,053
NONCURRENT LIABILITIES:	
Long-term debt (Note 6) .....	<u>6,546,000</u>
COMMITMENTS AND CONTINGENCIES (Note 11) .....	
TOTAL LIABILITIES	7,192,053
NET ASSETS:	
Invested in capital assets - net of related debt .....	(887,427)
Unrestricted .....	<u>2,711,319</u>
TOTAL NET ASSETS	<u>1,823,892</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 9,015,945</u>

See Accompanying Notes to Financial Statements

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (DEFICIT)  
FOR THE YEAR ENDED DECEMBER 31, 2005

REVENUE:		
Cable system revenue .....	\$ 896,456	
Telephone system revenue .....	4,414,616	
Data services revenue .....	<u>597,168</u>	
TOTAL REVENUES		\$ 5,908,240
OPERATING EXPENSES:		
Plant specific and programming .....	2,477,795	
Depreciation and amortization .....	905,617	
Customer services and marketing .....	335,555	
General and administrative .....	<u>234,024</u>	
TOTAL OPERATING EXPENSES		<u>3,952,991</u>
INCOME FROM OPERATIONS		1,955,249
NON-OPERATING INCOME (EXPENSE):		
Miscellaneous income .....	347,573	
Economic development payments .....	(40,000)	
Transfers to City in lieu of property taxes .....	(19,482)	
Interest income .....	51,064	
Interest expense .....	<u>(314,127)</u>	
TOTAL NON-OPERATING INCOME (EXPENSE) - NET		<u>25,028</u>
CHANGE IN NET ASSETS		1,980,277
NET ASSETS (DEFICIT) - DECEMBER 31, 2004 .....		<u>(156,385)</u>
NET ASSETS - DECEMBER 31, 2005		<u>\$ 1,823,892</u>

See Accompanying Notes to Financial Statements

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2005

CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from customers .....	\$ 5,243,758
Cash paid to suppliers .....	(2,695,865)
Cash paid to employees .....	(541,102)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>2,006,791</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Contributions paid for economic development .....	(40,000)
Transfer to City - in lieu of property tax .....	(19,482)
NET CASH USED BY NONCAPITAL FINANCING ACTIVITIES	<u>(59,482)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition and construction of capital assets .....	(457,291)
Payments received from leasing of facilities .....	169,845
Repayment of long-term debt .....	(504,000)
Interest paid .....	(627,705)
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(1,419,151)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest received from investments .....	51,064
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>51,064</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	579,222
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR .....	<u>1,168,288</u>
CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 1,747,510</u>

See Accompanying Notes to Financial Statements

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENT OF CASH FLOWS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2005

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Income from operations .....	<u>\$ 1,955,249</u>
Adjustments to reconcile income from operations to net cash provided by operating activities:	
Depreciation .....	900,821
Amortization .....	4,796
(Increase) decrease in:	
Consumer deposits .....	(1,051)
Accounts receivable .....	(607,406)
Unbilled usage .....	(57,263)
Materials and supplies inventory .....	(24,350)
Prepayments .....	48,238
Increase (decrease) in:	
Accounts payable .....	(204,084)
Accrued wages, vacations, and benefits .....	9,302
Consumer deposits .....	1,238
Accrued expenses .....	(18,699)
Total adjustments .....	<u>51,542</u>
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 <u>\$ 2,006,791</u>

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2005

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

The Municipal Communications Utility of the City of Spencer, Iowa (Communications Utility or Utility) operates as an independent unit of the City of Spencer and is managed, along with the Municipal Electric Utility and the Municipal Water Utility of the City of Spencer, Iowa, by a five member Board of Trustees. The Utility was formed to engage in the development and operation of a broadband communications system and the marketing of related services such as cable television, telephone, and high-speed data communications. The Utility's rates are set by its governing board.

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

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes. An audit of the City of Spencer for the year ended June 30, 2005 has been completed and is filed under separate cover.

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

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

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

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

**B. Capital Assets and Depreciation**

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

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

Depreciation is calculated on the straight-line basis. Current depreciation expense is approximately 10.26% of the original cost of depreciable communication plant in service.

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

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

**C. Accounts Receivable**

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

**D. Inventories**

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

**E. Unamortized Deferred Costs**

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

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

**F. Net Assets**

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

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

**G. Income Taxes**

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

**H. Revenues and Unbilled Usage**

Revenues are based on billing rates, which are applied to customers' consumption of communications services. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2005, totaled \$266,055.

**I. Estimates**

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

**2. CASH AND CASH EQUIVALENTS**

The utility's deposits in banks at December 31, 2005 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

Interest Rate Risk - The Utility's investment policy limits the investment 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 investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Utility.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

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

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

**3. CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2005 was as follows:

	<u>Beginning Balance</u>	<u>Additions and Transfers In</u>	<u>Deletions and Transfers Out</u>	<u>Ending Balance</u>
Capital assets not being depreciated:				
Land .....	\$ 10,342	_____	_____	\$ 10,342
Total capital assets not being depreciated	<u>10,342</u>	_____	_____	<u>10,342</u>
Capital assets being depreciated:				
Infrastructure .....	7,499,751	\$ 422,187		7,921,938
Buildings and improvements ....	8,284	5,466		13,750
Equipment .....	<u>801,522</u>	<u>29,638</u>	_____	<u>831,160</u>
Total capital assets being depreciated	<u>8,309,557</u>	<u>457,291</u>	_____	<u>8,766,848</u>
Less accumulated depreciation ...	<u>2,247,773</u>	<u>900,821</u>	_____	<u>3,148,594</u>
Total capital assets being depreciated - net .....	<u>6,061,784</u>	<u>(443,530)</u>	_____	<u>5,618,254</u>
Capital assets - net	<u>\$ 6,072,126</u>	<u>\$ (443,530)</u>	<u>\$ _____</u>	<u>\$5,628,596</u>

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

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Funds totaling \$19,482 were transferred to the City during 2005.

**5. LONG-TERM RECEIVABLE - NICP**

During December 2003, the Utility entered into an agreement with Northern Iowa Communications Partners, L.L.C. (NICP), an Iowa limited liability company, pursuant to the provisions of Chapter 28E of the Code of Iowa. Under this agreement, the Utility, along with other members of NICP, agrees to pay for the use of a shared switch for routing certain telecommunications traffic at rates adopted by NICP. The Utility will share in profits generated or shortfalls incurred through the 28E agreement due to the method used to determine an annual usage fee paid by NICP to the Utility. An NICP member will be responsible for maintaining the financial records related to the 28E agreement. The amount earned but not received by the Utility of \$177,728 is recorded as a receivable.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**6. NONCURRENT LIABILITIES**

Noncurrent liabilities activity for the year ended December 31, 2005 was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Note payable - Municipal Electric Utility .....	<u>\$7,050,000</u>	<u>          </u>	<u>\$504,000</u>	<u>\$6,546,000</u>	<u>          </u>

The Board of Trustees of the Municipal Electric Utility adopted a resolution on June 14, 1999, pursuant to Section 384.89 City Code of Iowa and Rule 2.5(5) of the rules promulgated by the City Finance Committee, allowing for the advance of funds not to exceed \$8,000,000 to the Municipal Communications Utility to be utilized for the construction and development of the communication system. These funds are to be repaid upon demand and bear a 4.5% per annum interest rate. No interest was payable at December 31, 2005.

**7. LEASES**

The Utility leases building space from the Water Utility. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized and totaled \$1,974 in 2005. No amount is payable at December 31, 2005.

The Utility leases bandwidth, property, and building space from the Electric Utility. The expense from the lease is classified as operating expense. The lease is a 20-year variable lease based on bandwidth and space utilized and totaled \$386,386 in 2005. No amount is payable at December 31, 2005.

**8. RETIREMENT SYSTEM**

**IPERS**

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

Plan members are required to contribute 3.70% of their annual 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 to IPERS for the years ended December 31, 2005, 2004, and 2003 were \$27,831, \$32,050, and \$26,291, respectively, equal to the required contributions for each year.

MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS - Continued  
DECEMBER 31, 2005

**8. RETIREMENT SYSTEM - Continued**

**Employees Pension Plan**

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

The Communications Utility's contribution to the Money Accumulation Pension Plan for 2005 totaled \$35,001.

**9. RISK MANAGEMENT**

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

**10. RELATED PARTIES**

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

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

Additional related party items are included in Notes 5, 6, and 7.

**11. COMMITMENTS**

The Utility has committed to provide annual support of \$28,000 to the Clay Regional Events Center during 2006 and 2007. The support is contingent on the Events Center receiving additional support from other area sources.

During 2005, the Communication Utility provided a letter of support to continue funding Iowa Great Lakes Corridor of Opportunity at a level of \$12,500 per year for four years.

**REQUIRED SUPPLEMENTARY INFORMATION**

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

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2005

	<u>Actual</u>	<u>Budgeted Amounts Final</u>	<u>Final to Actual Variance</u>
<b>Receipts:</b>			
Municipal Electric Utility .....	\$11,612,324		
Municipal Water Utility .....	1,094,784		
Municipal Communications Utility .....	<u>5,464,667</u>		
Combined receipts	<u>18,171,775</u>	\$17,837,918	\$ 333,857
<b>Disbursements, including capital outlay:</b>			
Municipal Electric Utility .....	16,260,229		
Municipal Water Utility .....	1,106,739		
Municipal Communications Utility .....	<u>4,885,445</u>		
Combined disbursements, including capital outlay	<u>22,252,413</u>	27,692,992	5,440,579
Transfers in .....		1,700,000	(1,700,000)
Transfers out .....		<u>(1,700,000)</u>	<u>1,700,000</u>
Transfers - net			
Combined excess (deficit) of receipts over disbursements	(4,080,638)	(9,855,074)	5,774,436
Combined beginning net assets .....	<u>29,804,339</u>	<u>32,449,450</u>	<u>(2,645,111)</u>
<b>COMBINED ENDING NET ASSETS</b>	<b><u>\$25,723,701</u></b>	<b><u>\$22,594,376</u></b>	<b><u>\$ 3,129,325</u></b>
	<u>Original Budget</u>	<u>Final Budget</u>	
Total revenues and transfers in .....	\$18,291,830	\$19,537,918	
Total expenditures and transfers out .....	<u>27,194,185</u>	<u>29,392,992</u>	
Excess (deficit) of receipts over disbursements	(8,902,355)	(9,855,074)	
Beginning balance - January 1 .....	<u>32,449,450</u>	<u>32,449,450</u>	
Ending balance - December 31	<u>\$23,547,095</u>	<u>\$22,594,376</u>	

See Accompanying Independent Auditors' Report

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

REQUIRED SUPPLEMENTARY INFORMATION

YEAR ENDED DECEMBER 31, 2005

	<u>Cash Basis</u>	<u>Accrual Adjustments</u>	<u>Accrual Basis</u>
<b>Revenues:</b>			
Municipal Electric Utility .....	\$11,612,324	\$ (783,744)	\$10,828,580
Municipal Water Utility .....	1,094,784	190,966	1,285,750
Municipal Communications Utility .....	<u>5,464,667</u>	<u>842,210</u>	<u>6,306,877</u>
Combined revenues	<u>18,171,775</u>	<u>249,432</u>	<u>18,421,207</u>
<b>Expenditures/expenses:</b>			
Municipal Electric Utility .....	16,260,229	(4,978,187)	11,282,042
Municipal Water Utility .....	1,106,739	(24,405)	1,082,334
Municipal Communications Utility .....	<u>4,885,445</u>	<u>(558,845)</u>	<u>4,326,600</u>
Combined expenditures/expenses	<u>22,252,413</u>	<u>(5,561,437)</u>	<u>16,690,976</u>
Net	(4,080,638)	5,810,869	1,730,231
Combined beginning net assets .....	<u>29,804,339</u>	<u>22,013,094</u>	<u>51,817,433</u>
<b>COMBINED ENDING NET ASSETS</b>	<b><u>\$25,723,701</u></b>	<b><u>\$27,823,963</u></b>	<b><u>\$53,547,664</u></b>

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING**

**YEAR ENDED DECEMBER 31, 2005**

**NOTE 1**

The budgetary comparison is presented as Required Supplementary Information in accordance with Government Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for each individual utility.

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

Formal and legal budgetary control is based upon nine major classes of disbursements, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business type activities. All Utility disbursements are included in business type activities function and are required to be budgeted. During the year, one budget amendment increased budgeted disbursements by \$2,198,807. This budget amendment is reflected in the final budgeted amounts.

**NOTE 2**

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

	Municipal Electric Utility	Municipal Water Utility	Municipal Communications Utility	Combined
Receipts .....	\$11,612,324	\$ 1,094,784	\$ 5,464,667	\$18,171,775
Disbursements, including capital outlay ..	<u>16,260,229</u>	<u>1,106,739</u>	<u>4,885,445</u>	<u>22,252,413</u>
Excess (deficit) of receipts over disbursements	(4,647,905)	(11,955)	579,222	(4,080,638)
Beginning net assets .....	<u>24,526,302</u>	<u>4,109,749</u>	<u>1,168,288</u>	<u>29,804,339</u>
<b>ENDING NET ASSETS</b>	<b><u>\$19,878,397</u></b>	<b><u>\$ 4,097,794</u></b>	<b><u>\$ 1,747,510</u></b>	<b><u>\$25,723,701</u></b>

**WINTHER, STAVE & CO., LLP**  
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**INDEPENDENT AUDITORS' 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**

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

We have audited the financial statements of the Municipal Communications Utility of the City of Spencer, Iowa (the Utility) as of and for the year ended December 31, 2005, and have issued our report thereon dated March 20, 2006. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 over financial reporting 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, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Governmental Auditing Standards*.

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

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

*Winter, Steve HC RHP*

March 20, 2006

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL COMMUNICATIONS UTILITY  
SCHEDULE OF FINDINGS  
FOR THE YEAR ENDED DECEMBER 31, 2005

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

No matters were noted.

SPENCER MUNICIPAL UTILITIES  
MUNICIPAL COMMUNICATIONS UTILITY  
SCHEDULE OF FINDINGS - Continued  
FOR THE YEAR ENDED DECEMBER 31, 2005

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

II-A-05 Official Depositories - A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2005.

II-B-05 Certified Budget - Disbursements during the year ended December 31, 2005 did not exceed the amounts budgeted in the business type activities function.

II-C-05 Questionable Expenditures - No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

II-D-05 Travel Expenses - No expenditures of Utility's money for travel expenses of spouses of Utility's officials or employees were noted.

II-E-05 Business Transactions - Business transactions between the Utility and Utility officials or employees are detailed as follows:

<u>Name, Title and Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
Tom Howe, Board Member Part owner of H & N Chevrolet	Maintenance & Repairs	\$ 1,351

In accordance with Chapter 362.5(10) of the Code of Iowa, the transactions with the Board Member do not appear to represent a conflict of interest since the transactions were less than \$1,500 during the year.

II-F-05 Bond Coverage - Surety bond coverage of Spencer Municipal Utilities' officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

II-G-05 Board Minutes - No transactions were found that we believe should have been approved in the Board minutes but were not.

II-H-05 Revenue Bonds/Notes - No revenue bonds/notes were issued to the Utility.

II-I-05 Deposits and Investments - No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility's investment policy were noted.

II-J-05 Telecommunication Services - No instances of noncompliance with Chapter 388.10 of the Code of Iowa were noted.