

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY

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

DECEMBER 31, 2005

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CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY

Independent Auditors' Report

Honorable Mayor and City Council
City of Estherville, Iowa

We have audited the accompanying basic financial statements of the Municipal Electric Utility, City of Estherville, Iowa as of and for the year ended December 31, 2005. These financial statements are the responsibility of the City of Estherville's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with 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 basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statements presentation. We believe our audit provides a reasonable basis for our opinion.

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

In our opinion, except for the effects of an incomplete inventory, as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Electric Utility, City of Estherville, Iowa at December 31, 2005, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated March 6, 2006 on our consideration of the Municipal Electric Utility, City of Estherville, Iowa's internal control over financial reporting and our tests of its compliance with certain

provisions of laws, regulations and contracts 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 on pages 7 through 10 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information on pages 30 and 31 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

Brinkman & Reed, CPA's

Brinkman & Reed, CPA's

March 6, 2006

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY

CITY OF ESTHERVILLE
MUNICIPAL ELECTRIC UTILITY
DECEMBER 31, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

This narrative overview and analysis of the financial activities of the Electric Utility is for the calendar year ending December 31, 2005. We encourage readers to consider the information in conjunction with the financial statements.

This is the second fiscal year the City has implemented new reporting standards with significant changes in content and structure. The City was required to comply with Government Standard Board Statement No. 34 (GASB-34), which mandated the changes. Theoretically, comparisons may be more meaningful and go further in explaining the Electric Utility's financial position and results of operations.

2005 FINANCIAL HIGHLIGHTS

Operating revenue of the Electric Utility increased 8.6% or \$318,997 from 2004 to 2005. The primary reason for the change was an increase in energy sales of 5,550,000 kilowatt hours or 10.3%.

Operating expenses increased 10.4% or \$333,658 from 2004 to 2005. The majority of this change was related to the increase in purchased power costs, more kWh's purchased and a higher cost per kWh.

The Electric Utility's net assets increased \$433,394 or 7.9% from 2004 to 2005.

USING THIS ANNUAL REPORT

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

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

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

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

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

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

Supplementary information further explains and supports the financial statements.

FINANCIAL ANALYSIS

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

| Net Assets | | |
|-------------------------------|-------------------------|--------------------|
| | Year ended December 31, | |
| | 2005 | 2004 |
| Current Assets & Other Assets | \$3,134,738 | \$3,090,846 |
| Capital Assets | <u>3,184,975</u> | <u>2,691,061</u> |
| Total Assets | <u>\$6,319,713</u> | <u>\$5,781,907</u> |
| Long Term Liabilities | \$ -0- | \$ -0- |
| Current Liabilities | <u>392,713</u> | <u>288,301</u> |
| Total Liabilities | <u>\$ 392,713</u> | <u>\$ 288,301</u> |
| Net Assets: | | |
| Invested in Capital Assets | \$3,070,491 | \$2,655,146 |
| Unrestricted | <u>2,856,509</u> | <u>2,838,460</u> |
| Total Net Assets | <u>\$5,927,000</u> | <u>\$5,493,606</u> |

Net assets increased from 2004 by approximately \$433,400, or 7.9%. The largest portion of the net assets is the investment in capital assets (e.g., land, infrastructure, buildings, and equipment). Unrestricted net assets is the part of net assets that can be used to finance day-to-day operations without constraints.

| Changes in Net Assets | | |
|--------------------------------------|-------------------------|--------------------|
| | Year ended December 31, | |
| | 2005 | 2004 |
| Revenues: | | |
| Operating Revenues: | | |
| Charges for service, sales, and rent | \$4,016,498 | \$3,697,501 |
| Non-operating revenues: | | |
| Investment earnings | <u>59,435</u> | <u>27,847</u> |
| Total revenues | <u>\$4,075,933</u> | <u>\$3,725,348</u> |
| Operating expenses: | | |
| Generation | \$1,987,093 | \$1,765,007 |
| Distribution | 611,975 | 558,708 |
| General and administration | 930,513 | 872,208 |
| Non-operating expenses: | | |
| Interest expense | 3,123 | 2,972 |
| Other non-operating expense | 3,410 | 138,589 |
| Transfers, net | <u>106,425</u> | <u>58,269</u> |
| Total expense and transfers | <u>\$3,642,539</u> | <u>\$3,395,753</u> |
| Increase in net assets | \$ 433,394 | \$ 329,595 |
| Net assets beginning of year | <u>\$5,493,606</u> | <u>\$5,164,011</u> |
| Net assets end of year | <u>\$5,927,000</u> | <u>\$5,493,606</u> |

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The Electric Utilities capital assets include land, buildings and improvements, and equipment. Capital assets totaled \$3,184,975 (net of accumulated depreciation) at December 31, 2005. See note 7 to the financial statements for more information about the capital assets.

Debt Administration

The Electric Utility has no long-term debt outstanding. The utility does hold customer deposits totaling \$69,622.

ECONOMIC FACTORS BEARING ON THE ELECTRIC UTILITY'S FUTURE

The proposed fiscal year 2007 budget includes a recommendation to increase electric rates. The last rate increase was made in 1984.

The following items are the basis for the recommendation:

The cost of energy received from Corn Belt Power Cooperative/Iowa Lakes Electric Cooperative has increased on January 1 in each of the last three (3) years. Corn Belt Power has also provided notice of termination of the current wholesale power agreement effective January 1, 2007. In addition, Western Area Power Administration (WAPA) increased their rate on January 1, 2006 and another increase will become effective January 1, 2007. The budgeted ending balance for the Electric Fund declines to less than \$300,000 on June 30, 2007.

The Electric Utility's budget increases \$160,000 in the upcoming fiscal year due to the increased cost of purchased power.

CONTACTING THE ELECTRIC UTILITY'S FINANCIAL MANAGEMENT

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

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY

Basic Financial Statements

City of Estherville, Iowa
Municipal Electric Utility
Statement of Net Assets
December 31, 2005

Exhibit A

Assets

Current Assets:

| | |
|--|------------------|
| Cash and Cash Equivalents | \$ 1,444,095 |
| Appropriated Cash - Equipment Sinking Fund | 138,931 |
| Designated Cash | 83,826 |
| Receivables: | |
| Accounts | 351,184 |
| Accounts - City of Estherville | 21,487 |
| Accrued Interest | 1,749 |
| Fuel and Lube Oil Inventory | 16,081 |
| Distribution Plant Inventory | 424,003 |
| Prepaid Insurance | <u>23,516</u> |
| Total Current Assets | <u>2,504,872</u> |

Noncurrent Assets:

| | |
|--|------------------|
| Designated Investments | 514,840 |
| Investment in Joint Venture | 115,026 |
| Capital Assets (Net of Accumulated Depreciation) | <u>3,184,975</u> |
| Total Noncurrent Assets | <u>3,814,841</u> |

| | |
|---------------------|-------------------------|
| Total Assets | <u>6,319,713</u> |
|---------------------|-------------------------|

Liabilities

Current Liabilities:

| | |
|---------------------------|--------------|
| Accounts Payable | 296,124 |
| Customer Deposits | 69,622 |
| Accrued Payroll | 18,407 |
| Accrued Sales and Use Tax | <u>8,560</u> |

| | |
|--------------------------|-----------------------|
| Total Liabilities | <u>392,713</u> |
|--------------------------|-----------------------|

Net Assets

| | |
|----------------------------|------------------|
| Invested in Capital Assets | 3,070,491 |
| Unrestricted | <u>2,856,509</u> |

| | |
|-------------------------|---------------------------|
| Total Net Assets | <u>\$5,927,000</u> |
|-------------------------|---------------------------|

See notes to financial statements.

City of Estherville, Iowa
Municipal Electric Utility
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended December 31, 2005

Exhibit B

Operating Revenues:

| | |
|---|------------------|
| Sales of Electricity to Customers | |
| Residential Sales | \$1,547,226 |
| Commerical Sales - Large | 1,114,768 |
| Commerical Sales - Small | 576,001 |
| Industrial Sales | 374,689 |
| Customer Service and Other Sales | <u>115,265</u> |
| Total Sales to Customers | <u>3,727,949</u> |
| Service to City | |
| Various Departments | <u>253,198</u> |
| Other Operating Revenues | |
| Sales of Service Work, Material and Miscellaneous | 35,331 |
| Rent and Sales of Property | <u>20</u> |
| Total Other Operating Revenues | <u>35,351</u> |
| Total Operating Revenues | 4,016,498 |

Operating Expenses:

| | |
|------------------------------------|------------------|
| Generation Expense | |
| Purchased Power - Net | 1,647,076 |
| Salaries | 141,985 |
| Utilities | 52,369 |
| Depreciation | 42,996 |
| Employee Insurance | 38,718 |
| Repairs and Maintenance | 21,787 |
| Payroll Taxes and IPERS | 18,230 |
| Fuel Oil | 11,235 |
| Natural Gas Fuel | 8,661 |
| Capital Improvements | 2,452 |
| Transportation and Vehicle Expense | 905 |
| Building and Structures | 547 |
| Operating Supplies and Expense | <u>132</u> |
| Total Generation Expense | <u>1,987,093</u> |

See notes to financial statements.

City of Estherville, Iowa
Municipal Electric Utility
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended December 31, 2005

Exhibit B

Operating Expenses - Continued

Distribution Expense

| | |
|---|----------------|
| Salaries | \$ 327,885 |
| Depreciation | 100,676 |
| Employee Insurance | 58,452 |
| Payroll Taxes and IPERS | 42,593 |
| Transportation and Vehicle Expense | 30,058 |
| Housing Grant | 14,000 |
| Capital Utility Improvements | 10,673 |
| Operating Supplies and Expense | 10,085 |
| Utilities | 7,686 |
| Equipment Repair | 3,548 |
| Building and Structures | 3,353 |
| Maintenance of Street and Traffic Lights & Supplies | 1,652 |
| Maintenance of Lines & Supplies | 1,314 |
| Total Distribution Expense | <u>611,975</u> |

Accounting and Collection Expenses

| | |
|---|----------------|
| Reimbursement to City for Expense | 333,750 |
| Meter Supplies | 5,352 |
| Total Accounting and Collection Expense | <u>339,102</u> |

Administration and General Expenses

| | |
|---|----------------|
| Payment in Lieu of Taxes | 439,544 |
| Insurance | 39,765 |
| Franchise Fees | 38,867 |
| Professional Services | 37,580 |
| Dues and Other Expenses | 35,655 |
| Total Administration and Collection Expense | <u>591,411</u> |

| | |
|-------------------------|------------------|
| Total Operating Expense | <u>3,529,581</u> |
|-------------------------|------------------|

| | |
|----------------------|---------|
| Net Operating Income | 486,917 |
|----------------------|---------|

See notes to financial statements.

City of Estherville, Iowa
Municipal Electric Utility
Statement of Revenues, Expenses and Changes in Net Assets
Year Ended December 31, 2005

Exhibit B

| | |
|--|--------------------|
| Non-Operating Revenues (Expenses): | |
| Interest Income | \$ 59,435 |
| Interest Expense | (3,123) |
| Loss on Wind Generation Project | <u>(3,410)</u> |
| Net Non-Operating Revenues | <u>52,902</u> |
| | |
| Change in Net Assets | 539,819 |
| | |
| Net Assets Beginning of Year | 5,493,606 |
| | |
| Add: Transfers From Other City Funds - Net | 168,825 |
| Less: Transfers To Other City Funds - Net | <u>(275,250)</u> |
| | |
| Net Assets End of Year | <u>\$5,927,000</u> |

See notes to financial statements.

City of Estherville, Iowa
Municipal Electric Utility
Statement of Cash Flows
Year Ended December 31, 2005

Exhibit C

| | |
|---|--------------------|
| Cash Flows From Operating Activities: | |
| Cash Received From Sales of Electricity to Customers | 3,677,492 |
| Cash Received From Service to City | 248,909 |
| Cash Received From Other Operating Revenues | 22,793 |
| Cash Paid to Suppliers for Goods and Services | (2,000,902) |
| Cash Paid to Employees for Services | (468,874) |
| Cash Paid to City for Payments in Lieu of Taxes | (439,544) |
| Cash Paid to City for Reimbursement of Expense | <u>(333,750)</u> |
| Net Cash Provided By Operating Activities | <u>706,124</u> |
| Cash Flows From Noncapital Financing Activities: | |
| Transfers from Other Funds | 168,825 |
| Transfers to Other Funds | <u>(275,250)</u> |
| Net Cash Used By Noncapital Financing Activities | <u>(106,425)</u> |
| Cash Flows From Capital and Related Financing Activities: | |
| Purchase of Capital Assets - Distribution | (421,825) |
| Purchase of Capital Assets - Generation | <u>(215,759)</u> |
| Net Cash Used By Capital and Related Financing Activities | <u>(637,584)</u> |
| Cash Flows From Investing Activities: | |
| Interest Income | 58,909 |
| Interest Expense | (2,110) |
| Loss on Wind Generation Project | <u>(3,100)</u> |
| Net Cash Provided By Investing Activities | <u>53,699</u> |
| Net Increase in Cash and Cash Equivalents | 15,814 |
| Cash and Cash Equivalents Beginning of Year | <u>1,651,038</u> |
| Cash and Cash Equivalents End of Year | <u>\$1,666,852</u> |
| Reconciliation of Operating Income to Net Cash Provided by Operating Activities: | |
| Operating Income | <u>\$ 486,917</u> |
| Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities: | |
| Depreciation | 143,672 |
| Changes in Assets and Liabilities: | |
| (Increase) in Accounts Receivable | (67,304) |
| Decrease in Inventory | 36,120 |
| Decrease in Prepaid Insurance | 3,452 |
| Increase in Accounts Payable | 100,042 |
| Increase in Customer Deposits Payable | 3,365 |
| Increase in Accrued Payroll | 996 |
| (Decrease) in Sales and Use Tax Payable | <u>(1,136)</u> |
| Total Adjustments | <u>219,207</u> |
| Net Cash Provided By Operating Activities | <u>\$ 706,124</u> |

See notes to financial statements.

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(1) Summary of Significant Accounting Policies

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

A. Reporting Entity

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

B. Basis of Presentation

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

C. Measurement Focus and Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

Measurement Focus and Basis of Accounting – Continued

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

The Utility distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

D. Assets, Liabilities and Net Investments

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

Cash, Investments and Cash Equivalents – The Utility considers all short-term investments that are highly liquid to be cash equivalents. Cash equivalents are readily convertible to known amounts of cash and, at the day of purchase, have a maturity date no longer than three months. Cash investments not meeting the definition of cash equivalents at December 31, 2005 include certificates of deposit of \$514,840.

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

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

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

Capital Assets - Continued

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

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

Interest is capitalized on qualified assets acquired with certain tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project with interest earned on invested proceeds over the same period. There were no qualifying assets acquired during the year ended December 31, 2005.

Compensated Absences – Utility employees accumulate a limited amount of earned but unused vacation hours for subsequent use or for payment upon termination, death or retirement. The Utility had no vacation payable at December 31, 2005.

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

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

(2) Cash and Investments

The Utility's deposits in banks at December 31, 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 depositories to insure there will be no loss of public funds.

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(2) Cash and Investments – Continued

The Utility is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Utility; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

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

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

The City of Estherville owns an 8% interest in the project and at December 31, 2005 and 2004 had a net investment of \$115,026. At this time, the City does not anticipate a need for much additional financial investment. The energy produced by the IDWGP will be apportioned among the parties based on their percentages of ownership. On November 19, 1998, the City entered into a two year agreement to sell its share of the generation from the IDWGP to Cedar Falls Utilities. The City was to receive payments for its generation on a semiannual basis as follows: Annual Payment = (Actual Operating Costs) + (Net Capital Cost) x (8.72%). This agreement has not been fulfilled as Cedar Falls Utilities has found the cost to deliver this energy to them is too high. Currently, Algona Municipal Utilities is purchasing the generated power at their avoided cost which has been determined to be \$.01517/KWH and \$.01213/KWH at December 31, 2005 and 2004 respectively. It has not been determined how long this arrangement will continue.

(3) Equipment Sinking Fund

City officials have established an “Equipment Sinking Fund”. This fund is increased by monthly deposits from various city departments; with purchases being made from the fund for vehicles and equipment. The Utility department’s 2005 balances and transactions are as follows:

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(3) Equipment Sinking Fund - Continued

| | Generation <u>Plant</u> | Distribution <u>Department</u> | <u>Total</u> |
|---------------------------|----------------------------|-----------------------------------|-------------------|
| Balance December 31, 2004 | \$ 4,200 | \$ 69,732 | \$ 73,932 |
| Deposits to Fund 2005 | - | 64,999 | 64,999 |
| Disbursements 2005 | <u>-</u> | <u>-</u> | <u>-</u> |
| Balance December 31, 2005 | <u>\$ 4,200</u> | <u>\$ 134,731</u> | <u>\$ 138,931</u> |

(4) Pension and Retirement Benefits

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

Plan members are required to contribute 3.70% of their annual covered salary and the City is required to contribute 5.75% of annual covered payroll for the years ended December 31, 2005, 2004 and 2003. Contribution requirements are established by state statute. The City's contributions to IPERS for years ended December 31, 2005, 2004 and 2003 were \$26,818, \$25,791, and \$24,030, respectively, equal to the required contributions for each year for the Municipal Electric Utility.

(5) Designated Cash

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

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

City officials and employees have estimated the Utility's share of accounting and collection expenses to be \$333,750 in 2005.

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(7) Capital Assets

A summary of capital assets at December 31, 2005 is as follows:

| | Balance Beginning of Year | Increases | Decreases | Balance End of Year |
|---|---------------------------------|-------------------|-------------|---------------------------|
| Capital assets not being depreciated: | | | | |
| Generation – Land | \$ 46,041 | \$ - | \$ - | \$ 46,041 |
| Distribution – Land and Easement | 8,324 | - | - | 8,324 |
| Total capital assets not being depreciated | <u>54,365</u> | - | - | <u>54,365</u> |
| Capital assets being depreciated: | | | | |
| Office Equipment | 105,849 | - | - | 105,849 |
| Generation | 4,693,719 | 215,760 | - | 4,909,479 |
| Distribution | 6,679,186 | 421,825 | - | 7,101,011 |
| Total capital assets being depreciated | <u>11,478,754</u> | <u>637,585</u> | - | <u>12,116,339</u> |
| Less accumulated depreciation for: | | | | |
| Office Equipment | 105,849 | - | - | 105,849 |
| Generation | 4,061,897 | 42,996 | - | 4,104,893 |
| Distribution | 4,674,311 | 100,676 | - | 4,774,987 |
| Total accumulated depreciation | <u>8,842,057</u> | <u>143,672</u> | - | <u>8,985,729</u> |
| Total capital assets being depreciated, net | <u>2,636,697</u> | <u>493,913</u> | - | <u>3,130,610</u> |
| Total capital assets, net | <u>\$ 2,691,062</u> | <u>\$ 493,913</u> | <u>\$ -</u> | <u>\$ 3,184,975</u> |

(8) Commitments – Agreement with Corn Belt Power Cooperative

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

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(8) Commitments – Agreement with Corn Belt Power Cooperative - Continued

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

1. The City agrees to purchase from Corn Belt all of its purchased electrical energy in excess of that which is available to the City from Western Area Power Administration, Iowa Distributed Wind Generation Project, and that power which the City generates upon request.
2. Corn Belt Power Cooperative will provide the necessary equipment (including the installation of a backup transformer) to the point of delivery. The City will provide the necessary equipment for the distribution system.
3. The energy rate will be equal to 24.50 mills per KWH (the “Base Rate”) from the date of this agreement until December 31, 2001. Beginning January 1, 2002 and January 1 of each year thereafter, Corn Belt may make adjustments to the energy rate. The adjustment shall be no greater than the cumulative percentage increase in the Bureau of Labor Statistics Consumer Price Index, U.S. City Average, Urban Wage Earners and Clerical workers from October 1998 to the October preceding the rate adjustment. There was no adjustment to the energy rate for the years ended 2001, 2002 or 2003. As of January 1, 2004, the energy rate was increased to 27.33 mills per KWH. As of January 1, 2005, the energy rate was increased to 28.33 mills per KWH. As of January 1, 2006, the energy rate was increased to 29.77 mills per KWH. Corn Belt Power Cooperative will also make available to the City up to 5,000 KW of peaking capacity during the months of May to October and the City will pay the following rate each month for the amount specified:

| | |
|-------------|------------------|
| 1998 | \$4.62 per KW |
| 1999 | 4.77 per KW |
| 2000 | 4.92 per KW |
| 2001 – 2005 | Priced at Market |

The City did not require the use of the 5,000 KW of peaking capacity in 2001 - 2005 so no rate was set.

4. The initial term of this agreement is for a period of five (5) years and will continue from year to year with no further action by either party. On or after the fourth anniversary of the effective date of this agreement, it may be

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(8) Commitments – Agreement with Corn Belt Power Cooperative - Continued

terminated by either party by giving one year's written notice. A written notice, dated December 6, 2005 from Corn Belt Power Cooperative, of termination of the wholesale power agreement effective December 31, 2006 has been received.

5. Corn Belt Power Cooperative purchased from Mid American Energy Company, the 69 KV portion of substation, 69KV transmission lines No. 1 & No. 2 for an amount equal to their original cost less accumulated depreciation. Upon termination of this agreement, the City shall purchase said facilities and the backup transformer at a price equal to Corn Belt Power Cooperative's original cost less accumulated depreciation as of the date of termination. The City has set aside a certificate of deposit in the amount of \$514,840 in anticipation of these repurchase requirements.
6. The effective date of this agreement was June 1, 1998.
7. The net cost of power purchased during 2005 under this agreement was \$1,248,763.

(9) Commitments – Agreement with Western Area Power Administration

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

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

1. WAPA agreed to supply the City electrical energy not to exceed 2,814 KW in the winter season and 2,743 KW in the summer season through December 31, 2005, at which point the contract rate of delivery will be adjusted. The estimated cost of power from WAPA is 1.54 cents per KWH not including the cost of transmission.

On December 15, 2005, the City entered into a new agreement with WAPA effective January 1, 2006 through December 31, 2010. Under this agreement the contract rate of delivery for firm power during any winter season shall be 2,808 KW and 2,739 KW during any summer season.

2. WAPA makes delivery of energy through Corn Belt Power Cooperative, the City's primary energy provider with whom the City has entered into an agreement dated November 1, 2000 for the delivery of this energy at an estimated rate of .462 cents per KWH. This transmission agreement was in effect January 1, 2001 through December 31, 2003.

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

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

On January 1, 2004, the City entered into a new transmission agreement effective January 1, 2004 through December 31, 2009. The terms of this agreement did not change from the prior transmission agreement. The net delivery cost during 2005 under this agreement was \$56,270.

3. The initial term of this agreement with WAPA is for a period of twenty (20) Years with service to begin on January 1, 2001.
4. The net cost of power purchased during 2005 under this agreement was \$237,003.

(10) Commitments – Agreement with Iowa Lakes Community College

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

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

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

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(11) Commitments – Agreement with Iowa Lakes Community College

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

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

1. The City agrees to purchase all of the output of the WTG delivered to the Interconnection Point. There are no minimum or maximum output requirements.
2. Payment will be calculated by multiplying the metered output by the avoided cost rate. Initially the avoided cost rate will be about 2.73 cents per KWH. The avoided cost rate may change from month to month to track the City’s actual avoided costs.
3. The agreement is for a period of 20 years from the commercial date of operation of the WTG. It may be terminated by ILCC at any time by giving the City two (2) years written notice. Either party may terminate by giving the other party at least sixty days’ prior notice that the other party is in default of any of the material terms and conditions of the agreement. Either party may terminate by giving the other party at least sixty days’ prior written notice if the Interconnection Agreement is terminated.
4. The City began receiving power from the WTG on February 15, 2005.
5. The net cost of power purchased during 2005 under this agreement was \$105,040.

(12) Risk Management

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

City of Estherville, Iowa
Municipal Electric Utility
Notes to Financial Statements - Continued
December 31, 2005

(13) Related Party Transactions

The Municipal Electric Utility, City of Estherville, Iowa had sales of electric power to the City of Estherville of \$253,198 during the year ended December 31, 2005. The Utility paid \$333,750 for accounting and collection, \$439,544 for payment in lieu of taxes and \$38,867 for franchise fees to the City of Estherville during the year ended December 31, 2005. The City of Estherville owed \$21,487 to the Utility at December 31, 2005.

The Utility is a fund of the City of Estherville.

(14) Electric Rate Increase

The proposed fiscal year 2007 City budget included a staff recommendation that electric rates be increased during fiscal year 2007. No action has been taken by City Council to increase rates.

Other Supplementary Information

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY
SCHEDULE OF STATISTICAL DATA
YEAR ENDED DECEMBER 31, 2005

UNAUDITED

| | <u>KWH Sold</u> | <u>Amount Billed</u> | <u>Average Unit Revenue Per KWH</u> | <u>Percent of Revenue To Total</u> | <u>Percent of KWH To Total</u> | <u>Number of Meters In Service</u> |
|----------------------------|--------------------------|----------------------------|-------------------------------------|------------------------------------|--------------------------------|------------------------------------|
| Service to Customers | | | | | | |
| Residential | 21,995,674 | \$ 1,541,963 | 7.01 | 39.92 % | 37.12 % | 2,740 |
| Small Commercial | 8,295,553 | 579,026 | 6.98 | 14.99 | 14.00 | 388 |
| Large Commercial | 17,464,502 | 1,114,234 | 6.38 | 28.84 | 29.47 | 31 |
| Industrial | <u>7,236,032</u> | <u>374,689</u> | 5.18 | <u>9.70</u> | <u>12.21</u> | <u>1</u> |
| Total Service to Customers | 54,991,761 | 3,609,912 | 6.56 | 93.45 | 92.80 | 3,160 |
| Service to City | <u>4,268,276</u> | <u>253,198</u> | 5.93 | <u>6.55</u> | <u>7.20</u> | <u>38</u> |
| Total | <u><u>59,260,037</u></u> | <u><u>\$ 3,863,110</u></u> | | <u><u>100.00</u></u> % | <u><u>100.00</u></u> % | <u><u>3,198</u></u> |

Analysis of Kilowatt Hours Generated and Purchased

| | |
|---|-------------------------|
| Total Kilowatt Hours Generated - 2005 | 176,300 |
| Kilowatt Hours Purchased - Net 2005 | <u>62,524,654</u> |
| | 62,700,954 |
| Less: Station Power Consumption | <u>(838,200)</u> |
| Total to Feeders | 61,862,754 |
| Kilowatt Hours Sold on Line | |
| Service to Customers | 54,991,761 |
| Service to City | 4,268,276 |
| Kilowatt Hours Used For Security/Traffic Lights | <u>638,331</u> |
| | <u>59,898,368</u> |
| Line Loss and Excess Generation 3.18% | <u><u>1,964,386</u></u> |

See Independent Auditors' Report

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY
OPERATIONAL ANALYSIS
YEAR ENDED DECEMBER 31, 2005

Schedule 2

UNAUDITED

REVENUE

Sales of electrical energy increased in 2005 to 59,260,037 kilowatt hours from 53,709,618 in 2004, an increase of 10.33%. Operating revenues from energy sales increased to \$3,981,147 up \$299,468 from the previous year. Other operating revenues increased \$19,529. Total operating revenues for 2005 were \$4,016,498 an increase of \$318,997 from the previous year.

OPERATION AND MAINTENANCE EXPENSE

Operating expenses in 2005 increased to \$3,529,581 up from \$3,195,923 in 2004 for an increase of \$333,658. Energy purchases continue to be the largest single item of operating expense and totaled \$1,647,076 up from \$1,467,350 in 2004. The cost of purchased power, natural gas and fuel oil represented approximately 47.23% of the total operating costs in 2005 and 46.40% in 2004.

NET INCOME

Net operating income before interest totaled \$486,917 in 2005, compared to \$501,578 for the prior year, a decrease of \$14,661. Depreciation expense increased \$14,680 for the current year, and interest expense increased \$151. Interest income increased \$31,588 in 2005 when compared to 2004.

Net income of \$539,819 was realized for 2005 compared to \$387,864 for 2004, an increase of \$151,955.

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

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTIC UTILITY

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

Honorable Mayor and City Council
City of Estherville, Iowa

We have audited the accompanying financial statements of Municipal Electric Utility, City of Estherville, Iowa as of and for the year ended December 31, 2005, and have issued our report thereon dated March 6, 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 Municipal Electric Utility, City of Estherville's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Municipal Electric Utility, City of Estherville, Iowa's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Part II of the accompanying Schedule of Findings.

A material weakness is a 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also

considered to be material weaknesses. However, we believe item II-A-05, the reportable condition described above, is a material weakness.

Compliance and Other Matters

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

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 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 members and customers of the Municipal Electric Utility, City of Estherville, Iowa and other parties to whom the Utility may report. This report is not intended to be and should not be used by anyone other than these specified parties.

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

Brinkman & Reed, CPA's

Brinkman & Reed, CPA's.

March 6, 2006

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2005

Part I: Summary of the Independent Auditors' Results:

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

CITY OF ESTHERVILLE, IOWA
MUNICIPAL ELECTRIC UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2005

Part II: Findings Related to the Financial Statements:

INSTANCES OF NON-COMPLIANCE:

No matters were noted.

REPORTABLE CONDITIONS:

II-A-05 Segregation of Duties - One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. We noted that employees who handle cash receipts are also involved with the preparation of bank reconciliations.

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

Response – The City will make every effort to comply.

Conclusion - Response accepted.

Part III: Other Findings Related to the Statutory Reporting:

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

III-B-05 Questionable Disbursements - No disbursements that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979 were noted.

III-C-05 Travel Expense - No disbursements of City money for travel expenses of spouses of City officials or employees were noted.

III-D-05 Council Minutes – No transactions were found that we believe should have been approved in the Council minutes but were not.

III-E-05 Deposits and Investments – We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the City's investment policy.