

CITY OF KALONA, IOWA  
INDEPENDENT AUDITOR'S REPORTS  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
BASIC FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION  
SCHEDULE OF FINDINGS

JUNE 30, 2007

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CITY OF KALONA, IOWA  
OFFICIALS  
June 30, 2007

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
Jerry Kauffman	Mayor	December, 2007
Ken Herington	Mayor Pro tem	December, 2009
Steve Lafaurie	Council Member	December, 2007
David Bentley	Council Member	December, 2009
Claudine Miller	Council Member	December, 2007
Aaron Kos	Council Member	December, 2009
Doug Morgan	City Administrator	Indefinite
Karen Christner	City Clerk	Appointed

# Gronewold, Bell, Kyhnn & Co. P.C.

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS AND FINANCIAL CONSULTANTS

1910 EAST 7th STREET BOX 369  
ATLANTIC, IOWA 50022-0369  
(712) 243-1800  
FAX (712) 243-1265  
CPA@GBKCO.COM

MARK D. KYHNN  
DAVID L. HANNASCH  
KENNETH P. TEGELS  
CHRISTOPHER J. NELSON  
DAVID A. GINTHER

## INDEPENDENT AUDITOR'S REPORT

To the Honorable Mayor and  
Members of the City Council

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Kalona, Iowa, as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements listed in the table of contents. These financial statements are the responsibility of city officials. 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 and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by officials, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinions.

As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles.

As explained in Note 1, the operations of two component units are excluded from these financial statements. In our opinion, accounting principles generally accepted in the United States of America require that such entities be blended with these financial statements.

In our opinion, except for the effects of the exclusion of the component units required to be included, as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the respective cash basis financial position of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Kalona as of June 30, 2007, and the respective changes in cash basis financial position for the year then ended in conformity with the basis of accounting described in Note 1.

To the Honorable Mayor and  
Members of the City Council

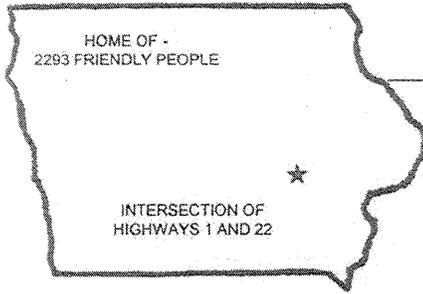
In accordance with Government Auditing Standards, we have also issued our report dated October 11, 2007 on our consideration of the City of Kalona's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and 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 internal control over financial reporting or 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 4d and 16 through 17 are not required parts 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 required supplementary information. We did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise City of Kalona's basic financial statements. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the year ended June 30, 2006 (none of which are presented herein) and expressed qualified opinions on those financial statements which were prepared in conformity with an other comprehensive basis of accounting. The financial statements for the two years ended June 30, 2005 (none of which are presented herein), were audited by other auditors whose reports expressed qualified opinions on those financial statements which were prepared in conformity with an other comprehensive basis of accounting. The supplementary information included in Schedules 1 through 4, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*Gronwald, Bell, Kuhn + Co. P.C.*

Atlantic, Iowa  
October 11, 2007



# CITY OF KALONA

511 C Avenue • P.O. Box 1213  
KALONA, IOWA 52247-1213

AREA CODE 319-656-2310

CITY COUNCIL

KEN HERINGTON  
STEVE LAFAURIE  
CLAUDINE MILLER  
DAVID BENTLEY  
AARON KOS

City of Kalona

## Management's Discussion & Analysis

The City of Kalona provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended June 30, 2007. We encourage readers to consider this information in conjunction with the City's financial statements, which follow.

### 2007 FINANCIAL HIGHLIGHTS

- Revenues of the City increased approximately 26% from fiscal year 2006 to 2007 because of increase in Local Option Sales Tax, use of money and property, and Riverboat Casino Funds.
- Disbursements of the City increased approximately 35% from fiscal year 2006 to 2007 due to completion of street improvement project and major repairs to sewer lift station.
- The City's total cash basis net assets increased approximately 9.2% or \$284,228 due mainly to funds received to cover the 3 projects that were going on during this time. Of this amount, the assets of the governmental activities increased approximately \$150,490 and the assets of the business type activities increased by approximately \$133,738.

### USING THIS ANNUAL REPORT

The annual report consists of a series of financial statements and other information, as follows:

Management's Discussion and Analysis shows basic financial statements and an overview of cash receipts and disbursements. The cash basis of accounting does not take into consideration accounts receivable or accounts payable.

The Government-wide Financial Statement consists of a Statement of Activities and Net Assets. This Statement includes information about the activities of the City as a whole and presents an overall view of the City's finances.

The Fund Financial Statements tell how governmental services were financed in the short term as well as what remains for future spending. Fund financial statements report the City's operations in more detail than the government-wide statement by providing information about the most significant funds.

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

Required Supplementary Information further explains and supports the financial statements with a comparison of the City's budget for the year.

## **BASIS OF ACCOUNTING**

The City maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles. Therefore, when reviewing the financial information and discussion within this annual report, the reader should keep in mind the limitations resulting from the use of the cash basis of accounting.

## **REPORTING THE CITY'S FINANCIAL ACTIVITIES**

### *Government-wide Financial Statement*

The Statement of Activities and Net Assets presents the City's net assets. Over time, increases or decreases in the City's net assets may serve as a useful indicator of whether the financial position of the City is improving or declining.

The Statement of Activities and Net Assets is divided into two kinds of activities:

- Governmental Activities include public safety, public works, culture and recreation, general government, debt service, and capital projects. These activities are financed mainly by property taxes and state/federal grants.
- Business Type Activities include the water system, sanitary sewer system, and garbage. Fees charged to the users finance these activities.

### *Fund Financial Statements*

The City has two kinds of funds:

1. Governmental funds account for most of the City's basic services. These focus on how money flows into and out of those funds, and the balances at year-end that are available for spending. The governmental funds include: 1) the General Fund, 2) the Special Revenue Funds, such as Road Use Tax and Urban Renewal Tax Increment, 3) the Debt Service Fund, and 4) the Capital Projects Fund. The governmental fund financial statements provide a detailed, short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs.

The required financial statement for governmental funds is a statement of cash receipts, disbursements and changes in cash balances.

2. Proprietary funds account for the City's Enterprise Funds. Enterprise funds are used to report business type activities. The City maintains three Enterprise Funds to provide separate information for the water, sewer and garbage funds, considered to be major funds of the City.

The required financial statement for proprietary funds is a statement of cash receipts, disbursements and changes in cash balances.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of financial position. The City's cash balance for governmental activities increased from \$2,347,825 to \$2,498,315. The analysis focuses on the changes in cash balances for governmental activities.

### Changes in Cash Basis Net Assets of Governmental Activities

	<u>Year ended June 30,</u>	
	<u>2007</u>	<u>2006</u>
Receipts and transfers:		
Program receipts:		
Charges for services	\$ 89,026	\$ 63,695
Operating Grants	228,509	214,910
General receipts:		
Property tax	659,797	589,695
Debt Service	27,063	53,068
Local Option Sales Tax	215,787	146,363
TIF Revenues	222,404	204,193
Grants and contributions not restricted to a specific purpose	62,490	--
Unrestricted interest	89,710	32,292
Miscellaneous	112,400	43,399
Transfer – In	95,849	89,209
Total receipts and transfers	<u>1,803,035</u>	<u>1,436,824</u>
 Disbursements and transfers:		
Public safety	142,978	133,259
Public works	481,566	144,316
Culture and recreation	370,763	331,379
Community and economic development	348,316	216,009
General government	186,825	169,350
Debt service	26,248	54,750
Capital projects	--	66,566
Transfers – Out	95,849	89,209
Total disbursements and transfers	<u>1,652,545</u>	<u>1,204,838</u>
 Increase in cash basis net assets	150,490	231,986
 Cash basis net assets beginning of year	<u>2,347,825</u>	<u>2,115,839</u>
Cash basis net assets end of year	<u>\$ 2,498,315</u>	<u>\$ 2,347,825</u>

## Changes in Cash Basis Net Assets of Business Type Activities

	<u>Year ended June 30,</u>	
	<u>2007</u>	<u>2006</u>
Receipts and transfers:		
Program receipts:		
Charges for services		
Water	\$ 389,988	\$ 337,519
Sewer	226,594	201,849
Garbage	53,427	44,645
General receipts:		
Other general receipts	85,042	8,213
Bond proceeds	--	2,888
Transfers in	57,686	52,303
Total receipts and transfers	<u>812,737</u>	<u>647,417</u>
Disbursements and transfers:		
Water	196,566	161,588
Sewer	208,516	119,015
Garbage	40,667	39,232
Debt Service	175,564	176,959
Capital Projects	--	5,250
Transfers out	57,686	52,303
Total disbursements and transfers	<u>678,999</u>	<u>554,347</u>
Increase in cash basis net assets	133,738	93,070
Cash basis net assets beginning of year	<u>747,242</u>	<u>654,172</u>
Cash basis net assets end of year	<u>\$ 880,980</u>	<u>\$ 747,242</u>

### INDIVIDUAL MAJOR GOVERNMENTAL FUND ANALYSIS

As Kalona, Iowa, completed the year, its funds reported a combined fund balance of \$3,379,295, which is an increase of \$284,228. Major reasons for changes in balances from fiscal year 2006 are:

- The General Fund revenues showed an increase due to better interest rates, increase in Local Option Sales Tax Fund, and development of Riverboat Casino Funds.
- The Road Use Tax Fund revenue decreased slightly and is based on per capita dollars from the state and disbursements increased due to the finishing of a project.
- The Tax Increment Financing Fund revenues increased by \$48,517 in fiscal year 2007. Revenue increase was because of additional increment financing available to be used to pay towards development agreements formed with the City.
- The Local Option Sales Tax Fund revenues increased by \$71,858 from fiscal year 2006. Revenue increase was due to increased sales activity. Expenditures increased with the purchase of various infrastructure items by different departments throughout the City.

## INDIVIDUAL MAJOR BUSINESS TYPE FUND ANALYSIS

The Water Utility Fund balance increased by \$98,520 from fiscal year 2006 due to an increased number of homes and more water usage.

The Sewer Utility Fund balance increased by \$22,458 from fiscal year 2006 due to an increased number of homes.

## BUDGETARY HIGHLIGHTS

The City amended its budget on May 21, 2007 resulting in an increase of receipts of approximately \$161,306 and disbursements of approximately \$766,611. Receipts increased due to Riverboat Casino Funds, Library Riverboat Casino Grant, and miscellaneous charges for services. Disbursements increased due to 6<sup>th</sup> Street Construction Project, equipment purchases for Rec Center, Pool, Park, Housing Grant Funds, Electric Municipalization, and repairs to the Sewer Lift Station.

## DEBT ADMINISTRATION

At June 30, 2007, the City had approximately \$2,996,000 in bonds and other long-term debt, compared to approximately \$3,163,000 last year, as shown below.

### Outstanding Debt at Year-End

	Year ended June 30,	
	2007	2006
General Obligation Corporate Purpose Bonds		
1997 Water Project	\$ 125,000	\$ 150,000
1995 Sewer Project (State Revolving Fund)	247,000	272,000
2003 Water Project (State Revolving Fund)	944,000	986,000
2003 Sewer Project (State Revolving Fund)	445,000	465,000
2004 Library Project	<u>1,235,000</u>	<u>1,290,000</u>
Total	<u>\$ 2,996,000</u>	<u>\$ 3,163,000</u>

Debt decreased as principal was paid down.

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The City of Kalona's elected and appointed officials considered factors such as tax rates and fees that will be charged for various City activities when they adopted the 2008 budget.

## CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide the citizens, taxpayers, customers, and creditors with a general overview of the City's finances and to show the City's accountability for all money received. If you have questions about this report or need additional information, please contact Douglas W. Morgan, City Administrator, or Karen Christner, City Clerk, at Box 1213, Kalona, Iowa 52247 or call 319-656-2310.

CITY OF KALONA, IOWA  
STATEMENT OF ACTIVITIES AND NET ASSETS - CASH BASIS  
As of and for the year ended June 30, 2007

	<u>Disbursements</u>	<u>Program Receipts</u>	
		<u>Charges for Service</u>	<u>Operating Grants, Contributions, and Restricted Interest</u>
Functions/Programs:			
Governmental activities:			
Public safety	\$ 142,978	\$ 115	\$ --
Public works	481,566	--	191,109
Culture and recreation	370,763	84,583	32,054
Community and economic development	348,316	1,875	5,346
General government	186,825	2,453	--
Debt service	26,248	--	--
Total governmental activities	<u>1,556,696</u>	<u>89,026</u>	<u>228,509</u>
Business type activities:			
Water	303,725	389,988	--
Sewer	276,921	226,594	--
Garbage	40,667	53,427	--
Total business type activities	<u>621,313</u>	<u>670,009</u>	<u>--</u>
<b>Total</b>	<u>\$ 2,178,009</u>	<u>\$ 759,035</u>	<u>\$ 228,509</u>
General Receipts:			
Property tax levied for:			
General purposes			
Tax increment financing			
Debt service			
Local option sales tax			
Grants and contributions not restricted to a specific purpose			
Unrestricted interest on investments			
Miscellaneous			
Total general receipts and transfers			
Change in cash basis net assets			
Cash basis net assets beginning of year			
Cash basis net assets end of year			

(continued next page)

Program Receipts Capital Grants, Contributions, and Restricted Interest	Net (Disbursements) Receipts and Changes in Cash Basis Net Assets		
	Governmental Activities	Business Type Activities	Total
\$ --	\$( 142,863)	\$ --	\$( 142,863)
--	( 290,457)	--	( 290,457)
--	( 254,126)	--	( 254,126)
--	( 341,095)	--	( 341,095)
--	( 184,372)	--	( 184,372)
--	( 26,248)	--	( 26,248)
--	( 1,239,161)	--	( 1,239,161)
--	--	86,263	86,263
--	--	( 50,327)	( 50,327)
--	--	12,760	12,760
--	--	48,696	48,696
<u>\$ --</u>	<u>( 1,239,161)</u>	<u>48,696</u>	<u>( 1,190,465)</u>
	659,797	--	659,797
	222,404	--	222,404
	27,063	--	27,063
	215,787	--	215,787
	62,490	--	62,490
	89,710	7,417	97,127
	112,400	77,625	190,025
	<u>1,389,651</u>	<u>85,042</u>	<u>1,474,693</u>
	150,490	133,738	284,228
	<u>2,347,825</u>	<u>747,242</u>	<u>3,095,067</u>
	<u>\$ 2,498,315</u>	<u>\$ 880,980</u>	<u>\$ 3,379,295</u>

CITY OF KALONA, IOWA  
STATEMENT OF ACTIVITIES AND NET ASSETS - CASH BASIS - Continued

As of and for the year ended June 30, 2007

	<u>Disbursements</u>	<u>Charges for Service</u>	<u>Program Receipts</u> Operating Grants, Contributions, and Restricted Interest
Cash Basis Net Assets			
Restricted:			
Employee benefits			
Urban renewal projects			
Debt service			
Other restricted			
Unrestricted			
Total cash basis net assets			

The accompanying notes are an integral part of these statements.

<u>Program Receipts</u> Capital Grants, Contributions, and Restricted Interest	<u>Net (Disbursements) Receipts and            Changes in Cash Basis Net Assets</u>		
	<u>Governmental            Activities</u>	<u>Business Type            Activities</u>	<u>Total</u>
	\$ 71,089	\$ --	\$ 71,089
	249,189	--	249,189
	141,635	--	141,635
	719,755	--	719,755
	<u>1,316,647</u>	<u>880,980</u>	<u>2,197,627</u>
	<u>\$ 2,498,315</u>	<u>\$ 880,980</u>	<u>\$ 3,379,295</u>

CITY OF KALONA, IOWA  
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS  
AND CHANGES IN CASH BALANCES  
GOVERNMENTAL FUNDS

As of and for the year ended June 30, 2007

	General	Special Revenue
		Road Use Tax
Receipts:		
Property tax	\$ 573,490	\$ --
Tax increment financing collections	--	--
Other city tax	15,491	--
Use of money and property	201,059	--
Licenses and permits	4,228	--
Intergovernmental	35,677	191,109
Charges for service	83,288	--
Miscellaneous	64,000	--
Total receipts	977,233	191,109
Disbursements:		
Operating:		
Public safety	142,978	--
Public works	198,883	271,822
Culture and recreation	331,254	--
Community and economic development	30,500	--
General government	172,627	--
Debt service	--	--
Total disbursements	876,242	271,822
Excess (deficiency) of receipts over (under) disbursements	100,991	( 80,713)
Other financing sources (uses):		
Operating transfers in	95,849	--
Operating transfers out	( 81,001)	--
Total other financing sources (uses)	14,848	--
Excess (deficiency) of receipts and other financing sources over (under) disbursements and other financing sources (uses)	115,839	( 80,713)
Balance beginning of year	1,200,808	404,851
Balance end of year	\$ 1,316,647	\$ 324,138

(continued next page)

<u>Special Revenue</u>		<u>Other Nonmajor Governmental Funds</u>	<u>Total</u>
<u>Urban Renewal Tax Increment</u>	<u>Local Option Sales Tax</u>		
\$ --	\$ --	\$ 95,498	\$ 668,988
222,404	--	--	222,404
--	215,787	2,381	233,659
--	--	2,774	203,833
--	--	--	4,228
--	--	--	226,786
--	--	--	83,288
--	--	--	64,000
<u>222,404</u>	<u>215,787</u>	<u>100,653</u>	<u>1,707,186</u>
--	--	--	142,978
--	--	10,861	481,566
--	--	39,509	370,763
173,887	143,929	--	348,316
--	--	14,198	186,825
--	--	26,248	26,248
<u>173,887</u>	<u>143,929</u>	<u>90,816</u>	<u>1,556,696</u>
48,517	71,858	9,837	150,490
--	--	--	95,849
<u>--</u>	<u>--</u>	<u>( 14,848)</u>	<u>( 95,849)</u>
<u>--</u>	<u>--</u>	<u>( 14,848)</u>	<u>--</u>
48,517	71,858	( 5,011)	150,490
<u>200,672</u>	<u>323,759</u>	<u>217,735</u>	<u>2,347,825</u>
<u>\$ 249,189</u>	<u>\$ 395,617</u>	<u>\$ 212,724</u>	<u>\$ 2,498,315</u>

CITY OF KALONA, IOWA  
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS  
AND CHANGES IN CASH BALANCES - Continued  
GOVERNMENTAL FUNDS

As of and for the year ended June 30, 2007

	<u>General</u>	<u>Special Revenue</u>
		<u>Road Use Tax</u>
Cash Basis Net Assets		
Reserved:		
Debt service	\$       --	\$       --
Unreserved:		
General fund	1,316,647	--
Special revenue funds	<u>          --</u>	<u>324,138</u>
Total cash basis net assets	<u>\$ 1,316,647</u>	<u>\$ 324,138</u>

The accompanying notes are an integral part of these statements.

<u>Special Revenue</u>		<u>Other Nonmajor Governmental Funds</u>	<u>Total</u>
<u>Urban Renewal Tax Increment</u>	<u>Local Option Sales Tax</u>		
\$ --	\$ --	\$ 141,635	\$ 141,635
--	--	--	1,316,647
<u>249,189</u>	<u>395,617</u>	<u>71,089</u>	<u>1,040,033</u>
<u>\$ 249,189</u>	<u>\$ 395,617</u>	<u>\$ 212,724</u>	<u>\$ 2,498,315</u>

CITY OF KALONA, IOWA  
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS  
AND CHANGES IN CASH BALANCES  
PROPRIETARY FUNDS

As of and for the year ended June 30, 2007

	Enterprise Funds			Total
	Water	Sewer	Garbage	
Operating Receipts:				
License and permits	\$ 9,672	\$ 6,300	\$ --	\$ 15,972
Use of money and property	1,169	445	--	1,614
Charges for services	<u>380,316</u>	<u>220,294</u>	<u>53,427</u>	<u>654,037</u>
Total operating receipts	391,157	227,039	53,427	671,623
Operating Disbursements:				
Business type activities	<u>196,566</u>	<u>208,516</u>	<u>40,667</u>	<u>445,749</u>
Total operating disbursements	<u>196,566</u>	<u>208,516</u>	<u>40,667</u>	<u>445,749</u>
Excess of receipts over disbursements	194,591	18,523	12,760	225,874
Non-operating receipts (disbursements):				
Interest on investments	4,994	2,423	--	7,417
Miscellaneous	6,094	69,917	--	76,011
Debt service	<u>( 107,159)</u>	<u>( 68,405)</u>	<u>--</u>	<u>( 175,564)</u>
Total non-operating receipts (disbursements)	<u>( 96,071)</u>	<u>3,935</u>	<u>--</u>	<u>( 92,136)</u>
Excess of receipts over disbursements	98,520	22,458	12,760	133,738
Other financing sources (uses):				
Operating transfers in	5,300	52,386	--	57,686
Operating transfers out	<u>( 5,300)</u>	<u>( 52,386)</u>	<u>--</u>	<u>( 57,686)</u>
Total other financing sources (uses)	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
Excess of receipts and other financing sources over disbursements and other financing uses	98,520	22,458	12,760	133,738
Cash balances beginning of year	<u>261,385</u>	<u>452,530</u>	<u>33,327</u>	<u>747,242</u>
Cash balances end of year	<u>\$ 359,905</u>	<u>\$ 474,988</u>	<u>\$ 46,087</u>	<u>\$ 880,980</u>
Cash Basis Fund Balances				
Unreserved	<u>\$ 359,905</u>	<u>\$ 474,988</u>	<u>\$ 46,087</u>	<u>\$ 880,980</u>
Total cash basis fund balances	<u>\$ 359,905</u>	<u>\$ 474,988</u>	<u>\$ 46,087</u>	<u>\$ 880,980</u>

The accompanying notes are an integral part of these statements.

CITY OF KALONA, IOWA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of Kalona, Iowa is a political subdivision of the State of Iowa located in Washington County. It was first incorporated in 1879 and operates under the Home Rule provisions of the Constitution of Iowa. The City operates under the Mayor-Council form of government with the Mayor and Council Members elected on a non-partisan basis. The City provides numerous services to citizens, including public safety, public works, culture, recreation, public improvements, and general administrative services. The City also provides water, sewer, and garbage utilities services for its citizens.

A. Reporting Entity

For financial reporting purposes, the City of Kalona has included all funds, organizations, agencies, boards, commissions and authorities. The City 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 City are such that exclusion would cause the City'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 City 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 City.

Excluded Component Units

The City has two component units. The Kalona Library Foundation, which is a non-profit corporation that is legally separate, is a component unit because it has the potential to provide benefits to the City of Kalona Library. The Friends of the Kalona Library is a separate non-profit organization created for the sole purpose of raising funds to support the Kalona Library. The City has elected to exclude the financial information of its component units from these financial statements. Both component units should be blended into the Special Revenue Funds of the City of Kalona.

Jointly Governed Organizations

The City also participates in several jointly governed organizations that provide goods or services to the citizenry of the City but do not meet the criteria of a joint venture since there is no ongoing financial interest or responsibility by the participating governments. City officials are members of the following boards and commissions: Washington County Joint E911 Service Board and Washington County Assessor's Board.

B. Basis of Presentation

Government-wide Financial Statements

The Statement of Activities and Net Assets reports information on all of the nonfiduciary activities of the City. For the most part, the effect of interfund activity has been removed from this statement. Governmental activities, which are supported by tax and intergovernmental revenues, are reported separately from business type activities, which rely to a significant extent on fees and charges for services.

CITY OF KALONA, IOWA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

The Statement of Activities and Net Assets presents the City's nonfiduciary net assets. Net assets are reported in two categories:

*Restricted net assets* result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

*Unrestricted net assets* consist of net assets that do not meet the definition of the preceding category. Unrestricted net assets often have constraints on resources imposed by management, which can be removed or modified.

The Statement of Activities and Net Assets demonstrates the degree to which the direct disbursements of a given function are offset by program receipts. Direct disbursements are those clearly identifiable with a specific function. Program receipts include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function and 2) grants, contributions and interest on investments restricted to meeting the operational or capital requirements of a particular function. Property tax and other items not properly included among program receipts are reported instead as general receipts.

Fund Financial Statements

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. All remaining governmental funds are aggregated and reported as nonmajor governmental funds.

The City reports the following major governmental funds:

The General Fund is the general operating fund of the City. All general tax receipts and other receipts not allocated by law or contractual agreement to some other fund are accounted for in this fund. From the fund are paid the general operating disbursements, the fixed charge and the capital improvement costs that are not paid from other funds.

Special Revenue:

The Road Use Tax Fund is used to account for road construction and maintenance.

The Urban Renewal Tax Increment Fund is used to account for urban renewal projects financed by tax increment financing.

The Local Option Sales Tax Fund is used to account for projects financed by the Local Option Sales Tax.

CITY OF KALONA, IOWA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

The City reports the following major proprietary funds:

The Water Fund accounts for the operation and maintenance of the City's water system.

The Sewer Fund accounts for the operation and maintenance of the City's waste water treatment and sanitary sewer system.

The City also reports the following additional proprietary fund:

The Garbage Fund accounts for the operation and maintenance of the City's garbage service.

C. Measurement Focus and Basis of Accounting

The City of Kalona maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles.

Under the terms of grant agreements, the City funds certain activities by a combination of specific cost-reimbursement grants. It is the City's policy to first apply cost-reimbursement grant resources and then general receipts.

Proprietary funds distinguish operating receipts and disbursements from non-operating items. Operating receipts and disbursements generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All receipts and disbursements not meeting this definition are reported as non-operating receipts and disbursements.

D. Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information.

During the year ended June 30, 2007, disbursements exceeded the amount budgeted in the general government function prior to a budget amendment on May 21, 2007.

NOTE 2 - CASH AND POOLED INVESTMENTS

The City's deposits in banks at June 30, 2007 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.

CITY OF KALONA, IOWA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2007

NOTE 2 - CASH AND POOLED INVESTMENTS - Continued

The City 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 City Council; 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.

Interest rate risk - The City'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 City.

Credit risk - The City had no investments with credit risk.

NOTE 3 - BONDS AND NOTES PAYABLE

Annual debt service requirements to maturity for general obligation and revenue capital loan notes are as follows:

Year Ending June 30,	General Obligation Capital Loan Notes		Revenue Capital Loan Notes		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2008	\$ 80,000	\$ 51,953	\$ 89,000	\$ 49,080	\$ 169,000	\$ 101,033
2009	80,000	49,605	94,000	46,410	174,000	96,015
2010	85,000	47,068	97,000	43,590	182,000	90,658
2011	85,000	44,213	99,000	40,680	184,000	84,893
2012	85,000	41,213	103,000	37,710	188,000	78,923
2013	65,000	38,050	107,000	34,620	172,000	72,670
2014	65,000	35,937	110,000	31,410	175,000	67,347
2015	65,000	33,695	114,000	28,110	179,000	61,805
2016	70,000	31,355	81,000	24,690	151,000	56,045
2017	70,000	28,730	84,000	22,260	154,000	50,990
2018	75,000	26,035	86,000	19,740	161,000	45,775
2019	80,000	23,072	88,000	17,160	168,000	40,232
2020	85,000	19,833	91,000	14,520	176,000	34,353
2021	85,000	16,305	94,000	11,790	179,000	28,095
2022	90,000	12,693	97,000	8,970	187,000	21,663
2023	95,000	8,777	99,000	6,060	194,000	14,837
2024	100,000	4,550	103,000	3,090	203,000	7,640
	<u>\$1,360,000</u>	<u>\$ 513,084</u>	<u>\$1,636,000</u>	<u>\$ 439,890</u>	<u>\$2,996,000</u>	<u>\$ 952,974</u>

The Code of Iowa requires that principal and interest on general obligation capital loan notes be paid from the Debt Service Fund. However, during the year, \$25,000 of note principal and \$7,862 of interest was paid from the Enterprise Water Fund and \$28,752 of note principal and \$46,248 of interest was paid out of the Special Revenue, Local Option Sales Tax Fund.

CITY OF KALONA, IOWA  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2007

NOTE 3 - BONDS AND NOTES PAYABLE - Continued

The resolutions providing for the issuance of the revenue capital loan notes include the following provisions.

- a. The notes will only be redeemed from the future earnings of the enterprise activity and the note holders hold a lien on the future earnings of the funds.
- b. Sufficient transfers shall be made into a separate and special fund to pay current expenses. The fund shall be known as the Sewer/Water Utility Operation and Maintenance Fund. There shall be deposited in the fund each month an amount sufficient to meet the current expenses of the month plus an amount equal to 1/12 of expenses payable on an annual basis such as insurance.
- c. Moneys shall next be disbursed to a separate and special fund to pay principal of and interest on the Notes and Parity Obligations known as the Sewer/Water Revenue Note Principal and Interest Sinking Fund (the "Sinking Fund"). The required amount to be deposited in the Sinking Fund in any month shall be an amount equal to 1/6 of the installment of interest coming due on the next payment and 1/12 of the installment of principal coming due on the next payment date.

NOTE 4 - PENSION AND RETIREMENT BENEFITS

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

Plan members are required to contribute 3.70% (3.90% effective July 1, 2007) of their annual covered salary and the City is required to contribute 5.75% (6.05% effective July 1, 2007) of annual covered percentages respectively. Contribution requirements are established by state statute. The City's contributions to IPERS for the years ended June 30, 2007, 2006, and 2005 were \$18,114, \$16,844, and \$14,185, respectively, equal to the required contribution for each year.

NOTE 5 - COMPENSATED ABSENCES

City employees accumulate a limited amount of earned but unused vacation and comp time hours for subsequent use or for payment upon termination, retirement or death. These accumulations are not recognized as disbursements by the City until used or paid. The City's liability for earned vacation and comp time leave termination payments payable to employees at June 30, 2007 is \$10,233 for vacation and \$7,659 for comp time, for a total liability of \$17,892. This liability has been computed on rates of pay in effect at June 30, 2007.

NOTE 6 - WORKER'S COMPENSATION

The City is a member of the Iowa Municipalities Worker's Compensation Association (IMWCA) which provides worker's compensation coverage to its members. The members own an interest in the assets of the claims payment fund.

CITY OF KALONA, IOWA  
 NOTES TO FINANCIAL STATEMENTS  
 June 30, 2007

NOTE 7 - RISK MANAGEMENT

The City of Kalona 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 City assumes liability for any deductibles 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.

NOTE 8 - INTERFUND TRANSFERS

The detail of interfund transfers for the year ended June 30, 2007 is as follows:

<u>Transfer to</u>	<u>Transfer from</u>	<u>Amount</u>
General	Capital Projects	\$ 14,848
General Fund Intrafund Transfers		<u>81,001</u>
		<u>\$ 95,849</u>
Water Fund Intrafund Transfers		\$ 5,300
Sewer Fund Intrafund Transfers		<u>52,386</u>
		<u>\$ 57,686</u>

Transfers generally move resources from the fund statutorily required to collect the resources to the fund statutorily required to disburse the resources.

NOTE 9 - SERVICE AGREEMENTS

The City has an agreement with Washington County to provide police protection for its citizens. The City paid \$69,076 for services during the year ended June 30, 2007, and approved an agreement in the amount of \$67,888 for the year ending June 30, 2008.

NOTE 10 - CONDUIT DEBT OBLIGATION

On July 11, 2005, Facility Revenue Bonds, Iowa Mennonite School Project, in the amount of \$1,300,000 were issued. These revenue bonds were issued for the purpose of financing the cost of constructing, equipping and furnishing a fine arts facility on the Iowa Mennonite School Campus. These bonds are a special limited obligation of the City and shall not be payable from or charged upon any funds other than Loan Repayments made by the Iowa Mennonite School, a Tax Exempt Organization. The bonds do not constitute a debt of the City within any constitutional or statutory limitation.

\* \* \*

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF KALONA, IOWA  
 BUDGETARY COMPARISON SCHEDULE  
 OF RECEIPTS, DISBURSEMENTS, AND CHANGES IN BALANCES -  
 BUDGET AND ACTUAL (CASH BASIS) - GOVERNMENTAL  
 FUNDS AND PROPRIETRY FUNDS  
 REQUIRED SUPPLEMENTARY INFORMATION

Year ended June 30, 2007

	<u>Governmental Funds Actual</u>	<u>Proprietary Funds Actual</u>	<u>Total</u>
Receipts:			
Property tax	\$ 668,988	\$ --	\$ 668,988
Tax increment financing collections	222,404	--	222,404
Other city tax	233,659	--	233,659
Use of money and property	203,833	9,031	212,864
Licenses and permits	4,228	15,972	20,200
Intergovernmental	226,786	--	226,786
Charges for service	83,288	654,037	737,325
Miscellaneous	64,000	76,011	140,011
Total receipts	<u>1,707,186</u>	<u>755,051</u>	<u>2,462,237</u>
Disbursements:			
Public safety	142,978	--	142,978
Public works	481,566	--	481,566
Culture and recreation	370,763	--	370,763
Community and economic development	348,316	--	348,316
General government	186,825	--	186,825
Debt service	26,248	--	26,248
Business type activities	--	621,313	621,313
Total disbursements	<u>1,556,696</u>	<u>621,313</u>	<u>2,178,009</u>
Excess (deficiency) of receipts over (under) disbursements	150,490	133,738	284,228
Balance beginning of year	<u>2,347,825</u>	<u>747,242</u>	<u>3,095,067</u>
Balance end of year	<u>\$ 2,498,315</u>	<u>\$ 880,980</u>	<u>\$ 3,379,295</u>

See accompanying independent auditor's report.

Budgeted Amounts		Final to Total Variance
Original	Final	
\$ 657,225	\$ 657,225	\$ 11,763
220,934	220,934	1,470
164,581	258,314	( 24,655)
6,420	6,420	206,444
3,000	3,000	17,200
205,653	220,653	6,133
644,117	693,228	44,097
9,250	12,712	127,299
<u>1,911,180</u>	<u>2,072,486</u>	<u>389,751</u>
148,319	148,319	5,341
307,303	650,848	169,282
377,742	436,074	65,311
368,283	480,016	131,700
125,186	235,498	48,673
26,248	26,248	--
504,189	646,878	25,565
<u>1,857,270</u>	<u>2,623,881</u>	<u>445,872</u>
53,910	( 551,395)	835,623
<u>2,801,227</u>	<u>2,801,227</u>	<u>293,840</u>
<u>\$ 2,855,137</u>	<u>\$ 2,249,832</u>	<u>\$ 1,129,463</u>

CITY OF KALONA, IOWA  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -  
BUDGETARY REPORTING

June 30, 2007

In accordance with the Code of Iowa, the City Council annually adopts a budget on the cash basis following required public notice and hearing for all funds except Fiduciary Funds. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures.

Formal and legal budgetary control is based upon ten major classes of disbursements known as functions, not by fund or fund type. These ten functions are: public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, business type activities and non-program. Function disbursements required to be budgeted included disbursements for the General Fund, Special Revenue Funds, Debt Service Fund, Capital Projects Funds and Business Type Funds. Although the budget document presents function disbursements by fund, the legal level of control is at the aggregated function level, not by fund. During the year, the budget amendment increased budgeted disbursements by \$766,611. The budget amendment is reflected in the final budgeted amount.

During the year ended June 30, 2007, disbursements exceeded the amount budgeted in the general government function prior to amendment of the budget.

OTHER SUPPLEMENTARY INFORMATION

CITY OF KALONA, IOWA  
SCHEDULE OF CASH RECEIPTS, DISBURSEMENTS  
AND CHANGES IN CASH BALANCES  
NONMAJOR GOVERNMENTAL FUNDS

As of and for the year ended June 30, 2007

	Special Revenue Employee Benefits	Debt Service
Receipts:		
Property tax	\$ 69,031	\$ 26,467
Other City tax	1,785	596
Use of money and property	--	2,774
Total receipts	70,816	29,837
Disbursements:		
Operating:		
Public works	10,861	--
Culture and recreation	39,509	--
General government	14,198	--
Debt service	--	26,248
Total disbursements	64,568	26,248
Excess (deficiency) of receipts over (under) disbursements	6,248	3,589
Other financing uses:		
Operating transfers out	--	--
Total other financing uses	--	--
Excess (deficiency) of receipts and other financing sources over (under) disbursements and other financing sources (uses)	6,248	3,589
Balance beginning of year	64,841	138,046
Balance end of year	\$ 71,089	\$ 141,635
Cash Basis Fund Balances		
Reserved:		
Debt service	\$ --	\$ 141,635
Unreserved:		
Special revenue funds	71,089	--
Total cash basis fund balances	\$ 71,089	\$ 141,635

See accompanying independent auditor's report.

<u>Capital Project</u>	<u>Library Project</u>	<u>Total</u>
\$	--	\$ 95,498
	--	2,381
	--	2,774
	<u>--</u>	<u>100,653</u>
	--	10,861
	--	39,509
	--	14,198
	<u>--</u>	<u>26,248</u>
	<u>--</u>	<u>90,816</u>
	--	9,837
	<u>( 14,848)</u>	<u>( 14,848)</u>
	<u>( 14,848)</u>	<u>( 14,848)</u>
	( 14,848)	( 5,011)
	<u>14,848</u>	<u>217,735</u>
<u>\$</u>	<u>--</u>	<u>\$ 212,724</u>
\$	--	\$ 141,635
	<u>--</u>	<u>71,089</u>
<u>\$</u>	<u>--</u>	<u>\$ 212,724</u>

CITY OF KALONA, IOWA  
 SCHEDULE OF INDEBTEDNESS  
 Year ended June 30, 2007

<u>Obligation</u>	<u>Date of Issue</u>	<u>Interest Rate</u>	<u>Amount Originally Issued</u>
General Obligation Capital Loan Notes:			
Water	April 1, 1997	4.10% - 5.45%	\$ 350,000
Library	June 1, 2004	1.30% - 4.55%	1,400,000
Total General Obligation Notes			
Notes Payable:			
State revolving fund loans			
Sewer	February 13, 1995	3.00%	489,000
Water	August 26, 2003	3.00%	1,067,000
Sewer	December 12, 2003	3.00%	503,000
Total SRF loans			
Total			

See accompanying independent auditor's report.

<u>Balance Beginning of Year</u>	<u>Redeemed During Year</u>	<u>Balance End of Year</u>	<u>Interest Paid</u>	<u>Interest Due and Unpaid</u>
\$ 150,000	\$ 25,000	\$ 125,000	\$ 7,862	\$ 1,042
<u>1,290,000</u>	<u>55,000</u>	<u>1,235,000</u>	<u>46,248</u>	<u>2,639</u>
<u>1,440,000</u>	<u>80,000</u>	<u>1,360,000</u>	<u>54,110</u>	<u>3,681</u>
272,000	25,000	247,000	12,348	812
986,000	42,000	944,000	29,580	4,190
<u>465,000</u>	<u>20,000</u>	<u>445,000</u>	<u>13,950</u>	<u>1,984</u>
<u>1,723,000</u>	<u>87,000</u>	<u>1,636,000</u>	<u>55,878</u>	<u>6,986</u>
<u>\$3,163,000</u>	<u>\$ 167,000</u>	<u>\$2,996,000</u>	<u>\$ 109,988</u>	<u>\$ 10,667</u>

CITY OF KALONA, IOWA  
 BOND AND NOTE MATURITIES  
 June 30, 2007

Year ending June 30,	General Obligation Capital Loan Notes				
	Water Note		Library Note		Total
	Issued April 1, 1997		Issued June 1, 2004		
	Interest		Interest		
Rate	Amount	Rate	Amount		
2008	5.10%	\$ 25,000	1.95%	\$ 55,000	\$ 80,000
2009	5.20	25,000	2.25	55,000	80,000
2010	5.30	25,000	2.55	60,000	85,000
2011	5.40	25,000	2.75	60,000	85,000
2012 and beyond	5.45	<u>25,000</u>	3.00-4.55	<u>1,005,000</u>	<u>1,030,000</u>
		<u>\$ 125,000</u>		<u>\$1,235,000</u>	<u>\$1,360,000</u>

State Revolving Funds

Year ending June 30,	Sewer Revenue Capital Loan Notes			
	Issued		Issued	
	February 13, 1995		December 12, 2003	
	Interest		Interest	
	Rate	Amount	Rate	Amount
2008	3.00%	\$ 26,000	3.00%	\$ 20,000
2009	3.00	28,000	3.00	21,000
2010	3.00	29,000	3.00	22,000
2011	3.00	30,000	3.00	22,000
2012 and beyond	3.00	<u>134,000</u>	3.00	<u>360,000</u>
		<u>\$ 247,000</u>		<u>\$ 445,000</u>

See accompanying independent auditor's report.

<u>State Revolving Funds</u>		
<u>Water Revenue</u>		
<u>Capital Loan Notes</u>		
<u>Issued</u>		
<u>August 26, 2003</u>		
<u>Interest</u>		
<u>Rate</u>	<u>Amount</u>	<u>Total</u>
3.00%	\$ 43,000	\$ 89,000
3.00	45,000	94,000
3.00	46,000	97,000
3.00	47,000	99,000
3.00	<u>763,000</u>	<u>1,257,000</u>
	<u>\$ 944,000</u>	<u>\$ 1,636,000</u>

CITY OF KALONA, IOWA  
 SCHEDULE OF RECEIPTS BY SOURCE AND  
 DISBURSEMENTS BY FUNCTION -  
 ALL GOVERNMENTAL FUNDS  
 For the Last Three Years

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Receipts:			
Property tax	\$ 668,988	\$ 642,763	\$ 565,919
Tax increment financing collections	222,404	204,193	256,747
Other city tax	233,659	163,745	193,729
Use of money and property	203,833	32,292	31,300
Licenses and permits	4,228	4,190	3,633
Intergovernmental	226,786	209,545	203,853
Charges for service	83,288	73,917	67,064
Miscellaneous	<u>64,000</u>	<u>16,970</u>	<u>40,876</u>
Total	<u>\$ 1,707,186</u>	<u>\$ 1,347,615</u>	<u>\$ 1,363,121</u>
Disbursements:			
Operating:			
Public safety	\$ 142,978	\$ 133,259	\$ 130,999
Public works	481,566	144,316	397,995
Culture and recreation	370,763	331,379	291,540
Community and economic development	348,316	216,009	254,635
General government	186,825	169,350	111,373
Debt service	26,248	54,750	--
Capital projects	<u>--</u>	<u>66,566</u>	<u>1,246,982</u>
Total	<u>\$ 1,556,696</u>	<u>\$ 1,115,629</u>	<u>\$ 2,433,524</u>

See accompanying independent auditor's report.

COMMENTS AND RECOMMENDATIONS

# Gronewold, Bell, Kyhnn & Co. P.C.

CERTIFIED PUBLIC ACCOUNTANTS • BUSINESS AND FINANCIAL CONSULTANTS

1910 EAST 7th STREET BOX 369  
ATLANTIC, IOWA 50022-0369  
(712) 243-1800  
FAX (712) 243-1265  
CPA@GBKCO.COM

MARK D. KYHNN  
DAVID L. HANNASCH  
KENNETH P. TEGELS  
CHRISTOPHER J. NELSON  
DAVID A. GINTHER

Independent Auditor's Report on Internal Control over Financial Reporting  
and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed in Accordance with  
Government Auditing Standards

To the Honorable Mayor and  
Members of the City Council

We have audited the accompanying financial statements of the governmental activities, business type activities, each major fund and the aggregate remaining fund information of City of Kalona, Iowa, as of and for the year ended June 30, 2007, which collectively comprise the City's basic financial statements listed in the table of contents and have issued our report thereon dated October 11, 2007. Our report expressed a qualified opinion on the financial statements which were prepared in conformity with an other comprehensive basis of accounting. 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 City of Kalona's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the City of Kalona's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Kalona's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and material weaknesses.

To the Honorable Mayor and  
Members of the City Council

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City of Kalona's ability to initiate, authorize, record, process, or report financial data reliably in accordance with an other comprehensive basis of accounting such that there is more than a remote likelihood a misstatement of the City of Kalona's financial statements that is more than inconsequential will not be prevented or detected by the City of Kalona's internal control. We consider the deficiencies in internal control described in Part I of the accompanying Schedule of Findings to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by the City of Kalona's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we believe item 07-I-A is a material weakness.

#### Compliance and Other Matters

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

Comments involving statutory and other legal matters about the City's operations for the year ended June 30, 2007 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the City. 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.

The City of Kalona's responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we have expressed our conclusions on the City's responses, we did not audit the City of Kalona's responses and, accordingly, we express no opinion on them.

To the Honorable Mayor and  
Members of the City Council

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

Granerud, Ben, Kuhn & Co. P.C.

Atlantic, Iowa  
October 11, 2007

CITY OF KALONA, IOWA

Schedule of Findings

Year ended June 30, 2007

PART I: Findings Related to the Financial Statements

SIGNIFICANT DEFICIENCIES:

07-I-A 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. However, because there are a limited number of people that have the primary responsibility for the accounting and financial duties, those aspects of internal accounting control which rely upon an adequate segregation of duties are missing in the City.

Recommendation: We recommend that the City review its control procedures to obtain the maximum internal control possible under the circumstances and the Council be aware of the lack of segregation of duties and that they act as an oversight group to the accounting personnel.

Response: Since there are only three employees at city hall, it is difficult to segregate duties. Duties are segregated to the best of our ability.

Conclusion: Response acknowledged.

\* \* \*

CITY OF KALONA, IOWA

Schedule of Findings

Year ended June 30, 2007

PART II: Other Findings Related to Statutory Reporting

07-II-A Certified Budget: Disbursements during the year ended June 30, 2007 exceeded the amounts budgeted in the general government function prior to a budget amendment on May 21, 2007. Chapter 384.20 of the Code of Iowa states, in part, "Public monies may not be expended or encumbered except under an annual or continuing appropriation."

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

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

Conclusion: Response accepted.

07-II-B Bond Coverage: Surety bond coverage of City 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.

07-II-C Council Minutes: No transactions were found that we believe should have been approved in the Council minutes but were not. However, minutes of the July, 2006 and April, 2007 Council meetings were not published timely as required by Chapter 372.13(6) of the Code of Iowa.

Recommendation: The City should publish minutes as required by Chapter 372.13(6) of the Code of Iowa.

Response: Our official publication has requested us to email all minutes, notices, etc. for their convenience. The same were emailed for a timely publishing, but if they do not have room then they set them off to the next week, when they have room. I am presuming this is what happened.

Conclusion: Response accepted.

07-II-D Questionable Disbursements: During the audit, we did not note any disbursements that did not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

07-II-E Travel Expense: No disbursements of City money for travel expenses of spouses of City officials or employees were noted.

07-II-F Deposits and Investments: We noted no instances of non-compliance with the deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa.

CITY OF KALONA, IOWA

Schedule of Findings

Year ended June 30, 2007

PART II: Other Findings Related to Statutory Reporting - Continued

07-II-G Cash Drawer: The City does not include the cash drawer in the fund balance. Chapter 384.20 of the Code of Iowa states in part that a City shall keep accounts which show an accurate and detailed statement of all public funds.

Recommendation: The City should include all cash funds in the fund balance to properly account for all funds.

Response: We will include the same in the future.

Conclusion: Response accepted.

07-II-H General Obligation Loan Notes: The Water General Obligation Capital Loan Notes were paid directly from the Water Fund. The Library General Obligation Capital Loan Note was paid directly from the Special Revenue, Local Option Sales Tax Fund. Section 384.4 of the Code of Iowa states "Moneys pledged or available to service general obligation bonds, and received from sources other than property taxes, must be deposited in the debt service fund."

Recommendation: The City should transfer water funds designated for payments on notes to debt service and then make note payments out of debt service.

Response: The City will take it under advisement.

Conclusion: The City should consider the implications of paying the note out of the Enterprise Water Fund.

07-II-I Business Transactions: In accordance with Chapter 362.5(10) of the Code of Iowa, no transactions between the City and the City officials and City employees were noted that represented conflicts of interest.

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