



# **Cedar Falls Utilities**

**Financial Statements of the Municipal  
Electric, Gas, Water, and Communications Utilities  
of the City of Cedar Falls, Iowa**

**Including Independent Auditors' Reports**

**For The Years Ended  
December 31, 2011 and 2010**



# **Cedar Falls Utilities**

**Financial Statements of the Municipal  
Electric Utility  
of the City of Cedar Falls, Iowa**

**Including Independent Auditors' Reports**

**For The Years Ended  
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MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF CEDAR FALLS, IOWA  
(Component Unit of the City of Cedar Falls, Iowa)

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheets of the Municipal Electric Utility of The City of Cedar Falls, Iowa (Municipal Electric Utility), a component unit of the City of Cedar Falls, Iowa, as of December 31, 2011 and 2010 and related statements of revenues, expenses and changes in net assets and statements of cash flows for the years then ended, as noted in the table of contents. These financial statements are the responsibility of the Municipal Electric Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Electric Utility as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will issue a report on our consideration of the Municipal Electric Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 read in conjunction with this report in considering the results of our audit.

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

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economical, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012

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The following discussion and analysis of the Municipal Electric Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2011, 2010 and 2009. This information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased as a result of 2011 operating income and non-operating revenues. At December 31, 2011, 2010 and 2009, total assets were \$189,259,556, \$175,872,932 and \$156,821,297, respectively, and total liabilities were \$65,205,600, \$65,683,143 and \$56,312,057, respectively, resulting in net assets of \$124,053,956, \$110,189,789 and \$100,509,240, respectively.
- An Electric rate increase of approximately 4.0% for all customer classes was effective in January 2011
- An Electric rate increase of approximately 6.0% for all customer classes was effective in January 2010.
- In 2011, operating revenues decreased 2.1% to \$51,916,645 while operating expenses decreased 2.1% to \$44,172,821.
- In 2010, operating revenues increased 38.0% to \$53,018,754 while operating expenses increased 26.2% to \$45,108,157.
- In 2009, operating revenues decreased 2.5% to \$38,417,765 while operating expenses increased 2.3% to \$35,745,824.
- In 2011, the Utility net operating income decreased by 2.1% to \$7,743,824 compared to net operating income of \$7,910,597 in 2010 and \$2,671,941 in 2009.
- The Utility delivered approximately 491,370,000 kilowatt hours (kWh) of electricity to its retail customers in 2011 as compared to approximately 483,148,000 kWh in 2010 and 456,492,000 kWh in 2009.
- On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, building furnishings and equipment, meters, switches, relays, tools and rendered the Streeter Station power plant units 6 and 7 and coal handling systems inoperable and in need of major repair. The Utility began immediate clean up and work with FEMA for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA for the recovery, repair and remediation of Utility assets damaged or destroyed in the flood. Additional detail on the 2008 Flood Event can be found in Note 12.
- On July 10, 2009, the City of Cedar Falls experienced a storm with extreme winds of approximately 106 MPH. The extreme winds uprooted and sheared trees snapping Electric Utility poles and distribution lines destroying them. The Utility began immediate clean up and also began working with the Federal Emergency Management Agency (FEMA) for reconstruction and repair of destroyed Utility distribution assets. Additional detail on the 2009 Wind Event can be found in Note 13.

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**Overview of the Financial Statements**

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

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

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

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

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

**Condensed Financial Information**

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

**Condensed Balance Sheet Information**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 62,195,006	\$ 62,595,644	\$ 46,305,981
Capital assets, net	121,845,880	110,985,955	108,356,428
Other noncurrent assets	5,218,670	2,291,333	2,158,888
Total assets	<u>\$189,259,556</u>	<u>\$175,872,932</u>	<u>\$156,821,297</u>
Current liabilities	\$ 10,186,271	\$ 8,185,595	\$ 7,177,332
Noncurrent liabilities	2,966,494	3,297,323	3,233,937
Long-term debt	52,052,835	54,200,225	45,900,788
Total liabilities	<u>\$ 65,205,600</u>	<u>\$ 65,683,143</u>	<u>\$ 56,312,057</u>

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Invested in capital assets, net of related debt	\$ 76,146,098	\$ 64,351,040	\$ 62,794,814
Restricted	6,690,882	7,162,009	6,716,184
Unrestricted	41,216,976	38,676,740	30,998,242
Total net assets	<u>\$124,053,956</u>	<u>\$110,189,789</u>	<u>\$ 100,509,240</u>

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Sales of electricity	\$49,799,768	\$50,347,269	\$34,700,713
Other	2,116,877	2,671,485	3,717,052
Total operating revenues	<u>51,916,645</u>	<u>53,018,754</u>	<u>38,417,765</u>
Fuel and Purchased Power	22,033,624	24,314,104	13,887,910
Operation and maintenance	9,220,238	8,904,283	8,373,285
Depreciation and amortization	3,957,361	3,825,289	4,220,126
Services and administrative	8,961,598	8,064,481	9,264,503
Total operating expenses	<u>44,172,821</u>	<u>45,108,157</u>	<u>35,745,824</u>
Operating Income	<u>7,743,824</u>	<u>7,910,597</u>	<u>2,671,941</u>
Interest income	276,495	200,080	562,606
Other, net	5,843,848	1,569,872	1,646,709
Total non-operating revenues (expenses)	<u>6,120,343</u>	<u>1,769,952</u>	<u>2,209,315</u>
Change in net assets	13,864,167	9,680,549	4,881,256
Net assets, beginning of year	<u>110,189,789</u>	<u>100,509,240</u>	<u>95,627,984</u>
Net assets, end of year	<u>\$124,053,956</u>	<u>\$110,189,789</u>	<u>\$100,509,240</u>

**Financial Analysis**

Current assets decreased 0.6% in 2011. Cash and investments - unrestricted increased by 4.2% primarily due to an increase in cash of 14.2%, \$2,941,150, offset by a decrease in short term investments of \$1,774,887, 25.2%. Cash and investments - restricted decreased by 26.6%, \$4,687,195, in 2011 due to the investment of \$3,301,578 of the 2010 debt proceeds in noncurrent assets - investments - restricted and the expenditure of \$1,180,844 of the 2010 debt proceeds on qualified capital projects. Receivables increased 43.0%, \$3,610,144, in 2011. Customer accounts receivable, less allowance for doubtful accounts, decreased in 2011 by 15.2%, \$606,464. Other receivables decreased \$289,868, 21.1%, due to a decrease in the receivable for MISO sales for resale and miscellaneous receivable. Government grants receivable increased 180.2%, \$4,629,063 primarily due to FEMA flood and wind projects. Fuel inventory decreased \$547,935, 7.83%, during 2011 due to a decrease in Streeter Station inventories of \$841,884, offset by increases in Walter Scott Generating Station Unit 3 (WS3) of \$74,671, Walter Scott Generating Station Unit 4 (WS4) of \$91,482 and the George Neal Unit 4 (Neal 4) of \$127,796 for coal and allowances. The Streeter Station average coal cost per ton increased \$.01 in 2011.

Current assets increased 35.2% in 2010. Cash and investments - unrestricted increased by 38.1% primarily due to an increase in cash of 50.0%, \$6,894,345, most

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of which was transferred from the restricted construction funds for monies spent on qualified capital projects and an increase in short term investments of \$748,509. Cash and investments - restricted increased by 85.7%, \$8,116,072, in 2010 due to proceeds from the issuance of new debt in 2010. Receivables decreased 9.7%, \$897,852, in 2010. Customer accounts receivable, less allowance for doubtful accounts, increased in 2010 by 6.7%, \$249,996. Other receivables decreased \$246,862, 15.3%, due to a decrease in the receivable for MISO sales for resale and miscellaneous receivable. In addition, government grants receivable decreased 23.3%, \$779,156. Fuel inventory increased \$987,704, 16.3%, during 2010 due to an increase in Streeter Station inventories of \$940,915, Walter Scott Generating Station Unit 3 (WS3) of \$60,074 and Walter Scott Generating Station Unit 4 (WS4) of \$63,280 for coal and allowances offset by a decrease in inventory for the George Neal Unit 4 (Neal 4) of \$76,565. The Streeter Station average coal cost per ton increased \$2.03 in 2010.

Current assets decreased 2.4% in 2009. Cash and investments - unrestricted increased by 15.2% primarily due to an increase in short term investments of \$3,593,434. Cash and investments - restricted decreased by 18.8% in 2009 due to construction fund investments maturing and funding authorized projects. Receivables decreased 23.9%, \$2,923,712, in 2009. Customer accounts receivable, less allowance for doubtful accounts, increased in 2009 by 3.0%, \$109,114, and Other receivables increased \$786,186, 94.4%, primarily due to a receivable for MISO sales for Resale of \$1,170,663, offset by a decrease in Government grants receivable of \$3,813,041. Fuel inventory increased \$1,419,818, 30.5%, during 2009 due to an increase in Streeter Station inventories of \$1,435,361 and Walter Scott Generating Station Unit 3 (WS3) of \$10,979 for coal and allowances offset by decreases in inventories for Walter Scott Generating Station Unit 4 (WS4) of \$20,350 and George Neal Unit 4 (Neal 4) of \$6,172. The Streeter Station average coal cost per ton increased \$3.71 in 2009.

Other noncurrent assets increased 204.8% in 2011 primarily due to the addition of \$3,301,578 in noncurrent investments of restricted 2010 bond debt proceeds offset by decreases in the long-term note receivable from the communications utility and loans receivable from customers for energy efficiency improvements. The total noncurrent outstanding balance on the Communications Utility note receivable at December 31, 2011 was \$738,090, a decrease of 20.0%. Deferred costs decreased \$86,296, 10.5%, primarily due to the amortization of the unamortized loss on reacquired debt related to the advanced refunding of the series 2003 revenue bonds and an increase of unamortized debt expense related to the issuance of new debt.

Other noncurrent assets increased 0.6% in 2010 due to a decrease in the long-term note receivable from the communications utility, loans receivable from customers for energy efficiency improvements and the reclassification from current to noncurrent of prepaid freight for the amount due per agreement with Iowa Northern Railway. Other noncurrent assets include the long-term note receivable from the Municipal Communications Utility. The total noncurrent outstanding balance on this note at December 31, 2010 was \$923,090, a decrease of 25.1%. Deferred costs increased \$419,262, 104.6%, primarily due to the addition of an unamortized loss on reacquired debt related to the advanced refunding of the series 2003 revenue bonds and an increase of unamortized debt expense related to the issuance of new debt.

Other noncurrent assets decreased 53.1% in 2009 primarily due to \$1,992,511 of long-term restricted investments from the 2007 bonds issued becoming current. Other noncurrent assets include the long-term note receivable from the Municipal

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Communications Utility. The total noncurrent outstanding balance on this note at December 31, 2009 was \$1,233,090, a decrease of 20.1%.

Current liabilities increased 24.4% in 2011 primarily as a result of an increase in accounts payable of 30.0%, \$1,239,347, and increase in reserve for surplus declaration of 88.0%, \$660,000 due to the allocation between the Electric and Gas Utilities returned to more typical amounts.

Current liabilities increased 14.0% in 2010 primarily as a result of an increase in accounts payable of 40.4%, \$1,190,770, and current installments of long term debt of 32.3%, \$515,000, due to the issuance of new debt in 2010.

Current liabilities decreased 8.8% in 2009 primarily as a result of a decrease in accounts payable of 22.8%, \$871,295.

Retail kWh sales increased in 2011 by 1.7%, 8,221,411 kWh. Total electric sales revenues decreased 1.1% in 2011 primarily due to the decrease in revenue from sales for resale of 12.6%, \$1,736,387 offset by the increase in retail sales of 3.3%, \$1,188,886 due to a 5.0% average rate increase for all customer classes, the increase in usage, and a decrease of 15.4%, \$0.002 per kWh, in the energy cost adjustment (ECA) passed through to customers making the average total ECA per kWh in 2011 \$0.011 compared to \$0.013 in 2010. The decrease in the ECA per kWh is attributable to the net effect of purchasing local load requirements from the MISO market, generating costs, offset by 68% of the revenue from the Western Units sales. The revenues from the Western Units sales into MISO for 2011 were \$11,344,742, down 13.2% from 2010.

Retail kWh sales increased in 2010 by 5.8%, 26,655,825 kWh. Total electric sales revenues increased 45.1% in 2010 primarily due to the increase in revenues from sales for resale and a 6% average rate increase for all customer classes and an increase of 100.2%, \$0.007 per kWh, in the energy cost adjustment (ECA) passed through to customers making the average total ECA per kWh in 2010 \$0.013 compared to \$0.006 in 2009. The increase in the ECA per kWh is attributable to the net effect of purchasing local load requirements from the MISO market, generating costs, offset by 62% of the revenue from the Western Units sales. Revenues from sales for resale increased \$9,128,237, 196.2%, due to the Utility turning over functional control of its transmission system to the non-profit Midwest Independent System Operator (MISO) effective September 1, 2009. The Utility is now a transmission owner in MISO and will receive revenue from MISO for its share of transmission revenue collected by MISO. In addition the Utility now sells the generation from its jointly owned Western Units (Water Scott Energy Center Unit 3 and Unit 4 and the George Neal Generating Station Unit 4) into the MISO market and either locally generates or purchases its local power needs from MISO. The revenues from the Western Units sales into MISO for 2010 were \$13,073,169.

Retail kWh sales increased in 2009 by 1.3%, 5,732,656 kWh. Total electric sales revenues increased 4.3% in 2009 primarily due to the increase in revenue from sales for resale. Revenue from sales for resale increased \$1,862,126, 66.8%, due to two offsetting factors. First, wholesale sales for resale decreased \$2,107,832 due to the Utility being unable to generate power, due to the flood, from its Streeter Units to sell to the wholesale market when the price was favorable. Second, the Utility turned over functional control of its transmission system to the non-profit Midwest Independent System Operator (MISO) effective September 1, 2009. The Utility is now a transmission owner in MISO and will receive revenue from MISO for its share of transmission revenue collected by MISO. In addition the Utility now must

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sell its generation from its jointly owned Western Units into the MISO market and purchase all of its local power needs from MISO. The revenues from the Western Units sales into MISO for the four months ending December 2009 were \$3,969,957.

Other operating revenues decreased 20.8% in 2011 primarily as a result of a decrease of \$524,378 in transmission revenues.

Other operating revenues decreased 28.1% in 2010 primarily as a result of a decrease of \$834,554 in FEMA grant revenue to reimburse expenses to repair operational flood and wind damage compared to 2009.

Other operating revenues decreased 39.4% in 2009 primarily as a result of a decrease of \$2,899,186 in FEMA grant revenue to reimburse expenses to repair operational flood damage compared to 2008.

Fuel costs decreased 23.1% in 2011 due to Streeter operating less in 2011 and lower Western Units costs due to selling 4.5% less into the MISO market compared to 2010. Since joining MISO in September 2009, Streeter generates to offset high purchased power costs when conditions are favorable. The Electric Utility now buys all energy, except what it generates locally to serve its native load, from MISO. This new arrangement increases purchased power costs as well as MISO Sales for Resale as discussed above. Due to lower wholesale market costs, purchased power costs decreased 2.8% in 2011 even though the Utility bought more electricity from the wholesale market for native load to substitute for the wholesale market not being favorable to generate from Streeter Station.

Fuel costs increased 54.8% in 2010 due to Streeter operating more in 2010 when the wholesale market was favorable and higher Western Units costs due to selling into the MISO market. Since joining MISO on September 1, 2009, Streeter now generates to offset high purchased power costs when conditions are favorable. Purchased Power costs increased 86.8% in 2010 due to the Utility buying more electricity from the wholesale market for native load to substitute for the wholesale market not being favorable to generate from Streeter Station. As discussed above, since joining MISO, the Electric Utility now buys all energy, except what it generates locally to serve its native load, from MISO. This new arrangement increases purchased power costs as well as MISO Sales for Resale as discussed above.

Fuel costs decreased 20.2% in 2009 due to Streeter not becoming operational until March 2009 and then operating only when the wholesale market was favorable. Since joining MISO on September 1, 2009, Streeter now generates to offset high purchased power costs when conditions are favorable. Purchased Power costs increased 49.5% in 2009 due to the Utility buying more electricity from the wholesale market for native load to substitute for being unable to generate from Streeter Station, due to flood damage, until March 2009. As discussed above, since joining MISO, the Electric Utility now buys all energy, except what it generates locally to serve its native load, from MISO. This new arrangement increases purchased power costs as well as MISO Sales for Resale as discussed above.

Operation and maintenance expenses increased 3.5%, \$315,955, in 2011. This is due to a 4.7%, \$207,793, increase in other production and generation costs and a 19.6%, \$449,343, increase in distribution costs due to the Utility's overhead to underground conversion project offset by a 15.8%, \$341,181, decrease in transmission cost primarily due to decreased transmission by others costs.

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Operation and maintenance expenses increased 6.3%, \$530,998, in 2010. This is due to a 57.0%, \$783,577, increase in transmission cost primarily due to increased transmission by others costs, offset by other production maintenance and operations costs which decreased by 5.2%, \$242,127, in 2010.

Operation and maintenance expenses increased 11.3%, \$852,340, in 2009. This is due to a 28.2%, \$523,443, increase in production maintenance due to increased steam turbine and gas turbine maintenance at Streeter and electric plant maintenance in the western generating units and related supervision and engineering costs. Transmission costs increased 4.3% in 2009 primarily due to increased supervision and engineering costs. Distribution costs increased 14.7%, \$296,428, in 2009 primarily due to expenses for line, pole, and equipment maintenance and repair due to damage caused by the July 2009 wind storm.

Depreciation and amortization expense increased by 3.5%, \$132,072, in 2011 primarily due to the completion of capital asset projects placed into service in 2010.

Depreciation and amortization expense decreased by 9.4%, \$394,837, in 2010 primarily due to changes made in the useful lives, and depreciation rates of the Western Units' assets resulting from a 2009 depreciation study.

Depreciation and amortization expense increased by 10.2%, \$390,652, in 2009 primarily due to changes made in the useful lives, and depreciation rates of locally owned assets resulting from a 2009 depreciation study and the addition of assets.

Services and administrative expenses increased by 11.1% in 2011. Administrative and general expenses increased 22.5%, \$1,192,514, in 2011 primarily due to 30.3%, \$492,679, increase in employee insurance and benefits due to several large medical insurance claims and \$660,000, 88.0%, more in the payment in lieu of tax (PILOT) paid to the City of Cedar Falls, Iowa. Outside services increased by 35.0%, \$123,638, due to increased use of consultants for MISO related studies and a cost of service study.

Services and administrative expenses decreased by 13.0% in 2010. The Utility offers customers' rebates through its House call energy efficiency program for selected energy efficiency measures. This program's expenses increased in 2010 by \$215,879, 35.4%. Administrative and general expenses decreased 21.4%, \$1,448,665, in 2010 primarily due to 65.1%, \$565,684, less in flood related repair costs, \$750,000, 50.0%, less in the payment in lieu of tax (PILOT) paid to the City of Cedar Falls, Iowa, and \$308,067, 15.9%, less in employee insurance and benefits expenses.

Services and administrative expenses decreased by 18.3% in 2009. The Utility began its House Call energy efficiency program in 2008 offering customers' rebates for selected energy efficiency measures. This program increased expenses by 72.8%, \$257,047, in 2009. Administrative and general expenses decreased 25.3% in 2009 primarily due to a decrease of \$3,047,622 in flood-related operational expenses offset by an 18.8%, \$305,938, increase in employee insurance and benefits expenses.

Interest Income increased 38.2% due to the investment of the 2010A debt proceeds. For other investments, the utility is experiencing a reduction in investments because of very low interest rates and difficulty getting banks to bid on placement

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of the investments during 2011. Funds that would have been invested were deposited into money market accounts waiting a strengthening in the investment markets.

Interest Income decreased 64.4% due to a reduction in investments because of very low interest rates and difficulty getting banks to bid on placement of the investments during 2010. Funds that would have been invested were deposited into money market accounts waiting a strengthening in the investment markets.

Interest Income decreased 55.1% due to a reduction in investments because of very low interest rates and difficulty getting banks to bid on placement of the investments during 2009. Funds that would have been invested were deposited into money market accounts waiting a strengthening in the investment markets.

Other, net increased 272.2%, \$4,273,976, in 2011 primarily due to a 279.1%, \$3,247,976, increase in intergovernmental grant funds revenue (FEMA reimbursements) due to repairs to capital assets caused by the 2008 flood and the 2009 wind storm, and a 55.9%, \$1,290,539, increase in miscellaneous revenues caused by expired customer advances and other customer contributions to capital offset by an increase in long-term debt interest expense of \$235,465, 11.7%.

Other, net decreased 4.7%, \$76,837, in 2010 primarily due to a 7.5%, \$81,475, increase in intergovernmental grant funds revenue (FEMA reimbursements) due to repairs to capital assets caused by the 2008 flood and the 2009 wind storm, and a 2.2%, \$49,932, increase in miscellaneous revenues offset by an increase in long-term debt interest expense of \$228,144, 12.8%.

Other, net decreased 70.7%, \$3,976,247, in 2009 primarily due to a \$3,540,722 decrease in FEMA grant revenue for costs for restoring and/or replacing capital assets due to the 2008 flood.

**Capital Assets and Debt Administration**

Net capital assets represent 64.4% of total assets for the Utility in 2011. Net capital assets increased 9.8% due to wind storm recovery capital projects, overhead to underground distribution system conversion projects, the construction of the new flood wall, and other environmental and upgrade projects.

Net capital assets represent 63.1% of total assets for the Utility in 2010. Net capital assets increased 2.4% due to wind storm recovery capital projects, overhead to underground distribution system conversion projects, and other environmental and upgrade projects.

Net capital assets represent 69.1% of total assets for the Utility in 2009. Net capital assets increased 5.6% from 2008 due to flood recovery capital projects, and WS3 environmental and upgrade projects.

Additional detail on the change in capital assets can be found in Note 4.

The Utility's total long-term debt at year end 2011 was \$52,052,835 compared to \$54,200,225 at year end 2010 and \$45,900,788 at year end 2009. The change in total long-term debt is due to the principal debt payments of \$2,110,000 in 2011, \$1,595,000 in 2010 and \$1,535,000 in 2009 plus amortization of debt discounts and premiums. In addition, in December 2010 the Board of Trustees authorized the issuance of \$10,000,000 in revenue capital loan notes for electric system improvements and extensions, and environmental upgrades to the Utility's generation

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units, transmission, and distribution assets. Also in December 2010, the Board of Trustees authorized the issuance of \$6,870,000 in refunding revenue capital loan notes for an advanced refunding of \$6,530,000 of principal of the outstanding \$8,240,000 of the 2003 revenue bonds. The advanced refunding has left \$1,710,000 principal remaining for the 2003 revenue bond issue. Annual payments for the 2003 revenue bonds will continue until the debt is extinguished in December 2014.

Additional detail on the outstanding loan can be found in Note 5.

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

Balance Sheets  
December 31, 2011 and 2010

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 188,476,471	\$ 181,815,583
Less accumulated depreciation	76,417,771	72,973,815
Capital assets, net (note 8)	<u>112,058,700</u>	<u>108,841,768</u>
Construction work in progress	9,787,180	2,144,187
Total capital assets, net	<u>121,845,880</u>	<u>110,985,955</u>
Noncurrent assets:		
Investments - Restricted (note 2 and 3)	3,301,578	-
Note receivable (note 9)	738,090	923,090
Loans receivable	335,634	438,579
Prepayments and other	109,457	109,457
Total noncurrent assets	<u>4,484,759</u>	<u>1,471,126</u>
Current assets:		
Cash and cash equivalents (note 3)	23,633,410	20,692,260
Cash - Restricted (note 2 and 3)	3,435,120	11,208,564
Investments - Unrestricted (note 3)	5,258,680	7,033,567
Investments - Restricted (note 2 and 3)	9,469,162	6,382,913
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$40,868 in 2011 and \$41,386 in 2010	3,378,454	3,984,918
Loans receivable	82,961	106,189
Interest (note 9)	82,167	56,526
Current installment of note receivable (note 9)	185,000	310,000
Government grants (note 12 and 13)	7,197,202	2,568,139
Other	1,081,958	1,371,826
Inventories:		
Fuel	6,512,801	7,060,736
Material and supplies	1,697,021	1,679,987
Prepayments and other	181,070	140,019
Total current assets	<u>62,195,006</u>	<u>62,595,644</u>
Deferred costs	<u>733,911</u>	<u>820,207</u>
Total assets	<u>\$ 189,259,556</u>	<u>\$ 175,872,932</u>

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

Balance Sheets  
December 31, 2011 and 2010

<u>Liabilities</u>	<u>2011</u>	<u>2010</u>
Long-term debt, less current installments (note 5)	\$ 52,052,835	\$ 54,200,225
Current liabilities:		
Accounts payable	5,376,488	4,137,141
Reserve for surplus declaration (note 9)	1,410,000	750,000
Accrued wages and vacations	762,338	743,814
Accrued interest	197,411	195,734
Other accrued expenses	275,034	248,906
Current installments of long-term debt (note 5)	2,165,000	2,110,000
Total current liabilities	<u>10,186,271</u>	<u>8,185,595</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	475,541	1,280,296
Other liabilities (note 5 and 11)	2,490,953	2,017,027
Total noncurrent liabilities	<u>2,966,494</u>	<u>3,297,323</u>
 Total liabilities	 <u>65,205,600</u>	 <u>65,683,143</u>
 <u>Net Assets</u>		
Invested in capital assets, net of related debt	76,146,098	64,351,040
Restricted	6,690,882	7,162,009
Unrestricted	41,216,976	38,676,740
Total net assets	<u>124,053,956</u>	<u>110,189,789</u>
 Total liabilities and net assets	 <u>\$ 189,259,556</u>	 <u>\$ 175,872,932</u>

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

Statements of Revenues, Expenses and Changes in Net Assets  
Years ended December 31, 2011, and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Sales of electricity:		
Residential	\$ 15,008,713	\$ 14,672,269
Large industrial & commercial	2,747,982	2,707,671
Small industrial & commercial	15,521,789	15,154,612
Governmental (note 9)	4,248,288	3,819,655
Sales for resale	12,043,230	13,779,617
Interdepartmental	229,766	213,445
Total sales of electricity	<u>49,799,768</u>	<u>50,347,269</u>
Other operating revenues (note 12 and 13)	2,116,877	2,671,485
Total operating revenues	<u>51,916,645</u>	<u>53,018,754</u>
 Operating expenses:		
Production and generation:		
Fuel	6,058,696	7,873,844
Purchased power	15,974,928	16,440,260
Other	4,657,491	4,449,698
Transmission	1,816,055	2,157,236
Distribution	2,746,692	2,297,349
Depreciation and amortization	3,957,361	3,825,289
Customer accounts	642,758	763,144
Customer service and information expenses	876,524	1,053,239
Sales	27,007	15,104
Administrative and general (note 9)	6,503,323	5,310,809
Taxes other than income taxes	911,986	922,185
Total operating expenses	<u>44,172,821</u>	<u>45,108,157</u>
 Operating income	<u>7,743,824</u>	<u>7,910,597</u>
 Non-operating revenues (expenses):		
Interest income (note 9)	276,495	200,080
Net increase (decrease) in the fair value of investments	(77,087)	(24,408)
Miscellaneous revenue (expense), net (note 9)	3,597,657	2,307,118
Intergovernmental grant funds (note 12 and 13)	4,411,548	1,163,572
Interest expense on long-term debt	(2,244,033)	(2,008,568)
AFUDC (note 1)	161,925	137,336
Interest income (expense) on security deposits	(6,162)	(5,178)
Total nonoperating revenues (expenses)	<u>6,120,343</u>	<u>1,769,952</u>
 Change in net assets	<u>13,864,167</u>	<u>9,680,549</u>
 Net assets, beginning of year	<u>110,189,789</u>	<u>100,509,240</u>
 Net assets, end of year	<u>\$ 124,053,956</u>	<u>\$ 110,189,789</u>

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

Statements of Cash Flows  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from customers	\$ 54,824,450	\$ 57,299,644
Cash paid to suppliers	(32,434,062)	(36,557,097)
Cash paid to employees	(3,797,349)	(3,766,641)
Payment in lieu of taxes to the City of Cedar Falls	(750,000)	(1,500,000)
Property tax paid	(477,071)	(471,266)
	<u>17,365,968</u>	<u>15,004,640</u>
Net cash provided by (used in) operating activities		
Cash flows from noncapital financing activities:		
Interest paid on customer deposits	(3,643)	(3,673)
Net cash provided by (used in) noncapital financing activities	<u>(3,643)</u>	<u>(3,673)</u>
Cash flows from capital and related financing activities:		
Proceeds from issuance of capital loan notes	-	16,870,000
Premium on issuance of capital loan notes	-	115,126
Discount on issuance of capital loan notes	-	(151,339)
Cost of issuance of capital loan notes	-	(83,700)
Principal payments on long-term debt	(2,110,000)	(1,595,000)
Recall of 2003 revenue bonds	-	(6,790,710)
Interest paid	(2,188,588)	(1,967,970)
Proceeds from customer advances for construction	60,700	122,400
Refunds of customer advances for construction	(157,600)	(200,051)
Acquisition, construction and removal cost of capital assets	(14,701,924)	(7,254,148)
Proceeds from sale of capital assets	86,079	133,553
Reimbursement of utility construction costs	945,887	959,005
	<u>(18,065,446)</u>	<u>157,166</u>
Net cash provided by (used in) capital and related financing activities		
Cash flows from investing activities:		
Proceeds from repayment of loan by associated utility	310,000	310,000
Loan to associated utility		
Proceeds from maturities of investment securities	15,818,801	18,148,721
Purchase of investment securities	(20,543,461)	(16,804,230)
Interest received	285,487	315,201
	<u>(4,129,173)</u>	<u>1,969,692</u>
Net cash provided by (used in) investing activities		
Net increase (decrease) in cash and cash equivalents	(4,832,294)	17,127,825
Cash and cash equivalents, beginning of year	<u>31,900,824</u>	<u>14,772,999</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 27,068,530</u>	<u>\$ 31,900,824</u>

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

Statements of Cash Flows, Continued  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 7,743,824	\$ 7,910,597
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization of capital assets	3,957,361	3,825,289
Other Income (expense), net	6,315,947	3,314,800
(Increase) decrease in accounts receivable	896,332	(3,134)
(Increase) decrease in loans receivable	126,173	92,983
(Increase) decrease in intergovernmental grants	(4,629,063)	779,156
(Increase) decrease in inventories	530,901	(1,461,410)
(Increase) decrease in prepayments and other	6,568	(70,782)
Increase (decrease) in accounts payable	1,239,347	1,190,770
Increase (decrease) in reserve for surplus declaration	660,000	(750,000)
Increase (decrease) in accrued wages and vacation	18,524	45,007
Increase (decrease) in other accrued expenses	26,128	(9,673)
Increase (decrease) in other liabilities	<u>473,926</u>	<u>141,037</u>
Net cash provided by operating activities	<u>\$ 17,365,968</u>	<u>\$ 15,004,640</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	161,925	137,336
Contributions from contractors in aid of construction	57,113	-
Expiration of customer advances for construction	707,855	-
Intergovernmental grants	4,767,865	1,288,833
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 23,633,410	\$ 20,692,260
Cash - Restricted	<u>3,435,120</u>	<u>11,208,564</u>
Cash and cash equivalents	<u>\$ 27,068,530</u>	<u>\$ 31,900,824</u>

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Electric Utility (Utility) of the City of Cedar Falls, Iowa is a separate and distinct city utility and is chartered under Iowa Code Section 388. The Utility is a component unit of the City of Cedar Falls, Iowa. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

The Utility's present capacity consists of one wholly owned and three jointly owned coal-fired plants, Walter Scott Energy Center Unit 3, Walter Scott Energy Center Unit 4, and George Neal Generating Station Unit 4 (Western Units) and one assigned by contract with a combined generating capacity of 111.9 megawatts. The Utility owns two combustion turbines with a generating capacity of 43.4 megawatts. The Utility also owns 1.5 megawatts of generating capacity in a jointly owned wind turbine facility. The Utility owns a total of 156.8 megawatts of generating capacity.

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

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

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 4.49% in 2011 and 4.63% 2010. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: land improvements - 45 years, infrastructure - 25 to 55 years, buildings and improvements - 20 to 70 years, and equipment - 10 to 60 years. The depreciation provisions were equivalent to an overall composite rate of 2.5% and 2.4% of depreciable assets for 2011 and 2010, respectively.

Capital assets may be contributed to the utility by outside parties. As these assets are completed and placed in service, the utility reports the value of these contributions in the statement of revenue, expenses, and changes in net assets.

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

(c) Cash and Investments

Investments are stated at their fair value on the balance sheets. The Utility's investments stated at fair value reflect quoted market prices at the balance

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

(c) Cash and Investments, Continued

sheet date, for U.S. Treasury and government agency debt securities. The cost of certificates of deposit approximates fair value.

The Utility considers all highly liquid investments with maturity of three months or less at purchase to be cash equivalents for purposes of the statements of cash flows. Included in cash and cash equivalents at December 31, 2011 and 2010 were \$2,750,000 and \$2,750,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(d) Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount and are reported net of allowances.

(e) Inventories

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

(f) Bond Issue Costs

Unamortized bond issue costs are amortized over the life of the bonds using the same percentage as the principal paid in a given year is to the total debt issued by issue.

(g) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets and increased by unspent debt proceeds of this capital related debt. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors or laws or regulations of government entities. Unrestricted net assets consist of net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted".

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

(h) Operating Revenues and Expenses

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

Revenues from the sale of electricity are based on billing rates, which are applied to customers' consumption of electricity. The Utility records estimated unbilled revenue, including amounts to be billed under a fuel adjustment clause, at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2011 and 2010, were \$1,522,355, and \$1,723,233 respectively, and are recorded in customer accounts receivable. The Utility

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

uses a fuel adjustment clause whereby increases or decreases in fuel costs and purchase power costs are billed to customers and included in operating revenue without changing base rates charged to its customers.

(i) Estimates

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

(j) Budgetary Information

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

Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year 2011 there were no budget amendments.

(k) Grants

The Electric Utility has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

(l) Employee Benefits

Employee benefits for accumulated sick leave hours are not accrued as they are not payable to employees. Vacation hours are earned monthly and are accrued and recorded as liabilities and unused vacation hours are paid upon termination of service. Accrued wages represents time employees worked during the calendar year.

The Electric Utility provides retirement severance pay to qualifying full-time employees upon death or retirement. Retirement severance pay will be credited at the rate of two days per year of continuous service, with a minimum of twenty years of continuous service needed to qualify. The retirement severance pay shall apply only to regular full-time employees hired prior to June 30, 2007. Employees who are hired after that date shall not be entitled to the benefit. As of December 31, 2011 and 2010 the accrued liability was \$622,923 and \$570,984, respectively.

(m) Customer Advances

Customer Advances represent amounts paid to the utility by developers to extend service to new areas. As customers are added, advances will be refunded to the developers over the defined term of the agreement. Expired advances are recorded as other non-operating income in the year they expire.

(n) Reclassifications

Reclassifications of prior year's amounts may have been made for comparability.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(2) Restricted Assets

The composition of restricted assets as of December 31, 2011 and 2010 was as follows:

	2011		Total
	Cash	Investments	
Current Assets - Restricted			
Bond Reserve	\$ 22,010	\$4,821,750	\$ 4,843,760
Bond and Interest	359,226	-	359,226
Streeter Landfill	600,496	-	600,496
Self Insured Medical and Dental	384,326	500,000	884,326
Construction	2,069,062	3,147,412	5,216,474
Improvement and Extension	-	1,000,000	1,000,000
Total Current Assets - Restricted	3,435,120	9,469,162	12,904,282
Noncurrent Assets - Restricted			
Construction	-	3,301,578	3,301,578
Total Noncurrent Assets - Restricted	-	3,301,578	3,301,578
 Total restricted assets	 <u>\$3,435,120</u>	 <u>\$12,770,740</u>	 <u>\$16,205,860</u>

	2010		Total
	Cash	Investments	
Current Assets - Restricted			
Bond Reserve	\$ 886	\$4,882,913	\$ 4,883,799
Bond and Interest	355,485	-	355,485
Streeter Landfill	565,065	-	565,065
Self Insured Medical and Dental	611,817	500,000	1,111,817
Construction	9,675,311	-	9,675,311
Improvement and Extension	-	1,000,000	1,000,000
Total Current Assets - Restricted	11,208,564	6,382,913	17,591,477
 Total restricted assets	 <u>\$11,208,564</u>	 <u>\$6,382,913</u>	 <u>\$17,591,477</u>

The monies deposited into the various funds have been invested in interest-bearing securities as required by the bond resolutions or legal requirement. Amounts deposited in the bond reserve, bond interest, construction, and improvement and extension funds may only be used for the purpose of paying principal and interest on the bonds when due or such other purposes as set forth in the bond resolutions and as a result are classified as restricted. Amounts deposited in the Streeter Landfill fund may only be used to cover costs related to the closure of the ash landfill. Amounts deposited in the Self-Insured Medical and Dental fund may only be used for medical and dental reserves and expenses.

(3) Cash on Hand, Deposits, and Investments

Cash on Hand

Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2011 was \$345 and 2010 was \$345.

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

Notes to Financial Statements  
December 31, 2011 and 2010

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

Deposits

At December 31, 2011, the Utility's carrying amount of deposits, including \$12,070,430 of certificates of deposits and \$18,068,670 of money market accounts, was \$36,388,614. At December 31, 2010, the Utility's carrying amount of deposits, including \$13,416,480 of certificates of deposits and \$25,678,952 of money market accounts, was \$42,566,959.

Investments

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

As of December 31, 2011, the Utility had the following Federal Agency Obligations investments and maturities. (The Utility assumes callable bonds will not be called):

Investment Type	Investment Maturities (In Years)		
	Less than 1	1 to 3	Total
Federal Agency Obligations	\$3,147,413	\$2,811,578	\$5,958,991

As of December 31, 2011 the Utility had \$5,958,991 in Federal Agency Obligation investments maturing on various dates between January 9, 2012 and October 15, 2013. These investments have a Standard & Poor's credit rating of AA+ and a Moody's Investor Services credit rating of Aaa. As of December 31, 2010, the Utility had no Federal Agency Obligation investments or maturities.

In addition, the Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$2,750,000 and \$2,750,000 at December 31, 2011 and 2010, respectively, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk

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

Credit Risk

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

Concentration of Credit Risk

The Utility's investment policy does not allow for a prime bankers' acceptance or commercial paper and other corporate debt balances to be greater than ten percent of its total deposits and investments. The policy also limits the amount that can

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

Notes to Financial Statements  
December 31, 2011 and 2010

3) Cash on Hand, Deposits, and Investments, Continued

be invested in a single issue to five percent of its total deposits and investments. The Utility held no such investments during the year.

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

Custodial Credit Risk - Investments

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

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

	2011	2010
Cash on hand	\$ 345	\$ 345
Carrying amount of deposits	36,388,614	42,566,959
Carrying amount of federal agency obligations	5,958,991	-
Carrying amount of Iowa Public Agency Investment Trust	2,750,000	2,750,000
Total	\$ 45,097,950	\$ 45,317,304
Current Assets		
Cash and cash equivalents	\$ 23,633,410	\$ 20,692,260
Investments	5,258,680	7,033,567
Restricted Cash	3,435,120	11,208,564
Restricted Investments	9,469,162	6,382,913
Noncurrent Investments		
Restricted	3,301,578	-
Total	\$ 45,097,950	\$ 45,317,304

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

Notes to Financial Statements  
December 31, 2011 and 2010

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

Of the unrestricted cash and investments listed above, the Board of Trustees of the Municipal Electric Utility has made reserve fund designations as follows:

	2011	2010
Unrestricted Cash and Investments		
Board Designated		
Generation	\$ 3,258,767	\$ 4,034,440
Western Units Landfill	321,550	326,278
Security Deposits	226,722	192,086
Operating	25,085,051	23,173,023
Total Cash and Investments		
Unrestricted	\$ 28,892,090	\$ 27,725,827

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2011 and 2010 follows:

2011	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being Depreciated:				
Land	\$ 1,071,983	\$ 254,872	\$ -	\$ 1,326,855
Construction, Work-in-progress	2,144,187	14,638,387	6,995,394	9,787,180
Total capital assets, Not being depreciated	3,216,170	14,893,259	6,995,394	11,114,035
Capital assets, being depreciated:				
Infrastructure	137,741,044	4,354,272	803,356	141,291,960
Buildings and improvements	22,872,789	1,961,526	8,209	24,826,106
Equipment	20,129,767	1,291,457	389,674	21,031,550
Total capital assets, being depreciated	180,743,600	7,607,255	1,201,239	187,149,616
Less accumulated depreciation	72,973,815	4,712,149	1,268,193	76,417,771
Total capital assets, being depreciated, net	107,769,785	2,895,106	(66,954)	110,731,845
Capital assets, net	\$110,985,955	\$ 17,788,365	\$ 6,928,440	\$121,845,880

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(4) Capital Assets, Continued

2010	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being Depreciated:				
Land	\$ 1,071,983	\$ -	\$ -	\$ 1,071,983
Construction, Work-in-progress	4,129,572	6,895,354	8,880,739	2,144,187
Total capital assets, Not being depreciated	<u>5,201,555</u>	<u>6,895,354</u>	<u>8,880,739</u>	<u>3,216,170</u>
Capital assets, being depreciated:				
Infrastructure	131,811,603	6,915,498	986,057	137,741,044
Buildings and improvements	21,923,245	1,084,793	135,249	22,872,789
Equipment	19,502,339	880,448	253,020	20,129,767
Total capital assets, being depreciated	<u>173,237,187</u>	<u>8,880,739</u>	<u>1,374,326</u>	<u>180,743,600</u>
Less accumulated depreciation	<u>70,082,314</u>	<u>4,426,083</u>	<u>1,534,582</u>	<u>72,973,815</u>
Total capital assets, being depreciated, net	<u>103,154,873</u>	<u>4,454,656</u>	<u>(160,256)</u>	<u>107,769,785</u>
Capital assets, net	<u>\$108,356,428</u>	<u>\$ 11,350,010</u>	<u>\$ 8,720,483</u>	<u>\$110,985,955</u>

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(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2011 and 2010 was as follows:

2011	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Revenue Bonds:					
Series 2003	\$ 1,710,000	\$ -	\$ 280,000	\$ 1,430,000	\$ 295,000
Series 2005	21,910,000	-	670,000	21,240,000	690,000
Series 2007	16,310,000	-	700,000	15,610,000	735,000
Capital Loan Notes:					
Series 2010A	10,000,000	-	410,000	9,590,000	395,000
Series 2010B	6,870,000	-	50,000	6,820,000	50,000
Unamortized premium	388,217	-	13,631	374,586	-
Unamortized discount	(877,992)	-	(31,241)	(846,751)	-
	<u>56,310,225</u>	<u>-</u>	<u>2,092,390</u>	<u>54,217,835</u>	<u>\$ 2,165,000</u>
Current installments of long-term debt	(2,110,000)	(55,000)	-	(2,165,000)	
Long-term debt, less current installments	<u>54,200,225</u>	<u>(55,000)</u>	<u>2,092,390</u>	<u>52,052,835</u>	
Customer advances for construction	1,280,296	60,700	865,455	475,541	
Other liabilities:					
Landfill closure	786,714	155,912	20,580	922,046	
Other deferred	136,223	362,121	233,555	264,789	
Accrued severance and OPEB	1,094,090	856,908	646,880	1,304,118	
Noncurrent liabilities	<u>3,297,323</u>	<u>1,435,641</u>	<u>1,766,470</u>	<u>2,966,494</u>	
Total noncurrent liabilities	<u>\$57,497,548</u>	<u>\$1,380,641</u>	<u>\$3,858,860</u>	<u>\$55,019,329</u>	

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(5) Noncurrent Liabilities, Continued

2010	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Revenue Bonds:					
Series 2003	\$ 8,510,000	\$ -	\$ 6,800,000	\$ 1,710,000	\$ 280,000
Series 2005	22,565,000	-	655,000	21,910,000	670,000
Series 2007	16,980,000	-	670,000	16,310,000	700,000
Capital Loan Notes:					
Series 2010A	-	10,000,000	-	10,000,000	410,000
Series 2010B	-	6,870,000	-	6,870,000	50,000
Unamortized premium	282,488	115,126	9,397	388,217	-
Unamortized discount	(841,700)	(151,339)	(115,047)	(877,992)	-
	<u>47,495,788</u>	<u>16,833,787</u>	<u>8,019,350</u>	<u>56,310,225</u>	<u>\$ 2,110,000</u>
Current installments of long-term debt	(1,595,000)	(515,000)	-	(2,110,000)	
Long-term debt, less current installments	<u>45,900,788</u>	<u>16,318,787</u>	<u>8,019,350</u>	<u>54,200,225</u>	
Customer advances for construction	1,357,947	126,599	204,250	1,280,296	
Other liabilities:					
Landfill closure	789,076	15,402	17,764	786,714	
Other deferred	93,437	3,769,793	3,727,007	136,223	
Accrued severance and OPEB	<u>993,477</u>	<u>416,926</u>	<u>316,313</u>	<u>1,094,090</u>	
Noncurrent liabilities	<u>3,233,937</u>	<u>4,328,720</u>	<u>4,265,334</u>	<u>3,297,323</u>	
Total noncurrent liabilities	<u>\$49,134,725</u>	<u>\$20,647,507</u>	<u>\$12,284,684</u>	<u>\$57,497,548</u>	

On December 21, 2010, new revenue capital loan notes series 2010B in the amount of \$6,870,000 were issued with interest rates throughout the term of the notes ranging from 2.50% and 3.80% to advance refund \$6,530,000 of outstanding Series 2003 revenue bonds with interest rates ranging from 4.00% to 4.5%. The net proceeds of \$6,762,320 (after payment of \$136,925 in underwriting fees, insurance and other issuance costs) were used to purchase U.S. government securities. Those securities were deposits in an irrevocable trust with an escrow agent to provide for \$6,807,162 of future debt service payments on the old bonds. As a result, the old bonds are considered to be defeased and the liability for that portion of the old bonds has been removed from the statement of net assets. The 2003 notes were called on December 1, 2011. At December 31, 2011, \$0 of notes outstanding are considered defeased.

The cash flow requirements on the old bonds prior to the advance refunding was \$9,141,210 from 2011 through 2023. The cash flow requirements on the new bonds are \$8,867,203 from 2011 through 2023. The advance refunding resulted in \$274,007 in future debt service payments and an economic gain of \$221,801.

On December 21, 2010, the Utility issued \$10,000,000 of Series 2010A revenue capital loan notes for the purpose of paying costs of improvements and extensions to the Utility and environmental upgrades of generation facilities owned or co-owned by

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(5) Noncurrent Liabilities, Continued

the Utility. The notes mature in 2030 and interest rates throughout the term of the notes are in a range between 3.00% and 4.75%.

During 2007, the Utility issued \$17,825,000 of Series 2007 revenue bonds for the purpose of paying costs of improvements and extensions to the Utility and environmental upgrades of generation facilities owned or co-owned by the Utility. The bonds mature in 2026 and interest rates throughout the term of the bonds are in a range between 4.00% and 4.375%.

During 2005, the Utility issued \$24,975,000 of Series 2005 revenue bonds for the purpose of paying costs of improvements and extensions to the Utility, including the construction of generation and related transmission facilities to serve the Utility. The bonds mature in 2024 and interest rates throughout the term of the bonds are in a range between 3.00% and 4.25%.

During 2003, the Utility issued \$10,000,000 of Series 2003 revenue bonds for the purpose of paying costs of improvements and extensions to the Utility, including the construction of generation and related transmission facilities to serve the Utility. As of December 31, 2011, after the advanced refunding described above, the remaining \$1,430,000 of Series 2003 revenue bonds mature in 2014 with interest rates ranging from 3.50% to 4.00%.

The Series 2003, 2005 and 2007 revenue bonds and 2010A and 2010B revenue capital loan notes require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds are in a range between 2.50% and 4.75%. The bonds and capital loan notes are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

Year	Series 2003 Electric Revenue Bonds		Series 2005 Electric Revenue Bonds	
	December 1 Principal Amount	3.50%-4.00% Interest Amount	December 1 Principal Amount	3.75%- 4.25% Interest Amount
2012	\$ 295,000	\$ 52,950	\$ 690,000	\$ 864,225
2013	555,000	42,625	1,370,000	838,350
2014	580,000	23,200	1,420,000	786,975
2015			1,480,000	730,175
2016			1,535,000	670,975
2017-2021			8,675,000	2,379,219
2022-2024			6,070,000	521,688
	<u>\$ 1,430,000</u>	<u>\$ 118,775</u>	<u>\$21,240,000</u>	<u>\$ 6,791,607</u>

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(5) Noncurrent Liabilities, Continued

Series 2007 Electric Revenue Bonds				
Year	December 1 Principal Amount	4.00%-4.375% Interest Amount		
2012	\$ 735,000	\$ 652,369		
2013	765,000	622,968		
2014	805,000	592,369		
2015	840,000	560,168		
2016	885,000	526,569		
2017-2021	5,085,000	2,060,344		
2022-2026	6,495,000	878,588		
	<u>\$15,610,000</u>	<u>\$ 5,893,375</u>		
Series 2010A Electric Revenue Capital Loan Notes				
Year	December 1 Principal Amount	3.00%-4.75% Interest Amount	Series 2010B Electric Revenue Refunding Capital Loan Notes	
			December 1 Principal Amount	2.50%- 3.80% Interest Amount
2012	\$ 395,000	\$ 367,688	\$ 50,000	\$ 208,480
2013	405,000	355,838	50,000	207,230
2014	410,000	343,688	50,000	205,980
2015	420,000	331,388	650,000	204,730
2016	430,000	318,787	670,000	188,480
2017-2021	2,290,000	1,391,162	3,675,000	663,315
2022-2026	2,675,000	944,112	1,675,000	94,500
2027-2030	2,565,000	306,012		
	<u>\$9,590,000</u>	<u>\$ 4,358,675</u>	<u>\$6,820,000</u>	<u>\$1,772,715</u>

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

All utility revenues net of specified operating expenses are pledged as security of the above revenue bonds until the bonds are defeased. Principal and interest paid for 2011 and 2010 were \$4,298,587 and \$10,092,769, respectively. Total sales of electricity gross revenues as defined for the same periods were \$49,799,768 and \$50,347,269. Annual principal and interest payments are expected to require 7.78% of gross revenues on average.

Iowa Administrative Code requires the Utility to place a final cover on its ash landfill site for its Streeter Station Generating Facility when it is closed and thereupon to have in place surveying monuments and an approved groundwater monitoring system. Iowa Administrative Code also requires the Utility to maintain the final cover, monitor ground water, and file reports with the Iowa Department of Natural Resources for ten years following closure of the site. Although closure and post closure costs are paid only near or after the date that the landfill is closed, the Utility reports a portion of these closure

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(5) Noncurrent Liabilities, Continued

and post closure costs as an operating expense in each period based on landfill capacity used as of each balance sheet date. Landfill closure and post closure care costs at December 31, 2011 are estimated to be \$600,496. This represents the cumulative estimated amount to date, based on the use of 100% of the estimated capacity of the landfill, to perform all closure and post closure care in 2012. Currently, the Utility has \$600,496 in restricted funds to cover the cost of the closure (see note 2). The Utility expects to close the landfill during 2012. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. In 2008 the Utility created a Landfill Closure liability for its ownership share of Walter Scott Energy Center - Unit 3, and George Neal Generating Station - Unit 4 generating units. The Walter Scott Energy Center - Unit 3 dry ash landfill was expected to be closed December 1, 2016 and its wet ash landfill is expected to be closed December 1, 2024. The Neal - Unit 4 land fill is expected to be closed December 1, 2017. A liability has been established and funds designated to pay the closing costs in the amount of \$321,550 (see note 3).

(6) Pension and Retirement Benefits

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

Plan members were required to contribute 4.50% of their annual covered salary and the Utility is required to contribute 6.95% of annual covered payroll through June 30, 2011. Beginning July 1, 2011 plan members are required to contribute 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2011, 2010, and 2009 were \$512,851; \$458,698; and \$427,457; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Prior to June 30, 2010, employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age qualified to convert their accrued sick leave value into paid health insurance premiums upon retirement. This benefit was phased out between January 1, 2008 and June 30, 2010. In 2008 the benefit was reduced to 75% of accrued sick leave and in 2009 to June 30, 2010 was reduced to 50% and zero thereafter.

(7) Income Tax Status

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

(8) Jointly-Owned Capital Assets

The Utility's share of jointly owned electric facilities at December 31, 2011 and 2010 is reflected in the following table. These facilities provide approximately 35% of the Utility's total generating capacity. The Utility is required to provide financing for its share of the facilities. The Utility's share of expenses associated with these facilities is included with the appropriate operating expenses in the statements of revenues, expenses and changes in net assets.

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(8) Jointly-Owned Capital Assets, Continued

Facility	Capital Assets, Net			
	Percentage Ownership	Capacity MW	2011	2010
Walter Scott Energy Center Unit 3	3.10%	21.00	\$12,460,394	\$12,271,536
Walter Scott Energy Center Unit 4	2.14%	16.90	28,041,671	26,799,736
George Neal Generating Station Unit 4	2.50%	15.00	2,203,126	2,236,929
Iowa Distributed Wind Generation Project	65.80%	1.50	622,457	659,312

(9) Related Party Transactions

The Utility makes payments in lieu of taxes upon approval by the Board of Trustees to the City of Cedar Falls, Iowa. Expenses for 2011 and 2010 were \$1,410,000 and \$750,000, respectively, which were recorded in administrative and general expenses. Subsequent to December 31, 2011, the Utility's Board of Trustees approved a payment of \$1,410,000 related to payments in lieu of taxes for 2011.

In addition, the Utility provides electric service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$921,256 and \$845,166 in 2011 and 2010, respectively.

The Electric Utility has extended a loan to the Municipal Communications Utility of the City of Cedar Falls, Iowa (Communications Utility), with an outstanding balance of \$923,090 and \$1,233,090 as of December 31, 2011 and 2010, respectively. Interest accrues on the loan at 3.10% and is paid semi-annually during January and July. Semi-annual principal payments continue through 2016. Accrued interest receivable was \$16,830 and \$21,674 at December 31, 2011 and 2010, respectively. Interest income for the years ended December 31, 2011 and 2010 was \$35,785 and \$45,395 respectively. In January 2012 the Board of Trustees of the Municipal Electric Utility adopted resolution No.5089 reducing the annual interest rate from 3.1% to 2.0% to be more reflective of the investment and borrowing markets.

For the year ended December 31, 2010, the Utility earned a management fee of \$69,863 from the Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous non-operating revenue. Due to a reallocation of labor and other costs among the Electric, Gas, Water and Communications Utilities this management fee was eliminated as of December 31, 2010.

(10) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks.

The Utilities maintain a risk management account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and have insurance for claims above this amount. In addition, the Utilities have aggregate stop loss coverage for the 2011 plan year for aggregate claims exceeding \$2.3 million.

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(10) Risk Management, Continued

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

	<u>2011</u>	<u>2010</u>
Unpaid claims and IBNR, beginning of year	\$ 187,000	\$ 325,000
Current year costs including IBNR	3,869,576	2,207,548
Claims paid	<u>(3,705,576)</u>	<u>(2,345,548)</u>
Unpaid claims and IBNR, end of year	<u>\$ 351,000</u>	<u>\$ 187,000</u>

The Utility has recorded \$217,620 and \$114,070 in accounts payable for its share of these unpaid claims at December 31, 2011 and 2010, respectively.

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

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2011.

Cash and cash equivalents and investments	\$56,188,298
Receivables	1,866,149
Other assets	<u>671,822</u>
Total assets	<u>\$58,726,269</u>
Total liabilities	\$27,019,782
Total equity	<u>31,706,487</u>
Total liabilities and equity	<u>\$58,726,269</u>
Total revenues	\$ 8,210,837
Total expenses	3,654,409
Distribution to members	<u>-</u>
Net increase in equity	<u>\$ 4,556,428</u>

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

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(11) Other Post-Employment Benefits (OPEB)

Plan Description

The Cedar Falls Utilities administers a single-employer defined benefit medical health care plan (The Plan) for all four utilities. The plan provides self-insured medical, vision, and prescription drug coverage to all active and retired employees and their eligible dependents. Eligible retirees receive health care coverage through the same plans that are available for active employees. To be eligible for these benefits employees at their retirement date must be a minimum of 55 years old, have been employed for the preceding four years, and be enrolled in the plan. Plan contributions are required from retirees based on an amount equal to the full cost of active members. These medical benefits terminate upon attaining Medicare eligibility. In addition, the Plan provides a \$5,000 in life insurance benefits to all retirees who elect this coverage and agree to pay a contribution for this coverage.

Funding Policy

The Utilities, with assistance from their third-party administrators, establishes and amends contribution requirements for both active and retiree members on an annual basis. The current funding policy is to pay health claims as they occur and the required contribution is based on pay-as-you-go financing. For the year ending December 31, 2011, the Utility contributed \$185,824 and retirees receiving benefits contributed \$114,053 through their required contributions.

Annual OPEB and Net OPEB Obligations

The Plan's annual OPEB expense is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of General Accounting Standards Board (GASB) Statement No 45. This standard was implemented in 2008. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following schedule shows the components of the annual OPEB expense for the year, the amount actually contributed to the plan, and changes in the net OPEB obligation:

	<u>2011</u>
Annual required contribution	\$ 299,000
Interest on Net OPEB Obligation	14,004
Adjustment to annual required contribution	<u>(11,000)</u>
Annual OPEB expense	302,004
Contributions and payments made	<u>71,771</u>
Increase in net OPEB obligation	\$ 230,233
Net OPEB obligation, December 31, 2010	<u>838,449</u>
Net OPEB obligation, December 31, 2011	<u><u>\$ 1,068,682</u></u>

The Electric Utility's share of the December 31, 2011 Net OPEB obligation is \$681,194.

The Utilities annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and net OPEB obligation for the years ended December 31, 2011, 2010 and 2009:

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(11) Other Post-Employment Benefits (OPEB), Continued

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage Of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449
December 31, 2009	\$ 302,004	5.64%	\$ 585,532

Funded Status and Funding Progress

As of January 1, 2009, the most recent actuarial valuation date, the actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$2,967,000. The Plan is unfunded since there are no assets and retiree benefits are paid annually on a cash basis. Because The Plan is unfunded, the AAL and UAAL are equal. The covered payroll is the yearly payroll of actives covered by the plan and was \$12,936,933, in 2011 and the ratio of the UAAL to the covered payroll was 22.9%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. There are no plans to fund The Plan at this time.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Significant methods and assumptions were as follows:

Actuarial valuation date:	January 1, 2009
Actuarial cost method:	Projected Unit Credit
Amortization method:	Level Percentage Of Projected Payroll
Remaining amortization period:	30 years
Actuarial assumptions:	
Discount Rate	5.0%
Healthcare Trend Rate	11.0% declining .5% annually to 6%
Projected Salary Increases	4.0%

The schedule of funding progress, presented as Required Supplemental Information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of the plan assets is increasing or decreasing over time relative to the actuarial liabilities for benefits.

Notes to Financial Statements  
December 31, 2011 and 2010

(12) Flood Event

On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, building furnishings and equipment, meters, switches, relays, tools and rendered the Streeter Station power plant units 6 and 7 and coal handling systems inoperable and in need of major repair. The Utility began immediate clean up and work with the Federal Emergency Management Agency (FEMA) for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA submitting costs related to recovery, repair and remediation and is still in the process of repairing and replacing assets lost in the flood. As of December 31, 2009, Utility administrative facilities were repaired and operational. Generation units were repaired and operational, and power plant office facilities were repaired and operational in early 2010. In 2011 and 2010, the Electric Utility has spent \$87 and \$14,662, respectively, in operational expense for flood recovery. In 2011 and 2010, the utility spent \$1,518,372 and \$739,130, respectively, in asset repair and replacement. In 2011 and 2010, the Utility has recognized \$88,226 and \$21,657, respectively, in Other Operating Revenues for FEMA reimbursement expected for operational losses and \$1,398,921 and \$584,822, respectively, in Other Non-Operating Revenues for FEMA reimbursement expected for capital losses. As of December 31, 2011 and 2010, the Utility recognized a receivable of \$3,407,444 and \$1,844,487, respectively, for FEMA flood disaster reimbursement.

(13) Wind Event

On July 10, 2009, the City of Cedar Falls experienced a storm with extreme winds of approximately 106 MPH. The extreme winds uprooted and sheared trees, blew over poles and lines, and slammed trees and branches into Electric Utility distribution facilities doing millions of dollars worth of damage. The Utility began immediate clean up and also began working with the Federal Emergency Management Agency (FEMA) for reconstruction and repair of severely damaged Utility distribution assets. As of December 31, 2009, the damaged assets have been temporarily repaired; however, they will be permanently repaired, restored, or replaced in the upcoming years. In 2011 and 2010, the Electric Utility spent \$3,965,113 and \$676,992, respectively, for wind damage recovery in asset repair and replacement. The Utility has recognized in \$3,988 in 2011 and \$0 in 2010 of Other Operating Revenues for FEMA reimbursement expected for operational losses and \$2,939,877 in 2011 and \$570,299 in 2010 of Other Non-Operating Revenues for FEMA reimbursement expected for capital losses. As of December 31, 2011 and 2010, the Utility recognized a receivable of \$3,564,312 and \$648,140, respectively, for FEMA wind storm disaster reimbursement.

(14) Commitments and Contingencies

The Utility has joint ownership interest in Walter Scott Energy Center Units 3 and 4, and the George Neal Generating Station Unit 4 (see note 8). Coal procurements are made by the agent for the joint owners on a system portfolio basis, which are a mix of 1, 2, and 3-year purchases to minimize risk. The Utility is obligated to purchase at least the annual amount of coal to operate the Utility's share at minimum load. The Utility's share of coal purchases for the years 2011 and 2010 were \$4,979,661 and \$4,701,383, respectively.

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

In 2007, the Utility contracted with Miron Construction Co. Inc (Miron) as its General Contractor, to construct a baghouse for Streeter Station Generating Unit 6 (Unit 6) to capture particulate matter from this unit. The baghouse construction was completed and Unit 6 was returned to operation in June 2007, however, Unit 6

Notes to Financial Statements  
December 31, 2011 and 2010

(14) Commitments and Contingencies, Continued

has only been able run at 8-12MW and has not attained its full capacity of 16.5 MW. When exceeding the 8-12 MW range, the bags in the baghouse become clogged, and the normal cleaning process is unable to keep up with the emission particles flowing through the baghouse and the Unit is shut down. Before and since the flood, the Utility continues to work with Miron to determine the root cause of the problem. However, formal arbitration measures have been invoked under the contract and Miron's performance bond carrier, CAN, is noticed and involved.

Unit 6 was back in service in March 2009 when all flood-related repairs were completed. Per the contract for the baghouse construction, a third party testing firm has been hired by Miron to conduct these performance tests and after 30 days or more of continuous operation ensure the baghouse meets the original contract specifications. Independently, the Utility has hired a consultant with baghouse expertise to witness the performance tests and help identify any problems with the baghouse design that is preventing Unit 6 from achieving full capacity and recommend an appropriate solution.

Since the baghouse has not performed as designed and therefore has not achieved substantial completion, the Utility has withheld progress payments to Miron. Miron has disputed this position. The parties have executed an agreement to toll statutes of limitations and allow remediation studies by Miron. Remediation efforts have not been successful and the arbitration hearings have been ordered for January 21, 2013 through January 29, 2013.

As of December 31, 2011, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$36,802,000 and an estimated time frame to complete through 2015.

(15) Subsequent Events

Effective January 1, 2012, the Board of Trustees approved a general electric rate increase. The average rate increase is approximately 4.0% for all customer classes.

In January 2012 the Board of Trustees of the Municipal Electric Utility adopted resolution No.5089 reducing the annual interest rate on the loan to the Communications Utility from 3.1% to 2.0% to be more reflective of the investment and borrowing markets.

Schedule of Funding Progress for the Other  
Post-Employment Benefits Plan  
Unaudited

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
2011	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,936,933	22.9%
2010	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,152,946	24.4%
2009	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$11,587,064	25.6%
2008	January 1, 2007	\$ -	\$3,436,000	\$3,436,000	0.0%	\$11,162,424	30.8%



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

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

We have audited the financial statements of the Municipal Electric Utility of the City of Cedar Falls, Iowa (Municipal Electric Utility) as of and for the year ended December 31, 2011, and have issued our report thereon dated March 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Internal Control Over Financial Reporting***

Management of the Municipal Electric Utility is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Municipal Electric Utility's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Electric Utility's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipal Electric Utility's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of the Municipal Electric Utility's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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

***Compliance and Other Matters***

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

This report is intended solely for the information and use of utility management, others within the entity, federal and state awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012



# **Cedar Falls Utilities**

**Financial Statements of the Municipal  
Gas Utility  
of the City of Cedar Falls, Iowa**

**Including Independent Auditors' Reports**

**For The Years Ended  
December 31, 2011 and 2010**

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

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheets of the Municipal Gas Utility of The City of Cedar Falls, Iowa (Municipal Gas Utility), a component unit of the City of Cedar Falls, Iowa, as of December 31, 2011 and 2010 and related statements of revenues, expenses and changes in net assets and statements of cash flows for the years then ended, as noted in the table of contents. These financial statements are the responsibility of the Municipal Gas Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Gas Utility as of December 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will issue a report on our consideration of the Municipal Gas Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 read in conjunction with this report in considering the results of our audit.

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

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economical, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012

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

Management Discussion and Analysis  
December 31, 2011, 2010 and 2009  
Unaudited

The following discussion and analysis of the Municipal Gas Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2011, 2010 and 2009. This information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased as a result of operating income in 2011. At December 31, 2011, 2010 and 2009, total assets were \$23,860,435, \$23,836,558 and \$23,827,603, respectively, and total liabilities were \$2,077,012, \$3,308,581 and \$2,803,390, respectively, resulting in net assets of \$21,783,423, \$20,527,977 and \$21,024,213, respectively.
- In 2011 operating revenues increased by 4.3% to \$14,406,520 and operating expenses decreased by 6.9% to \$13,477,919.
- In 2010 operating revenues decreased by 8.2% to \$13,813,417 and operating expenses increased by 1.4% to \$14,481,802.
- In 2009 operating revenues decreased by 27.4% to \$15,048,764 and operating expenses decreased by 25.1% to \$14,277,451.
- In 2011, the Utility experienced operating income of \$928,601, compared to an operating loss of \$668,385 in 2010 and operating income of \$771,313 in 2009.
- On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, office furnishings and equipment, meters, regulators, and tools. The Utility began immediate clean up and work with the Federal Emergency Management Agency (FEMA) for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA for the recovery, repair and remediation of Utility assets damaged or destroyed in the flood. Additional detail on the 2008 Flood Event can be found in Note 11.

**Overview of the Financial Statements**

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

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

The statements of revenues, expenses and changes in net assets present the results of the Utility's activities (revenues and expenses) over the course of the fiscal year and can provide information about the Utility's recovery of its costs. Retail sales rates are based on rates established by the Board of Trustees based on operating costs, debt service requirements, and anticipated capital needs. A

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

Management Discussion and Analysis  
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fundamental objective of this rate model is to provide adequate revenue to cover all expenses.

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

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

**Condensed Financial Information**

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

Condensed Balance Sheet Information

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$11,838,630	\$11,996,956	\$ 11,696,663
Capital assets, net	11,873,675	11,627,014	11,855,970
Other noncurrent assets	148,130	212,588	274,970
Total assets	<u>\$23,860,435</u>	<u>\$23,836,558</u>	<u>\$23,827,603</u>
Current liabilities	\$ 1,646,369	\$ 2,847,821	\$ 2,326,265
Noncurrent liabilities	430,643	460,760	477,125
Total liabilities	<u>\$ 2,077,012</u>	<u>\$ 3,308,581</u>	<u>\$ 2,803,390</u>
Invested in capital assets, net of related debt	\$11,873,674	\$11,627,014	\$11,855,970
Restricted	96,808	209,802	251,963
Unrestricted	9,812,941	8,691,161	8,916,280
Total net assets	<u>\$21,783,423</u>	<u>\$20,527,977</u>	<u>\$21,024,213</u>

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Condensed Revenues, Expenses and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Sales of gas	\$14,308,161	\$13,727,840	\$14,966,948
Other	98,359	85,577	81,816
Total operating revenues	<u>14,406,520</u>	<u>13,813,417</u>	<u>15,048,764</u>
Natural gas purchased for resale	9,217,259	9,100,183	9,986,088
Operation and maintenance	1,112,475	1,235,016	1,156,526
Depreciation	738,390	725,255	697,521
Service and administrative	2,409,795	3,421,348	2,437,316
Total operating expenses	<u>13,477,919</u>	<u>14,481,802</u>	<u>14,277,451</u>
Operating income (loss)	<u>928,601</u>	<u>(668,385)</u>	<u>771,313</u>
Interest income	1,318	3,330	23,062
Other, net	325,527	168,819	611,155
Total non-operating revenues (expenses)	<u>326,845</u>	<u>172,149</u>	<u>634,217</u>
Change in net assets	1,255,446	(496,236)	1,405,530
Net assets, beginning of year	<u>20,527,977</u>	<u>21,024,213</u>	<u>19,618,683</u>
Net assets, end of year	<u>\$21,783,423</u>	<u>\$20,527,977</u>	<u>\$21,024,213</u>

**Financial Analysis**

Current assets decreased 1.3% in 2011. Cash and investments - unrestricted increased by 2.0%, \$188,060 and restricted cash decreased 38.6%, \$94,004. Receivables decreased by 11.3%, \$262,782, primarily due to a decrease in Customer accounts receivable, less allowance for doubtful accounts, of \$524,830 and in other receivables of \$70,710 offset by an increase in Government grants receivable for FEMA assistance of \$346,780 and in trade receivables of \$2,863.

Current assets increased 2.6% in 2010. Cash and investments - unrestricted increased by 7.6%, \$648,929. Receivables decreased by 11.8%, \$311,294, primarily due to a decrease in Customer accounts receivable, less allowance for doubtful accounts, of \$196,047 and a decrease in Government grants receivable for FEMA assistance of \$169,578 and a decrease of trade receivables of \$17,747 offset by an increase in other receivables of \$76,239.

Current assets increased 4.8% in 2009. Cash and investments - unrestricted increased by 29.1%, \$1,939,739. Receivables decreased by 34.0%, \$1,360,062, primarily due to a decrease in Customer accounts receivable, less allowance for doubtful accounts, of \$1,123,469 and a decrease in Government grants receivable for FEMA assistance of \$260,383 offset by an increase of loans receivable of \$22,308 issued for customer energy efficiency initiatives.

Current liabilities decreased 42.2%, \$1,201,452, in 2011 primarily as a result of a decrease in accounts payable of \$559,487 and a decrease in reserve for surplus declaration of \$600,000.

Current liabilities increased 22.4%, \$521,556, in 2010 primarily as a result of an increase in reserve for surplus declaration of \$800,000.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Current liabilities decreased 22.4%, \$670,268, in 2009 primarily as a result of a decrease in accounts payable of 25.1%, \$657,711.

Gas revenues increased 4.3% in 2011 primarily because of an increase in sales to the University of Northern Iowa power plant of \$1,318,062 due to equipment repair and maintenance issues and the Electric Utility of \$243,270 due to increased gas usage for generation. Although overall gas usage increased 329,869 MCF in 2011, gas purchase prices decreased an average \$0.80 per MCF. Purchase Gas Adjustment (PGA) revenues decreased 5.0%. The average PGA decreased in 2011 to \$4.71 per MCF from \$4.96 per MCF during 2010, an average decrease of \$0.25 per MCF.

Gas revenues decreased 8.2% in 2010 primarily because of a decrease in usage of 152,991 MCF from 2009. Purchase Gas Adjustment (PGA) revenues increased 1.2%. The average PGA increased in 2010 to \$4.96 per MCF from \$4.90 per MCF during 2009, an average increase of \$0.06 per MCF.

Gas revenues decreased 27.4% in 2009 because of a decrease in Purchase Gas Adjustment (PGA) revenues. The average PGA decreased in 2009 to \$4.90 per MCF from \$8.74 per MCF during 2008, an average decrease of \$3.84 per MCF.

Natural gas purchased for resale expense increased 1.3% in 2011 primarily due to the increase in usage from 2010. Actual average wholesale natural gas costs in 2011 were \$4.51 per MCF compared to \$5.31 per MCF in 2010.

Natural gas purchased for resale expense decreased 8.9% in 2010 primarily due to the decrease in usage from 2009. Actual average wholesale natural gas costs in 2010 were \$5.31 per MCF compared to \$5.35 per MCF in 2009.

Natural gas purchased for resale expense decreased 32.8% in 2009 primarily due to the decrease in wholesale gas prices as reflected in the \$3.84 per MCF decrease in the average PGA from 2008.

Operation and maintenance expenses decreased 9.9% in 2011. This decrease is primarily attributable to an overall decrease in supervision and engineering wages and gas main maintenance costs.

Operation and maintenance expenses increased 6.8% in 2010. This increase is primarily attributable to an overall increase in supervision and engineering wages and gas main maintenance costs.

Operation and maintenance expenses increased 9.1% in 2009. This increase is primarily attributable to an overall increase in meter and regulator installation and maintenance costs.

Service and Administrative expenses decreased by 29.6% in 2011 primarily due to the \$200,000 payment in lieu of taxes (PILOT) to be paid to the City of Cedar Falls, compared to the \$800,000 PILOT for 2010. Customer accounts, customer service and information expenses and taxes other than income taxes expenses decreased by \$133,179 in 2011.

Service and Administrative expenses increased by 40.4% in 2010 primarily due to the \$800,000 payment in lieu of taxes to be paid to the City of Cedar Falls, which was not incurred in 2009 or 2008, and an increase of 64.7%, \$173,103, in the Utility's House Call energy efficiency program.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Service and administrative expenses decreased by .9% in 2009 primarily due to flood expenses related to operations of \$21,358 for 2009 compared to \$395,791 for 2008. Also, uncollectible accounts expense decreased by \$32,015 in 2009. These decreases were offset by increases in the Utility's House Call energy efficiency program of \$128,087 in 2009 and an increase in employee benefits and pensions of \$112,187 in 2009.

Interest income decreased 60.4% in 2011 primarily due to very low interest rates and difficulty in getting banks to bid on placement of the investments. Funds were deposited into money market accounts waiting a strengthening in the investment markets.

Interest income decreased 85.6% in 2010 primarily due to very low interest rates and difficulty in getting banks to bid on placement of the investments. Funds were deposited into money market accounts waiting a strengthening in the investment markets.

Interest income decreased 87.9% in 2009 primarily due to a reduction in investments of \$550,000 and due to very low interest rates and difficulty getting banks to bid on placement of the investments. Funds were deposited into money market accounts waiting a strengthening in the investment markets.

Other, net increased in 2011 by 92.8% primarily due to an increase of \$220,035 in intergovernmental grant funds offset by a decrease in miscellaneous non-operating income of \$64,982.

Other, net decreased in 2010 by 72.4% primarily due to an decrease of \$323,557 in miscellaneous non-operating income and \$86,391 decrease in contributions in aid of construction-TIF (Tax Increment Financing funds received from the City of Cedar Falls, Iowa).

Other, net increased in 2009 by 35.2% primarily due to an increase of \$330,783 in miscellaneous non-operating income and \$251,680 increase in contributions ins aid of construction-TIF (Tax Increment Financing funds received from the City of Cedar Falls, Iowa). These increases were offset by \$437,963 decrease in recognized FEMA grant revenue for the Utility's costs for restoring and/or replacing capital assets in 2009.

**Capital Assets and Debt Administration**

Net capital assets represent 49.8% of total assets for the Utility in 2011. Net capital assets increased 2.1% from the prior year primarily due increased completion of capital projects activity during 2011.

Net capital assets represent 48.8% of total assets for the Utility in 2010. Net capital assets decreased 1.9% from the prior year primarily due decreased capital projects activity during 2010.

Net capital assets represent 49.8% of total assets for the Utility in 2009. Net capital assets increased .9% from the prior year primarily due to the completion of capital projects during 2009.

Additional detail on the change in capital assets can be found in Note 4.

The Utility had no outstanding debt as of December 31, 2011, 2010, or 2009.

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

Balance Sheets  
December 31, 2011 and 2010

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 20,776,595	\$ 20,185,134
Less accumulated depreciation	<u>9,300,117</u>	<u>8,720,983</u>
	11,476,478	11,464,151
Construction work in progress	<u>397,197</u>	<u>162,863</u>
Net capital assets	<u>11,873,675</u>	<u>11,627,014</u>
Noncurrent assets:		
Loans receivable	<u>148,130</u>	<u>212,588</u>
Total noncurrent assets	<u>148,130</u>	<u>212,588</u>
Current assets:		
Cash and cash equivalents (note 3)	9,431,313	9,243,253
Cash - Restricted (note 2 and 3)	149,458	243,462
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$14,467 in 2011 and \$16,643 in 2010	1,486,073	2,010,903
Loans receivable	52,814	69,634
Interest	33	98
Trade	15,665	12,802
Government grants (note 11)	486,727	139,947
Other	22,917	93,627
Inventories:		
Material and supplies	155,100	152,070
Prepayments and other	<u>38,530</u>	<u>31,160</u>
Total current assets	<u>11,838,630</u>	<u>11,996,956</u>
Total assets	<u>\$ 23,860,435</u>	<u>\$ 23,836,558</u>

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

Balance Sheets  
December 31, 2011 and 2010

<u>Liabilities</u>	<u>2011</u>	<u>2010</u>
Current liabilities:		
Accounts payable	\$ 1,161,666	\$ 1,721,153
Reserve for surplus declaration (note 8)	200,000	800,000
Accrued wages and vacations	218,000	238,594
Other accrued expenses	66,703	88,074
Total current liabilities	<u>1,646,369</u>	<u>2,847,821</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	110,865	137,161
Other liabilities (note 5 and 10)	319,778	323,599
Total noncurrent liabilities	<u>430,643</u>	<u>460,760</u>
 Total liabilities	 <u>2,077,012</u>	 <u>3,308,581</u>
 <u>Net Assets</u>		
Invested in capital assets, net of related debt	11,873,675	11,627,014
Restricted	96,808	209,802
Unrestricted	9,812,940	8,691,161
Total net assets	<u>21,783,423</u>	<u>20,527,977</u>
 Total liabilities and net assets	 <u>\$ 23,860,435</u>	 <u>\$ 23,836,558</u>

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

Statements of Revenues, Expenses and Changes in Net Assets  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Sales of gas:		
Residential	\$ 7,257,256	\$ 7,793,027
Industrial	1,578,517	1,606,744
Commercial	2,892,942	3,218,046
Governmental (note 8)	2,192,423	956,703
Interdepartmental	387,023	153,320
Total sales of gas	<u>14,308,161</u>	<u>13,727,840</u>
Other operating revenues	98,359	85,577
Total operating revenues	<u>14,406,520</u>	<u>13,813,417</u>
 Operating expenses:		
Production:		
Natural gas purchased for resale	9,217,259	9,100,183
Other	511	12,046
Distribution	1,111,964	1,222,970
Depreciation	738,390	725,255
Customer accounts	321,861	420,100
Customer service and information expenses	418,300	440,646
Sales	10,153	4,049
Administrative and general (note 8)	1,536,502	2,414,876
Taxes other than income taxes	122,979	141,677
Total operating expenses	<u>13,477,919</u>	<u>14,481,802</u>
 Operating income (loss)	<u>928,601</u>	<u>(668,385)</u>
 Non-operating revenues (expenses):		
Interest income	1,318	3,330
Miscellaneous revenue (expense), net (note 8)	53,510	118,492
Intergovernmental grant funds (note 11)	270,362	50,327
AFUDC (note 1)	1,655	-
Total non-operating revenues (expenses)	<u>326,845</u>	<u>172,149</u>
 Change in net assets	1,255,446	(496,236)
 Net assets, beginning of year	<u>20,527,977</u>	<u>21,024,213</u>
 Net assets, end of year	<u>\$ 21,783,423</u>	<u>\$ 20,527,977</u>

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

Statements of Cash Flows  
Years ended December 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash received from customers	\$ 15,121,796	\$ 14,424,281
Cash paid to suppliers	(12,166,062)	(12,080,507)
Cash paid to employees	(1,058,892)	(1,233,211)
Payment in lieu of taxes to the City of Cedar Falls	(800,000)	-
	<hr/>	<hr/>
Net cash provided by (used in) operating activities	1,096,842	1,110,563
	<hr/>	<hr/>
Cash flows from capital and related financing activities:		
Proceeds from customer advances for construction	12,000	18,480
Refunds of customer advances for construction	(36,710)	(62,480)
Acquisition, construction and removal cost of capital assets	(983,943)	(560,684)
Proceeds from sale of capital assets	547	2,828
Reimbursement of utility construction costs	3,937	69,688
	<hr/>	<hr/>
Net cash provided by (used in) capital and related financing activities	(1,004,169)	(532,168)
	<hr/>	<hr/>
Cash flows from investing activities:		
Interest received	1,383	3,533
	<hr/>	<hr/>
Net cash provided by (used in) investing activities	1,383	3,533
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	94,056	581,928
Cash and cash equivalents, beginning of year	9,486,715	8,904,787
	<hr/>	<hr/>
Cash and cash equivalents, end of year (note 1)	<u>\$ 9,580,771</u>	<u>\$ 9,486,715</u>

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

Statements of Cash Flows, Continued  
Years ended December 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income (loss)	\$ 928,601	\$ (668,385)
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	738,390	725,255
Other Income (expense), net	318,349	160,688
(Increase) decrease in accounts receivable	521,967	213,794
(Increase) decrease in loans receivable	81,278	66,340
(Increase) decrease in intergovernmental grants	(346,780)	169,578
(Increase) decrease in inventory	(3,030)	(31,551)
(Increase) decrease in prepayments and other	63,340	(74,347)
Increase (decrease) in accounts payable	(559,487)	(241,149)
Increase (decrease) in reserve for surplus declaration	(600,000)	800,000
Increase (decrease) in accrued wages and vacation	(20,594)	(300)
Increase (decrease) in accrued expenses	(21,371)	(36,995)
Increase (decrease) in other liabilities	<u>(3,821)</u>	<u>27,635</u>
Net cash provided by operating activities	<u>\$ 1,096,842</u>	<u>\$ 1,110,563</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	1,655	-
Expiration of customer advances for construction	1,586	11,840
Intergovernmental grants	325,115	66,993
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 9,431,313	\$ 9,243,253
Cash - Restricted	<u>149,458</u>	<u>243,462</u>
Cash and cash equivalents	<u>\$ 9,580,771</u>	<u>\$ 9,486,715</u>

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Gas Utility (Utility) of the City of Cedar Falls, Iowa is a separate and distinct city utility and is chartered under Iowa Code Section 388. The Utility is a component unit of the City of Cedar Falls, Iowa. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

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

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

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 4.64% in 2011 and 0.00% 2010. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated services and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 15 to 65 years, buildings and improvements - 30 to 45 years, and equipment - 20 to 85 years. The depreciation provisions were equivalent to an overall composite rate of 3.6% of depreciable assets for 2011 and 3.6% for 2010.

Capital assets may be contributed to the utility by outside parties. As these assets are completed and placed in service, the utility reports the value of these contributions in the statement of revenue, expenses, and changes in net assets.

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

(c) Cash and Investments

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

The Utility considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents for purposes of the statement of cash flows. Included in cash and cash equivalents at December 31, 2011 and 2010 were \$2,300,000 and \$2,300,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

(d) Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount and are reported net of allowances.

(e) Inventories

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

(f) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of government entities. Unrestricted net assets consist of net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted".

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

(g) Natural Gas Commodity Purchases

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

(h) Operating Revenues and Expenses

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

Revenues from the sale of gas are based on billing rates, which are applied to customers' consumption of gas. The Utility records estimated unbilled revenue, including amounts to be billed under a purchased gas adjustment clause, at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2011 and 2010 were \$841,001 and \$1,203,292, respectively, and are recorded in customer accounts receivable. The Utility uses a purchased gas adjustment clause whereby increases and decreases in fuel costs are billed to customers and included in operating revenue without changing base rates charged to its customers.

(i) Estimates

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

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

(j) Budgetary Information

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

Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year 2011 there were no budget amendments.

(k) Grants

The Gas Utility has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

(l) Employee Benefits

Employee benefits for accumulated sick leave hours are not accrued as they are not payable to employees. Vacation hours are earned monthly and are accrued and recorded as liabilities and unused vacation hours are paid upon termination of service. Accrued wages represents time employees worked during the calendar year.

The Gas Utility provides retirement severance pay to qualifying full-time employees upon death or retirement. Retirement severance pay will be credited at the rate of two days per year of continuous service, with a minimum of twenty years of continuous service needed to qualify. The retirement severance pay shall apply only to regular full-time employees hired prior to June 30, 2007. Employees who are hired after that date shall not be entitled to the benefit. As of December 31, 2011 and 2010 the accrued liability was \$150,707 and \$168,487, respectively.

(m) Customer Advances

Customer Advances represent amounts paid to the utility by developers to extend service to new areas. As customers are added, advances will be refunded to the developers over the defined term of the agreement. Expired advances are recorded as other non-operating income in the year they expire.

(n) Reclassifications

Reclassifications of prior year's amounts may have been made for comparability.

(2) Restricted Assets

The composition of restricted assets as of December 31, 2011 and 2010 was as follows:

	2011		
	Cash	Investments	Total
Current Assets - Restricted			
Self-Insured Medical and Dental	\$ 149,458	-	\$ 149,458
Total Current Assets - Restricted	149,458	-	149,458
Total restricted assets	\$ 149,458	-	\$ 149,458

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

Notes to Financial Statements  
December 31, 2011 and 2010

(2) Restricted Assets, Continued

	2010		
Current Assets - Restricted	<u>Cash</u>	<u>Investments</u>	<u>Total</u>
Self-Insured Medical and Dental	\$ 243,462	\$ -	\$ 243,462
Total Current Assets - Restricted	243,462	-	243,462
Total restricted assets	<u>\$ 243,462</u>	<u>\$ -</u>	<u>\$ 243,462</u>

Amounts deposited in the Self-Insured Medical and Dental fund may only be used for medical and dental reserves and expenses.

(3) Cash on Hand, Deposits, and Investments

Cash on Hand

Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2011 and 2010 was \$100, respectively.

Deposits

At December 31, 2011, the Utility's carrying amount of deposits, including \$4,750,000 of money market accounts, was \$7,280,671. At December 31, 2010, the Utility's carrying amount of deposits, including \$4,750,000 of money market accounts, was \$7,186,615.

Investments

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

As of December 31, 2011 and 2010, the Utility had no Federal Agency Obligation investments or maturities.

In addition, the Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$2,300,000 and \$2,300,000 at December 31, 2011 and 2010, respectively, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk

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

Credit Risk

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

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

Notes to Financial Statements  
December 31, 2011 and 2010

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

Concentration of Credit Risk

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

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

Custodial Credit Risk - Investments

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

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

	2011	2010
Cash on hand	\$ 100	\$ 100
Carrying amount of deposits	7,280,671	7,186,615
Carrying amount of Iowa Public Agency Investment Trust	2,300,000	2,300,000
Total	\$ 9,580,771	\$ 9,486,715
Current Assets	2011	2010
Cash and cash equivalents	\$ 9,431,313	\$ 9,243,253
Investments	-	-
Restricted Cash	149,458	243,462
Total	\$ 9,580,771	\$ 9,486,715

Of the unrestricted cash and investments listed above, the Board of Trustees of the Municipal Gas Utility has made no reserve fund designations.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2011 and 2010 follows:

2011	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being depreciated:				
Land	\$ 41,350	\$ -	\$ 1,515	\$ 39,835
Construction, Work-in-progress	162,863	964,192	729,858	397,197
Total capital assets, not being depreciated	204,213	964,192	731,373	437,032
Capital assets, being depreciated:				
Infrastructure	17,483,213	688,358	136,881	18,034,690
Buildings and improvements	1,968,345	-	-	1,968,345
Equipment	692,226	41,499	-	733,725
Total capital assets, being depreciated	20,143,784	729,857	136,881	20,736,760
Less accumulated depreciation	8,720,983	738,951	159,817	9,300,117
Total capital assets, being depreciated, net	11,422,801	(9,094)	(22,936)	11,436,643
Capital assets, net	<u>\$11,627,014</u>	<u>\$ 955,098</u>	<u>\$ 708,437</u>	<u>\$11,873,675</u>
2010	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being depreciated:				
Land	\$ 41,350	\$ -	\$ -	\$ 41,350
Construction, Work-in-progress	231,332	467,425	535,894	162,863
Total capital assets, not being depreciated	272,682	467,425	535,894	204,213
Capital assets, being depreciated:				
Infrastructure	17,146,851	417,924	81,562	17,483,213
Buildings and improvements	1,942,909	103,599	78,163	1,968,345
Equipment	677,854	14,372	-	692,226
Total capital assets, being depreciated	19,767,614	535,895	159,725	20,143,784
Less accumulated depreciation	8,184,326	729,566	192,909	8,720,983
Total capital assets, being depreciated, net	11,583,288	(193,671)	(33,184)	11,422,801
Capital assets, net	<u>\$11,855,970</u>	<u>\$ 273,754</u>	<u>\$ 502,710</u>	<u>\$11,627,014</u>

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

Notes to Financial Statements  
December 31, 2011 and 2010

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2011 and 2010 was as follows:

<u>2011</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Customer advances for construction	\$ 137,161	\$ 12,150	\$ 38,446	\$ 110,865
Other liabilities	323,599	200,912	204,733	319,778
<b>Total noncurrent liabilities</b>	<b>\$ 460,760</b>	<b>\$ 213,062</b>	<b>\$ 243,179</b>	<b>\$ 430,643</b>

<u>2010</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Customer advances for construction	\$ 181,161	\$ 18,480	\$ 62,480	\$ 137,161
Other liabilities	295,964	124,791	97,156	323,599
<b>Total noncurrent liabilities</b>	<b>\$ 477,125</b>	<b>\$ 143,271</b>	<b>\$ 159,636</b>	<b>\$ 460,760</b>

(6) Pension and Retirement Benefits

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

Plan members were required to contribute 4.50% of their annual covered salary and the Utility is required to contribute 6.95% of annual covered payroll through June 30, 2011. Beginning July 1, 2011 plan members are required to contribute 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2011, 2010, and 2009 were \$135,767; \$141,229; and \$128,938; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Prior to June 30, 2010, employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age qualified to convert their accrued sick leave value into paid health insurance premiums upon retirement. This benefit was phased out between January 1, 2008 and June 30, 2010. In 2008 the benefit was reduced to 75% of accrued sick leave and in 2009 to June 30, 2010 it was reduced to 50% and zero thereafter.

(7) Income Tax Status

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

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

Notes to Financial Statements  
December 31, 2011 and 2010

(8) Related Party Transactions

The Utility provides gas service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$124,372 and \$141,413 in 2011 and 2010, respectively.

The Utility makes payments in lieu of taxes upon approval by the Board of Trustees to the City of Cedar Falls, Iowa. Expenses for 2011 and 2010 were \$200,000 and \$800,000 respectively, which were recorded in administrative and general expenses. Subsequent to December 31, 2011, the Utility's Board of Trustees approved a payment of \$200,000 related to payments in lieu of taxes for 2011.

For the year ended December 31, 2010, the Utility earned a management fee of \$21,424 from the Municipal Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous non-operating revenue. Due to a reallocation of labor and other costs among the Electric, Gas, Water and Communications Utilities this management fee has been eliminated as of December 31, 2010.

(9) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks.

The Utilities maintain a risk management account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and have insurance for claims above this amount. In addition, the Utilities have aggregate stop loss coverage for the 2011 plan year for aggregate claims exceeding \$2.3 million. Liabilities of the risk management account are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

Liabilities include an estimated amount for claims that have been incurred but not reported (IBNR) which represent estimates of the eventual loss on claims arising prior to year-end. The estimate is based on a percentage of claims unpaid at year end considering the Utilities claims payment history. Changes in the balances of the Utilities liabilities during the past two years are as follows:

	2011	2010
Unpaid claims and IBNR, beginning of year	\$ 187,000	\$ 325,000
Current year costs including IBNR	3,869,576	2,207,548
Claims paid	(3,705,576)	(2,345,548)
Unpaid claims and IBNR, end of year	\$ 351,000	\$ 187,000

The Utility has recorded \$52,650 and \$33,660 in accounts payable for its share of these unpaid claims and IBNR at December 31, 2011 and 2010, respectively.

The Utilities are a member of the Iowa Municipalities Workers' Compensation Association (the Association), which was established to provide members a group self-insurance program for their workers' compensation liabilities. Approximately 480 governmental entities participate in the Association. A board of trustees consisting of seven members is elected by the members participating in the Association to manage and conduct the business and affairs of the Association.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(9) Risk Management, Continued

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2011.

Cash and cash equivalents and investments	\$56,188,298
Receivables	1,866,149
Other assets	671,822
Total assets	<u>\$58,726,269</u>
Total liabilities	\$27,019,782
Total equity	<u>31,706,487</u>
Total liabilities and equity	<u>\$58,726,269</u>
Total revenues	\$ 8,210,837
Total expenses	3,654,409
Distribution to members	-
Net increase in equity	<u>\$ 4,556,428</u>

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

(10) Other Post-Employment Benefits (OPEB)

Plan Description

The Cedar Falls Utilities administers a single-employer defined benefit medical health care plan (The Plan) for all four utilities. The plan provides self-insured medical, vision, and prescription drug coverage, and to all active and retired employees and their eligible dependents. Eligible retirees receive health care coverage through the same plans that are available for active employees. To be eligible for these benefits employees at their retirement date must be a minimum of 55 years old, have been employed for the preceding four years, and be enrolled in the plan. Plan contributions are required from retirees based on an amount equal to the full cost of active members. These medical benefits terminate upon attaining Medicare eligibility. In addition, the Plan provides a \$5,000 in life insurance benefits to all retiree who elect this coverage and agree to pay a contribution for this coverage.

Funding Policy

The Utilities, with assistance from their third-party administrators, establishes and amends contribution requirements for both active and retiree members on an annual basis. The current funding policy is to pay health claims as they occur and the required contribution is based on pay-as-you-go financing. For the year ending December 31, 2011, the Utility contributed \$185,824 and retirees receiving benefits contributed \$114,053 through their required contributions.

Annual OPEB and Net OPEB Obligations

The Plan's annual OPEB expense is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of General Accounting Standards Board (GASB) Statement No 45. This standard was implemented in 2008. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year And amortize any unfunded actuarial liabilities (or

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

Notes to Financial Statements  
December 31, 2011 and 2010

(10) Other Post-Employment Benefits (OPEB), Continued

funding excess) over a period not to exceed thirty years. The following schedule shows the components of the annual OPEB expense for the year, the amount actually contributed to the plan, and changes in the net OPEB obligation:

	<u>2011</u>
Annual required contribution	\$ 299,000
Interest on Net OPEB Obligation	14,004
Adjustment to annual required contribution	<u>(11,000)</u>
Annual OPEB expense	302,004
Contributions and payments made	<u>71,771</u>
Increase in net OPEB obligation	\$ 230,233
Net OPEB obligation, December 31, 2010	<u>838,449</u>
Net OPEB obligation, December 31, 2011	<u><u>\$1,068,682</u></u>

The Gas Utility's share of the December 31, 2011 Net OPEB obligation is \$169,070.

The Utilities annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and net OPEB obligation for the year ended December 31, 2011, 2010 and 2009:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage Of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449
December 31, 2009	\$ 302,004	5.64%	\$ 585,532

Funded Status and Funding Progress

As of January 1, 2009, the most recent actuarial valuation date, the actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$2,967,000. The Plan is unfunded since there are no assets and retiree benefits are paid annually on a cash basis. Because The Plan is unfunded, the AAL and UAAL are equal. The covered payroll is the yearly payroll of actives covered by the plan and was \$12,936,933, in 2011 and the ratio of the UAAL to the covered payroll was 22.9%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. There are no plans to fund The Plan at this time.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(10) Other Post-Employment Benefits (OPEB), Continued

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Significant methods and assumptions were as follows:

Actuarial valuation date:	January 1, 2009
Actuarial cost method:	Projected Unit Credit
Amortization method:	Level Percentage Of Projected Payroll
Remaining amortization period:	30 years
Actuarial assumptions:	
Discount Rate	5.0%
Healthcare Trend Rate	11.0% declining .5% annually to 6%
Projected Salary Increases	4.0%

The schedule of funding progress, presented as Required Supplemental Information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of the plan assets is increasing or decreasing over time relative to the actuarial liabilities for benefits.

(11) Flood Event

On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, office furnishings and equipment, meters, regulators, and tools. The Utility began immediate clean up and work with the Federal Emergency Management Agency (FEMA) for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA submitting costs related to recovery, repair and remediation. As of December 31, 2009, Utility facilities were repaired and operational. As of December 31, 2011 and 2010, the Gas Utility has spent \$21 and \$556, respectively, in operational expense for flood recovery and \$324,678 and \$63,552, respectively, in asset repair and replacement. As of December 31, 2011 and 2010, The Utility has recognized \$(19,367) and \$(656), respectively, in Other Operating Revenues for FEMA reimbursement expected for operational losses and \$246,905 and \$50,327, respectively, in Non-Operating Revenues for FEMA reimbursement expected for capital losses. As of December 31, 2011 and 2010, the Utility recognized a receivable of \$415,905 and \$122,142, respectively, for FEMA flood disaster reimbursement.

(12) Commitments and Contingencies

The Utility has a natural gas transportation contract with a pipeline, which expires in 2022. Total payments include transportation charges and commodity charges. Minimum transportation payments for 2012 are expected to be approximately \$1,002,300 at current rates.

The Utility is a member of the Central Plains Energy Project. This organization was created in 2006 to accomplish the members' joint and cooperative action with respect to the acquisition, transportation, storage, management and related services and functions which are necessary to provide the members secure, reliable, and economic supplies of natural gas. This membership allows the Utility to purchase a fixed amount of gas for 30 years at a discount from market prices.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(12) Commitments and Contingencies, Continued

As of December 31, 2011, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$417,000 and an estimated time frame to complete through 2015.

Schedule of Funding Progress for the Other  
Post-Employment Benefits Plan  
Unaudited

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
2011	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,936,933	22.9%
2010	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,152,946	24.4%
2009	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$11,587,064	25.6%
2008	January 1, 2007	\$ -	\$3,436,000	\$3,436,000	0.0%	\$11,162,424	30.8%



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

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

We have audited the financial statements of the Municipal Gas Utility of the City of Cedar Falls, Iowa (Municipal Gas Utility) as of and for the year ended December 31, 2011, and have issued our report thereon dated March 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Internal Control Over Financial Reporting***

Management of the Municipal Gas Utility is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Municipal Gas Utility's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Gas Utility's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipal Gas Utility's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of the Municipal Gas Utility's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

***Compliance and Other Matters***

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

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

This report is intended solely for the information and use of utility management, others within the entity, federal and state awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012



# **Cedar Falls Utilities**

**Financial Statements of the Municipal  
Water Utility  
of the City of Cedar Falls, Iowa**

**Including Independent Auditors' Reports**

**For The Years Ended  
December 31, 2011 and 2010**

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

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheets of the Municipal Water Utility of The City of Cedar Falls, Iowa (Municipal Water Utility), a component unit of the City of Cedar Falls, Iowa, as of December 31, 2011 and 2010 and related statements of revenues, expenses and changes in net assets and statements of cash flows for the years then ended, as noted in the table of contents. These financial statements are the responsibility of the Municipal Water Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Water Utility as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will issue a report on our consideration of the Municipal Water Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 read in conjunction with this report in considering the results of our audit.

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

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economical, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012

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

Management Discussion and Analysis  
December 31, 2011, 2010 and 2009  
Unaudited

The following discussion and analysis of the Municipal Water Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2011, 2010 and 2009. This information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased in 2011 as a result of operating income, miscellaneous revenues, contributions in aid of construction and FEMA reimbursements for flood related capital projects. At December 31, 2011, 2010 and 2009, total assets were \$23,785,361, \$22,586,977 and \$22,236,340, respectively, and total liabilities were \$509,295, \$451,915 and \$483,725, respectively, resulting in net assets of \$23,276,066, \$22,135,062 and \$21,752,615, respectively.
- A water rate increase of approximately 9.0% for all customer classes was effective in January of 2011.
- A water rate increase of approximately 9.0% for all customer classes was effective in January of 2010.
- A water rate increase of approximately 9.0% for all customer classes was effective in January of 2009.
- In 2011, operating revenues increased by 15.8% to \$3,250,149 while operating expenses increased 5.0% to \$2,919,994. The 2011 increase in operating revenues is due to the 2011 rate increase and increased usage over 2010.
- In 2010, operating revenues decreased by 2.7% to \$2,805,864 while operating expenses decreased 1.9% to \$2,780,849. The 2010 decrease in operating revenues is due to the 2010 discovery of a meter error at the Electric Utility power plant which traced back to 2008. The amount refunded to the Electric Utility, and thus decreasing 2010 revenues, was approximately \$360,000. This was offset by the January 2010 water rate increase.
- In 2009, operating revenues increased by 9.3% to \$2,884,842 while operating expenses increased 8.5% to \$2,834,898. The 2009 increase in operating revenues is due to the 2009 rate increase and increased usage over 2008.
- In 2011, the Utility net operating income increased 1219.8% to \$330,155 compared to net operating income of \$25,015 in 2010 and \$49,944 in 2009.
- On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, office furnishings and equipment, meters, well equipment, and tools. The Utility began immediate clean up and work with the Federal Emergency Management Agency (FEMA) for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA for the recovery, repair and remediation of Utility assets damaged or destroyed in the flood. Additional detail on the 2008 Flood Event can be found in Note 11.

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

Management Discussion and Analysis  
December 31, 2011, 2010 and 2009  
Unaudited

**Overview of the Financial Statements**

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

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

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

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

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

**Condensed Financial Information**

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

**Condensed Balance Sheet Information**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 3,784,282	\$ 3,428,560	\$ 3,751,461
Capital assets, net	19,993,018	19,144,711	18,461,294
Other noncurrent assets	8,061	13,706	23,585
Total assets	<u>\$23,785,361</u>	<u>\$22,586,977</u>	<u>\$22,236,340</u>
Current liabilities	\$ 311,213	\$ 278,491	\$ 326,554
Noncurrent liabilities	198,082	173,424	157,171
Total liabilities	<u>\$ 509,295</u>	<u>\$ 451,915</u>	<u>\$ 483,725</u>

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

Management Discussion and Analysis  
December 31, 2011, 2010 and 2009  
Unaudited

Invested in capital assets, net of related debt	\$19,993,018	\$19,144,711	\$18,461,294
Restricted	33,466	96,026	97,808
Unrestricted	3,249,582	2,894,325	3,193,513
Total net assets	<u>\$23,276,066</u>	<u>\$22,135,062</u>	<u>\$21,752,615</u>

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Sales of water	\$ 3,088,803	\$ 2,662,889	\$ 2,742,925
Other	161,346	142,975	141,917
Total operating revenues	<u>3,250,149</u>	<u>2,805,864</u>	<u>2,884,842</u>
System operation and maintenance	1,186,057	1,179,664	1,232,708
Depreciation and amortization	561,741	543,343	505,120
Service and administrative	1,172,196	1,057,842	1,097,070
Total operating expenses	<u>2,919,994</u>	<u>2,780,849</u>	<u>2,834,898</u>
Operating income (loss)	<u>330,155</u>	<u>25,015</u>	<u>49,944</u>
Interest income	582	1,459	14,729
Other, net	367,079	240,614	269,032
Total non-operating revenues (expenses)	<u>367,661</u>	<u>242,073</u>	<u>283,761</u>
Income before capital contributions	697,816	267,088	333,705
Capital contributions	<u>443,188</u>	<u>115,359</u>	<u>791,432</u>
Change in net assets	1,141,004	382,447	1,125,137
Net assets, beginning of year	<u>22,135,062</u>	<u>21,752,615</u>	<u>20,627,478</u>
Net assets, end of year	<u>\$23,276,066</u>	<u>\$22,135,062</u>	<u>\$21,752,615</u>

**Financial Analysis**

Current assets increased 10.4% in 2011 primarily due to an increase of \$188,453 in cash and investments - unrestricted and an increase of \$167,645 in Government grants receivable for FEMA assistance.

Current assets decreased 8.6% in 2010 primarily due a decrease of \$228,387 in cash and investments - unrestricted and a decrease of \$86,239 in Government grants receivable for FEMA assistance.

Current assets increased 2.4% in 2009 primarily due an increase of \$202,987 in cash and investments - unrestricted offset by a decrease of \$121,336 in Government grants receivable for FEMA assistance.

Current liabilities increased 11.7% in 2011 due to a 28.7% increase in accounts payable offset by a decrease in wages and salaries payable.

Current liabilities decreased 14.7% in 2010 due to a 35.3% decrease in accounts payable offset by an increase in wages and salaries payable.

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

Management Discussion and Analysis  
December 31, 2011, 2010 and 2009  
Unaudited

Current liabilities decreased 43.4% in 2009 due to a 48.1% decrease in all accounts payable.

Noncurrent liabilities increased \$24,658 in 2011 primarily due to increased health and life actuarial liability for post-employment benefits.

Noncurrent liabilities increased \$16,252 in 2010 primarily due to increased health and life actuarial liability for post-employment benefits.

Noncurrent liabilities increased \$38,072 in 2009 primarily due to increased severance and retiree insurance liabilities.

System operation and maintenance expenses increased .5% in 2011 primarily due to a 17.8% increase in other, which includes pumping, water treatment and associated labor expense, and a 5.5% increase in power purchased from an affiliated utility offset by 7.1% decrease in distribution operations and maintenance expenses.

System operation and maintenance expenses decreased 4.3% in 2010 primarily due to a 2.6% decrease in distribution operations and maintenance expenses, a 10.7% decrease in other which is pumping, water treatment and associated labor expense, offset by a 1.2% increase in power purchased from an affiliated utility.

System operation and maintenance expenses increased 35.7% in 2009 primarily due to a 42.5% increase in distribution operations and maintenance expenses, \$229,249, due to major street repairs done in cooperation with the City of Cedar Falls, Iowa.

Depreciation expense increased 3.4% in 2011 resulting from completion of construction projects.

Depreciation expense increased 7.6% in 2010 resulting from completion of construction projects.

Depreciation expense increased 5.5% in 2009 due to completion of construction projects and a reallocation of expense resulting from a depreciation study completed in 2009.

Service and administrative expenses increased 10.8% in 2011 primarily due to an increase in labor costs in customer accounts and an increase in employee insurance and benefits expenses.

Service and administrative expenses decreased 3.6% in 2010 primarily due to a decrease in employee insurance and benefits expenses.

Service and administrative expenses decreased 6.2% in 2009 primarily due to flood expenses related to operations of \$8,965 in 2009 compared to \$184,482 in 2008.

Interest income decreased 60.1% in 2011 primarily due to a reduction in investments, very low interest rates, and difficulty getting banks to bid on placement of the investments. Funds remained deposited into money market accounts waiting a strengthening in the investment markets.

Interest income decreased 90.1% in 2010 primarily due to a reduction in investments, very low interest rates, and difficulty getting banks to bid on

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

Management Discussion and Analysis  
December 31, 2011, 2010 and 2009  
Unaudited

placement of the investments. Funds remained deposited into money market accounts waiting a strengthening in the investment markets.

Interest income decreased 85.5% in 2009 primarily due to a reduction in investments, very low interest rates, and difficulty getting banks to bid on placement of the investments. Funds were deposited into money market accounts waiting a strengthening in the investment markets.

Other, net revenues increased in 2011 by 52.6% due to an increase of \$26,175 in contribution in aid of construction from TIF (Tax Increment Financing) funds received from the City of Cedar Falls and a \$127,516 increase in intergovernmental grants.

Other, net revenues decreased in 2010 by 10.6% primarily due to a decrease of \$19,528 in contribution in aid of construction from TIF (Tax Increment Financing) funds received from the City of Cedar Falls.

Other, net revenues decreased in 2009 by 54.4% primarily due to a decrease of \$198,052 in recognized FEMA grant revenue for the Utility's costs of restoring and/or replacing capital assets.

Noncash capital contributions increased 284.2% in 2011 due to increase in new developments requiring distribution extensions during the year.

Noncash capital contributions decreased 85.4% in 2010 due to decrease in new developments requiring distribution extensions during the year.

Noncash capital contributions increased 15.3% in 2009 due to increase in new developments requiring distribution extensions during the year.

**Capital Assets and Debt Administration**

Net capital assets represent 84.1% of total assets for the Utility in 2011. Net capital assets increased 4.4% from the prior year primarily due to completion of capital projects in 2011.

Net capital assets represent 84.8% of total assets for the Utility in 2010. Net capital assets increased 3.7% from the prior year primarily due to completion of capital projects in 2010.

Net capital assets represent 83.0% of total assets for the Utility in 2009. Net capital assets increased 4.7% from the prior year primarily due to completion of capital projects in 2009.

Additional detail on the change in capital assets can be found in Note 4.

The Utility had no outstanding debt as of December 31, 2011, 2010, or 2009.

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

Balance Sheets  
December 31, 2011 and 2010

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 28,344,284	\$ 26,310,330
Less accumulated depreciation	<u>8,544,408</u>	<u>8,053,440</u>
	19,799,876	18,256,890
Construction work in progress	<u>193,142</u>	<u>887,821</u>
Net capital assets	<u>19,993,018</u>	<u>19,144,711</u>
Noncurrent assets:		
Loans Receivable	<u>8,061</u>	<u>13,706</u>
Total noncurrent investments	<u>8,061</u>	<u>13,706</u>
Current assets:		
Cash and cash equivalents (note 2)	2,931,894	2,743,441
Cash - Restricted (note 2 and 3)	61,546	110,986
Unrestricted investments: (note 2)	-	-
Receivables:		
Customer accounts, less allowance for doubtful		
accounts of \$3,546 in 2011 and \$3,271 in 2010	395,860	393,917
Loans receivable	1,384	10,007
Government grants (note 11)	206,232	38,587
Other	57,747	6,635
Interest	21	62
Material and supplies	106,120	107,621
Prepayments and other	23,478	17,304
Total current assets	<u>3,784,282</u>	<u>3,428,560</u>
Total assets	<u>\$ 23,785,361</u>	<u>\$ 22,586,977</u>



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

Statements of Revenues, Expenses and Changes in Net Assets  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Sales of water:		
Residential	\$ 2,217,461	\$ 2,019,409
Industrial	51,671	47,612
Commercial	598,429	541,413
Governmental (note 8)	204,498	198,028
Interdepartmental	16,744	(143,573)
Total sales of water	3,088,803	2,662,889
Other operating revenues	161,346	142,975
Total operating revenues	3,250,149	2,805,864
 Operating expenses		
Production:		
Purchased power from affiliated utility	149,001	141,265
Other	342,086	290,408
Distribution	694,970	747,991
Depreciation	561,741	543,343
Customer accounts	234,417	214,430
Customer service and information expenses	22,358	33,691
Sales	914	3,066
Administrative and general	833,279	730,057
Taxes other than income taxes	81,228	76,598
Total operating expenses	2,919,994	2,780,849
 Operating income (loss)	330,155	25,015
 Non-operating revenues (expenses):		
Interest income	582	1,459
Miscellaneous revenue (expense), net (note 8)	213,559	217,968
Intergovernmental grant funds (note 11)	150,162	22,646
AFUDC (note 1)	3,358	
Total non-operating revenues (expenses)	367,661	242,073
 Income before contributions	697,816	267,088
 Noncash Capital contributions	443,188	115,359
 Change in net assets	1,141,004	382,447
 Net assets, beginning of year	22,135,062	21,752,615
 Net assets, end of year	\$ 23,276,066	\$ 22,135,062

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

Statements of Cash Flows  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from customers	\$ 3,377,404	\$ 3,116,573
Cash paid to suppliers	(1,626,337)	(1,623,151)
Cash paid to employees	(708,616)	(660,935)
	<u>1,042,451</u>	<u>832,487</u>
Net cash provided by (used in) operating activities	<u>1,042,451</u>	<u>832,487</u>
Cash flows from capital and related financing activities:		
Proceeds from customer advances for construction	26,100	3,374
Refunds of customer advances for construction	(3,374)	-
Acquisition, construction and removal cost of capital assets	(971,642)	(1,149,053)
Proceeds from sale of capital assets	8,140	7,677
Reimbursement of utility construction costs	36,715	62,717
	<u>(904,061)</u>	<u>(1,075,285)</u>
Net cash provided by (used in) capital and related financing activities	<u>(904,061)</u>	<u>(1,075,285)</u>
Cash flows from investing activities:		
Interest received	623	1,590
	<u>623</u>	<u>1,590</u>
Net cash provided by (used in) investing activities	<u>623</u>	<u>1,590</u>
Net increase (decrease) in cash and cash equivalents	139,013	(241,208)
Cash and cash equivalents, beginning of year	<u>2,854,427</u>	<u>3,095,635</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 2,993,440</u>	<u>\$ 2,854,427</u>

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

Statements of Cash Flows, Continued  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating loss to net cash provided by operating activities		
Operating income (loss)	\$ 330,155	\$ 25,015
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation of capital assets	561,741	543,343
Other Income (expense), net	327,006	207,872
(Increase) decrease in accounts receivable	(1,943)	3,565
(Increase) decrease in loans receivable	14,268	10,423
(Increase) decrease in intergovernmental grants	(167,645)	86,239
(Increase) decrease in materials and supplies	1,501	(11,032)
(Increase) decrease in prepayments and other	(57,286)	2,246
Increase (decrease) in accounts payable	38,581	(73,223)
Increase (decrease) in accrued wages and vacation	(18,565)	25,908
Increase (decrease) in other accrued expenses	(10,020)	(4,122)
Increase (decrease) in other liabilities	<u>24,658</u>	<u>16,253</u>
Net cash provided by operating activities	<u>\$ 1,042,451</u>	<u>\$ 832,487</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	3,358	-
Contributions from contractors in aid of construction	443,188	115,359
Intergovernmental grants	167,505	22,337
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 2,931,894	\$ 2,743,441
Cash - Restricted	<u>61,546</u>	<u>110,986</u>
Cash and cash equivalents	<u>\$ 2,993,440</u>	<u>\$ 2,854,427</u>

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Water Utility (Utility) of the City of Cedar Falls, Iowa is a separate and distinct city utility and is chartered under Iowa Code Section 388. The Utility is a component unit of the City of Cedar Falls. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Energy Regulatory Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

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

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

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 4.64% in 2011 and 0.00% 2010. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 20 to 75 years, buildings and improvements - 30 to 45 years, and equipment - 20 to 85 years. The depreciation provisions were equivalent to an overall composite rate of 2.1% of depreciable assets for 2011 and 2.1% for 2010.

Capital assets may be contributed to the utility by outside parties. As these assets are completed and placed in service, the utility reports the value of these contributions in the statement of revenue, expenses, and changes in net assets.

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

(c) Cash and Investments

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

The Utility considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents for purposes of the statement of cash flows. Included in cash and cash equivalents at

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

(c) Cash and Investments, Continued

December 31, 2011 and 2010 were \$1,470,000 and \$1,470,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(d) Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount and are reported net of allowances.

(e) Inventories

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

(f) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of government entities. Unrestricted net assets consist of net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted".

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

(g) Operating Revenues and Expenses

Operating revenues include revenues resulting from the sale of water and service revenues. Operating expenses include expenses for power production, distribution, depreciation, customer accounts, customer service and information, sales, and administrative and general. Non-operating revenues and expenses include those derived from capital and non-capital activities, and investing activities.

Revenues from the sale of water are based on billing rates, which are applied to customers' consumption of water. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed as of December 31, 2011 and 2010, were \$122,107 and \$131,998, respectively, and are recorded in customer accounts receivable.

(h) Capital Contributions

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

(i) Estimates

The preparation of the financial statements in conformity with accounting principals generally accepted in the United States of America requires

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

(j) Budgetary Information

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

Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year 2011, there were no budget amendments.

(k) Grants

The Water Utility has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

(l) Employee Benefits

Employee benefits for accumulated sick leave hours are not accrued as they are not payable to employees. Vacation hours are earned monthly and are accrued and recorded as liabilities and unused vacation hours are paid upon termination of service. Accrued wages represents time employees worked during the calendar year.

The Water Utility provides retirement severance pay to qualifying full-time employees upon death or retirement. Retirement severance pay will be credited at the rate of two days per year of continuous service, with a minimum of twenty years of continuous service needed to qualify. The retirement severance pay shall apply only to regular full-time employees hired prior to June 30, 2007. Employees who are hired after that date shall not be entitled to the benefit. As of December 31, 2011 and 2010 the accrued liability was \$80,377 and \$74,883, respectively.

(m) Customer Advances

Customer Advances represent amounts paid to the utility by developers to extend service to new areas. As customers are added, advances will be refunded to the developers over the defined term of the agreement. Expired advances are recorded as other non-operating income in the year they expire.

(n) Reclassifications

Reclassifications of prior year's amounts may have been made for comparability.

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Notes to Financial Statements  
December 31, 2011 and 2010

(2) Restricted Assets

The composition of restricted assets as of December 31, 2011 and 2010 was as follows:

		2011		
	Cash	Investments	Total	
Current Assets - Restricted				
Self-Insured Medical and Dental	\$ 61,546	\$ -	\$ 61,546	
Total Current Assets - Restricted	61,546	-	61,546	
Total restricted assets	\$ 61,546	\$ -	\$ 61,546	
		2010		
	Cash	Investments	Total	
Current Assets - Restricted				
Self-Insured Medical and Dental	\$ 110,986	\$ -	\$ 110,986	
Total Current Assets - Restricted	110,986	-	110,986	
Total restricted assets	\$ 110,986	\$ -	\$ 110,986	

Amounts deposited in the Self-Insured Medical and Dental fund may only be used for medical and dental reserves and expenses.

(3) Cash on Hand, Deposits, and Investments

Cash on Hand

Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2011 was \$45 and 2010 was \$45.

Deposits

At December 31, 2011, the Utility's carrying amount of deposits, including \$700,000 of money market accounts, was \$1,523,395. At December 31, 2010, the Utility's carrying amount of deposits, including \$700,000 of money market accounts, was \$1,384,382.

Investments

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

As of December 31, 2011 and 2010, the Utility had no Federal Agency Obligation investments or maturities.

In addition, the Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$1,470,000 and \$1,470,000 at December 31, 2011 and 2010, respectively, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

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Notes to Financial Statements  
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(3) Cash on Hand, Deposits, and Investments, Continued

Interest Rate Risk

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

Credit Risk

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

Concentration of Credit Risk

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

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

Custodial Credit Risk - Investments

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

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

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Notes to Financial Statements  
December 31, 2011 and 2010

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

	2011	2010
Cash on hand	\$ 45	\$ 45
Carrying amount of deposits	1,523,395	1,384,382
Carrying amount of Iowa Public Agency Investment Trust	1,470,000	1,470,000
Total	\$ 2,993,440	\$ 2,854,427
Current Assets		
Cash and cash equivalents	\$ 2,931,894	\$ 2,743,441
Investments	-	-
Restricted Cash	61,546	110,986
Total	\$ 2,993,440	\$ 2,854,427

Of the unrestricted cash and investments listed above, the Board of Trustees of the Municipal Water Utility has made no reserve fund designations.

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2011 and 2010 follows:

2011	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being depreciated:				
Land	\$ 63,466	\$ -	\$ -	\$ 63,466
Construction, Work-in-progress	887,821	1,405,609	2,100,288	193,142
Total capital assets, not being depreciated	951,287	1,405,609	2,100,288	256,608
Capital assets, being depreciated:				
Infrastructure	25,008,824	2,100,288	66,334	27,042,778
Buildings and improvements	807,702	-	-	807,702
Equipment	430,338	-	-	430,338
Total capital assets, being depreciated	26,246,864	2,100,288	66,334	28,280,818
Less accumulated depreciation	8,053,440	573,042	82,074	8,544,408
Total capital assets, being depreciated, net	18,193,424	1,527,246	(15,740)	19,736,410
Capital assets, net	\$19,144,711	\$2,932,855	\$2,084,548	\$19,993,018

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA  
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Notes to Financial Statements  
December 31, 2011 and 2010

(4) Capital Assets, Continued

2010	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being depreciated:				
Land	\$ 63,466	\$ -	\$ -	\$ 63,466
Construction, Work-in-progress	571,254	1,232,735	916,168	887,821
Total capital assets, not being depreciated	634,720	1,232,735	916,168	951,287
Capital assets, being depreciated:				
Infrastructure	24,179,598	862,383	33,157	25,008,824
Buildings and improvements	799,063	41,994	33,355	807,702
Equipment	418,547	11,791	-	430,338
Total capital assets, being depreciated	25,397,208	916,168	66,512	26,246,864
Less accumulated depreciation	7,570,634	555,146	72,340	8,053,440
Total capital assets, being depreciated, net	17,826,574	361,022	(5,828)	18,193,424
Capital assets, net	\$18,461,294	\$1,593,757	\$ 910,340	\$19,144,711

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2011 and 2010 was as follows:

2011	Beginning Balance	Additions	Reductions	Ending Balance
Other liabilities	\$ 173,424	\$ 116,848	\$ 92,190	\$ 198,082
Total noncurrent liabilities	\$ 173,424	\$ 116,848	\$ 92,190	\$ 198,082
2010	Beginning Balance	Additions	Reductions	Ending Balance
Other liabilities	\$ 157,171	\$ 60,005	\$ 43,752	\$ 173,424
Total noncurrent liabilities	\$ 157,171	\$ 60,005	\$ 43,752	\$ 173,424

(6) Pension and Retirement Benefits

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

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Notes to Financial Statements  
December 31, 2011 and 2010

(6) Pension and Retirement Benefits, Continued

Plan members were required to contribute 4.50% of their annual covered salary and the Utility is required to contribute 6.95% of annual covered payroll through June 30, 2011. Beginning July 1, 2011 plan members are required to contribute 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2011, 2010 and 2009, were \$85,369; \$72,841; and \$68,847; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Prior to June 30, 2010, employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age qualified to convert their accrued sick leave value into paid health insurance premiums upon retirement. This benefit was phased out between January 1, 2008 and June 30, 2010. In 2008 the benefit was reduced to 75% of accrued sick leave and in 2009 to June 30, 2010 it was reduced to 50% and zero thereafter.

(7) Income Tax Status

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

(8) Related Party Transactions

The Utility provides water service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$68,865 and \$79,371 in 2011 and 2010, respectively.

The Utility also provides billing and collection services to the City for the City's sanitary sewer system and garbage and refuse service. Revenues from the service provided amounted to \$122,632 in 2011 and \$159,596 in 2010, and are recorded in miscellaneous non-operating revenue.

For the year ended December 31, 2010, the Utility earned a management fee of \$1,863 from the Municipal Communications Utility for administration, finance, human resources and legal services, which is recorded in miscellaneous non-operating revenue. Due to a reallocation of labor and other costs among the Electric, Gas, Water and Communications Utilities this management fee has been eliminated as of December 31, 2010.

(9) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks.

The Utilities maintain a risk management account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and have insurance for claims above this amount. In addition, the Utilities have aggregate stop loss coverage for the 2011 plan year for aggregate claims exceeding \$2.3 million. Liabilities of the risk management account are reported

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Notes to Financial Statements  
December 31, 2011 and 2010

(9) Risk Management, Continued

when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated.

Liabilities include an estimated amount for claims that have been incurred but not reported (IBNR) which represent estimates of the eventual loss on claims arising prior to year-end. The estimate is based on a percentage of claims unpaid at year end considering the Utilities claims payment history. Changes in the balances of the Utilities liabilities during the past two years are as follows:

	<u>2011</u>	<u>2010</u>
Unpaid claims and IBNR, beginning of year	\$ 187,000	\$ 325,000
Current year costs including IBNR	3,869,576	2,207,548
Claims paid	<u>(3,705,576)</u>	<u>(2,345,548)</u>
Unpaid claims and IBNR, end of year	<u>\$ 351,000</u>	<u>\$ 187,000</u>

The Utility has recorded \$28,080 and \$14,960 in accounts payable for its share of these unpaid claims and IBNR at December 31, 2011 and 2010, respectively.

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

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2011.

Cash and cash equivalents and investments	\$56,188,298
Receivables	1,866,149
Other assets	<u>671,822</u>
Total assets	<u>\$58,726,269</u>
Total liabilities	\$27,019,782
Total equity	<u>31,706,487</u>
Total liabilities and equity	<u>\$58,726,269</u>
Total revenues	\$ 8,210,837
Total expenses	3,654,409
Distribution to members	<u>-</u>
Net increase in equity	<u>\$ 4,556,428</u>

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

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Notes to Financial Statements  
December 31, 2011 and 2010

(10) Other Post-Employment Benefits (OPEB)

Plan Description

The Cedar Falls Utilities administers a single-employer defined benefit medical health care plan (The Plan) for all four utilities. The plan provides self-insured medical, vision, and prescription drug coverage, and to all active and retired employees and their eligible dependents. Eligible retirees receive health care coverage through the same plans that are available for active employees. To be eligible for these benefits employees at their retirement date must be a minimum of 55 years old, have been employed for the preceding four years, and be enrolled in the plan. Plan contributions are required from retirees based on an amount equal to the full cost of active members. These medical benefits terminate upon attaining Medicare eligibility. In addition, the Plan provides a \$5,000 in life insurance benefits to all retirees who elect this coverage and agree to pay a contribution for this coverage.

Funding Policy

The Utility, with assistance from their third-party administrators, establishes and amends contribution requirements for both active and retiree members on an annual basis. The current funding policy is to pay health claims as they occur and the required contribution is based on pay-as-you-go financing. For the year ending December 31, 2011, the Utility contributed \$185,824 and retirees receiving benefits contributed \$114,053 through their required contributions.

Annual OPEB and Net OPEB Obligations

The Plan's annual OPEB expense is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of General Accounting Standards Board (GASB) Statement No 45. This standard was implemented in 2008. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following schedule shows the components of the annual OPEB expense for the year, the amount actually contributed to the plan, and changes in the net OPEB obligation:

	2011
Annual required contribution	\$ 299,000
Interest on Net OPEB Obligation	14,004
Adjustment to annual required contribution	(11,000)
Annual OPEB expense	302,004
Contributions and payments made	71,771
Increase in net OPEB obligation	\$ 230,233
Net OPEB obligation, December 31, 2010	838,449
Net OPEB obligation, December 31, 2011	\$1,068,682

The Water Utility's share of the December 31, 2011 Net OPEB obligation is \$117,705.

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Notes to Financial Statements  
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(10) Other Post-Employment Benefits (OPEB), Continued

The Utilities annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and net OPEB obligation for the year ended December 31, 2011, 2010 and 2009:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage Of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449
December 31, 2009	\$ 302,004	5.64%	\$ 585,532

Funded Status and Funding Progress

As of January 1, 2009, the most recent actuarial valuation date, the actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$2,967,000. The Plan is unfunded since there are no assets and retiree benefits are paid annually on a cash basis. Because The Plan is unfunded, the AAL and UAAL are equal. The covered payroll is the yearly payroll of actives covered by the plan and was \$12,936,933, in 2011 and the ratio of the UAAL to the covered payroll was 22.9%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. There are no plans to fund The Plan at this time.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Significant methods and assumptions were as follows:

Actuarial valuation date:	January 1, 2009
Actuarial cost method:	Projected Unit Credit
Amortization method:	Level Percentage Of Projected Payroll
Remaining amortization period:	30 years
Actuarial assumptions:	
Discount Rate	5.0%
Healthcare Trend Rate	11.0% declining .5% annually to 6%
Projected Salary Increases	4.0%

The schedule of funding progress, presented as Required Supplemental Information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of the plan assets is increasing or decreasing over time relative to the actuarial liabilities for benefits.

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December 31, 2011 and 2010

(11) Flood Event

On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, office furnishings and equipment, meters, well equipment, and tools. The Utility began immediate clean up and work with the Federal Emergency Management Agency (FEMA) for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA submitting costs related to recovery, repair and remediation. As of December 31, 2009, Utility facilities and were repaired and operational. As of December 31, 2011 and 2010, the Water Utility has spent \$11 and \$247, respectively, in operational expense for flood recovery and \$147,240 and \$21,041, respectively, in asset repair and replacement. As of December 31, 2011 and 2010, the Utility has recognized \$18,935 and \$(309), respectively, in Other Operating Revenues for FEMA reimbursement expected for operational losses and \$141,625 and \$22,646, respectively, in Other Non-Operating Revenues for FEMA reimbursement expected for capital losses. As of December 31, 2011 and 2010, the Utility recognized a receivable of \$197,647 and \$38,352, respectively, for FEMA flood disaster reimbursement.

(12) Commitments and Contingencies

As of December 31, 2011, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$235,000 and an estimated time frame to complete through 2015.

Schedule of Funding Progress for the Other  
Post-Employment Benefits Plan  
Unaudited

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
2011	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,936,933	22.9%
2010	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,152,946	24.4%
2009	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$11,587,064	25.6%
2008	January 1, 2007	\$ -	\$3,436,000	\$3,436,000	0.0%	\$11,162,424	30.8%



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

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

We have audited the financial statements of the Municipal Water Utility of the City of Cedar Falls, Iowa (Municipal Water Utility) as of and for the year ended December 31, 2011, and have issued our report thereon dated March 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Internal Control Over Financial Reporting***

Management of the Municipal Water Utility is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Municipal Water Utility's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Water Utility's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipal Water Utility's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of the Municipal Water Utility's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

***Compliance and Other Matters***

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

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

This report is intended solely for the information and use of utility management, others within the entity, federal and state awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

*Baker Tilly Virchow Krause, LLP*  
Madison, Wisconsin  
March 30, 2012



# **Cedar Falls Utilities**

**Financial Statements of the Municipal  
Communications Utility  
of the City of Cedar Falls, Iowa**

**Including Independent Auditors' Reports**

**For The Years Ended  
December 31, 2011 and 2010**

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

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheets of the Municipal Communications Utility of The City of Cedar Falls, Iowa (Municipal Communications Utility), a component unit of the City of Cedar Falls, Iowa, as of December 31, 2011 and 2010 and related statements of revenues, expenses and changes in net assets and statements of cash flows for the years then ended, as noted in the table of contents. These financial statements are the responsibility of the Municipal Communications Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Communications Utility as of December 31, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will issue a report on our consideration of the Municipal Communications Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 read in conjunction with this report in considering the results of our audit.

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

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress as listed in the table of contents be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economical, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012

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

Management Discussion and Analysis  
December 31, 2011, 2010 and 2009  
Unaudited

The following discussion and analysis of the Municipal Communications Utility (Utility) of the City of Cedar Falls, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2011, 2010 and 2009. This information should be read in conjunction with the financial statements and the accompanying notes to the financial statements that follow this section.

**Financial Highlights**

- The Utility's net assets increased in 2011 as a result of operating income. At December 31, 2011, 2010 and 2009, total assets were \$34,155,542 and \$34,494,078, and \$19,311,878 respectively, and total liabilities were \$20,826,002 and \$21,624,072, and \$9,204,082 respectively, resulting in net assets of \$13,329,540 in 2011 and net assets of \$12,870,006 in 2010 and net assets of \$10,107,796 in 2009.
- Rate increases in Digital Premier Premium channel service of 8.3%, Digital Signature service of 26.3%, HD Essentials of 20.2% and premium movie channel services of 8.8% were effective in January 2011.
- Rate increases in Basic Lifeline and Basic Plus of 9.3%, Digital Premier Premium channel service of 5.9%, CyberHome/FiberHome data services of 12.5%, CyberOffice/FiberOffice data services of 4.5% and CyberOffice Plus/FiberOffice Plus data services of 6.3% were effective in January 2010.
- A rate increase in premium movie channel packages of approximately 16% and Digital Signature add-on package of 2.8% were effective in January of 2009.
- In 2011 operating revenues increased 3.3% to \$12,603,274 while operating expenses increased 28.8% to \$11,917,381.
- In 2010 operating revenues increased 8.0% to \$12,198,451 while operating expenses increased 3.6% to \$9,249,195.
- In 2009 operating revenues increased 2.7% to \$11,296,748 while operating expenses increased 3.6% to \$8,924,912.
- In 2011, the Utility net operating income decreased 76.7% to \$685,893 compared to net operating income of \$2,949,256 in 2010 and \$2,371,836 in 2009. The primary cause of the decrease is due to operations cost for the fiber to the premise project such as scheduling coordinators and costs of equipment replaced inside customer homes to upgrade their inside wiring to accommodate the fiber system.
- On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, office furnishings and equipment, and tools. The Utility began immediate clean up and work with the Federal Emergency Management Agency (FEMA) for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA for the recovery, repair and remediation of Utility assets damaged or destroyed in the flood. Additional detail on the 2008 Flood Event can be found in Note 11.

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- On July 10, 2009, the City of Cedar Falls experienced a storm with extreme winds of approximately 106 MPH. The extreme winds uprooted and sheared trees snapping poles and distribution lines damaging or destroying them. The Utility began immediate clean up and also began working with the Federal Emergency Management Agency (FEMA) for reconstruction and repair of destroyed Utility distribution assets. For additional detail on the 2009 Wind Storm Event see Note 12.

**Overview of the Financial Statements**

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

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

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

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

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

**Condensed Financial Information**

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

Condensed Balance Sheet Information

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 9,962,020	\$19,151,954	\$ 9,574,768
Capital assets, net	24,089,337	15,228,810	9,670,506
Other noncurrent assets	104,185	113,314	66,604
Total assets	<u>\$34,155,542</u>	<u>\$34,494,078</u>	<u>\$19,311,878</u>

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Current liabilities	\$ 4,028,046	\$ 3,112,766	\$ 2,484,205
Noncurrent liabilities	315,494	262,768	301,108
Long-term debt	<u>16,482,462</u>	<u>18,248,538</u>	<u>6,418,769</u>
Total liabilities	<u>\$20,826,002</u>	<u>\$21,624,072</u>	<u>\$ 9,204,082</u>

Invested in capital assets, net of related debt	\$ 6,626,929	\$ 3,747,880	\$ 3,313,508
Restricted	1,810,529	1,914,866	474,765
Unrestricted	<u>4,892,082</u>	<u>7,207,260</u>	<u>6,319,523</u>
Total net assets	<u>\$13,329,540</u>	<u>\$12,870,006</u>	<u>\$10,107,796</u>

Condensed Revenues, Expenses and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cable television	\$ 7,125,207	\$ 6,948,349	\$ 6,240,462
High speed data communications	5,479,181	5,220,455	4,891,370
Other Operating Revenue	(1,114)	29,647	164,916
Total operating revenues	<u>12,603,274</u>	<u>12,198,451</u>	<u>11,296,748</u>
System operation and maintenance	7,318,913	5,826,954	5,393,888
Depreciation	1,607,050	1,415,969	1,306,029
Sales, customer service, corporate operations	<u>2,991,418</u>	<u>2,006,272</u>	<u>2,224,995</u>
Total operating expenses	11,917,381	9,249,195	8,924,912
Operating income	685,893	2,949,256	2,371,836
Interest Income	12,768	12,650	22,402
Interest Expense	(544,889)	(327,114)	(169,578)
Other, net	<u>305,762</u>	<u>127,418</u>	<u>333,089</u>
Total non-operating revenues (expenses)	(226,359)	(187,046)	185,913
Change in net assets	459,534	2,762,210	2,557,749
Net assets, beginning of year	<u>12,870,006</u>	<u>10,107,796</u>	<u>7,550,047</u>
Net assets, end of year	<u>\$13,329,540</u>	<u>\$12,870,006</u>	<u>\$10,107,796</u>

**Financial Analysis**

Current assets decreased 48.0% in 2011. Cash and investments - unrestricted decreased by 32.6% and cash and investments - restricted decreased 74.5% primarily due to funds received from the issuance of new debt in 2010 being spent to fund the fiber to the premise infrastructure build out. Receivables increased 3.7%, \$59,476, primarily due to a 60.1%, \$36,961, increase in Government grants receivable and a 16.3% increase, \$18,593, in other receivables.

Current assets increased 100.0% in 2010. Cash and investments - unrestricted increased by 2.7% and cash and investments - restricted increased 536.5% primarily due to funds received from the issuance of new debt in 2010. Receivables decreased 15.1%, \$282,919, primarily due to a 63.5%, \$107,288, decrease in Government grants

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receivable and a 70.7% decrease, \$275,246, in other receivables offset by an 8.3% increase, \$108,473, in customer accounts receivable.

Current assets increased 69.4% in 2009. Cash and investments - unrestricted increased by 125.8% and cash and investments - restricted increased 38.1% primarily due to funds received from the refunding of existing debt and issuance of new debt in 2009. Receivables increased 24.0%, \$363,560, primarily due to a 93.6%, \$81,590, increase in Government grants receivable and other receivables increased 209.0%, \$263,450, primarily due to an increase in miscellaneous accounts receivable.

Current liabilities increased 29.4% in 2011 primarily due the \$784,494 increase in accounts payable.

Current liabilities increased 25.3% in 2010 primarily due the \$640,000 increase in current installments of long-term debt offset by a 9.4%, \$106,106, decrease in accounts payable.

Current liabilities increased 24.8% in 2009 primarily from the \$424,388 increase in accounts payable and a \$60,000 increase in current installments of long-term debt.

Noncurrent liabilities increased 20.1% in 2011 primarily due to a 37.1%, \$68,044, increase in other noncurrent liabilities for accrued severance and retirement insurance benefit liability.

Noncurrent liabilities decreased 12.7% in 2010 primarily due to a 36.0%, \$44,649, decrease in customer advances for construction offset by a 3.6%, \$6,309, increase in the severance and retirement benefit liability.

Noncurrent liabilities increased 13.9% in 2009 primarily due to a 34.5%, \$45,426, increase in the severance and retirement benefit liability, offset by a decrease in customer advances for construction by 6.5%, \$8,678.

Long-term debt decreased 9.7%, \$1,766,076, during 2011 due to a 9.1% decrease, \$1,581,076, in long-term debt, less current installments and a 20.0% decrease, \$185,000, in long-term note payable, less current installments. Long-term note payable, less current installments was comprised of two notes payable to the Municipal Electric Utility, Note A and Note B. Note A was paid in full during 2011.

Long-term debt increased 184.3%, \$11,829,769, during 2010. Long-term debt, less current installments increased 234.1%, \$12,139,769, as a result of the issuance of new debt in 2010, offset by a decrease in advances from affiliated companies of 25.1%, \$310,000.

Long-term debt increased 53.2%, \$2,228,567, during 2009. Long-term debt, less current installments increased 95.9%, \$2,538,567, as a result of refunding existing debt and issuance of new debt in 2009, offset by a decrease in advances from affiliated companies of 20.1%, \$310,000.

Cable television operating revenues increased 2.5% in 2011. Basic service revenues increased 1.0% and Basic Plus service revenues increased 2.2% in 2011 primarily due to an increase in the number of subscribers of 432. Digital Premier service revenues increased \$1,824, 1.5%, due to a \$3.00 per subscriber per month rate increase. Digital Signature service revenues increased \$59,286, 32.5%, due to a \$2.50 per subscriber per month rate increase. HD Essentials service revenues increased \$9,066, 10.7%, due to a \$1.00 per subscriber per month rate increase.

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Likewise, premium movie channel service revenues increased by \$9,319, 4.7%, due to an average \$6.00 per subscriber per month rate increase. Finally, equipment revenues increased \$132,993, 18.4%, during 2011 primarily due to an additional 1,074 subscribers renting cable television set top boxes.

Cable television operating revenues increased 11.3% in 2010. This is primarily due to rate changes in 2010. Basic service revenues increased 30.9% in 2010 primarily due to a \$2.00 per subscriber per month rate increase. Basic Plus service revenues increased 9.6% in 2010 primarily because of a \$2.00 per subscriber per month rate increase. Digital Premier service revenues decreased \$4,230, 3.4%, due to a \$2.00 per subscriber per month rate increase offset by a 7.7% reduction in subscribers to the service. Finally, advertising sales revenues increased by 32.5%, \$155,449, in 2010.

Cable television operating revenues increased 2.0% in 2009. This is primarily due to a rate changes in 2009. Basic Plus service revenues increased 1.7% in 2009 primarily because of a \$1.00 per subscriber per month rate increase at mid-year; premium movie channel and pay-per-view revenues increased approximately 13.8% due to an increased number of subscribers and the introduction Video On Demand services; because of programming and channel line-up changes, Digital Signature was split into 2 separate services - Digital Signature and Signature Sports - with no rate change impact and HD Essentials service rates were reduced by \$7.00 per subscriber per month. Additional High Definition programming being available to subscribers requires converter boxes which increased subscribers and, thus, equipment revenue by 15.1%. Finally, advertising sales revenues decreased by 18.4%, \$108,232.

Data communications operating revenues increased 5.0% in 2011. An increase of 702 subscribers in 2011 accounts for the increase. Data services revenue increased \$284,863, 5.9%, and Local private line revenue increased \$10,553, 6.7%, offset by a decrease in network access revenue of \$36,690, 16.0%.

Data communications operating revenues increased 6.7% in 2010. An increase of 396 subscribers in 2010 and a rate increase of \$5 per subscriber, not also subscribing to cable television service, accounts for the increase. Network access wholesale revenues increased 9.0% and modem-based data service sales increased by 7.1% offset by a 5.4% decrease in point-to-point data service revenues.

Data communications operating revenues increased 4.5% in 2009. An increase of 472 subscribers in 2009 accounts for the increase. Point-to-Point data service revenues increased by 13.6%, modem-based data service sales increased by 5.0% offset by a 9.6% decrease in network access wholesale revenues.

Total system operation and maintenance expenses increased 25.6% in 2011 due to cable television programming cost increases of \$208,119, 5.3%, and a \$766,363, 185.7%, increase in customer premise wiring due to the fiber to the premise infrastructure build out. Headend equipment and distribution system expense also increased \$186,468, 64.9%.

Total system operation and maintenance expenses increased 8.0% in 2010 due to Cable television programming cost increases of \$346,974, 10.0%, and a 58.9%, \$72,720, increase in network administration expense, a 32.2%, \$20,499, increase in engineering expense and a 22.1%, \$50,126, increase in access (Bandwidth) expenses in Data communications.

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Total system operation and maintenance expenses increased 4.7% in 2009 due to Cable television programming cost increases of \$216,723, 6.5%. In addition, data communications system operation and maintenance expenses decreased 7.2% primarily due to a 24.3%, \$29,502, decrease in Customer Premise Wiring expenses, and a 19.7%, \$55,662, decrease in Access (Bandwidth) Expenses.

Total sales, customer services, and corporate operations expenses increased 49.1% in 2011. Sales expenses increased by \$71,734, 19.2%, primarily due to a \$49,130 increase in sales and product advertising expense, a \$183,465 increase in customer operations primarily due to temporary customer service and installation personnel hired for converting customers from the coax system to the fiber system. Corporate operations increased by \$729,947, 72.9%, primarily due to an increase of approximately \$365,000 per year in wages due to a reallocation of wages among all the municipal utilities that share personnel with the Communications utility, and a \$393,259, 62.5% increase in human resources costs primarily due to an increase in medical insurance costs.

Total sales, customer services, and corporate operations expenses decreased 9.8% in 2010. Cable television sales expenses decreased by \$15,262, 5.0%, primarily due to a \$43,683 decrease in product advertising expense, a \$75,868 decrease in corporate operations primarily due to a decrease in employee insurance and benefits expense, offset by an increase of \$25,217 in Customer Operations. Data communication customer sales expense increased by 46.2% due to a \$27,848 increase in product advertising, offset by a \$44,210 decrease in customer operations and a \$134,846 decrease in corporate operations expenses due to decrease in employee insurance and benefits expense and reduction of payments to consultants in 2010 by \$70,000.

Total sales, customer services, and corporate operations expenses increased 7.7% in 2009. Cable television sales expenses increased by \$25,778, 9.2%, primarily due to a \$26,988 increase in product advertising expense, an increase of \$16,693 in Customer Operations primarily due to uncollectable accounts. Data communication customer operations expenses increased by 20.8% due to increased customer education expense required due to changing email products and an increase in uncollectible accounts. Corporate operations expenses decreased by \$25,507 due to a decrease in flood-related operational expenses.

Interest income decreased 0.9% in 2011 due to the continuing low interest rates for investments and cash accounts. Interest expense increased 66.6%, \$217,775, in 2011 primarily due to a full year of the new 2010 debt issued. Other, net increased by 140.0%, \$178,344, in 2011 primarily due to a 107.5%, \$108,338, increase in Allowance for Funds Used During Construction - AFUDC, and a \$67,594 increase in intergovernmental grant revenue.

Interest income decreased 43.5% in 2010 due to much lower interest rates for investments and cash accounts. Interest expense increased 92.9%, \$157,536, in 2010 primarily due to a full year of 2009 issued debt and new debt issued in 2010. Other, net decreased by 61.7%, \$205,671, in 2010 primarily due to a 85.6%, \$246,960, decrease in Contributions in Aid of Construction revenues offset by 189.5%, \$65,968, of increased Allowance for Funds Used During Construction - AFUDC.

Interest income decreased 76.2% in 2009 due to much lower interest rates for investments and cash accounts. Interest expense decreased 14.0% in 2009 primarily due to higher principal payments on long-term debt resulting in less interest paid in 2009. Other, net increased by 151.6%, \$200,718, in 2009 primarily due to an increase of \$17,163 in other non-operating income and \$140,072, in Contributions in

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Aid of Construction revenues and a 126.8%, \$19,461, increase in the Allowance for Funds Used During Construction (AFUDC).

**Capital Assets and Debt Administration**

Net capital assets represent 70.5% of total assets for the Utility in 2011. Net capital assets increased 58.2% in 2011 primarily due to beginning the fiber to the premise build out that is replacing the current fiber-coax hybrid system.

Net capital assets represent 44.1% of total assets for the Utility in 2010. Net capital assets increased 57.5% in 2010 primarily due to beginning the fiber to the premise build out that is replacing the current fiber-coax hybrid system.

Net capital assets represent 50.1% of total assets for the Utility in 2009. Net capital assets increased 16.0% in 2009 primarily due to digital set top box equipment, and head end equipment.

Additional detail on the change in capital assets can be found in Note 4.

The Utility's total long-term debt at year end 2011, excluding the outstanding loan with the Municipal Electric Utility, was \$17,299,372 of which \$15,744,372 is noncurrent debt and \$1,555,000 is current debt compared to \$18,715,448 of total long-term debt at year end 2010 of which \$17,325,448 was noncurrent debt and \$1,390,000 was current debt. The change in total long-term debt is primarily due to repayment of \$1,416,076 of debt during 2011.

The Utility's total long-term debt at year end 2010, excluding the outstanding loan with the Municipal Electric Utility, was \$18,715,448 of which \$17,325,448 was noncurrent debt and \$1,390,000 was current debt compared to \$5,935,679 of total long-term debt at year end 2009 of which \$5,185,679 was noncurrent debt and \$750,000 was current debt. The change in total long-term debt is primarily due to issuing \$13,130,000 in new debt during 2010.

The Utility's total long-term debt at year end 2009, excluding the outstanding loan with the Municipal Electric Utility, was \$5,935,679 of which \$5,185,679 was noncurrent debt and \$750,000 was current debt compared to \$3,337,112 of total long-term debt at year end 2008 of which \$2,647,112 was noncurrent debt and \$690,000 was current debt. The change in total long-term debt is due to the repayment of \$3,337,112 of debt and issuing \$5,960,000 in new debt during 2009.

The Utility has an outstanding loan with the Municipal Electric Utility totaling \$923,090, \$1,233,090, and \$1,543,090 at December 31, 2011, 2010 and 2009, respectively. Additional detail on the outstanding loan can be found in Note 5.

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

Balance Sheets  
Years ended December 31, 2011 and 2010

<u>Assets</u>	<u>2011</u>	<u>2010</u>
Current assets:		
Cash and cash equivalents (note 3)	\$ 3,755,435	\$ 5,568,343
Cash - Restricted (note 2 and 3)	993,083	8,775,696
Investments - Unrestricted (note 3)	-	-
Investments - Restricted (note 2 and 3)	1,674,000	1,678,178
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$29,119 in 2011 and \$25,700 in 2010	1,422,775	1,417,540
Interest	1,534	2,847
Government grants (note 11 and 12)	98,486	61,525
Other	132,821	114,228
Material and supplies	1,764,293	1,429,977
Prepayments and other	119,593	103,620
Total current assets	<u>9,962,020</u>	<u>19,151,954</u>
Capital assets: (note 4)		
Capital assets, in service	32,470,282	22,276,826
Less accumulated depreciation	<u>9,654,655</u>	<u>10,226,623</u>
	22,815,627	12,050,203
Construction work in progress	<u>1,273,710</u>	<u>3,178,607</u>
Net capital assets	<u>24,089,337</u>	<u>15,228,810</u>
Deferred costs, net of amortization	<u>104,185</u>	<u>113,314</u>
Total noncurrent assets	<u>24,193,522</u>	<u>15,342,124</u>
Total assets	<u>\$ 34,155,542</u>	<u>\$ 34,494,078</u>

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

Balance Sheets  
Years ended December 31, 2011 and 2010

<u>Liabilities</u>	<u>2011</u>	<u>2010</u>
Current liabilities:		
Accounts payable	\$ 1,806,842	\$ 1,022,348
Accrued wages and vacation	301,316	206,255
Accrued interest	60,680	68,764
Other accrued liabilities	119,208	115,399
Current installments of note payable (note 5)	185,000	310,000
Current installments of long-term debt (note 5)	1,555,000	1,390,000
Total current liabilities	<u>4,028,046</u>	<u>3,112,766</u>
Noncurrent liabilities: (note 5)		
Other liabilities (note 5 and 10)	251,419	183,375
Customer advances for construction	64,075	79,393
Total noncurrent liabilities	<u>315,494</u>	<u>262,768</u>
Long-term Debt (note 5)		
Long-term note payable, less current installments (note 5)	738,090	923,090
Long-term debt, less current installments (note 5)	15,744,372	17,325,448
	<u>16,482,462</u>	<u>18,248,538</u>
Total liabilities and Long-term debt	<u>20,826,002</u>	<u>21,624,072</u>
<u>Net Assets</u>		
Invested in capital assets, net of related debt	6,626,929	3,747,880
Restricted	1,810,529	1,914,866
Unrestricted	4,892,082	7,207,260
Total net assets	<u>13,329,540</u>	<u>12,870,006</u>
Total liabilities and net assets	<u>\$ 34,155,542</u>	<u>\$ 34,494,078</u>

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

Statements of Revenues, Expenses and Changes in Net Assets  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Cable system revenues	\$ 7,125,207	\$ 6,948,349
Data services revenue	5,118,548	4,833,685
Network access revenue	192,919	229,609
Local private line revenue	167,714	157,161
Other Operating Income	(1,114)	29,647
Total operating revenues	12,603,274	12,198,451
Operating expenses:		
Plant specific and programming	6,225,741	4,875,955
Depreciation	1,607,050	1,415,969
Plant nonspecific	1,093,172	950,999
Customer operations	813,895	630,430
Sales	446,108	374,374
Corporate operations (note 8)	1,731,415	1,001,468
Total operating expenses	11,917,381	9,249,195
Operating income	685,893	2,949,256
Non-operating revenues (expenses):		
Interest income	12,768	12,650
Miscellaneous revenue (expense), net	64,905	72,103
Intergovernmental grant funds (note 11 and 12)	67,526	(68)
Interest expense on long-term debt (note 5)	(544,889)	(327,114)
AFUDC (note 1)	209,116	100,778
Interest expense on affiliated note payable (note 5 and 8)	(35,785)	(45,395)
Total non-operating revenues (expenses)	(226,359)	(187,046)
Change in net assets	459,534	2,762,210
Net assets beginning of year	12,870,006	10,107,796
Net assets end of year	\$ 13,329,540	\$ 12,870,006

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

Statements of Cash Flows  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from customers	\$ 12,665,746	\$ 12,513,270
Intergovernmental grants	-	-
Cash paid to suppliers	(8,138,255)	(7,599,695)
Cash paid to employees	(1,583,163)	(1,187,312)
	<u>2,944,328</u>	<u>3,726,263</u>
Cash flows from noncapital financing activities:		
Payments on advance from affiliated utility	(310,000)	(310,000)
Interest paid Note Payable	(40,629)	(50,239)
	<u>(350,629)</u>	<u>(360,239)</u>
Cash flows from capital and related financing activities:		
Proceeds from issuance of GO Bonds and Capital Loan Notes	-	13,130,000
Premium on issuance of revenue bonds	-	490,762
Discount on issuance of revenue bonds	-	(94,971)
Cost of issuance of revenue bonds	-	(55,011)
Principal payments on long-term debt	(1,390,000)	(750,000)
Interest payments on long-term debt	(565,076)	(271,337)
Refunds of customer advances for construction	(15,318)	(17,649)
Acquisition, construction and removal cost of capital assets	(10,284,032)	(6,893,272)
Proceeds from sale of capital assets	19,460	11,823
Reimbursement of utility construction costs	27,487	22,455
Intergovernmental grants	-	-
	<u>(12,207,479)</u>	<u>5,572,800</u>
Cash flows from investing activities:		
Proceeds from maturities of investment securities	1,678,178	903,000
Purchase of investment securities	(1,674,000)	(1,678,178)
Interest received	14,081	21,568
	<u>18,259</u>	<u>(753,610)</u>
Net increase (decrease) in cash and cash equivalents	(9,595,521)	8,185,214
Cash and cash equivalents, beginning of year	<u>14,344,039</u>	<u>6,158,825</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 4,748,518</u>	<u>\$ 14,344,039</u>

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

Statements of Cash Flows, Continued  
Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 685,893	\$ 2,949,256
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	1,607,050	1,415,969
Other income (expense), net	111,055	30,534
(Increase) decrease in accounts receivable	(23,828)	166,773
(Increase) decrease in intergovernmental grants	(36,961)	107,228
(Increase) decrease in materials and supplies	(334,316)	(883,369)
(Increase) decrease in prepayments and other	(15,973)	(16,344)
Increase (decrease) in accounts payable	784,494	(106,106)
Increase (decrease) in accrued wages and vacation	95,061	42,480
Increase (decrease) in other accrued liabilities	3,809	13,533
Increase (decrease) in other noncurrent liabilities	68,044	6,309
Net cash provided by operating activities	<u>\$ 2,944,328</u>	<u>\$ 3,726,263</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	209,116	100,778
Contributions from contractors in aid of construction	21,376	41,501
Intergovernmental grants	55,344	(570)
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 3,755,435	\$ 5,568,343
Cash - Restricted	993,083	8,775,696
Cash and cash equivalents	<u>\$ 4,748,518</u>	<u>\$ 14,344,039</u>

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies

(a) Organization and Basis of Accounting

The Municipal Communications Utility (Utility) of the City of Cedar Falls, Iowa is a separate and distinct city utility and is chartered under Iowa Code Section 388. The Utility is a component unit of the City of Cedar Falls, Iowa. The Utility was formed to engage in the development and operation of a broadband communications system and the marketing of related services such as cable television and high-speed data communications. The Utility's rates are set by its governing board. The Utility follows the accounting practices prescribed through the Federal Communications Commission for regulated utilities and proprietary fund accounting for governmental entities under accounting principles generally accepted in the United States of America.

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

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

(b) Capital Assets and Depreciation

Capital assets are stated at original cost, including an allowance for funds used during construction. The allowance for funds used during construction (AFUDC) represents the estimated cost of funds used for construction purposes. AFUDC was capitalized on utility construction at a rate of 3.94% in 2011 and 4.92% in 2010. Depreciation of capital assets in service is calculated on a composite straight-line method at rates based on estimated service lives and salvage values of several classes of capital assets. The range of estimated service lives for the classes of capital assets are as follows: infrastructure - 18 to 35 years and equipment - 5 to 20 years. The depreciation provision was equivalent to an overall composite rate of 6.3% and 6.3% of depreciable assets for 2011 and 2010, respectively.

Capital assets may be contributed to the utility by outside parties. As these assets are completed and placed in service, the utility reports the value of these contributions in the statement of revenue, expenses, and changes in net assets.

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

(c) Cash and Investments

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

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

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

statements of cash flows. Included in cash and cash equivalents at December 31, 2011 and 2010 were \$250,000 and \$250,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

(d) Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount and are reported net of allowances.

(e) Inventories

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

(f) Bond Issue Costs

Debt discount, debt premium and debt issue costs are amortized over the life of the debt using the same percentage as the principal paid in a given year is to the total debt issued by issue.

(g) Net Assets

Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of government entities. Unrestricted net assets consist of net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted".

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

(h) Operating Revenues and Expenses

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

Revenues are based on billing rates, which are applied to customers' consumption of communications services. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not billed at December 31, 2011 and 2010, were \$398,962 and \$368,809, respectively.

(i) Estimates

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

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

Notes to Financial Statements  
December 31, 2011 and 2010

(1) Summary of Significant Accounting Policies, Continued

(j) Budgetary Information

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on the cash basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized on the cash basis budget and appropriations lapse at year end. Formal and legal budgetary control is based on the total of all four utilities as a whole. During the year 2011, there were no budget amendments.

(k) Grants

The Communications Utility has received federal and state grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

(l) Employee Benefits

Employee benefits for accumulated sick leave hours are not accrued as they are not payable to employees. Vacation hours are earned monthly and are accrued and recorded as liabilities and unused vacation hours are paid upon termination of service. Accrued wages represents time employees worked during the calendar year.

The Communications Utility provides retirement severance pay to qualifying full-time employees upon death or retirement. Retirement severance pay will be credited at the rate of two days per year of continuous service, with a minimum of twenty years of continuous service needed to qualify. The retirement severance pay shall apply only to regular full-time employees hired prior to June 30, 2007. Employees who are hired after that date shall not be entitled to the benefit. As of December 31, 2011 and 2010 the accrued liability was \$150,707 and \$121,685, respectively.

(m) Customer Advances

Customer Advances represent amounts paid to the utility by developers to extend service to new areas. As customers are added, advances will be refunded to the developers over the defined term of the agreement. Expired advances are recorded as other non-operating income in the year they expire.

(n) Reclassifications

Reclassifications of prior year's amounts may have been made for comparability.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(2) Restricted Assets

The composition of restricted assets as of December 31, 2011 and 2010 was as follows:

Current Assets - Restricted	2011		
	Cash	Investments	Total
Bond Reserve	\$ 4,285	\$ 1,674,000	\$ 1,678,285
Bond and Interest	173,433	-	173,433
Self-Insured Medical and Dental	55,311	-	55,311
Construction	760,054	-	760,054
Total Current Assets - Restricted	\$ 993,083	\$ 1,674,000	\$ 2,667,083
Total restricted assets	\$ 993,083	\$ 1,674,000	\$ 2,667,083

Current Assets - Restricted	2010		
	Cash	Investments	Total
Bond Reserve	\$ -	\$ 1,678,178	\$ 1,678,178
Bond and Interest	162,923	-	162,923
Self-Insured Medical and Dental	145,165	-	145,165
Construction	8,467,608	-	8,467,608
Total Current Assets - Restricted	\$ 8,775,696	\$ 1,678,178	\$10,453,874
Total restricted assets	\$ 8,775,696	\$ 1,678,178	\$10,453,874

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

(3) Cash on Hand, Deposits, and Investments

Cash on Hand

Cash on hand represents petty cash funds used for current operating purposes. The carrying amount at December 31, 2011 and 2010 was \$60.

Deposits

At December 31, 2011, the Utility's carrying amount of deposits, including \$1,314,000 of certificates of deposits and \$4,035,054 of money market accounts, was \$5,812,458. At December 31, 2010, the Utility's carrying amount of deposits, including \$364,000 of certificates of deposits and \$12,280,465 of money market accounts, was \$14,457,979.

Investments

The utility is authorized by statute to invest public funds not currently needed for operating expenses in obligations of the United State government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial

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

Notes to Financial Statements  
December 31, 2011 and 2010

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

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

As of December 31, 2011, the Utility had the following Federal Agency Obligations investments and maturities. (The Utility assumes callable bonds will not be called):

2011 Investment Type	Investment Maturities (In Years)		
	Less than 1	1 to 3	Total
Federal Agency Obligations	\$360,000	\$-	\$360,000

2010 Investment Type	Investment Maturities (In Years)		
	Less than 1	1 to 3	Total
Federal Agency Obligations	\$1,314,178	\$-	\$1,314,178

As of December 31, 2011 the Utility had \$360,000 in Federal Agency Obligation investments maturing February 22, 2012. This investment has a Standard & Poor's credit rating of AAA and Moody's Investor Services credit rating of Aaa. As of December 31, 2010, the Utility had \$1,314,178 in Federal Agency Obligation investments that matured September 8, 2011. This investment has a Standard & Poor's and Moody's Investor Services credit rating of AAA.

The Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$250,000 and \$250,000 at December 31, 2011 and 2010, respectively, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

Interest Rate Risk

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

Credit Risk

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

Concentration of Credit Risk

The Utility's investment policy does not allow for a prime bankers' acceptance or commercial paper and other corporate debt balances to be greater than ten percent of its total deposits and investments. The policy also limits the amount

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

Notes to Financial Statements  
December 31, 2011 and 2010

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

that can be invested in a single issue to five percent of its total deposits and investments. The Utility held no such investments during the year.

Custodial Credit Risk - Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the Utility's deposits may not be returned to it. The Utility's deposits are entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

Custodial Credit Risk - Investments

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

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

	<u>2011</u>	<u>2010</u>
Cash on hand	\$ 60	\$ 60
Carrying amount of deposits	5,812,458	14,457,979
Carrying amount of federal Agency obligations	360,000	1,314,178
Carrying amount of Iowa Public Agency Investment Trust	<u>250,000</u>	<u>250,000</u>
Total	<u>\$ 6,422,518</u>	<u>\$16,022,217</u>
Current Assets		
Cash and cash equivalents	\$ 3,755,435	\$ 5,568,343
Investments	-	-
Restricted Cash	993,083	8,775,696
Restricted Investments	<u>1,674,000</u>	<u>1,678,178</u>
Total	<u>\$ 6,422,518</u>	<u>\$16,022,217</u>

Of the unrestricted cash and investments listed above, the Board of Trustees of the Municipal Communications Utility has made no reserve fund designations.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2011 and 2010 follows:

2011	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being depreciated:				
Construction,				
Work-in-progress	\$ 3,178,607	\$10,533,863	\$12,438,760	\$ 1,273,710
Total capital assets, not being depreciated	<u>3,178,607</u>	<u>10,533,863</u>	<u>12,438,760</u>	<u>1,273,710</u>
Capital assets, being depreciated:				
Infrastructure	21,891,049	12,337,641	2,144,185	32,084,505
Equipment	385,777	-	-	385,777
Total capital assets, being depreciated	<u>22,276,826</u>	<u>12,337,641</u>	<u>2,144,185</u>	<u>32,470,282</u>
Less accumulated depreciation	<u>10,226,623</u>	<u>1,627,496</u>	<u>2,199,464</u>	<u>9,654,655</u>
Total capital assets, being depreciated, net	<u>12,050,203</u>	<u>10,710,145</u>	<u>(55,279)</u>	<u>22,815,627</u>
Capital assets, net	<u>\$ 15,228,810</u>	<u>\$21,244,008</u>	<u>\$12,383,481</u>	<u>\$ 24,089,337</u>
2010	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital Assets, not being depreciated:				
Construction,				
Work-in-progress	\$ 473,067	\$6,982,175	\$4,276,635	\$ 3,178,607
Total capital assets, not being depreciated	<u>473,067</u>	<u>6,982,175</u>	<u>4,276,635</u>	<u>3,178,607</u>
Capital assets, being depreciated:				
Infrastructure	18,490,268	4,220,376	819,595	21,891,049
Equipment	329,518	56,259	-	385,777
Total capital assets, being depreciated	<u>18,819,786</u>	<u>4,276,635</u>	<u>819,595</u>	<u>22,276,826</u>
Less accumulated depreciation	<u>9,622,347</u>	<u>1,428,622</u>	<u>824,346</u>	<u>10,226,623</u>
Total capital assets, being depreciated, net	<u>9,197,439</u>	<u>2,848,013</u>	<u>(4,751)</u>	<u>12,050,203</u>
Capital assets, net	<u>\$ 9,670,506</u>	<u>\$9,830,188</u>	<u>\$4,271,884</u>	<u>\$ 15,228,810</u>

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

Notes to Financial Statements  
December 31, 2011 and 2010

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2011 and 2010 was as follows:

2011	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
General obligation capital loan notes- Series 2009B	\$1,895,000	\$ -	\$145,000	\$1,750,000	\$155,000
Note payable - Municipal Electric Utility	1,233,090	-	310,000	923,090	185,000
Revenue capital loan notes-Series 2009	3,315,000	-	325,000	2,990,000	335,000
Revenue capital loan notes-Series 2010	13,130,000	-	920,000	12,210,000	1,065,000
Unamortized discount	(157,451)	-	(12,442)	(145,009)	-
Unamortized premium	532,899	-	38,518	494,381	-
	<u>19,948,538</u>	<u>-</u>	<u>1,726,076</u>	<u>18,222,462</u>	<u>\$1,740,000</u>
Current installments of long-term debt	<u>(1,700,000)</u>	<u>(40,000)</u>	<u>-</u>	<u>(1,740,000)</u>	
Long-term debt, less current installments	18,248,538	(40,000)	1,726,076	16,482,462	
Other noncurrent liabilities:					
Customer advances for construction	79,393	-	15,318	64,075	
Other liabilities	<u>183,375</u>	<u>206,512</u>	<u>138,468</u>	<u>251,419</u>	
Noncurrent liabilities	<u>262,768</u>	<u>206,512</u>	<u>153,786</u>	<u>315,494</u>	
Total noncurrent liabilities	<u>\$18,511,306</u>	<u>\$166,512</u>	<u>\$1,879,862</u>	<u>\$16,797,956</u>	

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

Notes to Financial Statements  
December 31, 2011 and 2010

(5) Noncurrent Liabilities, Continued

2010	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
General obligation capital loan notes- Series 2009B	\$2,320,000	\$ -	\$425,000	\$1,895,000	\$145,000
Note payable - Municipal Electric Utility	1,543,090	-	310,000	1,233,090	310,000
Revenue capital loan notes-Series 2009	3,640,000	-	325,000	3,315,000	325,000
Revenue capital loan notes-Series 2010	-	13,130,000	-	13,130,000	920,000
Unamortized discount	(70,589)	(94,971)	(8,109)	(157,451)	-
Unamortized premium	46,268	490,762	4,131	532,899	-
	<u>7,478,769</u>	<u>13,525,791</u>	<u>1,056,022</u>	<u>19,948,538</u>	<u>\$1,700,000</u>
Current installments of long-term debt	(1,060,000)	(640,000)	-	(1,700,000)	
Long-term debt, less current installments	6,418,769	12,885,791	1,056,022	18,248,538	
Other noncurrent liabilities:					
Customer advances for construction	124,042	-	44,649	79,393	
Other liabilities	177,066	73,176	66,867	183,375	
Noncurrent liabilities	<u>301,108</u>	<u>73,176</u>	<u>111,516</u>	<u>262,768</u>	
Total noncurrent liabilities	<u>\$6,719,877</u>	<u>\$12,958,967</u>	<u>\$1,167,538</u>	<u>\$18,511,306</u>	

All general obligation (G.O.) bonds and notes have been issued by the City on behalf of the Utility. The G.O. bonds and notes require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds are in a range between .75% and 3.8%. In 2009, the City issued \$2,320,000 in General Obligation Capital Loan Notes, Series 2009B. The proceeds of the bonds were used for the redemption of the outstanding Series 1998, Series 1999, and Series 2002 general obligation bonds to reduce total future debt service payments and the funding of qualified capital expenditures. The total debt service obligations of the bonds are as follows:

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

Notes to Financial Statements  
December 31, 2011 and 2010

(5) Noncurrent Liabilities, Continued

Year	General Obligation Capital Loan Notes, Series 2009B	
	December 1 Principal Amount	1.30%-3.80% Interest Amount
2012	\$ 155,000	\$ 49,893
2013	155,000	47,878
2014	165,000	45,242
2015	105,000	41,860
2016	110,000	39,340
2017-2021	625,000	144,865
2022-2024	435,000	32,870
	<u>\$1,750,000</u>	<u>\$ 401,948</u>

The Series 2009 and 2010 revenue capital loan notes require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds are in a range between 3.0% and 4.30%. The debt is secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

Year	Communications Utility Revenue Capital Loan Notes, Series 2009		Communications Utility Revenue Capital Loan Notes, Series 2010	
	December 1 Principal Amount	3.00%-4.30% Interest Amount	December 1 Principal Amount	3.00% Interest Amount
2012	\$ 335,000	\$ 110,010	\$ 1,065,000	\$ 366,300
2013	345,000	99,960	1,095,000	334,350
2014	355,000	89,610	1,120,000	301,500
2015	165,000	78,960	1,360,000	267,900
2016	170,000	74,010	1,400,000	227,100
2017-2021	945,000	263,255	6,170,000	471,750
2022-2024	675,000	58,578		
	<u>\$2,990,000</u>	<u>\$ 774,383</u>	<u>\$12,210,000</u>	<u>\$1,968,900</u>

In 2010, the Utility issued \$13,130,000 Communications Utility Revenue Capital Loan Notes, Series 2010 for the purpose of paying costs of improvements and extensions to the Utility. The notes mature in 2020 and interest rates throughout the term of the notes are 3.00%.

In 2009, the Utility issued \$3,640,000 Communications Utility Revenue Capital Loan Notes, Series 2009. The proceeds of the notes were used for the redemption of the outstanding Series 1999 revenue bonds to reduce total future debt service payments and the funding of other qualified capital expenditures.

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

Notes to Financial Statements  
 December 31, 2011 and 2010

(5) Noncurrent Liabilities, Continued

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

All utility revenues net of specified operating expenses are pledged as security of the above revenue capital loan notes until the notes are defeased. Principal and interest paid for 2011 and 2010 were \$1,758,660 and \$446,596, respectively. Total customer gross revenues as defined for the same periods were \$12,604,388 and \$12,168,804. Annual principal and interest payments are expected to require 10.95% of gross revenues on average.

The Board of Trustees of the Municipal Electric Utility authorized a loan to be extended to the Utility under Resolutions No. 2759, 2840, 2939, 2994, and 3086. The December 31, 2011 and 2010 outstanding balances on this loan were \$923,090 and \$1,108,090, respectively, bearing interest at 3.1%. The Board of Trustees of the Municipal Electric Utility approved an additional loan be extended to the Utility under Resolution No. 3497. The December 31, 2011 and 2010 outstanding balances on this loan were \$0 and \$125,000, respectively, bearing interest at 3.1%. In January 2012 the Board of Trustees of the Municipal Electric Utility adopted resolution No.5089 reducing the annual interest rate from 3.1% to 2.0% to be more reflective of the investment and borrowing markets. The notes require annual principal payments, due December 1, and semiannual interest payments, due January and July 1. Total debt service requirements are as follows:

Year	Notes Payable to the Municipal Electric Utility	
	Principal Amount	Interest Amount
2012	\$185,000	\$18,148
2013	185,000	14,448
2014	185,000	10,748
2015	185,000	7,048
2016	183,090	3,362
	<u>\$923,090</u>	<u>\$53,754</u>

(6) Pension and Retirement Benefits

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

Plan members were required to contribute 4.50% of their annual covered salary and the Utility is required to contribute 6.95% of annual covered payroll through June 30, 2011. Beginning July 1, 2011 plan members are required to contribute 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2011, 2010, and 2009, were \$215,512; \$138,226; and \$118,351, respectively, equal to the required contributions for each year.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(6) Pension and Retirement Benefits, Continued

In accordance with the Code of Iowa Section 509A, the Utility allows retiring employees to continue health insurance coverage on the self-funded health insurance plan at the employees' own cost until eligible for Medicare benefits. Prior to June 30, 2010, employees with 20 years of Utility service, 88 IPERS points and having reached 55 years of age qualified to convert their accrued sick leave value into paid health insurance premiums upon retirement. This benefit was phased out between January 1, 2008 and June 30, 2010. In 2008 the benefit was reduced to 75% of accrued sick leave and in 2009 to June 30, 2010 it was reduced to 50% and zero thereafter.

(7) Income Tax Status

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

(8) Related Party Transactions

The Utility provides communications service to the City. Operating revenues from the service provided amounted to \$63,765 and \$60,875 in 2011 and 2010, respectively.

Outstanding loan balances from the Municipal Electric Utility are \$923,090, and \$1,233,090 as of December 31, 2011, and 2010, respectively. Interest accrues on the loan at 3.1%, and is paid semi-annually during January and July. Annual principal payments continue through 2016 (see note 5). Accrued interest payable was \$16,830 and \$21,674 at December 31, 2011 and 2010, respectively. Interest expense for the years ended December 31, 2011 and 2010 was \$35,785 and \$45,395 respectively. In January 2012 the Board of Trustees of the Municipal Electric Utility adopted resolution No.5089 reducing the annual interest rate from 3.1% to 2.0% to be more reflective of the investment and borrowing markets.

Prior to January 1, 2011, the Utility paid the Municipal Electric, Gas, and Water Utilities a management fee for administration, finance, human resources and legal services as part of the program to equitably allocate Communications costs. For the year ended December 31, 2010, the Utility recorded a management fee to the Municipal Electric Utility of \$69,863; the Municipal Gas Utility of \$21,424; and the Municipal Water Utility of \$1,863. Due to a reallocation of labor and other costs among the Electric, Gas, Water and Communications Utilities this management fee has been eliminated as of December 31, 2010.

See note 5 for description of debt with the City. The interest paid to the City was \$51,288 and \$54,485 for the years ended December 31, 2011 and 2010, respectively. The accrued interest related to this debt was \$4,148 and \$4,285 at December 31, 2011 and 2010, respectively.

(9) Risk Management

The Cedar Falls Municipal Electric, Gas, Water, and Communications Utilities (Utilities) are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Utilities purchase commercial insurance for claims related to these risks.

The Utilities maintain a risk management account for risks related to their self-funded medical insurance plan. The risk management account provides employee health insurance coverage for the Utilities' employees and participating retirees. The Utilities self-fund the first \$60,000 of claims per individual and have insurance for claims above this amount. In addition, the Utilities have

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

Notes to Financial Statements  
December 31, 2011 and 2010

(9) Risk Management, Continued

aggregate stop loss coverage for the 2011 plan year for aggregate claims exceeding \$2.3 million.

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

	<u>2011</u>	<u>2010</u>
Unpaid claims and IBNR, beginning of year	\$ 187,000	\$ 325,000
Current year costs including IBNR	3,869,576	2,207,548
Claims paid	<u>(3,705,576)</u>	<u>(2,345,548)</u>
Unpaid claims and IBNR, end of year	<u>\$ 351,000</u>	<u>\$ 187,000</u>

The Utility has recorded \$52,650 and \$24,310 in accounts payable for its share of these unpaid claims at December 31, 2011 and 2010, respectively.

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

The following table sets forth summarized financial data of the Association as of and for its year ended June 30, 2011.

Cash and cash equivalents and investments	\$56,188,298
Receivables	1,866,149
Other assets	<u>671,822</u>
Total assets	<u>\$58,726,269</u>
Total liabilities	\$27,019,782
Total equity	<u>31,706,487</u>
Total liabilities and equity	<u>\$58,726,269</u>
Total revenues	\$ 8,210,837
Total expenses	3,654,409
Distribution to members	<u>-</u>
Net increase in equity	<u>\$ 4,556,428</u>

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

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

Notes to Financial Statements  
December 31, 2011 and 2010

(10) Other Post-Employment Benefits (OPEB)

Plan Description

The Cedar Falls Utilities administers a single-employer defined benefit medical health care plan (The Plan) for all four utilities. The plan provides self-insured medical, vision, and prescription drug coverage, and to all active and retired employees and their eligible dependents. Eligible retirees receive health care coverage through the same plans that are available for active employees. To be eligible for these benefits employees at their retirement date must be a minimum of 55 years old, have been employed for the preceding four years, and be enrolled in the plan. Plan contributions are required from retirees based on an amount equal to the full cost of active members. These medical benefits terminate upon attaining Medicare eligibility. In addition, the Plan provides a \$5,000 in life insurance benefits to all retirees who elect this coverage and agree to pay a contribution for this coverage.

Funding Policy

The Utilities, with assistance from their third-party administrators, establishes and amends contribution requirements for both active and retiree members on an annual basis. The current funding policy is to pay health claims as they occur and the required contribution is based on pay-as-you-go financing. For the year ending December 31, 2011, the Utility contributed \$185,824 and retirees receiving benefits contributed \$114,053 through their required contributions.

Annual OPEB and Net OPEB Obligations

The Plan's annual OPEB expense is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of General Accounting Standards Board (GASB) Statement No 45. This standard was implemented in 2008. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following schedule shows the components of the annual OPEB expense for the year, the amount actually contributed to the plan, and changes in the net OPEB obligation:

	<u>2011</u>
Annual required contribution	\$ 299,000
Interest on Net OPEB Obligation	14,004
Adjustment to annual required contribution	<u>(11,000)</u>
Annual OPEB expense	302,004
Contributions and payments made	<u>71,771</u>
Increase in net OPEB obligation	\$ 230,233
Net OPEB obligation, December 31, 2010	<u>838,449</u>
Net OPEB obligation, December 31, 2011	<u><u>\$1,068,682</u></u>

The Communications Utility's share of the December 31, 2011 Net OPEB obligation is \$100,712.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(10) Other Post-Employment Benefits (OPEB), Continued

The Utilities annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and net OPEB obligation for the year ended December 31, 2011, 2010 and 2009:

<u>Fiscal Year Ended</u>	Annual <u>OPEB Cost</u>	Percentage Of Annual OPEB Cost <u>Contributed</u>	Net OPEB <u>Obligation</u>
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449
December 31, 2009	\$ 302,004	5.64%	\$ 585,532

Funded Status and Funding Progress

As of January 1, 2009, the most recent actuarial valuation date, the actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$2,967,000. The Plan is unfunded since there are no assets and retiree benefits are paid annually on a cash basis. Because The Plan is unfunded, the AAL and UAAL are equal. The covered payroll is the yearly payroll of actives covered by the plan and was \$12,936,933, in 2011 and the ratio of the UAAL to the covered payroll was 22.9%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. There are no plans to fund The Plan at this time.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Significant methods and assumptions were as follows:

Actuarial valuation date:	January 1, 2009
Actuarial cost method:	Projected Unit Credit
Amortization method:	Level Percentage Of Projected Payroll
Remaining amortization period:	30 years
Actuarial assumptions:	
Discount Rate	5.0%
Healthcare Trend Rate	11.0% declining .5% annually to 6%
Projected Salary Increases	4.0%

The schedule of funding progress, presented as Required Supplemental Information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of the plan assets is increasing or decreasing over time relative to the actuarial liabilities for benefits.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(11) Flood Event

On June 10, 2008, Cedar Falls Utilities experienced a major flood event that destroyed or severely damaged many Utility assets. The flood destroyed the first floor of the administrative building, office furnishings and equipment, and tools. The Utility began immediate clean up and work with the Federal Emergency Management Agency (FEMA) for reconstruction, repair and remediation of Utility facilities. The Utility continues working with FEMA submitting costs related to recovery, repair and remediation. As of December 31, 2009, Utility facilities were repaired and operational. As of December 31, 2011 and 2010, the Communications Utility has spent \$21 and \$808, respectively, in operational expense for flood recovery. The Utility recognized \$(12,854) and \$(502) in 2011 and 2010, respectively, in Other Operating Revenues for adjustments to FEMA reimbursement expected for operational losses and \$80 and \$(68), respectively, in Other Non-operating Revenues for FEMA settlement reimbursement expected for capital losses. As of December 31, 2011 and 2010, the Utility recognized a receivable of \$26,830 and \$57,042, respectively, for FEMA flood disaster reimbursement.

(12) Wind Storm Event

On July 10, 2009, the City of Cedar Falls experienced a storm with extreme winds of approximately 106 MPH. The extreme winds uprooted and sheared trees, blew over poles and lines, and slammed trees and branches into Communications Utility distribution facilities severely damaging them. The Utility began immediate clean up and also began working with the Federal Emergency Management Agency (FEMA) for reconstruction and repair of damaged Utility distribution assets. As of December 31, 2010, the damaged assets were temporarily repaired, permanently repaired, restored, or replaced. The Utility recognized \$672 in 2011 and \$0 in 2010 in Other Operating Revenues for FEMA reimbursement expected for operational losses and \$430 in 2011 and \$0 in 2010 in Other Non-Operating Revenues for FEMA reimbursement expected for capital losses. As of December 31, 2011 and 2010, the Utility recognized a receivable of \$4,638 and \$4,483, respectively, for FEMA wind storm disaster reimbursement.

(13) Commitments and Contingencies

As of December 31, 2011, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$4,867,000 and an estimated time frame to complete through 2015.

(14) Subsequent Events

Effective January 2, 2012, the Board of Trustees approved rate increases of \$2 per month per subscriber, or 14.2%, for Basic Lifeline and \$2 per month per subscriber, or 6.1%, for Basic Plus. Cyber/FiberBasic services were increased \$5 per month per subscriber, Cyber/FiberHome service was increased \$6 per month per subscriber, Cyber/FiberOffice services increased \$5 per month per subscriber, Cyber/FiberOffice Plus service was increased \$5 per month per subscriber, and FiberOffice Extreme service was increased \$40 per month per subscriber. The Multi Service Discount for customers with both internet service and cable TV service was increased by \$2.50 per month per subscriber. The Board of Trustees also approved rate schedules for residential and commercial wireless services, cable TV services, and residential and commercial FiberNet internet services to be provided to CFU's rural area sometime in 2012.

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

Notes to Financial Statements  
December 31, 2011 and 2010

(14) Subsequent Events, Continued

In January 2012 the Board of Trustees adopted resolution No.5089 reducing the annual interest rate on the note between the Communications Utility and the Electric Utility from 3.1% to 2.0% to be more reflective of the investment and borrowing markets. They also approved loans from the Municipal Gas Utility to the Communications Utility not to exceed \$3.0 million. The interest rate will be the same as the Electric loan rate of 2%.

**Schedule of Funding Progress for the Other  
Post-Employment Benefits Plan  
Unaudited**

<b>Fiscal Year Ended</b>	<b>Actuarial Valuation Date</b>	<b>Actuarial Value of Assets</b>	<b>Actuarial Accrued Liability (AAL)</b>	<b>Unfunded AAL (UAAL)</b>	<b>Funded Ratio</b>	<b>Covered Payroll</b>	<b>UAAL as a Percentage of Covered Payroll</b>
2011	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,936,933	22.9%
2010	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$12,152,946	24.4%
2009	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	0.0%	\$11,587,064	25.6%
2008	January 1, 2007	\$ -	\$3,436,000	\$3,436,000	0.0%	\$11,162,424	30.8%



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

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

We have audited the financial statements of the Municipal Communications Utility of the City of Cedar Falls, Iowa (Municipal Communications Utility) as of and for the year ended December 31, 2011, and have issued our report thereon dated March 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States

***Internal Control Over Financial Reporting***

Management of the Municipal Communications Utility is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Municipal Communications Utility's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Communications Utility's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipal Communications Utility's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of the Municipal Communications Utility's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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

***Compliance and Other Matters***

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

This report is intended solely for the information and use of utility management, others within the entity, federal and state awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012

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

**REPORT ON INTERNAL CONTROL**

(Including Required Auditor Communications to the Board of Trustees)

As of and for the year ended December 31, 2011



Baker Tilly Virchow Krause, LLP  
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To the Board of Trustees  
Cedar Falls Utilities  
Cedar Falls, Iowa

Management of the Municipal Electric, Gas, Water, and Communications Utilities of the City of Cedar Falls, Iowa (Utility or Utilities) is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Utility's internal control over financial reporting as a basis for designing our audit procedures for the purpose of expressing an opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Utility's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Utility's internal control over financial reporting.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal controls such that there is a reasonable possibility that a material misstatement of the Municipal Water Utility's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the board and management and is not intended to be, and should not be, used by anyone other than the specified parties.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012

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## **COMMUNICATION TO THE BOARD OF TRUSTEES**

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This portion of the letter is to inform the board about significant matters related to the annual audit so that it can appropriately discharge its oversight responsibility of the financial reporting process.

### ***OUR RESPONSIBILITY UNDER AUDITING STANDARDS GENERALLY ACCEPTED IN THE UNITED STATES OF AMERICA***

The objective of a financial statement audit is the expression of an opinion on the financial statements. We conducted the audit in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* and OMB Circular A-133. These standards require that we plan and perform our audit to obtain reasonable, rather than absolute, assurance about whether the financial statements prepared by management with your oversight are free of material misstatement, whether caused by error or fraud. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit does not relieve management or (those charged with governance) of their responsibilities.

We will also consider the internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether CFU's financial statements are free of material misstatement, we will perform tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions is not an objective of our audit. Also in accordance with OMB Circular A-133, we will examine, on a test basis, evidence about CFU's compliance with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* applicable to each of its major federal programs for the purpose of expressing an opinion on CFU's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on CFU's compliance with those requirements.

We will issue a separate document which contains the results of our audit procedures to comply with OMB Circular A-133.

### ***OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS***

Our responsibility does not extend beyond the audited financial statements identified in this report. We do not have any obligation to and have not performed any procedures to corroborate other information contained in client prepared documents.

### ***PLANNED SCOPE AND TIMING OF THE AUDIT***

We performed the audit according to the planned scope and timing previously communicated to the Board and management at its April, 2011 Board meeting and in discussion with the Board Chair during audit fieldwork.

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**COMMUNICATION TO THE BOARD OF TRUSTEES (cont.)**

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***QUALITATIVE ASPECT OF ACCOUNTING POLICIES***

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Utilities are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies were not changed during 2011. We noted no transactions entered into by the Utilities during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

***ACCOUNTING ESTIMATES***

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were those related to unbilled revenues, incurred but not recorded claims, allowance for doubtful accounts and other post employment benefits. Other estimates include the recording of depreciation expense on utility infrastructure.

***FINANCIAL STATEMENT DISCLOSURES***

The disclosures in the financial statements are neutral, consistent, and clear.

***DIFFICULTIES ENCOUNTERED IN PERFORMING THE AUDIT***

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

***AUDIT ADJUSTMENTS***

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management.

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Utilities' financial reporting process. Matters underlying adjustments proposed by the auditor could potentially cause future financial statements to be materially misstated. We did not encounter any audit adjustments during the course of the audit. We also did not encounter any immaterial passed audit adjustments during the course of the audit.

***DISAGREEMENTS WITH MANAGEMENT***

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

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**COMMUNICATION TO THE BOARD OF TRUSTEES (cont.)**

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***CONSULTATIONS WITH OTHER ACCOUNTANTS***

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

***MANAGEMENT REPRESENTATIONS***

We have requested certain representations from management that are included in the management representation letter. This letter is attached.

***INDEPENDENCE***

We are not aware of any relationships between Baker Tilly Virchow Krause, LLP that, in our professional judgment, may reasonably be thought to bear on our independence.

Relating to our audit of the financial statements of for the year ended December 31, 2011, Baker Tilly Virchow Krause, LLP hereby confirms in accordance with the Code of Professional Conduct issued by the American Institute of Certified Public Accountants, that we are, in our professional judgment, independent with respect to the Utilities and provided no services to the Utilities other than audit services provided in connection with the audit of the current year's financial statements.

***OTHER AUDIT FINDINGS OR ISSUES***

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

We appreciate the courtesy and assistance extended to us by your personnel during the audit. If you have any questions on our comments, or if we can offer our services in any other way during the year, don't hesitate to contact us. Thank you for allowing us to serve the Utilities.



March 30, 2012

Baker Tilly Virchow Krause, LLP  
Ten Terrace Court  
P.O. Box 7398  
Madison, WI 53707

We are providing this letter in connection with your audits of the financial statements of The Municipal Electric, Gas, Water and Communications Utilities of the City of Cedar Falls, Iowa (Utility or Utilities), each a component unit of the City of Cedar Falls, Iowa, as of December 31, 2011 and 2010 and for the years then ended for the purpose of expressing opinions as to whether the financial statements of each Utility presents fairly, in all material respects, the respective financial position, results of operations, and cash flows of the Utility in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the financial statements of financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining internal control and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. For purposes of this letter, materiality is as follows for each utility: (1) Electric - \$278,000, (2) Gas - \$140,000 (3) Water - \$30,000 and (4) Communications - \$124,000. Items are considered material regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America, and include all disclosures necessary for such fair presentation and disclosures otherwise required to be included therein by the laws and regulations to which the Utilities are subject.
2. We have made available to you all:
  - a. Financial records and related data
3. Minutes of the meetings of our governing body and we have provided drafts minutes of the of the March 14, 2012 meeting.
4. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.

5. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
6. We are not aware of any deficiencies in the design or operation of internal control over financial reporting.
7. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.
8. We have no knowledge of any fraud or suspected fraud affecting the Utilities involving:
  - a. Management,
  - b. Employees who have significant roles in internal control over financial reporting, or
  - c. Others where the fraud could have a material effect on the combined financial statements.
9. We have no knowledge of any allegations of fraud or suspected fraud affecting the Utilities received in communications from employees, former employees, analysts, regulators, or others.  
(As to items 6, 7 and 8, we understand the term "fraud" to mean those matters described in Statement on Auditing Standards No. 99.)
10. We, along with the Board, are responsible for the Utilities' compliance with laws and regulations applicable to each utility, including debt contracts and debt covenants; and we have identified and disclosed to you all laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts, including legal and contractual provisions for reporting specific activities in separate funds.
10. There have been no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the combined financial statements or as a basis for recording a loss contingency.
11. The Utilities have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
12. The following, if material, have been properly recorded or disclosed in the combined financial statements:
  - a. Related-party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.  
(We understand the term "related party" to include those entities described in Statement on Auditing Standards No. 45, footnote 1.)
  - b. Joint ventures
  - c. Guarantees, whether written or oral, under which the Utilities are contingently liable.
  - d. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. (Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or

geographic areas for which events could occur that would significantly disrupt normal finances within the next year.)

13. Each Utility has appropriately reconciled its books and records (e.g., general ledger accounts) underlying the financial statements to their related supporting information (e.g., sub ledger or third-party data). All related reconciling items considered to be material were identified and included on the reconciliations and were appropriately adjusted in the combined financial statements. There were no material unreconciled differences or material general ledger suspense account items that should have been adjusted or reclassified to another account balance. There were no material general ledger suspense account items written off to a balance sheet account, which should have been written off to an income statement account and vice versa. All consolidating entries have been properly recorded. Each Utility has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral, except as disclosed in the combined financial statements.
14. Each Utility has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
15. Plant-in-Service is stated at original cost and includes only property that is used and useful in the Utility's business. The depreciation rates for 2011 and 2010 are appropriate for each Utility. All depreciation is structured for full recovery in rates.
16. All cash and bank accounts and all other properties and assets of the Utilities, of which we are aware, are included in the financial statements at December 31, 2011 and 2010.
17. There are no arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements, except that some cash is restricted as to bond agreements and is disclosed in the financial statements.
18. Receivables recorded in the financial statements represent bona fide claims against debtors for sales or other charges arising on or before the balance sheet dates and are not subject to discount. Receivables classified as current do not include any material amounts which are collectible after one year. All receivables have been appropriately reduced to their estimated net realizable value.
19. We have reviewed any loans receivable for impairment, applied a systematic methodology for measuring and documenting loan losses and made appropriate allowances thereon, if necessary.
20. Materials and supplies recorded in the financial statements are stated at the lower of cost or market, cost being determined on the basis of average cost, and due provision was made to reduce all slow-moving, obsolete, or unusable inventories to their estimated useful or scrap values. Inventory quantities at the balance sheet dates were determined from the Utilities' perpetual inventory records, which have been adjusted on the basis of physical inventories taken by competent employees at various times during the year. Liabilities for amounts unpaid are recorded for all items included in inventories at the balance sheet dates.
21. All borrowings and financial obligations of the Utilities, of which we are aware, are included in the financial statements at December 31, 2011 and 2010, as appropriate. We have fully disclosed to you all borrowing arrangements of which we are aware.

22. The Utilities have not violated any covenants or requirements of the bond resolutions and other agreements related to outstanding Utilities securities during any of the periods reported. We have fully disclosed to you all covenants and information related to how we determined our compliance with the terms of the covenants.
23. Tax-exempt bonds issued have retained their tax-exempt status.
24. We assume responsibility for the findings of specialists in evaluating coal inventory and the self-insurance reserves and have adequately considered the qualifications of the specialists in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give nor cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the objectivity of the specialists.
25. The Utilities have reviewed tangible long-lived assets, any operating lease agreements that contain return provisions that require the leased assets to be returned in the same condition that existed at lease inception (i.e., the agreement requires the removal of any leasehold improvements at the end of the lease term) and other agreements for associated asset retirement obligations (AROs), and have recognized related liabilities where required, in accordance with FASB Statement No. 143, *Accounting for Asset Retirement Obligations* and FIN 47 *Accounting for Conditional Asset Retirement Obligations*. The methods and assumptions used to measure the fair value of recorded or considered AROs are appropriate and reasonable under the circumstances and utilize the best available information. If no liability amounts for these areas have been recorded it has been determined that they do not exist at December 31, 2011 and 2010.
26. The Utilities record contributions in aid of construction from customer contributions, primarily relating to expansions to the Utilities' facilities, as Non-operating Revenues in the statements of revenues, expenses and changes in net assets. Non-Cash contributions of capital are valued at estimated market cost.
27. We are not aware of any commitments for future purchases of electricity for quantities in excess of anticipated requirements or at prices that will result in a loss or lack of ability to recover costs through current and future rates. There are no provisions for losses to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.
28. All liabilities of the Utilities, of which we are aware, are included in the financial statements at the balance sheet dates. Except as described in the notes to the financial statements, there are no other liabilities or gain or loss contingencies that are required to be accrued or disclosed by ASC 450 *Contingencies* (Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*), and no unasserted claims or assessments that our legal counsel has advised us are probable of assertion and required to be disclosed in accordance with that Statement.
29. Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) are properly classified.
30. With respect to information required by the Governmental Accounting Standards Board (GASB) to be presented with the basic financial statements (required supplementary information or RSI):
  - a. RSI is presented and measured according to authoritative guidelines on a basis consistent with that of the prior year.

- b. RRSI is consistent with the basic financial statements.
  - c. Management's discussion and analysis (MD&A) is based on facts, decisions, or conditions currently known to management.
31. The Utilities are in compliance with the requirements of the Code of Iowa Section 388.10 *Municipal Utilities Providing Telecommunications Services* regarding the subsidization of telecommunications operations by the electric and water utilities
32. We are unaware of any material changes in significant estimates included in the financial statements as of December 31, 2011, including but not limited to depreciation, self-insurance claims, other post-employment benefits, asset retirement obligations or bad debts.
33. With respect to federal and state award programs -
- a. We are responsible for understanding and complying and have complied with the requirements of the Single Audit Act Amendments of 1996, OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, the State Single Audit Guidelines, and any other applicable laws and regulations and provisions of contracts and grant agreements, including requirements relating to preparation of the schedule of expenditures of federal and state awards.
  - b. We understand that Baker Tilly, in accordance with *Government Auditing Standards*, will issue a report on the consideration of the Utilities' internal control over financial reporting and its tests of compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. Baker Tilly will issue a separate letter of management representation in connection with the issuance of that report.

To the best of our knowledge and belief, no events have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned combined financial statements.

Signed: 

Date: March 30, 2012

James R. Krieg, General Manager/CEO

Signed: 

Date: March 30, 2012

Lynn M. Miller, Director of Finance/CFO

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

REPORT ON FEDERAL AWARDS

For the Year Ended December 31, 2011

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

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

To the Board of Trustees  
of Cedar Falls Utilities  
Cedar Falls, Iowa

We have audited the financial statements of the Municipal Electric, Gas, Water, and Communications Utilities of the City of Cedar Falls, Iowa (Cedar Falls Utilities), component units of the City of Cedar Falls, Iowa, as of and for the year ended December 31, 2011, and have issued our report thereon dated March 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Internal Control Over Financial Reporting***

Management of Cedar Falls Utilities is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Cedar Falls Utilities internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Cedar Falls Utilities internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Cedar Falls Utilities internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

To the Board of Trustees  
of Cedar Falls Utilities  
Cedar Falls, Iowa

***Compliance and Other Matters***

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

We noted certain matters that we reported to management of Cedar Falls Utilities in a separate letter dated March 30, 2012.

This report is intended solely for the information and use of Cedar Falls Utilities management, others within the entity, federal and state awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
March 30, 2012



**BAKER TILLY**

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE  
A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL  
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND THE SCHEDULE  
OF EXPENDITURES OF FEDERAL AWARDS**

To the Board of Trustees  
of Cedar Falls Utilities  
Cedar Falls, Iowa

***Compliance***

We have audited the Municipal Electric, Gas, Water, and Communications Utilities of the City of Cedar Falls, Iowa (Cedar Falls Utilities), component units of the City of Cedar Falls, Iowa, compliance with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that could have a direct and material effect on its major federal program for the year ended December 31, 2011. Cedar Falls Utilities major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program's is the responsibility of Cedar Falls Utilities management. Our responsibility is to express an opinion on Cedar Falls Utilities compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Cedar Falls Utilities compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Cedar Falls Utilities compliance with those requirements.

In our opinion, Cedar Falls Utilities complied, in all material respects with the compliance requirements referred to above that could have a direct and material effect on each of its major federal major programs for the year ended December 31, 2011. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 11-01, 11-02, and 11-03

***Internal Control Over Compliance***

Management of Cedar Falls Utilities is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Cedar Falls Utilities internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of the internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Cedar Falls Utilities internal control over compliance.

To the Board of Trustees  
of Cedar Falls Utilities  
Cedar Falls, Iowa

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be *material weaknesses* as defined above.

#### **Schedule of Expenditures of Federal Awards**

We have audited the financial statements of Cedar Falls Utilities as of and for the year ended December 31, 2011 and have issued our report thereon dated March 30, 2012. Our audit was performed for the purpose of forming opinions on the financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the financial statements taken as a whole.

Cedar Falls Utilities responses to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit Cedar Falls Utilities response and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the Board of Trustees, management, others within the entity, federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

*Baker Tilly Virchow Krause, LLP*

Madison, Wisconsin  
April 5, 2012, except for the Schedule of Expenditures of  
Federal Awards, as to which the date is March 30, 2012

## CEDAR FALLS UTILITIES

### SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS Year Ended December 31, 2011

Grantor Agency / Pass-Through Agency/ Program Title	Federal CFDA Number	Grant Number	2011 Expend- itures
<b>FEDERAL PROGRAMS</b>			
<b>U. S. Department of Housing and Urban Development</b>			
Pass- through program from:			
City of Cedar Falls, Iowa:			
Community Development Block Grants/Entitlement Grants			
2010 Block Grant Low Income	81.128	CDBG	\$ 77,124
<b>U.S. Department of Energy</b>			
Renewable Energy Research and Development Program	81.087	DE-EE0000398	13,040
Pass- through program from:			
Iowa Association of Municipal Utilities:			
Smart Grid- ARRA	81.122	DE-EE0000359	74,590
Pass- through program from:			
Iowa Office of Energy Independence:			
State Energy Program Grant	81.041	DE-EE0000162	81,854
Total U.S. Department of Energy			<u>169,484</u>
<b>U.S. Department of Homeland Security</b>			
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Flood 2008 and Floodwall	97.036	013-000CA-00	1,862,471
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Wind Storm 2009 406 program	97.036	013-000CA-00	2,940,185
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Floodwall Pumps	97.039	HMGP-DR-1688-0035-01	89,300
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Western Iowa (JOU) Flood	97.036	000-UE48Z-00	58,806
Total Department of Homeland Security			<u>4,950,762</u>
<b>U.S. Department of Agriculture</b>			
Pass- through program from:			
Rural Utilities Service:			
Broadband Grant- ARRA	10.787	Iowa 1123-A39	67,017
<b>Total Federal Programs</b>			<u>\$ 5,264,387</u>

See accompanying notes to schedule of expenditures of federal awards.

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

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
For the Year Ended December 31, 2011

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**NOTE 1 – REPORTING ENTITY**

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This report on Federal Awards includes the federal awards of The Municipal Electric, Gas, Water, and Communications Utilities of the City of Cedar Falls, Iowa (Cedar Falls Utilities). The reporting entity for Cedar Falls Utilities is based upon criteria established by the Governmental Accounting Standards Board.

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**NOTE 2 – BASIS OF PRESENTATION**

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The accounting records for the federal awards are maintained on the accrual basis, i.e., when the revenue has been earned and the liability is incurred.

The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*.

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
For the Year Ended December 31, 2011

**SECTION I – SUMMARY OF AUDITORS’ RESULTS**

***FINANCIAL STATEMENTS***

Type of auditors’ report issued: **Unqualified**

Internal control over financial reporting:

- > Material weakness identified?                           yes              X   no
- > Significant deficiency identified?                       yes              X   none reported

Noncompliance material to financial statements noted?                           yes              X   no

***FEDERAL AWARDS***

Internal control over major programs:

- > Material weakness identified?                           yes              X   no
- > Significant deficiency identified?                       yes              X   none reported

Type of auditor’s report issued on compliance for major programs: unqualified

Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?                      X   yes                   no

Auditee qualified as low-risk auditee?                           yes              X   no

Dollar threshold used to distinguish between type A and type B programs:                      \$ 300,000  

Identification of major federal programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
97.036	Disaster Grants – Public Assistance, Presidentially Declared Disaster
81.122	Smart Grid - ARRA
10.787	Broadband Grant- ARRA

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

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
For the Year Ended December 31, 2011

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**SECTION II – FINANCIAL STATEMENT FINDINGS REQUIRED TO BE REPORTED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

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None

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**SECTION III – FEDERAL FINDINGS AND QUESTIONED COST**

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***Finding 11-01:***

***97.036 Disaster Grants – Public Assistance (Presidentially Declared Disasters)***

***Criteria:***

OMB Common Rule A-102 requires that Federal agencies, or their subgrantees, shall not award contracts to vendors that are debarred or suspended, or otherwise excluded from or ineligible for participation in Federal assistance programs under Executive Order 12549. Agencies, or subgrantees, shall establish procedures for the effective use of the List of Parties Excluded from Federal Procurement or Nonprocurement programs to assure that they do not contract with listed parties in violation of the Executive Order.

***Condition:***

The utility did not verify that vendors were not suspended or debarred before approving contracts with them.

***Effect:***

The utility could be awarding federal funds to vendors or subrecipients that have been suspended or debarred from federal contracts.

***Cause:***

The utility was unaware of this requirement.

***Recommendation:***

We recommend that the utility incorporate this step into the normal contracting process.

***Management Response:***

CFU was unaware of this requirement and has incorporated this step into the normal contracting process as recommended in late 2011. However, all vendors used in 2011 were not on the suspended or debarred listing.

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For the Year Ended December 31, 2011**

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**SECTION III – FEDERAL FINDINGS AND QUESTIONED COST (cont.)**

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***Finding 11-02: 1512 Reporting***

***10.787 Broadband Grant- ARRA***

***Criteria:***

The Federal Recipient Reporting Data Model v4 has instruction that determines how the data should be summarized and reported in the quarterly ARRA Section 1512 reports. The "Total Federal Amount ARRA Funds Received" is defined as the amount of recovery funds received through draw down, reimbursement, or invoice. Additionally, the "Total Federal Amount of ARRA Expenditure" data element is defined as the total amount of recovery funds received or will be received that were expended to projects or activities.

***Condition:***

During the review of the 1512 reports, it was noted that Cedar Falls Utilities was reporting total amount of expenditures as the total amount of ARRA funds received / invoiced. The reported value included total project expenditures not the reimbursable grant portions only, as is required for this type of reporting. In addition the total expenditure field was left blank, instead of reporting the total amount of ARRA expenditures as required.

***Cause:***

Cedar Falls Utilities was unaware of the specific guidelines for ARRA federal reporting and was following guidance given for other types of grant reports.

***Effect:***

If continued non-compliance is determined the awarding agency they may withhold reimbursement pending corrective action, wholly or partly suspend or terminate the current award, withhold future program funding or take other legal action.

***Recommendation:***

We recommend Cedar Falls Utilities correct these reporting fields on future reports. We also recommend implementing a control that ensures updates to the Federal Recipient Reporting Model or any other reporting templates are periodically checked and when updates occur the changes are not only reflected on the template, but are communicated to the appropriate personnel so that future reporting errors do not occur.

***Questioned Costs:*** None

***Management Response:***

The CFU RUS contacts never made CFU aware of the Federal Recipient Reporting Data Model v4 as the basis for completing the quarterly Recovery Act reporting. The RUS contact for this project changed due to retirement in late 2011 and CFU interpreted the meaning of the boxes based on the information presented on the "federalreporting.gov" website to complete the reports in 2011.

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OF THE CITY OF CEDAR FALLS, IOWA**

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
For the Year Ended December 31, 2011**

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**SECTION III – FEDERAL FINDINGS AND QUESTIONED COST (cont.)**

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***Management Response:*** (cont.)

After questions were raised by CFU's auditors to the CFU RUS contact concerning this issue it was clarified by the RUS contact to mean something different than what CFU was reporting. CFU will correct the reporting fields in the future as recommended and will continue to work with the RUS contact to make sure any updates are known and followed.

***Finding 11-03: Reporting***

***10.787 ARRA - Rural Utilities Service- Broadband Grant***

***Criteria:***

Per section 6.4 of the grant agreement between Cedar Fall Utilities and Rural Utility Service it stated that "Quarterly Report no later than thirty (30) calendar days after the end of each calendar year quarter the Grantee must submit to RUS utilizing RUS's online Broadband Collection and Analysis System (BCAS)." Additionally, per section 6.5 of the grant agreement "No later than ten (10) calendar days after each calendar quarter in which the Grantee receives the assistance award funded in whole or part with grant funds, the Grantee shall submit through <http://www.federalreporting.gov> the information required by 2 C.F.R. 176."

***Condition:***

During the review of the RUS reports, it was noted that two of the federal reports were submitted past the quarterly deadline outlined in the grant agreement. CFU also submitted its quarter two progress report past the reporting deadline.

***Cause:***

There were delays in setting up online BCAS account and delays in gathering information for the 1512 reports.

***Effect:***

If continued non-compliance is determined the awarding agency they may withhold reimbursement pending corrective action, wholly or partly suspend or terminate the current award, withhold future program funding or take other legal action.

***Recommendation:***

We recommend management develop formal processes and procedures to ensure timely submittal of reports.

***Management Response:***

This will be done in the future when possible; however, as we have already communicated to RUS, there are timing conflicts on a regular basis.

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**SECTION III – FEDERAL FINDINGS AND QUESTIONED COST (cont.)**

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***Management Response:*** (cont.)

CFU completes its preparation of its monthly financials on the 10<sup>th</sup> business day of each month and this quite often coincides with the due date of the BCAS quarterly reporting. Likewise the end of each calendar year quarter reports are due 30 days after, when CFU's first draft of preliminary financials are just being prepared and second draft for audit is prepared several weeks following that date. RUS has agreed to accept preliminary financials, but there is still a timing conflict as they are both due on the same day. Timely completion requires financial statement preparation, compilation of a non-regular cash flow statement, legal compliance review, and submittal by the General Manager. We will explore other means to meet these deadlines when possible.

April 5, 2012

Baker Tilly Virchow Krause, LLP  
Ten Terrace Court  
P.O. Box 7398  
Madison, WI 53707

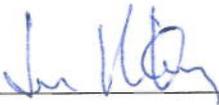
In connection with your audit of the federal awards received by The Municipal Electric, Gas, Water and Communications Utilities of the City of Cedar Falls, Iowa (Utility or Utilities), each a component unit of the City of Cedar Falls, Iowa, for the year ended December 31, 2011, in accordance with *Government Auditing Standards* and OMB Circular A-133, we confirm, to the best of our knowledge and belief, the following representations made to you during your audit:

1. We reaffirm, as the date hereof and as if made on the date hereof, representations made to you in a letter dated March 30, 2012, related to the financial statements of the Utilities.
2. In addition, with respect to the federal award programs:
  - a. We are responsible for understanding and complying with and have complied with the requirements of the Single Audit Act Amendments of 1996, OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, including requirements relating to preparation of the schedule of expenditures of federal awards.
  - b. We have prepared the schedule of expenditures of federal awards in accordance with OMB Circular A-133, and have identified and disclosed in the schedule expenditures made during the audit period for all awards provided by federal agencies in the form of grants, federal cost-reimbursement contracts, and other assistance.
  - c. We acknowledge our responsibility for presenting the schedule of expenditures of federal awards (SEFA) in accordance with the requirements of OMB Circular A-133 §310.b, and we believe the SEFA, including its form and content, is fairly presented in accordance with the Circular. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the SEFA.
  - d. If the SEFA is not presented with the audited financial statements, we will make the audited financial statements readily available to the intended users of the supplementary information.
  - e. We have identified and disclosed to you all of our government programs and related activities subject to OMB Circular A-133.

- f. We are responsible for understanding and complying with, and have complied with in all material respects, the requirements of laws, regulations, and the provisions of contracts and grant agreements related to each of our federal programs and have identified and disclosed to you the requirements of laws, regulations, and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each major federal program.
- g. We are responsible for establishing and maintaining, and have established and maintained, effective internal control over compliance requirements applicable to federal programs that provide reasonable assurance that we are administering our federal awards in compliance with laws, regulations, and the provisions of contracts and grant agreements that could have a material effect on our federal programs. We believe the internal control system is adequate and is functioning as intended. Also, no changes have been made in the internal control over compliance or other factors to the date of this letter that might significantly affect internal control, including any corrective action taken with regard to control deficiencies reported in the schedule of findings and questioned costs.
- h. We have made available to you all contracts and grant agreements including amendments and any other correspondence relevant to the programs and related activities subject to the governmental audit requirement.
- i. We have received no requests from a federal agency to audit one or more specific programs as a major program.
- j. We have complied with the direct and material compliance requirements, including when applicable, those set forth in the OMB Circular A-133 Compliance Supplement, relating to federal awards.
- k. We have disclosed any communications from grantors and pass-through entities concerning possible noncompliance with the direct and material compliance requirements, if any, including communications received from the end of the period covered by the compliance audit to the date of the auditors' report.
- l. Amounts claimed or used for matching were determined in accordance with relevant guidelines in OMB Circular A-87, Cost Principles for State, Local, and Tribal Governments, and OMB's Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments.
- m. We have disclosed to you our interpretation of compliance requirements that are subject to varying interpretations, if any.
- n. We have made available to you all documentation related to the compliance with the direct and material compliance requirements, including information related to federal program financial reports and claims for advances and reimbursements.
- o. We are not aware of any instances of noncompliance with direct and material compliance requirements that occurred subsequent to the period covered by the auditors' report.

- p. No changes have been made in internal control over compliance or other factors that might significantly affect internal control subsequent to the date as of which compliance was audited.
  - q. Federal program financial reports and claims for advances and reimbursements are supported by the books and records from which the financial statements have been prepared.
  - r. The copies of federal program financial reports provided you are true copies of the reports submitted, or electronically transmitted, to the respective federal and state agency or pass-through entity, as applicable.
  - s. We have charged costs to federal awards in accordance with applicable cost principles.
  - t. We are responsible for and have accurately prepared the auditee section of the Data Collection Form as required by OMB Circular A-133.
3. There are no:
- a. Violations or possible violations of laws and regulations and provisions of contracts and grant agreements whose effect should be considered when reporting on noncompliance.
  - b. We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that would affect federal award programs, and we have not consulted a lawyer concerning litigation, claims or assessments relating to the federal award programs.
4. There have been no unusual adjustments related to the federal award programs made between December 31, 2011, and the date of this letter.
5. There are no substantial contingent liabilities or commitments related to the federal award programs as of December 31, 2011, or as of the date of this letter.

Very truly yours,

Signed: 

Date: April 5, 2012

James R. Krieg, General Manager/CEO

Signed: 

Date: April 5, 2012

Lynn M. Miller, Director of Finance/CFO