



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, 2012 and 2011**



Cedar Falls Utilities

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Electric Utility
of the City of Cedar Falls, Iowa**

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December 31, 2012 and 2011**

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

Report on the Financial Statements

We have audited the accompanying financial statements of 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 and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control over financial reporting relevant to the Municipal Electric Utility's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Electric Utility's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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

Emphasis of Matters

As discussed in Note 1, the financial statements present only the Municipal Electric Utility component unit and do not purport to, and do not, present fairly the financial position of the City of Cedar Falls, Iowa, as of December 31, 2012 and 2011 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. Our opinion is not modified with respect to this matter.

As discussed in the Note 1, the Municipal Electric Utility adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective January 1, 2012. Our opinion is not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information 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, economic, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have issued our report dated April 4, 2013 on our consideration of the Municipal Electric Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, including those systems applicable to Municipal Electric Utility. 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* in considering the Municipal Electric Utility's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

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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, 2012, 2011 and 2010. 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 position increased as a result of 2012 operating income and non-operating revenues. At December 31, 2012, 2011 and 2010, total assets were \$201,304,895, \$189,259,556 and \$175,872,932, respectively, and total liabilities were \$65,024,484, \$65,205,600 and \$65,683,143, respectively, resulting in a net position of \$136,280,411, \$124,053,956 and \$110,189,789, respectively.
- An Electric rate increase of approximately 4.0% for all customer classes was effective in January 2012.
- An Electric rate increase of approximately 5.0% 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 2012, operating revenues decreased 4.9% to \$49,371,689 while operating expenses decreased 2.9% to \$42,895,363.
- 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 2012, the Utility net operating income decreased by 16.4% to \$6,476,326 compared to net operating income of \$7,743,824 in 2011 and \$7,910,597 in 2010.
- The Utility delivered approximately 490,591,000 kilowatt hours (kWh) of electricity to its retail customers in 2012 as compared to approximately 491,370,000 kWh in 2011 and 483,148,000 kWh in 2010.
- 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 statements of net position 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 position 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 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 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 Statement of Net Position

	2012	2011	2010
Current assets	\$ 63,561,116	\$ 62,334,184	\$ 62,782,441
Capital assets, net	133,559,906	121,845,880	110,985,955
Other noncurrent assets	4,183,873	5,079,492	2,104,536
Total assets	<u>\$201,304,895</u>	<u>\$189,259,556</u>	<u>\$175,872,932</u>
Current liabilities	\$ 11,236,690	\$ 10,186,271	\$ 8,185,595
Noncurrent liabilities	5,426,494	2,966,494	3,297,323
Long-term debt	48,361,300	52,052,835	54,200,225
Total liabilities	<u>\$ 65,024,484</u>	<u>\$ 65,205,600</u>	<u>\$ 65,683,143</u>

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Net investment in capital assets	\$ 87,762,796	\$ 76,146,098	\$ 64,351,040
Restricted	6,803,487	6,690,882	7,162,009
Unrestricted	41,714,128	41,216,976	38,676,740
Total net position	<u>\$136,280,411</u>	<u>\$124,053,956</u>	<u>\$110,189,789</u>

Condensed Revenues, Expenses and Changes in Net Position

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Sales of electricity	\$47,097,125	\$49,799,768	\$50,347,269
Other	2,274,564	2,116,877	2,671,485
Total operating revenues	<u>49,371,689</u>	<u>51,916,645</u>	<u>53,018,754</u>
Fuel and purchased power	20,146,886	22,033,624	24,314,104
Operation and maintenance	9,832,051	9,220,238	8,904,283
Depreciation and amortization	4,225,356	3,957,361	3,825,289
Services and administrative	8,691,070	8,961,598	8,064,481
Total operating expenses	<u>42,895,363</u>	<u>44,172,821</u>	<u>45,108,157</u>
Operating Income	<u>6,476,326</u>	<u>7,743,824</u>	<u>7,910,597</u>
Interest income	208,467	276,495	200,080
Other, net	5,541,662	5,843,848	1,569,872
Total non-operating revenues (expenses)	<u>5,750,129</u>	<u>6,120,343</u>	<u>1,769,952</u>
Change in net position	12,226,455	13,864,167	9,680,549
Net position, beginning of year	<u>124,053,956</u>	<u>110,189,789</u>	<u>100,509,240</u>
Net position, end of year	<u>\$136,280,411</u>	<u>\$124,053,956</u>	<u>\$110,189,789</u>

Financial Analysis

Current assets increased 2.0% in 2012. Cash and investments - unrestricted increased by 3.4% primarily due to an increase in cash of 5.8%, \$1,367,876, offset by a decrease in short term investments of 7.5%, \$395,060. Cash and investments - restricted decreased by 0.2%, \$25,261, due to a slight decrease in restricted cash. Receivables increased 2.3%, \$279,642, in 2012. Customer accounts receivable, less allowance for doubtful accounts, increased in 2012 by 12.9%, \$434,176 and Government grants receivable decreased 1.5%, \$109,164 primarily due to progress on FEMA flood and wind projects and reimbursements received from FEMA. Fuel inventory of oil, coal and allowances decreased 7.1 %, \$465,541, during 2012 due to a decrease in Streeter Station inventories of \$637,631, offset by increases in Walter Scott Generating Station Unit 3 (WS3) inventories of \$65,736, Walter Scott Generating Station Unit 4 (WS4) inventories of \$28,296 and the George Neal Unit 4 (Neal 4) of \$78,060. The Streeter Station average coal cost per ton remained unchanged from 2011.

Current assets decreased 0.7% in 2011. Cash and investments - unrestricted increased by 4.0% primarily due to an increase in cash of 13.9%, \$2,893,531, offset by a decrease in short term investments of 25.2%, \$1,774,887. Cash and investments - restricted decreased by 26.6%, \$4,687,195, in 2011 primarily due to the investment of

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\$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 21.1%, \$289,868, 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 of oil, coal and allowances decreased 7.8%, \$547,935, during 2011 due to a decrease in Streeter Station inventories of \$841,884, offset by increases in Walter Scott Generating Station Unit 3 (WS3) inventories of \$74,671, Walter Scott Generating Station Unit 4 (WS4) inventories of \$91,482 and the George Neal Unit 4 (Neal 4) inventories of \$127,796. The Streeter Station average coal cost per ton increased \$.01 in 2011.

Current assets increased 35.0% in 2010. Cash and investments - unrestricted increased by 37.7%, \$7,636,999 primarily due to an increase in cash of 49.2%, \$6,888,490, most 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 15.3%, \$246,862, due to a decrease in the receivable for MISO sales for resale and miscellaneous receivable. Government grants receivable decreased 23.3%, \$779,156. Fuel inventory of oil, coal and allowances increased 16.3%, \$987,704, during 2010 due to an increase in Streeter Station inventories of \$940,915, Walter Scott Generating Station Unit 3 (WS3) inventories of \$60,074 and Walter Scott Generating Station Unit 4 (WS4) inventories of \$63,280 offset by a decrease in inventory for the George Neal Unit 4 (Neal 4) inventories of \$76,565. The Streeter Station average coal cost per ton increased \$2.03 in 2010.

Other noncurrent assets decreased 17.6% in 2012 primarily due to the reclassification of \$3,301,578 in noncurrent investments of restricted 2010 bond debt proceeds to current investments-restricted and the addition of \$2,727,151 of tax increment financing (TIF) receivable for possible future TIF revenues as a result of the City of Cedar Falls preparing resolutions demonstrating TIF debt owed to the Electric Utility for certified expenditures 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, 2012 was \$553,090, a decrease of 25.1%.

Other noncurrent assets increased 141.4% 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%.

Other noncurrent assets increased 7.0% in 2010 due to the addition of \$384,398 in unamortized loss on reacquired debt related to the advanced refunding of the series 2003 revenue bonds and an increase of \$249,012 in unamortized debt expense related to the issuance of new debt and the reclassification from current to noncurrent of \$109,457 in prepaid freight for the amount due per agreement with Iowa Northern Railway partially offset by a \$310,000 decrease in the long-term note receivable from the Communications Utility and a \$86,274 decrease in loans receivable from customers for energy efficiency improvements. Other noncurrent assets include the long-term note receivable from the Municipal Communications Utility. The total noncurrent

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outstanding balance on the Communications Utility note receivable at December 31, 2010 was \$923,090, a decrease of 25.1%.

Current liabilities increased 10.3% in 2012 primarily as a result of an increase in accounts payable of 11.1%, \$596,703, and an increase of 19.6%, \$425,000, in current installments of long term debt.

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 of the surplus declaration between the Electric and Gas Utilities returning to historical 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.

Noncurrent liabilities increased \$2,460,000 in 2012 primarily due to the recording of a Tax Increment Financing (TIF) liability for possible future TIF revenues as a result of the City of Cedar Falls preparing resolutions demonstrating TIF debt owed to the Electric Utility for certified expenditures.

Noncurrent liabilities decreased \$330,829 in 2011 primarily due to a decrease in customer advances for construction.

Noncurrent liabilities increased \$63,386 in 2010 primarily due to an increase in health and life actuarial liability for post-employment benefits.

Retail kWh sales decreased in 2012 by 0.2%, 778,303 kWh. Total electric sales revenues decreased 5.4% in 2012 despite an average 4% rate increase for all customer classes primarily due to a warmer than usual winter and spring, and lower energy prices during the year. Fuel and purchased power costs decreased 8.6%, \$1,886,738, in 2012 and the energy cost adjustment (ECA) passed through to customers decreased 54.1%, \$0.0061 per kWh. The average annual ECA per kWh in 2012 and 2011 was \$0.0052 and \$0.0113, respectively. The decrease in the ECA per kWh is attributable to the net effect of purchasing local load requirements from the MISO market and CFU generation costs which are partially offset by 78% of the revenue from the Western Units sales. The revenues from the Western Units sales into MISO for 2012 were \$10,205,664, down 10.0% from 2011.

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, an increase in usage and a decrease of 11.2%, \$0.0014 per kWh, in the energy cost adjustment (ECA) passed through to customers. The average annual ECA per kWh in 2011 and 2010 was \$0.0113 and \$0.0127, respectively. The decrease in the ECA per kWh is attributable to the net effect of purchasing local load requirements from the MISO market and CFU generation costs which are partially offset by 64% 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 a full year of Western Unit revenues from sales for resale which increased 196.2%, \$9,128,237, an average 6% rate increase for all customer classes and an increase of 108.2%, \$0.0066 per kWh, in

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the energy cost adjustment (ECA) passed through to customers. The average annual ECA per kWh in 2010 and 2009 was \$0.0127 and \$0.0061, respectively. The increase in the ECA per kWh is attributable to the net effect of purchasing local load requirements from the MISO market and CFU generation costs which are 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) on September 1, 2009. The Utility is a transmission owner in MISO and receives revenue from MISO for its share of transmission revenue collected by MISO. In addition, the Utility sells power generated 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.

Other operating revenues increased 7.4% in 2012 primarily as a result of an increase of \$349,055 in transmission revenues.

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.

Fuel costs decreased 1.2% in 2012 due to Streeter operating less in 2012 and lower Western Units costs due to a 1.8% decrease in power sales into the MISO market compared to 2011. Since joining MISO in September 2009, Streeter generates power to offset high purchased power costs when conditions are favorable. The Electric Utility purchases all its power needs from MISO, except what it generates locally to serve its native load. This 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 11.4% in 2012 even though the Utility purchased more power from the wholesale market to serve its native load which is done when conditions in the wholesale market are favorable versus generating power at Streeter Station.

Fuel costs decreased 23.1% in 2011 due to Streeter operating less in 2011 and lower Western Units costs due to a 4.5% decrease in power sales into the MISO market compared to 2010. Since joining MISO in September 2009, Streeter generates power to offset high purchased power costs when conditions are favorable. The Electric Utility purchases all its power needs from MISO, except what it generates locally to serve its native load. This 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 purchased more power from the wholesale market to serve its native load which is done when conditions in the wholesale market are favorable versus generating power at Streeter Station.

Fuel costs increased 54.8% in 2010 due to Streeter and the Western Units increasing power sales into the MISO market due to a favorable market for such sales. Since joining MISO on September 1, 2009, Streeter now generates power to offset high purchased power costs when conditions are favorable. Purchased Power costs increased 86.8% in 2010 due to the Utility purchasing more power from the wholesale market to serve its native load which is done when conditions in the wholesale market are favorable versus generating power at Streeter Station. As discussed above, since joining MISO, the Electric Utility now purchases all its power needs from MISO, except what it generates locally to serve its native load. This arrangement increases purchased power costs as well as MISO Sales for Resale as discussed above.

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Operation and maintenance expenses increased 6.6%, \$611,813, in 2012. This is due to a 4.9%, \$228,248, increase in other production and generation costs, a 12.8%, \$232,769, increase in transmission costs, and a 5.5%, \$150,796, increase in distribution costs due to the Utility's overhead to underground conversion project.

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.

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.

Depreciation and amortization expense increased by 6.8%, \$267,995, in 2012 primarily due to the completion of capital asset projects placed into service in 2011.

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.

Services and administrative expenses decreased by 3.0% in 2012. Sales expense increased 99.9%, \$26,968, in 2012 offset by a 5.7%, \$36,539, decrease in customer accounts, a 8.7%, \$75,999, decrease in customer service and information expenses primarily due to energy efficiency incentives, and a 2.8%, \$184,436, decrease in administrative and general expenses primarily due to employee insurance and benefits and property insurance and liability expenses.

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 88.0%, \$660,000, payment in lieu of tax (PILOT) made to the City of Cedar Falls, Iowa. Outside services increased by 35.0%, \$123,638, due to the 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 by 35.4%, \$215,879, in 2010. Administrative and general expenses decreased 21.4%, \$1,448,665, in 2010 primarily due to \$565,684 less in flood related repair costs, \$750,000 less in the payment in lieu of tax (PILOT) made to the City of Cedar Falls, Iowa, and \$308,067 less in employee insurance and benefits expenses.

Interest Income decreased 24.6%, \$68,028, in 2012 due to expenditure of the invested 2010A debt proceeds. The utility is experiencing a reduction in interest income because of very low investment interest rates and difficulty getting banks to bid on placement of the investments. Funds that would have been invested or reinvested were deposited into money market accounts waiting a strengthening in the investment markets.

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Interest Income increased 38.2%, \$76,415, in 2011 due to the investment of the 2010A debt proceeds. The utility is experiencing a reduction in interest income because of very low investment interest rates and difficulty getting banks to bid on placement of the investments. Funds that would have been invested or reinvested were deposited into money market accounts waiting a strengthening in the investment markets.

Interest Income decreased 64.4%, \$362,526, in 2010 due to a reduction in interest income because of very low investment interest rates and difficulty getting banks to bid on placement of the investments. Funds that would have been invested or reinvested were deposited into money market accounts waiting a strengthening in the investment markets.

Other, net decreased 5.2%, \$302,186, in 2012 primarily due to a 17.7%, \$637,693, net decrease in miscellaneous revenues caused by a reduction in contributions in aid of construction and miscellaneous non-operating income partially offset by an increase in tax increment financing (TIF) revenues offset by a 2.7%, \$117,357, 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 116.0%, \$187,766, increase in the allowance for funds used during construction (AFUDC).

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 partially offset by a 11.7%, \$235,144, increase in long-term debt interest expense.

Other, net decreased 4.7%, \$76,837, in 2010 primarily due to a 12.8%, \$228,144, increase in long-term debt interest expense offset by 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.

Capital Assets and Debt Administration

Net capital assets represent 66.3% of total assets for the Utility in 2012. Net capital assets increased 9.6% 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 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.

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

The Utility's total long-term debt at year end 2012 was \$48,361,300 compared to \$52,052,835 at year end 2011 and \$54,200,225 at year end 2010. The change in total long-term debt is due to the principal debt payments of \$3,300,000 in 2012, \$2,110,000 in 2011 and \$1,595,000 in 2010 plus amortization of debt discounts and

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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premiums. 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 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 left \$1,710,000 principal remaining for the 2003 revenue bond issue. On June 11, 2012 the Utility refunded the \$1,430,000 outstanding balance of the 2003 revenue bonds.

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

FINANCIAL STATEMENTS

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

Statements of Net Position
December 31, 2012 and 2011

<u>Assets</u>	<u>2012</u>	<u>2011</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 193,118,239	\$ 188,476,471
Less accumulated depreciation	<u>78,980,669</u>	<u>76,417,771</u>
Capital assets, net	114,137,570	112,058,700
Construction work in progress	<u>19,422,336</u>	<u>9,787,180</u>
Total capital assets, net	<u>133,559,906</u>	<u>121,845,880</u>
Noncurrent assets:		
Investments - restricted (note 2 and 3)	-	3,301,578
Note receivable (note 9)	553,090	738,090
Loans receivable	244,602	335,634
Other (note 9)	2,727,151	-
Unamortized debt expense	224,008	239,751
Unamortized loss on reaquired debt	325,565	354,982
Prepayments and other	<u>109,457</u>	<u>109,457</u>
Total noncurrent assets	<u>4,183,873</u>	<u>5,079,492</u>
Current assets:		
Cash and cash equivalents (note 3)	25,140,464	23,772,588
Cash - restricted (note 2 and 3)	3,416,021	3,435,120
Investments - unrestricted (note 3)	4,863,620	5,258,680
Investments - restricted (note 2 and 3)	9,463,000	9,469,162
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$45,044 in 2012 and \$40,868 in 2011	3,812,630	3,378,454
Loans receivable	68,211	82,961
Interest (note 9)	50,292	82,167
Current installment of note receivable (note 9)	185,000	185,000
Government grants (note 12 and 13)	7,088,038	7,197,202
Trade	1,083,213	1,081,958
Inventories:		
Fuel	6,047,260	6,512,801
Material and supplies	2,118,704	1,697,021
Prepayments and other	<u>224,663</u>	<u>181,070</u>
Total current assets	<u>63,561,116</u>	<u>62,334,184</u>
 Total assets	 <u>\$ 201,304,895</u>	 <u>\$ 189,259,556</u>

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA

(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Net Position

December 31, 2012 and 2011

<u>Liabilities</u>	<u>2012</u>	<u>2011</u>
Long-term debt, less current installments (note 5)	\$ 48,361,300	\$ 52,052,835
Current liabilities:		
Accounts payable	5,973,191	5,376,488
Reserve for surplus declaration (note 9)	1,430,000	1,410,000
Accrued wages and vacations	776,865	762,338
Accrued interest	189,710	197,411
Other accrued expenses	276,924	275,034
Current installments of long-term debt (note 5)	2,590,000	2,165,000
Total current liabilities	<u>11,236,690</u>	<u>10,186,271</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	289,044	475,541
Other liabilities (note 5, 9 and 11)	5,137,450	2,490,953
Total noncurrent liabilities	<u>5,426,494</u>	<u>2,966,494</u>
 Total liabilities	 <u>65,024,484</u>	 <u>65,205,600</u>
<u>Net Position</u>		
Net investment in capital assets	87,762,796	76,146,098
Restricted	6,803,487	6,690,882
Unrestricted	41,714,128	41,216,976
Total net position	<u>136,280,411</u>	<u>124,053,956</u>
 Total liabilities and net position	 <u>\$ 201,304,895</u>	 <u>\$ 189,259,556</u>

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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 Position

Years ended December 31, 2012, and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Sales of electricity:		
Residential	\$ 14,866,934	\$ 15,008,713
Large industrial & commercial	2,646,048	2,747,982
Small industrial & commercial	14,734,335	15,521,789
Governmental (note 9)	3,677,025	4,248,288
Sales for resale	10,938,459	12,043,230
Interdepartmental	234,324	229,766
Total sales of electricity	<u>47,097,125</u>	<u>49,799,768</u>
Other operating revenues (note 12 and 13)	2,274,564	2,116,877
Total operating revenues	<u>49,371,689</u>	<u>51,916,645</u>
Operating expenses:		
Production and generation:		
Fuel	5,986,499	6,058,696
Purchased power	14,160,387	15,974,928
Other	4,885,739	4,657,491
Transmission	2,048,824	1,816,055
Distribution	2,897,488	2,746,692
Depreciation and amortization	4,225,356	3,957,361
Customer accounts	606,219	642,758
Customer service and information expenses	800,525	876,524
Sales	53,975	27,007
Administrative and general (note 9)	6,318,887	6,503,323
Taxes other than income taxes	911,464	911,986
Total operating expenses	<u>42,895,363</u>	<u>44,172,821</u>
Operating income	<u>6,476,326</u>	<u>7,743,824</u>
Non-operating revenues (expenses):		
Interest income (note 9)	208,467	276,495
Net increase (decrease) in the fair value of investments	(100,741)	(77,087)
Miscellaneous revenue (expense), net	2,959,964	3,597,657
Intergovernmental grant funds (note 12 and 13)	4,528,905	4,411,548
Interest expense on long-term debt	(2,189,221)	(2,244,033)
AFUDC (note 1)	349,691	161,925
Interest income (expense) on security deposits	(6,936)	(6,162)
Total nonoperating revenues (expenses)	<u>5,750,129</u>	<u>6,120,343</u>
Change in net position	<u>12,226,455</u>	<u>13,864,167</u>
Net position, beginning of year	<u>124,053,956</u>	<u>110,189,789</u>
Net position, end of year	<u>\$ 136,280,411</u>	<u>\$ 124,053,956</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers	\$ 49,193,067	\$ 53,010,875
Intergovernmental grants	40,178	-
Cash paid to suppliers	(32,377,649)	(32,481,680)
Cash paid to employees	(3,715,385)	(3,797,349)
Payment in lieu of taxes to the City of Cedar Falls	(1,410,000)	(750,000)
Property tax paid	(487,660)	(477,071)
	<u>11,242,551</u>	<u>15,504,775</u>
Cash flows from noncapital financing activities:		
Interest paid on customer deposits	(4,527)	(3,643)
	<u>(4,527)</u>	<u>(3,643)</u>
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(3,300,000)	(2,110,000)
Interest paid	(2,120,706)	(2,188,588)
Proceeds from customer advances for construction	161,500	60,700
Refunds of customer advances for construction	(347,997)	(157,600)
Acquisition, construction and removal cost of capital assets	(15,718,814)	(14,701,924)
Proceeds from sale of capital assets	129,123	86,079
Reimbursement of utility construction costs	2,906,966	2,759,462
Intergovernmental grants	4,373,280	-
	<u>(13,916,648)</u>	<u>(16,251,871)</u>
Cash flows from investing activities:		
Proceeds from repayment of loan by associated utility	185,000	310,000
Proceeds from maturities of investment securities	14,695,430	15,818,801
Purchase of investment securities	(11,093,370)	(20,543,461)
Interest received	240,341	285,487
	<u>4,027,401</u>	<u>(4,129,173)</u>
Net increase (decrease) in cash and cash equivalents	1,348,777	(4,879,912)
Cash and cash equivalents, beginning of year	<u>27,207,708</u>	<u>32,087,620</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 28,556,485</u>	<u>\$ 27,207,708</u>

See accompanying notes to financial statements.

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

Statements of Cash Flows, Continued
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 6,476,326	\$ 7,743,824
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization of capital assets	4,225,356	3,957,361
Other Income (expense), net	52,998	(126,691)
(Increase) decrease in accounts receivable	(435,431)	896,332
(Increase) decrease in loans receivable	105,782	126,173
(Increase) decrease in inventories	43,858	530,901
(Increase) decrease in prepayments and other	(43,593)	(41,050)
Increase (decrease) in accounts payable	596,703	1,239,347
Increase (decrease) in reserve for surplus declaration	20,000	660,000
Increase (decrease) in accrued wages and vacation	14,527	18,524
Increase (decrease) in other accrued expenses	1,890	26,128
Increase (decrease) in other liabilities	184,135	473,926
Net cash provided by operating activities	<u>\$ 11,242,551</u>	<u>\$ 15,504,775</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	349,691	161,925
Contributions from contractors in aid of construction	-	57,113
Expiration of customer advances for construction	-	707,855
Intergovernmental grants	-	4,767,865
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 25,140,464	\$ 23,772,588
Cash - restricted	3,416,021	3,435,120
Cash and cash equivalents	<u>\$ 28,556,485</u>	<u>\$ 27,207,708</u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)
Notes to Financial Statements
December 31, 2012 and 2011

(1) **Summary of Significant Accounting Policies**

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, 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.

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.

Accounting Changes

In December 2010, GASB issued Statement No. 62, ***"Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements"*** (Statement 62). GASB No. 62 incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance issued on or before November 30, 1989 included in: FASB Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure that do not conflict with or contradict GASB pronouncements. This statement also supersedes SGAS No. 20 ***"Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting"*** which eliminates the election for business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict or contradict GASB pronouncements. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

In June 2011, the Governmental Accounting Standards Board (GASB) issued Statement No. 63, ***"Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position"***. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards did not include guidance for these elements, which are distinct from assets and liabilities. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

The Governmental Accounting Standards Board (GASB) has approved GASB Statement No. 65, ***"Items Previously Reported as Assets and Liabilities"***; Statement No. 66, ***"Technical Corrections – 2012"*** which is an amendment of GASB Statements No.10 and No. 62; Statement no. 67, ***"Financial Reporting for Pension Plans"*** which is an amendment of GASB Statement No. 25; and Statement No. 68, ***"Accounting and Financial Reporting for Pensions"*** which is an amendment of GASB Statement No. 27. Application of these standards may restate portions of these financial statements.

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)
Notes to Financial Statements
December 31, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

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 3.21% in 2012 and 4.49% 2011. 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 2.4% and 2.5% of depreciable assets for 2012 and 2011, 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 position.

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.

Cash and Investments

Investments are stated at their fair value on the statement of net position. The Utility's investments stated at fair value reflect quoted market prices at the statement of net position 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, 2012 and 2011 were \$2,750,000 and \$2,750,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

Accounts Receivable and Allowance for Doubtful Accounts

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

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.

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.

Net Position

Net position represents the difference between assets and liabilities in the financial statements. Net investment in capital assets consists of capital assets, net of accumulated depreciation, reduced by the

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, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

Net Position, Continued

outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets. Net position is 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 position consists of net positions that do not meet the definition of "net investment in capital assets" 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 resources are available.

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, 2012 and 2011, were \$1,850,632, and \$1,522,355 respectively, and are recorded in customer accounts receivable. The Utility 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.

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.

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 years 2012 and 2011, there were no budget amendments.

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.

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, 2012 and 2011

(1) Summary of Significant Accounting Policies, Continued

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, 2012 and 2011 the accrued liability was \$738,286 and \$622,923, respectively.

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.

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, 2012 and 2011 was as follows:

Current Assets – Restricted	Cash	2012 Investments	Total
Bond Reserve	\$ 362	\$ 4,729,750	\$ 4,730,112
Bond and Interest	384,532	-	384,532
Streeter Landfill	629,000	-	629,000
Self-Insured Medical and Dental	481,186	500,000	981,186
Construction	1,920,941	3,233,250	5,154,191
Improvement and Extension	-	1,000,000	1,000,000
Total Current Assets – Restricted	3,416,021	9,463,000	12,879,021
 Noncurrent Assets – Restricted			
Construction	-	-	-
Total Noncurrent Assets – Restricted	-	-	-
 Total restricted assets	 \$ 3,416,021	 \$ 9,463,000	 \$ 12,879,021

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, 2012 and 2011

(2) Restricted Assets, Continued

Current Assets – Restricted	Cash	2011 Investments	Total
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	\$ 3,435,120	\$ 12,770,740	\$ 16,205,860

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, 2012 and 2011 was \$345.

Deposits

At December 31, 2012, the Utility's carrying amount of deposits, including \$11,583,370 of certificates of deposits and \$16,625,089 of money market accounts, was \$37,389,510. 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 \$36,527,792.

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, 2012, the Utility had the following Federal Agency Obligations investments and maturities. (The Utility assumes callable bonds will not be called):

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, 2012 and 2011

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

Investments, Continued

2012 Investment Type	Investment Maturities (in years)		Total
	Less than 1	1 to 3	
Federal Agency Obligations	\$2,743,250	\$-	\$2,743,250

As of December 31, 2012 the Utility had \$2,743,250 in Federal Agency Obligation investments maturing on various dates between January 9, 2013 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, 2011, the Utility had the following Federal Agency Obligation investments or maturities. (The Utility assumes callable bonds will not be called):

2011 Investment Type	Investment Maturities (in years)		Total
	Less than 1	1 to 3	
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.

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, 2012 and 2011, 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 2012 or 2011. 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 2012 or 2011.

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

Custodial Credit Risk – Deposits

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

Custodial Credit Risk – Investments

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

A reconciliation of the Utility's cash and cash equivalents and investments as shown on the statement of net position follows:

	2012	2011
Cash on hand	\$ 345	\$ 345
Carrying amount of deposits	37,389,510	36,527,792
Carrying amount of federal agency obligations	2,743,250	5,958,991
Carrying amount of Iowa Agency Investment Trust	2,750,000	2,750,000
Total	\$ 42,883,105	\$ 45,237,128
Current Assets		
Cash and cash equivalents	\$ 25,140,464	\$ 23,772,588
Investments	4,863,620	5,258,680
Restricted cash	3,416,021	3,435,120
Restricted investments	9,463,000	9,469,162
Noncurrent Investments		
Restricted	-	3,301,578
Total	\$ 42,883,105	\$ 45,237,128

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

	2012	2011
Unrestricted Cash and Investments		
Board Designated		
Generation	\$ 4,872,093	\$ 3,258,767
Western Units Landfill	322,003	321,550
Security Deposits	239,164	226,722
Operating	24,570,824	25,224,229
Total Cash and Investments Unrestricted	\$ 30,004,084	\$ 29,031,268

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(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2012 and 2011 follows:

2012	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 1,326,855	\$ -	\$ -	\$ 1,326,855
Construction, work-in-progress	9,787,180	16,439,850	6,804,694	19,422,336
Total capital assets, not being depreciated	11,114,035	16,439,850	6,804,694	20,749,191
Capital assets, being depreciated:				
Infrastructure	140,750,269	4,918,137	489,051	145,179,355
Buildings and improvements	25,367,797	501,742	119,661	25,749,878
Equipment	21,031,550	1,384,816	1,554,215	20,862,151
Total capital assets, being depreciated	187,149,616	6,804,695	2,162,927	191,791,384
Less accumulated depreciation	76,417,771	4,884,610	2,321,712	78,980,669
Total capital assets, being depreciated, net	110,731,845	1,920,085	(158,785)	112,810,715
Capital assets, net	\$ 121,845,880	\$ 18,359,935	\$ 6,645,909	\$ 133,559,906

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	15,509,849	7,866,856	9,787,180
Total capital assets, not being depreciated	3,216,170	15,764,721	7,866,856	11,114,035
Capital assets, being depreciated:				
Infrastructure	137,741,044	3,812,581	803,356	140,750,269
Buildings and improvements	22,872,789	2,503,217	8,209	25,367,797
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	\$ 18,659,827	\$ 7,799,902	\$ 121,845,880

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(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2012 and 2011 was as follows:

2012	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Revenue Bonds:					
Series 2003	\$ 1,430,000	\$ -	\$ 1,430,000	\$ -	\$ -
Series 2005	21,240,000	-	690,000	20,550,000	1,370,000
Series 2007	15,610,000	-	735,000	14,875,000	765,000
Capital Loan Notes:					
Series 2010A	9,590,000	-	395,000	9,195,000	405,000
Series 2010B	6,820,000	-	50,000	6,770,000	50,000
Unamortized premium	374,586	-	14,074	360,512	-
Unamortized discount	(846,751)	-	(47,539)	(799,212)	-
	54,217,835	-	3,266,535	50,951,300	2,590,000
Current installments of long-term debt	(2,165,000)	(425,000)	-	(2,590,000)	
Long-term debt, less current installments	52,052,835	(425,000)	3,266,535	48,361,300	
Customer advances for construction	475,541	161,500	347,997	289,044	
Other liabilities:					
Landfill closure	922,046	38,700	10,259	950,487	
Other	264,789	9,551,733	7,089,371	2,727,151	
Accrued severance and OPEB	1,304,118	363,644	207,950	1,459,812	
Noncurrent liabilities	2,966,494	10,115,577	7,655,577	5,426,494	
Total noncurrent liabilities	\$ 55,019,329	\$ 9,690,577	\$10,922,112	\$ 53,787,794	

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(5) Noncurrent Liabilities, Continued

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>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	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>	

On December 21, 2010, revenue refunding 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 4.0% 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 position. The 2003 notes were called on December 1, 2011. At December 31, 2011 \$0 of notes outstanding are considered defeased.

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 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

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(5) Noncurrent Liabilities, Continued

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 4.000% 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%. Interest rates over the remaining term of the bonds are in a range between 3.75% and 4.75%.

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. On June 10, 2012, after the advanced refunding described above, the remaining \$1,430,000 of Series 2003 revenue bonds were paid off.

The Series 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 2005 Electric Revenue Bonds		Series 2007 Electric Revenue Bonds	
	December 1	3.75% - 4.25%	December 1	4.00% - 4.375%
	Principal Amount	Interest Amount	Principal Amount	Interest Amount
2013	\$ 1,370,000	\$ 838,350	\$ 765,000	\$ 622,968
2014	1,420,000	786,975	805,000	592,369
2015	1,480,000	730,175	840,000	560,168
2016	1,535,000	670,975	885,000	526,569
2017	1,600,000	609,575	925,000	491,169
2018 – 2022	9,025,000	2,027,619	5,325,000	1,850,350
2023 – 2026	4,120,000	263,713	5,330,000	597,412
	<u>\$ 20,550,000</u>	<u>\$ 5,927,382</u>	<u>\$ 14,875,000</u>	<u>\$ 5,241,005</u>

Year	Series 2010A Electric Revenue Capital Loan Notes		Series 2010B Electric Revenue Refunding Capital Loan Notes	
	December 1	3.00% - 4.75%	December 1	2.50% - 3.80%
	Principal Amount	Interest Amount	Principal Amount	Interest Amount
2013	\$ 405,000	\$ 355,838	\$ 50,000	\$ 207,230
2014	410,000	343,687	50,000	205,980
2015	420,000	331,388	650,000	204,730
2016	430,000	318,787	670,000	188,480
2017	435,000	305,888	685,000	171,730
2018 – 2022	2,350,000	1,315,337	3,810,000	553,595
2023 – 2027	2,785,000	832,813	855,000	32,490
2028 – 2030	1,960,000	187,250		
	<u>\$ 9,195,000</u>	<u>\$ 3,990,988</u>	<u>\$ 6,770,000</u>	<u>\$ 1,564,235</u>

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(5) Noncurrent Liabilities, Continued

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 bonds until the bonds are defeased. Principal and interest paid for 2012 and 2011 were \$5,420,706 and \$4,298,587, respectively. Total sales of electricity gross revenues as defined for the same periods were \$47,097,124 and \$49,799,768. Annual principal and interest payments are expected to require 8.03% 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 and post closure costs as an operating expense in each period based on landfill capacity used as of each statement of net position date. Landfill closure and post closure care costs at December 31, 2012 are estimated to be \$628,484. 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 2013. Currently, the Utility has \$629,000 in restricted funds to cover the cost of the closure (see note 2). The Utility expects to close the landfill during 2013. 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 is expected to be closed December 1, 2020 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 \$322,003 (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 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll through June 30, 2012. Beginning July 1, 2012 plan members are required to contribute 5.78% of their annual covered salary and the Utility is required to contribute 8.67% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2012, 2011, and 2010 were \$579,454; \$512,851; and \$458,698; respectively, equal to the required contributions for each year.

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(6) Pension and Retirement Benefits, Continued

In accordance with the Code of Iowa, Chapter 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.

(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, 2012 and 2011 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.

Facility	Percentage Ownership	Capacity MW	Capital Assets, Net	
			2012	2011
Walter Scott Energy Center Unit 3	3.10%	21.0	\$ 12,362,033	\$ 12,460,394
Walter Scott Energy Center Unit 4	2.14%	16.9	28,692,386	28,041,671
George Neal Generating Station Unit 4	2.50%	15.0	2,414,202	2,203,126
Iowa Distributed Wind Generation Project	65.80%	1.5	299,890	622,457

(9) Related Party Transactions

The Utility provides electric service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$893,172 and \$921,256 in 2012 and 2011, respectively.

The City Council of the City of Cedar Falls, Iowa approved resolutions in 2012 to reimburse the Electric Utility for costs it incurred for improvement projects in the Tax Increment Financing (TIF) districts of the City of Cedar Falls, Iowa. This other receivable, with an outstanding balance of \$2,727,151 as of December 31, 2012, shall be repaid as TIF revenues are collected by the City. The Utility has recorded an offsetting other liability at December 31, 2012 and will recognize revenue for contributed capital from the City as amounts are received. Total amounts received from the TIF amounted to \$2,773,348 and \$1,813,575 in 2012 and 2011, respectively and is recorded as miscellaneous non-operating revenues in the Statements of Revenues, Expenses and Changes in Net Position.

The Utility makes payments in lieu of taxes upon approval by the Board of Trustees to the City of Cedar Falls, Iowa. Expenses for 2012 and 2011 were \$1,430,000 and \$1,410,000, respectively, which were recorded in administrative and general expenses. Subsequent to December 31, 2012, the Utility's Board of Trustees approved a payment of \$1,430,000 related to payments in lieu of taxes for 2012.

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 \$738,090 and \$923,090 as of December 31, 2012 and 2011, respectively. Interest accrues on the loan at 2.0% and is paid semi-annually during December and June. Annual principal payments continue through 2016. Accrued interest receivable was \$8,968 and \$16,830 at December 31, 2012 and 2011, respectively. Interest

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(9) Related Party Transactions, Continued

income for the years ended December 31, 2012 and 2011 was \$18,148 and \$35,785 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.

(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 2012 plan year for aggregate claims exceeding \$2.7 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 claims liabilities during the past two years are as follows:

	2012	2011
Unpaid claims and IBNR, beginning of year	\$ 351,000	\$ 187,000
Current year costs including IBNR	2,912,606	3,869,576
Claims paid	(3,069,606)	(3,705,576)
Unpaid claims and IBNR, end of year	\$ 194,000	\$ 351,000

The Utility has recorded \$124,160 and \$217,620 in accounts payable for its share of these unpaid claims at December 31, 2012 and 2011, 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 498 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, 2012:

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(10) Risk Management, Continued

Cash and cash equivalents and investments	\$	62,785,294
Receivables		1,593,981
Other assets		691,581
Total assets	\$	65,070,856
Total liabilities	\$	25,755,687
Total equity		39,315,169
Total liabilities and equity	\$	65,070,856
Total revenue	\$	11,433,229
Total expenses		3,824,547
Distribution to members		-
Net increase in equity	\$	7,608,682

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

(11) Other Post-Employment Benefits (OPEB)

Plan Description

The 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, 2012, the Utilities contributed \$180,589 and retirees receiving benefits contributed \$115,319 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:

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

Annual OPEB and Net OPEB Obligations, Continued

	2012
Annual required contribution	\$ 73,136
Interest on net OPEB obligation	53,435
Adjustment to annual required contribution	(41,179)
Annual OPEB expense	85,392
Contributions and payments made	65,270
Increase in net OPEB obligation	\$ 20,122
Net OPEB obligation, December 31, 2011	1,068,682
Net OPEB obligation, December 31, 2012	\$ 1,088,804

The Electric Utility's share of the December 31, 2012 Net OPEB obligation is \$721,526.

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, 2012, 2011 and 2010:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2012	\$ 85,392	76.44%	\$ 1,088,804
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449

Funded Status and Funding Progress

As of January 1, 2012, the most recent actuarial valuation date, the Utilities actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$908,961. 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 \$13,133,950 in 2012 and the ratio of the UAAL to the covered payroll was 6.9%.

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.

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

Funded Status and Funding Progress, Continued

Significant methods and assumptions were as follows:

Actuarial valuation date:	January 1, 2012
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	9.5% declining 0.5% annually to 5%
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.

(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 2012 and 2011, the Electric Utility spent \$2,848,958 and \$1,518,459, respectively, for flood recovery. As of December 31, 2012 and 2011, the Utility has recognized \$2,344,307 and \$1,487,147, respectively, in revenues for FEMA flood recovery reimbursement. As of December 31, 2012 and 2011, the Utility recognized a receivable of \$1,293,736 and \$3,407,444, respectively, for FEMA flood disaster reimbursement.

(13) 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 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 2012 and 2011, the Electric Utility spent \$2,679,047 and \$3,965,113, respectively, for wind storm disaster recovery. As of December 31, 2012 and 2011, the Utility has recognized in \$1,715,804 in 2012 and \$2,943,865,

MUNICIPAL ELECTRIC UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)
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December 31, 2012 and 2011

(13) Wind Storm Event, Continued

respectively, in revenues for FEMA wind storm disaster reimbursement. As of December 31, 2012 and 2011, the Utility recognized a receivable of \$5,255,812 and \$3,564,312, 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 2012 and 2011 were \$5,065,957 and \$4,979,661, 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 2006, 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 represented as completed but problems were immediately evident when Unit 6 was attempted to be returned to operation in June 2007. Unit 6 could not be operated in a commercially reasonable manner in accordance with the design criteria. 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 Unit 6 is shut down. Formal arbitration measures have been invoked under the contract and Miron's performance bond carrier, CNA, is noticed and involved. It is the contention of the Utility that Dustex, the subcontractor that furnished the baghouse modules, undersized them to obtain a competitive advantage. As a result of the undersized baghouse, Unit 6 cannot be operated at design capacity and does not have a spare module as required under the contract.

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 were held from January 21, 2013 through January 29, 2013. The arbitration was recessed until April 21, 2013. The Utility contends remediation and damages exceed \$9,000,000.

As of December 31, 2012, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$18,424,000 and an estimated time frame to complete through 2015.

(15) Subsequent Events

Effective January 1, 2013, the Board of Trustees approved a general electric rate restructuring. Rate elements to collect fuel costs were removed from base rates and will be collected through the fuel adjustment clause. Also, per kWh usage charges were reduced and equal amounts added to the customer charge. The average net impact of these changes for customers is rate neutral and revenue neutral for 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
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(15) Subsequent Events, Continued

In January 2013 the Board of Trustees adopted resolution No.5259 approving the continuation of the annual interest rate on the notes between the Communications Utility and the Electric Utility at 2.0% as reflective of the investment and borrowing markets.

**Municipal Electric, Gas, Water and Communications Utilities
Of the City of Cedar Falls, Iowa
Required Supplemental Information
December 31, 2012, 2011 and 2010**

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

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial		Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
			Accrued Liability (AAL)					
2012	January 1, 2012	\$ -	\$908,961	\$908,961	\$908,961	0.0%	\$13,133,950	6.9%
2011	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$12,936,933	22.9%
2010	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$12,152,946	24.4%
2009	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$11,587,064	25.6%
2008	January 1, 2007	\$ -	\$3,436,000	\$3,436,000	\$3,436,000	0.0%	\$11,162,424	30.8%

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*

Independent Auditors' Report

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

We have audited, 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, 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, 2012, and the related notes to the financial statements, and have issued our report thereon dated April 4, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Municipal Electric Utility's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our 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. Accordingly, we do not express an opinion on the effectiveness of the Municipal Electric Utility's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013



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, 2012 and 2011**

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

Report on the Financial Statements

We have audited the accompanying financial statements of 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 and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control over financial reporting relevant to the Municipal Gas Utility's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Gas Utility's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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

Emphasis of Matters

As discussed in Note 1, the financial statements present only the Municipal Gas Utility component unit and do not purport to, and do not, present fairly the financial position of The City of Cedar Falls, Iowa, as of December 31, 2012 and 2011 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. Our opinion is not modified with respect to this matter.

As discussed in the Note 1, the Municipal Gas Utility adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective January 1, 2012. Our opinion is not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information 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, economic, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have issued our report dated April 4, 2013 on our consideration of the Municipal Gas Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, including those systems applicable to Municipal Gas Utility. 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* in considering the Municipal Gas Utility's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2012, 2011 and 2010
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, 2012, 2011 and 2010. 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 position increased in 2012 as a result of operating income, miscellaneous revenues, and FEMA grant revenues. At December 31, 2012, 2011 and 2010, total assets were \$25,950,811, \$23,860,435 and \$23,836,558, respectively, and total liabilities were \$2,685,941, \$2,077,012 and \$3,308,581, respectively, resulting in a net position of \$23,264,870, \$21,783,423 and \$20,527,977, respectively.
- In 2012 operating revenues decreased by 28.4% to \$10,318,526 and operating expenses decreased by 26.2% to \$9,941,387.
- 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 2012, the Utility experienced operating income of \$377,139, compared to operating income of \$928,601 in 2011 and an operating loss of \$668,385 in 2010.
- 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 statements of net position 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 position 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

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

	2012	2011	2010
Sales of gas	\$10,256,726	\$14,308,161	\$13,727,840
Other	61,800	98,359	85,577
Total operating revenues	<u>10,318,526</u>	<u>14,406,520</u>	<u>13,813,417</u>
Natural gas purchased for resale	5,851,220	9,217,259	9,100,183
Operation and maintenance	1,094,317	1,112,475	1,235,016
Depreciation	760,235	738,390	725,255
Service and administrative	2,235,615	2,409,795	3,421,348
Total operating expenses	<u>9,941,387</u>	<u>13,477,919</u>	<u>14,481,802</u>
Operating income (loss)	<u>377,139</u>	<u>928,601</u>	<u>(668,385)</u>
Interest income	14,060	1,318	3,330
Other, net	1,090,248	325,527	168,819
Total non-operating revenues (expenses)	<u>1,104,308</u>	<u>326,845</u>	<u>172,149</u>
Change in net position	1,481,447	1,255,446	(496,236)
Net position, beginning of year	<u>21,783,423</u>	<u>20,527,977</u>	<u>21,024,213</u>
Net position, end of year	<u>\$23,264,870</u>	<u>\$21,783,423</u>	<u>\$20,527,977</u>

Financial Analysis

Current assets decreased 11.4% in 2012. Cash and cash equivalents decreased by 17.5%, \$1,649,080, primarily due to a \$3,000,000 loan made to the Municipal Communications Utility. Receivables increased by 14.6%, \$301,881, primarily due to the current installment of the note receivable for the loan made to the Municipal Communications Utility of \$600,000 offset by a decrease in Government grants receivable for FEMA assistance of \$342,226. Noncurrent assets increased by \$2,885,913 in 2012 due to the long-term portion of note receivable for the loan made to the Communications Utility of \$2,400,000 and an increase of \$535,856 in Other due to the recording of a Tax Increment Financing (TIF) receivable for possible future TIF revenues as a result of the City of Cedar Falls preparing resolutions demonstrating TIF debt owed to the Gas Utility for certified expenditures.

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.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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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 liabilities increased 4.3%, \$70,043, in 2012 primarily as a result of an increase in accounts payable of \$105,597 and a decrease in other accrued expenses of \$29,939.

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.

Noncurrent liabilities increased \$538,886 in 2012 primarily due to the recording of a Tax Increment Financing (TIF) liability for possible future TIF revenues as a result of the City of Cedar Falls preparing resolutions demonstrating TIF debt owed to the Gas Utility for certified expenditures.

Noncurrent liabilities decreased \$30,117 in 2011 primarily due to a decrease customer advances for construction.

Noncurrent liabilities decreased \$16,366 in 2010 primarily due to a decrease in customer advances for construction of \$44,000 offset by an increase in health and life actuarial liability for post-employment benefits of \$27,634.

Gas revenues decreased 28.4% in 2012 primarily because of an overall average 20.2% decrease in MCF sold due to warmer than normal weather in 2012 and a decrease in sales to the University of Northern Iowa power plant of \$1,429,098 due to the University having no equipment and maintenance issues. In addition to the overall gas usage decrease of 412,706 MCF's in 2012, gas purchase prices decreased an average \$0.92 per MCF. Purchase Gas Adjustment (PGA) revenues decreased 27.8%. The average PGA decreased in 2012 to \$3.40 per MCF from \$4.71 per MCF during 2011, an average decrease of \$1.31 per MCF.

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 1.3%. 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.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Natural gas purchased for resale expense decreased 36.5% in 2012 primarily due to the decrease in usage from 2011. Actual average wholesale natural gas costs in 2012 were \$3.59 per MCF compared to \$4.51 per MCF in 2011.

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.

Operation and maintenance expenses decreased 1.6% in 2012. This decrease is primarily attributable to an overall decrease in distribution load dispatching, operation distribution lines, main maintenance costs, and meter and regulator maintenance costs.

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

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.

Service and Administrative expenses decreased by 7.2% in 2012 primarily due to a \$90,619 decrease in administrative and general expenses. Customer accounts, customer service and information expenses and taxes other than income taxes expenses decreased by \$83,561 in 2012.

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.

Interest income increased \$12,742 in 2012 due to interest earned on the \$3,000,000 note receivable with the Municipal Communications Utility.

Interest income decreased \$2,012 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 \$19,732 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.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Other, net increased in 2012 by \$764,721 primarily due to an increase of \$300,433 in intergovernmental grant funds and \$464,231 in miscellaneous revenues.

Other, net increased in 2011 by \$156,708 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 \$442,336 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).

Capital Assets and Debt Administration

Net capital assets represent 47.9% of total assets for the Utility in 2012. Net capital assets increased 4.7% from the prior year primarily due increased completion of capital projects activity during 2012.

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.

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

The Utility had no outstanding debt as of December 31, 2012, 2011, or 2010.

FINANCIAL STATEMENTS

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

Statements of Net Position
December 31, 2012 and 2011

<u>Assets</u>	<u>2012</u>	<u>2011</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 21,110,725	\$ 20,776,595
Less accumulated depreciation	9,824,603	9,300,117
Capital assets, net	<u>11,286,122</u>	<u>11,476,478</u>
Construction work in progress	<u>1,146,341</u>	<u>397,197</u>
Total capital assets, net	<u>12,432,463</u>	<u>11,873,675</u>
Noncurrent assets:		
Loans receivable	98,187	148,130
Note receivable (note 8)	2,400,000	-
Other (note 8)	535,856	-
Total noncurrent assets	<u>3,034,043</u>	<u>148,130</u>
Current assets:		
Cash and cash equivalents (note 3)	7,782,233	9,431,313
Cash - restricted (note 2 and 3)	163,206	149,458
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$6,465 in 2012 and \$14,467 in 2011	1,426,102	1,486,073
Loans receivable	37,912	52,814
Interest	5,006	33
Current installment of note receivable (note 8)	600,000	-
Trade	75,536	15,665
Government grants (note 11)	144,501	486,727
Other	77,053	22,917
Inventories:		
Material and supplies	136,449	155,100
Prepayments and other	36,307	38,530
Total current assets	<u>10,484,305</u>	<u>11,838,630</u>
Total assets	<u>\$ 25,950,811</u>	<u>\$ 23,860,435</u>

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

Statements of Net Position
December 31, 2012 and 2011

<u>Liabilities</u>	<u>2012</u>	<u>2011</u>
Current liabilities:		
Accounts payable	\$ 1,267,263	\$ 1,161,666
Reserve for surplus declaration (note 8)	200,000	200,000
Accrued wages and vacations	212,385	218,000
Other accrued expenses	36,764	66,703
Total current liabilities	<u>1,716,412</u>	<u>1,646,369</u>
Noncurrent liabilities: (note 5)		
Customer advances for construction	118,305	110,865
Other liabilities (note 5, 8 and 10)	851,224	319,778
Total noncurrent liabilities	<u>969,529</u>	<u>430,643</u>
Total liabilities	<u>2,685,941</u>	<u>2,077,012</u>
<u>Net Position</u>		
Net investment in capital assets	12,432,463	11,873,675
Restricted	137,986	96,808
Unrestricted	10,694,421	9,812,940
Total net position	<u>23,264,870</u>	<u>21,783,423</u>
Total liabilities and net position	<u>\$ 25,950,811</u>	<u>\$ 23,860,435</u>

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MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)
Statements of Revenues, Expenses and Changes in Net Position
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Sales of gas:		
Residential	\$ 5,494,866	\$ 7,257,256
Industrial	1,107,731	1,578,517
Commercial	2,168,939	2,892,942
Governmental (note 8)	657,447	2,192,423
Interdepartmental	827,743	387,023
Total sales of gas	10,256,726	14,308,161
Other operating revenues	61,800	98,359
Total operating revenues	10,318,526	14,406,520
Operating expenses:		
Production:		
Natural gas purchased for resale	5,851,220	9,217,259
Other	11,824	511
Distribution	1,082,493	1,111,964
Depreciation	760,235	738,390
Customer accounts	296,567	321,861
Customer service and information expenses	352,062	418,300
Sales	18,754	10,153
Administrative and general (note 8)	1,445,883	1,536,502
Taxes other than income taxes	122,349	122,979
Total operating expenses	9,941,387	13,477,919
Operating income	377,139	928,601
Non-operating revenues (expenses):		
Interest income	14,060	1,318
Miscellaneous revenue (expense), net	517,741	53,510
Intergovernmental grant funds (note 11)	570,795	270,362
Interest expense on long-term debt		
AFUDC (note 1)	1,712	1,655
Total non-operating revenues (expenses)	1,104,308	326,845
Change in net position	1,481,447	1,255,446
Net position, beginning of year	21,783,423	20,527,977
Net position, end of year	\$ 23,264,870	\$ 21,783,423

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years ended December 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers	\$ 10,638,580	\$ 15,064,502
Intergovernmental grants	22,197	-
Cash paid to suppliers	(7,882,946)	(12,166,062)
Cash paid to employees	(1,022,324)	(1,058,892)
Payment in lieu of taxes to the City of Cedar Falls	(200,000)	(800,000)
	<u>1,555,507</u>	<u>1,039,548</u>
Net cash provided by (used in) operating activities		
Cash flows from capital and related financing activities:		
Proceeds from customer advances for construction	30,585	12,000
Refunds of customer advances for construction	(22,980)	(36,710)
Acquisition, construction and removal cost of capital assets	(1,318,486)	(983,943)
Proceeds from sale of capital assets	1,175	547
Reimbursement of utility construction costs	196,759	61,231
Intergovernmental grants	913,021	-
	<u>(199,926)</u>	<u>(946,875)</u>
Net cash provided by (used in) capital and related financing activities		
Cash flows from investing activities:		
Advance to affiliated company	(3,000,000)	-
Interest received	9,087	1,383
	<u>(2,990,913)</u>	<u>1,383</u>
Net cash provided by (used in) investing activities		
Net increase (decrease) in cash and cash equivalents	(1,635,332)	94,056
Cash and cash equivalents, beginning of year	<u>9,580,771</u>	<u>9,486,715</u>
Cash and cash equivalents, end of year (note 1)	<u>\$ 7,945,439</u>	<u>\$ 9,580,771</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 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income (loss)	\$ 377,139	\$ 928,601
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	760,235	738,390
Other Income (expense), net	320,817	(85,725)
(Increase) decrease in accounts receivable	100	521,967
(Increase) decrease in loans receivable	64,845	81,278
(Increase) decrease in inventory	18,651	(3,030)
(Increase) decrease in prepayments and other	(51,913)	63,340
Increase (decrease) in accounts payable	105,597	(559,487)
Increase (decrease) in reserve for surplus declaration	-	(600,000)
Increase (decrease) in accrued wages and vacation	(5,615)	(20,594)
Increase (decrease) in other accrued expenses	(29,939)	(21,371)
Increase (decrease) in other liabilities	<u>(4,410)</u>	<u>(3,821)</u>
Net cash provided by operating activities	<u>\$ 1,555,507</u>	<u>\$ 1,039,548</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	1,712	1,655
Expiration of customer advances for construction	165	1,586
Intergovernmental grants	-	325,115
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 7,782,233	\$ 9,431,313
Cash - Restricted	<u>163,206</u>	<u>149,458</u>
Cash and cash equivalents	<u>\$ 7,945,439</u>	<u>\$ 9,580,771</u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)
Notes to Financial Statements
December 31, 2012 and 2011

(1) **Summary of Significant Accounting Policies**

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.

Accounting Changes

In December 2010, GASB issued Statement No. 62, ***“Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements”*** (Statement 62). GASB No. 62 incorporates into the GASB’s authoritative literature certain accounting and financial reporting guidance issued on or before November 30, 1989 included in: FASB Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure that do not conflict with or contradict GASB pronouncements. This statement also supersedes SGAS No. 20 ***“Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting”*** which eliminates the election for business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict or contradict GASB pronouncements. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

In June 2011, the Governmental Accounting Standards Board (GASB) issued Statement No. 63, ***“Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position”***. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards did not include guidance for these elements, which are distinct from assets and liabilities. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

The Governmental Accounting Standards Board (GASB) has approved GASB Statement No. 65, ***“Items Previously Reported as Assets and Liabilities”***; Statement No. 66, ***“Technical Corrections – 2012”*** which is an amendment of GASB Statements No.10 and No. 62; Statement no. 67, ***“Financial Reporting for Pension Plans”*** which is an amendment of GASB Statement No. 25; and Statement No. 68, ***“Accounting and Financial Reporting for Pensions”*** which is an amendment of GASB Statement No. 27. Application of these standards may restate portions of these financial statements.

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 2.89% in 2012 and 4.64% 2011. Depreciation of capital assets in service is calculated on a composite straight-line method

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Notes to Financial Statements
December 31, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

Capital Assets and Depreciation, Continued

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 2012 and 3.6% for 2011.

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 position.

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.

Cash and Investments

Investments are stated at their fair value on the statement of net position. The Utility's investments stated at fair value reflect quoted market prices at the statement 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, 2012 and 2011 were \$2,300,000 and \$2,300,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

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

Net Position

Net position represents the difference between assets and liabilities in the financial statements. Net investment in capital assets 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 position is 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 position consists of net positions that do not meet the definition of "net investment in capital assets" 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 resources are available.

Natural Gas Commodity Purchases

The Utility has entered into agreements with natural gas suppliers to purchase gas for resale to our

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, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

Natural Gas Commodity Purchases, Continued

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.

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, 2012 and 2011 were \$1,019,787 and \$841,001, 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.

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.

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 years 2012 and 2011, there were no budget amendments.

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.

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.

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, 2012 and 2011

(1) Summary of Significant Accounting Policies, Continued

Employee Benefits, Continued

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, 2012 and 2011 the accrued liability was \$149,964 and \$150,707, respectively.

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.

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, 2012 and 2011 was as follows:

Current Assets - Restricted	Cash	2012 Investments	Total
Self-Insured Medical and Dental	\$163,206	\$ -	\$163,206
Total Current Assets – Restricted	\$163,206	\$ -	\$163,206
Total restricted assets	\$163,206	\$ -	\$163,206

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

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, 2012 and 2011 was \$100.

Deposits

At December 31, 2012, the Utility's carrying amount of deposits, including \$2,750,000 of money market accounts, was \$5,645,339. At December 31, 2011, the Utility's carrying amount of deposits, including \$4,750,000 of money market accounts, was \$7,280,671.

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, 2012 and 2011

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

Investments

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

As of December 31, 2012 and 2011, 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, 2012 and 2011, 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 2012 or 2011. 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 2012 or 2011.

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.

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, 2012 and 2011

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

Custodial Credit Risk – Investments, Continued

A reconciliation of the Utility's cash and cash equivalents and investments as shown on the statement of net position follows:

	2012		2011	
Cash on hand	\$	100	\$	100
Carrying amount of deposits		5,645,339		7,280,671
Carrying amount of Iowa Public Agency Investment Trust		2,300,000		2,300,000
Total	\$	7,945,439	\$	9,580,771
Current Assets				
Cash and cash equivalents	\$	7,782,233	\$	9,431,313
Investments		-		-
Restricted cash		163,206		149,458
Total	\$	7,945,439	\$	9,580,771

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

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2012 and 2011 follows:

	2012	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:					
Land		\$ 39,835	\$ -	\$ -	\$ 39,835
Construction, work-in-progress		397,197	1,313,761	564,617	1,146,341
Total capital assets, not being depreciated		437,032	1,313,761	564,617	1,186,176
Capital assets, being depreciated:					
Infrastructure		18,034,690	495,168	141,344	18,388,514
Buildings and improvements		1,968,345	61,216	-	2,029,561
Equipment		733,725	8,234	89,144	652,815
Total capital assets, being depreciated		20,736,760	564,618	230,488	21,070,890
Less accumulated depreciation		9,300,117	761,849	237,363	9,824,603
Total capital assets, being depreciated, net		11,436,643	(197,231)	(6,875)	11,246,287
Capital assets, net		\$ 11,873,675	\$ 1,116,530	\$ 557,742	\$ 12,432,463

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, 2012 and 2011

(4) Capital Assets, Continued

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	\$ 11,627,014	\$ 955,098	\$ 708,437	\$ 11,873,675

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2012 and 2011 was as follows:

2012	Beginning Balance	Additions	Reductions	Ending Balance
Customer advances for construction	\$ 110,865	\$ 30,585	\$ 23,145	\$ 118,305
Other liabilities	-	535,857	-	535,857
Accrued severance and OPEB	319,778	58,492	62,903	315,367
Total non-current liabilities	\$ 430,643	\$ 624,934	\$ 86,048	\$ 969,529

2011	Beginning Balance	Additions	Reductions	Ending Balance
Customer advances for construction	\$ 137,161	\$ 12,150	\$ 38,445	\$ 110,865
Other liabilities	-	-	-	-
Accrued severance and OPEB	323,599	200,912	204,733	319,778
Total non-current liabilities	\$ 460,760	\$ 213,062	\$ 243,179	\$ 430,643

(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

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Notes to Financial Statements
December 31, 2012 and 2011

(6) Pension and Retirement Benefits, Continued

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 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll through June 30, 2012. Beginning July 1, 2012 plan members are required to contribute 5.78% of their annual covered salary and the Utility is required to contribute 8.67% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2012, 2011, and 2010 were \$149,413; \$135,767; and \$141,229; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa, Chapter 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

(7) Income Tax Status

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

(8) Related Party Transactions

The Utility provides gas service to the City of Cedar Falls, Iowa. Operating revenues from the service provided amounted to \$87,476 and \$124,372 in 2012 and 2011, respectively.

The City Council of the City of Cedar Falls, Iowa approved resolutions in 2012 to reimburse the Communications Utility for costs it incurred for improvement projects in the Tax Increment Financing (TIF) districts of the City of Cedar Falls, Iowa. This other receivable, with an outstanding balance of \$535,856 as of December 31, 2012, shall be repaid as TIF revenues are collected by the City. The Utility has recorded an offsetting other liability at December 31, 2012 and will recognize revenue for contributed capital from the City as amounts are received. Total amounts received from the TIF amounted to \$183,423 and \$57,294 in 2012 and 2011, respectively and is recorded as miscellaneous non-operating revenues in the Statements of Revenues, Expenses and Changes in Net Position.

The Utility makes payments in lieu of taxes upon approval by the Board of Trustees to the City of Cedar Falls, Iowa. Expenses for 2012 and 2011 were \$200,000 and \$200,000 respectively, which were recorded in administrative and general expenses. Subsequent to December 31, 2012, the Utility's Board of Trustees approved a payment of \$200,000 related to payments in lieu of taxes for 2012.

The Gas Utility has extended a loan to the Municipal Communications Utility of the City of Cedar Falls, Iowa (Communications Utility), with an outstanding balance of \$3,000,000 and \$0 as of December 31, 2012 and 2011, respectively. Interest accrues on the loan at 2.0% and is paid semi-annually during December and June. Annual principal payments continue through 2017. Accrued interest receivable was \$4,986 and \$0 at December 31, 2012 and 2011, respectively. Interest income for the years ended December 31, 2012 and 2011 was \$13,315 and \$0 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.

MUNICIPAL GAS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Notes to Financial Statements
December 31, 2012 and 2011

(9) Risk Management, Continued

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 2012 plan year for aggregate claims exceeding \$2.7 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:

	2012	2011
Unpaid claims and IBNR, beginning of year	\$ 351,000	\$ 187,000
Current year costs including IBNR	2,912,606	3,869,576
Claims paid	(3,069,606)	(3,705,576)
Unpaid claims and IBNR, end of year	\$ 194,000	\$ 351,000

The Utility has recorded \$25,220 and \$52,650 in accounts payable for its share of these unpaid claims and IBNR at December 31, 2012 and 2011, 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 498 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, 2012:

Cash and cash equivalents and investments	\$	62,785,294
Receivables		1,593,981
Other assets		691,581
Total assets	\$	65,070,856
 Total liabilities	 \$	 25,755,687
Total equity		39,315,169
Total liabilities and equity	\$	65,070,856
 Total revenue	 \$	 11,433,229
Total expenses		3,824,547
Distribution to members		-
Net increase in equity	\$	7,608,682

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 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, 2012 and 2011

(10) Other Post-Employment Benefits (OPEB)

Plan Description

The 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, 2012, the Utilities contributed \$180,589 and retirees receiving benefits contributed \$115,319 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:

	2012
Annual required contribution	\$ 73,136
Interest on net OPEB obligation	53,435
Adjustment to annual required contribution	(41,179)
Annual OPEB expense	85,392
Contributions and payments made	65,270
Increase in net OPEB obligation	\$ 20,122
Net OPEB obligation, December 31, 2011	1,068,682
Net OPEB obligation, December 31, 2012	\$ 1,088,804

The Gas Utility's share of the December 31, 2012 Net OPEB obligation is \$165,403.

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, 2012, 2011 and 2010:

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, 2012 and 2011

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

Annual OPEB and Net OPEB Obligations, Continued

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2012	\$ 85,392	76.44%	\$ 1,088,804
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449

Funded Status and Funding Progress

As of January 1, 2012, the most recent actuarial valuation date, the Utilities actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$908,961. 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 \$13,133,950 in 2012 and the ratio of the UAAL to the covered payroll was 6.9%.

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, 2012
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	9.5% declining 0.5% annually to 5%
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 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, 2012 and 2011

(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. In 2012 and 2011, the Gas Utility spent \$688,858 and \$324,699, respectively, for flood recovery. In 2012 and 2011, the Utility has recognized \$574,143 and \$227,538, respectively, in revenues for FEMA flood recovery reimbursement. As of December 31, 2012 and 2011, the Utility recognized a receivable of \$144,501 and \$415,905, 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 2013 are expected to be approximately \$930,693 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.

As of December 31, 2012, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$1,761,000 and an estimated time frame to complete through 2013.

(13) Subsequent Events

Effective January 1, 2013, the Board of Trustees approved a general gas rate restructuring. The Delivery Charges per MCF were reduced and equal amounts added to the customer charge. The average net impact of these changes for customers is rate neutral and revenue neutral for the Utility.

In January 2013 the Board of Trustees adopted resolution No.5259 approving the continuation of the annual interest rate on the notes between the Communications Utility and Gas Utility at 2.0% as reflective of the investment and borrowing markets.

**Municipal Electric, Gas, Water and Communications Utilities
Of the City of Cedar Falls, Iowa
Required Supplemental Information
December 31, 2012, 2011 and 2010**

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

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial		Funded Ratio	Covered Payroll	UAAAL as a Percentage of Covered Payroll
			Accrued Liability (AAL)	Unfunded AAL (UAAAL)			
2012	January 1, 2012	\$ -	\$908,961	\$908,961	0.0%	\$13,133,950	6.9%
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%

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*

Independent Auditors' Report

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

We have audited, 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, 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, 2012, and the related notes to the financial statements, and have issued our report thereon dated April 4, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Municipal Gas Utility's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our 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. Accordingly, we do not express an opinion on the effectiveness of the Municipal Gas Utility's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipal Gas Utility's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013



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, 2012 and 2011**

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

Report on the Financial Statements

We have audited the accompanying financial statements of 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 and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control over financial reporting relevant to the Municipal Water Utility's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Water Utility's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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

Emphasis of Matters

As discussed in Note 1, the financial statements present only the Municipal Water Utility component unit and do not purport to, and do not, present fairly the financial position of the City of Cedar Falls, Iowa, as of December 31, 2012 and 2011 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. Our opinion is not modified with respect to this matter.

As discussed in the Note 1, the Municipal Water Utility adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective January 1, 2012. Our opinion is not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information 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, economic, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, have issued our report dated April 4, 2013 on our consideration of the Municipal Water Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, including those systems applicable to Municipal Water Utility. 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* in considering the Municipal Water Utility's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2012, 2011 and 2010
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, 2012, 2011 and 2010. 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 position increased in 2012 as a result of operating income, miscellaneous revenues, contributions in aid of construction and FEMA grant revenues. At December 31, 2012, 2011 and 2010, total assets were \$26,107,994, \$23,785,361 and \$22,586,977, respectively, and total liabilities were \$1,039,136, \$509,295 and \$451,915, respectively, resulting in a net position of \$25,068,858, \$23,276,066 and \$22,135,062, respectively.
- There was no water rate increase in 2012.
- 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.
- In 2012, operating revenues increased by 8.3% to \$3,518,385 while operating expenses increased 3.0% to \$3,006,156.
- 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 2012, the Utility net operating income increased 55.1% to \$512,229 compared to net operating income of \$330,155 in 2011 and \$25,015 in 2010.
- 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.

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.

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, 2012, 2011 and 2010
Unaudited

The financial statements report information about the Utility using full accrual accounting methods as utilized by similar entities in the private sector.

The statements of net position 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 position 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 Statement of Net Position

	2012	2011	2010
Current assets	\$ 4,416,619	\$ 3,784,282	\$ 3,428,560
Capital assets, net	21,156,185	19,993,018	19,144,711
Other noncurrent assets	535,190	8,061	13,706
Total assets	<u>\$26,107,994</u>	<u>\$23,785,361</u>	<u>\$22,586,977</u>
Current liabilities	\$ 299,518	\$ 311,213	\$ 278,491
Noncurrent liabilities	739,618	198,082	173,424
Total liabilities	<u>\$ 1,039,136</u>	<u>\$ 509,295</u>	<u>\$ 451,915</u>
Net investment in capital assets	\$21,156,185	\$19,993,018	\$19,144,711
Restricted	56,974	33,466	96,026
Unrestricted	3,855,699	3,249,582	2,894,325
Total net position	<u>\$25,068,858</u>	<u>\$23,276,066</u>	<u>\$22,135,062</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, 2012, 2011 and 2010
Unaudited

Condensed Revenues, Expenses and Changes in Net Position

	2012	2011	2010
Sales of water	\$ 3,336,884	\$ 3,088,803	\$ 2,662,889
Other	181,501	161,346	142,975
Total operating revenues	<u>3,518,385</u>	<u>3,250,149</u>	<u>2,805,864</u>
System operation and maintenance	1,172,164	1,186,057	1,179,664
Depreciation and amortization	604,605	561,741	543,343
Service and administrative	1,229,387	1,172,196	1,057,842
Total operating expenses	<u>3,006,156</u>	<u>2,919,994</u>	<u>2,780,849</u>
Operating income (loss)	<u>512,229</u>	<u>330,155</u>	<u>25,015</u>
Interest income	243	582	1,459
Other, net	695,003	367,079	240,614
Total non-operating revenues (expenses)	<u>695,246</u>	<u>367,661</u>	<u>242,073</u>
Income before capital contributions	1,207,475	697,816	267,088
Capital contributions	<u>585,317</u>	<u>443,188</u>	<u>115,359</u>
Change in net position	1,792,792	1,141,004	382,447
Net position, beginning of year	<u>23,276,066</u>	<u>22,135,062</u>	<u>21,752,615</u>
Net position, end of year	<u><u>\$25,068,858</u></u>	<u><u>\$23,276,066</u></u>	<u><u>\$22,135,062</u></u>

Financial Analysis

Current assets increased 16.7% in 2012 primarily due to an increase of \$772,116 in cash and cash equivalents and a decrease of \$134,197 in Government grants receivable for FEMA assistance. Noncurrent assets increased by \$527,129 in 2012 due to an increase of \$532,122 in Other due to the recording of a Tax Increment Financing (TIF) receivable for possible future TIF revenues as a result of the City of Cedar Falls preparing resolutions demonstrating TIF debt owed to the Water Utility for certified expenditures.

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 liabilities decreased 3.8% in 2012 due to a 10.6% decrease in accounts payable offset by a 9.4% increase in wages and salaries payable.

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.

MUNICIPAL WATER 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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Unaudited

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.

Noncurrent liabilities increased \$541,536 in 2012 primarily due to the recording of a Tax Increment Financing (TIF) liability for possible future TIF revenues as a result of the City of Cedar Falls preparing resolutions demonstrating TIF debt owed to the Water Utility for certified expenditures.

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.

System operation and maintenance expenses decreased 1.2% in 2012 primarily due to a 12.9% decrease in other, which includes pumping, water treatment and associated labor expense, offset by a 10.4% increase in power purchased from an affiliated utility and a 2.1% increase in distribution operations and maintenance expenses.

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.

Depreciation expense increased 7.6% in 2012 resulting from completion of construction projects.

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.

Service and administrative expenses increased 4.9% in 2012 primarily due to an increase in labor costs in customer accounts offset by a decrease in administrative and general expenses.

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.

Interest income decreased \$339 in 2012 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.

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, 2012, 2011 and 2010
Unaudited

Interest income decreased \$877 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 \$13,270 in 2010 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.

Other, net revenues increased in 2012 by 89.3% due to an increase of \$188,091 in contribution in aid of construction from TIF (Tax Increment Financing) funds received from the City of Cedar Falls and a \$142,035 increase in intergovernmental grants.

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.

Noncash capital contributions increased \$142,129 in 2012 due to increase in distribution extensions during the year.

Noncash capital contributions increased \$327,829 in 2011 due to increase in distribution extensions during the year.

Noncash capital contributions decreased \$676,073 in 2010 due to decrease in distribution extensions during the year.

Capital Assets and Debt Administration

Net capital assets represent 81.0% of total assets for the Utility in 2012. Net capital assets increased 5.8% from the prior year primarily due to completion of capital projects in 2012.

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.

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

The Utility had no outstanding debt as of December 31, 2012, 2011, or 2010.

FINANCIAL STATEMENTS

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

Statements of Net Position
December 31, 2012 and 2011

<u>Assets</u>	<u>2012</u>	<u>2011</u>
Capital assets: (note 4)		
Capital assets, in service	\$ 29,565,265	\$ 28,344,284
Less accumulated depreciation	8,981,686	8,544,408
Capital assets, net	<u>20,583,579</u>	<u>19,799,876</u>
Construction work in progress	572,606	193,142
Total capital assets, net	<u>21,156,185</u>	<u>19,993,018</u>
Noncurrent assets:		
Loans Receivable	3,068	8,061
Other (note 8)	532,122	-
Total noncurrent investments	<u>535,190</u>	<u>8,061</u>
Current assets:		
Cash and cash equivalents (note 2)	3,704,010	2,931,894
Cash - restricted (note 2 and 3)	72,494	61,546
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$2,408 in 2012 and \$3,546 in 2011	415,655	395,860
Loans receivable	624	1,384
Government grants (note 11)	72,035	206,232
Other	16,723	57,747
Interest	13	21
Material and supplies	110,378	106,120
Prepayments and other	24,687	23,478
Total current assets	<u>4,416,619</u>	<u>3,784,282</u>
 Total assets	 <u>\$ 26,107,994</u>	 <u>\$ 23,785,361</u>

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

Statements of Net Position
December 31, 2012 and 2011

<u>Liabilities</u>	<u>2012</u>	<u>2011</u>
Current liabilities:		
Accounts payable	\$ 154,492	\$ 172,880
Accrued wages and vacations	134,867	123,230
Other accrued expenses	10,159	15,103
Total current liabilities	<u>299,518</u>	<u>311,213</u>
Noncurrent liabilities:		
Other liabilities (note 5, 8 and 10)	739,618	198,082
Total noncurrent liabilities	<u>739,618</u>	<u>198,082</u>
Total liabilities	<u>1,039,136</u>	<u>509,295</u>
 <u>Net Position</u>		
Net investments in capital assets	21,156,185	19,993,018
Restricted	56,974	33,466
Unrestricted	3,855,699	3,249,582
Total net position	<u>25,068,858</u>	<u>23,276,066</u>
Total liabilities and net position	<u>\$ 26,107,994</u>	<u>\$ 23,785,361</u>

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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 Position
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Sales of water:		
Residential	\$ 2,400,958	\$ 2,217,461
Industrial	56,052	51,671
Commercial	668,283	598,429
Governmental (note 8)	195,747	204,498
Interdepartmental	15,844	16,744
Total sales of water	3,336,884	3,088,803
Other operating revenues	181,501	161,346
Total operating revenues	3,518,385	3,250,149
Operating expenses		
Production:		
Purchased power from affiliated utility	164,486	149,001
Other	297,975	342,086
Distribution	709,703	694,970
Depreciation	604,605	561,741
Customer accounts	282,736	234,417
Customer service and information expenses	36,660	22,358
Sales	4,756	914
Administrative and general	817,756	833,279
Taxes other than income taxes	87,479	81,228
Total operating expenses	3,006,156	2,919,994
Operating income	512,229	330,155
Non-operating revenues (expenses):		
Interest income	243	582
Miscellaneous revenue (expense), net	399,741	213,559
Interest expense on long-term debt		
Intergovernmental grant funds (note 11)	292,196	150,162
AFUDC (note 1)	3,066	3,358
Total non-operating revenues (expenses)	695,246	367,661
Income before contributions	1,207,475	697,816
Noncash Capital contributions	585,317	443,188
Change in net position	1,792,792	1,141,004
Net position, beginning of year	23,276,066	22,135,062
Net position, end of year	\$ 25,068,858	\$ 23,276,066

See accompanying notes to financial statements.

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

Statements of Cash Flows
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers	\$ 3,714,760	\$ 3,334,903
Intergovernmental grants	1,674	-
Cash paid to suppliers	(1,660,644)	(1,626,337)
Cash paid to employees	(761,394)	(708,616)
	<hr/>	<hr/>
Net cash provided by (used in) operating activities	1,294,396	999,950
	<hr/>	<hr/>
Cash flows from capital and related financing activities:		
Proceeds from customer advances for construction	-	26,100
Refunds of customer advances for construction	-	(3,374)
Acquisition, construction and removal cost of capital assets	(1,181,943)	(971,642)
Proceeds from sale of capital assets	2,554	8,140
Reimbursement of utility construction costs	241,413	79,216
Intergovernmental grants	426,393	-
	<hr/>	<hr/>
Net cash provided by (used in) capital and related financing activities	(511,583)	(861,560)
	<hr/>	<hr/>
Cash flows from investing activities:		
Interest received	251	623
	<hr/>	<hr/>
Net cash provided by (used in) investing activities	251	623
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	783,064	139,013
Cash and cash equivalents, beginning of year	2,993,440	2,854,427
	<hr/>	<hr/>
Cash and cash equivalents, end of year (note 1)	<u>\$ 3,776,504</u>	<u>\$ 2,993,440</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, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income (loss) to net cash provided by operating activities		
Operating income (loss)	\$ 512,229	\$ 330,155
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation of capital assets	604,605	561,741
Other Income (expense), net	158,328	116,860
(Increase) decrease in accounts receivable	(19,795)	(1,943)
(Increase) decrease in loans receivable	5,753	14,268
(Increase) decrease in materials and supplies	(4,258)	1,501
(Increase) decrease in prepayments and other	39,815	(57,286)
Increase (decrease) in accounts payable	(18,388)	38,581
Increase (decrease) in accrued wages and vacation	11,637	(18,565)
Increase (decrease) in other accrued expenses	(4,944)	(10,020)
Increase (decrease) in other liabilities	<u>9,414</u>	<u>24,658</u>
Net cash provided by operating activities	<u>\$ 1,294,396</u>	<u>\$ 999,950</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	3,066	3,358
Contributions from contractors in aid of construction	585,317	443,188
Intergovernmental grants	-	167,505
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 3,704,010	\$ 2,931,894
Cash - restricted	<u>72,494</u>	<u>61,546</u>
Cash and cash equivalents	<u>\$ 3,776,504</u>	<u>\$ 2,993,440</u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

MUNICIPAL WATER UTILITY OF THE CITY OF CEDAR FALLS, IOWA
(A Component Unit of the City of Cedar Falls, Iowa)
Notes to Financial Statements
December 31, 2012 and 2011

(1) **Summary of Significant Accounting Policies**

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.

Accounting Changes

In December 2010, GASB issued Statement No. 62, ***“Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements”*** (Statement 62). GASB No. 62 incorporates into the GASB’s authoritative literature certain accounting and financial reporting guidance issued on or before November 30, 1989 included in: FASB Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure that do not conflict with or contradict GASB pronouncements. This statement also supersedes SGAS No. 20 ***“Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting”*** which eliminates the election for business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict or contradict GASB pronouncements. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

In June 2011, the Governmental Accounting Standards Board (GASB) issued Statement No. 63, ***“Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position”***. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards did not include guidance for these elements, which are distinct from assets and liabilities. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

The Governmental Accounting Standards Board (GASB) has approved GASB Statement No. 65, ***“Items Previously Reported as Assets and Liabilities”***; Statement No. 66, ***“Technical Corrections – 2012”*** which is an amendment of GASB Statements No.10 and No. 62; Statement no. 67, ***“Financial Reporting for Pension Plans”*** which is an amendment of GASB Statement No. 25; and Statement No. 68, ***“Accounting and Financial Reporting for Pensions”*** which is an amendment of GASB Statement No. 27. Application of these standards may restate portions of these financial statements.

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 2.89% in 2012 and 4.64% 2011. Depreciation of capital assets in service is calculated on a composite straight-line method

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, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

Capital Assets and Depreciation, Continued

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 2012 and 2.1% for 2011.

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 position.

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.

Cash and Investments

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

The Utility considers all highly liquid investments with maturity of three months or less when purchased to be cash equivalents for purposes of the statement of cash flows. Included in cash and cash equivalents at December 31, 2012 and 2011 were \$1,470,000 and \$1,470,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

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

Net Position

Net position represents the difference between assets and liabilities in the financial statements. Net investment in capital assets 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 position is 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 position consists of net positions that do not meet the definition of "net investment in capital assets" 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 resources are available.

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, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

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, 2012 and 2011, were \$130,234 and \$122,107, respectively, and are recorded in customer accounts receivable.

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.

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.

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 years 2012 and 2011, there were no budget amendments.

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.

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

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, 2012 and 2011

(1) Summary of Significant Accounting Policies, Continued

Employee Benefits, Continued

who are hired after that date shall not be entitled to the benefit. As of December 31, 2012 and 2011 the accrued liability was \$92,286 and \$80,377, respectively.

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.

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, 2012 and 2011 was as follows:

Current Assets - Restricted	Cash	2012 Investments	Total
Self-Insured Medical and Dental	\$ 72,494	\$ -	\$ 72,494
Total Current Assets – Restricted	\$ 72,494	\$ -	\$ 72,494
Total restricted assets	\$ 72,494	\$ -	\$ 72,494

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

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, 2012 and 2011 was \$45.

Deposits

At December 31, 2012, the Utility's carrying amount of deposits, including \$700,000 of money market accounts, was \$2,306,459. At December 31, 2011, the Utility's carrying amount of deposits, including \$700,000 of money market accounts, was \$1,523,395.

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, 2012 and 2011

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

Investments

The Utility is authorized by statute to invest public funds not currently needed for operating expenses in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the

Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

As of December 31, 2012 and 2011, 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, 2012 and 2011, 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 2012 or 2011. 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 2012 or 2011.

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.

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, 2012 and 2011

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

Custodial Credit Risk – Investments, Continued

A reconciliation of the Utility's cash and cash equivalents and investments as shown on the statement of net position follows:

	2012	2011
Cash on hand	\$ 45	\$ 45
Carrying amount of deposits	2,306,459	1,523,395
Carrying amount of Iowa Public Agency Investment Trust	1,470,000	1,470,000
Total	<u>\$ 3,776,504</u>	<u>\$ 2,993,440</u>
Current Assets		
Cash and cash equivalents	\$ 3,704,010	\$ 2,931,894
Investments	-	-
Restricted cash	72,494	61,546
Total	<u>\$ 3,776,504</u>	<u>\$ 2,993,440</u>

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, 2012 and 2011 follows:

2012	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	193,142	1,765,502	1,386,038	572,606
Total capital assets, not being depreciated	256,608	1,765,502	1,386,038	636,072
Capital assets, being depreciated:				
Infrastructure	27,030,572	1,342,270	86,893	28,285,949
Buildings and improvements	807,702	31,171	-	838,873
Equipment	442,544	12,597	78,164	376,977
Total capital assets, being depreciated	28,280,818	1,386,038	165,057	29,501,799
Less accumulated depreciation	8,544,408	610,827	173,549	8,981,686
Total capital assets, being depreciated, net	19,736,410	775,211	(8,492)	20,520,113
Capital assets, net	<u>\$ 19,993,018</u>	<u>\$ 2,540,713</u>	<u>\$ 1,377,546</u>	<u>\$ 21,156,185</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, 2012 and 2011

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	2,088,082	66,334	27,030,572
Buildings and improvements	807,702	-	-	807,702
Equipment	430,338	12,206	-	442,544
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

(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2012 and 2011 was as follows:

2012	Beginning Balance	Additions	Reductions	Ending Balance
Other liabilities	\$ -	\$ 532,122	\$ -	\$ 532,122
Accrued severance and OPEB	198,082	35,732	26,318	207,496
Total non-current liabilities	\$ 198,082	\$ 567,854	\$ 26,318	\$ 739,618

2011	Beginning Balance	Additions	Reductions	Ending Balance
Other liabilities	\$ -	\$ -	\$ -	\$ -
Accrued severance and OPEB	173,424	116,848	92,190	198,082
Total non-current liabilities	\$ 173,424	\$ 116,848	\$ 92,190	\$ 198,082

(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 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll through June 30, 2012. Beginning July 1, 2012 plan members are required to contribute 5.78% of their annual covered salary and the Utility is

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, 2012 and 2011

(6) Pension and Retirement Benefits, Continued

required to contribute 8.67% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2012, 2011 and 2010, were \$106,155; \$85,369; and \$72,841; respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa, Chapter 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.

(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 \$65,630 and \$68,865 in 2012 and 2011, respectively.

The City Council of the City of Cedar Falls, Iowa approved resolutions in 2012 to reimburse the Communications Utility for costs it incurred for improvement projects in the Tax Increment Financing (TIF) districts of the City of Cedar Falls, Iowa. This other receivable, with an outstanding balance of \$532,122 as of December 31, 2012, shall be repaid as TIF revenues are collected by the City. The Utility has recorded an offsetting other liability at December 31, 2012 and will recognize revenue for contributed capital from the City as amounts are received. Total amounts received from the TIF amounted to \$230,592 and \$42,501 in 2012 and 2011, respectively and is recorded as miscellaneous non-operating revenues in the Statements of Revenues, Expenses and Changes in Net Position.

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 \$157,680 in 2012 and \$122,632 in 2011, and are recorded in miscellaneous non-operating revenue.

(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 2012 plan year for aggregate claims exceeding \$2.7 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:

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, 2012 and 2011

(9) Risk Management, Continued

	<u>2012</u>	<u>2011</u>
Unpaid claims and IBNR, beginning of year	\$ 351,000	\$ 187,000
Current year costs including IBNR	2,912,606	3,869,576
Claims paid	(3,069,606)	(3,705,576)
Unpaid claims and IBNR, end of year	<u>\$ 194,000</u>	<u>\$ 351,000</u>

The Utility has recorded \$15,520 and \$28,080 in accounts payable for its share of these unpaid claims and IBNR at December 31, 2012 and 2011, 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 498 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, 2012:

Cash and cash equivalents and investments	\$ 62,785,294
Receivables	1,593,981
Other assets	691,581
Total assets	<u>\$ 65,070,856</u>
Total liabilities	\$ 25,755,687
Total equity	39,315,169
Total liabilities and equity	<u>\$ 65,070,856</u>
Total revenue	\$ 11,433,229
Total expenses	3,824,547
Distribution to members	-
Net increase in equity	<u>\$ 7,608,682</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.

(10) Other Post-Employment Benefits (OPEB)

Plan Description

The 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.

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, 2012 and 2011

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

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, 2012, the Utilities contributed \$180,589 and retirees receiving benefits contributed \$115,319 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:

	2012
Annual required contribution	\$ 73,136
Interest on net OPEB obligation	53,435
Adjustment to annual required contribution	(41,179)
Annual OPEB expense	85,392
Contributions and payments made	65,270
Increase in net OPEB obligation	\$ 20,122
Net OPEB obligation, December 31, 2011	1,068,682
Net OPEB obligation, December 31, 2012	\$ 1,088,804

The Water Utility's share of the December 31, 2012 Net OPEB obligation is \$115,210.

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, 2012, 2011 and 2010:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2012	\$ 85,392	76.44%	\$ 1,088,804
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449

Funded Status and Funding Progress

As of January 1, 2012, the most recent actuarial valuation date, the Utilities actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$908,961. 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 \$13,133,950 in 2012 and the ratio of the UAAL to the covered payroll was 6.9%.

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, 2012 and 2011

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

Funded Status and Funding Progress, Continued

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, 2012
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	9.5% declining 0.5% annually to 5%
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, 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. In 2012 and 2011, the Water Utility spent \$357,470 and \$147,251, respectively, for flood recovery. As of December 31, 2012 and 2011, the Utility has recognized \$293,578 and \$160,560, respectively, in revenues for FEMA flood recovery reimbursement. As of December 31, 2012 and 2011, the Utility recognized a receivable of \$72,035 and \$197,647, respectively, for FEMA flood disaster reimbursement.

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, 2012 and 2011

(12) Commitments and Contingencies

As of December 31, 2012, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$1,000 and an estimated time frame to complete through 2013.

(13) Subsequent Events

Effective January 1, 2013, the Board of Trustees approved a 7% water rate increase.

**Municipal Electric, Gas, Water and Communications Utilities
Of the City of Cedar Falls, Iowa
Required Supplemental Information
December 31, 2012, 2011 and 2010**

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

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial		Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
			Accrued Liability (AAL)					
2012	January 1, 2012	\$ -	\$908,961	\$908,961	\$908,961	0.0%	\$13,133,950	6.9%
2011	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$12,936,933	22.9%
2010	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$12,152,946	24.4%
2009	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$11,587,064	25.6%
2008	January 1, 2007	\$ -	\$3,436,000	\$3,436,000	\$3,436,000	0.0%	\$11,162,424	30.8%

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*

Independent Auditors' Report

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

We have audited, 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, 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, 2012, and the related notes to the financial statements, and have issued our report thereon dated April 4, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Municipal Water Utility's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our 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. Accordingly, we do not express an opinion on the effectiveness of the Municipal Water Utility's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipal Water Utility's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013



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, 2012 and 2011**

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

Report on the Financial Statements

We have audited the accompanying financial statements of 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 and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control over financial reporting relevant to the Municipal Communications Utility's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Communications Utility's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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

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, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statements present only the Municipal Communications Utility component unit and do not purport to, and do not, present fairly the financial position of the City of Cedar Falls, Iowa, as of December 31, 2012 and 2011 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. Our opinion is not modified with respect to this matter.

As discussed in the Note 1, the Municipal Communications Utility adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective January 1, 2012. Our opinion is not modified with respect to this matter.

Other Matters

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Schedule of Funding Progress information 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, economic, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have issued our report dated April 4, 2013 on our consideration of the Municipal Communications Utility's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters, including those systems applicable to Municipal Communications Utility. 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* in considering the Municipal Communications Utility's internal control over financial reporting and compliance.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2012, 2011 and 2010
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, 2012, 2011 and 2010. 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 position increased in 2012 as a result of operating and non-operating income. At December 31, 2012, 2011 and 2010, total assets were \$38,111,685, \$34,155,542, and \$34,494,078, respectively, and total liabilities were \$23,388,688, \$20,826,002, and \$21,624,072, respectively, resulting in a net position of \$14,722,997, \$13,329,540, and \$12,870,006, respectively.
- Rate increases in Basic Lifeline of 14.2%, Basic Plus of 6.1%, Cyber/FiberBasic of 20.0%, Cyber/FiberHome of 13.3%, Cyber/FiberOffice of 8.7%, Cyber/FiberOffice Plus of 5.9%, FiberOffice Extreme of 10.0%, and a 50.0% increase in the Multi-service Discount were effective in January 2012.
- 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.
- In 2012 operating revenues increased 13.5% to \$14,309,713 while operating expenses increased 10.8% to \$13,199,726.
- 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 2012, the Utility's net operating income increased 61.8% to \$1,109,987 compared to net operating income of \$685,893 in 2011 and \$2,949,256 in 2010. The primary cause of the increase is due to revenue growth from increases in rates and number of subscribers.
- 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.
- 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

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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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 statements of net position 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 position 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 costs. For the discussion of the Communications Utility service rates as disclosed herein, the Communications Utility rates are billed on a per subscriber per month basis.

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 Statement of Net Position Information

	2012	2011	2010
Current assets	\$ 7,915,924	\$ 9,962,020	\$19,151,954
Capital assets, net	29,227,223	24,089,337	15,228,810
Other noncurrent assets	968,538	104,185	113,314
Total assets	<u>\$38,111,685</u>	<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)
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Current liabilities	\$ 5,141,833	\$ 4,028,046	\$ 3,112,766
Noncurrent liabilities	1,174,744	315,494	262,768
Long-term debt	17,072,111	16,482,462	18,248,538
Total liabilities	<u>\$23,388,688</u>	<u>\$20,826,002</u>	<u>\$21,624,072</u>
Net investment in capital assets	\$ 9,775,113	\$ 6,626,929	\$ 3,747,880
Restricted	1,852,120	1,810,529	1,914,866
Unrestricted	3,095,764	4,892,082	7,207,260
Total net position	<u>\$14,722,997</u>	<u>\$13,329,540</u>	<u>\$12,870,006</u>

Condensed Revenues, Expenses and Changes in Net Position

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Cable television	\$ 7,913,921	\$ 7,125,207	\$ 6,948,349
High speed data communications	6,391,826	5,479,181	5,220,455
Other operating revenue	3,966	(1,114)	29,647
Total operating revenues	<u>14,309,713</u>	<u>12,603,274</u>	<u>12,198,451</u>
System operation and maintenance	8,009,105	7,318,913	5,826,954
Depreciation	2,190,992	1,607,050	1,415,969
Sales, customer service, corporate operations	2,999,629	2,991,418	2,006,272
Total operating expenses	<u>13,199,726</u>	<u>11,917,381</u>	<u>9,249,195</u>
Operating income	1,109,987	685,893	2,949,256
Interest income	6,006	12,768	12,650
Interest expense	(502,144)	(544,889)	(327,114)
Other, net	779,608	305,762	127,418
Total non-operating revenues (expenses)	<u>283,470</u>	<u>(226,359)</u>	<u>(187,046)</u>
Change in net position	1,393,457	459,534	2,762,210
Net position, beginning of year	<u>13,329,540</u>	<u>12,870,006</u>	<u>10,107,796</u>
Net position, end of year	<u>\$14,722,997</u>	<u>\$13,329,540</u>	<u>\$12,870,006</u>

Financial Analysis

Current assets decreased 20.5% in 2012. Cash and investments – unrestricted decreased by 37.6% and cash and investments – restricted decreased 28.0% primarily due to expenditure of funds for the fiber to the

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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premise infrastructure and rural broadband projects. Receivables increased 41.8%, \$691,457, primarily due to a 20.1%, \$286,236, increase in customer accounts receivable and a \$404,260 increase in Government grants receivable due to the rural broadband grant project.

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%, \$18,593, increase 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 receivable and a 70.7%, \$275,246, decrease in other receivables offset by an 8.3%, \$108,473 increase in customer accounts receivable.

Noncurrent assets increased \$864,343, in 2012 due to an increase in other of \$874,313 for the addition of a tax increment financing (TIF) receivable.

Noncurrent assets decreased 8.1%, \$9,129, in 2011 due to the amortization of debt expense on the capital loan notes issued in 2009 and 2010.

Noncurrent assets increased 70.1%, \$46,710, in 2010 due to the increase in unamortized of debt expense from the issuance of capital loan notes in 2010.

Current liabilities increased 27.7% in 2012 primarily due the \$410,989 increase in accounts payable and a \$600,000 current installment of a note payable to the Municipal Gas Utility for a \$3,000,000 loan in 2012.

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.

Noncurrent liabilities increased \$859,250 in 2012 primarily due to the recording of a Tax Increment Financing (TIF) liability for possible future TIF revenues as a result of the City of Cedar Falls preparing resolutions demonstrating TIF debt owed to the Communications Utility for certified expenditures.

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.

Long-term debt increased 3.6%, \$589,649, during 2012 due to an increase of \$2,215,000 in long-term note payable, less current installments offset by a decrease of \$1,625,351 in long-term debt less, current installments. Long-term note payable, less current installments is comprised of notes payable to the Municipal

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Electric Utility and Municipal Gas Utility. Additional information on the long term notes payable can be found in Notes 5 and 11.

Long-term debt decreased 9.7%, \$1,766,076, during 2011 due to a 9.1%, \$1,581,076 decrease in long-term debt, less current installments and a 20.0%, \$185,000, decrease 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 the note payable to the Electric Utility of 25.1%, \$310,000.

Cable television operating revenues increased 11.1% in 2012. Basic service revenues increased 19.3% and Basic Plus service revenues increased 7.4% in 2012 primarily due to rate increases and an increase of 95 subscribers.

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 of 432 subscribers. Digital Premier service revenues increased 1.5%, \$1,824, primarily due to a \$3.00 per month rate increase. Digital Signature service revenues increased 32.5%, \$59,286, primarily due to a \$2.50 per month rate increase. HD Essentials service revenues increased 10.7%, \$9,066, primarily due to a \$1.00 per month rate increase. Premium movie channel service revenues increased by 4.7%, \$9,319, primarily due to an average rate increase of \$6.00 per month. Equipment revenues increased 18.4%, \$132,993, 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 month rate increase. Basic Plus service revenues increased 9.6% in 2010 primarily because of a \$2.00 per month rate increase. Digital Premier service revenues decreased 3.4%, \$4,230, due to a 7.7% reduction in subscribers partially offset by a \$2.00 per month rate increase. Advertising sales revenues increased by 32.5%, \$155,449, in 2010.

Data communications operating revenues increased 16.7% in 2012. This is due to rate increases and an increase of 492 subscribers. Network access revenue increased 22.5% primarily due to subscribers choosing higher valued services partially offset by a decrease of 12 subscribers. Local private line revenues increased 7.3% due to an increase of 5 subscribers.

Data communications operating revenues increased 5.0% in 2011. This is primarily due to an increase of 702 subscribers. Data services revenue increased 5.9%, \$284,863, and Local private line revenue increased 6.7%, \$10,553, offset by a decrease in network access revenue of 16.0%, \$36,690.

Data communications operating revenues increased 6.7% in 2010. This is due to an increase of 396 subscribers and a rate increase of \$5 per subscriber for subscribers of Data communications services only. Network access wholesale revenues increased 9.0% and modem-based data service sales increased by 7.1% offset by a decrease of 5.4% in point-to-point data service revenues.

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Total system operation and maintenance expenses increased 9.4% in 2012 primarily due to cable television programming cost increases of 11.4%, \$ 468,461, access expense increase of 42.0%, \$172,060, and depreciation expense increase of 36.3%, \$583,942.

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

Total system operation and maintenance expenses increased 8.0% in 2010 due to a 9.8%, \$346,974, increase in cable television programming costs 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.

Total sales, customer services, and corporate operations expenses increased 0.3% in 2012. Sales expenses increased 13.4%, \$9,842, primarily due to a 11.9%, \$38,489, increase in sales and product advertising expense offset by a 0.4%, \$3,430, decrease in customer operations and a 2.78%, \$48,200, decrease in corporate operations primarily due to lower legal expenses.

Total sales, customer services, and corporate operations expenses increased 49.1% in 2011. Sales expenses increased by 19.2%, \$71,734, primarily due to a 13.6%, \$49,130, increase in sales and product advertising expense, a 29.1%, \$183,465, increase in customer operations primarily due to temporary customer service and installers hired for converting customers from the coax system to the fiber system. Corporate operations increased by 72.9%, \$729,947, primarily due an increase of approximately \$365,000 per year in wages due a reallocation of wages among all the municipal utilities that share personnel with the Communications utility, and a 62.5%, \$393,259, increase in human resources costs primarily due to medical insurance costs.

Total sales, customer services, and corporate operations expenses decreased 9.8% in 2010. Corporate operations decreased 17.4%, \$210,713, primarily due a decrease in employee insurance and benefits expense, and customer operations decreased 2.9%, \$18,993, primarily due to a reduction in uncollectible revenue. These were partially offset by an increase of 3.0%, \$10,983, in sales expense.

Interest income decreased \$6,762 in 2012 due to the continuing low interest rates for investments and cash accounts. Interest expense decreased 7.8%, \$42,745, in 2012 primarily due to less outstanding debt. Other, net increased \$473,846 in 2012 primarily due to a \$415,164 increase in intergovernmental grant revenue and a \$199,383 increase in miscellaneous revenues due to tax increment financing (TIF) revenues offset by a 69.4%, \$145,022, decrease in Allowance for Funds Used During Construction – AFUDC.

Interest income decreased 0.9%, \$118, 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%, \$9,752, 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

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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.

Capital Assets and Debt Administration

Net capital assets represent 76.7% of total assets for the Utility in 2012. Net capital assets increased 21.3% in 2012 primarily due to the continuation of the fiber to the premise build out that is replacing the fiber-coax hybrid system and the rural broadband project.

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 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 fiber-coax hybrid system.

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

The Utility's total long-term debt at year end 2012, excluding the outstanding loans with the Municipal Electric Utility and the Municipal Gas Utility, was \$15,714,021 of which \$14,119,021 is noncurrent debt and \$1,595,000 is current debt compared to \$17,299,372 of total long-term debt at year end 2011 of which \$15,744,372 was noncurrent debt and \$1,555,000 was current debt. The change in total long-term debt is primarily due to repayment of \$1,585,350 of debt during 2012. Additional detail on the outstanding long-term debt can be found in Note 5.

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 issuance of \$13,130,000 in new debt.

The Utility has an outstanding loan with the Municipal Electric Utility totaling \$553,090, \$923,090, and \$1,233,090 at December 31, 2012, 2011 and 2010, respectively. The Utility has an outstanding loan with the Municipal Gas Utility totaling \$3,000,000 at December 31, 2012. Additional detail on the outstanding loan can be found in Notes 5 and 11.

FINANCIAL STATEMENTS

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MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA

(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Net Position
December 31, 2012 and 2011

<u>Assets</u>	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents (note 3)	\$ 2,341,894	\$ 3,755,435
Cash - restricted (note 2 and 3)	259,544	993,083
Investments - restricted (note 2 and 3)	1,661,858	1,674,000
Receivables:		
Customer accounts, less allowance for doubtful accounts of \$21,083 in 2012 and \$29,119 in 2011	1,709,011	1,422,775
Interest	4,448	1,534
Government grants (note 11 and 12)	502,746	98,486
Other	130,868	132,821
Material and supplies	1,183,414	1,764,293
Prepayments and other	122,141	119,593
Total current assets	<u>7,915,924</u>	<u>9,962,020</u>
Noncurrent assets:		
Noncurrent investments: (note 3)		
Other (note 8)	874,313	-
Unamortized debt expense	94,225	104,185
Total noncurrent assets	<u>968,538</u>	<u>104,185</u>
Capital assets: (note 4)		
Capital assets, in service	35,247,872	32,470,282
Less accumulated depreciation	7,431,058	9,654,655
Capital assets, net	<u>27,816,814</u>	<u>22,815,627</u>
Construction work in progress	1,410,409	1,273,710
Total capital assets, net	<u>29,227,223</u>	<u>24,089,337</u>
Total assets	<u>\$ 38,111,685</u>	<u>\$ 34,155,542</u>

See accompanying notes to financial statements.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA

(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Net Position

December 31, 2012 and 2011

<u>Liabilities</u>	<u>2012</u>	<u>2011</u>
Current liabilities:		
Accounts payable	\$ 2,217,831	\$ 1,806,842
Accrued wages and vacation	363,755	301,316
Accrued interest	54,137	60,680
Other accrued liabilities	126,110	119,208
Current installments of note payable (note 5)	785,000	185,000
Current installments of long-term debt (note 5)	1,595,000	1,555,000
Total current liabilities	<u>5,141,833</u>	<u>4,028,046</u>
Noncurrent liabilities: (note 5)		
Other liabilities (note 5, 8 and 10)	1,134,013	251,419
Customer advances for construction	40,731	64,075
Total noncurrent liabilities	<u>1,174,744</u>	<u>315,494</u>
Long-term Debt (note 5)		
Long-term note payable, less current installments (note 5)	2,953,090	738,090
Long-term debt, less current installments (note 5)	14,119,021	15,744,372
	<u>17,072,111</u>	<u>16,482,462</u>
Total liabilities	<u>23,388,688</u>	<u>20,826,002</u>
<u>Net Position</u>		
Net investment in capital assets	9,775,113	6,626,929
Restricted	1,852,120	1,810,529
Unrestricted	3,095,764	4,892,082
Total net position	<u>14,722,997</u>	<u>13,329,540</u>
Total liabilities and net position	<u>\$ 38,111,685</u>	<u>\$ 34,155,542</u>

See accompanying notes to financial statements.

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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 Position

Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Cable system revenues	\$ 7,913,921	\$ 7,125,207
Data services revenue	5,975,439	5,118,548
Network access revenue	236,407	192,919
Local private line revenue	179,980	167,714
Other operating income	3,966	(1,114)
Total operating revenues	<u>14,309,713</u>	<u>12,603,274</u>
Operating expenses:		
Plant specific and programming	6,653,462	6,225,741
Depreciation	2,190,992	1,607,050
Plant nonspecific	1,355,643	1,093,172
Customer operations	810,465	813,895
Sales	505,950	446,108
Corporate operations (note 8)	1,683,214	1,731,415
Total operating expenses	<u>13,199,726</u>	<u>11,917,381</u>
Operating income	<u>1,109,987</u>	<u>685,893</u>
Non-operating revenues (expenses):		
Interest income	6,006	12,768
Miscellaneous revenue (expense), net	264,288	64,905
Intergovernmental grant funds (note 11 and 12)	482,690	67,526
Interest expense on long-term debt (note 5)	(502,144)	(544,889)
AFUDC (note 1)	64,094	209,116
Interest expense on affiliated note payable (note 5 and 8)	(31,464)	(35,785)
Total non-operating revenues (expenses)	<u>283,470</u>	<u>(226,359)</u>
Change in net position	1,393,457	459,534
Net position, beginning of year	<u>13,329,540</u>	<u>12,870,006</u>
Net position, end of year	<u>\$ 14,722,997</u>	<u>\$ 13,329,540</u>

See accompanying notes to financial statements.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA

(A Component Unit of the City of Cedar Falls, Iowa)

Statements of Cash Flows

Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities:		
Cash received from customers	\$ 14,057,032	\$ 12,611,506
Cash paid to suppliers	(8,310,927)	(8,138,255)
Cash paid to employees	(1,666,398)	(1,583,163)
	<hr/>	<hr/>
Net cash provided by (used in) operating activities	4,079,707	2,890,088
Cash flows from noncapital financing activities:		
Advance from affiliated utility	3,000,000	-
Payments on advance from affiliated utility	(185,000)	(310,000)
Interest paid on note Payable	(34,339)	(40,629)
	<hr/>	<hr/>
Net cash provided by (used in) used in noncapital financing activities	2,780,661	(350,629)
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(1,555,000)	(1,390,000)
Interest payments on long-term debt	(526,203)	(565,076)
Refunds of customer advances for construction	(23,344)	(15,318)
Acquisition, construction and removal cost of capital assets	(7,335,388)	(10,284,032)
Proceeds from sale of capital assets	70,604	19,460
Reimbursement of utility construction costs	276,345	81,727
Intergovernmental grants	70,304	-
	<hr/>	<hr/>
Net cash provided by (used in) capital and related financing activities	(9,022,682)	(12,153,239)
Cash flows from investing activities:		
Proceeds from maturities of investment securities	1,674,000	1,678,178
Purchase of investment securities	(1,664,677)	(1,674,000)
Interest received	5,911	14,081
	<hr/>	<hr/>
Net cash provided by (used in) investing activities	15,234	18,259
Net increase (decrease) in cash and cash equivalents	(2,147,080)	(9,595,521)
Cash and cash equivalents, beginning of year	<hr/> 4,748,518	<hr/> 14,344,039
Cash and cash equivalents, end of year (note 1)	<u>\$ 2,601,438</u>	<u>\$ 4,748,518</u>

See accompanying notes to financial statements.

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Statements of Cash Flows, Continued
Years ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 1,109,987	\$ 685,893
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation of capital assets	2,190,992	1,607,050
Other income (expense), net	(3,931)	19,854
(Increase) decrease in accounts receivable	(284,283)	(23,828)
(Increase) decrease in materials and supplies	580,879	(334,316)
(Increase) decrease in prepayments and other	(2,548)	(15,973)
Increase (decrease) in accounts payable	410,989	784,494
Increase (decrease) in accrued wages and vacation	62,439	95,061
Increase (decrease) in other accrued liabilities	6,902	3,809
Increase (decrease) in other noncurrent liabilities	<u>8,281</u>	<u>68,044</u>
Net cash provided by operating activities	<u>\$ 4,079,707</u>	<u>\$ 2,890,088</u>
Schedule of noncash investing, capital and financing activities:		
AFUDC	64,094	209,116
Contributions from contractors in aid of construction	-	21,376
Intergovernmental grants	-	55,344
Reconciliation of cash and cash equivalents to statement of net assets accounts:		
Cash and cash equivalents	\$ 2,341,894	\$ 3,755,435
Cash - Restricted	<u>259,544</u>	<u>993,083</u>
Cash and cash equivalents	<u>\$ 2,601,438</u>	<u>\$ 4,748,518</u>

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

MUNICIPAL COMMUNICATIONS UTILITY OF THE CITY OF CEDAR FALLS, IOWA
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Notes to Financial Statements
December 31, 2012 and 2011

(1) **Summary of Significant Accounting Policies**

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.

Accounting Changes

In December 2010, GASB issued Statement No. 62, ***“Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements”*** (Statement 62). GASB No. 62 incorporates into the GASB’s authoritative literature certain accounting and financial reporting guidance issued on or before November 30, 1989 included in: FASB Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure that do not conflict with or contradict GASB pronouncements. This statement also supersedes SGAS No. 20 ***“Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting”*** which eliminates the election for business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict or contradict GASB pronouncements. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

In June 2011, the Governmental Accounting Standards Board (GASB) issued Statement No. 63, ***“Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position”***. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards did not include guidance for these elements, which are distinct from assets and liabilities. This statement is effective for the Utility for 2012. The Utility has assessed the financial statement impact of adopting this statement and its impact is not material.

The Governmental Accounting Standards Board (GASB) has approved GASB Statement No. 65, ***“Items Previously Reported as Assets and Liabilities”***; Statement No. 66, ***“Technical Corrections – 2012”*** which is an amendment of GASB Statements No.10 and No. 62; Statement no. 67, ***“Financial Reporting for Pension Plans”*** which is an amendment of GASB Statement No. 25; and Statement No. 68, ***“Accounting and Financial Reporting for Pensions”*** which is an amendment of GASB Statement No. 27. Application of these standards may restate portions of these financial statements.

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

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December 31, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

Capital Assets and Depreciation, Continued

construction purposes. AFUDC was capitalized on utility construction at a rate of 2.95% in 2012 and 3.94% in 2011. 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 6.5% and 6.3% of depreciable assets for 2012 and 2011, 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 position.

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.

Cash and Investments

Investments are stated at their fair value on the statement of net position. The Utility's investments stated at fair value reflect quoted market prices at the statement of net position 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, 2012 and 2011 were \$6,570 and \$250,000, respectively, for amounts invested in the Iowa Public Agency Investment Trust (IPAIT).

Accounts Receivable and Allowance for Doubtful Accounts

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

Inventories

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

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.

Net Position

Net position represents the difference between assets and liabilities in the financial statements. Net investment in capital assets 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 position is 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 position consists of net positions that do not meet the definition of "net investment in capital assets" or "restricted".

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, 2012 and 2011

(1) **Summary of Significant Accounting Policies, Continued**

Net Position, Continued

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

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.

Operating Revenues and Expenses

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, 2012 and 2011, were \$438,004 and \$398,962, respectively.

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.

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 years 2012 and 2011, there were no budget amendments.

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.

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.

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, 2012 and 2011

(1) Summary of Significant Accounting Policies, Continued

Employee Benefits, Continued

Employees who are hired after that date shall not be entitled to the benefit. As of December 31, 2012 and 2011 the accrued liability was \$173,036 and \$150,707, respectively.

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.

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, 2012 and 2011 was as follows:

Current Assets – Restricted	Cash	2012 Investments	Total
Bond Reserve	\$ 16,427	\$ 1,661,858	\$ 1,678,285
Bond and Interest	173,099	-	173,099
Self-Insured Medical and Dental	70,018	-	70,018
Construction	-	-	-
Total Current Assets – Restricted	259,544	1,661,858	1,921,402
 Total restricted assets	 \$ 259,544	 \$ 1,661,858	 \$ 1,921,402

Current Assets – Restricted	Cash	2011 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

The monies deposited into the various accounts have been invested in interest-bearing securities as required by the bond resolution. 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 Self-Insured Medical and Dental fund may only be used for medical and dental reserves and expenses.

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(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, 2012 and 2011 was \$60.

Deposits

At December 31, 2012, the Utility's carrying amount of deposits, including \$340,000 of certificates of deposits and \$575,000 of money market accounts, was \$2,934,808. 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.

Investments

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

As of December 31, 2012 and 2011, the Utility had the following Federal Agency Obligations investments and maturities. (The Utility assumes callable bonds will not be called):

2012 Investment Type	Investment Maturities (in years)		Total
	Less than 1	1 to 3	
Federal Agency Obligations	\$1,321,858	\$ -	\$1,321,858

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

As of December 31, 2012 the Utility had a \$1,321,858 Federal Agency Obligation investment maturing September 23, 2013. This investment has a Standard & Poor's credit rating of AA+ and Moody's Investor Services credit rating of Aaa. As of December 31, 2011, the Utility had a \$360,000 Federal Agency Obligation investment that matured February 22, 2012. This investment had a Standard & Poor's rating of AAA and Moody's Investor Services credit rating of Aaa.

In addition, the Utility had investments in the Iowa Public Agency Investment Trust which are valued at an amortized cost of \$6,570 and \$250,000 at December 31, 2012 and 2011, respectively, pursuant to Rule 2a-7 under the Investment Company Act of 1940.

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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 2012 or 2011. 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 2012 or 2011.

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 statement of net position follows:

	2012	2011
Cash on hand	\$ 60	\$ 60
Carrying amount of deposits	2,934,808	5,812,458
Carrying amount of federal agency obligations	1,321,858	360,000
Carrying amount of Iowa Agency Investment Trust	6,570	250,000
Total	<u>\$ 4,263,296</u>	<u>\$ 6,422,518</u>
Current Assets		
Cash and cash equivalents	\$ 2,341,894	\$ 3,755,435
Investments	-	-
Restricted cash	259,544	993,083
Restricted investments	1,661,858	1,674,000
Total	<u>\$ 4,263,296</u>	<u>\$ 6,422,518</u>

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

Custodial Credit Risk – Investments, Continued

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

(4) Capital Assets

A summary of capital assets activity for the years ended December 31, 2012 and 2011 follows:

2012	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets, not being depreciated:				
Construction, work-in-progress	\$ 1,273,710	\$ 7,382,169	\$ 7,245,470	\$ 1,410,409
Total capital assets, not being depreciated	1,273,710	7,382,169	7,245,470	1,410,409
Capital assets, being depreciated:				
Infrastructure	17,441,768	3,026,616	3,263,325	17,205,059
Equipment	15,028,514	4,218,854	1,204,555	18,042,813
Total capital assets, being depreciated	32,470,282	7,245,470	4,467,880	35,247,872
Less accumulated depreciation	9,654,655	2,291,273	4,514,870	7,431,058
Total capital assets, being depreciated, net	22,815,627	4,954,197	(46,990)	27,816,814
Capital assets, net	<u>\$ 24,089,337</u>	<u>\$ 12,336,366</u>	<u>\$ 7,198,480</u>	<u>\$ 29,227,223</u>
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	3,178,607	10,533,863	12,438,760	1,273,710
Capital assets, being depreciated:				
Infrastructure	12,870,560	5,885,518	1,314,310	17,441,768
Equipment	9,406,266	6,452,123	829,875	15,028,514
Total capital assets, being depreciated	22,276,826	12,337,641	2,144,185	32,470,282
Less accumulated depreciation	10,226,623	1,627,496	2,199,464	9,654,655
Total capital assets, being depreciated, net	12,050,203	10,710,145	(55,279)	22,185,627
Capital assets, net	<u>\$ 15,228,810</u>	<u>\$ 21,244,008</u>	<u>\$ 12,383,481</u>	<u>\$ 24,089,337</u>

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(5) Noncurrent Liabilities

Noncurrent liabilities activity for the years ended December 31, 2012 and 2011 was as follows:

2012	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
General obligation capital loan notes:					
Series 2009B	\$ 1,750,000	\$ -	\$ 155,000	\$ 1,595,000	\$ 155,000
Note payable-Municipal Electric Utility	923,090	-	185,000	738,090	185,000
Note payable-Municipal Gas Utility	-	3,000,000	-	3,000,000	600,000
Capital loan Notes:					
Series 2009	2,990,000	-	335,000	2,655,000	345,000
Series 2010	12,210,000	-	1,065,000	11,145,000	1,095,000
Unamortized premium	494,381	-	44,065	450,316	-
Unamortized discount	(145,009)	-	(13,714)	(131,295)	-
	<u>18,222,462</u>	<u>3,000,000</u>	<u>1,770,351</u>	<u>19,452,111</u>	<u>2,380,000</u>
Current installments of long-term debt	(1,740,000)	(640,000)	-	(2,380,000)	
Long-term debt, less current installments	<u>16,482,462</u>	<u>2,360,000</u>	<u>1,770,351</u>	<u>17,072,111</u>	
Customer advances for construction	64,075	-	23,344	40,731	
Other liabilities	-	874,313	-	874,313	
Accrued severance and OPEB	251,419	57,632	49,351	259,700	
Noncurrent liabilities	<u>315,494</u>	<u>931,945</u>	<u>72,695</u>	<u>1,174,744</u>	
Total noncurrent liabilities	<u>\$ 16,797,956</u>	<u>\$ 3,291,945</u>	<u>\$ 1,843,046</u>	<u>\$ 18,246,855</u>	

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(5) Noncurrent Liabilities, Continued

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
Capital loan Notes:					
Series 2009	3,315,000	-	325,000	2,990,000	335,000
Series 2010	13,130,000	-	920,000	12,210,000	1,065,000
Unamortized premium	532,899	-	28,518	494,381	-
Unamortized discount	(157,451)	-	(12,442)	(145,009)	-
	<u>19,948,538</u>	-	<u>1,726,076</u>	<u>18,222,462</u>	<u>1,740,000</u>
Current installments of long-term debt	(1,700,000)	(40,000)	-	(1,740,000)	
Long-term debt, less current installments	<u>18,248,538</u>	<u>(40,000)</u>	<u>1,726,076</u>	<u>16,482,462</u>	
Customer advances for construction	79,393	-	15,318	64,075	
Other liabilities	-	-	-	-	
Accrued severance and OPEB	183,375	206,512	138,468	251,419	
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>	

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%. Interest rates over the remaining term of the bonds are in a range between 1.3% 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:

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(5) Noncurrent Liabilities, Continued

Year	General Obligation Capital Loan Notes, Series 2009B	
	December 1 Principal Amount	1.30% - 3.80% Interest Amount
2013	\$ 155,000	\$ 47,878
2014	165,000	45,242
2015	105,000	41,860
2016	110,000	39,340
2017	115,000	36,370
2018 – 2022	650,000	124,600
2023 – 2024	295,000	16,765
	<u>\$ 1,595,000</u>	<u>\$ 352,055</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	Series 2009 Communications Revenue Capital Loan Notes		Series 2010 Communications Revenue Capital Loan Notes	
	December 1 Principal Amount	3.00% - 4.30% Interest Amount	December 1 Principal Amount	3.00% Interest Amount
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	175,000	67,210	1,455,000	185,100
2018 – 2022	985,000	224,850	4,715,000	286,650
2023 – 2024	460,000	29,773		
	<u>\$ 2,655,000</u>	<u>\$ 664,373</u>	<u>\$ 11,145,000</u>	<u>\$ 1,602,600</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.

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 capital loan notes until the notes are defeased. Principal and interest paid for 2012 and 2011 were \$1,876,310 and \$1,758,660, respectively. Total customer gross revenues as defined for the same periods were \$14,305,746 and \$12,604,388. Annual principal and interest payments are expected to require 9.36% of gross revenues on average.

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(5) Noncurrent Liabilities, Continued

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, 2012 and 2011 outstanding balances on this loan were \$738,090 and \$923,090, 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. This note was paid in full on July 1, 2011. 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 note requires annual principal payments, due December 1, and semiannual interest payments, due January and July 1. In January 2012, The Board of Trustees of the Municipal Gas Utility authorized a loan of up to \$3,000,000 be extended to the Utility under Resolutions No. 5077, bearing interest at 2.0%. The December 31, 2012 and 2011 outstanding balances on this loan were \$3,000,000 and \$0, respectively. Total debt service requirements are as follows:

Notes Payable to Municipal Electric Utility			Notes Payable to Municipal Gas Utility		
Year	Principal Amount	Interest Amount	Year	Principal Amount	Interest Amount
2013	\$ 185,000	\$ 14,448	2013	\$ 600,000	\$ 60,000
2014	185,000	10,747	2014	600,000	48,000
2015	185,000	7,048	2015	600,000	36,000
2016	183,090	3,351	2016	600,000	24,000
2017	-	-	2017	600,000	12,000
	<u>\$ 738,090</u>	<u>\$ 35,594</u>		<u>\$ 3,000,000</u>	<u>\$ 180,000</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 5.38% of their annual covered salary and the Utility is required to contribute 8.07% of annual covered payroll through June 30, 2012. Beginning July 1, 2012 plan members are required to contribute 5.78% of their annual covered salary and the Utility is required to contribute 8.67% of annual covered payroll. Contribution requirements are established by State statute. The Utility's contributions for the years ended December 31, 2012, 2011, and 2010, were \$251,418; \$215,512; and \$138,226, respectively, equal to the required contributions for each year.

In accordance with the Code of Iowa, Chapter 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.

(7) Income Tax Status

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

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(8) Related Party Transactions

The Utility provides communications service to the City. Operating revenues from the service provided amounted to \$54,740 and \$63,765 in 2012 and 2011, respectively.

The City Council of the City of Cedar Falls, Iowa approved resolutions in 2012 to reimburse the Communications Utility for costs it incurred for improvement projects in the Tax Increment Financing (TIF) districts of the City of Cedar Falls, Iowa. This other receivable, with an outstanding balance of \$874,313 as of December 31, 2012, shall be repaid as TIF revenues are collected by the City. The Utility has recorded an offsetting other liability at December 31, 2012 and will recognize revenue for contributed capital from the City as amounts are received. Total amounts received from the TIF amounted to \$202,320 and \$54,240 in 2012 and 2011, respectively and is recorded as miscellaneous non-operating revenues in the Statements of Revenues, Expenses and Changes in Net Position.

Outstanding loan balances from the Municipal Electric Utility are \$738,090, and \$923,090 as of December 31, 2012, and 2011, respectively. Interest accrues on the loan at 2.0%, and is paid semi-annually during December and June. Annual principal payments continue through 2016 (see note 5). Accrued interest payable was \$8,968 and \$16,830 at December 31, 2012 and 2011, respectively. Interest expense for the years ended December 31, 2012 and 2011 was \$18,148 and \$35,785 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.

Outstanding loan balances from the Municipal Gas Utility are \$3,000,000, and \$0 as of December 31, 2012, and 2011, respectively. Interest accrues on the loan at 2.0%, and is paid semi-annually during December and June. Annual principal payments continue through 2017 (see note 5). Accrued interest payable was \$4,986 and \$0 at December 31, 2012 and 2011, respectively. Interest expense for the years ended December 31, 2012 and 2011 was \$13,315 and \$0 respectively.

See note 5 for description of debt with the City. The interest paid to the City was \$49,725 and \$51,288 for the years ended December 31, 2012 and 2011, respectively. The accrued interest related to this debt was \$3,990 and \$4,158 at December 31, 2012 and 2011, 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 aggregate stop loss coverage for the 2012 plan year for aggregate claims exceeding \$2.7 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

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(9) Risk Management, Continued

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:

	2012	2011
Unpaid claims and IBNR, beginning of year	\$ 351,000	\$ 187,000
Current year costs including IBNR	2,912,606	3,869,576
Claims paid	(3,069,606)	(3,705,576)
Unpaid claims and IBNR, end of year	\$ 194,000	\$ 351,000

The Utility has recorded \$29,100 and \$52,650 in accounts payable for its share of these unpaid claims at December 31, 2012 and 2011, 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 498 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, 2012:

Cash and cash equivalents and investments	\$ 62,785,294
Receivables	1,593,981
Other assets	691,581
Total assets	\$ 65,070,856
Total liabilities	\$ 25,755,687
Total equity	39,315,169
Total liabilities and equity	\$ 65,070,856
Total revenue	\$ 11,433,229
Total expenses	3,824,547
Distribution to members	-
Net increase in equity	\$ 7,608,682

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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(10) Other Post-Employment Benefits (OPEB)

Plan Description

The 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, 2012, the Utilities contributed \$180,589 and retirees receiving benefits contributed \$115,319 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:

	2012
Annual required contribution	\$ 73,136
Interest on net OPEB obligation	53,435
Adjustment to annual required contribution	(41,179)
Annual OPEB expense	85,392
Contributions and payments made	65,270
Increase in net OPEB obligation	\$ 20,122
Net OPEB obligation, December 31, 2011	1,068,682
Net OPEB obligation, December 31, 2012	\$ 1,088,804

The Communications Utility's share of the December 31, 2012 Net OPEB obligation is \$86,664.

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, 2012, 2011 and 2010:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2012	\$ 85,392	76.44%	\$ 1,088,804
December 31, 2011	\$ 302,004	23.76%	\$ 1,068,682
December 31, 2010	\$ 302,004	16.25%	\$ 838,449

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

Funded Status and Funding Progress

As of January 1, 2012, the most recent actuarial valuation date, the Utilities actuarial accrued liability (AAL) and unfunded actuarial accrued liability (UAAL) for benefits was \$908,961. 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 \$13,133,950 in 2012 and the ratio of the UAAL to the covered payroll was 6.9%.

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, 2012
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	9.5% declining 0.5% annually to 5%
Projected Salary Increases	4.0%

The schedule of funding progress, presented as Required Supplemental Information following the notes to the financial statements, presents multi-year 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, 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.

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, 2012 and 2011

(11) Flood Event, Continued

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, 2012 and 2011, the Communications Utility spent \$0 and \$21, respectively, for flood recovery. As of December 31, 2012 and 2011, the Utility has recognized \$(4,971) and \$(12,774), respectively, in revenues for FEMA flood recovery reimbursement. As of December 31, 2012 and 2011, the Utility recognized a receivable of \$9,359 and \$26,830, 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. As of December 31, 2012 and 2011, the Utility has recognized \$(1,184) and \$1,102, respectively, in revenues for FEMA wind storm disaster reimbursement. As of December 31, 2012 and 2011, the Utility recognized a receivable of \$3,651 and \$4,638, respectively, for FEMA wind storm disaster reimbursement.

(13) Commitments and Contingencies

As of December 31, 2012, the Utility was involved in several construction projects with an estimated cost to complete of approximately \$1,568,000 and an estimated time frame to complete through 2015.

(14) Subsequent Events

Effective January 2, 2013, the Board of Trustees approved the following rate increases per month per subscriber: \$2, or 12.5%, for Basic Lifeline; \$2.50, or 7.1%, for Basic Plus; \$1, or 8.3% for Signature service; \$1, or 28.6%, for Signature Sports; \$1, or 16.8% for HD Essentials; and an average of \$2, or 9.9%, for premium movie channels.

In January 2013 the Board of Trustees adopted resolution No.5259 approving the continuation of the annual interest rate on the notes between the Communications Utility and the Electric Utility and the Gas Utility at 2.0% as reflective of the investment and borrowing markets.

**Municipal Electric, Gas, Water and Communications Utilities
Of the City of Cedar Falls, Iowa
Required Supplemental Information
December 31, 2012, 2011 and 2010**

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

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial		Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
			Accrued Liability (AAL)					
2012	January 1, 2012	\$ -	\$908,961	\$908,961	\$908,961	0.0%	\$13,133,950	6.9%
2011	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$12,936,933	22.9%
2010	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$12,152,946	24.4%
2009	January 1, 2009	\$ -	\$2,967,000	\$2,967,000	\$2,967,000	0.0%	\$11,587,064	25.6%
2008	January 1, 2007	\$ -	\$3,436,000	\$3,436,000	\$3,436,000	0.0%	\$11,162,424	30.8%

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*

Independent Auditors' Report

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

We have audited, 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, 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, 2012, and the related notes to the financial statements, and have issued our report thereon dated April 4, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Municipal Communications Utility's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our 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. Accordingly, we do not express an opinion on the effectiveness of the Municipal Communications Utility's internal control.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013

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

REPORT ON FEDERAL AWARDS

Including Independent Auditors' Report

For the Year Ended December 31, 2012

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

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

Independent Auditors' Report

To the Board of Trustees
of Cedar Falls Utilities
Cedar Falls, Iowa

We have audited, 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, 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, 2012, and the related notes to the financial statements, and have issued our report thereon dated April 4, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Cedar Falls Utilities internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of Cedar Falls Utilities internal control.

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. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

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 from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013

REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM;
REPORT ON INTERNAL CONTROL OVER COMPLIANCE;
AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
REQUIRED BY OMB CIRCULAR A-133

Independent Auditors' Report

To the Board of Trustees
of Cedar Falls Utilities
Cedar Falls, Iowa

Report on Compliance for Each Major Federal Program

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 each of the Cedar Falls Utilities' major federal programs for the year ended December 31, 2012. Cedar Falls Utilities' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Cedar Falls Utilities' major federal programs based on our audit of the types of compliance requirements referred to above. 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 on compliance for each major federal program. However, our audit does not provide a legal determination of Cedar Falls Utilities' compliance.

Opinion on Each Major Federal Program

In our opinion, Cedar Falls Utilities complied, in all material respects, with the types of 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, 2012.

To the Board of Trustees
of Cedar Falls Utilities
Cedar Falls, Iowa

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, 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 12-01. Our opinion on each major federal program is not modified with respect to these matters.

Cedar Falls Utilities' Response

The Cedar Falls Utilities' response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The Cedar Falls Utilities' response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of Cedar Falls Utilities is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Cedar Falls Utilities' internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on 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.

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. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be *material weaknesses*. However, material weaknesses may exist that have not been identified.

Purpose of this Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

To the Board of Trustees
of Cedar Falls Utilities
Cedar Falls, Iowa

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the financial statements of Cedar Falls Utilities as of and for the year ended December 31, 2012, and the related notes to the financial statements. We issued our report thereon dated April 4, 2013, which contained unmodified opinions on those financial statements. Our audit was conducted 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 additional 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 as a whole.

Baker Tilly Virchow Krause, LLP

Madison, Wisconsin
April 4, 2013

CEDAR FALLS UTILITIES

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS Year Ended December 31, 2012

Grantor Agency / Pass-Through Agency/ Program Title	Federal CFDA Number	Grant Number	2012 Expend- itures
FEDERAL PROGRAMS			
U. S. Department of Housing and Urban Development			
Pass-through program from:			
City of Cedar Falls, Iowa:			
Community Development Block Grants/Entitlement Grants			
Block Grant Low Income	81.128	CDBG	\$ <u>7,796</u>
U.S. Department of Energy			
Renewable Energy Research and Development Program	81.087	DE-EE0000398	35,656
Pass-through program from:			
Iowa Association of Municipal Utilities:			
Smart Grid - ARRA	81.122	DE-EE0000359	346,321
Pass-through program from:			
Iowa Economic Development Authority (IEDA)			
State Energy Program Grant	81.041	DE-EE0000162	<u>81,854</u>
Total U.S. Department of Energy			<u>463,831</u>
U.S. Department of Homeland Security			
Pass-through program from:			
Iowa Homeland Security and Emergency Management Division (IHSMD)			
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Flood 2008	97.036	013-000CA-00	3,207,058
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Wind Storm 2009 406 program	97.036	013-000CA-00	1,714,620
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Wind Storm 404 program	97.039	HMGP-DR-1763-0188-01	129,655
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Floodwall Pumps	97.039	013-000CA-00	3,300
Disaster Grants - Public Assistance (Presidentially Declared Disasters) - Western Iowa (JOU) Flood	97.036	000-UE48Z-00	<u>(103)</u>
Total Department of Homeland Security			<u>5,054,530</u>
U.S. Department of Agriculture			
Pass-through program from:			
Rural Utilities Service:			
Broadband Grant - ARRA	10.787	Iowa 1123-A39	<u>480,719</u>
TOTAL FEDERAL PROGRAMS			<u>\$ 6,006,876</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, 2012

NOTE 1 – REPORTING ENTITY

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.

NOTE 2 – BASIS OF PRESENTATION

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, 2012

SECTION I – SUMMARY OF AUDITORS’ RESULTS

FINANCIAL STATEMENTS

Type of auditors’ report issued: Unmodified

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: unmodified

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, 2012**

**SECTION II – FINANCIAL STATEMENT FINDINGS REQUIRED TO BE REPORTED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

None

SECTION III – FEDERAL FINDINGS AND QUESTIONED COST

Finding 12-01:

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 prior to August 2011. Documentation of subsequent verification was not maintained by the utility for contracts entered into before implementing the verification process.

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 until August 2011.

Recommendation:

We recommend that the utility continue to incorporate this step into the normal contracting process and maintain documentation that the verification was completed for both new contracts awarded and previous contracts where verification was done after the contract was awarded.

Management Response:

CFU was unaware of this requirement until August 2011 when it took action to incorporate this verification measure into its contracting process. CFU believed it completed the verification and documentation for all vendors paid in 2011 and this documentation was linked to PO images in the procurement system. During 2012 testing, an expenditure using a purchase order issued before August 2011 was sampled and the documentation of this verification was not readily available.