

**SPENCER MUNICIPAL UTILITIES**  
**INDEPENDENT AUDITORS' REPORTS**  
**FINANCIAL STATEMENTS**  
**AND SUPPLEMENTAL INFORMATION**  
**DECEMBER 31, 2012 AND 2011**



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## SPENCER MUNICIPAL UTILITIES

### OFFICIALS

<u>Board of Trustees</u>	<u>Title</u>	<u>Term Expires</u>
<b>(Before July 2012)</b>		
Dave Hultgren	Chairman	6-30-2014
Gary Tolzmann	Vice-Chairman	6-30-2012
Sandi Schmidt	Secretary	6-30-2016
Murray Hart	Treasurer	6-30-2013
Alison Simpson	Trustee	6-30-2017
<u>Management</u>		
Steven Pick	General Manager	
Trisha Bruning	Finance Manager	
<b>(After July 2012)</b>		
Dave Hultgren	Chairman	6-30-2014
Alison Simpson	Vice-Chairman	6-30-2017
Sandi Schmidt	Secretary	6-30-2016
Murray Hart	Treasurer	6-30-2013
Dave Cronk	Trustee	6-30-2018
<u>Management</u>		
Steven Pick	General Manager	
Trisha Bruning	Finance Manager	

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**SPENCER MUNICIPAL UTILITIES**

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

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## INDEPENDENT AUDITORS' REPORT

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of The Municipal Electric Utility of the City of Spencer, Iowa (the Utility), as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Utility's basic 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.

### ***Auditor's Responsibility***

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

### ***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Utility as of December 31, 2012 and 2011 and the respective changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Funding Progress for the Retiree Health Plan information on pages 4 through 7 and page 26 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 Information***

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Utility's basic financial statements. The supplementary information on pages 27 through 29 is presented for purposes of additional analysis and is not a required part of the financial statements.

The supplementary 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 information is fairly stated in all material respects in relation to the financial statements as a whole.

### ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 1, 2013 on our consideration of the 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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Utility's internal control over financial reporting and compliance.

*Williams + Company, P.C.*  
Certified Public Accountants

Spencer, Iowa  
April 1, 2013

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of management's discussion and analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Electric Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2012 and 2011.

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

### **2012 Financial Highlights**

The Utility delivered approximately 152,785,000 kilowatt hours (kWh) of electricity to its retail customers in 2012 compared to approximately 165,800,000 kWh in 2011.

The Utility's net position decreased by \$133,888 to \$46,140,293 as a result of power supply cost increase of approximately \$502,000, or 7%, for the year ended December 31, 2012. In addition, lieu of tax was higher than normal due to \$287,500 grant which assisted in development of Stoneybrook First Addition as well as a decrease of approximately \$113,000 of interest income compared to 2011.

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

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).

The statements of revenues, expenses and changes in net position report all revenues and expenses incurred during the fiscal year.

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.

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Condensed Financial Information

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

#### Condensed Statements of Net Position

	<u>2012</u>	<u>2011</u>
Current assets	\$14,279,809	\$13,998,668
Noncurrent assets	4,636,114	6,719,013
Capital assets, net of depr.	40,271,855	38,973,465
Deferred costs	<u>177,540</u>	<u>203,761</u>
Total assets	<u>59,365,318</u>	<u>59,894,907</u>
Current liabilities	3,741,674	2,980,444
Noncurrent liabilities	52,349	41,925
Bonds Payable	<u>9,431,002</u>	<u>10,598,357</u>
Total liabilities	<u>13,225,025</u>	<u>13,620,726</u>
Investments in capital assets, net of related debt	31,590,509	30,486,903
Restricted	2,196,611	2,112,508
Unrestricted	<u>12,353,173</u>	<u>13,674,770</u>
Total net position	<u>\$46,140,293</u>	<u>\$46,274,181</u>

#### Condensed Statements of Revenues, Expenses and Changes in Net Position

Sales of electricity	\$10,449,274	\$10,208,176
Other	<u>1,321,790</u>	<u>1,332,181</u>
Total operating revenue	<u>11,771,064</u>	<u>11,540,357</u>
Power supply costs	8,000,701	7,498,554
Distribution system maintenance	1,200,841	1,541,041
Depreciation & amortization	2,545,039	2,468,227
Customer service & administration	<u>1,031,729</u>	<u>1,050,783</u>
Total operating expenses	<u>12,778,310</u>	<u>12,558,605</u>
Operating (loss)	(1,007,246)	(1,018,248)
Interest income	138,476	251,516
Interest expense	(272,563)	(340,271)
Other income (expense)	<u>1,007,445</u>	<u>1,340,204</u>
Total non-operating revenues	<u>873,358</u>	<u>1,251,449</u>
Change in net position	(133,888)	233,201
Net position, beginning of year	<u>46,274,181</u>	<u>46,040,980</u>
Net position, end of year	<u>\$46,140,293</u>	<u>\$46,274,181</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### **Financial Analysis**

The Utility's total assets decreased by approximately \$530,000. This was primarily due to approximately \$1,281,000 paid out of the bond proceed reserve for the N4 scrubber project. Total funds paid for the N4 scrubber project as of December 31, 2012 is approximately \$1,301,000 with an estimated \$1,653,000 remaining to be paid as the project is completed. Current liabilities increased in 2012 compared to 2011 due to N4 scrubber payable amount due of \$726,600 in addition to payables related to construction of the 520 2<sup>nd</sup> Avenue East building. The Utility also received the remaining \$1,000,000 of the loan made to the Spencer Municipal Communications Utility in 1999.

The Utility's gross revenues increased by approximately \$231,000 or 2% due to capturing a full year of electric rate increase that was effective 4/1/2011. The rate increase implemented was approximately 10%. However, kWh sales decreased in 2012 compared to 2011 by approximately 13,000,000 kWh. While the ECA revenue increased by approximately \$87,000 as well as lease revenue related to power supply increased by approximately \$141,000 in 2012 compared to 2011, the power supply cost increased by approximately \$502,000.

The total operating loss generated in 2012 was \$1,007,246 compared to an operating loss of \$1,018,248 in 2011.

Utility non-operating income (expense) resulted in \$873,358 of income, which was a 30% decrease from 2011. This was due to an increase in Lieu of Property Taxes paid to the City of Spencer primarily affected by the Stoneybrook First Addition grant in addition to an approximately \$41,000 increase in Lieu of Property Taxes due to the electric rate increase. In addition, amounts paid for economic development increased by approximately \$53,000 in 2012 compared to 2011 due to Storefront Interest payments stemming from the Storefront Initiative project.

The total net change in position decreased from \$233,201 in 2011 to (\$133,888) in 2012.

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

Net capital assets increased by approximately \$1,298,000 due to improvements made to the 520 2<sup>nd</sup> Avenue East project as well as the N4 scrubber project.

### **Economic Factors**

Retail sales decreased by 8,850,000 kWh and Commercial sales decreased by 4,005,000 kWh in 2012 compared to 2011. This represents an approximate 14% and 6% decrease, respectively, from 2011 to 2012.

The utility adopted an Energy Cost Adjustment (ECA) for all consumption beginning September 7, 2005. The ECA is calculated monthly and is designed to recoup the additional costs of power supply from the consumer.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

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**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF NET POSITION  
DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents		
Unrestricted	\$ 1,655,125	\$ 1,600,674
Restricted	213,859	130,112
Board Designated	6,000,000	5,998,930
Consumer Deposits	74,935	76,895
Investments		
Restricted	1,525,278	1,750,123
Board Designated	1,500,000	1,000,000
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$6,500 and \$6,500)	1,610,416	1,791,504
Unbilled Usage	223,914	225,770
Materials and Supplies Inventory	617,845	603,197
Fuel Inventory	557,677	469,565
Notes Receivable - City of Spencer	25,000	25,000
Prepayments	275,760	326,898
	<b>14,279,809</b>	<b>13,998,668</b>
<b>Capital Assets:</b>		
Land	150,704	142,741
Construction in Progress	4,218,428	2,087,572
Plant in Service	76,585,568	74,976,409
Accumulated Depreciation	(40,682,845)	(38,233,257)
	<b>40,271,855</b>	<b>38,973,465</b>
<b>Noncurrent Assets</b>		
Noncurrent Investments:		
Unrestricted	628,094	326,706
Board Designated	1,000,000	1,501,070
Restricted	2,194,590	3,270,307
Notes Receivable - City of Spencer	813,430	620,930
Notes Receivable -Municipal Communications Utility	-	1,000,000
Unamortized Bond Issue Costs	177,540	203,761
	<b>4,813,654</b>	<b>6,922,774</b>
<b>Total Assets</b>	<b>\$ 59,365,318</b>	<b>\$ 59,894,907</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF NET POSITION  
DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts Payable	\$ 2,283,155	\$ 1,562,448
Payroll and Sales Tax Payable	33,235	34,994
Accrued Payroll and Compensated Absences	152,246	147,947
Accrued Interest Payable	29,403	24,460
Consumer Deposits	74,935	76,895
Deferred Revenue	3,700	3,700
Current Maturities of Long-Term Debt	1,165,000	1,130,000
	<b>3,741,674</b>	<b>2,980,444</b>
<b>Noncurrent Liabilities</b>		
Bonds Payable	10,596,002	11,728,357
Less - Current Maturities	(1,165,000)	(1,130,000)
Net OPEB Liability	52,349	41,925
	<b>9,483,351</b>	<b>10,640,282</b>
	<b>13,225,025</b>	<b>13,620,726</b>
<b>NET POSITION</b>		
<b>Net Position</b>		
Invested in Capital Assets, Net of Related Debt	31,590,509	30,486,903
Restricted	2,196,611	2,112,508
Unrestricted	12,353,173	13,674,770
	<b>\$ 46,140,293</b>	<b>\$ 46,274,181</b>

See Accompanying Notes to Financial Statements

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**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF REVENUES, EXPENSES AND  
CHANGES IN NET POSITION  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>Operating Revenues:</b>		
Residential	\$ 3,752,130	\$ 3,736,024
Commercial	4,954,142	4,834,447
Public Authorities	590,781	572,713
Sales for Resale	1,260,854	1,167,152
Energy Cost Adjustment Revenue	1,152,221	1,064,992
Penalties	24,295	22,212
Miscellaneous	36,641	142,817
	<b>11,771,064</b>	<b>11,540,357</b>
<b>Operating Expenses:</b>		
Generation and Transmission		
Neal #4 Fuel and Generation	1,343,650	1,182,727
Walter Scott #4 Fuel and Generation	1,523,258	1,329,300
Purchased Power	5,028,475	4,871,318
Other	105,318	115,209
Distribution	1,200,841	1,541,041
Depreciation and Amortization	2,545,039	2,468,227
Customer Operations	395,557	345,750
General and Administrative	636,172	705,033
	<b>12,778,310</b>	<b>12,558,605</b>
<b>Operating (Loss)</b>	<b>(1,007,246)</b>	<b>(1,018,248)</b>
<b>Non-Operating Income (Expense):</b>		
Interest Income on Investments	138,476	251,516
Resource Conservation	(209,011)	(230,339)
Economic Development Payment	(107,188)	(54,362)
Leased Facilities	2,120,848	2,082,204
Interest Expense	(272,563)	(340,271)
Gain on Plant Retirements	12,207	18,780
Payment in Lieu of Property Taxes	(809,411)	(476,079)
	<b>873,358</b>	<b>1,251,449</b>
<b>Change in Net Position</b>	<b>(133,888)</b>	<b>233,201</b>
<b>Net Position at Beginning of Year</b>	<b>46,274,181</b>	<b>46,040,980</b>
<b>Net Position at End of Year</b>	<b>\$ 46,140,293</b>	<b>\$ 46,274,181</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>Cash Flows From Operating Activities:</b>		
Cash Received From Customers	\$ 11,952,048	\$ 11,194,095
Cash Payments to Suppliers for Goods and Services	(7,863,589)	(8,243,468)
Cash Payments to Employees for Services	(1,687,633)	(1,874,437)
Cash Payments for Resource Conservation	(209,011)	(230,339)
Cash Payments for Economic Development and In Lieu of Property Taxes	(916,599)	(530,441)
Payments Received From Leasing of Facilities	2,120,848	2,082,204
	<b>3,396,064</b>	<b>2,397,614</b>
<b>Cash Flows From Capital and Related Financing Activities:</b>		
Acquisition & Construction of Property and Equipment	(3,806,259)	(4,271,430)
Proceeds from Revenue Bond	-	8,973,554
Revenue Bond Principal Repayment	(1,130,000)	(5,225,000)
Proceeds from Sale of Capital Assets	1,258	22,125
Interest Paid	(269,975)	(343,593)
	<b>(5,204,976)</b>	<b>(844,344)</b>
<b>Cash Flows From Investing Activities:</b>		
Payments Received on Note Receivable -City of Spencer	95,000	25,000
Loan Advances for Note Receivable -City of Spencer	(287,500)	-
Payments Received on Note Receivables - Communications	1,000,000	2,000,000
Proceeds From Redemption of Investments	5,025,244	3,750,000
Purchase of Investments	(4,025,000)	(4,787,633)
Interest Received From Investments	138,476	251,516
	<b>1,946,220</b>	<b>1,238,883</b>
<b>Net Cash Provided By Investing Activities</b>	<b>1,946,220</b>	<b>1,238,883</b>
<b>Net Increase in Cash</b>	<b>137,308</b>	<b>2,792,153</b>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>7,806,611</b>	<b>5,014,458</b>
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 7,943,919</b>	<b>\$ 7,806,611</b>
<b>Reconciliation:</b>		
<b>Cash and Cash Equivalents</b>		
Unrestricted	\$ 1,655,125	\$ 1,600,674
Restricted	213,859	130,112
Board Designated	6,000,000	5,998,930
Consumer Deposits	74,935	76,895
	<b>\$ 7,943,919</b>	<b>\$ 7,806,611</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>Reconciliation of Operating (Loss) to Net Cash Provided by Operating Activities</b>		
Operating (Loss)	\$ (1,007,246)	\$ (1,018,248)
<b>Adjustments to Reconcile Operating (Loss) to Net Cash Provided By Operating Activities</b>		
Depreciation and Amortization	2,545,039	2,468,227
Leased Facilities Income	2,120,848	2,082,204
Contributions Paid for Economic Development	(107,188)	(54,362)
Payment in Lieu of Property Taxes	(809,411)	(476,079)
Payment for Resource Conservation	(209,011)	(230,339)
(Increase) Decrease in Operating Assets:		
Accounts Receivable	181,088	(596,757)
Unbilled Usage	1,856	244,611
Materials and Supplies Inventory	(14,648)	37,008
Fuel Inventory	(88,112)	(92,667)
Prepayments	51,138	(16,382)
Increase (Decrease) in Operating Liabilities:		
Accounts Payable	720,707	20,610
Accrued Payroll and Compensated Absences	2,540	11,927
Consumer Deposits	(1,960)	2,184
Deferred Revenue	-	3,700
Net OPEB Liability	10,424	11,977
Total Adjustments	4,403,310	3,415,862
<b>Net Cash Provided By Operating Activities</b>	\$ 3,396,064	\$ 2,397,614

See Accompanying Notes to Financial Statements

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

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

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

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

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes.

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

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

**B. Capital Assets and Depreciation**

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new electric facilities. In addition, net interest costs on construction debt are capitalized. During 2012, the Utility had \$19,749 of interest expense that was capitalized from the scrubber construction on George Neal Generating Station Unit No. 4 from 2011 Revenue Bond financing.

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.215% undivided interest in a 644 MW electric generation station known as George Neal Generating Station Unit No. 4. The Electric Utility's 1.215% ownership interest in this plant represents a total investment of \$7,067,980 included in utility plant in service with \$4,348,539 included in accumulated depreciation. Operating costs associated with this plant and depreciation are reflected in the statement of income.

Under a joint ownership agreement with other utilities, the Electric Utility has a 1.14% undivided interest in a 790 MW electric generation station known as Walter Scott, Jr. Energy Center Unit 4, which was placed in service in 2007. The Electric Utility's 1.14% ownership interest in this plant represents a total investment of \$15,906,311 included in utility plant in service with \$2,354,070 included in accumulated depreciation. Operating costs associated with this plant and depreciation are reflected in the statement of income.

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

Depreciation is provided on a straight-line basis. Current depreciation expense is approximately 2.50% of the original cost of depreciable electric plant in service. MidAmerican Energy had expected life studies conducted on its plants and based on the results the life was extended from 33 to 40 years.

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

Infrastructure	20-40 years
Building and improvements	20 years
Equipment	5 years

**C. Accounts Receivable**

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

**D. Inventories**

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

**E. Unamortized Bond Issue Costs**

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

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**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**F. Net Position**

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

**G. Income Taxes**

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

**H. Revenues and Unbilled Usage**

Revenues are based on billing rates, which are applied to customers' consumption of electricity. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2012 and 2011, totaled \$223,914 and \$225,770, respectively.

**I. Estimates**

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

**Note 2 - CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS**

The Utility's deposits in Banks at December 31, 2012 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

The Utility had investments in Iowa Public Agency Investment Trust which are valued at an amortized cost of \$1,038,376 in pursuant to Rule 2a-7 under the Investment Company Act of 1940.

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

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**Note 2 - CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS (Continued)**

Credit Risk – The Utility’s investment in the Iowa Public Agency Investment Trust is unrated.

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

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

Reconciliation of the Utility’s cash and cash equivalents, current investments and noncurrent investments is as follows:

Cash and cash equivalents:	2012	2011
Board designated	\$ 6,000,000	\$ 5,998,930
Consumer Deposits	74,935	76,895
Restricted	213,859	130,112
Unrestricted	1,655,125	1,600,674
Total cash and cash equivalents	7,943,919	7,806,611
Current Investments:		
Restricted	1,525,278	1,750,123
Board designated	1,500,000	1,000,000
Total current investments	3,025,278	2,750,123
Noncurrent investments:		
Unrestricted	628,094	326,706
Board designated	1,000,000	1,501,070
Restricted	2,194,590	3,270,307
Total noncurrent investments	3,822,684	5,098,083
Total cash and cash equivalents and noncurrent investments	\$14,791,881	\$15,654,817

**Note 3 - BOARD DESIGNATED FUNDS**

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

Assets of the funds as of December 31, 2012 and 2011 are summarized as follows:

	2012	2011
	Replacement and Construction Reserve	Replacement and Construction Reserve
Cash and Cash Equivalents	\$ 6,000,000	\$ 5,998,930
Current Investments	1,500,000	1,000,000
Noncurrent Investments	1,000,000	1,501,070
Total	\$ 8,500,000	\$ 8,500,000

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**Note 4 - CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2012 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 142,741	\$ 7,963	\$ -	\$ 150,704
Construction in progress	2,087,572	2,397,544	(266,688)	4,218,428
Total capital assets not being depreciated	2,230,313	2,405,507	(266,688)	4,369,132
Capital assets being depreciated:				
Infrastructure	67,013,926	1,364,276	(34,683)	68,343,519
Buildings and improvements	728,875	-	-	728,875
Equipment	7,233,608	322,120	(42,554)	7,513,174
Total capital assets being depreciated	74,976,409	1,686,396	(77,237)	76,585,568
Less accumulated depreciation	38,233,257	2,518,818	(69,230)	40,682,845
Total capital assets being depreciated - net	36,743,152	(832,422)	(8,007)	35,902,723
Capital assets – net	\$38,973,465	\$1,573,085	\$ (274,695)	\$40,271,855

Capital assets activity for the year ended December 31, 2011 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 123,604	\$ 19,137	\$ -	\$ 142,741
Construction in progress	1,071,725	2,687,798	(1,671,951)	2,087,572
Total capital assets not being depreciated	1,195,329	2,706,935	(1,671,951)	2,230,313
Capital assets being depreciated:				
Infrastructure	64,599,373	2,438,283	(23,730)	67,013,926
Buildings and improvements	728,875	-	-	728,875
Equipment	6,716,190	666,534	(149,116)	7,233,608
Total capital assets being depreciated	72,044,438	3,104,817	(172,846)	74,976,409
Less accumulated depreciation	35,954,304	2,453,406	(174,453)	38,233,257
Total capital assets being depreciated - net	36,090,134	651,411	1,607	36,743,152
Capital assets – net	\$37,285,463	\$3,358,346	\$(1,670,344)	\$38,973,465

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**Note 4 - CAPITAL ASSETS (Continued)**

**Reconciliation of Investment in Capital Assets:**

	2012	2011
Capital Assets (Net of Accumulated)	\$ 40,271,855	\$ 38,973,465
Unamortized Bond Discount	177,540	203,761
Unspent Bond Proceeds	1,737,116	3,038,034
Less: Bonds Payable	(10,596,002)	(11,728,357)
	\$ 31,590,509	\$ 30,486,903

**Construction in Progress**

The Utility projects included in the 2012 Construction in Progress are \$2,341,272 of improvements made to the 520 2<sup>nd</sup> Ave East project; \$1,877,128 of improvements to the George Neal Generating Station Unit No. 4 and \$28 for work begun on 2013 projects.

The Utility projects included in the 2011 Construction in Progress are \$1,530,323 of improvements made to the 520 2<sup>nd</sup> Ave East project; \$293,371 of improvements to the George Neal Generating Station Unit No. 4 scrubber and \$263,878 for uncompleted 2011 projects.

**Note 5 - TRANSFERS IN LIEU OF PROPERTY TAXES/NOTE RECEIVABLE**

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Currently, transfers approximate 5% of gross sales (excluding the energy cost adjustment), less actual property taxes paid (on the George Neal Generating Station Unit No. 4, on the Walter Scott Jr. Unit No. 4, 121 E 7<sup>th</sup> St and 520 2<sup>nd</sup> Avenue East) and returned to the City of Spencer, Iowa. Additionally, funds declared to be surplus can be, and have been, transferred to the City.

During 2007, the Utility loaned the City \$375,000 to fund the economic development loan to Shine Bros. Corp. The City reimburses the Utility in equal payments of \$2,083 without interest, payable monthly. The balance of this note at December 31, 2012 was \$237,500 and December 31, 2011 was \$262,500.

A loan agreement was effective on July 15, 2009 between Spencer Municipal Utilities and the City of Spencer. The City borrowed \$383,430 for the purposes of loaning to Spencer Industries Foundation, Inc. The funds were used to construct an industrial building. The City is to repay the loan the earlier of the sale or lease of the building or by July 15, 2019. Interest will not accrue on the loan until July 15, 2014 at a rate of 3%.

A loan and grant funding agreement was effective on May 10, 2012 between Spencer Municipal Utilities and the City of Spencer. The City of Spencer borrowed \$287,500 for the purpose of substantial expansion of affordable housing located in Stoneybrook First Addition. The loan will be repaid to Spencer Municipal Utilities in installment payments with any unpaid remaining

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**Note 5 - TRANSFERS IN LIEU OF PROPERTY TAXES/NOTE RECEIVABLE (Continued)**

balance to be paid in full no later than September 15, 2015. Spencer Municipal Utilities also granted \$287,500 to the City of Spencer via lieu of tax who in turn contributed the funds to Jobs Trust for the same purpose of providing affordable housing in Stoneybrook First Addition. The balance of this note at December 31, 2012 was \$217,500.

**Note 6 - NOTE RECEIVABLE – MUNICIPAL COMMUNICATIONS UTILITY**

The Board of Trustees has approved an \$8,000,000 line of credit for the Municipal Communications Utility for use in start-up and construction costs related to bringing the Communications Utility into operation. The balance of the line of credit at December 31, 2012 and 2011 was \$0 and \$1,000,000, respectively. Outstanding balances bear interest at a rate of 4.5% per annum.

**Note 7 – BONDS PAYABLE**

Bonds payable activity for the year ended December 31, 2012 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Series 2008 revenue bonds	\$ 2,755,000	\$ -	\$ 645,000	\$ 2,110,000	\$ 670,000
Series 2011 revenue bonds	8,950,000	-	485,000	8,465,000	495,000
Total revenue bonds	\$11,705,000	\$ -	\$1,130,000	\$ 10,575,000	\$1,165,000

Bonds Payable listed on Statement of Net Position include Unamortized Bond Premiums of \$21,002.

During 2011 the 2004 bonds were refinanced into the 2011 bonds to take advantage of low interest rates which resulted in a 1% rate reduction. The remaining \$4,345,000 was borrowed for purchasing additional ownership interest in WS4 as well as covering future construction costs in the N4 scrubber project.

The Series 2008 and 2011 revenue bonds require annual principal payments, due December 1, and semiannual interest payments, due June 1 and December 1. Interest rates throughout the term of the bonds range between 1.5% and 4.6%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

	Series 2008		Series 2011	
	Principal	Interest	Principal	Interest
2013	\$ 670,000	\$ 94,000	\$ 495,000	\$ 166,463
2014	700,000	65,190	505,000	159,038
2015	740,000	34,040	505,000	151,463
2016	-	-	1,080,000	143,888
2017	-	-	1,105,000	127,688
2018-2021	-	-	4,775,000	285,083
Total	\$ 2,110,000	\$ 193,230	\$ 8,465,000	\$ 1,033,623

**MUNICIPAL ELECTRIC UTILITY  
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**Note 7 – BONDS PAYABLE (Continued)**

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

**Revenue Bonds**

The Utility has pledged future utility revenue, net of specified operating expenses, to repay outstanding utility revenue bonds. The bonds are payable solely from the utility's net revenues and are payable through 2021. The total principal and interest remaining to be paid on the bonds is \$12,568,265. Principal and interest due for the current year and total combined utilities net revenues were \$1,425,150 and \$621,194, respectively.

**Restricted Funds**

Outstanding Electric Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the Utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. As of December 31, 2012 the Utility is in compliance with all bond covenant requirements.

At December 31, 2012, the special funds consisted of the following:

	Cash and Cash Equivalents	Current Investments	Noncurrent Investments	Total
Bond Sinking Fund	\$ 208,573	\$ -	\$ -	\$ 208,573
Bond Reserve Fund	17	775,038	457,474	1,232,529
Bond Improvement Fund	-	750,240	-	750,240
Other Restricted Funds	5,269	-	-	5,269
<b>Total Restricted Net Assets</b>	<b>\$ 213,859</b>	<b>\$ 1,525,278</b>	<b>\$ 457,474</b>	<b>\$ 2,196,611</b>

At December 31, 2011, the special funds consisted of the following:

	Cash and Cash Equivalents	Current Investments	Noncurrent Investments	Total
Bond Sinking Fund	\$ 125,617	\$ -	\$ -	\$ 125,617
Bond Reserve Fund	16	775,322	457,474	1,232,812
Bond Improvement Fund	-	750,123	-	750,123
Other Restricted Funds	3,956	-	-	3,956
<b>Total Restricted Net Assets</b>	<b>\$ 129,589</b>	<b>\$ 1,525,445</b>	<b>\$ 457,474</b>	<b>\$ 2,112,508</b>

**MUNICIPAL ELECTRIC UTILITY  
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**Note 7 – BONDS PAYABLE (Continued)**

Monthly deposits into two bond sinking funds are required to establish the amount necessary to pay the next installments of principal and interest on the 2008 and 2011 Electric Revenue Bonds. Bond reserve funds for the 2008 and 2011 Electric Revenue Bonds equaled the required balance at December 31, 2012; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

The bond improvement fund balance at December 31, 2012 equaled the minimum balance required; therefore monthly deposits into the fund are not currently required. These funds are to be used first for principal and interest payments when insufficient funds are available in the sinking and reserve funds and second for extraordinary unbudgeted maintenance expenses or system repairs, renewals and replacements.

**Note 8 - RATE MATTERS**

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

**Note 9 - NUMBER OF METER CONNECTIONS**

The number of meter connections totaled 6,121 and 6,084 at December 31, 2012 and 2011, respectively.

**Note 10 - LEASES**

The Utility leases electrical generation capacity of a jet turbine generator, its share of the Neal 4 plant, its share of the Wisdom 2 plant, and its share of the Walter Scott 4 plant under operating leases to other utilities or their associations. The revenues from such leases are classified as leased facilities. The Utility's investment in these facilities is included in capital assets in service and is set forth as follows:

	<u>2012</u>		<u>2011</u>
Jet turbine generator	\$3,269,202	\$	2,537,488
Neal 4 plant	7,067,980		5,221,156
Wisdom 2 plant	2,314,530		2,314,530
Walter Scott 4 plant	15,906,311		15,905,363
Total	<u>28,558,023</u>		<u>25,978,537</u>
Less accumulated depreciation	<u>(9,613,670)</u>		<u>(8,925,807)</u>
Net investment	<u>\$18,944,353</u>	\$	<u>17,052,730</u>

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**Note 10 – LEASES (Continued)**

The lease of the Neal 4, Walter Scott 4, and Wisdom 2 plant are long-term commitments based on capacity. The amount is determined by formula based on usage and totaled \$0, \$1,058,772 and \$186,127, respectively, in 2012. The leases of the jet turbine generator are both by non-cancelable lease and a variable lease determined by capacity and totaled \$99,836 in 2012 and \$54,987 in 2011. The following is a schedule of future minimum rentals on non-cancelable operating leases on the jet turbine generator as of December 31, 2012:

2013	\$ 65,000
2014	65,000
2015	120,000
2016	120,000
2017	120,000
Total minimum lease payment receivable	\$ 490,000

Beginning in 2016 going forward, the jet turbine operating lease amount will increase based upon the respective year's CPI.

The Utility leases bandwidth, property, and building space to the Water Utility and Communications Utility. The revenues from such leases are classified as leased facilities and totaled \$448,931 and \$436,391 in 2012 and 2011, respectively. The leases are 20-year variable leases based on bandwidth and space utilized. The payable at December 31, 2012 and 2011 was \$0 and \$413,510, respectively.

The Utility leased building space from the Water Utility through December of 2011. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized and totaled \$9,600 in 2011, respectively. The payable at December 31, 2011 was \$9,600.

**Note 11 - RETIREMENT SYSTEM**

**IPERS**

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

Plan members were required to contribute 5.38% through June 30, 2012 and 5.78% presently of their annual salary and the Utility was required to contribute 8.07% through June 30, 2012 and 8.67% presently of annual payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2012, 2011 and 2010 were \$147,601, \$132,694 and \$118,799, respectively, equal to the required contributions for the year.

**Employees Pension Plan**

All full-time employees of the Electric Utility who have completed six months of continuous employment and are 18 years of age are eligible to participate in a 457b Pension Plan

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**Note 11 - RETIREMENT SYSTEM – (Continued)**

administered by Security National Bank. The Utility contributes 8% of the employees' compensation for all employees contributing at least 2% of their salary.

The Electric Utility's contribution to the 457b Pension Plan for 2012 and 2011 totaled \$135,296 and \$137,824, respectively.

**Note 12 – OTHER POST EMPLOYMENT BENEFITS**

*Plan Description.* The Utility operates a single-employer retiree benefit plan which provides medical/prescription drug benefits for retirees and their family.

The medical/prescription drug coverage is provided through a fully-insured plan. Retirees under age 65 pay the same premium for the medical/prescription drug benefit as active employees, which results in an implicit subsidy and an OPEB liability.

*Funding Policy.* The Utility currently finances the retiree benefit plan on a pay-as-you-go basis.

*Annual OPEB Cost and NET OPEB Obligation.* The Utility's annual other post-employment benefit (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years.

The following table shows the components of the Utility's annual OPEB for the year, the amount actually contributed to the plan, and changes in the Utility's net OPEB obligation to the plan:

	<u>2012</u>	<u>2011</u>
Annual required contribution	\$ 26,833	\$ 26,897
Interest on net OPEB obligation	1,677	1,198
Adjustment to annual required contribution	<u>(1,666)</u>	<u>(1,190)</u>
Annual OPEB cost (Expense)	26,844	26,905
Contributions made	<u>(16,420)</u>	<u>(14,928)</u>
Increase in net OPEB obligation	10,424	11,977
Net OPEB obligation – beginning of year	<u>41,925</u>	<u>29,948</u>
Net OPEB obligation – end of year	<u>\$ 52,349</u>	<u>\$ 41,925</u>

The Utility's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2012	\$ 26,844	61%	\$ 52,349
2011	\$ 26,905	55%	\$ 41,925

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**Note 12 – OTHER POST EMPLOYMENT BENEFITS (Continued)**

*Funded Status and Funding Progress.* The funded status of the plan as of December 31, 2012 and 2011 was as follows:

	2012	2011
Actuarial accrued liability (AAL)	\$ 319,016	\$ 320,816
Actuarial value of plan assets	-	-
Unfunded actuarial accrued liability (UAAL)	\$ 319,016	\$ 320,816
Covered payroll (active members)	\$1,605,106	\$1,558,355
UAAL as a percentage of covered payroll	19.9%	20.6%

*Actuarial Methods and Assumptions.* 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. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan 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 plan members to that point and do not explicitly reflect the potential effect of legal or contractual funding limitation. The actuarial methods and assumptions used include techniques that are designed to reduce the effect of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2012 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4% interest discount rate. The projected annual medical trend rate is 9.5%. The ultimate medical trend rate is 4.5%. The medical trend rate is reduced 0.5% each year until reaching the 4.5% ultimate trend rate.

Mortality rates are from the RP-2000 Combined Mortality Table projected to 2010 using Scale AA. The salary increase rate was assumed to be 3% per year. The UAAL is being amortized as a level dollar amount on an open basis over 30 years.

**Note 13 - RISK MANAGEMENT**

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

**MUNICIPAL ELECTRIC UTILITY  
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**Note 14 - RELATED PARTIES**

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

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

Additional related party items are included in Notes 6 and 10.

**Note 15 - COMMITMENTS**

Beginning in 2011, the Electric Utility signed an advertising and signage agreement with the Clay County Regional Event Center. The agreement is effective September 1, 2011 and terminates on August 31, 2014. The annual amount due is \$5,950. A portion of the annual cost is split between the Water and Communications Utility. The Electric Utility is responsible for \$2,677.50 of the annual amount due.

Beginning in 2013, the Electric Utility pledged support to the Iowa Great Lakes Corridor of Opportunity for four years at a level of \$37,500 per year for 2013 and 2014 and \$25,000 for 2015 and 2016. This commitment is subject to annual review by the Utility Board.

Beginning in 2013, the Electric Utility pledged support to Startup City Spencer which is a regional incubator providing access to startup services. The support pledged is for five years at a level of \$5,000 per year.

In late 2012 the following contracts were entered into by the Electric Utility for constructing improvements to the property located at 520 2<sup>nd</sup> Avenue East:

- KCL Engineering: mechanical and electrical engineering contract in the amount of \$28,500, of which \$0 was paid as of December 31, 2012.
- Denison Drywall: removal of exterior finishes, framing and exterior insulation finishing of roof, flashing and trim contract in the amount of \$222,574, of which \$103,968 was paid as of December 31, 2012.
- Midstates Builders, Inc.: excavation, concrete footings, foundation walls and insulation, and installation of brick and cast stone masonry materials contract in the amount of \$129,110, of which \$110,355 was paid as of December 31, 2012.
- Midstates Builders, Inc.: structural framing, 2<sup>nd</sup> floor concrete floor system, concrete foundations and decking contract in the amount of \$397,520, of which \$0 was paid as of December 31, 2012.
- Northwest Glass Company: removal and placement of new doors, windows, hardware, flashing and trim contract in the amount of \$41,793, of which \$0 was paid as of December 31, 2012.
- Christians Sheet Metal: trench drain and rough in plumbing for crew room, shop/wash bay area and north and south parking garage areas in the amount not to exceed \$60,953, of which \$0 was paid as of December 31, 2012.

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**REQUIRED SUPPLEMENTAL INFORMATION**

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
FUNDING PROGRESS FOR THE RETIREE HEALTH PLAN  
REQUIRED SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

Year Ended December 31,	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2008	12/31/2008	\$ -	\$ 133,585	\$ 133,585	0%	\$ 1,648,850	8.1%
2009	12/31/2009	-	142,863	142,863	0%	1,698,315	8.4%
2010	12/31/2010	-	160,019	160,019	0%	1,749,265	9.1%
2011	12/31/2011	-	320,816	320,816	0%	1,558,355	20.6%
2012	12/31/2012	\$ -	\$ 319,016	\$ 319,016	0%	\$ 1,605,106	19.9%

See Note 12 to the accompanying Notes to Financial Statements for the plan description, funding policy, annual OPEB Cost and Net OPEB Obligation, and the funded status and funding progress.

**SUPPLEMENTAL INFORMATION**

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, EXPENDITURES  
AND CHANGES IN NET POSITION - BUDGET AND ACTUAL (CASH BASIS)  
OTHER SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
<b>Receipts:</b>				
Municipal Electric Utility			\$ 14,212,630	
Municipal Water Utility			4,518,834	
Municipal Communications Utility			7,424,509	
Total Receipts	<u>\$ 28,125,407</u>	<u>\$ 28,025,648</u>	<u>26,155,973</u>	<u>\$ (1,869,675)</u>
<b>Expenditures:</b>				
Municipal Electric Utility			15,883,066	
Municipal Water Utility			2,961,454	
Municipal Communications Utility			6,859,155	
Total Expenditures	<u>28,979,297</u>	<u>28,089,649</u>	<u>25,703,675</u>	<u>(2,385,974)</u>
<b>Change in Net Position</b>	(853,890)	(64,001)	452,298	(4,255,649)
<b>Net Position at Beginning of Year</b>	<u>17,221,992</u>	<u>17,765,279</u>	<u>17,765,279</u>	<u>-</u>
<b>Net Position at End of Year</b>	<u>\$ 16,368,102</u>	<u>\$ 17,701,278</u>	<u>\$ 18,217,577</u>	<u>\$ (4,255,649)</u>

See Accompanying Independent Auditors' Report

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGET TO GAAP RECONCILIATION  
OTHER SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

	Cash Basis	Accrual Adjustments	Accrual Basis
<b>Receipts:</b>			
Municipal Electric Utility	\$ 14,212,630	\$ (170,035)	\$ 14,042,595
Municipal Water Utility	4,518,834	(2,443,592)	2,075,242
Municipal Communications Utility	7,424,509	(750,806)	6,673,703
Total Receipts	<u>26,155,973</u>	<u>(3,364,433)</u>	<u>22,791,540</u>
<b>Expenditures:</b>			
Municipal Electric Utility	15,883,066	(1,706,583)	14,176,483
Municipal Water Utility	2,961,454	(1,404,219)	1,557,235
Municipal Communications Utility	6,859,155	(1,013,712)	5,845,443
Total Expenditures	<u>25,703,675</u>	<u>(4,124,514)</u>	<u>21,579,161</u>
<b>Change in Net Position</b>	452,298	760,081	1,212,379
<b>Net Position at Beginning of Year</b>	<u>17,765,279</u>	<u>43,632,395</u>	<u>61,397,674</u>
<b>Net Position at End of Year</b>	<u>\$ 18,217,577</u>	<u>\$ 44,392,476</u>	<u>\$ 62,610,053</u>

See Accompanying Independent Auditors' Report

**MUNICIPAL ELECTRIC UTILITY  
OF THE CITY OF SPENCER, IOWA  
OTHER SUPPLEMENTARY INFORMATION –  
BUDGETARY REPORTING  
YEAR ENDED DECEMBER 31, 2012**

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

Formal and legal budgetary control is based upon nine major classes of expenditures, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, and business type activities. All Utility expenditures are included in business type activities function and are required to be budgeted.

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

Board of Trustees  
Spencer Municipal Utilities – Municipal Electric Utility  
Spencer, Iowa 51301

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 business-type activities of Municipal Electric Utility of the City of Spencer, Iowa (Spencer Municipal Utility), Spencer, Iowa as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements listed in the table of contents, and have issued our report thereon dated April 1, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Spencer Municipal 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Spencer Municipal Utility's internal control. Accordingly, we do not express an opinion on the effectiveness of Spencer Municipal Utility's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and is not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect 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 a material misstatement of the District's financial statements will not be prevented or detected and corrected on a timely basis. We did not consider any deficiencies to be material weaknesses.

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. We consider the deficiency described in the accompanying Schedule of Findings as item 12-II-A to be a significant deficiency.

## **Compliance and Other Matters**

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

## **Spencer Municipal Utility's Response to Findings**

Spencer Municipal Utility's responses to findings identified in our audit are described in the accompanying Schedule of Findings. Spencer Municipal Utility's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

## **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 result 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.

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

Spencer, Iowa  
April 1, 2013

*Williams & Company, P.C.*  
Certified Public Accountants

**SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2012**

**Part I: Summary of the Independent Auditors' Results:**

- (a) An unqualified opinion was issued on the financial statements.
- (b) Significant deficiency in internal control over financial reporting was disclosed by the audit of the financial statements.
- (c) The audit did not disclose any noncompliance, which is material to the financial statements.

**Part II: Findings Related to the General Purpose Financial Statements**

**SIGNIFICANT DEFICIENCY:**

12-II-A Financial Reporting – During the audit, we identified immaterial amounts of accrued compensated absences and accrued property taxes not initially identified by Spencer Municipal Utility's internal control. These amounts were either not recorded or not properly recorded in Spencer Municipal Utility's financial statements. Adjustments were subsequently made by Spencer Municipal Utility, if applicable, to properly include or reclassify these amounts in the financial statements.

Recommendation – Spencer Municipal Utility should implement procedures to ensure all accounts are properly identified, classified, and included in Spencer Municipal Utility's financial statements.

Response – We will revise our current procedures to ensure the proper amounts are recorded in the financial statements in the future.

Conclusion - Response accepted.

**INSTANCES OF NONCOMPLIANCE:**

No matters were reported.

**SPENCER MUNICIPAL UTILITIES  
MUNICIPAL ELECTRIC UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2012**

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

III-A-12 Certified Budget – Disbursements during the year ended December 31, 2012 did not exceed the amounts budgeted in the business type activities function.

III-B-12 Questionable Expenditures – No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General’s opinion dated April 25, 1979.

III-C-12 Travel Expenses – No expenditures of the Utility’s money for travel expenses of spouses of Utility’s officials or employees were noted.

III-D-12 Business Transactions – Business transactions between Utility and Utility officials and employees are detailed as follows:

<u>Name, Title and Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
Michael Morisch, SMU employee Morisch Maintenance Services	1.5 Self Dumping Dumpster Welding table with 6” vise	\$ 535 \$ 535
Dave Hultgren, Board Member Owner, Northwest Equipment	Maintenance & Repairs	\$ 137

(1) These transactions do not appear to represent a conflict of interest since the total transaction was less than \$1,500 during the year, per Chapter 362.5(10) of the Code of Iowa.

III-E-12 Bond Coverage – Surety bond coverage of Spencer Municipal Utilities’ officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

III-F-12 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

III-G-12 Revenue Bonds – As of December 31, 2012 the Utility is in compliance with all bond covenant requirements.

III-H-12 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility’s investment policy were noted.

**SPENCER MUNICIPAL UTILITIES**

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

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## INDEPENDENT AUDITORS' REPORT

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of The Municipal Water Utility of the City of Spencer, Iowa (the Utility), as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Utility's basic 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.

### *Auditor's Responsibility*

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

### *Opinions*

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Utility as of December 31, 2012 and 2011 and the respective changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

***Other Matters***

***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Funding Progress for the Retiree Health Plan information on pages 36 through 39 and page 56 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 Information***

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Utility's basic financial statements. The supplementary information on pages 57 through 59 is presented for purposes of additional analysis and is not a required part of the financial statements.

The supplementary 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 information is fairly stated in all material respects in relation to the financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 1, 2013 on our consideration of the 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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Utility's internal control over financial reporting and compliance.

*Williams + Company, P.C.*  
Certified Public Accountants

Spencer, Iowa  
April 1, 2013

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of management's discussion and analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Water Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2012 and 2011.

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

### **2012 Financial Highlights**

The Utility delivered approximately 428,173,000 gallons of water to its retail customers in 2012 compared to approximately 418,896,000 gallons in 2011.

The Utility's net position increased by \$518,007 to \$7,619,710 as a result of operations for the year ended December 31, 2012.

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

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).

The statements of revenues, expenses and changes in net position report all revenues and expenses incurred during the fiscal year.

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.

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Condensed Financial Information

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

#### Condensed Statements of Net Position

	<u>2012</u>	<u>2011</u>
Current assets	\$ 4,177,490	\$2,519,281
Capital assets, net of depr.	7,112,911	6,165,579
Deferred costs	<u>62,865</u>	<u>6,976</u>
Total assets	<u>11,353,266</u>	<u>8,691,836</u>
Current liabilities	1,355,148	770,076
Noncurrent liabilities	11,591	9,057
Long-term debt	<u>2,366,817</u>	<u>811,000</u>
Total liabilities	<u>3,733,556</u>	<u>1,590,133</u>
Investments in capital assets, net of related debt	4,581,094	5,280,579
Restricted	349,867	174,557
Unrestricted	<u>2,688,749</u>	<u>1,646,567</u>
Total net position	<u>\$7,619,710</u>	<u>\$7,101,703</u>

#### Condensed Statements of Revenues, Expenses and Changes in Net Position

Sales of water	\$1,964,894	\$1,748,373
Other	<u>13,595</u>	<u>8,575</u>
Total operating revenue	<u>1,978,489</u>	<u>1,756,948</u>
System operation & maintenance	736,605	780,908
Depreciation & amortization	505,367	442,294
Customer service & administration	<u>192,122</u>	<u>186,460</u>
Total operating expenses	<u>1,434,094</u>	<u>1,409,662</u>
Operating income	544,395	347,286
Interest income	4,879	7,446
Interest expense	(33,773)	(31,183)
Other income (expense)	<u>2,506</u>	<u>(16,394)</u>
Total non-operating (expenses)	<u>(26,388)</u>	<u>(40,131)</u>
Change in net position	518,007	307,155
Net position, beginning of year	<u>7,101,703</u>	<u>6,794,548</u>
Net position, end of year	<u>\$7,619,710</u>	<u>\$7,101,703</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### **Financial Analysis**

The Utility's net position increased by approximately \$518,000.

The Utility's gross revenues increased by approximately \$221,500 or 13%. Outside water sales were higher in 2012 by approximately 22 million gallons or 30%. In addition, rates were increased effective with September 2012 consumption.

System operation & maintenance expenses decreased by approximately \$44,000 in 2012 compared to 2011. In 2012, distribution costs, meter purchases, cost to locate and power costs increased by approximately \$110,000 compared to 2011. However, in 2011 \$144,000 of extraordinary cost was incurred to abandon a well. In removing the extraordinary well abandonment cost from the comparison, 2012 operating expenses were higher by approximately \$100,000.

Total operating income generated in 2012 was \$544,395 compared to a \$347,286 gain in 2011.

Contributions in Aid of Construction totaled \$2,914 for the year ended December 31, 2012 compared to \$0 for the year ended December 31, 2011.

The Utility had a net profit of \$518,007 for the year ended December 31, 2012 compared to a net profit of \$307,155 for the year ended December 31, 2011.

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

Net capital assets increased by approximately \$947,000 in 2012 compared to 2011. The increase was due to the completion of water main projects, replacement as well as new main, which included 13,480 lineal feet of 6", 8", 10" and 12" water main during the year ended December 31, 2012.

On June 28, 2012 the Utility issued \$2,530,000 in Revenue Bonds. The funds were used to refinance the existing loan, \$811,000 and reduce the interest rate by 0.91%. The bond funds were also used to recover \$604,000 of 2011 water main project costs and the cost of the 1.5 million gallon tank project that was paid out of the Utility's cash. The remaining bond funds were used to increase the required bond reserve fund by \$100,585 as well as cover \$958,000 of main improvement costs in addition to bond financing fees.

In late 2012, the utility entered into an agreement with Bolton & Menk to conduct a water plant evaluation. The purpose of the study is to identify areas that need improvement from a reliability standpoint as well as increasing the treatment capacity of the plant. The utility also entered into an agreement with Leggette, Brashears & Graham, Inc. ("LBG") to conduct a review of the well field to identify future well capacity requirements, well locations as well as overall management of the aquifer.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### **Economic Factors**

During the year ended December 31, 2012, the Utility experienced a net profit of \$518,007. The rate adjustment effective with consumption beginning September 1, 2012 in addition to higher than normal outside water usage allowed the Utility sufficient coverage of operational and non-operational expenses. Management will continue to monitor the operations of the Utility in addition to projected capital expenditures and propose rate adjustments accordingly.

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

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

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**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF NET POSITION  
DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents		
Unrestricted	\$ 1,544,354	\$ 162,284
Board Designated	1,579,106	1,579,106
Restricted	349,867	174,557
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$2,500 and \$2,500)	572,285	487,797
Unbilled Usage	32,864	31,985
Materials and Supplies Inventory	86,981	74,211
Prepayments and Other	12,033	9,341
<b>Total Current Assets</b>	<b>4,177,490</b>	<b>2,519,281</b>
<b>Capital Assets:</b>		
Land	359,081	258,533
Construction in Progress	320,406	58,504
Plant in Service	14,312,980	13,225,740
Accumulated Depreciation	(7,879,556)	(7,377,198)
<b>Total Capital Assets</b>	<b>7,112,911</b>	<b>6,165,579</b>
<b>Noncurrent Assets:</b>		
Unamortized Bond Issue Costs	62,865	6,976
<b>Total Noncurrent Assets</b>	<b>62,865</b>	<b>6,976</b>
<b>Total Assets</b>	<b>\$ 11,353,266</b>	<b>\$ 8,691,836</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF NET POSITION  
DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts Payable	\$ 1,145,890	\$ 670,478
Payroll and Sales Tax Payable	10,370	9,753
Accrued Payroll and Compensated Absences	15,352	11,444
Accrued Interest Payable	18,536	4,401
Current Maturities of Long-Term Debt	165,000	74,000
	1,355,148	770,076
<b>Noncurrent Liabilities:</b>		
Bonds Payable	2,531,817	885,000
Less - Current Maturities	(165,000)	(74,000)
Net OPEB Liability	11,591	9,057
	2,378,408	820,057
<b>Total Liabilities</b>	<b>3,733,556</b>	<b>1,590,133</b>
<b>NET POSITION</b>		
<b>Net Position</b>		
Invested in Capital Assets, Net of Related Debt	4,581,094	5,280,579
Restricted	349,867	174,557
Unrestricted	2,688,749	1,646,567
	\$ 7,619,710	\$ 7,101,703
<b>Total Net Position</b>	<b>\$ 7,619,710</b>	<b>\$ 7,101,703</b>

See Accompanying Notes to Financial Statements

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**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF REVENUES, EXPENSES AND  
CHANGES IN NET POSITION  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>Operating Revenues:</b>		
Residential	\$ 1,380,430	\$ 1,237,324
Commercial	584,464	511,049
Service Permits	11,150	5,975
Miscellaneous	2,445	2,600
	<b>1,978,489</b>	<b>1,756,948</b>
<b>Operating Expenses:</b>		
Treatment	385,000	548,330
Distribution	351,605	232,578
Depreciation and Amortization	505,367	442,294
Customer Operations	37,031	26,110
General and Administrative	155,091	160,350
	<b>1,434,094</b>	<b>1,409,662</b>
<b>Operating Income</b>	<b>544,395</b>	<b>347,286</b>
<b>Non-Operating Income (Expense):</b>		
Interest Income on Investments	4,879	7,446
Contributions From Developers	2,914	-
Resource Conservation	(52)	4,889
Leased Facilities	88,230	35,715
Interest Expense	(33,773)	(29,959)
Bond Amortization Expense	-	(1,224)
Inventory Sales	730	280
Gain on Plant Retirements	-	15,940
Payment in Lieu of Property Taxes	(89,316)	(73,218)
	<b>(26,388)</b>	<b>(40,131)</b>
<b>Change in Net Position</b>	<b>518,007</b>	<b>307,155</b>
<b>Net Position at Beginning of Year</b>	<b>7,101,703</b>	<b>6,794,548</b>
<b>Net Position at End of Year</b>	<b>\$ 7,619,710</b>	<b>\$ 7,101,703</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	<u>2012</u>	<u>2011</u>
<b>Cash Flows From Operating Activities:</b>		
Cash Received From Customers	\$ 1,893,122	\$ 1,643,630
Cash Payments to Suppliers for Goods and Services	(84,850)	(479,688)
Cash Payments to Employees for Services	(376,868)	(354,168)
Cash Payments In Lieu of Property Taxes	(89,316)	(73,218)
Cash Payments for Resource Conservation	(52)	4,889
Payments Received From Leasing of Facilities	88,230	35,715
	<hr/>	<hr/>
<b>Net Cash Provided By Operating Activities</b>	<b>1,430,266</b>	<b>777,160</b>
<b>Cash Flows From Capital and Related Financing Activities:</b>		
Acquisition & Construction of Property and Equipment	(1,505,673)	(822,182)
Proceeds from Revenue Bond	2,531,873	-
Proceeds from Sale of Capital Assets	-	21,100
Revenue Bond Principal Repayment	(885,000)	(72,000)
Payments Received From Sale of Inventory	730	280
Interest Paid	(19,695)	(31,649)
	<hr/>	<hr/>
<b>Net Cash Provided (Used) By Capital and Related Financing Activities</b>	<b>122,235</b>	<b>(904,451)</b>
<b>Cash Flows From Investing Activities:</b>		
Interest Received From Investments	4,879	7,446
	<hr/>	<hr/>
<b>Net Cash Provided By Investing Activities</b>	<b>4,879</b>	<b>7,446</b>
	<hr/>	<hr/>
<b>Net Increase (Decrease) in Cash</b>	<b>1,557,380</b>	<b>(119,845)</b>
	<hr/>	<hr/>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>1,915,947</b>	<b>2,035,792</b>
	<hr/>	<hr/>
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 3,473,327</b>	<b>\$ 1,915,947</b>
	<hr/> <hr/>	<hr/> <hr/>
<b>Reconciliation:</b>		
<b>Cash and Cash Equivalents</b>		
Unrestricted	\$ 1,544,354	\$ 162,284
Restricted	349,867	174,557
Board Designated	1,579,106	1,579,106
	<hr/>	<hr/>
	<b>\$ 3,473,327</b>	<b>\$ 1,915,947</b>
	<hr/> <hr/>	<hr/> <hr/>

See Accompanying Notes to Financial Statements

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating Income	\$ 544,395	\$ 347,286
<b>Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities</b>		
Depreciation and Amortization	505,367	442,294
Leased Facilities Income	88,230	35,715
Payment in Lieu of Property Taxes	(89,316)	(73,218)
Payment for Resource Conservation	(52)	4,889
(Increase) Decrease in Operating Assets:		
Accounts Receivable	(84,488)	(151,326)
Unbilled Usage	(879)	38,008
Materials and Supplies Inventory	(12,770)	(3,391)
Prepayments	(2,692)	(353)
Increase (Decrease) in Operating Liabilities:		
Accounts Payable	475,412	138,216
Accrued Payroll and Compensated Absences	4,525	(3,459)
Net OPEB Liability	2,534	2,499
Total Adjustments	885,871	429,874
<b>Net Cash Provided By Operating Activities</b>	<b>\$ 1,430,266</b>	<b>\$ 777,160</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

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

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

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

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes.

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

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

**B. Capital Assets and Depreciation**

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

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

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Depreciation is provided on a straight-line basis. Depreciation expense is approximately 3.43% of the original cost of depreciable water plant in service.

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

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

**C. Accounts Receivable**

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

**D. Inventories**

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

**E. Unamortized Bond Issue Costs**

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

**F. Net Position**

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

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

**G. Income Taxes**

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

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**H. Revenues and Unbilled Usage**

Revenues are based on billing rates, which are applied to customers' consumption of water. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2012 and 2011 totaled \$32,864 and \$31,985, respectively.

**I. Estimates**

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

**Note 2 - CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS**

The Utility's deposits in bank at December 31, 2012 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

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

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

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

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

Cash and cash equivalents:	2012	2011
Board designated	\$ 1,579,106	\$ 1,579,106
Restricted	349,867	174,557
Unrestricted	<u>1,544,354</u>	<u>162,284</u>
Total cash and cash equivalents	<u>\$ 3,473,327</u>	<u>\$ 1,915,947</u>

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 3 - BOARD DESIGNATED FUNDS**

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

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

Assets of the funds as of December 31, 2012 and 2011 are summarized as follows:

	Contingency Reserve	Replacement and Construction Reserve	Total
Cash and cash equivalents	\$ 469,106	\$ 1,110,000	\$ 1,579,106
Total	<u>\$ 469,106</u>	<u>\$ 1,110,000</u>	<u>\$ 1,579,106</u>

**Note 4 - CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2012 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 258,533	\$ 100,548	\$ -	\$ 359,081
Construction in progress	58,504	320,406	(58,504)	320,406
Total capital assets not being depreciated	<u>317,037</u>	<u>420,954</u>	<u>(58,504)</u>	<u>679,487</u>
Capital assets being depreciated:				
Infrastructure	8,157,204	1,030,631	-	9,187,835
Buildings and equipment	4,803,606	55,530	-	4,859,136
Vehicles	264,930	1,079	-	266,009
Total capital assets being depreciated	<u>13,225,740</u>	<u>1,087,240</u>	<u>-</u>	<u>14,312,980</u>
Less accumulated depreciation	<u>7,377,198</u>	<u>502,358</u>	<u>-</u>	<u>7,879,556</u>
Total capital assets being depreciated - net	<u>5,848,542</u>	<u>584,882</u>	<u>-</u>	<u>6,433,424</u>
Capital assets - net	<u>\$ 6,165,579</u>	<u>\$ 1,005,836</u>	<u>\$ (58,504)</u>	<u>\$ 7,112,911</u>

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 4 - CAPITAL ASSETS (Continued)**

Capital assets activity for the year ended December 31, 2011 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 258,533	\$ -	\$ -	\$ 258,533
Construction in progress	103,734	58,504	(103,734)	58,504
Total capital assets not being depreciated	362,267	58,504	(103,734)	317,037
Capital assets being depreciated:				
Infrastructure	7,797,308	359,896	-	8,157,204
Buildings and equipment	4,407,091	396,515	-	4,803,606
Vehicles	208,229	111,000	(54,299)	264,930
Total capital assets being depreciated	12,412,628	867,411	(54,299)	13,225,740
Less accumulated depreciation	6,984,043	442,295	(49,140)	7,377,198
Total capital assets being depreciated - net	5,428,585	425,116	(5,159)	5,848,542
Capital assets - net	\$ 5,790,852	\$ 483,620	\$(108,893)	\$ 6,165,579

**Reconciliation of Investment in Capital Assets:**

	<u>2012</u>	<u>2011</u>
Capital Assets (Net of Accumulated)	\$ 7,112,911	\$ 6,165,579
Less: Bonds Payable	(2,531,817)	(885,000)
	<u>\$ 4,581,094</u>	<u>\$ 5,280,579</u>

**Construction in Progress**

The Utility projects included in the 2012 Construction in Progress are \$55,866 for new well and water plant improvements and \$264,540 of new and replacement water main improvement projects.

The Utility projects included in the 2011 Construction in Progress are \$58,504 of new and replacement water main improvement projects.

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 5 - SEWER, STORM WATER, AND SOLID WASTE**

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

**Note 6 - TRANSFERS IN LIEU OF PROPERTY TAXES**

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

**Note 7 - BONDS PAYABLE**

Bonds payable activity for the year ended December 31, 2012 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 2012 revenue bonds	\$ -	\$2,530,000	\$ -	\$2,530,000	\$ 165,000
Series 2000 revenue bonds	885,000	-	885,000	-	-
<b>Total</b>	<b>\$ 885,000</b>	<b>\$2,530,000</b>	<b>\$ 885,000</b>	<b>\$2,530,000</b>	<b>\$ 165,000</b>

Bonds payable activity for the year ended December 31, 2011 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 2000 revenue bonds	\$ 957,000	\$ -	\$ 72,000	\$ 885,000	\$ 74,000

Bond payable listed on Statement of Net Position includes Unamortized Bond Premiums of \$1,817.

The Series 2012 revenue bonds require annual principal payments, due November 1, and semiannual interest payments, due May 1 and November 1. Interest rate through May 1, 2015 is 1.000%. Effective May 1, 2015 the rate is 1.150% and increases annually throughout the term of the bonds with a final rate of 2.600%. The bonds are secured by the future net revenues of the Utility. Long-term debt matures and bears interest as follows:

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 7 – BONDS PAYABLE (Continued)**

	Series 2012	
	Principal	Interest
2013	\$ 165,000	\$ 55,202
2014	160,000	42,875
2015	165,000	41,250
2016	165,000	39,476
2017	170,000	37,423
2018-2022	900,000	144,424
2023-2026	805,000	41,307
Total	\$ 2,530,000	\$ 401,957

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

**Revenue Bonds**

The Utility has pledged future utility revenue, net of specified operating expenses, to repay outstanding utility revenue bonds. The bonds are payable solely from the utility's net revenues and are payable through 2026. The total principal and interest remaining to be paid on the bonds is \$2,931,957. Principal and interest paid for the current year and total combined utilities net revenues were \$94,138 and 1,049,711, respectively.

**Restricted Funds**

Outstanding Water Revenue Bonds are collateralized by the revenue of the Utility and the various special funds established by bond covenants. The covenants provide that the revenue of the Utility is to be used first to pay operating and maintenance expenses of the system and second to establish and maintain the special funds. Remaining revenues may then be used for any lawful purpose. The covenants also contain provisions which, among other items, restrict the issuance of additional revenue bonds unless the special funds noted above contain the required amounts and certain financial ratios are met. As of December 31, 2012 and 2011 the Utility is in compliance with all bond covenant requirements except the Net Revenue requirement.

The special funds consisted of the following:

	2012	2011
Bond Sinking Fund	\$ 134,282	\$ 59,557
Bond Reserve Fund	215,585	115,000
Total	\$ 349,867	\$ 174,557

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 7 – BONDS PAYABLE (Continued)**

Monthly deposits into the bond sinking fund are required to establish the amount necessary to pay the next installments of principal and interest. The bond reserve fund at December 31, 2012 and 2011 equaled the required balance; therefore monthly deposits into the fund are not currently required. These funds may be used to pay principal and interest payments when insufficient funds are available in the sinking fund.

**Note 8 - RATE MATTERS**

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

**Note 9 - NUMBER OF METER CONNECTIONS**

The number of meter connections totaled 5,884 and 5,850 at December 31, 2012 and 2011, respectively.

**Note 10 - LEASES**

The Utility leases building space to the Electric Utility and Communications Utility. The revenues from such leases are classified as leased facilities. The leases are monthly leases based on building space utilized and totaled \$0 in 2012 and \$11,968 in 2011. The receivable at December 31, 2011 was \$11,968. Effective January 2012 the Utility entered into a 6 month lease with month to month option thereafter. The lease is a monthly lease and totaled \$60,000 in 2012 of which \$0 was receivable at December 31, 2012.

The Utility lease bandwidth and building space from the Electric and Communications Utilities. The expense from such leases is classified as operating expense. The lease is a 20-year variable lease based on bandwidth and space utilized and totaled \$23,418 and \$23,418 in 2012 and 2011. The payable at December 31, 2012 and 2011 was \$0 and \$23,418, respectively.

**IPERS**

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

Plan members were required to contribute 5.38% through June 30, 2012 and 5.78% presently of their annual salary and the Utility was required to contribute 8.07% through June 30, 2012 and 8.67% presently of annual payroll. Contribution requirements are established by State statute.

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 11 - RETIREMENT SYSTEM – (Continued)**

The Utility's contributions to IPERS for the years ended December 31, 2012, 2011 and 2010 were \$22,456, \$17,817 and \$19,567, respectively, equal to the required contributions for each year.

**Employees Pension Plan**

All full-time employees of the Water Utility who have completed six months of continuous employment and are 18 years of age are eligible to participate in a 457b Pension Plan administered by Security National Bank. The Utility contributes 8% of the employees' compensation for all employees contributing at least 2% of their salary.

The Water Utility's contribution to the Money Accumulation Pension Plan for 2012 and 2011 totaled \$21,416 and \$16,258, respectively.

**Note 12 – OTHER POST EMPLOYMENT BENEFITS**

*Plan Description.* The Utility operates a single-employer retiree benefit plan which provides medical/prescription drug benefits for retirees and their family.

The medical/prescription drug coverage is provided through a fully-insured plan. Retirees under age 65 pay the same premium for the medical/prescription drug benefit as active employees, which results in an implicit subsidy and an OPEB liability.

*Funding Policy.* The Utility currently finances the retiree benefit plan on a pay-as-you-go basis.

*Annual OPEB Cost and NET OPEB Obligation.* The Utility's annual other post-employment benefit (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years.

The following table shows the components of the Utility's annual OPEB for the year, the amount actually contributed to the plan, and changes in the Utility's net OPEB obligation to the plan:

	<u>2012</u>	<u>2011</u>
Annual required contribution	\$ 2,531	\$ 2,498
Interest on net OPEB obligation	363	262
Adjustment to annual required contribution	<u>(360)</u>	<u>(261)</u>
Annual OPEB cost (Expense)	2,534	2,499
Contributions made	<u>0</u>	<u>(0)</u>
Increase in net OPEB obligation	2,534	2,499
Net OPEB obligation – beginning of year	<u>9,057</u>	<u>6,558</u>
Net OPEB obligation – end of year	<u>\$ 11,591</u>	<u>\$ 9,057</u>

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
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**Note 12 – OTHER POST EMPLOYMENT BENEFITS (Continued)**

The Utility's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2012	\$ 2,534	0%	\$ 11,591
2011	\$ 2,499	0%	\$ 9,057

*Funded Status and Funding Progress.* The funded status of the plan as of December 31, 2012 was as follows:

	2012	2011
Actuarial accrued liability (AAL)	\$15,921	\$14,137
Actuarial value of plan assets	-	-
Unfunded actuarial accrued liability (UAAL)	\$15,921	\$14,137
Covered payroll (active members)	\$266,434	\$258,674
UAAL as a percentage of covered payroll	6.0%	5.5%

*Actuarial Methods and Assumptions.* 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. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan 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 plan members to that point and do not explicitly reflect the potential effect of legal or contractual funding limitation. The actuarial methods and assumptions used include techniques that are designed to reduce the effect of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2012 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4% interest discount rate. The projected annual medical trend rate is 9.5%. The ultimate medical trend rate is 4.5%. The medical trend rate is reduced 0.5% each year until reaching the 4.5% ultimate trend rate.

Mortality rates are from the RP-2000 Combined Mortality Table projected to 2010 using Scale AA. The salary increase rate was assumed to be 3% per year. The UAAL is being amortized as a level dollar amount on an open basis over 30 years.

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 13 - RISK MANAGEMENT**

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

**Note 14 - RELATED PARTIES**

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

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

Additional related party items are included in Note 10.

**Note 15 - COMMITMENTS**

Spencer Municipal Utilities entered into an agreement with Beck Excavating, Inc., in April 2012. The contract is in the amount of \$181,801 for improvements to water mains located by West 3<sup>rd</sup> Street and 4<sup>th</sup> Avenue West. The improvements included main replacement of approximately 1,142 lineal feet of 12" pipe and 10 lineal feet of 6" pipe. Project completion should occur no later than July 31, 2013.

Spencer Municipal Utilities entered into an agreement with Valley Contracting, Inc., in August 2012. The contract is in the amount of \$160,394 for improvements to water mains located by West 3<sup>rd</sup> Street from 2<sup>nd</sup> Avenue West to 4<sup>th</sup> Avenue West. The improvements included main replacement of approximately 1,200 lineal feet of 12" pipe. Project completion should occur no later than November 15, 2013.

Beginning in 2011, the Water Utility signed an advertising and signage agreement with the Clay County Regional Event Center. The agreement is effective September 1, 2011 and terminates on August 31, 2014. The annual amount due is \$5,950. A portion of the annual cost is split between the Electric and Communications Utility. The Water Utility is responsible for \$595 of the annual amount due.

In September of 2012, the utility entered into an agreement with Bolton & Menk, Inc. to conduct a water plant evaluation. The purpose of the study is to identify areas that need improvement from a reliability standpoint as well as increasing the treatment capacity of the plant. The cost of services is not to exceed \$70,000.

The utility also entered into an agreement in November of 2012 with Leggette, Brashears & Graham, Inc. ("LBG") to conduct a review of the well field to identify future well capacity requirements, well locations as well as overall management of the aquifer. The estimated cost is \$37,680 up to \$45,000 depending on the well size for the test well drilling.

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**REQUIRED SUPPLEMENTAL INFORMATION**

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
FUNDING PROGRESS FOR THE RETIREE HEALTH PLAN  
REQUIRED SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

Year Ended December 31,	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2008	12/31/2008	\$ -	\$ 11,713	\$ 11,713	0%	\$ 360,103	3.3%
2009	12/31/2009	-	13,726	13,726	0%	370,906	3.7%
2010	12/31/2010	-	16,680	16,680	0%	382,033	4.4%
2011	12/31/2011	-	14,137	14,137	0%	258,674	5.5%
2012	12/31/2012	\$ -	\$ 15,921	\$ 15,921	0%	\$ 266,434	6.0%

See Note 12 to the accompanying Notes to Financial Statements for the plan description, funding policy, annual OPEB Cost and Net OPEB Obligation, and the funded status and funding progress.

**SUPPLEMENTAL INFORMATION**

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, EXPENDITURES  
AND CHANGES IN NET POSITION - BUDGET AND ACTUAL (CASH BASIS)  
OTHER SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
<b>Receipts:</b>				
Municipal Electric Utility			\$ 14,212,630	
Municipal Water Utility			4,518,834	
Municipal Communications Utility			7,424,509	
Total Receipts	\$ 28,125,407	\$ 28,025,648	26,155,973	\$ (1,869,675)
<b>Expenditures:</b>				
Municipal Electric Utility			15,883,066	
Municipal Water Utility			2,961,454	
Municipal Communications Utility			6,859,155	
Total Expenditures	28,979,297	28,089,649	25,703,675	(2,385,974)
<b>Change in Net Position</b>	(853,890)	(64,001)	452,298	(4,255,649)
<b>Net Position at Beginning of Year</b>	17,221,992	17,765,279	17,765,279	-
<b>Net Position at End of Year</b>	\$ 16,368,102	\$ 17,701,278	\$ 18,217,577	\$ (4,255,649)

See Accompanying Independent Auditors' Report

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGET TO GAAP RECONCILIATION  
OTHER SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

	Cash Basis	Accrual Adjustments	Accrual Basis
<b>Receipts:</b>			
Municipal Electric Utility	\$ 14,212,630	\$ (170,035)	\$ 14,042,595
Municipal Water Utility	4,518,834	(2,443,592)	2,075,242
Municipal Communications Utility	7,424,509	(752,107)	6,673,703
Total Receipts	<u>26,155,973</u>	<u>(3,365,734)</u>	<u>22,791,540</u>
<b>Expenditures:</b>			
Municipal Electric Utility	15,883,066	(1,706,583)	14,176,483
Municipal Water Utility	2,961,454	(1,404,219)	1,557,235
Municipal Communications Utility	6,859,155	(1,015,013)	5,845,443
Total Expenditures	<u>25,703,675</u>	<u>(4,125,815)</u>	<u>21,579,161</u>
<b>Change in Net Position</b>	452,298	760,081	1,212,379
<b>Net Position at Beginning of Year</b>	<u>17,765,279</u>	<u>43,632,395</u>	<u>61,397,674</u>
<b>Net Position at End of Year</b>	<u>\$ 18,217,577</u>	<u>\$ 44,392,476</u>	<u>\$ 62,610,053</u>

See Accompanying Independent Auditors' Report

**MUNICIPAL WATER UTILITY  
OF THE CITY OF SPENCER, IOWA  
OTHER SUPPLEMENTARY INFORMATION –  
BUDGETARY REPORTING  
YEAR ENDED DECEMBER 31, 2012**

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

Formal and legal budgetary control is based upon nine major classes of expenditures, known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, and business type activities. All Utility expenditures are included in business type activities function and are required to be budgeted.

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

Board of Trustees  
Spencer Municipal Utilities – Municipal Water Utility  
Spencer, Iowa 51301

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 business-type activities of Municipal Water Utility of the City of Spencer, Iowa (Spencer Municipal Utility), Spencer, Iowa as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements listed in the table of contents, and have issued our report thereon dated April 1, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Spencer Municipal 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Spencer Municipal Utility's internal control. Accordingly, we do not express an opinion on the effectiveness of Spencer Municipal Utility's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and is not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect 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 a material misstatement of the District's financial statements will not be prevented or detected and corrected on a timely basis. We did not consider any deficiencies to be material weaknesses.

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. We consider the deficiency described in the accompanying Schedule of Findings as item 12-II-A to be a significant deficiency.

## **Compliance and Other Matters**

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

## **Spencer Municipal Utility's Response to Findings**

Spencer Municipal Utility's responses to findings identified in our audit are described in the accompanying Schedule of Findings. Spencer Municipal Utility's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

## **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 result 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.

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

Spencer, Iowa  
April 1, 2013

*Williams + Company, P.C.*  
Certified Public Accountants

**SPENCER MUNICIPAL UTILITIES  
MUNICIPAL WATER UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2012**

**Part I: Summary of the Independent Auditors' Results:**

- (a) An unqualified opinion was issued on the financial statements.
- (b) Significant deficiency in internal control over financial reporting was disclosed by the audit of the financial statements.
- (c) The audit did not disclose any noncompliance, which is material to the financial statements.

**Part II: Findings Related to the General Purpose Financial Statements**

**SIGNIFICANT DEFICIENCY:**

12-II-A Financial Reporting – During the audit, we identified immaterial amounts of accrued compensated absences and bond premiums not initially identified by Spencer Municipal Utility's internal control. These amounts were either not recorded or not properly recorded in Spencer Municipal Utility's financial statements. Adjustments were subsequently made by Spencer Municipal Utility, if applicable, to properly include or reclassify these amounts in the financial statements.

Recommendation – Spencer Municipal Utility should implement procedures to ensure all accounts are properly identified, classified, and included in Spencer Municipal Utility's financial statements.

Response – We will revise our current procedures to ensure the proper amounts are recorded in the financial statements in the future.

Conclusion - Response accepted.

**INSTANCES OF NONCOMPLIANCE:**

No matters were reported.

**SPENCER MUNICIPAL UTILITIES  
MUNICIPAL WATER UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2012**

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

- III-A-12 Certified Budget – Disbursements during the year ended December 31, 2012 did not exceed the amounts budgeted in the business type activities function.
- III-B-12 Questionable Expenditures – No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General’s opinion dated April 25, 1979.
- III-C-12 Travel Expenses – No expenditures of the Utility’s money for travel expenses of spouses of Utility’s officials or employees were noted.
- III-D-12 Business Transactions – No business transactions between Utility and Utility officials and employees were noted.
- III-E-12 Bond Coverage – Surety bond coverage of Spencer Municipal Utilities’ officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- III-F-12 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.
- III-G-12 Revenue Bonds – As of December 31, 2012 the Utility is in compliance with all bond covenant requirements.
- III-H-12 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility’s investment policy were noted.

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

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## INDEPENDENT AUDITORS' REPORT

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

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the business-type activities of The Municipal Communications Utility of the City of Spencer, Iowa (the Utility), as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Utility's basic 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.

### ***Auditor's Responsibility***

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

### ***Opinions***

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Utility as of December 31, 2012 and 2011 and the respective changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and Funding Progress for the Retiree Health Plan information on pages 66 through 69 and page 84 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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 Information***

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Utility's basic financial statements. The supplementary information on pages 85 through 87 is presented for purposes of additional analysis and is not a required part of the financial statements.

The supplementary 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 information is fairly stated in all material respects in relation to the financial statements as a whole.

### ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated April 1, 2013 on our consideration of the 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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Utility's internal control over financial reporting and compliance.

*Williams + Company, P.C.*  
Certified Public Accountants

Spencer, Iowa  
April 1, 2013

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The purpose of management's discussion and analysis (MD&A) is to provide the reader with an introduction to the financial statements. Our discussion and analysis of the Municipal Communications Utility (Utility) of the City of Spencer, Iowa's financial performance provides an overview of the Utility's financial activities for the years ended December 31, 2012 and 2011.

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

### **2012 Financial Highlights**

Total assets decreased by approximately \$472,000 which was mainly attributable to adjusting the allowance based on settlements with access.

Total liabilities decreased by approximately \$1,300,000 stemming from a payment of \$1,000,000 to the Electric Utility to pay the remaining balance of the 1999 loan and reduction in payables to Communication Partners pertaining to access revenues.

Total net position increased by \$828,260 as the result of the utility operations.

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

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).

The statements of revenues, expenses and changes in net position report all revenues and expenses incurred during the fiscal year.

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.

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### Condensed Financial Information

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

#### Condensed Statements of Net Position

	<u>2012</u>	<u>2011</u>
Current assets	\$5,363,239	\$5,562,429
Capital assets, net of depreciation	3,591,222	3,864,152
Noncurrent assets	<u>829,238</u>	<u>831,114</u>
Total assets	<u>9,785,699</u>	<u>10,257,695</u>
Current liabilities	857,891	1,166,581
Noncurrent liabilities	<u>77,758</u>	<u>1,069,324</u>
Total liabilities	<u>935,649</u>	<u>2,235,905</u>
Investments in capital assets, net of related debt	3,591,222	2,864,152
Unrestricted	<u>5,258,828</u>	<u>5,157,638</u>
Total net position	<u>\$8,850,050</u>	<u>\$8,021,790</u>

#### Condensed Statements of Revenues, Expenses and Changes in Net Position

Cable television revenue	\$2,509,156	\$2,082,052
Telephone revenue	2,309,944	1,985,379
Data revenue	1,572,315	1,434,109
Miscellaneous revenue	<u>15,328</u>	<u>14,928</u>
Total operating revenue	<u>6,406,743</u>	<u>5,516,468</u>
System operation & maintenance	3,561,057	3,464,441
Depreciation & amortization	778,266	1,159,384
Customer service & administration	<u>1,355,781</u>	<u>1,174,079</u>
Total operating expenses	<u>5,695,104</u>	<u>5,797,904</u>
Operating income (loss)	711,639	(281,436)
Interest income	14,814	25,335
Interest expense	(45,000)	(141,788)
Other income (expense)	<u>146,807</u>	<u>191,800</u>
Total non-operating revenues	<u>116,621</u>	<u>75,347</u>
Change in net position	828,260	(206,089)
Net position, beginning of year	<u>8,021,790</u>	<u>8,227,879</u>
Net position, end of year	<u>\$8,850,050</u>	<u>\$8,021,790</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### **Financial Analysis**

The Utility's total assets decreased by approximately \$472,000.

The Utility's gross revenues increased by approximately \$890,000 or 16%. The revenue increase was primarily due to the rate increase on basic plus cable effective November 1, 2011. Due to the rate increase, new technology in video streaming, etc. the Utility has experienced a decrease of approximately 400 fewer basic plus subscribers on average, 13% decrease, and approximately 200 basic customers on average, or 6% decrease, in 2012 compared to 2011. Effective June 1, 2012 bulk tv rates increased which provided an additional \$51,000 or 3% of the gross revenue increase. Revenue also increased due to realizing a full year of the residential internet rate increase effective November 1, 2011. Telephone sales revenue increased in 2012 by approximately \$325,000 due to access revenue.

Total operating expenses increased by approximately \$97,000. The increase was primarily due to VOIP installations in customer households in 2012. The VOIP installations began due to the Utility's loss of maintenance support on the ADC equipment which provided phone service to customers. There were 605 installations completed in 2012 compared to 100 completed in 2011. In addition, due to the bandwidth increase in internet the annual cable & wire facilities expense increased in 2012 by approximately \$14,000.

The customer service and administration increased by approximately \$182,000 from 2011 to 2012. The increase was due to new website design created in 2012, promotions for services such as multi room DVR, BTN2GO, Tiger Plan as well as Homecoming and Holiday promotions. Additional marketing was made available to customers to educate them on changes occurring with the Utility. The increase in 2012 was also due to an accounting change implemented regarding the allocation of benefits.

Total operating income generated in 2012 was \$711,639 compared to (\$281,436) operating loss in 2011.

The Utility had a net income of \$828,260 for the year ended December 31, 2012 compared to a net loss of (\$206,089) for the year ended December 31, 2011.

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

Net capital assets decreased by approximately \$273,000 and \$699,000 for years ending December 31, 2012 and 2011, respectively. This was due to depreciation exceeding assets placed in service for both years ending December 31, 2012 and 2011.

### **Economic Factors**

The Utility has begun to experience a slight decrease in its Cable TV subscriber base in addition to telephone line customers, primarily residential. Necessary customer rate increases in Cable TV were implemented to cover annual programming increases charged

## MANAGEMENT'S DISCUSSION AND ANALYSIS

to the Utility for providing cable service. Although the Verizon, AT&T, XO Communications and Global Crossing lawsuits were settled, uncertainty remains as to the outcome of legal litigation concerning collectable access revenues with Sprint. Management remains conservative in estimating access collectable balances.

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

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

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**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF NET POSITION  
DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and Cash Equivalents	\$ 3,895,676	\$ 3,330,322
Consumer Deposits	59,404	61,023
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$7,975,808 and \$15,715,438)	1,076,877	1,724,778
Unbilled Usage	131,973	238,221
Materials and Supplies Inventory	117,671	96,545
Prepayments and Other	83,638	111,540
<b>Total Current Assets</b>	<b>5,365,239</b>	<b>5,562,429</b>
<b>Capital Assets:</b>		
Land	10,342	10,342
Property and Equipment	13,571,865	13,067,728
Accumulated Depreciation	(9,990,985)	(9,213,918)
<b>Total Capital Assets</b>	<b>3,591,222</b>	<b>3,864,152</b>
<b>Noncurrent Assets:</b>		
Unamortized Bond Issue Costs	-	1,200
Long-term Receivables	829,238	829,914
<b>Total Noncurrent Assets</b>	<b>829,238</b>	<b>831,114</b>
<b>Total Assets</b>	<b>9,785,699</b>	<b>10,257,695</b>
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts Payable	704,253	1,018,258
Payroll and Sales Tax Payable	25,302	23,665
Accrued Payroll and Compensated Absences	66,532	61,235
Deferred Revenue	2,400	2,400
Consumer Deposits	59,404	61,023
<b>Total Current Liabilities</b>	<b>857,891</b>	<b>1,166,581</b>
<b>Noncurrent Liabilities</b>		
Deferred Revenue	37,200	39,600
Note Payable	-	1,000,000
Net OPEB Liability	40,558	29,724
<b>Total Noncurrent Liabilities</b>	<b>77,758</b>	<b>1,069,324</b>
<b>Total Liabilities</b>	<b>935,649</b>	<b>2,235,905</b>
<b>NET POSITION</b>		
<b>Net Position</b>		
Invested in Capital Assets, Net of Related Debt	3,591,222	2,864,152
Unrestricted	5,258,828	5,157,638
<b>Total Net Position</b>	<b>\$ 8,850,050</b>	<b>\$ 8,021,790</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF REVENUES, EXPENSES AND  
CHANGES IN NET POSITION  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>Operating Revenues:</b>		
Cable System Revenue	\$ 2,509,156	\$ 2,082,052
Telephone System Revenue	2,309,944	1,985,379
Data Services Revenue	1,572,315	1,434,109
Miscellaneous Income	15,328	14,928
<b>Total Operating Revenues</b>	6,406,743	5,516,468
<b>Operating Expenses:</b>		
Plant Specific and Programming	3,561,057	3,464,441
Depreciation and Amortization	778,266	1,159,384
Customer Services and Marketing	767,437	580,472
General and Administrative	588,344	593,607
<b>Total Operating Expenses</b>	5,695,104	5,797,904
<b>Operating Income (Loss)</b>	711,639	(281,436)
<b>Non-Operating Income (Expense):</b>		
Leased Facilities	175,509	178,775
Net Income from Joint Ventures	74,324	65,584
Economic Development Payment	(25,700)	(37,401)
Interest Income	14,814	25,335
Interest Expense	(45,000)	(141,788)
Inventory Sales	2,313	1,012
Payment in Lieu of Property Taxes	(79,639)	(16,170)
<b>Total Non-Operating Income</b>	116,621	75,347
<b>Change in Net Position</b>	828,260	(206,089)
<b>Net Position at Beginning of Year</b>	8,021,790	8,227,879
<b>Net Position at End of Year</b>	\$ 8,850,050	\$ 8,021,790

See Accompanying Notes to Financial Statements

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

	2012	2011
<b>Cash Flows From Operating Activities:</b>		
Cash Received From Customers	\$ 7,156,873	\$ 5,352,055
Cash Payments to Suppliers for Goods and Services	(3,702,929)	(3,304,695)
Cash Payments to Employees for Services	(1,501,751)	(1,534,553)
Cash Payments for Economic Development and In Lieu of Property Taxes	(105,339)	(53,571)
Payments Received From Leasing of Facilities	175,509	178,775
	2,022,363	638,011
<b>Net Cash Provided By Operating Activities</b>	<b>2,022,363</b>	<b>638,011</b>
<b>Cash Flows From Capital and Related Financing Activities:</b>		
Acquisition & Construction of Property and Equipment	(504,136)	(455,525)
Payments Received from Sale of Inventory	2,313	1,012
Note Payable Principal Payment	(1,000,000)	(2,000,000)
Interest Paid	(45,000)	(141,788)
	(1,546,823)	(2,596,301)
<b>Net Cash (Used) By Capital and Related Financing Activities</b>	<b>(1,546,823)</b>	<b>(2,596,301)</b>
<b>Cash Flows From Investing Activities:</b>		
Other Investments	75,000	989
Interest Received From Investments	14,814	25,335
	89,814	26,324
<b>Net Cash Provided By Investing Activities</b>	<b>89,814</b>	<b>26,324</b>
<b>Net Increase (Decrease) in Cash</b>	<b>565,354</b>	<b>(1,931,966)</b>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>3,330,322</b>	<b>5,262,288</b>
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 3,895,676</b>	<b>\$ 3,330,322</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
STATEMENTS OF CASH FLOWS (CONTINUED)  
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**

**Reconciliation of Operating Income (Loss) to Net  
Cash Provided by Operating Activities**

Operating Income (Loss)	\$	711,639	\$	(281,436)
<b>Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided By Operating Activities</b>				
Depreciation and Amortization		778,266		1,159,384
Leased Facilities Income		175,509		178,775
Contributions Paid for Economic Development		(25,700)		(37,401)
Payment in Lieu of Property Taxes		(79,639)		(16,170)
(Increase) Decrease in Operating Assets:				
Consumer Deposits		(1,619)		2,005
Accounts Receivable		647,901		(127,017)
Unbilled Usage		106,248		(37,001)
Materials and Supplies Inventory		(21,126)		(10,860)
Prepayments		27,902		(62,870)
Increase (Decrease) in Operating Liabilities:				
Accounts Payable		(314,005)		(134,642)
Accrued Payroll and Compensated Absences		6,934		(1,051)
Consumer Deposits		1,619		(2,005)
Deferred Revenue		(2,400)		(2,400)
Net OPEB Liability		10,834		10,700
Total Adjustments		<u>1,310,724</u>		<u>919,447</u>
<b>Net Cash Provided By Operating Activities</b>	<b>\$</b>	<b>2,022,363</b>	<b>\$</b>	<b>638,011</b>

See Accompanying Notes to Financial Statements

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**A. Organization and Basis of Accounting**

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

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

The Utility is not considered to be a component unit of the City of Spencer for financial statement purposes.

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

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

**B. Capital Assets and Depreciation**

Capital assets are stated at original cost when first devoted to public service. Currently, such costs include labor-related expenditures, such as payroll taxes, pensions, and other fringe benefits and administrative costs for labor related to the construction of new communications facilities. In addition, net interest costs on construction debt are capitalized. Replacements and betterments of capital assets are charged to capital assets. Routine maintenance and repairs are charged to expense as incurred. Depreciation is calculated on the straight-line basis. Current depreciation expense is approximately 5.73% of the original cost of depreciable communication plant in service.

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

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

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

**C. Accounts Receivable**

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

**D. Inventories**

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

**E. Unamortized Deferred Costs**

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

**F. Net Position**

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

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

**G. Income Taxes**

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

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**H. Revenues and Unbilled Usage**

Revenues are based on billing rates, which are applied to customers' consumption of communications services. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2012 and 2011, totaled \$131,973 and \$238,221, respectively.

**I. Estimates**

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

**Note 2 - CASH AND CASH EQUIVALENTS**

The Utility's deposits in banks at December 31, 2012 and 2011 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

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

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

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 3 - CAPITAL ASSETS**

Capital assets activity for the year ended December 31, 2012 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 10,342	\$ -	\$ -	\$ 10,342
Total capital assets not being depreciated	10,342	-	-	10,342
Capital assets being depreciated:				
Infrastructure	10,709,555	453,915	-	11,163,470
Buildings and improvements	946,851	40	(875)	946,016
Equipment	1,411,322	51,057	-	1,462,379
Total capital assets being depreciated	13,067,728	505,012	(875)	13,571,865
Less accumulated depreciation	9,213,918	777,067	-	9,990,985
Total capital assets being depreciated - net	3,853,810	(272,055)	(875)	3,580,880
Capital assets - net	\$3,864,152	\$ (272,055)	\$ (875)	\$3,591,222

Capital assets activity for the year ended December 31, 2011 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 10,342	\$ -	\$ -	\$ 10,342
Total capital assets not being depreciated	10,342	-	-	10,342
Capital assets being depreciated:				
Infrastructure	10,387,166	322,389	-	10,709,555
Buildings and improvements	944,777	2,074	-	946,851
Equipment	1,280,261	238,251	(107,190)	1,411,322
Total capital assets being depreciated	12,612,204	562,714	(107,190)	13,067,728
Less accumulated depreciation	8,059,331	1,154,587	-	9,213,918
Total capital assets being depreciated - net	4,552,873	(591,874)	(107,190)	3,853,810
Capital assets - net	\$4,563,215	\$ (591,874)	\$ (107,190)	\$3,864,152

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 3 - CAPITAL ASSETS - Continued**

**Reconciliation of Investment in Capital Assets:**

	2012	2011
Capital Assets (Net of Accumulated)	\$ 3,591,222	\$ 3,864,152
Less: Note Payable	-	(1,000,000)
	\$ 3,591,222	\$ 2,864,152

**Note 4 - TRANSFERS IN LIEU OF PROPERTY TAX**

By resolution of the Board of Trustees, voluntary transfers in lieu of property taxes are made to the City of Spencer, Iowa. Funds totaling \$79,639 and \$16,170 were transferred to the City during 2012 and 2011, respectively.

**Note 5 - LONG-TERM RECEIVABLES**

During December 2003, the Utility entered into an agreement with Northern Iowa Communications Partners, LLC (NICP), an Iowa limited liability company, pursuant to the provisions of Chapter 28E of the Code of Iowa. Under this agreement, the Utility, along with other members of NICP, agrees to pay for the use of a shared switch for routing certain telecommunications traffic at rates adopted by NICP. The Utility will share in profits generated or shortfalls incurred through the 28E agreement due to the method used to determine an annual usage fee paid by NICP to the Utility. An NICP member will be responsible for maintaining the financial records related to the 28E agreement. The amount earned but not received by the Utility in 2012 and 2011 was \$199,257 and \$201,893, respectively. These amounts are recorded as a receivable.

During May 2006, the Utility entered into an agreement with Evertek, Inc., an Iowa Corporation, to create Clay County Communications, LLC as a separate legal entity. Clay County Communications shall function as if it were a limited liability company organized under Iowa Code Chapter 490A. The purpose of this agreement and Clay County Communications is to provide wired and/or wireless communications services in Clay County, Iowa. The Utility and Evertek, Inc. each initially contributed \$400,000. During 2007 the Utility and Evertek, Inc. each made an additional contribution \$150,000. The Utility accounts for the joint venture on the equity method, and has recorded the balance of \$629,982 and \$628,021 as a receivable in 2012 and 2011, respectively.

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 6 – NOTE PAYABLE**

Note payable activity for the year ended December 31, 2012 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Note Payable - Municipal Electric Utility	\$ 1,000,000	\$ -	(\$1,000,000)	\$ -	\$ -

Note payable activity for the year ended December 31, 2011 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Note Payable - Municipal Electric Utility	\$ 3,000,000	\$ -	\$(2,000,000)	\$ 1,000,000	\$ -

The Board of Trustees of the Municipal Electric Utility adopted a resolution on June 14, 1999, pursuant to Section 384.89 City Code of Iowa and Rule 2.5(5) of the rules promulgated by the City Finance Committee, allowing for the advance of funds not to exceed \$8,000,000 to the Municipal Communications Utility to be utilized for the construction and development of the communication system. These funds are to be repaid upon demand and bear a 4.5% per annum interest rate.

**Note 7 - LEASES and LONG TERM DEFERRED REVENUE**

Spencer Municipal Utilities entered into a 20 year fiber lease agreement with the Iowa Rural Health Telecommunications Program on July 1, 2009. The contract amount for the lease is \$48,000 and is due in full upon construction completion. Construction was completed and \$48,000 was collected in 2009. Spencer Municipal Utilities recognized \$2,400 and \$2,400 in revenue during 2012 and 2011, respectively. In 2012, there was \$2,400 as short term deferred revenue and the remaining \$37,200 as long term revenue. Spencer Municipal Utilities is responsible for maintenance of the fiber.

The Utility leases building space from the Water Utility. The expense from the lease is classified as operating expense. The lease is a monthly lease based on building space utilized and totaled \$0 in 2012 and \$2,368 in 2011. The payable at December 31, 2012 and 2011 was \$0 and \$2,368, respectively.

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 7 -- LEASES and LONG TERM DEFERRED REVENUE - Continued**

The Utility leases bandwidth, property, and building space from the Electric Utility. The expense from the lease is classified as operating expense. The lease is a 20-year variable lease based on bandwidth and space utilized and totaled \$412,218 and \$411,212 in 2012 and 2011, respectively. The payable at December 31, 2012 and 2011 was \$0 and \$411,212, respectively.

**Note 8 - RETIREMENT SYSTEM**

**IPERS**

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

Plan members were required to contribute 5.38% through June 30, 2012 and 5.78% presently of their annual salary and the Utility was required to contribute 8.07% through June 30, 2012 and 8.67% presently of annual payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2012, 2011 and 2010 were \$83,704, \$73,200 and \$60,526, respectively, equal to the required contributions for the year.

**Employees Pension Plan**

All full-time employees of the Communications Utility who have completed six months of continuous employment and are 18 years of age are eligible to participate in a 457b Pension Plan administered by Security National Bank. The Utility contributes 8% of the employees' compensation for all employees contributing at least 2% of their salary.

The Communications Utility's contribution to the Money Accumulation Pension Plan for 2012 and 2011 totaled \$75,854 and \$74,300, respectively.

**Note 9 – OTHER POST EMPLOYMENT BENEFITS**

*Plan Description.* The Utility operates a single-employer retiree benefit plan which provides medical/prescription drug benefits for retirees and their family.

The medical/prescription drug coverage is provided through a fully-insured plan. Retirees under age 65 pay the same premium for the medical/prescription drug benefit as active employees, which results in an implicit subsidy and an OPEB liability.

*Funding Policy.* The Utility currently finances the retiree benefit plan on a pay-as-you-go basis.

*Annual OPEB Cost and NET OPEB Obligation.* The Utility's annual other post-employment benefit (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years.

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 9 - OTHER POST EMPLOYMENT BENEFITS - Continued**

The following table shows the components of the Utility's annual OPEB for the year, the amount actually contributed to the plan, and changes in the Utility's net OPEB obligation to the plan:

	<u>2012</u>	<u>2011</u>
Annual required contribution	\$ 11,155	\$ 10,992
Interest on net OPEB obligation	1,188	761
Adjustment to annual required contribution	<u>(1,181)</u>	<u>(756)</u>
Annual OPEB cost (Expense)	11,162	10,997
Contributions (estimated)	<u>(328)</u>	<u>(297)</u>
Increase in net OPEB obligation	10,834	10,700
Net OPEB obligation – beginning of year	<u>29,724</u>	<u>19,024</u>
Net OPEB obligation – end of year	<u>\$ 40,558</u>	<u>\$ 29,724</u>

The Utility's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2012	\$ 11,162	3%	\$ 40,558
2011	\$ 10,997	3%	\$ 29,724

*Funded Status and Funding Progress.* The funded status of the plan as of December 31, 2012 was as follows:

	<u>2012</u>	<u>2011</u>
Actuarial accrued liability (AAL)	\$52,858	\$45,009
Actuarial value of plan assets	<u>-</u>	<u>-</u>
Unfunded actuarial accrued liability (UAAL)	\$52,858	\$45,009
Covered payroll (active members)	\$1,039,894	\$1,009,606
UAAL as a percentage of covered payroll	5.0%	3.6%

*Actuarial Methods and Assumptions.* 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

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 9 – OTHER POST EMPLOYMENT BENEFITS (Continued)**

compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan 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 plan members to that point and do not explicitly reflect the potential effect of legal or contractual funding limitation. The actuarial methods and assumptions used include techniques that are designed to reduce the effect of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2012 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4% interest discount rate. The projected annual medical trend rate is 9.5%. The ultimate medical trend rate is 4.5%. The medical trend rate is reduced 0.5% each year until reaching the 4.5% ultimate trend rate.

Mortality rates are from the RP-2000 Combined Mortality Table projected to 2010 using Scale AA. The salary increase rate was assumed to be 3% per year. The UAAL is being amortized as a level dollar amount on an open basis over 30 years.

**Note 10 - RISK MANAGEMENT**

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

**Note 11 - RELATED PARTIES**

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

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

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

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
NOTES TO FINANCIAL STATEMENTS  
DECEMBER 31, 2012 AND 2011**

**Note 12 – CONTINGENCIES**

In the last five years, the Utility has provided Iowa based telephone numbers to callers who are then connected to a conference call. The Utility maintains these are terminated in Iowa and charges long-distance carriers a fee for terminating access services. The Utility then pays a portion of the revenue to other communication providers who supply a portion of the services. Until 2007 the long-distance carriers have paid these charges to the Utility and the Utility has paid the other communication providers. In 2007, Sprint, has filed a lawsuit alleging that the calls are not terminated in Iowa, and that the Utility is not entitled to the terminating access charges that are billed to them. In 2010, the Utility filed a claim against AT&T for unpaid communications access. The Utility has filed counter-claims or claims against Sprint, Verizon, AT&T and Qwest so that the statute of limitations does not run for filing counter claims. The Utility has also suspended its payments to the other providers pending the outcome of the litigation. In September 2010, the Utility settled its lawsuit with Verizon. On June 6, 2012, the Utility settled its lawsuit with AT&T. On August 2, 2012 the Utility settled its lawsuit with XO Communications. The allowance account for carrier receivables was reduced in 2012 by approximately \$9,170,000 due to the AT&T and XO Communications settlement. Management's belief that a reasonable estimate of 10% of the gross revenues generated by terminating these long distance calls will be collected. The decision to reduce the estimate from 15% to 10% was determined on the basis of the remaining unsettled carrier litigation arguments. Due to this estimate change the allowance account was increased by approximately \$262,000.

**Note 13 - COMMITMENTS**

Beginning in 2011, the Communications Utility signed an advertising and signage agreement with the Clay County Regional Event Center. The agreement is effective September 1, 2011 and terminates on August 31, 2014. The annual amount due is \$5,950. A portion of the annual cost is split between the Electric and Water Utility. The Communication Utility is responsible for \$2,677.50 of the annual amount due.

Beginning in 2013, the Communications Utility pledged support to the Iowa Great Lakes Corridor of Opportunity for four years at a level of \$37,500 per year for 2013 and 2014 and \$25,000 for 2015 and 2016. This commitment is subject to annual review by the Utility Board.

Beginning in 2013, the Communications Utility pledged support to Startup City Spencer which is a regional incubator providing access to startup services. The support pledged is for five years at a level of \$5,000 per year.

**REQUIRED SUPPLEMENTAL INFORMATION**

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
FUNDING PROGRESS FOR THE RETIREE HEALTH PLAN  
REQUIRED SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

Year Ended December 31,	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2008	12/31/2008	\$ -	\$ 22,881	\$ 22,881	0%	\$ 958,187	2.4%
2009	12/31/2009	-	28,668	\$ 28,668	0%	986,933	2.9%
2010	12/31/2010	-	36,624	\$ 36,624	0%	1,016,541	3.6%
2011	12/31/2011	-	45,009	\$ 45,009	0%	1,009,606	4.5%
2012	12/31/2012	\$ -	\$ 52,828	\$ 52,828	0%	\$ 1,039,894	5.0%

See Note 9 to the accompanying Notes to Financial Statements for the plan description, funding policy, annual OPEB Cost and Net OPEB Obligation, and the funded status and funding progress.

**SUPPLEMENTAL INFORMATION**

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, EXPENDITURES  
AND CHANGES IN NET POSITION - BUDGET AND ACTUAL (CASH BASIS)  
OTHER SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
<b>Receipts:</b>				
Municipal Electric Utility			\$ 14,212,630	
Municipal Water Utility			4,518,834	
Municipal Communications Utility			7,424,509	
Total Receipts	<u>\$ 28,125,407</u>	<u>\$ 28,025,648</u>	<u>26,155,973</u>	<u>\$ (1,869,675)</u>
<b>Expenditures:</b>				
Municipal Electric Utility			15,883,066	
Municipal Water Utility			2,961,454	
Municipal Communications Utility			6,859,155	
Total Expenditures	<u>28,979,297</u>	<u>28,089,649</u>	<u>25,703,675</u>	<u>(2,385,974)</u>
<b>Change in Net Position</b>	(853,890)	(64,001)	452,298	(4,255,649)
<b>Net Position at Beginning of Year</b>	<u>17,221,992</u>	<u>17,765,279</u>	<u>17,765,279</u>	<u>-</u>
<b>Net Position at End of Year</b>	<u>\$ 16,368,102</u>	<u>\$ 17,701,278</u>	<u>\$ 18,217,577</u>	<u>\$ (4,255,649)</u>

See Accompanying Independent Auditors' Report

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
BUDGET TO GAAP RECONCILIATION  
OTHER SUPPLEMENTARY INFORMATION  
FOR YEAR ENDED DECEMBER 31, 2012**

	Cash Basis	Accrual Adjustments	Accrual Basis
<b>Receipts:</b>			
Municipal Electric Utility	\$ 14,212,630	\$ (170,035)	\$ 14,042,595
Municipal Water Utility	4,518,834	(2,443,592)	2,075,242
Municipal Communications Utility	7,424,509	(752,107)	6,673,703
<b>Total Receipts</b>	<u>26,155,973</u>	<u>(3,365,734)</u>	<u>22,791,540</u>
<b>Expenditures:</b>			
Municipal Electric Utility	15,883,066	(1,706,583)	14,176,483
Municipal Water Utility	2,961,454	(1,404,219)	1,557,235
Municipal Communications Utility	6,859,155	(1,015,013)	5,845,443
<b>Total Expenditures</b>	<u>25,703,675</u>	<u>(4,125,815)</u>	<u>21,579,161</u>
<b>Change in Net Position</b>	452,298	760,081	1,212,379
<b>Net Position at Beginning of Year</b>	<u>17,765,279</u>	<u>43,632,395</u>	<u>61,397,674</u>
<b>Net Postion at End of Year</b>	<u>\$ 18,217,577</u>	<u>\$ 44,392,476</u>	<u>\$ 62,610,053</u>

See Accompanying Independent Auditors' Report

**MUNICIPAL COMMUNICATIONS UTILITY  
OF THE CITY OF SPENCER, IOWA  
OTHER SUPPLEMENTARY INFORMATION –  
BUDGETARY REPORTING  
YEAR ENDED DECEMBER 31, 2012**

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

Formal and legal budgetary control is based upon nine major classes of expenditures known as functions, not by fund. These functions are public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, and business type activities. All Utility expenditures are included in business type activities function and are required to be budgeted.

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

Board of Trustees  
Spencer Municipal Utilities – Municipal Communications Utility  
Spencer, Iowa 51301

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 business-type activities of Municipal Communications Utility of the City of Spencer, Iowa (Spencer Municipal Utility), Spencer, Iowa as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the District's basic financial statements listed in the table of contents, and have issued our report thereon dated April 1, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Spencer Municipal 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Spencer Municipal Utility's internal control. Accordingly, we do not express an opinion on the effectiveness of Spencer Municipal Utility's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and is not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect 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 a material misstatement of the District's financial statements will not be prevented or detected and corrected on a timely basis. We did not consider any deficiencies to be material weaknesses.

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. We consider the deficiency described in the accompanying Schedule of Findings as item 12-II-A to be a significant deficiency.

## **Compliance and Other Matters**

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

## **Spencer Municipal Utility's Response to Findings**

Spencer Municipal Utility's responses to findings identified in our audit are described in the accompanying Schedule of Findings. Spencer Municipal Utility's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

## **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 result 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.

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

*Williams + Company, P.C.*

Certified Public Accountants

Spencer, Iowa  
April 1, 2013

**SPENCER MUNICIPAL UTILITIES  
MUNICIPAL COMMUNICATIONS UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2012**

**Part I: Summary of the Independent Auditors' Results:**

- (a) An unqualified opinion was issued on the financial statements.
- (b) Significant deficiency in internal control over financial reporting was disclosed by the audit of the financial statements.
- (c) The audit did not disclose any noncompliance, which is material to the financial statements.

**Part II: Findings Related to the General Purpose Financial Statements**

**SIGNIFICANT DEFICIENCY:**

12-II-A     Financial Reporting – During the audit, we identified immaterial amount of compensated absences not initially identified by Spencer Municipal Utility's internal control. This amount was either not recorded or not properly recorded in Spencer Municipal Utility's financial statements. An adjustment was subsequently made by Spencer Municipal Utility, if applicable, to properly include or reclassify these amounts in the financial statements.

Recommendation – Spencer Municipal Utility should implement procedures to ensure all accounts are properly identified, classified, and included in Spencer Municipal Utility's financial statements.

Response – We will revise our current procedures to ensure the proper amounts are recorded in the financial statements in the future.

Conclusion - Response accepted.

**INSTANCES OF NONCOMPLIANCE:**

No matters were reported.

**SPENCER MUNICIPAL UTILITIES  
MUNICIPAL COMMUNICATIONS UTILITY  
SCHEDULE OF FINDINGS  
YEAR ENDED DECEMBER 31, 2012**

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

- III-A-12 Certified Budget – Disbursements during the year ended December 31, 2012 did not exceed the amounts budgeted in the business type activities function.
- III-B-12 Questionable Expenditures – No expenditures were noted which did not meet the requirements of public purpose as defined in an Attorney General’s opinion dated April 25, 1979.
- III-C-12 Travel Expenses – No expenditures of the Utility’s money for travel expenses of spouses of Utility’s officials or employees were noted.
- III-D-12 Business Transactions – No business transactions between Utility and Utility officials and employees were noted.
- III-E-12 Bond Coverage – Surety bond coverage of Spencer Municipal Utilities’ officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- III-F-12 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.
- III-G-12 Revenue Bonds – As of December 31, 2012 the Utility is in compliance with all bond covenant requirements.
- III-H-12 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12(B) and 12(c) of the Code of Iowa and the Utility’s investment policy were noted.