

SPENCER MUNICIPAL UTILITIES
INDEPENDENT AUDITORS' REPORTS
FINANCIAL STATEMENTS
AND SUPPLEMENTAL INFORMATION
DECEMBER 31, 2013 AND 2012

TABLE OF CONTENTS

	<u>Page</u>
Officials	1
Municipal Electric Utility:	
Independent Auditors' Report	2 - 3
Management's Discussion and Analysis	4 - 6
Financial Statements:	
Statements of Net Position	7 - 8
Statements of Revenues, Expenses and Changes in Net Position	9
Statements of Cash Flows.....	10 - 11
Notes to Financial Statements	12 - 24
Required Supplementary Information:	
Funding Progress for the Retiree Health Plan	25
Other Supplementary Information:	
Budgetary Reporting.....	26-28
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 <i>Government Auditing Standards</i>	29 - 30
Schedule of Findings	31- 32
Municipal Water Utility:	
Independent Auditors' Report	33 - 34
Management's Discussion and Analysis	35 - 38
Financial Statements:	
Statements of Net Position	39
Statements of Revenues, Expenses and Changes in Net Position	40
Statements of Cash Flows.....	41 - 42
Notes to Financial Statements	43 - 53
Required Supplementary Information:	
Funding Progress for the Retiree Health Plan	54
Other Supplementary Information:	
Budgetary Reporting.....	55-57

TABLE OF CONTENTS - Continued

	<u>Page</u>
Municipal Water Utility (Continued):	
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 <i>Government Auditing Standards</i>	58 - 59
Schedule of Findings	60 - 61
Municipal Communications Utility:	
Independent Auditors' Report	62 - 63
Management's Discussion and Analysis	64 - 67
Financial Statements:	
Statements of Net Position	68
Statements of Revenues, Expenses and Changes in Net Position	69
Statements of Cash Flows.....	70 - 71
Notes to Financial Statements	72 - 79
Required Supplementary Information:	
Funding Progress for the Retiree Health Plan	80
Other Supplementary Information:	
Budgetary Reporting.....	81 - 83
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 <i>Government Auditing Standards</i>	84 - 85
Schedule of Findings	86 - 87

SPENCER MUNICIPAL UTILITIES

OFFICIALS

<u>Board of Trustees</u>	<u>Title</u>	<u>Term Expires</u>
(Before July 2013)		
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	
(After July 2013)		
Dave Hultgren	Chairman	6-30-2014
Alison Simpson	Vice-Chairman	6-30-2017
Sandi Schmidt	Secretary	6-30-2016
Murray Hart	Treasurer	6-30-2019
Dave Cronk	Trustee	6-30-2018
<u>Management</u>		
Steven Pick	General Manager	
Trisha Bruning	Finance Manager	

SPENCER MUNICIPAL UTILITIES

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



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, 2013 and 2012, 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 opinion.

Opinion

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, 2013 and 2012 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.

Emphasis of Matter

In 2013, the Utility adopted new accounting guidance, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

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 6 and page 25 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.

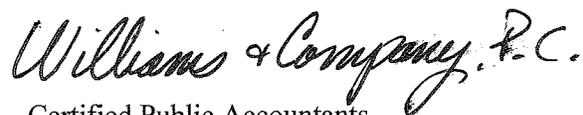
Other Information

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 26 through 28 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, 2014 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.


Certified Public Accountants

Spencer, Iowa
April 1, 2014

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, 2013 and 2012.

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

2013 Financial Highlights

The Utility delivered approximately 156,777,000 kilowatt hours (kWh) of electricity to its retail customers in 2013 compared to approximately 152,785,000 kWh in 2012.

The Utility's net position increased by \$85,925 to \$46,048,678. One factor leading to increased net position stemmed from the Utility increasing rates effective with June 2013 usage. In addition, lieu of tax was approximately \$380,000 lower in 2013 compared to 2012 due to funding of Stoneybrook First Addition grant and storefront interest paid in 2012. Power supply costs increased approximately \$536,000 in 2013 compared to 2012 primarily due to an unplanned outage as well as planned outage for the scrubber/baghouse tie-in project in the George Neal Generating Station Unit No. 4. Other factors of increased power supply costs in 2013 included increased cost to transport coal at the Walter Scott, Jr. Energy Center Unit 4 and additional power purchases from NIMECA.

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>2013</u>	<u>2012</u>
Current assets	\$10,058,801	\$14,279,809
Noncurrent assets	4,858,885	4,636,114
Capital Assets, net of depreciation	<u>42,886,498</u>	<u>40,271,855</u>
Total assets	<u>57,804,184</u>	<u>59,187,778</u>
Current Liabilities	3,469,086	3,741,674
Noncurrent Liabilities	62,773	52,349
Bonds Payable	<u>8,223,647</u>	<u>9,431,002</u>
Total liabilities	<u>11,755,506</u>	<u>13,225,025</u>
Net Investment in Capital Assets	33,457,851	31,412,969
Restricted	2,105,180	2,196,611
Unrestricted	<u>10,485,647</u>	<u>12,353,173</u>
Total Net Position	<u>\$46,048,678</u>	<u>\$45,962,753</u>

Condensed Statement of Revenues, Expenses and Changes in Net Position

Sales of Electricity	\$10,979,841	\$10,449,274
Other	<u>1,511,851</u>	<u>1,321,790</u>
Total Operating Revenue	<u>12,491,692</u>	<u>11,771,064</u>
Power Supply Costs	8,536,319	8,000,701
Distribution System Maintenance	1,258,033	1,200,841
Depreciation & Amortization	2,599,412	2,545,039
Customer Service & Administration	<u>1,129,830</u>	<u>1,031,729</u>
Total Operating Expenses	<u>13,523,594</u>	<u>12,778,310</u>
Operating (Loss)	(1,031,902)	(1,007,246)
Interest Income	57,520	138,476
Interest Expense	(215,115)	(272,563)
Other Income (Expense)	<u>1,275,422</u>	<u>1,007,445</u>
Total Non-Operating Revenues	<u>1,117,827</u>	<u>873,358</u>
Change in Net Position	85,925	(133,888)
Net Position, Beginning of Year	<u>45,962,753</u>	<u>46,096,641</u>
Net Position, End of Year	<u>\$46,048,678</u>	<u>\$45,962,753</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Analysis

The Utility's total assets decreased by approximately \$1,384,000. Part of the decrease was due to payment of the remaining \$1,737,000 of bond proceed reserve for the George Neal Generating Station Unit No. 4 scrubber project and other plant capital projects in 2013. Total funds paid for the scrubber project and other capital projects during 2013 was approximately \$2,070,000. The scrubber project is anticipated to be completed in early 2014 with final projected costs to be paid of approximately \$266,000. Net investment in capital assets increased by approximately \$744,000 as of December 31, 2013 compared to December 31, 2012. Projects included in that increase were improvements to generating power plants, to the Utility's distribution system, and Utility's building located at 520 2nd Avenue East. No additional debt was issued in 2013 and all capital projects were funded from cash and cash reserves.

The Utility's gross revenues increased by approximately \$721,000 or 6% due to the electric rate increase effective June 2013. In addition, kWh sales increased in 2013 compared to 2012 by approximately 4,000,000 kWh. While the ECA revenue increased in 2013 by approximately \$83,000 as well as lease revenue related to power supply increased by approximately \$157,000, the power supply costs increased by approximately \$536,000.

Total operating loss generated in 2013 was \$1,031,902 compared to an operating loss of \$1,007,246 in 2012.

Utility non-operating income (expense) resulted in \$1,118,000 of income, which was a 28% increase from 2012. This was primarily affected due to a decrease in Lieu of Property Taxes paid to the City of Spencer regarding a \$287,500 grant for Stoneybrook First Addition and storefront interest paid in 2012. Resource Conservation increased in 2013 compared to 2012 by approximately \$94,000 stemming from commercial energy rebates for Geo Heat pumps and Insulation. Interest income for the Utility decreased in 2013 due to a lower interest rate environment and decrease in cash balances.

The change in net position increased from (\$133,888) in 2012 to \$85,925 in 2013.

Economic Factors

Retail sales increased by 5,010,000 kWh while Commercial sales decreased by 1,400,000 kWh in 2013 compared to 2012. This represents an approximate 8% increase and 2% decrease, respectively, from 2012 to 2013.

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.

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, 520 2nd Avenue East, Suite 1, Spencer, Iowa 51301.

FINANCIAL STATEMENTS

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF NET POSITION
DECEMBER 31, 2013 AND 2012**

	2013	2012
ASSETS		
Current Assets:		
Cash and Cash Equivalents		
Unrestricted	\$ 1,161,983	\$ 1,655,125
Restricted	1,354,735	213,859
Board Designated	4,362,490	6,000,000
Consumer Deposits	79,300	74,935
Investments		
Restricted	-	1,525,278
Board Designated	-	1,500,000
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$6,500 and \$6,500)	1,447,338	1,610,416
Unbilled Usage	293,822	223,914
Materials and Supplies Inventory	566,495	617,845
Fuel Inventory	508,272	557,677
Notes Receivable - City of Spencer	25,000	25,000
Prepayments	259,366	275,760
	10,058,801	14,279,809
Capital Assets:		
Land	150,704	150,704
Construction in Progress	7,251,136	4,218,428
Plant in Service	78,640,090	76,585,568
Accumulated Depreciation	(43,155,432)	(40,682,845)
	42,886,498	40,271,855
Noncurrent Assets		
Noncurrent Investments:		
Unrestricted	-	628,094
Board Designated	3,537,510	1,000,000
Restricted	750,445	2,194,590
Notes Receivable - City of Spencer	570,930	813,430
	4,858,885	4,636,114
Total Assets	\$ 57,804,184	\$ 59,187,778

See Accompanying Notes to Financial Statements

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF NET POSITION
DECEMBER 31, 2013 AND 2012**

	2013	2012
LIABILITIES		
Current Liabilities:		
Accounts Payable	\$ 1,854,994	\$ 2,283,155
Payroll and Sales Tax Payable	34,333	33,235
Accrued Payroll and Compensated Absences	272,653	152,246
Accrued Interest Payable	18,606	29,403
Consumer Deposits	79,300	74,935
Deferred Revenue	4,200	3,700
Current Maturities of Long-Term Debt	1,205,000	1,165,000
	3,469,086	3,741,674
Noncurrent Liabilities		
Bonds Payable	9,428,647	10,596,002
Less - Current Maturities	(1,205,000)	(1,165,000)
Net OPEB Liability	62,773	52,349
	8,286,420	9,483,351
	11,755,506	13,225,025
NET POSITION		
Net Position		
Net Investment in Capital Assets	33,457,851	31,412,969
Restricted	2,105,180	2,196,611
Unrestricted	10,485,647	12,353,173
	\$ 46,048,678	\$ 45,962,753

See Accompanying Notes to Financial Statements

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
Operating Revenues:		
Residential	\$ 4,154,017	\$ 3,752,130
Commercial	4,990,072	4,954,142
Public Authorities	600,426	590,781
Sales for Resale	1,427,739	1,260,854
Energy Cost Adjustment Revenue	1,235,326	1,152,221
Penalties	25,183	24,295
Miscellaneous	58,929	36,641
	12,491,692	11,771,064
Operating Expenses:		
Generation and Transmission		
Neal #4 Fuel and Generation	1,521,732	1,343,650
Walter Scott #4 Fuel and Generation	1,601,656	1,523,258
Purchased Power	5,275,451	5,028,475
Other	137,480	105,318
Distribution	1,258,033	1,200,841
Depreciation and Amortization	2,599,412	2,545,039
Customer Operations	414,314	395,557
General and Administrative	715,516	636,172
	13,523,594	12,778,310
Operating (Loss)	(1,031,902)	(1,007,246)
Non-Operating Income (Expense):		
Interest Income on Investments	57,520	138,476
Resource Conservation	(302,805)	(209,011)
Economic Development Payment	(85,082)	(107,188)
Leased Facilities	2,124,695	2,120,848
Interest Expense	(215,115)	(272,563)
Gain (Loss) on Plant Retirements	(18,261)	12,207
Payment in Lieu of Property Taxes	(443,125)	(809,411)
	1,117,827	873,358
Change in Net Position	85,925	(133,888)
Net Position at Beginning of Year	45,962,753	46,274,181
Prior Period Adjustment - Change in Accounting	-	(177,540)
Net Position at Beginning of Year, as Restated	45,962,753	46,096,641
Net Position at End of Year	\$ 46,048,678	\$ 45,962,753

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, 2013 AND 2012**

	2013	2012
Cash Flows From Operating Activities:		
Cash Received From Customers	\$ 12,589,727	\$ 11,952,048
Cash Payments to Suppliers for Goods and Services	(9,427,279)	(7,863,589)
Cash Payments to Employees for Services	(1,675,986)	(1,687,633)
Cash Payments for Resource Conservation	(302,805)	(209,011)
Cash Payments for Economic Development and In Lieu of Property Taxes	(528,207)	(916,599)
Payments Received From Leasing of Facilities	2,124,695	2,120,848
	2,780,145	3,396,064
Cash Flows From Capital and Related Financing Activities:		
Acquisition & Construction of Property and Equipment	(5,233,386)	(3,806,259)
Revenue Bond Principal Repayment	(1,165,000)	(1,130,000)
Proceeds from Sale of Capital Assets	1,070	1,258
Interest Paid	(228,267)	(269,975)
	(6,625,583)	(5,204,976)
Cash Flows From Investing Activities:		
Payments Received on Note Receivable -City of Spencer	242,500	95,000
Loan Advances for Note Receivable -City of Spencer	-	(287,500)
Payments Received on Note Receivables - Communications	-	1,000,000
Proceeds From Redemption of Investments	5,847,556	5,025,244
Purchase of Investments	(3,287,549)	(4,025,000)
Interest Received From Investments	57,520	138,476
	2,860,027	1,946,220
Net Cash Provided By Investing Activities	2,860,027	1,946,220
Net Increase (Decrease) in Cash	(985,411)	137,308
Cash and Cash Equivalents at Beginning of Year	7,943,919	7,806,611
Cash and Cash Equivalents at End of Year	\$ 6,958,508	\$ 7,943,919
Reconciliation:		
Cash and Cash Equivalents		
Unrestricted	\$ 1,161,983	\$ 1,655,125
Restricted	1,354,735	213,859
Board Designated	4,362,490	6,000,000
Consumer Deposits	79,300	74,935
	\$ 6,958,508	\$ 7,943,919

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, 2013 AND 2012**

	2013	2012
Reconciliation of Operating (Loss) to Net Cash Provided by Operating Activities		
Operating (Loss)	\$ (1,031,902)	\$ (1,007,246)
Adjustments to Reconcile Operating (Loss) to Net Cash Provided By Operating Activities		
Depreciation and Amortization	2,599,412	2,545,039
Leased Facilities Income	2,124,695	2,120,848
Contributions Paid for Economic Development	(85,082)	(107,188)
Payment in Lieu of Property Taxes	(443,125)	(809,411)
Payment for Resource Conservation	(302,805)	(209,011)
(Increase) Decrease in Operating Assets:		
Accounts Receivable	163,078	181,088
Unbilled Usage	(69,908)	1,856
Materials and Supplies Inventory	51,350	(14,648)
Fuel Inventory	49,405	(88,112)
Prepayments	16,394	51,138
Increase (Decrease) in Operating Liabilities:		
Accounts Payable	(428,161)	720,707
Accrued Payroll and Compensated Absences	121,505	2,540
Consumer Deposits	4,365	(1,960)
Deferred Revenue	500	-
Net OPEB Liability	10,424	10,424
Total Adjustments	3,812,047	4,403,310
Net Cash Provided By Operating Activities	\$ 2,780,145	\$ 3,396,064

See Accompanying Notes to Financial Statements

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

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 managed, 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 2013 and 2012, the Utility had \$28,407 and \$19,749, respectively, of interest expense that was capitalized from the scrubber construction on George Neal Generating Station Unit No. 4 from 2011 Revenue Bond financing.

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

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

total investment of \$9,083,364 included in utility plant in service with \$4,408,067 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 \$16,006,461 included in utility plant in service with \$2,750,665 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 3.03% 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. Net Position

Net position represents the difference between assets and liabilities in the financial statements. Net investment in capital assets, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets 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.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

F. 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.

G. 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, 2013 and 2012, totaled \$293,822 and \$223,914, respectively.

H. 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, 2013 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 \$750,000 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.

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.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

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

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:	2013	2012
Board designated	\$ 4,362,490	\$ 6,000,000
Consumer Deposits	79,300	74,935
Restricted	1,354,735	213,859
Unrestricted	1,161,983	1,655,125
Total cash and cash equivalents	6,958,508	7,943,919
Current Investments:		
Restricted	-	1,525,278
Board designated	-	1,500,000
Total current investments	-	3,025,278
Noncurrent investments:		
Unrestricted	-	628,094
Board designated	3,537,510	1,000,000
Restricted	750,445	2,194,590
Total noncurrent investments	4,287,955	3,822,684
Total cash and cash equivalents and noncurrent investments	\$11,246,463	\$14,791,881

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, 2013 and 2012 are summarized as follows:

	2013	2012
	Replacement and Construction Reserve	Replacement and Construction Reserve
Cash and cash equivalents	\$ 4,362,490	\$ 5,998,930
Current Investments	-	1,000,000
Noncurrent investments	3,537,510	1,501,070
Total	\$ 7,900,000	\$ 8,500,000

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 4 - CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2013 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 150,704	\$ -	\$ -	\$ 150,704
Construction in progress	4,218,428	3,032,718	(10)	7,251,136
Total capital assets not being depreciated	4,369,132	3,032,718	(10)	7,401,840
Capital assets being depreciated:				
Infrastructure	68,343,519	2,028,096	(119,788)	70,251,827
Buildings and improvements	728,875	-	-	728,875
Equipment	7,513,174	161,460	(15,246)	7,659,388
Total capital assets being depreciated	76,585,568	2,189,556	(135,034)	78,640,090
Less accumulated depreciation	40,682,845	2,599,412	(126,825)	43,155,432
Total capital assets being depreciated - net	35,902,723	(409,856)	(8,209)	35,484,658
Net capital assets	\$40,271,855	\$2,622,862	\$(8,219)	\$42,886,498

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	67,307,297	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
Net capital assets	\$38,973,465	\$1,573,085	\$(274,695)	\$40,271,855

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 4 - CAPITAL ASSETS (Continued)

Reconciliation of Net Investment in Capital Assets:

	2013	2012
Capital Assets (Net of Accumulated)	\$ 42,886,498	\$ 40,271,855
Unspent Bond Proceeds	-	1,737,116
Less: Bonds Payable	(9,428,647)	(10,596,002)
	\$ 33,457,851	\$ 31,412,969

Construction in Progress

The Utility projects included in the 2013 Construction in Progress are \$4,594,350 of improvements made to the 520 2nd Ave East project; \$2,656,593 of improvements to the George Neal Generating Station Unit No. 4 and \$193 for work begun on 2013 projects.

The Utility projects included in the 2012 Construction in Progress are \$2,341,272 of improvements made to the 520 2nd 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.

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 7th St and 520 2nd 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, 2013 was \$212,500 and December 31, 2012 was \$237,500.

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 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

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

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

Trust for the same purpose of providing affordable housing in Stoneybrook First Addition. The ending balance of this loan as of December 31, 2013 and December 31, 2012 was \$0 and \$217,500, respectively.

Note 6 – BONDS PAYABLE

Bonds payable activity for the year ended December 31, 2013 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Series 2008 revenue bonds	\$ 2,110,000	\$ -	\$ 670,000	\$ 1,440,000	\$ 700,000
Series 2011 revenue bonds	8,465,000	-	495,000	7,970,000	505,000
Total revenue bonds	<u>\$10,575,000</u>	<u>\$ -</u>	<u>\$1,165,000</u>	<u>\$ 9,410,000</u>	<u>\$1,205,000</u>

Bonds Payable listed on Statement of Net Position include Unamortized Bond Premiums of \$18,647.

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
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	-	-	1,140,000	108,350
2019-2021	-	-	3,635,000	176,733
Total	<u>\$ 1,440,000</u>	<u>\$ 99,230</u>	<u>\$ 7,970,000</u>	<u>\$ 867,160</u>

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 \$10,376,390. Principal and interest due for the current year and total combined utilities net revenues were \$1,425,463 and \$1,093,098, respectively.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 6 – BONDS PAYABLE (Continued)

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, 2013 the Utility is in compliance with all bond covenant requirements.

At December 31, 2013, the special funds consisted of the following:

	Cash and Cash Equivalents	Current Investments	Noncurrent Investments	Total
Bond Sinking Fund	\$ 118,469	\$ -	\$ -	\$ 118,469
Bond Reserve Fund	1,232,440	-	-	1,232,440
Bond Improvement Fund	-	-	750,445	750,445
Other Restricted Funds	3,826	-	-	3,826
Total Restricted Net Position	\$ 1,354,735	\$ -	\$ 750,445	\$ 2,105,180

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
Total Restricted Net Position	\$ 213,859	\$ 1,525,278	\$ 457,474	\$ 2,196,611

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, 2013; 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.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 6 – BONDS PAYABLE (Continued)

The bond improvement fund balance at December 31, 2013 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 7 - 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 8 - NUMBER OF METER CONNECTIONS

The number of meter connections totaled 6,170 and 6,121 at December 31, 2013 and 2012, respectively.

Note 9 - 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:

	2013	2012
Jet turbine generator	\$ 3,269,202	\$ 3,269,202
Neal 4 plant	9,083,364	7,067,980
Wisdom 2 plant	2,315,377	2,314,530
Walter Scott 4 plant	16,006,462	15,905,311
Total	30,674,405	28,557,023
Less accumulated depreciation	(10,242,785)	(9,613,670)
Net investment	<u>\$ 20,431,620</u>	<u>\$ 18,943,353</u>

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 \$12,130, \$1,089,907 and \$169,506, respectively, in 2013. The leases of the jet turbine generator are both by non-cancelable lease and a variable lease determined by capacity and totaled \$95,828 in 2013 and \$99,836 in 2012.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 9 – LEASES (Continued)

The following is a schedule of future minimum rentals on non-cancelable operating leases on the jet turbine generator as of December 31, 2013:

2014	\$ 65,000
2015	120,000
2016	120,000
2017	120,000
Total minimum lease payment receivable	\$ 425,000

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 \$448,938 and \$448,931 in 2013 and 2012, respectively. The leases are 20-year variable leases based on bandwidth and space utilized. The payable at December 31, 2013 and 2012 was \$0.

Note 10 - 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 5.78% through June 30, 2013 and 5.95% presently of their annual salary and the Utility was required to contribute 8.67% through June 30, 2013 and 8.93% presently of annual payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2013, 2012 and 2011 were \$168,180, \$147,601 and \$132,694, 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 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 2013 and 2012 totaled \$145,701 and \$135,296, respectively.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 11 – 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>2013</u>	<u>2012</u>
Annual required contribution	\$ 26,833	\$ 26,833
Interest on net OPEB obligation	1,677	1,677
Adjustment to annual required contribution	<u>(1,666)</u>	<u>(1,666)</u>
Annual OPEB cost (Expense)	26,844	26,844
Contributions made	<u>(16,420)</u>	<u>(16,420)</u>
Increase in net OPEB obligation	10,424	10,424
Net OPEB obligation – beginning of year	<u>52,349</u>	<u>41,925</u>
Net OPEB obligation – end of year	<u>\$ 62,773</u>	<u>\$ 52,349</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
2013	\$ 26,844	61%	\$ 62,773
2012	\$ 26,844	61%	\$ 52,349

Funded Status and Funding Progress. The funded status of the plan as of December 31, 2013 was as follows:

	<u>2013</u>	<u>2012</u>
Actuarial accrued liability (AAL)	\$ 319,016	\$ 319,016
Actuarial value of plan assets	<u>-</u>	<u>-</u>
Unfunded actuarial accrued liability (UAAL)	<u>\$ 319,016</u>	<u>\$ 319,016</u>
Covered payroll (active members)	\$1,677,547	\$1,605,106
UAAL as a percentage of covered payroll	19.0%	19.9%

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 11 – OTHER POST EMPLOYMENT BENEFITS (Continued)

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.

The December 31, 2012 actuarial valuation was used for recording 2013 OPEB costs. 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 12 - 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 in the electric power industry, does not insure its transmission or distribution lines due to the high cost of such coverage.

Note 13 - RELATED PARTIES

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

One member of the Board of Trustees holds a non-controlling interest in a financial institution where the Utility maintains cash balances.

Additional related party items is included in Note 9.

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 14 - 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 October 2013 the Utility Board approved the Utility to receive a \$300,000 grant from USDA Rural Development with the intention of the Utility providing \$60,000 of matching funds to be used for the City of Spencer's emergency communications center. As of December 31, 2013 \$0 had been funded.

As of December 31, 2013 the following amounts remained to be paid for contracts were entered into by the Electric Utility for constructing improvements to the property located at 520 2nd Avenue East:

-KCL Engineering: mechanical and electrical engineering contract in the amount of \$28,500, of which remaining \$1,425 was paid in January of 2014.

-Woodruff Construction: General Contractor for front office & lobby and hvac improvements contract in the amount \$2,205,118, of which \$1,758,644 was paid as of 12/31/2013

NOTE 15 --PRIOR PERIOD ADJUSTMENT - ACCOUNTING CHANGE

During 2013, the Utility implemented Governmental Accounting Standards Board Statement No. 65 and the Utility has restated the beginning net position in the Statement of Net Position. In previous years, bond issuance costs were deferred and amortized over the term of the bonds. GASB No. 65 now requires these costs to be recognized in the period the loan originated. This results in decreasing the 2012 beginning net position by \$177,540.

Net Position, As Previously Reported	\$46,274,181
Accounting Change – Bond Costs	<u>(177,540)</u>
Beginning Net Position, As Restated	<u>\$46,096,641</u>

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, 2013**

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%
2013	12/31/2012	\$ -	\$ 319,016	\$ 319,016	0%	\$ 1,677,547	19.0%

See Note 11 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)
FOR ELECTRIC, WATER, AND COMMUNICATIONS
OTHER SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2013**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
Receipts:				
Municipal Electric Utility			\$ 14,773,012	
Municipal Water Utility			2,285,315	
Municipal Communications Utility			7,524,873	
Total Receipts	\$ 32,590,069	\$ 27,630,703	24,583,200	\$ (3,047,503)
Expenditures:				
Municipal Electric Utility			18,560,930	
Municipal Water Utility			3,722,457	
Municipal Communications Utility			8,558,233	
Total Expenditures	36,423,905	38,041,831	30,841,620	(7,200,211)
Change in Net Position	(3,833,836)	(10,411,128)	(6,258,420)	(10,247,714)
Net Position at Beginning of Year	17,701,278	22,074,627	22,074,627	-
Net Position at End of Year	\$ 13,867,442	\$ 11,663,499	\$ 15,816,207	\$ (10,247,714)

See Accompanying Independent Auditors' Report

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGET TO GAAP RECONCILIATION
FOR ELECTRIC, WATER, AND COMMUNICATIONS
OTHER SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2013**

	Cash Basis	Accrual Adjustments	Accrual Basis
Receipts:			
Municipal Electric Utility	\$ 14,773,012	\$ (99,105)	\$ 14,673,907
Municipal Water Utility	2,285,315	64,970	2,350,285
Municipal Communications Utility	7,524,873	(355,062)	7,169,811
Total Receipts	<u>24,583,200</u>	<u>(389,197)</u>	<u>24,194,003</u>
Expenditures:			
Municipal Electric Utility	18,560,930	(3,972,948)	14,587,982
Municipal Water Utility	3,722,457	(2,031,550)	1,690,907
Municipal Communications Utility	8,558,233	(2,984,602)	5,573,631
Total Expenditures	<u>30,841,620</u>	<u>(8,989,100)</u>	<u>21,852,520</u>
Change in Net Position	(6,258,420)	8,599,903	2,341,483
Net Position at Beginning of Year	<u>22,074,627</u>	<u>40,295,021</u>	<u>62,369,648</u>
Net Position at End of Year	<u>\$ 15,816,207</u>	<u>\$ 48,894,924</u>	<u>\$ 64,711,131</u>

**MUNICIPAL ELECTRIC UTILITY
OF THE CITY OF SPENCER, IOWA
OTHER SUPPLEMENTARY INFORMATION –
BUDGETARY REPORTING
YEAR ENDED DECEMBER 31, 2013**

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.



**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, 2013, 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, 2014.

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.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, described in the accompanying Schedule of Findings as item 13-II-A that we consider 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*.

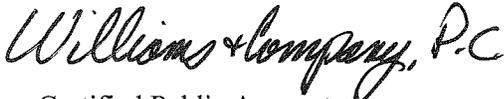
Spencer Municipal Utility's Response to Findings

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.


Certified Public Accountants

Spencer, Iowa
April 1, 2014

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL ELECTRIC UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2013**

Part I: Summary of the Independent Auditors' Results:

- (a) An unmodified 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:

13-II-A Financial Reporting – During the audit, we identified immaterial amounts of payables, accrued interest and expenses 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, 2013**

Part III: Other Findings Related to Required Statutory Reporting

III-A-13 Certified Budget – Disbursements during the year ended December 31, 2013 did not exceed the amounts budgeted in the business type activities function.

III-B-13 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-13 Travel Expenses – No expenditures of the Utility’s money for travel expenses of spouses of Utility’s officials or employees were noted.

III-D-13 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>
Dan Shuck, SMU Employee Owner of Accurate Appliance	Fridge, Stove, Microwave, Washer and Dryer	\$ 2,566 (1)
Dave Hultgren, Board Member Owner, Northwest Equipment	Maintenance and Repairs	\$ 158 (2)
Jason Remillard, SMU Employee Owner, Remillard Grafx	Maintenance and Repairs Marketing	\$ 81 (2) \$ 39 (2)

- (1) This transaction may represent a conflict of interest since the total transaction was more than \$1,500 during the year, per Chapter 362.5(10) of the Code of Iowa. However, competitive bids were received for this transaction.
- (2) 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-13 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-13 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

III-G-13 Revenue Bonds – As of December 31, 2013 the Utility is in compliance with all bond covenant requirements.

III-H-13 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**



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, 2013 and 2012, 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 opinion.

Opinion

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, 2013 and 2012 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.

Emphasis of Matter

In 2013, the Utility adopted new accounting guidance, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

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 35 through 38 and page 54 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 55 through 57 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, 2014 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, 2014

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, 2013 and 2012.

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

2013 Financial Highlights

The Utility delivered approximately 428,173,000 gallons of water to its retail customers in 2013 compared to approximately 406,694,000 gallons in 2012.

The Utility's net position increased by \$659,378 to \$8,216,223 as a result of operations for the year ended December 31, 2013.

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>2013</u>	<u>2012</u>
Current Assets	\$ 2,772,641	\$4,177,490
Capital Assets, Net of Depreciation	<u>8,820,057</u>	<u>7,112,911</u>
Total Assets	<u>11,592,698</u>	<u>11,290,401</u>
Current Liabilities	1,155,670	1,355,148
Noncurrent Liabilities	14,125	11,591
Long-Term Debt	<u>2,206,680</u>	<u>2,366,817</u>
Total Liabilities	<u>3,376,475</u>	<u>3,733,556</u>
Net Investment in Capital Assets	6,453,377	4,581,094
Restricted	337,665	818,973
Unrestricted	<u>1,425,181</u>	<u>2,156,778</u>
Total Net Position	<u>\$8,216,223</u>	<u>\$7,556,845</u>

Condensed Statements of Revenues, Expenses and Changes in Net Position

Sales of Water	\$2,210,022	\$1,964,894
Other	<u>24,760</u>	<u>13,595</u>
Total Operating Revenue	<u>2,234,782</u>	<u>1,978,489</u>
System Operation & Maintenance	809,377	736,605
Depreciation & Amortization	522,772	505,367
Customer Service & Administration	<u>218,646</u>	<u>192,122</u>
Total Operating Expenses	<u>1,550,795</u>	<u>1,434,094</u>
Operating Income	683,987	544,395
Interest Income	5,182	4,879
Interest Expense	(43,809)	(33,773)
Other Income (Expense)	<u>14,018</u>	<u>2,506</u>
Total Non-Operating Revenues	<u>(24,609)</u>	<u>(26,388)</u>
Change in Net Position	659,378	518,007
Net Position, Beginning of Year	<u>7,556,845</u>	<u>7,038,838</u>
Net Position, End of Year	<u>\$8,216,223</u>	<u>\$7,556,845</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Analysis

The Utility's total net position increased by approximately \$659,000.

The Utility's gross revenues increased by approximately \$256,000 or 13%. Water sales and outside water sales were lower in 2013 by approximately 9 million, 2%, and 13 million, 17%, gallons, respectively. Water sales rates were increased effective with June 2013 consumption in addition to eliminating the declining rate structure so all customers pay the same rate for all consumption. In addition, effective June 2013, the customer charge was increased from \$10 to \$15 per customer connections to the water main.

System operating expenses increased by approximately \$73,000 in 2013 compared to 2012. In 2013, maintenance of the water plant, meter purchases, cost to locate and power costs increased by approximately \$30,000 compared to 2012. In addition, roads were needed to access wells 12 and 13 which cost approximately \$20,000. Also, the quantity of lime purchased in 2013 compared to 2012 increased by approximately 12% in addition to an increase in the fuel surcharge of lime delivery of approximately 49%. The quantity of other chemicals used in the treatment of water also increased in 2013 vs. 2012. In total, the chemical cost increase in 2013 compared to 2012 was approximately \$24,000.

Total operating income generated in 2013 was \$683,987 compared to a \$544,395 gain in 2012.

Contributions in Aid of Construction totaled \$52,657 for the year ended December 31, 2013 compared to \$2,914 for the year ended December 31, 2012.

The Utility had a change in net position of \$659,378 for the year ended December 31, 2013 compared to a change in net position of \$518,007 for the year ended December 31, 2012.

Capital Assets and Debt Administration

Net capital assets increased by approximately \$1,700,000 in 2013 compared to 2012. The increase was partially due to the completion of water main projects, replacement as well as new main, which included 17,456 lineal feet of 4", 6", 8", 10" and 12" water main during the year ended December 31, 2013. In addition, the cost of construction in progress relating to wells 12 and 13, new water plant, 32nd Avenue pump house and Utility's ownership in the 520 2nd Avenue East building.

The water plant evaluation, conducted by Bolton & Menk, has been completed. Leggette, Brashears & Graham, Inc. ("LBG") completed their review of the well field to identify future well capacity requirements, well locations as well as overall management of the aquifer. Design is substantially complete for both the water plant, well 12 and well 13 construction. The Utility will begin construction once permits have been approved by the DNR.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Economic Factors

During the year ended December 31, 2013, the Utility experienced a change in net position of \$659,378. The rate adjustment effective with consumption beginning June 1, 2013 in addition to the increase in customer charge effective June 1, 2013 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, 520 2nd Avenue East, Suite 1, Spencer, Iowa 51301.

FINANCIAL STATEMENTS

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF NET POSITION
DECEMBER 31, 2013 AND 2012**

	2013	2012
ASSETS		
Current Assets:		
Cash and Cash Equivalents		
Unrestricted	\$ 179,414	\$ 1,544,354
Board Designated	1,519,106	1,579,106
Restricted	337,665	349,867
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$2,500 and \$2,500)	580,671	572,285
Unbilled Usage	42,192	32,864
Materials and Supplies Inventory	100,420	86,981
Prepayments and Other	13,173	12,033
	2,772,641	4,177,490
Capital Assets:		
Land	449,581	359,081
Construction in Progress	1,169,767	320,406
Plant in Service	15,603,037	14,312,980
Accumulated Depreciation	(8,402,328)	(7,879,556)
	8,820,057	7,112,911
Total Assets	11,592,698	11,290,401
LIABILITIES		
Current Liabilities:		
Accounts Payable	948,912	1,145,890
Payroll and Sales Tax Payable	3,546	10,370
Accrued Payroll and Compensated Absences	30,533	15,352
Accrued Interest Payable	7,279	18,536
Unearned Revenue	5,400	-
Current Maturities of Long-Term Debt	160,000	165,000
	1,155,670	1,355,148
Noncurrent Liabilities:		
Bonds Payable	2,366,680	2,531,817
Less - Current Maturities	(160,000)	(165,000)
Net OPEB Liability	14,125	11,591
	2,220,805	2,378,408
Total Liabilities	3,376,475	3,733,556
NET POSITION		
Net Position		
Net Investment in Capital Assets	6,453,377	4,581,094
Restricted	337,665	349,867
Unrestricted	1,425,181	2,625,884
	\$ 8,216,223	\$ 7,556,845

See Accompanying Notes to Financial Statements

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET POSITION
FOR THE YEARS ENDED DECEMBER 31, 2013 AND 2012**

	2013	2012
Operating Revenues:		
Residential	\$ 1,565,743	\$ 1,380,430
Commercial	644,279	584,464
Service Permits	22,000	11,150
Miscellaneous	2,760	2,445
	2,234,782	1,978,489
Operating Expenses:		
Treatment	449,068	385,000
Distribution	360,309	351,605
Depreciation and Amortization	522,772	505,367
Customer Operations	48,852	37,031
General and Administrative	169,794	155,091
	1,550,795	1,434,094
Operating Income	683,987	544,395
Non-Operating Income (Expense):		
Interest Income on Investments	5,182	4,879
Contributions From Developers	52,657	2,914
Resource Conservation	-	(52)
Leased Facilities	57,486	88,230
Interest Expense	(43,809)	(33,773)
Inventory Sales	178	730
Payment in Lieu of Property Taxes	(96,303)	(89,316)
	(24,609)	(26,388)
Change in Net Position	659,378	518,007
Net Position at Beginning of Year	7,556,845	7,101,703
Prior Period Adjustment - Change in Accounting	-	(62,865)
Net Position at Beginning of Year, as Restated	7,556,845	7,038,838
Net Position at End of Year	\$ 8,216,223	\$ 7,556,845

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, 2013 AND 2012**

	2013	2012
Cash Flows From Operating Activities:		
Cash Received From Customers	\$ 2,222,468	\$ 1,893,122
Cash Payments to Suppliers for Goods and Services	(839,393)	(84,850)
Cash Payments to Employees for Services	(389,296)	(376,868)
Cash Payments In Lieu of Property Taxes	(96,303)	(89,316)
Cash Payments for Resource Conservation	-	(52)
Payments Received From Leasing of Facilities	57,487	88,230
	954,963	1,430,266
Net Cash Provided By Operating Activities		
Cash Flows From Capital and Related Financing Activities:		
Acquisition & Construction of Property and Equipment	(2,177,261)	(1,505,673)
Proceeds from Revenue Bond	-	2,531,873
Revenue Bond Principal Repayment	(165,000)	(885,000)
Payments Received From Sale of Inventory	178	730
Interest Paid	(55,204)	(19,695)
	(2,397,287)	122,235
Net Cash Provided (Used) By Capital and Related Financing Activities		
Cash Flows From Investing Activities:		
Interest Received From Investments	5,182	4,879
	(1,437,142)	1,557,380
Net Increase (Decrease) in Cash		
Cash and Cash Equivalents at Beginning of Year	3,473,327	1,915,947
Cash and Cash Equivalents at End of Year	\$ 2,036,185	\$ 3,473,327
Reconciliation:		
Cash and Cash Equivalents		
Unrestricted	\$ 179,414	\$ 1,544,354
Restricted	337,665	349,867
Board Designated	1,519,106	1,579,106
	\$ 2,036,185	\$ 3,473,327

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, 2013 AND 2012**

	2013	2012
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating Income	\$ 683,987	\$ 544,395
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities		
Depreciation and Amortization	522,772	505,367
Leased Facilities Income	57,487	88,230
Payment in Lieu of Property Taxes	(96,303)	(89,316)
Payment for Resource Conservation	-	(52)
(Increase) Decrease in Operating Assets:		
Accounts Receivable	(8,386)	(84,488)
Unbilled Usage	(9,328)	(879)
Materials and Supplies Inventory	(13,439)	(12,770)
Prepayments	(1,140)	(2,692)
Increase (Decrease) in Operating Liabilities:		
Accounts Payable	(196,978)	475,412
Accrued Payroll and Compensated Absences	8,357	4,525
Unearned Revenue	5,400	-
Net OPEB Liability	2,534	2,534
Total Adjustments	270,976	885,871
Net Cash Provided By Operating Activities	\$ 954,963	\$ 1,430,266

See Accompanying Notes to Financial Statements

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

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 managed, 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.

Depreciation is provided on a straight-line basis. Depreciation expense is approximately 3.21% of the original cost of depreciable water plant in service.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Net Position

Net position represents the difference between assets and liabilities in the financial statements. Net investment in capital assets, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets 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 position is available.

F. 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.

G. Revenues and Unbilled Usage

Revenues are based on billing rates, which are applied to customers' consumption of water and number of connections to the water main. The Utility records estimated unbilled revenue at the end of accounting periods. Revenues earned, but not yet billed at December 31, 2013 and 2012 totaled \$42,192 and \$32,864, respectively.

H. 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.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 2 - CASH AND CASH EQUIVALENTS AND NONCURRENT INVESTMENTS

The Utility's deposits in bank at December 31, 2013 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:

	2013	2012
Cash and cash equivalents:		
Board designated	\$ 1,519,106	\$ 1,579,106
Restricted	337,665	349,867
Unrestricted	179,415	1,544,354
Total cash and cash equivalents	<u>\$ 2,036,186</u>	<u>\$ 3,473,327</u>

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 position, 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 position, are being designated for replacement of property, plant, and equipment and for new construction. These funds cannot be expended without Board approval.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 3 - BOARD DESIGNATED FUNDS (Continued)

Assets of the funds as of December 31, 2013 are summarized as follows:

	Contingency Reserve	Replacement and Construction Reserve	Total
Cash and cash equivalents	\$ 469,106	\$ 1,050,000	\$ 1,519,106
Total	<u>\$ 469,106</u>	<u>\$ 1,050,000</u>	<u>\$ 1,519,106</u>

Assets of the funds as of December 31, 2012 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, 2013 was as follows:

	Beginning Balance	Additions and Transfers In	Deletions and Transfers Out	Ending Balance
Capital assets not being depreciated:				
Land	\$ 359,081	\$ 90,500	\$ -	\$ 449,581
Construction in progress	320,406	1,115,543	(266,182)	1,169,767
Total capital assets not being depreciated	<u>679,487</u>	<u>1,206,043</u>	<u>(266,182)</u>	<u>1,619,348</u>
Capital assets being depreciated:				
Infrastructure	9,187,835	1,010,740	-	10,198,575
Buildings and equipment	4,859,136	269,317	-	5,128,453
Vehicles	266,009	10,000	-	276,009
Total capital assets being depreciated	<u>14,312,980</u>	<u>1,290,057</u>	<u>-</u>	<u>15,603,037</u>
Less accumulated depreciation	<u>7,879,556</u>	<u>522,772</u>	<u>-</u>	<u>8,402,328</u>
Total capital assets being depreciated - net	<u>6,433,424</u>	<u>767,285</u>	<u>-</u>	<u>7,200,709</u>
Net capital assets	<u>\$ 7,112,911</u>	<u>\$1,973,328</u>	<u>\$(266,182)</u>	<u>\$ 8,820,057</u>

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 4 - CAPITAL ASSETS (Continued)

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	317,037	420,954	(58,504)	679,487
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	13,225,740	1,087,240	-	14,312,980
Less accumulated depreciation	7,377,198	502,358	-	7,879,556
Total capital assets being depreciated - net	5,848,542	584,882	-	6,433,424
Net capital assets	\$ 6,165,579	\$1,005,836	\$(58,504)	\$ 7,112,911

Reconciliation of Net Investment in Capital Assets:

	<u>2013</u>	<u>2012</u>
Capital Assets (Net of Accumulated)	\$ 8,820,057	\$ 7,112,911
Less: Bonds Payable	(2,366,680)	(2,531,817)
	<u>\$ 6,453,377</u>	<u>\$ 4,581,094</u>

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.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 7 – BONDS PAYABLE

Bonds payable activity for the year ended December 31, 2013 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 2012 Revenue Bonds	\$2,530,000	\$ -	\$ 165,000	\$2,365,000	\$160,000
Total	<u>\$2,530,000</u>	<u>\$ -</u>	<u>\$ 165,000</u>	<u>\$2,365,000</u>	<u>\$160,000</u>

The Bonds Payable on the Statement of Net Position include \$1,680 of unamortized premiums.

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	\$160,000
Series 2000 Revenue Bonds	885,000	-	885,000	-	-
Total	<u>\$ -</u>	<u>\$ 2,530,000</u>	<u>\$ 885,000</u>	<u>\$2,530,000</u>	<u>\$160,000</u>

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 5/1/2015 is 1.000%. Effective 5/1/2015 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:

	Series 2012	
	Principal	Interest
2014	\$ 160,000	\$ 42,875
2015	165,000	41,250
2016	165,000	39,476
2017	170,000	37,423
2018	170,000	35,085
2019-2023	920,000	126,909
2024-2026	615,000	23,737
Total	<u>\$ 2,365,000</u>	<u>\$ 346,755</u>

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.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 7 – BONDS PAYABLE (Continued)

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 \$2,711,755. Principal and interest paid for the current year and total combined utilities net revenues were \$220,202 and \$1,206,757, 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, 2013 and 2012 the Utility is in compliance with all bond covenant requirements.

The special funds consisted of the following:

	2013	2012
Bond Sinking Fund	\$ 122,080	\$ 134,282
Bond Reserve Fund	215,585	215,585
Total	\$ 337,665	\$ 349,867

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, 2013 and 2012 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 5,955 and 5,884 at December 31, 2013 and 2012, respectively.

Note 10 - LEASES

Effective January 2012 the Utility entered into a six month lease with month to month option thereafter. The lease is a monthly lease and totaled \$60,000 in 2012. The Utility received lease payments totaling \$20,000 in 2013 due to tenant terminating the month to month lease. Effective

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 10 – LEASES (Continued)

November 2013 the Utility entered into a two year lease with month to month option for one year thereafter. The lease is a monthly lease and totaled \$800 in 2013. A one year and ten month lease was entered into December 2013, effective January 2014. The lease is a monthly lease.

Effective September 2006 the Utility entered into a nine year lease with five year term option thereafter. The lease was amended effective July 2012 for additional equipment. The lease is a monthly lease and totaled \$18,000 and \$15,000 in 2013 and 2012, respectively.

Effective April 2013 the Utility entered into a two year 11 month lease with two five year term options thereafter. The lease is a monthly lease and totaled \$4,995 in 2013.

Effective March 2009 the Utility entered into a seven year extended lease term. The lease is a monthly lease and totaled \$13,692 and \$13,230 in 2013 and 2012, respectively.

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 in 2013 and 2012. The payable at December 31, 2013 and 2012 was \$0.

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 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 5.78% through June 30, 2013 and 5.95% presently of their annual salary and the Utility was required to contribute 8.67% through June 30, 2013 and 8.93% presently of annual payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2013, 2012 and 2011 were \$25,316, \$22,456 and \$17,817, 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 2013 and 2012 totaled \$20,746 and \$21,416, respectively.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

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>2013</u>	<u>2012</u>
Annual required contribution	\$ 2,531	\$ 2,531
Interest on net OPEB obligation	363	363
Adjustment to annual required contribution	<u>(360)</u>	<u>(360)</u>
Annual OPEB cost (Expense)	2,534	2,534
Contributions made	<u>0</u>	<u>0</u>
Increase in net OPEB obligation	2,534	2,534
Net OPEB obligation – beginning of year	<u>11,591</u>	<u>9,057</u>
Net OPEB obligation – end of year	<u>\$14,125</u>	<u>\$11,591</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
2013	\$ 2,534	0%	\$ 14,125
2012	\$ 2,534	0%	\$ 11,591

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 12 – OTHER POST EMPLOYMENT BENEFITS (Continued)

Funded Status and Funding Progress. The funded status of the plan as of December 31, 2013 was as follows:

	2013	2012
Actuarial accrued liability (AAL)	\$ 15,921	\$ 15,921
Actuarial value of plan assets	-	-
Unfunded actuarial accrued liability (UAAL)	<u>\$ 15,921</u>	<u>\$ 15,921</u>
Covered payroll (active members)	\$270,662	\$266,434
UAAL as a percentage of covered payroll	6.0%	6.0%

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.

The December 31, 2012 actuarial valuation was used for recording 2013 OPEB costs. 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 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.

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

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.

One member of the Board of Trustees holds a non-controlling interest 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 \$215,766 for improvements to water mains located by West 3rd Street and 4th Avenue West. The improvements included main replacement of approximately 1,142 lineal feet of 12” pipe and 10 lineal feet of 6” pipe. Project was completed in 2013 and \$105,205 remained unpaid as of December 31, 2013.

Spencer Municipal Utilities entered into an agreement with Valley Contracting, Inc., in June 2013. The contract is in the amount of \$591,725 for improvements to water mains located by North Water tower to 24th St and 10th Avenue East to 18th St East. The improvements included main replacement of approximately 1,993 lineal feet of 6” pipe, 7,116 lineal feet of 12” pipe and 6 lineal feet of 16” pipe. Project completion should occur no later than June 2014.

NOTE 16 –PRIOR PERIOD ADJUSTMENT - ACCOUNTING CHANGE

During 2013, the Utility implemented Governmental Accounting Standards Board Statement No. 65 and the Utility has restated the beginning net position in the Statement of Net Position. In previous years, bond issuance costs were deferred and amortized over the term of the bonds. GASB No. 65 now requires these costs to be recognized in the period the loan originated. This results in decreasing the 2012 beginning net position by \$62,865.

Net Position, As Previously Reported	\$7,101,703
Accounting Change – Bond Costs	<u>(62,865)</u>
Beginning Net Position, As Restated	<u>\$7,038,838</u>

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, 2013**

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%
2013	12/31/2012	\$ -	\$ 15,921	\$ 15,921	0%	\$ 270,662	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)
FOR ELECTRIC, WATER, AND COMMUNICATIONS
OTHER SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2013**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
Receipts:				
Municipal Electric Utility			\$ 14,773,012	
Municipal Water Utility			2,285,315	
Municipal Communications Utility			7,524,873	
Total Receipts	\$ 32,590,069	\$ 27,630,703	24,583,200	\$ (3,047,503)
Expenditures:				
Municipal Electric Utility			18,560,930	
Municipal Water Utility			3,722,457	
Municipal Communications Utility			8,558,233	
Total Expenditures	36,423,905	38,041,831	30,841,620	(7,200,211)
Change in Net Position	(3,833,836)	(10,411,128)	(6,258,420)	(10,247,714)
Net Position at Beginning of Year	17,701,278	22,074,627	22,074,627	-
Net Position at End of Year	\$ 13,867,442	\$ 11,663,499	\$ 15,816,207	\$ (10,247,714)

See Accompanying Independent Auditors' Report

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGET TO GAAP RECONCILIATION
FOR ELECTRIC, WATER, AND COMMUNICATIONS
OTHER SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2013**

	Cash Basis	Accrual Adjustments	Accrual Basis
Receipts:			
Municipal Electric Utility	\$ 14,773,012	\$ (99,105)	\$ 14,673,907
Municipal Water Utility	2,285,315	64,970	2,350,285
Municipal Communications Utility	7,524,873	(355,062)	7,169,811
Total Receipts	<u>24,583,200</u>	<u>(389,197)</u>	<u>24,194,003</u>
Expenditures:			
Municipal Electric Utility	18,560,930	(3,972,948)	14,587,982
Municipal Water Utility	3,722,457	(2,031,550)	1,690,907
Municipal Communications Utility	8,558,233	(2,984,602)	5,573,631
Total Expenditures	<u>30,841,620</u>	<u>(8,989,100)</u>	<u>21,852,520</u>
Change in Net Position	(6,258,420)	8,599,903	2,341,483
Net Position at Beginning of Year	<u>22,074,627</u>	<u>43,632,395</u>	<u>62,369,648</u>
Net Position at End of Year	<u>\$ 15,816,207</u>	<u>\$ 52,232,298</u>	<u>\$ 64,711,131</u>

See Accompanying Independent Auditors' Report

**MUNICIPAL WATER UTILITY
OF THE CITY OF SPENCER, IOWA
OTHER SUPPLEMENTARY INFORMATION –
BUDGETARY REPORTING
YEAR ENDED DECEMBER 31, 2013**

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.



**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, 2013, 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, 2014.

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.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify a deficiency in internal control, described in the accompanying Schedule of Findings as item 13-II-A that we consider 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, 2014

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL WATER UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2013**

Part I: Summary of the Independent Auditors' Results:

- (a) An unmodified 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:

13-II-A Financial Reporting – During the audit, we identified immaterial amounts of accrued interest and expense 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, 2013**

Part III: Other Findings Related to Required Statutory Reporting

III-A-13 Certified Budget – Disbursements during the year ended December 31, 2013 did not exceed the amounts budgeted in the business type activities function.

III-B-13 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-13 Travel Expenses – No expenditures of the Utility’s money for travel expenses of spouses of Utility’s officials or employees were noted.

III-D-13 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>
Jason Remillard, SMU Employee	Maintenance and Repairs	\$ 10 (1)
Owner, Remillard Grafx	Marketing	\$ 9 (1)

(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-13 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-13 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

III-G-13 Revenue Bonds – As of December 31, 2013 the Utility is in compliance with all bond covenant requirements.

III-H-13 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



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, 2013 and 2012, 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 opinion.

Opinion

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, 2013 and 2012 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.

Emphasis of Matter

In 2013, the Utility adopted new accounting guidance, GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

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 64 through 67 and page 80 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 81 through 83 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, 2014 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.

William & Company, P.C.
Certified Public Accountants

Spencer, Iowa
April 1, 2014

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, 2013 and 2012.

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

2013 Financial Highlights

Total net capital assets increased by approximately \$3,160,000 which was mainly attributable to the Fiber to the Home construction which amounted to approximately \$1,700,000. The Utility's ownership in the 520 2nd Avenue East building, in the amount of approximately \$1,600,000, also attributed to the increase in net capital assets. In addition, the purchase of a new phone switch and satellite also attributed to the increase in net capital assets.

Total liabilities increased as of December 31, 2013 compared to December 31, 2012 by approximately \$161,000 primarily from an increase in payments owed to both the Electric and Water Utility.

Total net position increased by \$1,596,180 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>2013</u>	<u>2012</u>
Current Assets	\$ 3,898,647	\$5,365,239
Capital Assets, Net of Depreciation	6,752,477	3,591,222
Noncurrent assets	<u>891,598</u>	<u>829,238</u>
Total assets	<u>11,542,722</u>	<u>9,785,699</u>
Current Liabilities	1,010,300	857,891
Noncurrent Liabilities	<u>86,192</u>	<u>77,758</u>
Total liabilities	<u>1,096,492</u>	<u>935,649</u>
Net Investment in Capital Assets	6,752,477	3,591,222
Unrestricted	<u>3,693,753</u>	<u>5,258,828</u>
Total net position	<u>\$10,446,230</u>	<u>\$8,850,050</u>

Condensed Statements of Revenues, Expenses and Changes in Net Position

Cable Television Revenue	\$2,753,916	\$2,509,156
Telephone Revenue	2,483,730	2,309,944
Data Revenue	1,633,047	1,572,315
Miscellaneous Revenue	<u>16,315</u>	<u>15,328</u>
Total Operating Revenue	<u>6,887,008</u>	<u>6,406,743</u>
Plant Specific and Programming	3,482,076	3,561,057
Depreciation & Amortization	658,686	778,266
Customer service & Administration	<u>1,401,135</u>	<u>1,355,781</u>
Total operating expenses	<u>5,541,897</u>	<u>5,695,104</u>
Operating Income	1,345,111	711,639
Interest Income	13,241	14,814
Interest Expense	-	(45,000)
Other Income (Expense)	<u>237,828</u>	<u>146,807</u>
Total Non-Operating Revenues	<u>251,069</u>	<u>116,621</u>
Change in Net Position	1,596,180	828,260
Net Position, Beginning of Year	<u>8,850,050</u>	<u>8,021,790</u>
Net Position, End of Year	<u>\$10,446,230</u>	<u>\$8,850,050</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Analysis

The Utility's total assets increased by approximately \$1,760,000.

The Utility's gross revenues increased by approximately \$480,000 or 7%. The revenue increase was primarily due to the elimination of the one wire discount which amounted to approximately \$236,000. Bulk tv revenue also increased by approximately \$22,000 due to contract renewals effective June 2013 which included increased rates. Internet revenue also increased due to a 2% increase in overall internet customers and customers moving to higher internet speeds which amounted to an approximately \$52,000 increase. Telephone sales revenue increased in 2013 by approximately \$174,000 due to access revenue.

Total operating expenses decreased by approximately \$153,000. The decrease was partially due to the drop in tv premium programming fees paid based on a 29% decrease, or 68 customers, from 2013 compared to 2012. The Utility incurred employee turnover which resulted in reassignment of some job duties to other positions, longer than anticipated period to rehire for certain positions and transfer within Utility to open position and elimination of positions. Operating expenses also decreased in 2013 due to an increase in capital projects and decrease in depreciation expense.

The customer service and administration increased by approximately \$45,000 from 2012 to 2013. The increase was due to a change in the employee handbook which converted sick leave to PTO and therefore changed the accounting of unused balances.

Total operating income generated in 2013 was \$1,345,111 compared to \$711,639 in 2012.

The Utility had an increase in net position of \$1,596,180 for the year ended December 31, 2013 compared to an increase in net position of \$828,260 for the year ended December 31, 2012.

Capital Assets and Debt Administration

Net capital assets increased by approximately \$3,160,000 for year ending December 31, 2013 compared to a decrease by approximately \$273,000 for year ending December 31, 2012. The decrease was due to depreciation exceeding assets placed in service for both years ending December 31, 2012.

Economic Factors

The Utility has continued to experience a slight decrease in its Cable TV subscriber base and telephone line customers, primarily residential. Rate increases in 2011 to Cable TV were implemented to cover annual programming increases charged to the Utility for providing cable service. In addition, the elimination of the one wire discount in February 2013 led to residential customers dropping phone lines and or Cable TV premium channels. As customers continue to acquire more electronic devices and stream online

MANAGEMENT'S DISCUSSION AND ANALYSIS

Economic Factors (Continued)

videos, tv content, etc. in their home it is essential that the Utility continues to provide fast and reliable internet service. In order to do so the continuation of the Fiber to the Home construction will be a top priority for the Utility. The Fiber to the Home project that began mid 2013 will be completed mid to late 2014.

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, 520 2nd Avenue East, Suite 1, Spencer, Iowa 51301.

FINANCIAL STATEMENTS

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
STATEMENTS OF NET POSITION
DECEMBER 31, 2013 AND 2012**

	2013	2012
ASSETS		
Current Assets:		
Cash and Cash Equivalents	\$ 2,862,316	\$ 3,895,676
Consumer Deposits	50,437	59,404
Accounts Receivable (Net of Allowance for Doubtful Accounts of \$7,600 and \$7,975,808)	687,426	1,076,877
Unbilled Usage	92,635	131,973
Materials and Supplies Inventory	114,616	117,671
Prepayments and Other	91,217	83,638
Total Current Assets	3,898,647	5,365,239
Capital Assets:		
Land	10,342	10,342
Property and Equipment	17,371,078	13,571,865
Accumulated Depreciation	(10,628,943)	(9,990,985)
Total Capital Assets	6,752,477	3,591,222
Noncurrent Assets:		
Long-term Receivables	891,598	829,238
Total Noncurrent Assets	891,598	829,238
Total Assets	11,542,722	9,785,699
LIABILITIES		
Current Liabilities:		
Accounts Payable	813,280	704,253
Payroll and Sales Tax Payable	19,713	25,302
Accrued Payroll and Compensated Absences	124,470	66,532
Deferred Revenue	2,400	2,400
Consumer Deposits	50,437	59,404
Total Current Liabilities	1,010,300	857,891
Noncurrent Liabilities		
Deferred Revenue	34,800	37,200
Net OPEB Liability	51,392	40,558
Total Noncurrent Liabilities	86,192	77,758
Total Liabilities	1,096,492	935,649
NET POSITION		
Net Position		
Net Investment in Capital Assets	6,752,477	3,591,222
Unrestricted	3,693,753	5,258,828
Total Net Position	\$ 10,446,230	\$ 8,850,050

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, 2013 AND 2012**

	2013	2012
Operating Revenues:		
Cable System Revenue	\$ 2,753,916	\$ 2,509,156
Telephone System Revenue	2,483,730	2,309,944
Data Services Revenue	1,633,047	1,572,315
Miscellaneous Income	16,315	15,328
Total Operating Revenues	6,887,008	6,406,743
Operating Expenses:		
Plant Specific and Programming	3,482,076	3,561,057
Depreciation and Amortization	658,686	778,266
Customer Services and Marketing	768,300	767,437
General and Administrative	632,835	588,344
Total Operating Expenses	5,541,897	5,695,104
Operating Income	1,345,111	711,639
Non-Operating Income (Expense):		
Leased Facilities	156,685	175,509
Net Income from Joint Ventures	103,164	74,324
Economic Development Payment	(31,734)	(25,700)
Interest Income	13,241	14,814
Interest Expense	-	(45,000)
Inventory Sales	328	2,313
Gain on Plant Retirements	9,385	-
Payment in Lieu of Property Taxes	-	(79,639)
Total Non-Operating Income	251,069	116,621
Change in Net Position	1,596,180	828,260
Net Position at Beginning of Year	8,850,050	8,021,790
Net Position at End of Year	\$ 10,446,230	\$ 8,850,050

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, 2013 AND 2012**

	2013	2012
Cash Flows From Operating Activities:		
Cash Received From Customers	\$ 7,304,430	\$ 7,156,873
Cash Payments to Suppliers for Goods and Services	(3,255,297)	(3,702,929)
Cash Payments to Employees for Services	(1,451,261)	(1,501,751)
Cash Payments for Economic Development and In Lieu of Property Taxes	(31,734)	(105,339)
Payments Received From Leasing of Facilities	156,685	175,509
	2,722,823	2,022,363
Cash Flows From Capital and Related Financing Activities:		
Acquisition & Construction of Property and Equipment	(3,819,941)	(504,136)
Proceeds from the Sale of Assets	9,385	-
Payments Received from Sale of Inventory	328	2,313
Note Payable Principal Payment	-	(1,000,000)
Interest Paid	-	(45,000)
	(3,810,228)	(1,546,823)
Cash Flows From Investing Activities:		
Other Investments	40,804	75,000
Interest Received From Investments	13,241	14,814
	54,045	89,814
Net Cash Provided By Investing Activities	54,045	89,814
Net Increase (Decrease) in Cash	(1,033,360)	565,354
Cash and Cash Equivalents at Beginning of Year	3,895,676	3,330,322
Cash and Cash Equivalents at End of Year	\$ 2,862,316	\$ 3,895,676

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, 2013 AND 2012**

**Reconciliation of Operating Income to Net
Cash Provided by Operating Activities**

Operating Income	\$ 1,345,111	\$ 711,639
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities		
Depreciation and Amortization	658,686	778,266
Leased Facilities Income	156,685	175,509
Contributions Paid for Economic Development	(31,734)	(25,700)
Payment in Lieu of Property Taxes	-	(79,639)
(Increase) Decrease in Operating Assets:		
Consumer Deposits	8,967	(1,619)
Accounts Receivable	389,451	647,901
Unbilled Usage	39,338	106,248
Materials and Supplies Inventory	3,055	(21,126)
Prepayments	(7,579)	27,902
Increase (Decrease) in Operating Liabilities:		
Accounts Payable	109,027	(314,005)
Accrued Payroll and Compensated Absences	52,349	6,934
Consumer Deposits	(8,967)	1,619
Deferred Revenue	(2,400)	(2,400)
Net OPEB Liability	10,834	10,834
Total Adjustments	<u>1,377,712</u>	<u>1,310,724</u>
Net Cash Provided By Operating Activities	<u>\$ 2,722,823</u>	<u>\$ 2,022,363</u>

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

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 managed, 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 3.79% 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, 2013 AND 2012**

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. Net Position

Net position represents the difference between assets and liabilities in the financial statements. Net investment in capital assets, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction or improvement of those assets 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 position is available.

F. 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.

G. 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, 2013 and 2012, totaled \$92,635 and \$131,973, respectively.

H. 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.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 2 - CASH AND CASH EQUIVALENTS

The Utility's deposits in banks at December 31, 2013 and 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.

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.

Note 3 - CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2013 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	11,163,470	2,109,530	(20,728)	13,252,272
Buildings and improvements	946,016	555,642	-	1,501,658
Equipment	1,462,379	1,154,769	-	2,617,148
Total capital assets being depreciated	13,571,865	3,819,941	(20,728)	17,371,078
Less accumulated depreciation	9,990,985	658,686	(20,728)	10,628,943
Total capital assets being depreciated - net	3,580,880	3,161,255	-	6,742,135
Net capital assets	\$3,591,222	\$3,161,255	\$ -	\$6,752,477

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 3 - CAPITAL ASSETS (Continued)

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
Net capital assets	\$3,864,152	\$ (272,055)	\$ (875)	\$3,591,222

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 \$0 and \$79,639 were transferred to the City during 2013 and 2012, 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 2013 and 2012 was \$230,270 and \$199,257, 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

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 5 - LONG-TERM RECEIVABLES (Continued)

equity method, and has recorded the balance of \$661,328 and \$629,982 as a receivable in 2013 and 2012, respectively.

Note 6 - LEASES and LONG TERM UNEARNED 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 2013 and 2012, respectively. In 2013, there was \$2,400 as short term unearned revenue and the remaining \$34,800 as long term revenue. Spencer Municipal Utilities is responsible for maintenance of the fiber.

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 \$412,224 and \$412,218 in 2013 and 2012, respectively. The payable at December 31, 2013 and 2012 was \$0.

Note 7 - 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 5.78% through June 30, 2013 and 5.95% presently of their annual salary and the Utility was required to contribute 8.67% through June 30, 2013 and 8.93% presently of annual payroll. Contribution requirements are established by State statute. The Utility's contributions to IPERS for the years ended December 31, 2013, 2012 and 2011 were \$86,290, \$83,704 and \$73,200, 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 2013 and 2012 totaled \$78,313 and \$75,854, respectively.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 8 – 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>2013</u>	<u>2012</u>
Annual required contribution	\$ 11,155	\$ 11,155
Interest on net OPEB obligation	1,188	1,188
Adjustment to annual required contribution	<u>(1,181)</u>	<u>(1,181)</u>
Annual OPEB cost (Expense)	11,162	11,162
Contributions (estimated)	<u>(328)</u>	<u>(328)</u>
Increase in net OPEB obligation	10,834	10,834
Net OPEB obligation – beginning of year	<u>40,558</u>	<u>29,724</u>
Net OPEB obligation – end of year	<u>\$ 51,392</u>	<u>\$ 40,558</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
2013	\$ 11,162	3%	\$ 51,392
2012	\$ 11,162	3%	\$ 40,558

Funded Status and Funding Progress. The funded status of the plan as of December 31, 2013 was as follows:

	<u>2013</u>	<u>2012</u>
Actuarial accrued liability (AAL)	\$ 52,858	\$ 52,858
Actuarial value of plan assets	<u>-</u>	<u>-</u>
Unfunded actuarial accrued liability (UAAL)	<u>\$ 52,858</u>	<u>\$ 52,858</u>
Covered payroll (active members)	\$1,042,869	\$1,039,894
UAAL as a percentage of covered payroll	5.0%	5.0%

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 8 – OTHER POST EMPLOYMENT BENEFITS (Continued)

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.

The December 31, 2012 actuarial valuation was used for recording 2013 OPEB costs. 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 9 - 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 10 - RELATED PARTIES

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

One member of the Board of Trustees holds a non-controlling interest in a financial institution where the Utility maintains cash balances.

Additional related party items are included in Note 6.

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012**

Note 11 – CONTINGENCIES

Until February 2012, 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. As of December 31, 2013 all carrier litigation arguments were settled. The allowance account for carrier receivables as of December 31, 2013 and December 31, 2012 was \$0 and \$7,585,315, respectively.

Note 12 - 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.

Note 13 - SUBSEQUENT EVENT

As of January 23, 2014 an agreement was executed between NICP and AT&T Mobility Spectrum, LLC. The agreement pertains to NICP selling its rights of geographic area and spectrum to AT&T Mobility Spectrum, LLC. The Communications Utility, as participating Member of NICP, anticipates 10% receipt of sale proceeds.

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, 2013**

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%
2013	12/31/2012	\$ -	\$ 52,828	\$ 52,828	0%	\$ 1,042,869	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)
FOR ELECTRIC, WATER, AND COMMUNICATIONS
OTHER SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2013**

	Budgeted Amounts		Actual	Final to Actual Variance
	Original	Amended		
Receipts:				
Municipal Electric Utility			\$ 14,773,012	
Municipal Water Utility			2,285,315	
Municipal Communications Utility			7,524,873	
Total Receipts	\$ 32,590,069	\$ 27,630,703	24,583,200	\$ (3,047,503)
Expenditures:				
Municipal Electric Utility			18,560,930	
Municipal Water Utility			3,722,457	
Municipal Communications Utility			8,558,233	
Total Expenditures	36,423,905	38,041,831	30,841,620	(7,200,211)
Change in Net Position	(3,833,836)	(10,411,128)	(6,258,420)	(10,247,714)
Net Position at Beginning of Year	17,701,578	22,074,627	22,074,627	-
Net Position at End of Year	\$ 13,867,742	\$ 11,663,499	\$ 15,816,207	\$ (10,247,714)

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
BUDGET TO GAAP RECONCILIATION
FOR ELECTRIC, WATER, AND COMMUNICATIONS
OTHER SUPPLEMENTARY INFORMATION
FOR YEAR ENDED DECEMBER 31, 2013**

	Cash Basis	Accrual Adjustments	Accrual Basis
Receipts:			
Municipal Electric Utility	\$ 14,773,012	\$ (99,105)	\$ 14,673,907
Municipal Water Utility	2,285,315	64,970	2,350,285
Municipal Communications Utility	7,524,873	(355,062)	7,169,811
Total Receipts	<u>24,583,200</u>	<u>(389,197)</u>	<u>24,194,003</u>
Expenditures:			
Municipal Electric Utility	18,560,930	(3,972,948)	14,587,982
Municipal Water Utility	3,722,457	(2,031,550)	1,690,907
Municipal Communications Utility	8,558,233	(2,984,602)	5,573,631
Total Expenditures	<u>30,841,620</u>	<u>(8,989,100)</u>	<u>21,852,520</u>
Change in Net Position	(6,258,420)	8,599,903	2,341,483
Net Position at Beginning of Year	<u>22,074,627</u>	<u>43,632,395</u>	<u>62,369,648</u>
Net Postion at End of Year	<u>\$ 15,816,207</u>	<u>\$ 52,232,298</u>	<u>\$ 64,711,131</u>

**MUNICIPAL COMMUNICATIONS UTILITY
OF THE CITY OF SPENCER, IOWA
OTHER SUPPLEMENTARY INFORMATION –
BUDGETARY REPORTING
YEAR ENDED DECEMBER 31, 2013**

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.



**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, 2013, 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, 2014.

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 material weakness

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 consider the deficiency in internal control described in the accompanying Schedule of Findings as item 13-II-A to be a material weakness.

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, 2014

**SPENCER MUNICIPAL UTILITIES
MUNICIPAL COMMUNICATIONS UTILITY
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2013**

Part I: Summary of the Independent Auditors' Results:

- (a) An unmodified opinion was issued on the financial statements.
- (b) Material Weakness 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

MATERIAL WEAKNESS:

13-II-A Financial Reporting – During the audit, we identified material amounts of prepaid expenses and payables, and immaterial amounts of capital assets, accumulated depreciation, revenue and expenses 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, 2013**

Part III: Other Findings Related to Required Statutory Reporting

III-A-13 Certified Budget – Disbursements during the year ended December 31, 2013 did not exceed the amounts budgeted in the business type activities function.

III-B-13 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-13 Travel Expenses – No expenditures of the Utility’s money for travel expenses of spouses of Utility’s officials or employees were noted.

III-D-13 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>
Jason Remillard, SMU Employee Owner, Remillard Grafx	Marketing	\$ 39 (1)

(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-13 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-13 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

III-G-13 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.