



OFFICE OF AUDITOR OF STATE
STATE OF IOWA

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NEWS RELEASE

FOR RELEASE

June 11, 2007

Contact: Andy Nielsen
515/281-5834

Auditor of State David A. Vaudt today released an audit report on the City of Earlham, Iowa.

The City's receipts totaled \$1,347,681 for the year ended June 30, 2006, a 15.7 percent decrease from 2005. The receipts included \$365,467 in property tax, \$15,694 from tax increment financing, \$645,614 from charges for service, \$172,189 from operating grants, contributions and restricted interest, \$32,835 from capital grants, contributions and restricted interest, \$80,637 from local option sales tax, \$5,411 from unrestricted interest on investments and \$29,834 from other general receipts.

Disbursements for the year totaled \$1,318,991, a 19.5 percent decrease from the prior year, and included \$272,121 for public works, \$211,389 for culture and recreation and \$182,777 for public safety. Also, disbursements for business type activities totaled \$400,161.

The significant decrease in receipts and disbursements is due primarily to proceeds from the sale of notes and redemption of interim financing notes in the prior year.

A copy of the audit report is available for review in the City Clerk's Office, in the Office of Auditor of State and on the Auditor of State's web site at <http://auditor.iowa.gov/reports/reports.htm>.

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CITY OF EARLHAM
INDEPENDENT AUDITOR'S REPORTS
BASIC FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS

JUNE 30, 2006

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City of Earlham

Officials

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
(Before January 2006)		
Richard Rothert	Mayor	Jan 2006
Andrew Arnburg	Mayor Pro tem	Jan 2006
Jeff Beisner	Council Member	Jan 2006
Doug Waugh	Council Member	Jan 2006
Alan Howarth	Council Member	Jan 2008
Scott Petersen	Council Member	Jan 2008
(After January 2006)		
Richard Rothert	Mayor	Jan 2008
Doug Waugh	Mayor Pro tem	Jan 2010
Alan Howarth	Council Member	Jan 2008
Scott Petersen	Council Member	Jan 2008
Andrew Arnburg	Council Member	Jan 2010
Jeff Beisner	Council Member	Jan 2010
Marilyn Sesker	Clerk/Treasurer	(Resigned)
Kathleen Timmerman	Clerk/Treasurer	Indefinite
Dean Nelson	Attorney	Indefinite

City of Earlham



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Independent Auditor's Report

To the Honorable Mayor and
Members of the City Council:

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Earlham, Iowa, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

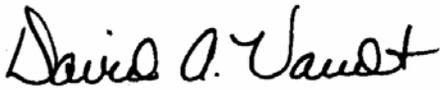
As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis financial position of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Earlham as of June 30, 2006, and the respective changes in cash basis financial position for the year then ended in conformity with the basis of accounting described in Note 1.

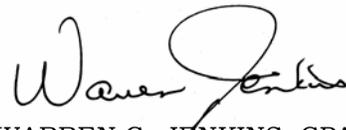
In accordance with Government Auditing Standards, we have also issued our report dated April 9, 2007 on our consideration of the City of Earlham's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 7 through 12 and 28 through 30 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Earlham's basic financial statements. The financial statements for the year ended June 30, 2005 (which are not presented herein) were audited by other auditors who expressed unqualified opinions on those financial statements which were prepared in conformity with an other comprehensive basis of accounting. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the two years ended June 30, 2004 (which are not presented herein) and expressed unqualified opinions on those financial statements which were prepared in conformity with an other comprehensive basis of accounting. Other supplementary information included in Schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



DAVID A. VAUDT, CPA
Auditor of State



WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

April 9, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The City of Earlham provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended June 30, 2006. We encourage readers to consider this information in conjunction with the City's financial statements, which follow.

2006 FINANCIAL HIGHLIGHTS

- Receipts of the City's governmental activities decreased 26%, or approximately \$307,000, from fiscal 2005 to fiscal 2006. Note proceeds decreased approximately \$289,000 from the prior year.
- Disbursements of the City's governmental activities decreased 20%, or approximately \$227,000, in fiscal 2006 from fiscal 2005. Public works and culture and recreation disbursements increased approximately \$63,000 and \$55,000, respectively, while capital projects disbursements decreased approximately \$352,000.
- The City's total cash basis net assets increased 2.9%, or approximately \$29,000, from June 30, 2005 to June 30, 2006. Of this amount, the net assets of the governmental activities decreased approximately \$48,000 and the net assets of the business type activities increased approximately \$77,000.

USING THIS ANNUAL REPORT

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

Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the City's financial activities.

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

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

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

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

Other Supplementary Information provides detailed information about the nonmajor governmental funds.

BASIS OF ACCOUNTING

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

REPORTING THE CITY'S FINANCIAL ACTIVITIES

Government-wide Financial Statement

One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Activities and Net Assets reports information which helps answer this question.

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

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

- Governmental Activities include public safety, public works, culture and recreation, community and economic development, general government, debt service and capital projects. Property tax and state and federal grants finance most of these activities.
- Business Type Activities include the waterworks and the sanitary sewer system. These activities are financed primarily by user charges.

Fund Financial Statements

The City has two kinds of funds:

1) Governmental funds account for most of the City's basic services. These focus on how money flows into and out of those funds and the balances at year-end that are available for spending. The governmental funds include: 1) the General Fund, 2) the Special Revenue Funds, such as Road Use Tax and Urban Renewal Tax Increment, 3) the Debt Service Fund, 4) the Capital Projects Fund and 5) the Permanent Funds. The governmental fund financial statements provide a detailed, short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs.

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

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

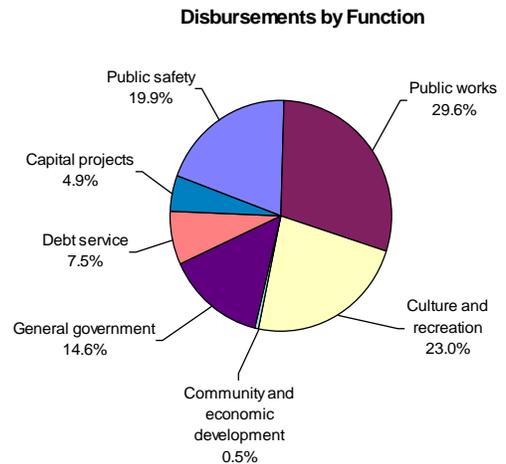
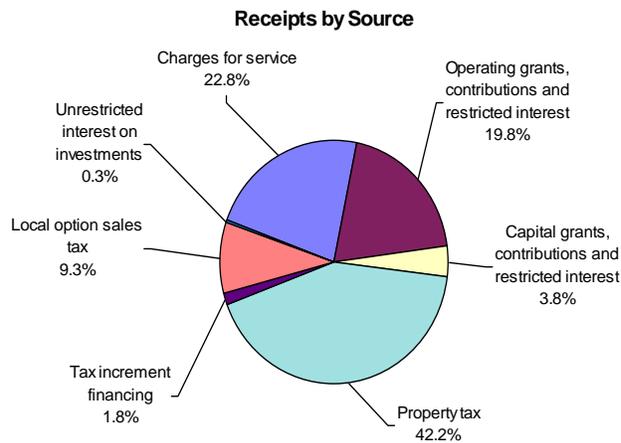
The required financial statement for proprietary funds is a statement of cash receipts, disbursements and changes in cash balances.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of financial position. The City's cash balance for governmental activities decreased from a year ago, decreasing from \$410,754 to \$362,656. The analysis that follows focuses on the changes in cash basis net assets of governmental activities.

Changes in Cash Basis Net Assets of Governmental Activities

	Year ended June 30,	
	2006	2005
Receipts and transfers:		
Program receipts:		
Charges for service	\$ 198,066	131,924
Operating grants, contributions and restricted interest	172,189	227,527
Capital grants, contributions and restricted interest	32,835	14,227
General receipts:		
Property tax	365,467	315,519
Tax increment financing	15,694	85,462
Local option sales tax	80,637	52,942
Unrestricted interest on investments	2,578	1,123
Note proceeds	-	288,920
Other general receipts	12,973	18,264
Transfers, net	(9,707)	41,567
Total receipts and transfers	870,732	1,177,475
Disbursements:		
Public safety	182,777	203,851
Public works	272,121	209,269
Culture and recreation	211,389	156,372
Community and economic development	4,233	23,862
General government	134,156	108,381
Debt service	68,929	46,904
Capital projects	45,225	397,617
Total disbursements	918,830	1,146,256
 Increase (decrease) in cash basis net assets	 (48,098)	 31,219
Cash basis net assets beginning of year	410,754	379,535
Cash basis net assets end of year	\$ 362,656	410,754



Changes in Cash Basis Net Assets of Business Type Activities		
	Year ended June 30,	
	2006	2005
Receipts and transfers:		
Program receipts:		
Charges for service:		
Water	\$ 272,198	280,004
Sewer	175,350	171,345
General receipts:		
Unrestricted interest on investments	2,833	2,560
Other general receipts	16,861	8,104
Transfers, net	9,707	(41,567)
Total receipts and transfers	476,949	420,446
Disbursements:		
Water	230,634	348,880
Sewer	169,527	142,633
Total disbursements	400,161	491,513
Increase (decrease) in cash basis net assets	76,788	(71,067)
Cash basis net assets beginning of year	589,753	660,820
Cash basis net assets end of year	\$ 666,541	589,753

Total business type activities cash basis net assets increased from a year ago, increasing from \$589,753 to \$666,541. The change is primarily due to a decrease in disbursements for water main improvements.

INDIVIDUAL MAJOR GOVERNMENTAL FUND ANALYSIS

As the City of Earlham completed the year, its governmental funds reported a combined fund balance of \$362,656, a decrease of more than \$48,000 below last year's total of \$410,754. The following are the major reasons for the changes in fund balances of the major funds from the prior year.

- The General Fund cash balance decreased \$32,408 from the prior year balance, as restated (see note 11 to the financial statements) to \$(7,184). Total receipts increased 8.6% and total disbursements increased 10.8%. Receipt increases include the employee benefits property tax, local option sales tax, interest on investments and rent. Disbursements increased approximately \$55,000 due to culture and recreation, primarily due to playground and swimming pool equipment.
- The Special Revenue, Road Use Tax Fund cash balance decreased \$16,768 to \$168,470 during the fiscal year. This change was attributable to an increase in disbursements, primarily due to street equipment purchases totaling \$33,000 and street resurfacing of \$39,000.
- The Special Revenue, Urban Renewal Tax Increment Fund cash balance decreased \$18,520 to \$58,128 during the fiscal year. The decrease was due to the tax increment financing debt certificate filed with the County asking for less than the prior year and the City using part of the prior year taxes in the current year for street project costs.
- The Permanent, Hoadley Library Trust Fund was established to account for a bequest received by the Earlham Public Library. At the end of the fiscal year, the cash balance was \$388,815, an increase of \$3,654 over the previous year. Transfers from the Trust Fund to the Library operating fund increased by \$1,782 due to an increase in income from investments.

- The Permanent, Cemetery Perpetual Care Fund cash balance increased \$344 to \$66,290 during the fiscal year. The increase was not significant.

INDIVIDUAL MAJOR BUSINESS TYPE FUND ANALYSIS

- The Water Fund cash balance increased \$57,415 to \$278,076, due primarily to a decrease in disbursements for water main improvements in the current year.
- The Sewer Fund cash balance increased \$19,373 to \$388,465 during the fiscal year. Disbursements increased in the current year due to sewer repair costs, utility and insurance expenses, but the Sewer Fund received a \$9,707 transfer from the Capital Projects Fund during the year and receipts exceeded disbursements by \$9,666.

BUDGETARY HIGHLIGHTS

Over the course of the year, the City amended its budget one time. The amendment was approved on May 8, 2006 and resulted in a decrease in business type activities disbursements of approximately \$97,000 due to a reduction in construction and improvement costs related to the water and sewer funds. The City increased some of the governmental activities functions by insignificant amounts and the total budget was decreased \$18,042.

The City's receipts were \$110,874 less than budgeted. This was primarily due to the City budgeting more in intergovernmental receipts for grants that were not received. Also, actual charges for service receipts were \$59,684 less than budgeted, mainly due to water collections not being as great as expected after the rate increase.

With the amendment, total disbursements were \$137,741 less than the amended budget. The actual disbursements for the public works and community and economic development functions were \$28,721 and \$26,767, respectively, less than the amended budget. This was primarily due to budgeting for equipment and engineering services in excess of actual disbursements. Also, the City was under budget in the business type activities function by \$84,797 for the year ended June 30, 2006. This was primarily due to budgeting for improvements that did not occur in the current year.

DEBT ADMINISTRATION

At June 30, 2006, the City had \$2,718,902 in notes and other long-term debt outstanding, compared to \$2,824,775 last year, as shown below.

	Outstanding Debt at Year-End	
	June 30,	
	2006	2005
General obligation notes	\$ 295,000	295,000
Urban renewal tax increment financing revenue notes	50,000	60,000
Revenue notes	1,150,000	1,206,000
Water service agreement	1,103,836	1,114,957
Lease-purchase agreements	120,066	148,818
Total	\$ 2,718,902	2,824,775

Debt decreased as a result of issuing no new debt while redeeming \$105,873 during the year.

The Constitution of the State of Iowa limits the amount of general obligation debt cities can issue to 5% of the assessed value of all property within the City's corporate limits. The City's outstanding general obligation debt of \$1,568,912 is below its constitutional debt limit of \$2,624,000.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The City of Earlham's elected and appointed officials and citizens considered many factors when setting the fiscal year 2007 budget, tax rates and fees charged for various City activities. One of these factors is the increase in property valuations used to calculate tax askings and levy rates. Taxable property valuations for fiscal year 2007 increased \$983,769 and the tax rates were decreased, which resulted in a tax asking decrease of \$23,591 overall.

These factors were taken into account when adopting the budget for fiscal year 2007. The City will consider these decreases in receipts to finance programs we currently offer. Budgeted disbursements are expected to decrease by approximately \$41,000. The decrease is due to a decrease in budgeted culture and recreation and business type activities. The City has added no major new programs or initiatives to the 2007 budget.

If these estimates are realized, the City's budgeted cash balance is expected to increase by approximately \$177,000 by the close of 2007. The City will be using accumulated cash balances to finance programs currently offered.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Kathy Timmerman, City Clerk, 140 S. Chestnut, City of Earlham, Iowa, 50072.

Basic Financial Statements

City of Earlham

Statement of Activities and Net Assets – Cash Basis

As of and for the year ended June 30, 2006

	Disbursements	Program Receipts		
		Charges for Service	Operating Grants, Contributions and Restricted Interest	Capital Grants, Contributions and Restricted Interest
Functions/Programs:				
Governmental activities:				
Public safety	\$ 182,777	36,098	12,089	-
Public works	272,121	101,580	109,844	-
Culture and recreation	211,389	41,011	49,159	-
Community and economic development	4,233	-	-	-
General government	134,156	702	877	-
Debt service	68,929	-	-	-
Capital projects	45,225	18,675	220	32,835
Total governmental activities	918,830	198,066	172,189	32,835
Business type activities:				
Water	230,634	272,198	-	-
Sewer	169,527	175,350	-	-
Total business type activities	400,161	447,548	-	-
Total	\$ 1,318,991	645,614	172,189	32,835

General Receipts:

Property and other city tax levied for:
 General purposes
 Tax increment financing
 Debt service
 Local option sales tax
 Unrestricted interest on investments
 Miscellaneous
 Transfers

Total general receipts and transfers

Change in cash basis net assets

Cash basis net assets beginning of year

Cash basis net assets end of year

Cash Basis Net Assets

Restricted:
 Streets
 Urban renewal purposes
 Debt service
 Library trust
 Cemetery perpetual care
 Other purposes
 Unrestricted

Total cash basis net assets

See notes to financial statements.

Net (Disbursements) Receipts and
Changes in Cash Basis Net Assets

Governmental Activities	Business Type Activities	Total
(134,590)	-	(134,590)
(60,697)	-	(60,697)
(121,219)	-	(121,219)
(4,233)	-	(4,233)
(132,577)	-	(132,577)
(68,929)	-	(68,929)
6,505	-	6,505
(515,740)	-	(515,740)
-	41,564	41,564
-	5,823	5,823
-	47,387	47,387
(515,740)	47,387	(468,353)
333,158	-	333,158
15,694	-	15,694
32,309	-	32,309
80,637	-	80,637
2,578	2,833	5,411
12,973	16,861	29,834
(9,707)	9,707	-
467,642	29,401	497,043
(48,098)	76,788	28,690
410,754	589,753	1,000,507
\$ 362,656	666,541	1,029,197
\$ 168,470	-	168,470
58,128	-	58,128
-	157,744	157,744
388,815	-	388,815
66,290	-	66,290
39,154	-	39,154
(358,201)	508,797	150,596
\$ 362,656	666,541	1,029,197

City of Earlham

Statement of Cash Receipts, Disbursements
and Changes in Cash Balances
Governmental Funds

As of and for the year ended June 30, 2006

	Special Revenue		
	General	Road Use Tax	Urban Renewal Tax Increment
Receipts:			
Property tax	\$ 320,207	-	58
Tax increment financing	-	-	15,694
Other city tax	92,366	-	-
Licenses and permits	9,667	-	-
Use of money and property	28,880	-	-
Intergovernmental	42,309	108,676	-
Charges for service	128,233	-	-
Special assessments	-	-	-
Miscellaneous	21,161	1,168	-
Total receipts	642,823	109,844	15,752
Disbursements:			
Operating:			
Public safety	172,511	-	-
Public works	126,042	126,612	19,467
Culture and recreation	211,242	-	-
Community and economic development	4,233	-	-
General government	134,156	-	-
Debt service	37,629	-	14,805
Capital projects	-	-	-
Total disbursements	685,813	126,612	34,272
Excess (deficiency) of receipts over (under) disbursements	(42,990)	(16,768)	(18,520)
Other financing sources (uses):			
Operating transfers in	10,582	-	-
Operating transfers out	-	-	-
Total other financing sources (uses)	10,582	-	-
Net change in cash balances	(32,408)	(16,768)	(18,520)
Cash balances beginning of year (as restated)	25,224	185,238	76,648
Cash balances end of year	\$ (7,184)	168,470	58,128
Cash Basis Fund Balances			
Unreserved:			
General fund	\$ (7,184)	-	-
Special revenue funds	-	168,470	58,128
Debt service fund	-	-	-
Capital projects fund	-	-	-
Permanent funds	-	-	-
Total cash basis fund balances	\$ (7,184)	168,470	58,128

See notes to financial statements.

Permanent		Nonmajor	Total
Hoadley Library Trust	Cemetery Perpetual Care		
-	-	32,309	352,574
-	-	-	15,694
-	-	1,164	93,530
-	-	-	9,667
14,383	244	718	44,225
-	-	-	150,985
-	100	-	128,333
-	-	51,510	51,510
-	-	11,592	33,921
14,383	344	97,293	880,439
-	-	10,266	182,777
-	-	-	272,121
147	-	-	211,389
-	-	-	4,233
-	-	-	134,156
-	-	16,495	68,929
-	-	45,225	45,225
147	-	71,986	918,830
14,236	344	25,307	(38,391)
-	-	-	10,582
(10,582)	-	(9,707)	(20,289)
(10,582)	-	(9,707)	(9,707)
3,654	344	15,600	(48,098)
385,161	65,946	(327,463)	410,754
388,815	66,290	(311,863)	362,656
-	-	-	(7,184)
-	-	39,154	265,752
-	-	(13,654)	(13,654)
-	-	(337,363)	(337,363)
388,815	66,290	-	455,105
388,815	66,290	(311,863)	362,656

Exhibit C

City of Earlham

Statement of Cash Receipts, Disbursements
and Changes in Cash Balances
Proprietary Funds

As of and for the year ended June 30, 2006

	Enterprise		
	Water	Sewer	Total
Operating receipts:			
Charges for service	\$ 272,198	175,350	447,548
Operating disbursements:			
Business type activities	155,826	74,332	230,158
Excess of operating receipts over operating disbursements	116,372	101,018	217,390
Non-operating receipts (disbursements):			
Interest on investments	1,371	1,462	2,833
Miscellaneous	14,480	2,381	16,861
Debt service	(74,808)	(95,195)	(170,003)
Total non-operating receipts (disbursements)	(58,957)	(91,352)	(150,309)
Excess of receipts over disbursements	57,415	9,666	67,081
Operating transfers in	-	9,707	9,707
Net change in cash balances	57,415	19,373	76,788
Cash balances beginning of year	220,661	369,092	589,753
Cash balances end of year	\$ 278,076	388,465	666,541
Cash Basis Fund Balances			
Reserved for debt service	\$ 50,347	107,397	157,744
Unreserved	227,729	281,068	508,797
Total cash basis fund balances	\$ 278,076	388,465	666,541

See notes to financial statements.

City of Earlham

Notes to Financial Statements

June 30, 2006

(1) Summary of Significant Accounting Policies

The City of Earlham is a political subdivision of the State of Iowa located in Madison County. It was first incorporated in 1870 and operates under the Home Rule provisions of the Constitution of Iowa. The City operates under the Mayor-Council form of government with the Mayor and Council Members elected on a non-partisan basis. The City provides numerous services to citizens, including public safety, public works, health and social services, culture and recreation, community and economic development and general government services. The City also provides water and sewer utilities for its citizens.

A. Reporting Entity

For financial reporting purposes, the City of Earlham has included all funds, organizations, agencies, boards, commissions and authorities. The City has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the City to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the City.

These financial statements present the City of Earlham (the primary government) and its component unit. The component unit discussed below is included in the City's reporting entity because of the significance of its operational or financial relationship with the City.

Blended Component Unit

The Earlham Volunteer Fire and Rescue Association was established as a non-profit corporation in accordance with Chapter 504A of the Code of Iowa. The Association is legally separate from the City but is so intertwined with the City that it is, in substance, the same as the City. The Association is reported as part of the City and blended in the Special Revenue Funds. The Association receives donations for the benefit of the Earlham Fire Department. These donations are to be used to purchase items which are not included in the City's budget.

Jointly Governed Organizations

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

B. Basis of Presentation

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

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

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

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

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

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

The City reports the following major governmental funds:

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

Special Revenue:

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

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

Permanent:

The Hoadley Library Trust Fund is utilized to account for resources held by the City which are legally restricted.

The Cemetery Perpetual Care Fund is utilized to account for resources that are legally restricted to where only the earnings, and not principal, may be used for purposes of maintaining the City's cemetery.

The City reports the following major proprietary funds:

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

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

C. Measurement Focus and Basis of Accounting

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

Under the terms of grant agreements, the City funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants and general receipts. Thus, when program disbursements are paid, there are both restricted and unrestricted cash basis net assets available to finance the program. It is the City's policy to first apply cost-reimbursement grant resources to such programs, followed by categorical block grants and then by general receipts.

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

D. Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information. During the year ended June 30, 2006, disbursements exceeded the amounts budgeted in the public safety, general government and debt service functions.

(2) Cash and Pooled Investments

The City’s deposits in banks at June 30, 2006 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 City is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the City Council; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

At June 30, 2006, the City had the following investments:

Type	Carrying Amount	Fair Value	Maturity
Common stock	\$ 93,743	176,439	N/A

Investments in common stock were not identified as an allowable investment in the City’s investment policy. The disclosures for concentration of credit risk, credit risk and interest rate risk are not applicable.

(3) Notes and Water Service Agreement Payable

Annual debt service requirements to maturity for general obligation notes, urban renewal tax increment financing revenue notes, revenue notes and water service agreement are as follows:

Year Ending June 30,	General Obligation Notes		Urban Renewal Tax Increment Financing (TIF) Revenue Notes		Sewer Revenue Notes		Water Service Agreement		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
	2007	\$ 30,000	10,353	10,000	3,695	57,000	34,500	11,705	56,299	108,705
2008	30,000	9,542	10,000	2,975	59,000	32,790	12,319	55,685	111,319	100,992
2009	30,000	8,673	10,000	2,245	60,000	31,020	12,965	55,039	112,965	96,977
2010	30,000	7,742	10,000	1,505	62,000	29,220	13,646	54,358	115,646	92,825
2011	30,000	6,753	10,000	775	65,000	27,360	14,362	53,642	119,362	88,530
2012-2016	145,000	14,830	-	-	352,000	106,620	83,934	256,086	580,934	377,536
2017-2021	-	-	-	-	406,000	50,670	108,391	231,629	514,391	282,299
2022-2026	-	-	-	-	89,000	2,670	139,973	200,047	228,973	202,717
2027-2031	-	-	-	-	-	-	180,756	159,264	180,756	159,264
2032-2036	-	-	-	-	-	-	233,425	106,595	233,425	106,595
2037-2041	-	-	-	-	-	-	292,360	38,544	292,360	38,544
Total	\$ 295,000	57,893	50,000	11,195	1,150,000	314,850	1,103,836	1,267,188	2,598,836	1,651,126

Revenue Notes

The urban renewal tax increment financing (TIF) revenue notes were issued for the purpose of defraying a portion of the costs of carrying out an urban renewal project of the City. The notes are payable solely from the income and proceeds of the Special Revenue, Urban Renewal Tax Increment Fund and the taxes to be paid into the fund in accordance with Chapter 403.19 of the Code of Iowa.

The proceeds of the urban renewal tax increment financing revenue notes shall be expended only for purposes which are consistent with the plans of the City's urban renewal area. The notes are not a general obligation of the City. However, the debt is subject to the constitutional debt limitation of the City.

The resolutions providing for the issuance of the TIF and sewer revenue notes include the following provisions.

- (a) The notes will only be redeemed from the future earnings of the respective activity and the note holders hold a lien on the future earnings of the funds.
- (b) Sufficient monthly transfers shall be made to separate sewer and TIF revenue note sinking accounts within the Enterprise Fund and Special Revenue Funds for the purpose of making the note principal and interest payments when due.
- (c) Additional monthly transfers of 25% of the sinking account requirement to a sewer reserve account and to a TIF revenue reserve account within the Enterprise Funds and Special Revenue Funds shall be made until specific minimum balances have been accumulated. These accounts are restricted for the purpose of paying for any additional improvements, extensions or repairs to the system.

Water Service Agreement

The Warren Water District has entered into a loan with the USDA to construct a water supply distribution system. The City has entered into a water service agreement with the Warren Water District to purchase 345,000 gallons per day and pay a fee for connection to the system. The City owns capacity in the water line, is responsible for a portion of the loan and makes monthly payments to the Warren Water District.

During the year ended June 30, 2006, the City made monthly payments of \$5,667 to the Warren Water District for a total of \$68,004, of which \$56,883 was interest and \$11,121 was principal. The City also paid \$567 per month to the Warren Water District as a contribution to the reserve fund maintained by the District. The balance due on this agreement at June 30, 2006 is \$1,103,836.

(4) Lease Purchase Agreements

The City has entered into lease purchase agreements to lease a fire pumper truck, a rescue unit box and a police cruiser. The following is a schedule of the future minimum lease payments, including interest at rates ranging from 5.75% to 7.25% per annum, and the present value of net minimum payments under agreements in effect at June 30, 2006:

Year Ending June 30,	Fire Pumper Truck	Rescue Unit Box	Police Cruiser	Total
2007	\$ 21,253	10,445	5,930	37,628
2008	21,253	10,446	5,930	37,629
2009	21,253	-	-	21,253
2010	21,253	-	-	21,253
2011	21,253	-	-	21,253
Total minimum lease payments	106,265	20,891	11,860	139,016
Less amount representing interest	15,928	2,071	951	18,950
Present value of net minimum lease payments	\$ 90,337	18,820	10,909	120,066

Payments under lease purchase agreements during the year ended June 30, 2006 totaled \$37,629 from the General Fund.

(5) Pension and Retirement Benefits

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

Most regular plan members are required to contribute 3.70% of their annual covered salary and the City is required to contribute 5.75% of covered salary. Certain employees in special risk occupations and the City contribute an actuarially determined contribution rate. Contribution requirements are established by state statute. The City's contributions to IPERS for the years ended June 30, 2006, 2005 and 2004 were \$17,224, \$15,917 and \$13,581, respectively, equal to the required contributions for each year.

(6) Compensated Absences

City employees accumulate a limited amount of earned but unused vacation, compensatory time and sick leave hours for subsequent use or for payment upon termination, retirement or death. These accumulations are not recognized as disbursements by the City until used or paid. The City's approximate liability for earned vacation, compensatory time and sick leave termination payments payable to employees at June 30, 2006, primarily relating to the General Fund, is as follows:

Type of Benefit	Amount
Vacation	\$ 14,000
Compensatory time	4,000
Sick leave	<u>20,000</u>
Total	<u>\$ 38,000</u>

This liability has been computed based on rates of pay in effect at June 30, 2006.

(7) Interfund Transfers

The detail of interfund transfers for the year ended June 30, 2006 is as follows:

Transfer to	Transfer from	Amount
General	Permanent: Hoadley Library Trust	\$ 10,582
Enterprise: Sewer	Capital Projects	9,707
Total		<u>\$ 20,289</u>

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

(8) Related Party Transactions

The City had business transactions between the City and City officials totaling \$20,481 during the year ended June 30, 2006.

(9) Risk Management

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

(10) Deficit Balances

The General, Debt Service and Capital Projects Funds had deficit balances of \$7,184, \$13,654 and \$337,363 at June 30, 2006. The General and Debt Service Fund deficits will be eliminated with future revenues. The City is considering issuing bonds to eliminate the Capital Projects Fund deficit.

(11) Restatements

The beginning cash balance of the General Fund has been restated to reclassify the Earlham Volunteer Fire and Rescue Association activity and cash balance from the General Fund to a Special Revenue Fund. The beginning General Fund balance, previously reported at \$62,555, was reduced \$37,331 to \$25,224.

(12) Subsequent Events

In July 2006, the City approved the purchase of a dump truck for \$19,975 and a snow plow for \$39,500. In November 2006, the City entered into a bank loan for \$20,000 to finance a TIF street resurfacing project.

City of Earlham

Required Supplementary Information

City of Earlham
 Budgetary Comparison Schedule
 of Receipts, Disbursements, and Changes in Balances -
 Budget and Actual (Cash Basis) – All Governmental Funds and Proprietary Funds

Required Supplementary Information

Year ended June 30, 2006

	Governmental Funds Actual	Proprietary Funds Actual	Less Funds not Required to be Budgeted
Receipts:			
Property tax	\$ 352,574	-	-
Tax increment financing	15,694	-	-
Other city tax	93,530	-	-
Licenses and permits	9,667	-	-
Use of money and property	44,225	2,833	718
Intergovernmental	150,985	-	-
Charges for service	128,333	447,548	-
Special assessments	51,510	-	-
Miscellaneous	33,921	16,861	11,371
Total receipts	880,439	467,242	12,089
Disbursements:			
Public safety	182,777	-	10,266
Public works	272,121	-	-
Culture and recreation	211,389	-	-
Community and economic development	4,233	-	-
General government	134,156	-	-
Debt service	68,929	-	-
Capital projects	45,225	-	-
Business type activities	-	400,161	-
Total disbursements	918,830	400,161	10,266
Excess (deficiency) of receipts over (under) disbursements	(38,391)	67,081	1,823
Other financing sources (uses), net	(9,707)	9,707	-
Excess (deficiency) of receipts and other financing sources over (under) disbursements and other financing uses	(48,098)	76,788	1,823
Balances beginning of year	410,754	589,753	37,331
Balances end of year	\$ 362,656	666,541	39,154

See accompanying independent auditor's report.

Total	Budgeted Amounts		Final to Total Variance
	Original	Final	
352,574	347,668	360,917	(8,343)
15,694	14,405	14,405	1,289
93,530	13,249	80,509	13,021
9,667	12,650	12,650	(2,983)
46,340	17,800	17,800	28,540
150,985	257,849	240,843	(89,858)
575,881	663,114	635,565	(59,684)
51,510	8,000	71,927	(20,417)
39,411	-	11,850	27,561
<u>1,335,592</u>	<u>1,334,735</u>	<u>1,446,466</u>	<u>(110,874)</u>
172,511	162,549	169,089	(3,422)
272,121	280,862	300,842	28,721
211,389	215,247	214,874	3,485
4,233	7,500	31,000	26,767
134,156	104,735	133,610	(546)
68,929	62,093	62,093	(6,836)
45,225	50,000	50,000	4,775
400,161	581,522	484,958	84,797
<u>1,308,725</u>	<u>1,464,508</u>	<u>1,446,466</u>	<u>137,741</u>
26,867	(129,773)	-	26,867
-	-	-	-
26,867	(129,773)	-	26,867
963,176	708,874	708,874	254,302
<u>990,043</u>	<u>579,101</u>	<u>708,874</u>	<u>281,169</u>

City of Earlham

Notes to Required Supplementary Information – Budgetary Reporting

June 30, 2006

The budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for the General Fund and each major Special Revenue Fund.

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

Formal and legal budgetary control is based upon ten major classes of disbursements known as functions, not by fund. These ten functions are: public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects, business type activities and non-program. Function disbursements required to be budgeted include disbursements for the General Fund, the Special Revenue Funds, the Debt Service Fund, the Capital Projects Fund, the Permanent Funds and the Proprietary Funds. Although the budget document presents function disbursements by fund, the legal level of control is at the aggregated function level, not by fund. During the year, one budget amendment decreased budgeted disbursements by \$18,042. The budget amendment is reflected in the final budgeted amounts.

During the year ended June 30, 2006, disbursements exceeded the amounts budgeted in the public safety, general government and debt service functions.

Other Supplementary Information

City of Earlham

Schedule of Cash Receipts, Disbursements
and Changes in Cash Balances
Nonmajor Governmental Funds

As of and for the year ended June 30, 2006

	Special Revenue	
	Volunteer Fire and Rescue Association	Debt Service
Receipts:		
Property tax	\$ -	32,309
Other city tax	-	1,164
Use of money and property	718	-
Special assessments	-	-
Miscellaneous	11,371	-
Total receipts	12,089	33,473
Disbursements:		
Operating:		
Public safety	10,266	-
Debt service	-	16,495
Capital projects	-	-
Total disbursements	10,266	16,495
Excess of receipts over disbursements	1,823	16,978
Other financing uses:		
Operating transfers out	-	-
Net change in cash balances	1,823	16,978
Cash balances beginning of year (as restated)	37,331	(30,632)
Cash balances end of year	\$ 39,154	(13,654)
Cash Basis Fund Balances		
Unreserved:		
Special revenue funds	\$ 39,154	-
Debt service fund	-	(13,654)
Capital projects fund	-	-
Total cash basis fund balances	\$ 39,154	(13,654)

See accompanying independent auditor's report.

Capital Projects	Total
-	32,309
-	1,164
-	718
51,510	51,510
221	11,592
51,731	97,293

-	10,266
-	16,495
45,225	45,225
45,225	71,986

6,506	25,307
-------	--------

(9,707)	(9,707)
(3,201)	15,600
(334,162)	(327,463)
(337,363)	(311,863)

-	39,154
-	(13,654)
(337,363)	(337,363)
(337,363)	(311,863)

City of Earlham
Schedule of Indebtedness
Year ended June 30, 2006

Obligation	Date of Issue	Interest Rates	Amount Originally Issued
General obligation notes:			
Street and sidewalk improvements	Nov 15, 2004	2.70 - 4.15%	\$ 295,000
Urban renewal tax increment financing (TIF) revenue notes			
	Jun 1, 1999	6.60 - 7.55%	\$ 100,000
Revenue notes:			
Sewer	Oct 22, 2001	3.00%	\$ 1,200,000
Sewer	Jun 25, 2002	3.00	250,000
Total			
Water service agreement:			
Warren Water District	Jul 10, 2000	5.125%	\$ 1,154,167
Lease-purchase agreements:			
Fire truck	Apr 23, 2002	5.50%	\$ 132,201
Rescue unit box	Sep 16, 2002	7.25	42,656
Police cruiser	Jun 22, 2005	5.75	15,902
Total			

See accompanying independent auditor's report.

Balance Beginning of Year	Redeemed During Year	Balance End of Year	Interest Paid
295,000	-	295,000	15,989
60,000	10,000	50,000	4,405
1,062,000	49,000	1,013,000	31,860
144,000	7,000	137,000	4,320
\$ 1,206,000	56,000	1,150,000	36,180
1,114,957	11,121	1,103,836	56,883
105,603	15,266	90,337	5,987
27,313	8,493	18,820	1,953
15,902	4,993	10,909	937
\$ 148,818	28,752	120,066	8,877

City of Earlham

Note and Water Service Agreement Maturities

June 30, 2006

Year Ending June 30,	General Obligation Notes		Urban Renewal Tax		Sewer	
	Street and Sidewalk		Increment Financing			
	Improvements		(TIF) Revenue Notes			
	Issued Nov 15, 2004		Issued Jun 1, 1999		Issued Oct 22, 2001	
	Interest		Interest		Interest	
	Rates	Amount	Rates	Amount	Rates	Amount
2007	2.70%	\$ 30,000	7.20%	\$ 10,000	3.00%	\$ 50,000
2008	2.90	30,000	7.30	10,000	3.00	52,000
2009	3.10	30,000	7.40	10,000	3.00	53,000
2010	3.30	30,000	7.50	10,000	3.00	55,000
2011	3.50	30,000	7.55	10,000	3.00	57,000
2012	3.70	35,000		-	3.00	58,000
2013	3.85	35,000		-	3.00	60,000
2014	4.00	35,000		-	3.00	62,000
2015	4.15	40,000		-	3.00	64,000
2016		-		-	3.00	66,000
2017		-		-	3.00	67,000
2018		-		-	3.00	69,000
2019		-		-	3.00	72,000
2020		-		-	3.00	74,000
2021		-		-	3.00	76,000
2022		-		-	3.00	78,000
2023		-		-		-
2024		-		-		-
2025		-		-		-
2026		-		-		-
2027		-		-		-
2028		-		-		-
2029		-		-		-
2030		-		-		-
2031		-		-		-
2032		-		-		-
2033		-		-		-
2034		-		-		-
2035		-		-		-
2036		-		-		-
2037		-		-		-
2038		-		-		-
2039		-		-		-
2040		-		-		-
2041		-		-		-
Total		<u>\$ 295,000</u>		<u>\$ 50,000</u>		<u>\$ 1,013,000</u>

See accompanying independent auditor's report.

Revenue Notes			Water Service Agreement		
Issued Jun 25, 2002			Jul 10, 2000		
Interest			Interest		
Rates	Amount	Total	Rates	Amount	
3.00%	\$ 7,000	57,000	5.125%	\$ 11,705	
3.00	7,000	59,000	5.125	12,319	
3.00	7,000	60,000	5.125	12,965	
3.00	7,000	62,000	5.125	13,646	
3.00	8,000	65,000	5.125	14,362	
3.00	8,000	66,000	5.125	15,115	
3.00	8,000	68,000	5.125	15,908	
3.00	8,000	70,000	5.125	16,743	
3.00	9,000	73,000	5.125	17,622	
3.00	9,000	75,000	5.125	18,546	
3.00	9,000	76,000	5.125	19,519	
3.00	9,000	78,000	5.125	20,544	
3.00	10,000	82,000	5.125	21,622	
3.00	10,000	84,000	5.125	22,756	
3.00	10,000	86,000	5.125	23,950	
3.00	11,000	89,000	5.125	25,207	
	-	-	5.125	26,529	
	-	-	5.125	27,921	
	-	-	5.125	29,387	
	-	-	5.125	30,929	
	-	-	5.125	32,551	
	-	-	5.125	34,259	
	-	-	5.125	36,057	
	-	-	5.125	37,949	
	-	-	5.125	39,940	
	-	-	5.125	42,036	
	-	-	5.125	44,242	
	-	-	5.125	46,563	
	-	-	5.125	49,006	
	-	-	5.125	51,578	
	-	-	5.125	54,284	
	-	-	5.125	57,132	
	-	-	5.125	60,130	
	-	-	5.125	63,285	
	-	-	5.125	57,529	
	<u>\$ 137,000</u>	<u>1,150,000</u>		<u>\$ 1,103,836</u>	

Schedule 4

City of Earlham

Schedule of Receipts By Source and Disbursements By Function -
All Governmental Funds

For the Last Four Years

	2006	2005	2004	2003
Receipts:				
Property tax	\$ 352,574	315,519	319,481	281,806
Tax increment financing	15,694	85,462	15,823	16,411
Other city tax	93,530	52,942	-	-
Licenses and permits	9,667	7,464	10,157	11,075
Use of money and property	44,225	17,138	19,974	22,716
Intergovernmental	150,985	201,684	179,195	171,169
Charges for service	128,333	131,941	102,251	104,976
Special assessments	51,510	9,879	11,055	7,728
Miscellaneous	33,921	24,959	75,166	74,115
Total	\$ 880,439	846,988	733,102	689,996
Disbursements:				
Operating:				
Public safety	\$ 182,777	203,851	132,968	207,737
Public works	272,121	209,269	249,564	209,642
Culture and recreation	211,389	156,372	144,262	142,631
Community and economic development	4,233	23,862	37,472	-
General government	134,156	108,381	137,550	94,173
Debt service	68,929	319,479	42,231	46,199
Capital projects	45,225	125,042	243,090	691,465
Total	\$ 918,830	1,146,256	987,137	1,391,847

See accompanying independent auditor's report.



**OFFICE OF AUDITOR OF STATE
STATE OF IOWA**

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

To the Honorable Mayor and
Members of the City Council:

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Earlham, Iowa, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements listed in the table of contents, and have issued our report thereon dated April 9, 2007. Our report expressed an unqualified opinion on the financial statements which were prepared in conformity with an other comprehensive basis of accounting. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the City of Earlham's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we believe items (A) and (C) are material weaknesses.

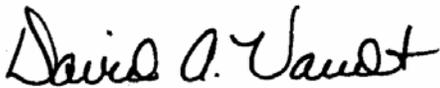
Compliance and Other Matters

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

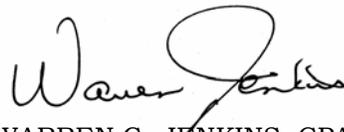
Comments involving statutory and other legal matters about the City's operations for the year ended June 30, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the City. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

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

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the City of Earlham 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.



DAVID A. VAUDT, CPA
Auditor of State



WARREN G. JENKINS, CPA
Chief Deputy Auditor of State

April 9, 2007

City of Earlham

Schedule of Findings

Year ended June 30, 2006

Findings Related to the Financial Statements:

REPORTABLE CONDITIONS:

- (A) Segregation of Duties – One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. The cash receipts listing, bank deposits and the posting of the cash receipts to the cash receipts journal, utility billing and collection, disbursement preparation and check signing, payroll and bank reconciliations are all done by the same person.

Recommendation – We realize segregation of duties is difficult with a limited number of office employees. However, the City should review its control procedures to obtain the maximum internal control possible under the circumstances.

Response – We will review this and change procedures to obtain maximum control.

Conclusion – Response acknowledged. The City should segregate duties to the extent possible with existing personnel and utilize administrative personnel to provide additional control through review of financial transactions and reports.

- (B) Records of Accounts – The City maintains separate bank accounts for the library operating, community center and library trust which pertain to those operations. The financial transactions and the resulting balances were not entirely included in the City's accounting records and were not included in the City's annual budget or monthly financial reports. However, those financial transactions and the resulting balances are included in these financial statements.

Recommendation – Chapter 384.20 of the Code of Iowa states, in part, "A City shall keep accounts which show an accurate and detailed statement of all public funds collected, received, or expended for any City purpose." For better accountability, financial and budgetary control, the financial activity and balances of all City accounts should be included in the City's accounting records and annual budget and should be reported to the Council on a monthly basis.

Response – We discussed this with the library and will discuss this with the community center and will have these accounts placed in the City's accounting records for next year.

Conclusion – Response accepted.

City of Earlham

Schedule of Findings

Year ended June 30, 2006

- (C) Reconciliation of Utility Billings, Collections and Delinquencies – Utility billings, collections and delinquent accounts were reconciled throughout the year but variances were not investigated and explained or corrected. This matter was resolved for audit purposes.

Recommendation – Procedures should be established to explain and correct variances on the reconciliation of utility billings, collections and delinquencies for each billing period. The Council or a Council-designated independent person should review the reconciliations.

Response – We are now considering all adjustments in the billing system and are reconciling billings to collections and delinquents. We will have a designated independent person review the reconciliations monthly.

Conclusion – Response accepted.

- (D) Electronic Data Processing Systems – During our review of internal control, the existing control activities in the City’s computer-based systems were evaluated in order to determine activities, from a control standpoint, were designed to provide reasonable assurance regarding the achievement of objectives in the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. The following weaknesses in the City’s computer-based systems were noted:

The City does not have written policies for:

- Internet and personal usage.
- Password privacy and usage.
- A disaster recovery plan.

Recommendation – The City should develop written policies addressing the above items in order to improve the City’s control over computer based systems.

Response – We will establish written policies for these.

Conclusion – Response accepted.

- (E) Earlham Volunteer Fire and Rescue Association – The Earlham Volunteer Fire and Rescue Association maintains records legally separate from the City of Earlham but reported in this audit report. One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. The cash receipts listing, bank deposits, disbursement preparation, check signing and bank reconciliations are all done by the same person. Also, prenumbered receipts are not used to record each collection made by the Association.

City of Earlham

Schedule of Findings

Year ended June 30, 2006

Recommendation – We realize segregation of duties is difficult with a limited number of Association staff. However, the Association should review its control procedures to obtain the maximum internal control possible under the circumstances.

Response – Our membership receives a list of paid bills and the financial report on a monthly basis for review and approval. We will obtain prenumbered receipts and immediately begin using them for collections.

Conclusion – Response acknowledged. The Association should segregate duties to the extent possible with existing personnel and utilize administrative personnel to provide additional control through review of financial transactions and reports.

- (F) Records of Investments – A detailed record of investment transactions was not maintained.

Recommendation – A detailed record of investment transactions by fund should be maintained. This record should include investment number, purchase date, redemption date, interest rate, amount of investment and interest received.

Response – We will begin using an investment register immediately.

Conclusion – Response accepted.

- (G) Segregation of Duties – Library – One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. The cash receipts listing, bank deposits and the posting of the cash receipts to the cash receipts journal, disbursement preparation, check signing and payroll are all done by the same person.

Recommendation – We realize segregation of duties is difficult with a limited number of office employees. However, the Library should review its control procedures to obtain the maximum internal control possible under the circumstances.

Response – We plan to turn over record keeping duties to the City.

Conclusion – Response accepted.

INSTANCES OF NON-COMPLIANCE:

No matters were reported.

City of Earlham
 Schedule of Findings
 Year ended June 30, 2006

Findings Related to Required Statutory Reporting:

- (1) Certified Budget – Disbursements during the year ended June 30, 2006 exceeded the amounts budgeted in the public safety, general government and debt service functions. Chapter 384.20 of the Code of Iowa states, in part “Public monies may not be expended or encumbered except under an annual or continuing appropriation.”

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

Response – We will amend the budget in sufficient amounts in the future.

Conclusion – Response accepted.

- (2) Questionable Disbursements – No disbursements we believe may not meet the requirements of public purpose as defined in an Attorney General’s opinion dated April 25, 1979 were noted.

- (3) Travel Expense – No disbursements of City money for travel expenses of spouses of City officials or employees were noted.

- (4) Business Transactions – Business transactions between the City and City officials or employees are detailed as follows:

Name, Title, and Business Connection	Transaction Description	Amount
Andrew Arnburn, Council Member, Manager of Earlham Building Center	Lumber and supplies	\$ 12,941
Jeff Beisner, Council Member, partner at Associated Grading and Excavating	Excavating projects	7,540

In accordance with Chapter 362.5(11) of the Code of Iowa, the transactions with the Council Members appear to represent conflicts of interest since total transactions with each individual were greater than \$2,500 during the fiscal year.

Recommendation – The City should consult legal counsel to determine the disposition of this matter.

Response – We will consult legal counsel in regard to this matter.

Conclusion – Response accepted.

City of Earlham

Schedule of Findings

Year ended June 30, 2006

- (5) Bond Coverage – Surety bond coverage of City officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure the coverage is adequate for current operations.
- (6) Council Minutes – No transactions were found that we believe should have been approved in the Council minutes but were not.

The Council went into closed session on September 12, 2005. However, the minutes record did not document the specific information regarding the closed session as required by Chapter 21 of the Code of Iowa, commonly known as the open-meetings law.

Although minutes of Council proceedings were published within fifteen days as required by Chapter 372.13(6) of the Code of Iowa, the publications did not include a summary of receipts as required.

Recommendation – The City should comply with Chapter 21 of the Code of Iowa and should publish minutes as required.

Response – We will make sure that the specific section of the Code of Iowa is included in the minutes when closing a meeting and will publish a summary of receipts with the minutes publication as required.

Conclusion – Response accepted.

- (7) Deposits and Investments – The City Library Board has an investment in common stock which appears to violate Chapter 12B.10(5) of the Code of Iowa and the City's investment policy. Also, the City's investment policy refers to Chapter 452 of the Code of Iowa, but the provisions previously contained in Chapter 452 have been moved to Chapters 12B and 12C of the Code of Iowa.

Recommendation – The City should comply with Chapter 12B and Chapter 12C of the Code of Iowa and the City's investment policy. The City should amend the investment policy to refer to the proper sections of the Code of Iowa.

Response – We will discuss this matter with the Library Board and will amend our investment policy to refer to Chapter 12B and Chapter 12C.

Conclusion – Response acknowledged. The City Library Board should consult legal counsel to determine the allowability of the investment in common stock. If it is found to be an unallowable investment, the City Library Board should take appropriate action to resolve the issue.

City of Earlham

Schedule of Findings

Year ended June 30, 2006

- (8) Revenue Notes – Except as follows, the City is in compliance with the resolutions providing for the issuance of the urban renewal tax increment financing and sewer revenue notes.

The urban renewal tax increment financing revenue note resolution states, in part, “The City will establish sinking and reserve funds to pay debt when due. The City has not established these funds.”

Recommendation – The City should establish a TIF sinking fund and a TIF reserve fund and make the required transfers to these funds and pay the TIF debt from the TIF sinking fund.

Response – We will establish the required sinking and reserve funds for this note.

Conclusion – Response accepted.

- (9) Special Revenue Funds – The City has levied taxes for employee benefits and recorded the resulting property tax receipts and employee benefits disbursements in the General fund.

Also, the local option sales tax collections were recorded in the General Fund and disbursements were not adequately identified to determine compliance with the ballot which requires the local option sales tax be used for capital improvement projects as determined by the Council.

Recommendation – The City should establish a Special Revenue, Employee Benefits Fund. The employee benefits levy collections should be recorded in this fund and employee benefits related only to the General and Road Use Tax Funds should be paid from this fund.

Also, the City should establish a Special Revenue, Local Option Sales Tax Fund to properly account for these revenues and uses of the tax funds.

Response – We will establish the Employee Benefits Fund and have currently established the Local Option Sales Tax Fund to account for this activity.

Conclusion – Response accepted.

- (10) Financial Condition – The General, Debt Service and Capital Projects Funds had deficit balances at June 30, 2006 of \$7,184, \$13,654 and \$337,363, respectively.

Recommendation – The City should investigate alternatives to eliminate these deficits in order to return these funds to a sound financial position.

Response – We will investigate these in order to bring them to sound financial positions. The General and Debt Service Fund deficits will be eliminated with future revenues. The City is considering issuing bonds for the Capital Projects Fund.

Conclusion – Response accepted.

City of Earlham

Staff

This audit was performed by:

K. David Voy, CPA, Manager
Paul F. Kearney, CGFM, Senior Auditor
Andrew N. Pulford, Staff Auditor
Gelu Sherpa, Assistant Auditor

A handwritten signature in black ink that reads "Andrew E. Nielsen". The signature is written in a cursive style with a large initial 'A' and a distinct 'E'.

Andrew E. Nielsen, CPA
Deputy Auditor of State