

October 24, 2003

Honorable Mayor, City Council, and Citizens
City of Cedar Rapids, Iowa

The Comprehensive Annual Financial Report (CAFR) for the City of Cedar Rapids, Iowa, for the fiscal year ended June 30, 2003, as prepared by the Office of City Controller-Auditor, is submitted herewith in accordance with the provisions of Section 384.22 of the Code of Iowa, 1995, as amended, and in the format recommended by the Government Finance Officers Association.

Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with the City. We believe the data, as presented, is accurate in all material aspects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the City as measured by the financial activity of its various funds; and that all disclosures necessary to enable the reader to gain the maximum understanding of the City's financial activity have been included.

This CAFR is organized into four sections: the Introductory Section, the Financial Section, the Statistical Section, and the Compliance Section. The Introductory Section contains the names of the principal officers, an organization chart, a Certificate of Achievement for Excellence in Financial Reporting, the table of contents, and this letter of transmittal. The Financial Section contains the opinion of the independent auditors, management's discussion and analysis, the basic financial statements, notes to the basic financial statements, and nonmajor funds and other schedules of the City of Cedar Rapids for the fiscal year ended June 30, 2003. The Statistical Section contains comprehensive statistical data which is intended to give the reader a broader and more complete understanding of the financial condition of the City of Cedar Rapids. This section includes many comparative schedules. The City is required to undergo an annual audit in conformity with the provisions of the New Single Audit Act and the U. S. Office of Management and Budget Circular A-133, Audits of State, Local Governments, and Non-Profit Organizations. The Compliance Section includes information relating to this audit such as a schedule of expenditures of federal awards, findings and questioned costs, as well as the independent auditor's reports on compliance and internal control.

THE REPORTING ENTITY, ITS PURPOSE, AND SERVICES

The City of Cedar Rapids was incorporated in 1849 and has operated under the commission form of government since 1908. Under this form of government, each of the commissioners is also a City Council member. All of the Council is elected at large every two years on a non-partisan basis. Each candidate runs for a specific area of responsibility. The City provides the following services: public safety, public works, solid waste collection, animal control, parking, ground transportation, community development, and municipal water and sewer. The City also provides various cultural and recreational opportunities through various departments and commissions.

The City's financial statements include all funds, departments, boards and commissions and other government entities that do not have separate legal status as required by accounting principles generally accepted in the United States of America. Two component units are included in our financial report: the Eastern Iowa Airport, and BlueStem, a solid waste management agency.

ECONOMIC CONDITIONS AND OUTLOOK

Cedar Rapids, the second largest city in the State of Iowa, is located twenty-five miles north of Iowa City and one hundred-thirty miles east of Des Moines, the State Capital. Cedar Rapids is an important manufacturing, service and trade area serving an eight county area with a combined population estimated at 410,100. The population of Linn County based upon the 2000 census is 191,701 of which 120,758 reside within Cedar Rapids.

Our unemployment rate of 4.2% was up from last year but our rate is still below the national and state of Iowa rates as well as being one of the lowest rates of all the major communities in Iowa. This increase in our unemployment rate reflects work force reductions at Rockwell Collins and MCI WorldCom, the city's first and third largest employers as well as the national economic slowdown. Resident total employment of 111,600 represents a decrease of 1,500 over the previous year. Even though our total employment dropped, over 1,000 new jobs and more than \$111 million in capital investment was created in Cedar Rapids during the last fiscal year.

The mean household income in 2003 was \$73,612 in the Cedar Rapids MSA. Comparable mean household income for 2002 was \$73,187. Both of these amounts are presented in 1996 constant dollars.

Although FY03 was not a banner year in terms of total building permits values, the total value of permits was substantial. New construction generated a value of \$75.3 million. The value of permits for remodeling, repairs, and additions totaled approximately \$55.2 million. Combining these two amounts together yields a total value of permits issued of \$130.5. Based upon the city's records, approximately one single family dwelling per day is being built within the City of Cedar Rapids.

Annual residential sales of 3,763 again were up slightly from last year. The average sale price was \$134,662 was an increase of 3.3 percent over the previous year.

Retail sales in the metro area reached an all-time high for the second consecutive year. The amount of retail sales surpassed \$2.72 billion in the county of which \$2.29 billion was generated in Cedar Rapids. These amounts compare to \$2.62 billion and \$2.23 billion respectively for the previous year.

Cedar Rapids continued to maintain its low property tax rate during fiscal year FY03 as evidenced by our rate of \$12.83 per 1000 of taxable valuation, which is a decrease of \$.21 as compared to FY02. This rate, one of the lowest in the State of Iowa of the eight largest cities, is due to prudent financial management and a good property tax base.

MAJOR INITIATIVES

FOR THE YEAR

The City ended its fiscal year's budget in a manner that enabled it to maintain its Targeted Fund Balance (TFB) and still generate a surplus in the General Fund. The City has a self-imposed financial policy that provides that it will maintain a General Fund Unreserved, Undesignated Fund Balance that is equal to twenty-five percent of the following fiscal year's General Fund expenditures. This same policy allows General Fund departments to carry-over one half of their unexpended appropriation into the following fiscal year. The amount available to be carried over after maintaining the TFB was approximately \$1.5 million. The City decided after learning of a major shortfall in the amount of state aid for FY04 not to allow departments to carryover any funds other than capital from FY03 to FY04. Overall, the General Fund expenditures were under budget by 4.4 percent.

Regionalism continues to be the focus of our economic development initiatives. The state's first regional laborshed study was completed and confirmed that the Cedar Rapids/Iowa City Technology CorridorTM has one work force. Priority One, the economic development arm of the Cedar Rapids Chamber of Commerce, reported the following FY03 accomplishments:

Business Development

- Assisted in the creation of 992 jobs.
- Located two new companies in the area.
- Assisted twenty-three area companies in expansion, training, and support.
- Increased the capital investment base by \$111,305,000 through industrial and office development.
- Interviewed 427 existing businesses through the Priority business Committee and Priority One staff to determine their needs.

Workforce Development

- Hosted 462,875 visits this fiscal year on the Corridor Careers web site.
- Identified 465 companies this fiscal year utilizing one or more of Priority One's workforce development tools.
- Identified 246 companies that have hired employees by using at least one of Priority One's workforce development tools.
- Provided area employment information to 45 community colleges and 4-year institutions.

FOR THE FUTURE

The City, as part of its budgeting and resource allocation process, has started a program known as Cedar Rapids Managing for Results or CRMFR. Managing for Results is a management approach that focuses on defining and then achieving the results that are important to a local government. The organization develops a shared, widely understood framework using performance measurement for setting goals and objectives, managing, allocating resources and evaluating its accomplishments. Managing for Results can benefit a local government by improving the focus on key results and sharpening the organization's management skills to achieve those results. It is a tool for more responsive and accountable government. Research has shown that citizens are very knowledgeable about performance measures and believe they should be reported. Furthermore, they are very interested in whether and to what degree their government is using performance measures for the management of operations and what effect the use of performance measures is having on their government.

The City Council budget initiatives for FY2004 are as follows:

- A safe community where people feel secure.
- An available and thriving cultural and recreational community that achieves a high quality of life.
- A progressive, sustainable, economically vital community with a healthy economy that successfully manages growth and change.
- An effective, accessible, and accountable city government that works openly and respectfully with and for the community.

The total budget for FY2004, approximately \$284 million, is an increase of \$2 million, which is less than 1 per cent over the current year's budget. Although the City's assessed valuations increased by only 1.41%, taxable valuations increased by 2.93 percent. This change in the amount of a percentage increase in taxable as compared to assessed is a product of the state ordered rollbacks on both residential and commercial property. Residential property will be taxed at 51.39 percent as compared to 51.67 percent for the current fiscal year. Commercial property will be taxed at 100 percent as compared to 97.77 percent for the current fiscal year. The property tax levy will increase by \$.24 to \$13.07/\$1,000 of taxable valuation. Taxes, primarily property taxes, account for approximately 24.5 percent of the revenue sources for this budget.

The major reasons for the budget increase are Personal Services and Purchased Services. Personal Services is increasing by \$5.4 million or 6.46 percent. Labor settlements, city wide, were projected at a 3.25 percent increase over the current levels in wages. Health care costs were budgeted at a 20 percent increase which will most likely result in another increase at a double-digit level for FY2005 if current health care costs trends continue. The City was also faced with a 20.5 percent increase in our fire and police pension costs. Purchased

Services is increasing because of increased health care costs as reflected in the Risk Management fund where the actual payments for health care are reflected.

The City established a PILOT (payment in lieu of taxes) program for its enterprise departments starting in FY2000. Initially, only the Water and Water Pollution Control departments contributed to this program in the amounts of \$250,000 and \$100,000 respectively. This program was expanded in FY2001 to include Sewer Maintenance and Solid Waste and Recycling and again in 2002 with Golf and Parking contributing. During the FY2004 budget process, the Council adopted criteria for determining the amount of PILOT contributions it would receive from its Enterprise Departments. These new criteria resulted in an approximate ten percent reduction. The departments and their amount of the PILOT contributions for FY2004 are shown as follows:

Golf	\$49,209
Parking	114,898
Sewer Maintenance	6,937
Solid Waste and Recycling	11,963
Water	271,398
Water Pollution Control	346,528
Totals	\$800,933

The amounts collected will be distributed with the other pooled revenues within the General Fund.

The Iowa General Assembly enacted legislation in 1998 which replaces current property tax assessment procedure in valuing the property of entities involved primarily in the production, delivery, service and sale of electricity and natural gas with a utility replacement tax (URT) formula based upon the delivery of energy by these entities. Under the enabling legislation, S.F. 2416, electric and natural gas utilities will pay replacement taxes to local taxing districts (calculated so as to approximate historical tax collections), and their properties will be removed from the property tax base of political subdivisions, including the City. The implementation of the URT began with the 1999 assessments thus impacting the fiscal year 2001 budget. This legislation will have immediate and lasting impact on cities by the way it restructures the taxation of utility properties. The enabling legislation provided the change would be revenue neutral and thus created a three-year period, which is referred to as a "true-up phase". During this initial three-year period, there was a process designed to insure that the taxing entities will receive 100 percent of the difference between what they would have received from property taxes as compared to the URT. It became apparent during FY04 that the city would lose some property tax dollars due this new method of taxing utilities. It is possible that the general obligation debt capacity of the City could also be proportionately reduced in future years as there is no assurance that the legislation will not operate so as to reduce the amount of debt the City can issue or otherwise adversely affect the City's ability to levy taxes in the future for the payment of the principal and interest on its outstanding debt obligations.

The greatest challenge the area economy will face in fiscal 2004 is the continued slowing of the local as well as waiting for the national economy to rebound. This slowing locally is mitigated by the development of a high-tech manufacturing and a diversified employment base. Priority One, in conjunction with the Iowa City Area Development Group, will continue to market the Technology Corridor to high-growth industries throughout North America. We think it is only a matter of time before we see our economy rebound and continued population and labor force growth. This economic slowdown has also created problems at the state level, which in turn has caused the State of Iowa to reduce state aid payments they were formerly making to Iowa cities and counties. The City of Cedar Rapids lost over \$2.3 million in FY04 due to the state's decision to try and balance their budget by not making these payments to the cities and counties. The City was forced mid-fiscal year to address this lack of revenue by various means to include the elimination of all general fund capital purchases originally budgeted for FY04.

The City issued \$46.6 million of General Obligation Refunding Bonds, Series 2003A in March of 2003. Details regarding this refunding can be found in the Notes to Financial Statements, pages 58-59. This refunding was done to achieve interest cost savings. The City also issued \$22,530,000 of general obligation bonds in

August of this calendar year. Again the details regarding this issue can also be found in the Notes to Financial Statements, pages 67.

FINANCIAL INFORMATION

The management of the City is responsible for the establishment and continued maintenance of an internal control structure to ensure that all City assets are protected from loss, theft, or misuse. The management must also ensure that adequate accounting data is available to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to provide reasonable assurance these objectives are met. The concept of reasonable assurance recognizes: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the valuation of costs and benefits requires estimates and judgments by management.

Single Audit

A recipient of federal and state financial assistance, the City is also responsible for ensuring that an adequate internal control structure is in place to ensure compliance with applicable laws and regulations related to those programs. This internal control structure is subject to periodic evaluation by management.

Budgetary Controls

The City's management team takes a very active role in the financial planning and management of the City for both the short-term daily operations and the long-range planning. The City adopts its annual program budget to include all funds except fiduciary funds. While budgetary control is exercised at the program level, management control is exercised on a major objective of expenditure basis. The daily operations are closely monitored through the City's automated integrated, on-line financial system which provides daily appropriations status capabilities, weekly cash management forecasting reports, and monthly, current and year-to-date, budget by major object of expenditure reports. Estimated revenues are also closely monitored as to their impact on budgeted expenditures. If a department falls short of its discretionary revenue projections, adjustments must be made in its appropriations to reflect these shortfalls. Encumbrance accounting is employed in all funds for management control purposes. Appropriations as adopted and amended lapse at the end of the fiscal year. Encumbrances outstanding at year-end are reflected as reservations of the Governmental fund balances, which serve as authorizations for expenditures in the subsequent year. Capital projects are appropriated on a yearly basis.

In terms of long-range planning, the City annually, in compliance with a Council resolution, develops and issues a five-year capital improvements program, which is funded primarily through the sale of general obligation bonds. All operating departments are also required to submit a five-year capital equipment program as part of the annual operating budget process.

General Government Financial Analysis

A financial analysis of the general governmental functions for fiscal 2002-03, as compared to fiscal 2001-02, follows. Included in this analysis are the revenues and expenditures of the General Fund, Special Revenue Fund, and the Debt Service Fund.

Revenues

The general government revenues of \$110,555,570 available to the City of Cedar Rapids represent an increase of 11.98 percent over FY02. Taxes, primarily property, accounted for \$76,789,145 or 69.46 percent of the total, as compared to 63.61 percent the prior fiscal year. This amount represents a 22.16 percent increase over FY02 that is due primarily to the 1 percent voter approved sales tax to fund major upgrades to the City's swimming pools. Interest income decreased 29.54 percent, which caused the Use of Money and Property classification to decrease. Interest income has been decreasing over the last couple of fiscal years due to the declining but now stable, low interest rates. Miscellaneous revenues decreased by 31.83 percent primarily due

to the prior year bond offering and prior year contributions to the new ballpark. All of these changes are reflected tabularly as follows:

	Amount		Percent Change Over Prior Year	Increase (Decrease) Over Prior Year
	2002-03	2001-02		
Taxes	\$76,789,145	\$62,860,475	22.16%	\$13,928,670
Licenses and Permits	1,736,776	1,942,391	-10.59%	(205,615)
Fines and Forfeits	361,697	366,894	-1.42%	(5,197)
Charges for Services	2,006,073	1,622,569	23.64%	383,504
Intergovernmental Revenue	22,564,343	21,092,862	6.98%	1,471,481
Use of Money and Property	2,783,019	4,428,762	-37.16%	(1,645,743)
Rents and Royalties	594,306	954,131	-37.71%	(359,825)
Miscellaneous and Other (including bond proceeds, excluding 2003 refunding bonds)	<u>3,720,211</u>	<u>5,457,520</u>	-31.83%	<u>(1,737,309)</u>
Totals	<u>\$110,555,570</u>	<u>\$98,725,604</u>	11.98%	<u>\$11,829,966</u>

Expenditures

Expenditures for general government purposes totaled \$103,272,677, an increase of 15.48 percent over the prior fiscal year. The major reason for the increase in expenditures for Public Safety was increased Personal Services as well as additional costs associated with the department's aviation program. The increase in Debt Service was a result of the refunding bond issue in which the City used other sources for payment.

Function	Amount		Percent Change Over Prior Year	Increase (Decrease) Over Prior Year
	2002-03	2001-02		
General	\$11,344,499	\$10,273,013	10.43%	\$1,071,486
Street	13,337,026	12,980,572	2.75%	356,454
Public Safety	33,446,349	31,167,902	7.31%	2,278,447
Parks and Recreation	6,801,060	6,141,370	10.74%	659,690
Library	3,710,843	3,583,851	3.54%	126,992
Debt Service	20,520,233	12,680,369	61.81%	7,837,220
Other	<u>14,112,667</u>	<u>12,599,797</u>	12.03%	<u>1,515,513</u>
Totals	<u>\$103,272,677</u>	<u>\$89,426,874</u>	<u>15.48%</u>	<u>13,845,802</u>

Enterprise Funds

The City operated ten enterprise funds during the fiscal year ended June 30, 2003. These funds are set up to operate primarily from the proceeds of user charges. A comparison of the operating income (loss) before depreciation for the fiscal years ended June 30, 2003, and 2002 follows:

	Operating Income (Loss) Before Depreciation	
	2002-03	2001-02
Ground Transportation System	\$(4,713,570)	\$(4,516,034)
Parking System	418,332	752,008
Water	6,534,800	6,841,580
Water Pollution Control	3,992,754	2,910,356
Sanitary Sewer	4,200,780	3,788,060
Solid Waste Management	1,588,621	966,954
Golf	20,747	275,230
Paramount Theatre	(105,619)	(176,492)
US Cellular Center	(166,837)	(48,780)
Ice Arena	54,938	(23,291)

Water Pollution Control and Sanitary Sewer operating income increased over the prior year due to a 16.4 percent and 8.9 percent increase respectively in operating revenues. Solid Waste Management operating income also increased due to, a 10.3 percent decrease in operating expenses. Regarding decreases in operating income, all of the other enterprise operations experienced operating income decreases. Water had the largest dollar decrease. Although its operating revenues were up, they were more than offset by operating expenses primarily increase in Personal Service. Golf had the largest percentage decrease. This decrease was reflected in reduced operating income due to a golf course being out of commission what it was under reconstruction.

Retirement Plans

With the exception of police and fire the City's employees are covered by the Iowa Public Employees Retirement System (IPERS). The State annually sets a tax rate to be contributed by all municipal entities when combined with local employee contributions is sufficient to meet the needs of the State plan. All covered employees are required to contribute 3.7 percent of their salary--employers contribute 5.75 percent (prior to July 1, 1975, the rate of contribution was identical). There is no allocation of unfunded liability to any municipal entity and upon the retirement of employees, responsibility for their benefits is solely that of IPERS.

Fire and police employees are covered by the Municipal Fire and Police Retirement System of Iowa (MFPRSI). This is a cost-sharing multiple-employer defined benefit retirement system administered by a board of trustees. Plan members are required to contribute 9.35% of their annual covered salary and the City is required to contribute at an actuarially determined rate with the current rate being 20.48 percent of annual covered payroll.

The City had acted as the custodian for the water retirement systems for the City. During the year ended June 30, 2003, employees of this system were transferred to the Iowa Public Employees Retirement System. The amount of the reserve at the time of the transfer, \$13,745,119, was placed in a reserve for retirement fund within the City Water Department and the actuarial liability of \$8,879,964 was paid to the Iowa Public Employees Retirement System. The remaining balance has been reserved within the Water Department.

Debt Administration

Unmatured general obligation bonds totaling \$239,904,400 are outstanding as of June 30, 2003, of which \$143,126,010 are considered to be self-supporting, and are therefore shown as long-term debt in the Enterprise Fund. An additional \$9,605,600 of these outstanding bonds are to be paid by the Eastern Iowa Airport (Airport), a component unit of the City of Cedar Rapids.

We currently have available legal debt capacity of over \$88.9 million. Over sixty-nine percent of our outstanding property tax supported debt is to be retired within ten fiscal years. The property tax requirement for debt service decreased slightly for FY2004 to \$1.71/1000 per taxable value.

Moody's Investor Services continues to rate the City's general obligation bonds Aaa. This rating is predicated on the City's strong financial management, a diverse and substantial economic and tax base, and a low debt burden with a rapid payout. FY03 marked our thirty-first anniversary of maintaining this rating. Moody's has rated the 1993 issue of parking revenue bonds A3.

Cash Management

The City maintains almost all deposits, except for those funds that must maintain their demand deposits separately, in one demand deposit account in the General Fund. The majority of the City's investments are handled through an investment pool. This concept provides for greater investment earnings, which are then allocated on a systematic basis. The City's overall investment earnings of \$8,700,000 was down compared to the prior years due to the average rate of return on the City's pooled investments for FY03 being 3.28 percent as compared to FY02's 4.26 percent.

Risk Management

The City's risk management program strives to protect the City's assets in a cost effective and responsible manner using a combination of the four recognized methods of treating risks: elimination, reduction, transfer, and retention. Safety and loss prevention programs help reduce the City's exposure to risks. Those risks that cannot be eliminated or reduced are either transferred or retained. Funded self-retention of risks is being employed not only because it is cost effective but it also enables the City to: stabilize insurance costs; build a fund to provide a reliable and constant source of funds to pay claims; and provide a high level of service by handling claims promptly and courteously. In fiscal year 2003, the City transferred its risk through the purchase of liability insurance to cover its airport, aircraft, and underground petroleum storage tanks. The City retains or "self-insures" its general liability, auto liability, bus liability, errors and omissions, and police professional liability. A combination of risk transfer and risk retention is employed in handling the City's health and dental benefits, property, and workers' compensation exposures. Employee and dependent health benefits are self-insured, with a third party providing claims administration and excess stop loss insurance. Property insurance is purchased with a large deductible. Benefits due City employees under the Iowa Workers' Compensation Laws are self-insured with excess stop loss insurance. The City accounts for and finances its retained risks through the Risk Management Internal Service Fund, whose net assets were in excess of \$19.0 million dollars as of June 30, 2003. In compliance with Statement 10 of the Governmental Accounting Standards Board, the City's financial statements show as an expense and liability, the estimated cost of all claims which have occurred. Claim liabilities are based on the estimated total cost of all claims including claims reported but not settled, and claims incurred but not reported. The tort liability and workers' compensation claims liabilities are shown at a 95% confidence level, as determined by an independent actuary, in the City's June 30, 2003, financial statements. The amount of incurred but unpaid health and dental bills are also determined by an independent actuary as required by the State Code of Iowa.

Additional Financial Information

Additional information to include a narrative overview and analysis of the financial statements of the City of Cedar Rapids can be found in the Management's Discussion and Analysis (M D & A) portion of the Financial Section of this CAFR starting at page 18 and continuing through page 26. Although the M D & A is not a required part of the City's basic financial statements, it is part of the supplementary information required by the Governmental Accounting Standards Board.

OTHER INFORMATION

Form of Government

The City has operated under the Commission form of government since 1908, under which non-partisan citywide elections are held every two years for the mayor and four commissioners, each of whom runs for a specific area of responsibility and collectively form the City Council. Additionally, 250 volunteers serve on various boards and commissions.

Independent Audit

The State Code requires an annual audit of the financial statements of the City. McGladrey & Pullen, LLP Certified Public Accountants conducted the audit for FY03. Their opinion has been included in this report.

Awards

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Cedar Rapids, Iowa for its comprehensive annual financial report for the fiscal year ended June 30, 2002. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a

period of one year only. We believe our current report continues to conform to Certificate of Achievement Program requirements, and we are submitting it to GFOA.

Acknowledgments

The preparation of this report could not be accomplished without the efficient and dedicated services of the entire staff of the offices of the City Controller-Auditor and City Treasurer. We would also like to thank the members of the City Council for their prudent management of the City's finances.

Respectfully submitted,

Lyle K. Hanson
Commissioner of Accounts & Finance

Robert E. McMahan
City Controller-Auditor