

October 28, 2005

The Honorable Mayor, City Council Members,
And Citizens of the City of Cedar Rapids, Iowa:

The City of Cedar Rapids, Iowa, is required by various state and federal regulations to publish a complete set of financial statements presented in conformity with accounting principles generally accepted in the United States of America (generally accepted accounting principles or GAAP) and audited in accordance with auditing standards generally accepted in the United States of America by a firm of licensed certified public accountants. Pursuant to these requirements, the Comprehensive Annual Financial Report (CAFR) of the City of Cedar Rapids, Iowa (City) for the fiscal year ended June 30, 2005 as prepared by the Office of the City Controller-Auditor is hereby submitted in accordance with the provisions of Chapter 11.6 of the Code of Iowa.

Management assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements.

McGladrey & Pullen, Certified Public Accountants, have issued an unqualified (“clean”) opinion on the City’s financial statements for the year ended June 30, 2005. The independent auditor’s report is located at the front of the financial section of this report.

The independent audit of the financial statements of the City was part of a broader, federally mandated single audit designed to meet the special needs of federal grantor agencies. The standards governing single audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government’s internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. Information related to this single audit, including the Schedule of Expenditures of Federal Awards, Independent Auditors’ Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards, Independent Auditor’s Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133, and Schedule of Findings and Questioned Costs is included in the section entitled Compliance Section.

Management's discussion and analysis (MD&A) immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the basic financial statements. MD&A complement this letter of transmittal and should be read in conjunction with it.

PROFILE OF THE CITY OF CEDAR RAPIDS

The City of Cedar Rapids, incorporated in 1849, 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 434,041. The population of Linn County based upon the 2004 census is 197,262 of which 122,206 reside within Cedar Rapids. The City of Cedar Rapids is empowered to levy a property tax on real property located within its boundaries. It also is empowered by state statute to extend its corporate limits by annexation, which it has done from time to time.

The City of Cedar Rapids 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.

During fiscal year 2005, a petition submitted on October 29, 2004, signed by 10,262 citizens, asked the City Council to create a Home Rule Charter Commission to prepare a Home Rule Charter to be voted upon with the current form of government. The Home Rule Charter Commission was formed on November 5, 2004. On April 5, 2005, the Home Rule Charter Commission filed the proposed charter with the City of Cedar Rapids, Iowa. The proposed charter called for a part-time mayor, part-time city council, and a full-time city manager.

A general election was held on June 14, 2005, with the citizens being asked to vote on retaining the existing commission form or adopting the Home Rule Charter form. The election resulted in the Home Rule Charter form being approved by the citizens of Cedar Rapids, Iowa. The new form of government will consist of nine council members. Five of the members will each represent a specific district. The remaining four council members will be elected at-large, with the Mayor being one of those seats. The election for the new form of government will take place on Tuesday, November 8, 2005, and, if necessary, a run-off election will occur on Tuesday, December 6, 2005. The new City Council will take office on January 2, 2006, and will be responsible for hiring the City Manager. A transition team, comprised of the City Clerk, City Controller-Auditor, and City Attorney, has been created to address operational concerns and other administrative matters during this transition process.

The City of Cedar Rapids provides a full range of services, including 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. Three component units are included in our financial report: The Eastern Iowa Airport, Cedar Rapids/Linn County Solid Waste Agency, and Cedar Rapids Public Library Foundation.

The annual budget serves as a foundation for the City's financial planning and control. The City Council is responsible for developing a budget proposal. Council is required to hold public hearings on the proposed budget and to adopt the final budget no later than March 15 for the fiscal year beginning the following July 1. The budget is prepared by fund and function. Department heads may transfer resources within the department as they see fit.

FACTORS AFFECTING FINANCIAL CONDITION

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 Corridor™ has one work force. Priority One, the economic development arm of the Cedar Rapids Chamber of Commerce, reported the following FY05 accomplishments:

Business Development

- Assisted in the creation of 842 jobs.
- Located six new companies in the area.
- Assisted twenty-three area companies in expansion, training, and support.
- Increased the capital investment base by \$175,379,000 through industrial and office development.
- Over the course of the next five years Priority One looks to assist in the creation of 6,000 new jobs and generate \$175 million in capital investment.

In addition, the 2005 Laborshed Study, conducted by the Workforce Research Bureau of Iowa Workforce Development, reveals the Technology Corridor laborshed region has grown from 16 to 20 counties in two years. Based on figures in the 2005 study, the potential available laborforce in the Cedar Rapids area is estimated to be 88,500. Since the 2003 study, the workforce in Cedar Rapids' metropolitan area has increased 52.3 percent. The increase reflects growth in the laborshed area, new population growth, increased numbers of people willing to re-enter the workforce and travel to the region's central nodes for work.

Nearly two-thirds of the workers in the Technology Corridor are employed in the following five areas: Education, Healthcare/Social Services, Advanced Manufacturing, Wholesale and Retail Trade, and Professional Services.

The Cedar Rapids Area Chamber of Commerce partnered with The Greater Cedar Rapids Community Foundation to convene the entire county to focus on 15 initiatives that could be accomplished over the next five years in Linn County. The 15 initiatives chosen are as follows: Designate an arts and entertainment district along 3rd Street SE, make health care accessible to the underserved, grow and sustain locally-owned businesses, make parks more attractive to youth and families, develop the riverfront, expand downtown housing, create a year-round district along Rockford Road SW, rejuvenate abandoned and deteriorating commercial property, build a state-of-the-art activity center, empower neighborhoods, upgrade and expand the U.S. Cellular Center, develop and implement a comprehensive solid waste management plan, connect and expand Linn County trails, launch a best-in-the-nation early childhood education program, and develop light rail service. Many of the initiatives outlined by the Fifteen in 5 Committee involve projects in the City. Over the course of the next few years the City will be working with citizens and business leaders to make these initiatives a reality.

The City has also partnered with local organizations and businesses to launch an effort to bring the talents of a diverse work force from around the world to this region. This effort is essential for Technology Corridor businesses to compete in a global economy and the City has pledged financial support for this project through calendar year 2010.

Cedar Rapids' unemployment rate of 4.3% increased slightly for fiscal year ending 2005, but remained lower than fiscal year ending 2005 state unemployment rate of 4.6% and the national unemployment rate for June 2005 of 5.0%.

The Cedar Rapids MSA mean household income in 2005 was \$68,495 as compared to \$68,200 in 2004. These amounts are presented in 1996 constant dollar.

The average hourly rate in manufacturing was \$19.40 in 2004 as compared to \$17.70 in 2003. The average hourly workweek also increased to 43.3 hours in 2002 from 42.9 in 2001.

Retail sales in the metro area reached an all time high of \$2.83 billion for calendar year 2004 compared to \$2.75 billion in calendar year 2003. Of this total, \$2.39 billion was generated in Cedar Rapids.

The total value of building permits in FY 2005 was approximately \$173.2 million. This compares with an amount of \$148.0 for FY 2004. This amount represents an increase of 17 percent from the previous fiscal year.

Long-term financial planning

Unreserved fund balance in the general fund was \$24.5 million or 32 percent of total general fund budgeted expenditures for fiscal year 2006. This percentage falls within the City's policy guidelines for reserves, which at a minimum must be 25 percent of next fiscal year's budgeted general fund expenditures as established by Council resolution. By maintaining an appropriate reserve balance the City is able to react to both known and

unknown events that will have an impact on the City finances without disrupting services provided to its citizens in the short term.

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 FY2006 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.

Relevant financial policies

Internal Controls

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 short-term daily operations and 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 and 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, in compliance with a Council resolution, annually 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.

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 that is sufficient to meet the needs of the State plan when combined with local employee contributions. 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) except for airport safety employees, in which case the percentages are 6.16 percent and 9.23 percent respectively. 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 24.92 percent of annual covered payroll. 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 MFPRSI.

Debt Administration

The City's debt management policy strives to repay 30 to 60 percent of the principal amount of its general obligation debt within five years and at least 60 percent within ten fiscal years. Capital projects financed through issuance of debt are programmed to be paid off completely within the expected useful life of the capital project. Currently, the City is on pace to repay over 70 percent of its debt within ten fiscal years. 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. FY05 marked our thirty-third anniversary of maintaining this rating.

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.

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 2005, the City transferred its risk through the purchase of liability insurance to cover its airport, underground fuel storage tanks, six vehicles, maintenance of a non-owned air-ambulance, lead paint hazard control program and liquor liability. The City retains or "self-insures" without excess insurance, the rest of its general liability, errors and employment practices liability, police liability, auto liability, bus liability, and owned aircraft liability exposures. The City also self-insures its workers compensation, health and dental benefits without stop loss insurance. A combination of risk transfer and risk retention is employed in handling the City's property exposures. Property insurance is purchased with large deductibles. The City accounts for and finances its retained risks through the Risk Management Internal Service Fund. 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, 2005, 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.

AWARDS AND ACKNOWLEDGEMENTS

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Cedar Rapids, Iowa, for its comprehensive annual financial report (CAFR) for the fiscal year ended June 30, 2004. This was the twenty-fourth consecutive year that the City has received this prestigious award. In order to be awarded a Certificate of Achievement, the City had to publish an easily readable and efficiently organized CAFR that satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

In addition, the City also received the GFOA's Distinguished Budget Presentation Award for its annual budget for the fiscal year beginning July 1, 2005. In order to qualify for the Distinguished Budget Presentation Award, the City's budget document had to be judged proficient as a policy document, a financial plan, an operations guide, and a communications device. The City has received this award for seven years. The award is valid for a period of one year only.

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

Casey J. Drew, CPA
City Controller-Auditor