



WATERLOO WATER WORKS

WATERLOO, IOWA

DECEMBER 31, 2004

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Officials

Name	Title	Term Expires
Craig Caslavka	Chairman - Board of Trustees	January 12, 2010
Terry Kuntz	Vice-Chairman - Board of Trustees	January 12, 2006
Rodger Burris	Trustee	January 12, 2008
Dennis Clark, PE	Secretary, Treasurer and General Manager	Indefinite
Steve Scharfenberg	Assistant Treasurer and Assistant General Manager	Indefinite

**Waterloo Water Works
Management's Discussion and Analysis
June 30, 2004**

The Waterloo Water Work's (Utility) discussion and analysis is designed to offer readers of the Utility's financial statements a narrative overview and analysis of the financial activities of the Utility for the year ended December 31, 2004. Readers are encouraged to read the Management's Discussion and Analysis in conjunction with the Utility's financial statements, which begin on Page 8.

Financial Highlights

- The Utility's assets exceeded its liabilities by \$18.1 million at December 31, 2004. Of this amount, \$1.4 million may be used to meet ongoing obligations to the citizens and creditors. The remaining net assets are invested in capital assets or are restricted for debt repayment.
- The operating revenue of the Utility exceeded operating expenses by \$121,094 and \$391,455 for the years ended December 31, 2004 and 2003, respectively.
- At December 31, 2004, the Utility's unrestricted cash, certificates of deposits and trade receivables of approximately \$2.15 million exceeded total current liabilities by approximately \$620,000. This excess is available for spending at the Utility's discretion. Included in current liabilities is an estimated net pension obligation of \$126,391 which is based on an independent actuarial determination as of January 1, 2004.
- The Utility has capital loan notes outstanding of \$560,000 at December 31, 2004 which are reported net of unamortized discounts and reacquisition costs of \$5,109.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Utility's basic financial statements. The Utility is a single purpose component unit of the City of Waterloo, Iowa (City). The Utility provides water to its customers at rates designed to recover the cost of providing the water, including costs associated with installation and maintenance of water pumping, storage and transmission systems. As a result, the Utility prepares financial statements as a single enterprise fund in a manner similar to a private-sector business.

The statements of net assets present information on all of the Utility's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Utility is improving or deteriorating.

The statements of revenue, expenses and changes in net assets present information showing how the Utility's net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenue and expenses are reported in this statement for some transactions that will result in cash flows in the following year.

The statements of cash flows present information showing major sources and uses of cash by four types of activities. The activities are operating; noncapital financing; capital and related financing; and investing. Also included is a schedule which reconciles income from operations to net cash provided by operating activities.

The basic financial statements can be found on Pages 8 through 10 of this report.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. Notes are considered to be an integral part of financial statements prepared in accordance with generally accepted accounting principles. The notes to the financial statements can be found on Pages 11 through 19 of this report.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. The Utility's assets exceeded its liabilities by \$18.1 million and \$18 million on December 31, 2004 and 2003, respectively.

The following is a summary of the composition of net assets at December 31:

	2004	2003 (Restated - Note 13)
Current assets	\$ 2,192,814	\$ 2,140,948
Noncurrent, noncapital assets	978,996	973,923
Capital assets, net of accumulated depreciation	<u>16,990,877</u>	<u>16,994,188</u>
Total Assets	<u>20,162,687</u>	<u>20,109,059</u>
Current liabilities	1,531,481	1,444,961
Liabilities payable from restricted assets	112,348	110,023
Other long-term liabilities (net)	<u>379,504</u>	<u>598,407</u>
Total Liabilities	<u>2,023,333</u>	<u>2,153,391</u>
Net Assets		
Invested in capital assets (net of related debt)	16,401,373	16,180,354
Restricted	322,500	322,500
Unrestricted	<u>1,415,481</u>	<u>1,452,814</u>
Total Net Assets	<u>\$ 18,139,354</u>	<u>\$ 17,955,668</u>

Net assets invested in capital assets are by far the largest portion of the Utility's net assets, 90% at December 31, 2004, and reflect its net investment in capital assets (e.g., land, buildings, machinery, equipment, meters and water supply system). The Utility uses these capital assets to provide water and services to the citizens; consequently, these assets are not available for future spending.

Restricted net assets represent resources that are subject to external restrictions on how they may be used.

Unrestricted net assets may be used to meet the Utility's ongoing obligations to citizens and creditors. It is the Utility's intention to use these assets for future operating purposes and capital asset acquisition and improvements.

At both December 31, 2004 and 2003, the Utility reported positive balances in all three categories of net assets.

Governmental activities. Since the Utility is a single purpose enterprise, it has no activities classified as "governmental".

The following is a summary of the changes in net assets for the years ended December 31:

	2004	2003 (Restated - Note 13)
Operating revenue.....	\$ 3,586,449	\$ 3,687,661
Operating expenses	<u>3,465,355</u>	<u>3,296,206</u>
Operating Income	121,094	391,455
Net nonoperating revenue.....	83,892	68,805
Capital contributions.....	65,071	60,554
Transfers to City of Waterloo.....	<u>(86,371)</u>	<u>(113,209)</u>
Change in Net Assets	183,686	407,605
Net Assets - Beginning of Year	<u>17,955,668</u>	<u>17,548,063</u>
Net Assets - End of Year.....	<u>\$ 18,139,354</u>	<u>\$ 17,955,668</u>

Operating revenue is the Utility's primary source of revenue and is generated from water sales and other services to customers. For 2004, operating revenue decreased \$101,216 from 2003 due primarily to a decrease in water usage.

Operating expenses totaled \$3,465,355 for 2004, a \$169,145 increase from 2003. These expenses represent the Utility's costs to provide water and services to customers. Operating expenses included depreciation expense of \$426,272 and \$231,663 for the years ended December 31, 2004 and 2003, respectively.

Net nonoperating revenue includes interest income and expense, amortization of debt issuance costs, gains and losses on the sale of assets and rent from leasing space for billboards and antennas. Net nonoperating revenue increased by \$15,087 between 2004 and 2003. Rent income totaled \$98,813 and \$88,972 for the years ended December 31, 2004 and 2003, respectively.

Capital contributions totaled \$65,071 and \$60,554 for years ended December 31, 2004 and 2003, respectively. These contributions are received as "front footage" fees as property is developed with resulting taps into the Utility's water distribution system.

Transfers to City of Waterloo of \$86,371 and \$113,209 for the years ended December 31, 2004 and 2003, respectively, are equal to the value of metered water provided to the City at no charge. Operating revenue includes an amount equal to the transfer. The Utility also provides unmetered water to the City at no charge. However, no reasonable estimate of the value can be made. Therefore, the value of unmetered water is not included in the financial statements.

Budgetary Highlights

Each year, the Board of Trustees adopts a budget using the modified cash basis of accounting which differs from the accrual basis of accounting used for the accompanying financial statements. The Utility's original budget was not amended during either of the years ended December 31, 2004 or 2003.

Actual cash receipts were approximately \$25,000 greater than budgeted. The majority of this variance was due to receipts over budget for other sales and services, including rent of approximately \$47,000 along with receipts under budget for water sales and interest income of approximately \$13,000 and \$14,000, respectively.

Actual cash disbursements were approximately \$10,000 greater than budget due to payment of discretionary items while believing the Utility was under budget.

Capital Assets and Long-term Debt

The Utility's investment in capital assets amounted to approximately \$16.9 million at both December 31, 2004 and 2003 (net of accumulated depreciation of approximately \$5.9 million and \$5.5 million at December 31, 2004 and 2003, respectively). This investment in capital assets includes land; buildings and improvements; water supply and distribution systems; meters; machinery; and equipment.

Major capital asset construction and acquisition during 2004 included the following:

- Installation of 1.69 miles of water mains.
- Purchase of two trucks.
- Replacement of fence around the University Avenue water tower.
- Purchase of a hydraulic pavement breaker.

The following is a summary of the capital assets, at cost, at December 31:

	2004	2003
Land	\$ 164,152	\$ 164,152
Buildings and improvements	1,706,706	1,798,477
Water supply system	3,682,347	3,668,722
Distribution system	14,191,228	13,851,349
Meters and equipment.....	1,482,681	1,382,781
Machinery and equipment.....	<u>1,694,087</u>	<u>1,667,411</u>
Total.....	<u>\$ 22,921,201</u>	<u>\$ 22,532,892</u>

Additional information about the Utility's capital assets can be found in Note 6 to the financial statements.

At December 31, 2003, total Utility long-term debt (consisting of capital loan notes) was \$765,000 less unamortized discounts and reacquisition costs of \$8,591 for a net long-term debt of \$756,409. During 2004, the Utility repaid \$205,000 of principal and paid \$36,820 of interest on the debt and amortized to expense \$3,482 of discounts and reacquisition costs. At December 31, 2004, total Utility long-term debt was \$560,000 less unamortized discounts and reacquisition costs of \$5,109 for a net long-term debt of \$554,891. Principal of \$210,000 and interest of \$27,225 is due during the year ending December 31, 2005.

Debt indentures require that certain covenants relating to the maintenance and efficiency of the operating system, the rate structure, restrictions on borrowings, leasing or disposition of assets and minimum insurance coverage be adhered to. During 2004 and 2003, the Utility was in compliance with required covenants.

Additional information about the Utility's long-term debt can be found in Notes 4 and 7 to the financial statements.

Economic Factors and Next Year's Budget and Rates

The Utility's primary source of revenue is water sales. Water rates are scheduled to increase 15% on March 1, 2005. Budgeted revenue has been adjusted to reflect the increase in rates.

Operating expenditures for 2005 are also expected to remain about the same as expenditures in 2004. Capital expenditures are expected to increase as the Utility is planning to complete the 18th Street Bridge River Crossing at an approximate cost of \$262,000.

Independent Auditor's Report

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the accompanying balance sheets of the Waterloo Water Works, a component unit of the City of Waterloo, Iowa, at December 31, 2004 and 2003, and the related statements of revenue, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Waterloo Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards and provisions 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, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Waterloo Water Works at December 31, 2004 and 2003, and the changes in its financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 17, 2005 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying Management's Discussion and Analysis on Pages 2 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

HOGAN - HANSEN

HOGAN - HANSEN
Waterloo, Iowa
February 17, 2005

Balance Sheets

At December 31, 2004 and 2003

	2004	2003 (Restated - Note 13)
Assets		
Current Assets		
Cash	\$ 830,834	\$ 926,128
Time certificates of deposit.....	665,152	557,477
Receivables		
Trade accounts	656,463	601,576
Accrued interest	6,524	3,104
Notes.....	10,372	11,417
Prepaid expenses.....	23,469	41,246
Total Current Assets	<u>2,192,814</u>	<u>2,140,948</u>
Noncurrent Assets		
Restricted time certificates of deposit.....	434,848	432,523
Unamortized capital loan notes issuance costs.....	7,388	10,983
Notes receivable - long-term portion	74,117	98,570
Repair assessments receivable.....	119,907	100,210
Plant - Not in Service		
Land	67,004	67,004
Pipes and valves.....	275,732	264,633
Subtotal	<u>978,996</u>	<u>973,923</u>
Capital Assets		
Land	164,152	164,152
Buildings and improvements.....	1,706,706	1,798,477
Water supply system.....	3,682,346	3,668,722
Distribution system.....	14,191,228	13,851,349
Meters and equipment	1,482,681	1,382,781
Machinery and equipment.....	1,694,088	1,667,411
Total Capital Assets	22,921,201	22,532,892
Less accumulated depreciation	(5,930,324)	(5,538,704)
Net Capital Assets	<u>16,990,877</u>	<u>16,994,188</u>
Total Noncurrent Assets	<u>17,969,873</u>	<u>17,968,111</u>
Total Assets	<u>\$ 20,162,687</u>	<u>\$ 20,109,059</u>

See accompanying notes to the financial statements.

	2004	2003 (Restated - Note 13)
Liabilities and Net Assets		
Current Liabilities		
Current maturities of water revenue capital loan notes	\$ 210,000	\$ 205,000
Current maturities of obligations under capital lease.....	—	10,427
Accounts payable	134,511	96,162
Accrued employee compensation	101,694	79,549
Net pension obligation	126,391	104,380
Customer deposits.....	12,010	4,610
Due to Other Governments		
City of Waterloo		
Garbage fees.....	303,034	288,793
Sewer fees	589,921	600,401
City of Raymond	12,500	13,823
Black Hawk County.....	<u>41,420</u>	<u>41,816</u>
Total Current Liabilities	1,531,481	1,444,961
 Liabilities Payable From Restricted Assets	 112,348	 110,023
 Obligations Under Capital Lease	 34,613	 46,998
 Water Revenue Capital Loan Notes	 <u>344,891</u>	 <u>551,409</u>
Total Liabilities	<u>2,023,333</u>	<u>2,153,391</u>
 Net Assets		
Invested in capital assets, net of related debt	16,401,373	16,180,354
Restricted for debt service.....	322,500	322,500
Unrestricted	<u>1,415,481</u>	<u>1,452,814</u>
Total Net Assets	<u>18,139,354</u>	<u>17,955,668</u>
 Total Liabilities and Net Assets	 <u>\$ 20,162,687</u>	 <u>\$ 20,109,059</u>

Statements of Revenue, Expenses and Changes in Net Assets

Years Ended December 31, 2004 and 2003

	2004	2003 (Restated - Note 13)
Operating Revenue		
Water sales.....	\$ 3,258,094	\$ 3,357,551
Metered water provided to the City of Waterloo	86,371	113,209
Fire protection.....	49,345	49,728
Billing and collection fees	99,462	95,318
Other sales and service.....	<u>93,177</u>	<u>71,855</u>
Total Operating Revenue	<u>3,586,449</u>	<u>3,687,661</u>
Operating Expenses		
Salaries and benefits	1,925,896	1,896,406
Contractual services	613,620	618,308
Commodities.....	499,567	549,829
Depreciation	<u>426,272</u>	<u>231,663</u>
Total Operating Expenses.....	<u>3,465,355</u>	<u>3,296,206</u>
Operating Income.....	<u>121,094</u>	<u>391,455</u>
Nonoperating Revenue (Expenses)		
Interest income	31,595	43,680
Interest expense	(42,593)	(54,607)
Amortization.....	(3,595)	(4,852)
Gain (loss) on disposal of assets.....	(328)	(4,388)
Billboard and antenna rent	<u>98,813</u>	<u>88,972</u>
Total Nonoperating Revenue	<u>83,892</u>	<u>68,805</u>
Change in Net Assets Before Contributions and Transfers	204,986	460,260
Capital contributions	65,071	60,554
Transfers to City of Waterloo.....	<u>(86,371)</u>	<u>(113,209)</u>
Change in Net Assets.....	<u>183,686</u>	<u>407,605</u>
Net Assets - Beginning of Year, as previously reported	17,955,668	17,469,340
Prior period adjustment (Note 13)	<u>—</u>	<u>78,723</u>
Net Assets - Beginning of Year, as Restated	<u>17,955,668</u>	<u>17,548,063</u>
Net Assets - End of Year.....	<u>\$ 18,139,354</u>	<u>\$ 17,955,668</u>

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2004 and 2003

	2004	2003 (Restated - Note 13)
Cash Flows From Operating Activities		
Cash received from customers	\$ 3,344,287	\$ 3,415,734
Cash collected on behalf of primary government	9,729,691	9,424,971
Cash collected on behalf of other governments	295,355	295,403
Cash paid to primary government (less 1% collection fee)	(9,637,484)	(9,172,685)
Cash paid to other governments (less collection fee).....	(294,588)	(295,475)
Cash paid to or on behalf of employees	(1,881,740)	(1,932,007)
Cash paid to suppliers.....	(901,779)	(1,011,507)
Net Cash Provided by Operating Activities	<u>653,742</u>	<u>724,434</u>
Cash Flows From Noncapital Financing Activities		
Billboard and antenna rent	<u>98,813</u>	<u>88,972</u>
Cash Flows From Capital and Related Financing Activities		
Contributed capital.....	65,071	60,554
Collections on note receivable for water main, including interest (2004 - \$5,948; 2003 - \$10,079)	31,446	55,356
Repayments of water revenue capital loan notes.....	(205,000)	(260,000)
Interest paid on water revenue capital loan notes.....	(36,820)	(49,140)
Proceeds from sale of property and equipment.....	645	810
Repayments of obligations under capital lease	(22,812)	—
Interest paid on obligations under capital lease	(2,291)	—
Acquisition of capital assets	(227,347)	(186,190)
Acquisition of plant not in service	(362,968)	(217,862)
Net Cash Used in Capital and Related Financing Activities	<u>(760,076)</u>	<u>(596,472)</u>
Cash Flows From Investing Activities		
Proceeds from the sales and maturities of certificates of deposit ...	990,000	840,000
Purchase of certificates of deposit.....	(1,100,000)	(840,000)
Interest received on savings and certificates of deposits	22,227	35,494
Net Cash Provided by (Used in) Investing Activities	<u>(87,773)</u>	<u>35,494</u>
Net Increase (Decrease) in Cash	<u>(95,294)</u>	<u>252,428</u>
Cash - Beginning of Year	926,128	673,700
Cash - End of Year	<u>\$ 830,834</u>	<u>\$ 926,128</u>
Unrestricted cash.....	\$ 830,834	\$ 926,128
Restricted cash.....	—	—
Total Cash	<u>\$ 830,834</u>	<u>\$ 926,128</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 121,094	\$ 391,455
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	426,272	231,663
Water provided to the City of Waterloo, not billed	(86,371)	(113,209)
Inventory used in operations	165,435	177,314
Change in Assets and Liabilities		
Increase in trade accounts and repair assessments receivable	(74,584)	(65,813)
(Increase) decrease in prepaid expenses	17,777	(663)
Increase (decrease) in accounts payable	28,196	9,725
Increase in accrued employee compensation.....	22,145	7,236
Increase (decrease) in net pension obligation	22,011	(42,837)
Increase in customer deposits, due to other governments and liabilities payable from restricted assets	11,767	129,563
Net Cash Provided by Operating Activities	<u>\$ 653,742</u>	<u>\$ 724,434</u>

See accompanying notes to the financial statements.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Reporting Entity

The Waterloo Water Works (Utility) is a municipal utility that is a political subdivision and component unit of the City of Waterloo, Iowa. The Utility provides water to customers in the cities of Waterloo, Elk Run Heights, Hudson, Raymond and adjacent areas of Black Hawk County. The Utility's rates are set by its governing board. The Waterloo Water Works Board of Trustees has oversight responsibility for all water pumping and distribution to Waterloo and surrounding areas. All activities with which the Board has oversight responsibility are included in the financial statements.

Measurement Focus and Basis of Accounting

The Utility is accounted for on the flow of economic resources measurement focus and uses the accrual basis of accounting. Under this method, revenue is recorded when earned and expenses are recorded when incurred. All Financial Accounting Standards Board (FASB) pronouncements are applied in accounting and reporting for its proprietary operations unless they are contradicted with pronouncements issued by the Governmental Accounting Standards Board (GASB).

Use of Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported revenue and expenses.

Cash and Certificates of Deposit

The Utility's deposits at year end were entirely insured or collateralized with securities held by the Utility or by their agents in the Utility's name or by nontransferable letters of credit.

Trade Accounts Receivable

Water sales are billed monthly or quarterly, depending upon the quantity of water used or if requested by the customer. Accordingly, water sales are billed monthly to the larger commercial accounts and certain multi-family residential customers, while most residential customers are billed quarterly. Water sales are estimated for the period from the previous billing to year end and are included in revenue and trade accounts receivable. Unbilled revenue included in receivables at December 31, 2004 and 2003 was \$386,616 and \$353,985, respectively.

Budgeting

The Utility is required to prepare a budget each year and submit it, subject to review by the City of Waterloo, to the State of Iowa. The Utility prepares its budget using the cash basis of accounting modified by reducing cash balances and receipts and disbursements by amounts held on behalf of the City of Waterloo and customer deposits. The Utility's 2004 and 2003 budget and comparison to cash basis activity is as follows:

	2004	2003
Business-Type Activity - Water		
Actual disbursements	\$ 3,944,927	\$ 3,832,155
Budgeted disbursements	<u>3,934,900</u>	<u>4,030,000</u>
Actual Disbursements Over (Under) Budget	<u>\$ 10,027</u>	<u>\$ (197,845)</u>

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Capital Assets

The capital assets consist of assets in service and assets not in service consisting of land and inventories of pipe, valves, meters and other items which will generally be converted to capital assets. Capital assets are recorded at cost with depreciation computed under the straight-line method over useful lives as follows:

Type	Estimated Useful Lives
Buildings and improvements	8 - 40 Years
Water supply system	10 - 40 Years
Distribution system	99 Years
Meters and equipment.....	5 - 63 Years
Machinery and equipment	5 - 26 Years

Depreciation expense for the years ended December 31, 2004 and 2003 was \$426,272 and \$231,663, respectively. During the year ended December 31, 2004, management changed the estimated useful lives of certain distribution system assets resulting in an increase in 2004 depreciation expense of approximately \$200,000.

Major outlays for capital assets and improvements are capitalized as "in process" while projects are constructed and transferred to capital assets upon completion. Interest incurred on construction debt during the construction phase of capital assets is reflected in the capitalized value of the asset constructed, net of interest earned on the invested proceeds over the same period.

Operating Revenue

The Utility defines operating revenue as revenue derived from the sale of water and from the collection of garbage and sewer fees for the City of Waterloo and other governments. Nonoperating revenue is defined as anything other than revenue from the sale of water and from the collection of fees for the City of Waterloo.

Restricted Resources

When an expense is incurred for which both restricted and unrestricted net assets are available, the Utility first uses the restricted resources. Unrestricted resources are used once the restricted resources have been depleted.

Unamortized Water Revenue Capital Loan Notes Issuance Costs

Costs to issue the 1999 and 2001 water revenue capital loan notes of \$14,176 and \$14,523, respectively, are amortized using the effective interest method over the life of the notes, seven and nine years, respectively. Accumulated amortization was \$21,311 and \$17,716 at December 31, 2004 and 2003, respectively. Amortization of note issue costs for 2004 and 2003 was \$3,595 and \$4,852, respectively.

Discount on Water Revenue Capital Loan Notes

Original discounts on the 1999 and 2001 water revenue capital loan notes of \$5,250 and \$8,750, respectively, are amortized using the effective interest method over the life of the notes, seven and nine years, respectively. Accumulated amortization at December 31, 2004 and 2003 was \$9,731 and \$7,929, respectively. Discount amortization for 2004 and 2003, which was added to interest expense, was \$1,802 and \$2,395, respectively.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Reacquisition Costs

Costs to reacquire 1989 water revenue bonds and 1994 water revenue capital loan notes of \$15,080 and \$1,872, respectively, are amortized using the effective interest method over the shorter of the remaining lives of the reacquired debt or newly issued debt, seven years and two years, respectively. Accumulated amortization at December 31, 2004 and 2003 was \$16,112 and \$14,432, respectively. Amortization of reacquisition costs for 2004 and 2003, which was added to interest expense was \$1,680 and \$3,072, respectively.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Utility considers all highly liquid debt instruments purchased with original maturities of less than three months to be cash equivalents.

(2) Cash Flow Statement Supplementary Information

Schedule of Noncash Investing and Financing Activities	2004	2003
Interest expense.....	\$ 42,593	\$ 54,607
Less noncash amortization of water revenue capital loan notes discount and reacquisition costs.....	<u>(3,482)</u>	<u>(5,467)</u>
Cash Paid for Interest	<u>\$ 39,111</u>	<u>\$ 49,140</u>
Total purchases of plant not in service.....	\$ 371,021	\$ 217,862
Less increase in plant not in service.....	(11,099)	4,522
Less plant not in service used in operations.....	<u>(165,435)</u>	<u>(177,314)</u>
Increase in Capital Assets From Noncash Transfers of Plant Not in Service	<u>\$ 194,487</u>	<u>\$ 45,070</u>
Cost of capital asset acquisitions	\$ 225,044	\$ 154,509
Amounts Payable		
Current year	(2,100)	(4,403)
Prior year	4,403	7,988
Amounts Payable From Restricted Assets		
Prior year	<u>—</u>	<u>28,096</u>
Cash Paid for Acquisition of Capital Assets	<u>\$ 227,347</u>	<u>\$ 186,190</u>
Capital Lease Obligation Incurred for Equipment	<u>\$ —</u>	<u>\$ 64,925</u>

Notes to the Financial Statements

(3) Deposits and Investments

The Utility's deposits in banks and credit unions at December 31, 2004 and 2003 are entirely covered by federal depository insurance, by the State Sinking Fund or are collateralized either with securities held by the Utility or by nontransferable letters of credit in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Utility is authorized by statute 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 Board of Trustees and the Treasurer of the State of Iowa; 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.

The Utility's certificates of deposit are stated at cost which approximates fair value. Certificates of deposit are purchased with maturities of 12 to 15 months and yields of 2.15% to 2.53%. Certain certificates of deposit are restricted to comply with debt covenants and to secure customer deposits.

(4) Restricted Assets

Restricted assets represent monies set aside under terms of bond covenants and to provide security for deposits and advances. The composition of these funds at December 31, 2004 and 2003 was as follows:

	Restricted Asset	Corresponding Liability	Restricted Net Assets
2004			
Customer deposits.....	\$ 112,348	\$ 112,348	\$ —
Capital Loan Note Covenants			
Debt reserve	122,500	—	122,500
Debt capital improvement reserve	200,000	—	200,000
Total	<u>\$ 434,848</u>	<u>\$ 112,348</u>	<u>\$ 322,500</u>
2003			
Customer deposits.....	\$ 110,023	\$ 110,023	\$ —
Capital Loan Note Covenants			
Debt reserve	122,500	—	122,500
Debt capital improvement reserve	200,000	—	200,000
Total	<u>\$ 432,523</u>	<u>\$ 110,023</u>	<u>\$ 322,500</u>

Restricted assets are invested in certificates of deposit with earnings thereon being deposited as general revenue of the Utility. Debt sinking and debt reserve amounts may only be used for payment of principal and interest on long-term debt. Debt sinking had the following activity:

Notes to the Financial Statements

(4) Restricted Assets

Balance, January 1, 2003.....	\$	—
Monthly allocations during 2003.....		309,140
Interest payments made.....		(49,140)
Principal payments made.....		<u>(260,000)</u>
Balance, December 31, 2003.....		—
Monthly allocations during 2004.....		241,820
Interest payments made.....		(36,820)
Principal payments made.....		<u>(205,000)</u>
Balance, December 31, 2004.....	\$	<u>—</u>

(5) Notes Receivable

As part of a water main extension project which was completed in October, 1996, 86 residents in the area of South Kimball Avenue signed agreements to pay the Utility a \$5,500 participation fee for access to, and future water purchases from, the water main. The participants had two options: payment of the total fee up front by August 30, 1996 or payment of \$500 down and the remainder with a 15-year term promissory note. Terms of the agreements call for quarterly payments (billed with their water) of \$125.13, including interest at a rate of 5.82% through August, 2011. For any resident who waited until after August 30, 1996 to become a participant, an additional fee is being charged ranging from 1% to 1.5% per month and promissory notes are no longer being accepted. The participation fee increased to \$7,414 starting September, 1999.

(6) Capital Assets

Capital asset activity for the years ended December 31, 2004 and 2003 was as follows:

	Balance 12-31-02	Increase	Decrease	Balance 12-31-03	Increase	Decrease	Balance 12-31-04
Capital Assets Not Being Depreciated							
Land.....	\$ 164,152	\$ —	\$ —	\$ 164,152	\$ —	\$ —	\$ 164,152
Capital Assets Being Depreciated							
Buildings and improvements..	1,697,931	100,546	—	1,798,477	8,775	(100,546)	1,706,706
Water supply system.....	3,654,517	14,205	—	3,668,722	13,625	—	3,682,347
Distribution system.....	13,795,450	55,899	—	13,851,349	339,879	—	14,191,228
Meters and equipment.....	1,381,191	1,590	—	1,382,781	100,546	(646)	1,482,681
Machinery and equipment.....	<u>1,631,381</u>	<u>124,321</u>	<u>(88,291)</u>	<u>1,667,411</u>	<u>62,374</u>	<u>(35,698)</u>	<u>1,694,087</u>
Total Capital Assets Being Depreciated.....	<u>22,160,470</u>	<u>296,561</u>	<u>(88,291)</u>	<u>22,368,740</u>	<u>525,199</u>	<u>(136,890)</u>	<u>22,757,049</u>
Less Accumulated Depreciation for							
Buildings and improvements	(524,105)	(29,387)	—	(553,492)	(26,205)	3,450	(576,247)
Water supply system.....	(1,753,862)	(73,973)	—	(1,827,835)	(74,529)	—	(1,902,364)
Distribution system.....	(1,699,974)	(38,789)	—	(1,738,763)	(223,676)	—	(1,962,439)
Meters and equipment.....	(497,889)	(30,251)	—	(528,140)	(39,087)	645	(566,582)
Machinery and equipment.....	<u>(902,843)</u>	<u>(59,263)</u>	<u>71,632</u>	<u>(890,474)</u>	<u>(62,775)</u>	<u>30,557</u>	<u>(922,692)</u>
Total Accumulated Depreciation.....	<u>(5,378,673)</u>	<u>(231,663)</u>	<u>71,632</u>	<u>(5,538,704)</u>	<u>(426,272)</u>	<u>34,652</u>	<u>(5,930,324)</u>
Net Capital Assets Being Depreciated.....	<u>16,781,797</u>	<u>64,898</u>	<u>(16,659)</u>	<u>16,830,036</u>	<u>98,927</u>	<u>(102,238)</u>	<u>16,826,725</u>
Net Capital Assets.....	<u>\$ 16,945,949</u>	<u>\$ 64,898</u>	<u>\$(16,659)</u>	<u>\$ 16,994,188</u>	<u>\$ 98,927</u>	<u>\$(102,238)</u>	<u>\$ 16,990,877</u>

Notes to the Financial Statements

(7) Summary of Debt

	<u>Current Portion</u>		<u>Long-Term Portion</u>	
	2004	2003	2004	2003
Water Revenue Capital Loan Notes				
Series 1999B capital loan notes, Wells Fargo Bank Iowa, N.A. - paying and registered agent, due in annual payments ranging from \$140,000 to \$150,000 through December, 2005, plus interest semi-annually at 4.6%, secured by first lien on net revenue.	\$ 150,000	\$ 150,000	\$ —	\$ 150,000
Series 2001 capital loan notes, Wells Fargo Bank Iowa, N.A. - paying and registered agent, due in annual payments ranging from \$55,000 to \$120,000 through December, 2010, plus interest semi-annually at rates ranging from 4.9% to 5.1%, depending on maturity, secured by first lien on net revenue.	<u>60,000</u>	<u>55,000</u>	<u>350,000</u>	<u>410,000</u>
Subtotal	210,000	205,000	350,000	560,000
Less: Unamortized discount	—	—	(4,269)	(6,071)
Unamortized reacquisition costs	<u>—</u>	<u>—</u>	<u>(840)</u>	<u>(2,520)</u>
Total	<u>\$ 210,000</u>	<u>\$ 205,000</u>	<u>\$ 344,891</u>	<u>\$ 551,409</u>
Obligations Under Capital Lease				
John Deere Credit, backhoe lease, discounted at a rate of 4.25%, due in annual payments of \$12,552, through January, 2008.	<u>\$ —</u>	<u>\$ 10,427</u>	<u>\$ 34,613</u>	<u>\$ 46,998</u>

The Water Works paid the lease payment due in January, 2005 at the end of 2004. Accordingly, there is no current maturity of obligations under capital lease.

Interest expense for 2004 and 2003 includes \$36,820 and \$49,140 on the notes plus \$3,482 and \$5,467, respectively, for amortization. Interest expense for 2004 also includes \$2,291 incurred under capital lease obligations. No interest expense was incurred during 2003 for obligations under capital lease.

At December 31, 2004 annual maturities of long-term debt were as follows:

Year Ending December 31,	Principal	Interest	Total
2005.....	\$ 210,000	\$ 27,225	\$ 237,225
2006.....	60,000	17,385	77,385
2007.....	65,000	14,445	79,445
2008.....	70,000	11,260	81,260
2009.....	75,000	7,830	82,830
2010.....	<u>80,000</u>	<u>4,080</u>	<u>84,080</u>
	<u>\$ 560,000</u>	<u>\$ 82,225</u>	<u>\$ 642,225</u>

Notes to the Financial Statements

(7) Summary of Debt

Debt indentures require that certain covenants relating to the maintenance and efficiency of the operating system, the rate structure, restrictions on borrowings, leasing or disposition of assets and minimum insurance coverage be adhered to. During 2004 and 2003, the Utility was in compliance with required covenants.

The following is a summary of the changes in debt for the years ended December 31, 2004 and 2003:

	Water Revenue Capital Loan Notes	Obligations Under Capital Lease
Balance - December 31, 2002.....	\$ 1,025,000	\$ —
Additions.....	—	57,425
Retirements	<u>(260,000)</u>	<u>—</u>
Balance - December 31, 2003.....	765,000	57,425
Retirements	<u>(205,000)</u>	<u>(22,812)</u>
Balance - December 31, 2004	<u>\$ 560,000</u>	<u>\$ 34,613</u>

(8) Capital Leases

During 2003, the Utility began leasing a backhoe. Annual payments of \$12,552 are due beginning in January, 2004 and continue through January, 2008. See Note 7.

The following is an analysis of the leased property under capital leases by major class:

Class of Property	Asset Balance
Machinery and equipment	\$ 64,925
Less accumulated amortization	<u>(4,689)</u>
	<u>\$ 60,236</u>

The following is a schedule by years of future minimum lease payments under capital leases:

Year Ending December 31,	
2005.....	\$ —
2006.....	12,552
2007.....	12,552
2008.....	<u>12,551</u>
Total Minimum Lease Payments	37,655
Less amount representing interest	<u>(3,042)</u>
Present Value of Net Minimum Lease Payments.....	<u>\$ 34,613</u>

Notes to the Financial Statements

(9) Compensated Absences

The Utility's employees accumulate vacation days during the year based on the anniversary date of their employment. As of December 31, 2004 and 2003, \$37,391 and \$35,544, respectively, was accrued for unused vacation days.

The Utility has a sick time policy for all hourly employees. Under this plan, employees earn sick time hours during the year up to a maximum which is specified in the plan. At year end, 25% of the current year unused hours, up to a maximum of 14 hours, is paid out in cash and the remaining hours are carried over to the next year as banked hours which do not vest.

(10) Related Party Transactions

The Utility provides customer file maintenance, meter reading, billing and collecting services for the City of Waterloo's (City) Sanitation (Garbage) and Sanitary Sewer Enterprise Funds and keeps 1% of cash collected as a service fee. During 2004 and 2003, the Utility recorded \$95,967 and \$91,811, respectively, as City service fees and forwarded approximately \$9,637,000 and \$9,170,000, respectively, to the City. At December 31, 2004, the Utility's payables to the City were \$303,034 and \$589,921 for garbage and sewer collections, respectively, compared to \$288,793 and \$600,401, respectively, at December 31, 2003, which have not been reduced for the Utility's City service fee. The Utility pays office expenses (data processing charges, postage and other expenses of the billing cycle) and passes approximately one-half of those costs on to the City. During 2004 and 2003, the Utility received approximately \$40,000 and \$38,000, respectively, from the City which reduced office expenses.

The Utility also provides metered and unmetered water to the City at no charge. Metered water furnished to the City is valued at equivalent sales rates and is included in the financial statements as water sales and transfers to the City. During the years ended December 31, 2004 and 2003, the Utility provided metered water to the City valued at approximately \$86,400 and \$113,200, respectively.

(11) Retirement Plan

Plan Description

The Utility maintains the Waterloo Water Works Pension Plan (Plan), which is a single employer defined benefit plan administered by the Pension Committee of the Waterloo Water Works. The Plan provides retirement benefits to plan members and beneficiaries. Cost-of-living adjustments are provided to members and beneficiaries at the discretion of the Committee. The Plan does not issue a stand-alone financial report. The actuarial report on the Plan is held at the Utility's office.

Funding Policy

The contribution requirements of Plan members and the Utility are established and may be amended by the Utility. Plan member contributions are not currently required. The Utility is required to contribute amounts necessary to provide benefits based on the actuarial valuation. The amount contributed to the Plan during 2004 and 2003 was \$50,000 and \$150,000, respectively.

Notes to the Financial Statements

(11) Retirement Plan

Annual Pension Cost and Net Pension Obligation

The annual pension cost for 2004 was determined as part of the actuarial valuation using the January 1, 2004 aggregate actuarial method. This method does not identify or separately amortize unfunded actuarial accrued liabilities. The actuarial assumptions for 2003 and 2002 included (a) 8% investment rate of return (net of administrative expenses) and (b) projected salary increases of 3% per year, compounded annually and retirement at age 65. The actuarial valuation at January 1, 2004 assumes retirement at age 62 with 30 years of service. The assumptions did not include any postretirement benefits. The actuarial value of assets was determined using the current market value of investments.

Three-Year Trend Information

Year Ended	Annual Pension Cost (APC)			Percentage of APC Contributed	Net Pension Obligation
	Normal Cost	Interest	Total		
December 31, 2002	\$92,791	\$7,423	\$100,214	0%	\$147,217
December 31, 2003	99,225	7,938	107,163	140%	104,380
December 31, 2004	77,788	(5,777)	72,011	69%	126,391

(12) Risk Management

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

(13) Prior Period Adjustment

In prior years, management chose not to record a receivable for unpaid repair costs which had been assessed against the property, since the amount was not material to the Water Works' financial statements. At December 31, 2004, the amount was material, requiring a prior period adjustment in order to properly record the asset to the Water Works' financial statements. The effect of the prior period adjustment was to increase unrestricted net assets by \$21,487 and \$78,723 at December 31, 2003 and 2002, respectively, and increase operating income \$21,487 for the year ended December 31, 2003. The prior period adjustment had no effect on the 2004 financial statements.

Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting ---

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the financial statements of the Waterloo Water Works as of and for the year ended December 31, 2004, and have issued our report thereon dated February 17, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, Chapter 11 of the Code of Iowa and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Utility's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance 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 noncompliance that are required to be reported under *Government Auditing Standards*.

The following comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2004 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. 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. Prior year findings relative to statutory or other legal matters have been resolved.

04-CS-1 Official Depositories - A resolution naming official depositories has been approved by the Utility. The maximum deposit amounts stated in the resolution were not exceeded during the year ended December 31, 2004.

04-CS-2 Budget

Finding - Operating cash disbursements during the year ended December 31, 2004 exceeded the amounts budgeted by \$10,927. Chapter 384.20 of the Code of Iowa states in part that public monies may not be expended or encumbered except under an annual or continuing appropriation.

Auditor's Recommendation - The budget should be amended in accordance with Chapter 384.18 of the Code of Iowa before disbursements are allowed to exceed the budget.

Utility's Response - The Utility was under budget just before year end. Because the Utility was under budget, the Utility prepaid some bills. The Utility neglected to take into account a payroll tax deposit and went over budget.

Auditor's Conclusion - Response accepted.

- 04-CS-3 Questionable Disbursements** - We noted no disbursements that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- 04-CS-4 Travel Expense** - No disbursements of the Utility's money for travel expenses of spouses of the Utility officials or employees were noted.
- 04-CS-5 Business Transactions** - No business transactions between the Utility's officials or employees and the Utility were noted.
- 04-CS-6 Bond Coverage** - Surety bond coverage of the Utility officials and employees is in accordance with statutory provisions and was reviewed and updated during the year. We recommend that the amount of coverage continue to be reviewed annually to insure that the coverage is adequate for current operations.
- 04-CS-7 Board Minutes** - No transactions were found that we believe should have been included in the minutes but were not. Minutes of Trustees proceedings were published within 15 days as required by Chapter 372.13(6) of the Code of Iowa.
- 04-CS-8 Water Revenue Capital Loan Notes** - No violations of water revenue capital loan note covenants were noted.
- 04-CS-9 Deposits and Investments** - We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B or 12C of the Code of Iowa.

04-CS-10 Compliance With Escheat Law

Finding - During our audit, we noted 33 outstanding checks that were over three years old.

Auditor's Recommendation -The City should attempt to locate the payee and reissue the checks or else complete the appropriate reports and submit the amounts to the Treasurer - State of Iowa.

City's Response - All outstanding checks will be reviewed. Some were voided and reissued or staff contacted the payees. We will also implement procedures to ensure that staff review the dates of outstanding checks throughout the year and make the necessary follow-up.

Auditor's Conclusion - Response accepted.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Utility's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses.

A material weakness is a 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. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

This report, a public record by law, is intended solely for the information and use of the Board of Trustees, management and others within the Utility and is not intended to be and should not be used by anyone other than these specified parties.

HOGAN - HANSEN

HOGAN - HANSEN

Waterloo, Iowa
February 17, 2005