

OTTUMWA WATER WORKS
OTTUMWA, IOWA

INDEPENDENT AUDITOR'S REPORT
BASIC FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS

DECEMBER 31, 2004

Anderson, Larkin & Co. P.C.

OTTUMWA WATER WORKS

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OTTUMWA WATER WORKS

OFFICIALS
DECEMBER 31, 2004

<u>NAME</u>	<u>TITLE</u>	<u>TERM EXPIRES</u>
Teri Messerschmitt	Water Works Trustee	July, 2007
Charles Ellis	Water Works Trustee	July, 2008
Max Miller	Water Works Trustee	July, 2009
Bruce Turner	Water Works Trustee	July, 2010
Jack Kirk	Water Works Trustee	July, 2006
Richard Wilcox	General Manager	Indefinite
Phillip Carlo	Financial Service Manager	Indefinite

Anderson, Larkin & Co. P.C.

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Ottumwa Water Works
Ottumwa, Iowa

We have audited the accompanying financial statements of Ottumwa Water Works as of and for the year ended December 31, 2004. These financial statements are the responsibility of Ottumwa Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards, 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides 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 Ottumwa Water Works as of December 31, 2004, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 13, during the year ended December 31, 2004, Ottumwa Water Works, adopted Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments; Statement No. 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus; and Statement No. 38, Certain Financial Statement Note Disclosures.

In accordance with Government Auditing Standards, we have also issued our report dated February 9, 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.

Management's Discussion and Analysis on pages three through five 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 principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion thereon.

Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the Utility's basic financial statements. The financial statements for the years ended December 31, 2003, 2002 and 2001 (none of which are presented herein) were audited by other auditors, who expressed an unqualified opinion on those financial statements. Other supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, has been subjected to the auditing procedures applied in our audit of the basic financial statements, and in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

ANDERSON, LARKIN & CO. P.C.

Ottumwa, Iowa
February 9, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

Ottumwa Water Works provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the calendar year ended December 31, 2004. We encourage readers to consider this information in conjunction with the Utility's financial statements which follow.

FINANCIAL HIGHLIGHTS

The Utility's operating revenues increased by 6% or \$221,468 from 2003 to 2004. Increases in revenue from the sale of hydro electric power accounted for the majority of the increase.

The Utility's operating expenses increased 7% or \$227,141 from 2003 to 2004. This increase included a \$129,905 increase in group health insurance, a \$38,811 increase in hydro plant maintenance supplies, a \$30,846 increase in depreciation expense, and a 2.5% increase in salaries and payroll taxes.

The Utility's net assets increased 1% or \$255,182 from 2003 to 2004.

USING THIS ANNUAL REPORT

The Ottumwa Water Works is a publicly owned utility and presents its financial statements using the economic resources measurement focus and accrual basis of accounting which is the same measurement focus and basis of accounting employed by private sector business enterprises. This discussion and analysis is intended to serve as an introduction to Ottumwa Water Work's basic financial statements. The annual report consists of a series of financial statements and other information as follows:

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

The Statement of Net Assets presents information about 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 Statement of Revenues, Expenses and Changes in Net Assets is the basic statement of activities for proprietary funds. This statement presents information on the Utility's operating revenues and expenses, non-operating revenues and expenses and whether the Utility's financial position has improved or deteriorated as a result of the year's activities.

The Statement of Cash Flows presents the change in the Utility's cash and cash equivalents during the year. This information can assist the user of the report in determining how the Utility financed its activities and how it met its cash requirements.

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

FINANCIAL ANALYSIS OF THE UTILITY

Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Utility's financial position. The Utility's net assets for the year 2004 total approximately \$19,336,941. This compares to approximately \$19,081,759 for the year 2003. A summary of the Utility's net assets as of December 31, 2004 are presented below

NET ASSETS

	December 31,	
	2004	2003
Current assets	\$ 3,323,995	\$ 4,573,971
Capital assets at cost, less accumulated depreciation	17,241,489	16,289,153
Other assets	<u>150,000</u>	<u>-</u>
Total assets	<u>20,715,484</u>	<u>20,863,124</u>
 Current Liabilities	 <u>1,378,543</u>	 <u>1,781,365</u>
Unrestricted assets	19,301,142	18,940,519
Restricted assets	<u>35,799</u>	<u>141,240</u>
Total Net Assets	<u>\$ 19,336,941</u>	<u>\$ 19,081,759</u>

Statements of Revenues, Expenses and Changes in Net Assets

Operating revenues are received from the sale of water to Ottumwa residents, sale of hydro electric power, and other miscellaneous income. Non-operating revenues and expenses include interest income. The utilization of capital assets is reflected in the financial statements as depreciation, which allocates the cost of an asset over its expected useful life. A summary of revenues, expenses and changes in net assets for the year December 31, 2004 and 2003 is presented below:

	<u>CHANGES IN NET ASSETS</u>	
	Year Ended December 31,	
	2004	2003
Operating revenue:		
Sale of water	\$ 3,126,928	\$ 3,155,347
Sale of electricity	555,367	320,390
Miscellaneous income	<u>223,491</u>	<u>208,581</u>
Total operating revenue	<u>3,905,786</u>	<u>3,684,318</u>
Operating expenses:		
Production	510,484	535,051
Distribution	638,219	602,923
Hydro	132,060	73,250
Financial services	207,851	202,189
Administration	453,014	413,067
General plant expense	1,022,665	941,518
Depreciation	<u>739,588</u>	<u>708,742</u>
Total operating expenses	<u>3,703,881</u>	<u>3,476,740</u>
Operating income	201,905	207,578
Nonoperating revenue:		
Interest income	<u>53,277</u>	<u>98,011</u>
Change in net assets	255,182	305,589
Net assets – Beginning of year (as restated)	<u>19,081,759</u>	<u>18,776,170</u>
Net assets – End of year (as restated)	<u>\$ 19,336,941</u>	<u>\$ 19,081,759</u>

The Statement of Revenues, Expenses and Changes in Net Assets reflects a positive year with an increase in the net assets at the end of the year.

In calendar year 2004, operating revenue increased 6%, or \$221,468, due in part to increased sales of hydro electric power. Operating expenses increased 7% or \$227,141. This increase included a \$129,905 increase in group health insurance, a \$38,811 increase in hydro plant maintenance supplies, a \$30,846 increase in depreciation expense, and a 2.5% increase in salaries and payroll taxes.

Statement of Cash Flows

The Statement of Cash Flows presents information related to cash inflows and outflows, summarized by operating, capital and related financing and investing activities. Cash flows from operating activities include the sale of water, electricity and other receipts reduced by payments to suppliers and employees. Cash flows from capital and related financing activities includes the purchase of capital assets. Cash flows from investing activities includes interest income and the purchase of certificates of deposit.

Budget

The Utility submits a budget to the City of Ottumwa on an annual basis. Receipts for the year exceeded the amounts budgeted by \$82,573 and disbursements were less than amounts budgeted by \$4,126,895. A planned capital project to replace turbines in the hydro dam was not completed as expected during the year causing the disbursements to be significantly less than amounts budgeted.

CAPITAL ASSETS

At December 31, 2004, the Utility had approximately \$17,241,489 invested in capital assets, net of accumulated depreciation of approximately \$17,071,507. Depreciation charges totaled \$739,523 for the year of 2004. More detailed information about the Utility's capital assets is presented in the Notes to Financial Statements.

ECONOMIC FACTORS

Ottumwa Water Works continued to improve its financial position during the current calendar year. However, the current condition of the economy in the State continues to be a concern for Utility officials. Some of the realities that may potentially become challenges for the Utility to meet are:

- The Utilities distribution system requires constant maintenance and upkeep.

- The continued inflationary increases in health care, chemical, and energy costs.

- Technology continues to expand and current technology becomes outdated presenting an on-going challenge to maintain up to date technology at a reasonable cost.

The Utility anticipates the current year will be much like the last and we will maintain a close watch over resources to maintain our ability to react to unknown issues.

CONTACTING THE UTILITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, customers and creditors with a general overview of the Utility's finances and to show the Utility's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Ottumwa Water Works, P.O. Box 20, Ottumwa, Iowa.

OTTUMWA WATER WORKSSTATEMENT OF NET ASSETS
DECEMBER 31, 2004ASSETSCURRENT ASSETS:

Cash and cash equivalents	\$ 1,019,971
Certificates of deposit	1,280,000
Accounts receivable	896,747
Inventory	101,549
Accrued interest receivable	14,263
Prepaid expenses	11,465
Total current assets	<u>3,323,995</u>

CAPITAL ASSETS:

Buildings	3,221,541
Water distribution system	27,357,088
Equipment and vehicles	1,455,164
Office equipment	557,572
Total	<u>32,591,365</u>
Less accumulated depreciation	<u>17,071,507</u>
Depreciated value of capital assets	15,519,858
Land	114,477
Construction in progress	<u>1,607,154</u>
Total capital assets	<u>17,241,489</u>

OTHER ASSETS:

Certificates of deposit	<u>150,000</u>
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TOTAL ASSETS	<u>20,715,484</u>
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CURRENT LIABILITIES:

Accounts payable	111,767
Accrued payroll and related expenses	28,751
Accrued sales tax	23,728
Accrued interest	7,140
Sick leave payable	169,895
Accrued vacation payable	65,971
Self insurance payable	50,865
Accrued disability and life insurance	129,652
Customer deposits	136,716
Revenue bonds payable	32,000
Accrued sewer and refuse collections	622,058

TOTAL LIABILITIES	<u>1,378,543</u>
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NET ASSETS:

Unrestricted	2,091,653
Invested in capital assets, net of related debt	17,209,489
Restricted for debt service	35,799

TOTAL NET ASSETS	<u>\$ 19,336,941</u>
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See Accompanying Notes to the Financial Statements

OTTUMWA WATER WORKSSTATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2004OPERATING REVENUE:

Sale of water	\$ 3,126,928
Sale of electricity	555,367
Miscellaneous income	223,491
Total operating revenue	<u>3,905,786</u>

OPERATING EXPENSES:

Production	510,484
Distribution	638,219
Hydro	132,060
Financial services	207,851
Administration	453,014
General plant	1,022,665
Depreciation	739,588
Total operating expenses	<u>3,703,881</u>

OPERATING INCOME	201,905
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NONOPERATING REVENUE:

Interest income	<u>53,277</u>
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CHANGE IN NET ASSETS	255,182
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<u>NET ASSETS - BEGINNING OF YEAR (AS RESTATED)</u>	<u>19,081,759</u>
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<u>NET ASSETS - END OF YEAR</u>	<u>\$ 19,336,941</u>
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OTTUMWA WATER WORKSSTATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2004CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from customers	\$ 3,610,257
Cash received from other operating receipts	223,491
Cash paid to suppliers for goods and services	(2,393,555)
Cash paid to employees for services	<u>(866,380)</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES 573,813

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Purchase of capital assets	<u>(1,691,924)</u>
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CASH FLOWS FROM INVESTING ACTIVITIES:

Interest on investments	42,095
Purchase of certificates of deposit	(1,430,000)
Sale of certificates of deposit	<u>2,280,000</u>

NET CASH PROVIDED BY INVESTING ACTIVITIES 892,095

CASH FLOWS FROM FINANCING ACTIVITIES:

Principal payments on long-term debt	<u>(100,000)</u>
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NET DECREASE IN CASH AND CASH EQUIVALENTS (326,016)

CASH AND CASH EQUIVALENTS - Beginning of year 1,345,987

CASH AND CASH EQUIVALENTS - End of year \$ 1,019,971

RECONCILIATION OF OPERATING INCOME TO NET CASHPROVIDED BY OPERATING ACTIVITIES:

Operating income	\$ 201,905
Adjustments to reconcile change in net assets to cash provided by operating activities:	
Depreciation expense	739,588
Change in operating assets and liabilities:	
Increase in accounts receivable	(72,038)
Decrease in inventory	10,415
Increase in prepaid expenses	(3,235)
Decrease in accounts payable	(338,373)
Increase in accrued payroll and related expenses	1,590
Increase in accrued sales tax	3,605
Decrease in accrued interest	(2,100)
Decrease in sick leave payable	(926)
Decrease in accrued vacation payable	(4,927)
Increase in self insurance payable	26,950
Increase in accrued disability and life insurance	4,303
Decrease in customer deposits	(60,495)
Increase in accrued sewer and refuse collections	<u>67,551</u>

NET CASH PROVIDED BY OPERATING ACTIVITIES \$ 573,813

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Interest expense paid during the year	\$ 2,100
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OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Ottumwa Water Works is organized as a municipal water utility which was established in 1910. They are overseen by a five member board appointed by the City Council and Mayor of the City of Ottumwa and the Utility's operating budget is subject to the approval of the City Council. The Water Works is considered by the City of Ottumwa to be substantially autonomous. The Water Works is funded entirely by water user charges collected from users of the Water Works' system.

The financial statements of the Water Works have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board.

Reporting Entity

For financial reporting purposes, Ottumwa Water Works has included all funds, organizations, agencies, boards, commissions and authorities. The Utility has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Utility. Ottumwa Water Works has no component units which meet the Governmental Accounting Standards Board criteria.

Ottumwa Water Works is not presented as a Component Unit in the City of Ottumwa's financial statements. The Utility is a legally separate entity from the City, but is financially accountable to the City. The Utility is governed by a five-member Board appointed by the City Council and the Utility's operating budget is subject to the approval of the City Council.

Basis of Presentation

The accounts of the Ottumwa Water Works are organized as an enterprise fund. Enterprise funds are used to account for operations (a) financed and operated in a manner similar to private business enterprises, where the intent of the governing body is the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Measurement Focus and Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The Ottumwa Water Works applies all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements; Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

The Ottumwa Water Works distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Investments

The following accounting policies are followed in preparing the Statement of Net Assets:

Cash, Investments and Cash Equivalents – The Ottumwa Water Works considers all short-term investments that are highly liquid to be cash equivalents. Cash equivalents are readily convertible to known amounts of cash and, at the day of purchase, have a maturity date no longer than three months. Cash investments not meeting the definition of cash equivalents at December 31, 2004 include certificates of deposit of \$1,430,000.

Accounts Receivable – Ottumwa Water Works grants credit to customers, substantially all of whom are located in Ottumwa, Iowa. The risk of loss on the accounts receivable is the balance due at the time of default. Accounts receivable are considered past due after 30 days and are charged off when management determines the account is uncollectible. The Ottumwa Water Works uses the reserve method of accounting for uncollectible accounts. At December 31, 2004, the reserve of \$41,329 is provided to allow for uncollectible customer accounts.

Capital Assets – Capital assets are accounted for at historical cost. Depreciation of all exhaustible capital assets is charged as an expense against operations. The cost of repair and maintenance is charged to expense, while the cost of renewals or substantial betterments is capitalized. The cost and accumulated depreciation of assets disposed of are deleted, with any gain or loss recorded in current operations.

Reportable capital assets are defined by the Utility as assets with initial, individual costs in excess of the following thresholds and estimated useful lives in excess of one year.

<u>Asset Class</u>	<u>Amount</u>
Buildings	\$ 500
Water distribution system	500
Equipment and vehicles	500
Office equipment	500

Capital assets of the Utility are depreciated using the straight line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Useful lives (In years)</u>
Buildings	15-25
Water distribution system	40-50
Equipment and vehicles	5-7
Office equipment	5-7

Material and Chemicals Inventory – Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

During 1992, the Ottumwa Water Works changed its purchased material goods inventory to carry only selected groups of items and material individual items over a predetermined dollar amount. All other small parts and immaterial cost items will be charged off when purchased.

Compensated Absences – Utility employees accumulate a limited amount of earned but unused vacation hours for subsequent use or for payment upon termination, death or retirement. The Utility's liability for accrued vacation has been computed based on rates of pay in effect at December 31, 2004.

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 revenues and expenses. Accordingly, actual results could differ from those estimates.

NOTE 2 – DEPOSITS AND INVESTMENTS

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

The Municipal 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 Utility Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-ended management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The Utility's investments are categorized to give an indication of the level of risk assumed by the Utility at year end. The Utility's investments are all category 1, which means that the investments are insured or registered or the securities are held by the Utility or its agent in the Utility's name.

The Utility's investments at December 31, 2004 are as follows:

Certificates of deposit:

Original maturity 6 to 12 months	\$ 1,280,000
Original maturity greater than 12 months	<u>150,000</u>
	<u>\$ 1,430,000</u>

The investments are recorded at cost which approximates fair value.

NOTE 3 – CAPITAL ASSETS

The following is a summary of capital assets by amounts for the major classifications of property and equipment for the year ended December 31, 2004:

	<u>Balance</u> <u>December 31, 2003</u>	<u>Additions</u>	<u>Deletions/ Reclassifications</u>	<u>Balance</u> <u>December 31, 2004</u>
Buildings	\$ 3,211,542	\$ 9,999	\$ -	\$ 3,221,541
Water distribution system	25,023,558	2,333,530	-	27,357,088
Equipment and vehicles	1,452,406	2,758	-	1,455,164
Office equipment	<u>557,572</u>	<u>-</u>	<u>-</u>	<u>557,572</u>
Subtotal	30,245,078	2,346,287	-	32,591,365
Less accumulated depreciation	<u>16,331,919</u>	<u>739,588</u>	<u>-</u>	<u>17,071,507</u>
	13,913,159	1,606,699	-	15,519,858
Land	114,477	-	-	114,477
Construction in progress	<u>2,261,517</u>	<u>1,691,924</u>	<u>2,346,287</u>	<u>1,607,154</u>
Total capital assets	<u>\$ 16,289,153</u>	<u>\$ 3,298,623</u>	<u>\$ 2,346,287</u>	<u>\$ 17,241,489</u>

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 4 – PENSION AND RETIREMENT BENEFITS

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

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll for the years ended June 30, 2004, 2003 and 2002. Contribution requirements are established by state statute. The Utility's contributions to IPERS for the years ended December 31, 2004, 2003 and 2002 were \$69,605, \$65,565 and \$61,119 respectively, equal to the required contributions for each year.

NOTE 5 – SELF INSURANCE PROGRAM

The Company has a self-insurance program for hospitalization and medical coverage for its employees. The program is administered through a service agreement with Cottingham Butler. The Company limits its losses through the use of stop-loss policies from reinsurers. Specific individual losses for claims are limited to \$20,000 a year. The Company's aggregate annual loss limitation is based on a formula that considers, among other things, the total number of employees. For December 31, 2004, the Company incurred \$475,933 in expense under the program.

Amounts payable from Ottumwa Water Works at December 31, 2004 total \$50,865 which is for incurred but not reported (IBNR) and reported but not paid claims. The amounts are based on estimates of the amounts necessary to pay prior-year and current-year claims. A liability has been established based on the requirements of Governmental Accounting Standards Board Statement Number 10, which requires that a liability for claims be reported in information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Settlements have not exceeded the stop-loss coverage in any of the past three years. A reconciliation of changes in the aggregate liability for claims for the current year is as follows:

Unpaid claims as of December 31, 2003	\$ 23,915
Incurred claims (including claims incurred but not reported as of December 31, 2004):	
Provision for current-year events where the Utility has retained risk of loss	475,933
Payments:	
Claims attributable to current-year events where the Utility has retained risk of loss	<u>448,983</u>
Unpaid claims as of December 31, 2004	<u>\$ 50,865</u>

NOTE 6 – OTHER EMPLOYEE BENEFITS

The Water Works employees accumulate sick leave and vacation hours for subsequent use. The liability for accrued vacation at December 31, 2004 is \$65,971. The Water Works has a policy of paying one-half of the unused accumulated sick leave upon retirement of any employee. The maximum number of days an employee can accumulate is 120. Upon the death of any employee, 100% of the accumulated sick leave is paid. One-half of unused sick leave totals \$169,895, and is reflected in the financial statements as a liability at December 31, 2004.

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 6 – OTHER EMPLOYEE BENEFITS (Continued)

Effective November 1, 1989, the Water Works began a long-term disability plan. Once an employee has accumulated the maximum number of days of sick leave referred to in the preceding paragraph, they begin to accumulate long-term disability days. The days are accumulated at 50% of the normal sick leave accrual rate, the maximum number of days to be accrued is 120. The compensation is computed at 60% of the employee's normal salary and is paid only after all normal sick leave benefits are exhausted.

The amount of the accrual reflected on the balance sheet at December 31, 2004 for the long-term disability benefit is \$120,652.

NOTE 7 – POST RETIREMENT BENEFITS

On July 22, 1992, the Ottumwa Water Works approved a policy to drop the group term life insurance coverage on existing retirees and instead pay a one-time death benefit equal to the term coverage in effect as of this date. The total death benefit payable as of December 31, 2004 was \$9,000 and covers nine retirees. Only these nine retirees are covered by this provision. Any employees retiring on or after July 22, 1992 will not receive this benefit.

NOTE 8 – DESIGNATED ASSETS

The Ottumwa Water Works has designated assets comprised of demand deposits, passbook savings, and certificates of deposits that are to be used for a specific purpose. A summary of the designated assets is as follows:

Capital Improvements and Extension Projects Fund – This fund is designated for use in completing capital improvements as set forth in the March 5, 1991 Stanley Consultants' Ottumwa Water Works Distribution System Analysis as approved by the Board of Trustees November 22, 1994. The amount designated for the capital improvements fund as of December 31, 2004 is \$181,295.

Meter Deposit Fund – This fund is used to account for cash collected on customer deposits. The amount designated for the meter deposit fund as of December 31, 2004 is \$218,823.

NOTE 9 – RESTRICTED FOR DEBT SERVICE

Restricted net assets are available for the following purpose for the year ended December 31, 2004:

Water revenue bond sinking fund	\$ <u>35,799</u>
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NOTE 10 – RELATED PARTY TRANSACTIONS

The water works provides billing and collection services to the City of Ottumwa for sewer and refuse services. The following is a summary of the balances for the year ended December 31, 2004:

Accrued sewer services charges	\$ 448,011
Accrued refuse collection fees	<u>174,047</u>
Total accrued sewer and refuse collections	\$ <u>622,058</u>

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 11 – REVENUE BONDS AND INTEREST

Annual debt service requirements to maturity for revenue bonds are as follows:

<u>Maturing</u> <u>Year Ending December 31,</u> <u>Fully Matured</u>	<u>Interest Rate</u> <u>Various</u>	<u>Outstanding</u> <u>Amount</u> <u>\$ 32,000</u>	<u>Interest</u> <u>\$ 7,140</u>

The resolutions providing for the issuance of the revenue bonds include the following provisions:

- (a) The bonds will only be redeemed from the future earnings of the enterprise activity and the bond holders hold a lien on the future earnings of the funds.
- (b) Sufficient monthly cash transfers shall be made to a water revenue bond sinking account for the purpose of making bond principal and interest payments when due.
- (c) Additional monthly cash transfers shall be made to a bond and interest reserve account until there has been accumulated an amount equal to two years' interest on the bonds then outstanding. This account is restricted for the purpose of paying bond principal and interest should funds be insufficient in the water revenue bond sinking account.
- (d) In addition, there shall be deposited to a capital improvement and extension account the sum of \$3,000 each month until there has been accumulated a sum of \$500,000. This account shall be used solely and only to pay bonds and interest should deficiencies exist in the water revenue bond sinking account or the bond and interest reserve account to pay subordinate revenue bonds issued to make necessary improvements and extensions to pay for capital improvements and extensions to the existing Water Works' plan not covered by issuance of bonds and to call and redeem such bonds as they may be then subject to redemption prior to maturity.
- (e) There shall also be paid into a bond redemption account on a monthly basis one-half of the balance of net earnings remaining after first making the required payments into the water revenue bond sinking account, the bond and interest reserve account and the capital improvement and extension account. This account is restricted to remedying any deficiency in the other required accounts. The Water Works reserves, in the aforementioned accounts, exceeds the outstanding bond and interest amounts and therefore, this provision does not apply.

NOTE 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. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The Utility assumes liability for any deductibles and claims in excess of coverage limitations.

NOTE 13 – ACCOUNTING CHANGE

For the year ended December 31, 2004, the Utility implemented Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments; Statement No. 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus; and Statement No. 38, Certain Financial Statement Note Disclosures.

Implementation of these statements had no effect on the beginning net asset balances of the Utility.

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 14 – PRIOR PERIOD ADJUSTMENT

During the year ended December 31, 2004, a change was made to the net assets of Ottumwa Water Works to record the liability for the self insurance program and accrued vacation payable. In prior years, costs related to the self insurance program and accrued vacation were expensed when paid

Net assets December 31, 2003, as previously reported	\$ 19,176,572
Recording the liability for the self insurance program at December 31, 2003	(23,915)
Recording the liability for accrued vacation payable at December 31, 2003	<u>(70,898)</u>
Net assets December 31, 2003, as restated	\$ <u>19,081,759</u>

Anderson, Larkin & Co. P.C.

OTTUMWA WATER WORKS

BUDGETARY COMPARISON SCHEDULE OF
RECEIPTS, DISBURSEMENTS AND CHANGES IN
BALANCES - BUDGET AND ACTUAL
YEAR ENDED DECEMBER 31, 2004

	<u>Actual</u>	<u>Adjustments</u>	<u>Net</u>	<u>Budget</u>	<u>Variance Favorable (Unfavorable)</u>
Receipts:					
Use of money and property	\$ 53,277	\$ -	\$ 53,277	\$ 40,000	\$ 13,277
Charges for service	<u>3,905,786</u>	<u>-</u>	<u>3,905,786</u>	<u>3,836,490</u>	<u>69,296</u>
	<u>3,959,063</u>	<u>-</u>	<u>3,959,063</u>	<u>3,876,490</u>	<u>82,573</u>
Disbursements:					
Business-type activities	3,703,881	(739,588)	2,964,293	2,936,712	(27,581)
Capital projects/debt service	<u>-</u>	<u>1,791,924</u>	<u>1,791,924</u>	<u>5,946,400</u>	<u>4,154,476</u>
	<u>3,703,881</u>	<u>1,052,336</u>	<u>4,756,217</u>	<u>8,883,112</u>	<u>4,126,895</u>
Excess (deficiency) of receipts over (under) disbursements	255,182	(1,052,336)	(797,154)	(5,006,632)	4,209,468
Other financing sources, net	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,064,000</u>	<u>(6,064,000)</u>
Excess (deficiency) of receipts and other financing sources over (under) disbursements	\$ <u>255,182</u>	\$ <u>(1,052,336)</u>	\$ <u>(797,154)</u>	\$ <u>1,057,378</u>	\$ <u>(1,854,532)</u>

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING

YEAR ENDED DECEMBER 31, 2004

In accordance with the Code of Iowa, the Utility annually adopts a budget on the modified accrual basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures. Encumbrances are not recognized on the modified accrual basis budget and appropriations lapse at year end.

Formal and legal budgetary control is based upon nine major classes of expenses known as functions, not by fund or fund type. These nine functions are: public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business-type activities. All utility expenses are categorized as business-type activities. Although the budget document presents function expenses by fund, the legal level of control is at the aggregated function level, not by fund. During the year, there were no budget amendments.

OTHER SUPPLEMENTARY INFORMATION

Anderson, Larkin & Co. P.C.

OTTUMWA WATER WORKS

DETAIL SCHEDULE OF REVENUES AND EXPENSES
YEAR ENDED DECEMBER 31, 2004

OPERATING REVENUE:

Sale of water	\$ 3,126,928
Sale of electricity	555,367
Miscellaneous income:	
Fire protection - Private	75,074
Customer forfeitures	23,998
Service connections	28,388
Service charge - Sewer billing	41,665
Service charge - Refuse billing	21,834
Miscellaneous	<u>32,532</u>
TOTAL OPERATING REVENUE	<u>3,905,786</u>

OPERATING EXPENSES:

Production:	
Supervision	49,678
Maintenance labor	65,073
Operations labor	167,583
Chemicals/carbon	222,300
Laboratory supplies	<u>5,850</u>
	<u>510,484</u>
Distribution:	
Supervision	48,839
Maintenance labor	273,517
Maintenance materials	184,140
Labor	<u>131,723</u>
	<u>638,219</u>
Hydro:	
Maintenance labor	13,402
Operations labor	49,171
Supplies	49,891
Lease and rentals	11,827
Contract labor	<u>7,769</u>
	<u>132,060</u>
Financial services:	
Financial services supervision	45,884
Financial services labor	95,956
Office supplies	16,014
Postage expense	40,904
Customer deposit accounts interest	2,393
Noncollectable accounts	<u>6,700</u>
	<u>207,851</u>

OTTUMWA WATER WORKS

DETAIL SCHEDULE OF REVENUES AND EXPENSES
YEAR ENDED DECEMBER 31, 2004

OPERATING EXPENSES: (Continued)

Administration:

Executive salaries	57,567
Board salaries	1,300
Training expense	3,595
Vacation pay	58,623
Holiday expense	57,034
Longevity expense	17,808
Casual pay	21,446
Sick pay	39,841
Disability	4,303
Payroll tax - FICA	92,459
IPERS	69,605
Subscriptions	800
Legal services	20,850
Business expense	7,783
	<u>453,014</u>

General plant:

Employee's miscellaneous expense	11,981
General property expense	64,477
Safety program	17,572
Liability insurance	45,325
Workmen's compensation insurance	21,858
Group health insurance	500,662
Group term life insurance	3,280
Contract labor	54,907
Fuel and power	218,457
General services	58,292
Contingency	(98)
Gas and oil	16,072
Lease and rental	9,880
	<u>1,022,665</u>

Depreciation 739,588

TOTAL OPERATING EXPENSES 3,703,881

OPERATING INCOME 201,905

NONOPERATING REVENUE:

Interest income 53,277

CHANGE IN NET ASSETS \$ 255,182

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Board of Trustees
Ottumwa Water Works
Ottumwa, Iowa

We have audited the financial statements of Ottumwa Water Works, as of and for the year ended December 31, 2004, and have issued our report thereon dated February 9, 2005. We conducted our audit in accordance with U.S. generally accepted auditing standards, 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, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance that are required to be reported under Government Auditing Standards.

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.

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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Utility's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings.

A material weakness is a 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 in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we believe item I-A-04 is a material weakness. Prior year reportable conditions have been resolved except for item I-A-04.

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

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Ottumwa Water Works during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

ANDERSON, LARKIN & CO P.C.

Ottumwa, Iowa
February 9, 2005

OTTUMWA WATER WORKS
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004

Part I: Findings Related to the Financial Statements

Instances of Non-Compliance:

No matters were noted.

Reportable Conditions:

I-A-04 Segregation of Duties - One important aspect of the internal controls is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible.

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

Response - We will continue to institute segregation and rotation of employee's duties wherever possible in relation to our staff size.

Conclusion - Response accepted.

Part II: Other Findings Related to Statutory Reporting

II-A-04 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.

II-B-04 Certified Budget - Ottumwa Water Works' expenses during the year ended December 31, 2004 did not exceed the amount budgeted.

II-C-04 Questionable Disbursements - No expenses that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979 were noted.

II-D-04 Travel Expense - No expenditures of money for travel expenses of spouses of Utility officials or employees were noted.

II-E-04 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.

II-F-04 Bond Coverage - Surety bond coverage of Utility officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

II-G-04 Trustee Minutes - No transactions were found that we believe should have been approved in the minutes but were not.

II-H-04 Revenue Bonds - The Water Works has complied with the revenue bond provisions for the year ended December 31, 2004.

OTTUMWA WATER WORKS
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2004

Part II: Other Findings Related to Statutory Reporting (Continued)

II-I-04 Deposits and Investments – We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa, however, the Water Works’ investment policy has not been updated to stay current with the new provisions of the Code of Iowa.

Recommendation – The Water Works should review their investment policy periodically to stay current with the Code of Iowa.

Response – We will review and revise our policies.

Conclusion – Response accepted.

Anderson, Larkin & Co. P.C.