

VINTON MUNICIPAL WATER UTILITY

VINTON, IOWA

JUNE 30, 2006

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Officials

Name	Title	Term Expires
Elected Officials - Prior to January, 2006		
John R. Watson	Mayor	January 1, 2006
Casey Cooling	Council Member - 1st Ward	January 1, 2006
F. Ronald Elwick	Council Member - 2nd Ward	January 1, 2008
Bill Owens	Council Member - 3rd Ward	January 1, 2006
Lisa Vermedahl	Council Member - 4th Ward	January 1, 2008
David Redlinger	Council Member at Large	January 1, 2006
Don Burkey	Council Member at Large	January 1, 2008
Elected Officials - After January, 2006		
John R. Watson	Mayor	January 1, 2008
Ron Hessenius	Council Member - 1st Ward	January 1, 2010
F. Ronald Elwick	Council Member - 2nd Ward	January 1, 2008
Bud Maynard	Council Member - 3rd Ward	January 1, 2010
Lisa Vermedahl	Council Member - 4th Ward	January 1, 2008
David Redlinger	Council Member at Large	January 1, 2010
Don Burkey	Council Member at Large	January 1, 2008
Appointed Officials		
Cindy Michael	Treasurer/City Clerk	Indefinite
Donald J. Martin	City Coordinator	June 30, 2006
Fischer Law Firm	City Attorney	Indefinite

Independent Auditor's Report

To the Honorable Mayor and
Members of the City Council
Vinton Municipal Water Utility
Vinton, Iowa

We have audited the accompanying balance sheet of the Vinton Municipal Water Utility, an enterprise fund of the City of Vinton, Iowa, at June 30, 2006, and the related statement of revenue, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the City of Vinton's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall 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 the Vinton Municipal Water Utility, an enterprise fund of the City of Vinton, Iowa, at June 30, 2006, 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 August 11, 2006 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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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 3 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
August 11, 2006

Vinton Municipal Water Utility Management's Discussion and Analysis

Management of the Vinton Municipal Water Utility (Utility) provides this Management's Discussion and Analysis of its annual financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended June 30, 2006. We encourage our readers to consider this information in conjunction with the Utility's financial statements, which follow.

2006 Financial Highlights

- Operating revenue of the Utility increased 2.4%, or approximately \$12,000, from 2005 to 2006.
- Operating expenses decreased 3.4%, or approximately \$14,000, in fiscal 2006 from fiscal 2005.
- The Utility's net assets increased 2.6%, or approximately \$43,000, from June 30, 2005 to June 30, 2006.
- The Utility has revenue bonds outstanding of \$1,183,000 at June 30, 2006 which are reported net of unamortized discounts and reacquisition costs of \$9,613.

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 enterprise fund of the City of Vinton, 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, and to provide for the retirement of debt when due. As a result, the Utility prepares financial statements in a manner similar to a private-sector business.

The statement of net assets presents 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 statement of revenue, expenses and changes in net assets presents 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 statement of cash flows presents 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 7 through 9 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 10 through 17 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 \$1.67 million and \$1.63 million on June 30, 2006 and 2005, respectively.

The following is a summary of the composition of net assets at June 30:

	2006	2005
Current assets.....	\$ 180,280	\$ 185,909
Restricted assets	467,955	280,066
Capital assets, net of accumulated depreciation	2,369,887	2,124,244
Noncurrent, noncapital assets	<u>15,806</u>	<u>4,134</u>
Total Assets	<u>3,033,928</u>	<u>2,594,353</u>
Current liabilities	16,634	29,794
Liabilities payable from restricted assets	396,351	270,510
Other long-term liabilities (net)	<u>948,054</u>	<u>664,165</u>
Total Liabilities	<u>1,361,039</u>	<u>964,469</u>
Net Assets		
Invested in capital assets (net of related debt)	1,196,500	1,193,357
Restricted	295,104	276,278
Unrestricted	<u>181,285</u>	<u>160,249</u>
Total Net Assets	<u>\$ 1,672,889</u>	<u>\$ 1,629,884</u>

Net assets invested in capital assets are by far the largest portion of the Utility's net assets, 72% at June 30, 2006, and reflect its net investment in capital assets (e.g., land, water plant distribution system and equipment). 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 June 30, 2006 and 2005, 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 June 30:

	2006	2005
Operating revenue	\$ 498,347	\$ 486,564
Operating expenses.....	<u>389,834</u>	<u>403,597</u>
Operating Income.....	108,513	82,967
Net nonoperating expense.....	(4,072)	(44,306)
Net transfers to other funds	<u>(61,436)</u>	<u>(55,491)</u>
Change in Net Assets.....	43,005	(16,830)
Net Assets - Beginning of Year.....	<u>1,629,884</u>	<u>1,646,714</u>
Net Assets - End of Year	<u>\$ 1,672,889</u>	<u>\$ 1,629,884</u>

Operating revenue is the Utility's primary source of revenue and is generated from water sales and other services to customers. For 2006, operating revenue increased \$11,783 from 2005 due primarily to the continued effect of the January, 2005 increase in water rates.

Operating expenses totaled \$389,834 for 2006, a \$13,763 decrease from 2005. These expenses represent the Utility's costs to provide water and services to customers. Operating expenses included depreciation expense of \$95,229 and \$96,892 for the years ended June 30, 2006 and 2005, respectively.

Net nonoperating expense includes interest income and expense, amortization of bond issuance costs, gain on the sale of assets and rent from leasing space. Net nonoperating expense decreased by \$40,234 between 2006 and 2005. The decrease was due to increased interest revenue and gain on the sale of an asset.

Transfers to the City of Vinton's General Fund and from the City's Wastewater Treatment Fund of \$93,002 and \$31,566 are as directed by the City Council to transfer surplus net assets to the General Fund.

Budgetary Highlights

Each year, the City Council adopts a budget using the cash basis of accounting which differs from the accrual basis of accounting used for the accompanying financial statements. The Utility's budget is included in the total business-type activities budget of the City and its discrete component unit, the Vinton Municipal Electric Utility.

Capital Assets and Long-Term Debt

The Utility's investment in capital assets amounted to approximately \$2.4 million and \$2.1 million at June 30, 2006 and 2005, respectively, (net of accumulated depreciation of approximately \$1.3 million at both June 30, 2006 and 2005). This investment in capital assets includes land, construction in progress, water plant, water distribution system, equipment and vehicles.

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

- 13th Street extension.
- Second Avenue water main.
- Replacement of loader/backhoe.

The following is a summary of the capital assets, at cost, at June 30:

	2006	2005
Land	\$ 70,051	\$ 70,051
Construction in progress	191,498	—
Water plant.....	2,025,204	2,025,204
Distribution system.....	989,607	989,607
Equipment and vehicles.....	<u>360,242</u>	<u>297,986</u>
Total	<u>\$ 3,636,602</u>	<u>\$ 3,382,848</u>

Additional information about the Utility's capital assets can be found in Note 5 to the financial statements.

At June 30, 2005, total Utility long-term debt was \$935,000 less unamortized discount of \$4,113 for a net long-term debt of \$930,887. During 2006, the Utility repaid \$112,000 of principal, issued new debt of \$1,150,000, called and retired \$790,000 of old debt and paid \$48,252 of interest on the debt. In addition, \$14,962 and \$4,600 of debt issue costs and discounts, respectively, on new debt were capitalized. Unamortized bond issue costs and discounts on refunded debt of \$5,156 was reclassified as reacquisition costs. For the year, amortization of bond discounts and issue costs of \$1,128 and \$1,262, respectively, were charged to interest expense and amortization expense, respectively. At June 30, 2006, total Utility long-term debt was \$1,183,000 less unamortized discounts and reacquisition costs of \$4,457 and \$5,156, respectively, for a net long-term debt of \$1,173,387. Principal of \$102,000 and interest of \$51,005 will be due during the year ending June 30, 2007.

Due to the extension of maturity dates and debt issue costs, debt refunding resulted in increased current and future debt service costs of approximately \$26,200 and an economic loss of approximately \$19,600. Debt indentures require adherence to certain covenants relating to the maintenance and efficiency of the operating system, the rate structure, restrictions on borrowings, leasing or disposition of assets, minimum insurance coverage, use of proceeds and sinking fund requirements. During the year ended June 30, 2006, covenants were violated in that debt proceeds were commingled with other cash and transfers and debt payments from the sinking fund were not as required.

Additional information about the Utility's long-term debt can be found in Note 6 to the financial statements.

Economic Factors and Next Year's Budget and Rates

The Utility's primary source of revenue is water sales. Budgeted revenue reflects the rates in effect at June 30, 2006.

Operating expenses for 2007 are expected to increase modestly over the same expenses in 2006 due to increases in energy costs and other operating expense increases. Remaining bond proceeds of \$229,780 restricted for capital outlay are expected to be disbursed during the next 12 months.

Contacting the Utility's Financial Management

This financial report is designed to provide our citizens, taxpayers, 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 Cindy Michael, Treasurer/City Clerk, P.O. Box 529, Vinton, IA 52349.

Balance Sheet

At June 30, 2006

Assets

Current Assets

Cash	\$ 89,797
Receivables	
Trade accounts (net of allowance for doubtful accounts)	46,483
Accrued interest	960
Unbilled revenue	26,493
Prepaid expenses	16,547
Total Current Assets	<u>180,280</u>

Restricted Assets

Cash	252,955
Certificates of deposit	215,000
Total Restricted Assets	<u>467,955</u>

Noncurrent Assets

Capital Assets

Land	70,051
Construction in progress	191,498
Water plant	2,025,204
Distribution system	989,607
Equipment and vehicles	360,242
Total Capital Assets	<u>3,636,602</u>
Less accumulated depreciation	<u>(1,266,715)</u>
Net Capital Assets	2,369,887
Bond issue costs (net of accumulated amortization - \$4,831)	15,806
Total Noncurrent Assets	<u>2,385,693</u>

Total Assets

\$ 3,033,928

Liabilities and Net Assets

Current Liabilities

Accounts payable	\$ 1,641
Current maturities of revenue bonds	1,833
Accrued payroll	4,857
Accrued compensated absences	8,303
Total Current Liabilities	<u>16,634</u>

Liabilities Payable From Restricted Assets

Revenue bonds	223,500
Accounts and retainages	165,074
Accrued interest	7,777
Total Liabilities Payable From Restricted Assets	<u>396,351</u>

Revenue Bonds (net of unamortized discount and reacquisition costs - \$9,613)

948,054

Total Liabilities

1,361,039

Net Assets

Invested in capital assets, net of related debt	1,196,500
Restricted by debt covenants	295,104
Unrestricted	181,285
Total Net Assets	<u>1,672,889</u>

Total Liabilities and Net Assets

\$ 3,033,928

See accompanying notes to the financial statements

Statement of Revenue, Expenses and Changes in Net Assets

Year Ended June 30, 2006

Operating Revenue

Water sales.....	\$ 374,992
Water and service to other City departments and component unit.....	118,006
Miscellaneous sales and services	<u>5,349</u>
Total Operating Revenue	<u>498,347</u>

Operating Expenses

Wages	86,165
Payroll taxes	7,307
Retirement plan	5,840
Employee benefits	40,447
Advertising and publications.....	997
Electric utility.....	17,962
Communications and other utilities.....	6,635
Office supplies and postage	5,422
Administrative services provided by the City of Vinton.....	34,864
Insurance.....	24,907
Professional fees.....	5,165
Dues, memberships and subscriptions.....	1,167
Laundry and sanitation	1,091
Chemicals.....	7,826
Water testing	1,373
Repairs, Maintenance and Operating Supplies	
Plant and distribution system	9,637
Vehicles	8,933
Other	24,586
Depreciation	95,229
Miscellaneous.....	<u>4,281</u>
Total Operating Expenses	<u>389,834</u>

Operating Income **108,513**

Nonoperating Revenue (Expenses)

Interest income	18,073
Rental income.....	4,320
Gain on disposition of fixed assets	25,000
Interest expense	(50,203)
Amortization of bond issue costs.....	<u>(1,262)</u>
Total Nonoperating Expenses.....	<u>(4,072)</u>

Change in Net Assets Before Transfers **104,441**

Transfers in.....	31,566
Transfers out	<u>(93,002)</u>

Change in Net Assets..... **43,005**

Net Assets - Beginning of Year

	<u>1,629,884</u>
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Net Assets - End of Year **\$ 1,672,889**

See accompanying notes to the financial statements.

Statement of Cash Flows

Year Ended June 30, 2006

Cash Flows From Operating Activities

Cash received from customers.....	\$ 382,076
Cash received from City of Vinton.....	118,006
Cash paid to City of Vinton for services.....	(34,864)
Cash paid to electric utility (less collection fee).....	(17,962)
Cash paid to or on behalf of employees.....	(97,295)
Cash paid to suppliers.....	<u>(158,078)</u>
Net Cash Provided by Operating Activities.....	<u>191,883</u>

Cash Flows From Noncapital Financing Activities

Billboard and antenna rent.....	4,320
Net transfers.....	<u>(61,436)</u>
Net Cash Used in Noncapital Financing Activities.....	<u>(57,116)</u>

Cash Flows From Capital and Related Financing Activities

Repayments of water revenue bonds.....	(902,000)
Interest paid on water revenue bonds.....	(48,252)
Proceeds from sale of water revenue bonds.....	1,148,478
Payments of bond issue costs.....	(8,064)
Acquisition of capital assets.....	<u>(157,696)</u>
Net Cash Provided by Capital and Related Financing Activities.....	<u>32,466</u>

Cash Flows From Investing Activities

Proceeds from the maturities of certificates of deposit.....	287,410
Purchase of certificates of deposit.....	(245,000)
Interest received on savings and certificates of deposits.....	<u>17,894</u>
Net Cash Provided by Investing Activities.....	<u>60,304</u>

Net Increase in Cash..... **227,537**

Cash - Beginning of Year..... 115,215

Cash - End of Year..... **\$ 342,752**

Reconciliation of Operating Income to Net Cash Provided by Operating Activities

Operating income.....	\$ 108,513
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities	
Depreciation.....	95,229
Change in Assets and Liabilities	
Decrease in trade accounts and unbilled revenue receivable.....	1,735
Decrease in prepaid expenses.....	1,311
Decrease in accounts payable.....	(4,329)
Decrease in accrued employee compensation.....	<u>(10,576)</u>

Net Cash Provided by Operating Activities..... **\$ 191,883**

See accompanying notes to the financial statements.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Reporting Entity

The Vinton Municipal Water Utility (Utility) is a municipal utility that is an enterprise fund of the City of Vinton, Iowa (City). The Utility provides water to customers within the City. The Utility's rates are set by its governing board. The Mayor and City Council of the City serve as the governing board and have oversight responsibility for the Utility. These financial statements of the Utility are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Government Accounting Standards Board (GASB).

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.

The Utility applies all applicable GASB pronouncements, as well as the following pronouncements 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 Utility distinguishes operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

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 cash, including amounts restricted by bond covenants, is combined with cash held by other City funds and deposited into a single checking or single money market savings account. Interest earned on accounts is allocated by the City among the various funds. Certificates of deposit are not combined but are held for and identified by specific restricted purpose.

Trade Accounts Receivable

Water sales are billed monthly in conjunction with other City-provided utilities. Payment is due within 20 days of billing. After proper notice, unless other arrangements are made by the customer, service may be discontinued to customers with unpaid bills 30 days or more past due. Uncollected accounts are normally written off against water sales after 90 days. Historically, account balances written off have not been material. Utility management believes that all trade accounts receivable as shown on the balance sheet to be collectible.

Unbilled Revenue Receivable

Sales of water used from the time of the last meter reading in June through June 30 have not been billed and the resulting receivable is not included in trade receivables. The utility estimates unbilled revenue based on the proportion of unbilled days in June to the number of days in the billing period times the amount billed in July. The result is reported as unbilled revenue receivable.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

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.

Capital Assets

Except for the cost of capital improvements derived from 1956 and 1967 water revenue bonds, the accompanying balance sheet does not include the cost nor the accumulated depreciation of capital improvements placed in service prior to January 1, 1971. Management believes that the net book value of such assets to be immaterial to total net assets of the Utility.

The capital assets consist of assets in service and assets not in service consisting of land and construction in progress. Capital assets are recorded at cost with depreciation computed under the straight-line method over useful lives as follows:

Type	Estimated Useful Lives
Water plant	5 - 50 Years
Distribution system	6 - 50 Years
Equipment and vehicles	5 - 25 Years

Depreciation expense for the year ended June 30, 2006 was \$95,229.

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.

Unamortized Water Revenue Bond Issuance Costs

Costs to issue the 2002 and 2006 water revenue bonds of \$5,675 and \$14,962, respectively, are amortized using the effective interest method over the life of the bonds, 20 and 9 years, respectively. Accumulated amortization was \$4,831 at June 30, 2006. Amortization of bond issue costs for the year was \$1,262.

Discount on Water Revenue Bonds

Original discount on the 2006 water revenue bonds of \$4,600 is amortized using the effective interest method over the life of the bonds, nine years. Accumulated amortization at June 30, 2006 was \$143. Discount amortization for the year, which was added to interest expense, was \$1,128 which includes \$985 for 1997 bond discounts.

Reacquisition Costs

Costs to reacquire 1997 water revenue bonds, consisting of unamortized issue costs and discounts on the 1997 bonds, of \$5,156 will be amortized beginning in fiscal year 2007 using the effective interest method over the shorter of the remaining life of the reacquired debt or newly issued debt, six years.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Compensated Absences

Utility employees accumulate a limited amount of earned but unused vacation and sick hours for subsequent payment upon termination of employment. The Utility's liability for compensated absences is computed based on rates of pay in effect on June 30 of the year accrued.

Operating Revenue

The Utility defines operating revenue as revenue derived from the sale of water. Nonoperating revenue is defined as anything other than revenue from the sale of water.

Budgeting

The Utility's budget is included as part of the City's budget and is prepared on the cash basis of accounting. Disbursements are, for legal budget compliance, combined for all City proprietary activities. Budget amounts for capital outlay, debt service and transfers out are presented on a combined basis only. The City budgeted water operations in the amount of \$471,989. The Utility reported cash outflows from operating activities of \$308,199.

(2) Cash Flow Statement Supplementary Information

Schedule of Noncash Investing and Financing Activities

Interest expense	\$ 50,203
Plus	
Accrued interest payable - beginning of year	3,876
Accrued interest received on bonds sold	3,078
Less accrued interest payable - end of year	(7,777)
Noncash amortization of water revenue bond discounts	(1,128)
Cash Paid for Interest	<u>\$ 48,252</u>
Face value of water revenue bonds sold	\$ 1,150,000
Plus accrued interest received on bonds sold	3,078
Less discount on bonds sold	(4,600)
Proceeds From Sale of Water Revenue Bonds	<u>\$ 1,148,478</u>
Cost of debt issuance	\$ 14,962
Current year accounts payable	(6,898)
Cash Paid for Debt Issue Costs	<u>\$ 8,064</u>
Cost of capital asset acquisitions	\$ 340,872
Trade-in value allowed on equipment	(25,000)
Amounts Payable	
Current year	(158,176)
Prior year	—
Cash Paid for Acquisition of Capital Assets	<u>\$ 157,696</u>
Interest income	\$ 18,073
Accrued Interest Receivable	
Beginning of year	781
End of year	(960)
Cash Received for Interest on Savings and Certificates of Deposit	<u>\$ 17,894</u>

Notes to the Financial Statements

(3) Deposits and Investments

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

The 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 City Council 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 11 to 15 months and yields of 2.53% to 4.18%. Certain certificates of deposit are restricted to comply with debt covenants and to secure customer deposits.

The Utility had no investments meeting the disclosure requirements of GASB Statement No. 3, as amended by Statement No. 40.

(4) Restricted Assets

Restricted assets represent monies set aside under terms of bond covenants. The composition of these funds at June 30, 2006 was as follows:

	Restricted Asset	<u>Corresponding Liability</u>		Restricted Net Assets (Excludes Bonds)
		Bonds	Other	
Projects.....	\$ 229,780	\$ —	\$ 158,176	\$ 71,604
Bond sinking note covenants.....	23,175	8,500	14,675	8,500
Debt reserve	115,000	115,000	—	115,000
Debt capital improvement reserve.....	100,000	100,000	—	100,000
Total	<u>\$ 467,955</u>	<u>\$ 223,500</u>	<u>\$ 172,851</u>	<u>\$ 295,104</u>

Project and bond sinking assets are deposited into checking or savings accounts until needed. Debt reserve and debt capital improvement reserve restricted assets are invested in certificates of deposit. Earnings on restricted assets are considered general revenue of the Utility. Project assets, along with interest earned thereon, can only be used for bond issuance purposes with any remaining balance to be transferred to debt sinking. Debt sinking amounts may only be used for payment of principal and interest on long-term debt and refunding costs. Debt reserve and debt capital improvement reserve assets can only be used to pay 2006 bond principal and interest costs when the balance in debt sinking is inadequate to pay amounts as due. In certain circumstances, monies from the debt capital improvement reserve can be used for system repairs, maintenance, rent or capital improvements. Debt sinking had the following activity:

Notes to the Financial Statements

(4) Restricted Assets

Balance - July 1, 2005	\$ 22,656
Required allocations	150,794
Additional allocations	9,544
Transfer from debt reserve	42,410
Bond proceeds	765,630
Issue costs paid	(8,064)
Interest payments made	(48,251)
Principal payments made	(902,000)
Reversal of excess allocations	(9,544)
Balance - June 30, 2006	<u>\$ 23,175</u>

(5) Capital Assets

Capital asset activity for the year was as follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital Assets Not Being Depreciated				
Land	\$ 70,051	\$ —	\$ —	\$ 70,051
Construction in progress	<u>—</u>	<u>191,498</u>	<u>—</u>	<u>191,498</u>
Total Capital Assets Not Being Depreciated	<u>70,051</u>	<u>191,498</u>	<u>—</u>	<u>261,549</u>
Capital Assets Being Depreciated				
Water plant	2,025,204	—	—	2,025,204
Distribution system	989,607	—	—	989,607
Equipment and vehicles	<u>297,986</u>	<u>149,374</u>	<u>87,118</u>	<u>360,242</u>
Total Capital Assets Being Depreciated	<u>3,312,797</u>	<u>149,374</u>	<u>87,118</u>	<u>3,375,053</u>
Less Accumulated Depreciation for				
Water plant	586,767	54,674	—	641,441
Distribution system	427,040	22,260	—	449,300
Equipment and vehicles	<u>244,797</u>	<u>18,295</u>	<u>87,118</u>	<u>175,974</u>
Total Accumulated Depreciation	<u>1,258,604</u>	<u>95,229</u>	<u>87,118</u>	<u>1,266,715</u>
Net Capital Assets Being Depreciated	<u>2,054,193</u>	<u>54,145</u>	<u>—</u>	<u>2,108,338</u>
Net Capital Assets	<u>\$ 2,124,244</u>	<u>\$ 245,643</u>	<u>\$ —</u>	<u>\$ 2,369,887</u>

Notes to the Financial Statements

(6) Summary of Debt

	Current Portion	Long-Term Portion
Water Revenue Bonds		
Series 2002 Water Revenue Bonds, Iowa Department of Natural Resources, due in annual payments ranging from \$2,000 to \$3,000 through June 1, 2022, plus interest semi-annually at 3%, secured by first lien on net revenue.	\$ 2,000	\$ 31,000
Series 2006 Water Revenue Bonds, Bankers Trust Company, Des Moines, Iowa - paying and registered agent, due in annual payments ranging from \$100,000 to \$150,000 through June 1, 2015, plus interest semi-annually at rates ranging from 3.8% to 4.2%, depending on maturity, secured by first lien on net revenue and restricted assets.	<u>100,000</u>	<u>1,050,000</u>
Subtotal	102,000	1,081,000
Less		
Unamortized discount	—	(4,457)
Unamortized reacquisition costs	<u>—</u>	<u>(5,156)</u>
Total	<u>\$ 102,000</u>	<u>\$ 1,071,387</u>

Interest expense for the year includes \$49,075 on the bonds and \$1,128 for discount amortization.

On May 28, 2006, the City closed on \$1,150,000 of Series 2006 tax-exempt revenue bonds dated May 1, 2006. Proceeds plus \$42,410 from water debt reserves were used to refund \$790,000 of series 1997 water revenue bonds, pay debt issue costs and provide for water system construction costs and equipment purchases. Series 1997 bonds maturing June 1, 2007 through 2012 were called and retired at face value on June 1, 2006. Interest rates on the 2006 bonds are approximately 1.15% less than the 1997 bonds. The 2006 bonds mature on June 1, 2007 through 2015, three years longer than the 1997 bond maturities. The extended maturity plus costs of issuance resulted in increased current and future debt service costs of approximately \$26,200 and an economic loss of approximately \$19,600.

At June 30, 2006 annual maturities of long-term debt were as follows:

	Principal	Interest	Total
Year ending June 30, 2007	\$ 102,000	\$ 51,005	\$ 153,005
Year ending June 30, 2008	117,000	43,298	160,298
Year ending June 30, 2009	122,000	38,810	160,810
Year ending June 30, 2010	127,000	34,070	161,070
Year ending June 30, 2011	127,000	29,073	156,073
Five years ending June 30, 2016	575,000	62,849	637,849
Five years ending June 30, 2021	10,000	1,350	11,350
Year ending June 30, 2022	<u>3,000</u>	<u>90</u>	<u>3,090</u>
	<u>\$ 1,183,000</u>	<u>\$ 260,545</u>	<u>\$ 1,443,545</u>

Notes to the Financial Statements

(6) Summary of Debt

Resolutions providing for the issuance of tax-exempt water revenue bonds include covenants related to the maintenance and efficiency of the operating system; the rate structure; additional borrowings; restricted assets, including transfers to a restricted bond principal and interest sinking account on the first of each month and payment of bond principal and interest from the sinking account; minimum insurance coverage; proper books and accounts and auditing thereof; and maintaining the tax-exempt status of the bonds.

During the year, transfers to the sinking account were made in approximately the middle of each quarter rather than the first of each month; amounts transferred were not computed in accordance with the specified method; debt principal and interest payments were made from the City's General Obligation Debt Service Fund rather than the Water Fund, debt sinking account as required; and proceeds restricted for projects were commingled with unrestricted City cash. Account balances were reclassified effective June 30, 2006 to provide for year-end compliance.

(7) Compensated Absences

The Utility's employees accumulate vacation days during the year based on the anniversary date of their employment. As of June 30, 2006, \$2,303 was accrued for unused vacation days.

The Utility has a sick time policy for all hourly employees. Under this plan, employees earn eight sick time hours per month. At retirement, death or permanent disability, one-half of the unused hours, with a maximum of 480 hours, is paid to the employee. At June 30, 2006, \$6,000 was accrued for unused sick pay.

(8) Retirement Plan

Plan Description

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

Plan members are required to contribute 3.7% of their annual salary and the employer is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by state statute. The Utility's contribution to IPERS for the years ended June 30, 2006, 2005 and 2004 were \$5,840, \$6,231 and \$6,249, respectively, equal to the required contributions for each year.

Notes to the Financial Statements

(9) Related Party Transactions

The Utility is an enterprise fund of the City. All transactions are processed by the City, including payroll under the City's employer federal identification number. The Utility provides water to the City and its discretely presented component unit, Vinton Municipal Electric Utility (VMEU). The Utility receives electricity from VMEU and various services from the City. For the year, the Utility included \$118,006, in operating revenue, for sales and services to the City and VMEU. The Utility recognized operating expenses of \$17,962 and \$34,864 from VMEU and the City, respectively.

Bond covenants allow surplus revenue to be used for any legal purpose. Transfers between, from and to other City funds are direct transfers of surplus revenue. At the direction of the City Council, the Utility received a transfer in of \$31,566 from the Wastewater Treatment Enterprise Fund and transferred \$93,002 to the City's General Fund.

(10) 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.

(11) Construction Commitments

The City Council approved three major construction projects for water mains and water tower painting which remain open at June 30, 2006. In addition to payables reported in the attached balance sheet, the Utility is committed to approximately \$70,000 on construction contracts.

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

To the Honorable Mayor and
Members of the City Council
Vinton Municipal Water Utility
Vinton, Iowa

We have audited the financial statements of the Vinton Municipal Water Utility, an enterprise fund of the City of Vinton, Iowa, as of and for the year ended June 30, 2006, and have issued our report thereon dated August 11, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the 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 an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of 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 Part I of 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 caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of 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, we believe that reportable condition 06-IC-1 is a material weakness.

Compliance and Other Matters

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 or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that are described in the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the Utility's operations for the year ended June 30, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the 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.

This report, a public record by law, is intended solely for the information and the use of the officials and customers of the Vinton Municipal Water 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.

HOGAN - HANSEN

HOGAN - HANSEN

Waterloo, Iowa
August 11, 2006

Schedule of Findings

Part I: Findings Related to the Financial Statements

06-IC-1 Segregation of Duties

Finding - One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. We noted that certain functions are not entirely segregated.

Auditor's Recommendation - With a limited number of office employees, segregation of duties is difficult. However, the Utility management should review its control procedures to obtain the maximum internal control possible under the circumstances, segregate duties to the extent possible with existing personnel and utilize administrative personnel to provide additional control through review of financial transactions and reports.

Utility's and City's Response - The City Council is aware of the condition. We will review procedures and make changes when appropriate.

Auditor's Conclusion - Response accepted.

Part II: Compliance and Other Matters

- 06-C-1 Budget** - Operating cash disbursements during the year ended June 30, 2006 did not exceed the amounts budgeted.
- 06-C-2 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.
- 06-C-3 Travel Expense** - No disbursements of the Utility's money for travel expenses of spouses of the Utility officials or employees were noted.
- 06-C-4 Business Transactions** - No business transactions between the Utility's officials or employees and the Utility were noted.
- 06-C-5 Bond Coverage** - Surety bond coverage of City officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to ensure that the coverage is adequate for current operations.
- 06-C-6 Council Minutes** - No transactions were found that we believe should have been approved in the Council minutes that were not.
- 06-C-7 Deposits and Investments** - We noted no instances of noncompliance with deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa and the City's investment policy.

Schedule of Findings

06-C-8 Water Revenue Bonds

A. Accountability of Tax-Exempt Bond Proceeds

Finding - Bond covenants require the Utility to maintain accountability of bond proceeds to ensure that the proceeds, plus interest earned on the proceeds until expended, have been properly expended on projects for which the bonds were issued. To meet this requirement, cash proceeds should be maintained in a separate, restricted account. The account can be either a general ledger account or a bank account; however, earnings on the account must be identifiable and be used for the same tax-exempt purposes as the original proceeds. Portions of the bond proceeds were commingled with other City general ledger and bank accounts. Accountability over earnings and some expenditures became difficult.

Auditor's Recommendation - To maintain accountability over bond proceeds, we recommend that bond proceeds and earnings thereon be accounted for in separate general ledger "project" cash accounts and not commingled with other City cash.

Utility's Response - As of June 30, 2006, remaining bond proceeds were identified as restricted cash. Documentation will be maintained to provide accountability over proper use of tax-exempt bond proceeds and interest earned thereon until expended.

Auditor's Conclusion - Response accepted

B. Proper Use of Bond Sinking Account

Finding - Bond covenants require that the Utility transfer cash to a restricted account for bond principal and interest, that the transfers be made on each the first of each month, that the transfers be equal to 1/6 of the next interest payment plus 1/12 of the next principal payment so that when payments are due, sufficient cash is available in the sinking fund to make the payment and that principal and interest payments be made from the sinking fund. We noted that transfers were made to the account; however, the payments were made on approximately the middle of each calendar quarter rather than the first of each month, amounts transferred were not made in specified amounts and that the Utility transferred the sinking account cash to the City's General Obligation Debt Service Fund. The Utility's general ledger did not reflect bond interest or principal payments.

Auditor's Recommendation - To comply with bond covenants and to properly report bond principal and interest payments, we recommend that transfers to the sinking account be made the first business day of each month, that the transfers be computed and made in required amounts and that bond principal and interest payments be made from the sinking account rather than transferred to other City funds.

Utility's Response - As of June 30, 2006, cash in the sinking account was adjusted to the required balance, transfers from the sinking account to the Debt Service Fund of the City were reversed and the payments were reported as debt service payments by the Utility. The City intends to revise its procedures to begin transferring cash between accounts in compliance with the bond covenants.

Auditor's Conclusion - Response accepted.