

WATERLOO WATER WORKS

WATERLOO, IOWA

DECEMBER 31, 2005

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Officials

Name	Title	Term Expires
Craig Caslavka	Chairman - Board of Trustees	January 12, 2010
Terry Kuntz	Vice-Chairman - Board of Trustees	January 12, 2012
Rodger Burris	Trustee	January 12, 2008
Dennis Clark, PE	Secretary, Treasurer and General Manager	Indefinite
Steve Scharfenberg	Assistant Treasurer and Assistant General Manager	Indefinite

**Waterloo Water Works
Management's Discussion and Analysis
December 31, 2005**

The Waterloo Water Work's (Utility) discussion and analysis is designed to offer readers of the Utility's financial statements a narrative overview and analysis of the financial activities of the Utility for the year ended December 31, 2005. Readers are encouraged to read the Management's Discussion and Analysis in conjunction with the Utility's financial statements, which begin on Page 8.

Financial Highlights

- The Utility's assets exceeded its liabilities by \$19.1 million at December 31, 2005. Of this amount, approximately \$1.6 million may be used to meet ongoing obligations to the citizens and creditors. The remaining net assets are invested in capital assets or are restricted for debt repayment.
- The operating revenue of the Utility exceeded operating expenses by \$759,401 and \$121,094 for the years ended December 31, 2005 and 2004, respectively.
- At December 31, 2005, the Utility's unrestricted cash, certificates of deposits and trade receivables of approximately \$2.6 million exceeded total current liabilities by approximately \$1.3 million. This excess is available for spending at the Utility's discretion. Included in current liabilities is an estimated net pension obligation of \$90,546 which is based on an independent actuarial determination as of January 1, 2005.
- The Utility has capital loan notes outstanding of \$350,000 at December 31, 2005 which are reported net of unamortized discounts costs of \$2,900.

Overview of the Financial Statements

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

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

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

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

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

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

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. The Utility's assets exceeded its liabilities by \$19.1 million and \$18.1 million on December 31, 2005 and 2004, respectively.

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

	2005	2004
Current assets.....	\$ 2,606,903	\$ 2,192,814
Noncurrent, noncapital assets.....	565,000	636,260
Capital assets, net of accumulated depreciation	<u>17,660,283</u>	<u>17,333,613</u>
Total Assets	<u>20,832,186</u>	<u>20,162,687</u>
Current liabilities.....	1,296,186	1,531,481
Liabilities payable from restricted assets.....	113,344	112,348
Other long-term liabilities (net)	<u>310,661</u>	<u>379,504</u>
Total Liabilities	<u>1,720,191</u>	<u>2,023,333</u>
Net Assets		
Invested in capital assets (net of related debt).....	17,289,622	16,401,373
Restricted.....	270,000	322,500
Unrestricted.....	<u>1,552,373</u>	<u>1,415,481</u>
Total Net Assets	<u>\$ 19,111,995</u>	<u>\$ 18,139,354</u>

Net assets invested in capital assets are by far the largest portion of the Utility's net assets, 90% at December 31, 2005, and reflect its net investment in capital assets (e.g., land, buildings, machinery, equipment, meters and water supply system). The Utility uses these capital assets to provide water and services to the citizens; consequently, these assets are not available for future spending.

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

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

At both December 31, 2005 and 2004, the Utility reported positive balances in all three categories of net assets.

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

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

	2005	2004
Operating revenue.....	\$ 4,193,407	\$ 3,586,449
Operating expenses	<u>3,434,006</u>	<u>3,465,355</u>
Operating Income	759,401	121,094
Net nonoperating revenue.....	124,844	83,892
Capital contributions.....	198,036	65,071
Transfers to City of Waterloo.....	<u>(109,640)</u>	<u>(86,371)</u>
Change in Net Assets	972,641	183,686
Net Assets - Beginning of Year	<u>18,139,354</u>	<u>17,955,668</u>
Net Assets - End of Year.....	<u>\$ 19,111,995</u>	<u>\$ 18,139,354</u>

Operating revenue is the Utility's primary source of revenue and is generated from water sales and other services to customers. For 2005, operating revenue increased \$606,958 from 2004 due primarily to an increase in water rates.

Operating expenses totaled \$3,434,006 for 2005, a \$31,349 decrease from 2004. These expenses represent the Utility's costs to provide water and services to customers. Operating expenses included depreciation expense of \$436,200 and \$426,272 for the years ended December 31, 2005 and 2004, respectively.

Net nonoperating revenue includes interest income and expense, amortization of debt issuance costs, gains and losses on the sale of assets and rent from leasing space for billboards and antennas. Net nonoperating revenue increased by \$40,952 between 2005 and 2004. Rent income totaled \$98,082 and \$98,813 for the years ended December 31, 2005 and 2004, respectively.

Capital contributions totaled \$198,036 and \$65,071 for years ended December 31, 2005 and 2004, respectively. These contributions are received as "front footage" fees as property is developed with resulting taps into the Utility's water distribution system.

Transfers to City of Waterloo of \$109,640 and \$86,371 for the years ended December 31, 2005 and 2004, respectively, are equal to the value of metered water provided to the City at no charge. Operating revenue includes an amount equal to the transfer. The Utility also provides unmetered water to the City at no charge. However, no reasonable estimate of the value can be made. Therefore, the value of unmetered water is not included in the financial statements.

Budgetary Highlights

Each year, the Board of Trustees adopts a budget using the modified cash basis of accounting which differs from the accrual basis of accounting used for the accompanying financial statements. The Utility's original budget was not amended during either of the years ended December 31, 2005 or 2004.

Actual cash receipts were approximately \$329,000 greater than budgeted. The majority of this variance was due to receipts over budget for water sales from increased pumpage, front footage and fire protection.

Actual cash disbursements were approximately \$20,000 less than budgeted.

Capital Assets and Long-term Debt

The Utility's investment in capital assets amounted to approximately \$17.6 million and \$17.3 million at December 31, 2005 and 2004, respectively, (net of accumulated depreciation of approximately \$6.3 million and \$5.9 million at December 31, 2005 and 2004, respectively). This investment in capital assets includes land; buildings and improvements; water supply and distribution systems; meters; machinery; and equipment.

Major capital asset construction and acquisition during 2005 included the following:

- Installation of 1.74 miles of water mains.
- Purchase of two vehicles.
- Installation of 18th Street River Crossing main.
- Updated video security system.
- Updated computer, testing and safety equipment.

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

	2005	2004
Land	\$ 231,156	\$ 231,156
Pipes and valves	343,454	275,732
Buildings and improvements	1,708,661	1,706,706
Water supply system	3,682,347	3,682,347
Distribution system	14,524,357	14,191,228
Meters and equipment.....	1,482,681	1,482,681
Machinery and equipment.....	1,727,677	1,694,087
Construction in progress	301,188	—
Total	<u>\$ 24,001,521</u>	<u>\$ 23,263,937</u>

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

At December 31, 2004, total Utility long-term debt was \$560,000 less unamortized discounts and reacquisition costs of \$5,109 for a net long-term debt of \$554,891. During 2005, the Utility repaid \$210,000 of principal and paid \$27,225 of interest on the debt and amortized to expense \$2,209 of discounts and reacquisition costs. At December 31, 2005, total Utility long-term debt was \$350,000 less unamortized discounts of \$2,900 for a net long-term debt of \$347,100. Principal of \$60,000 and interest of \$17,385 is due during the year ending December 31, 2006.

Debt indentures require that certain covenants relating to the maintenance and efficiency of the operating system, the rate structure, restrictions on borrowings, leasing or disposition of assets and minimum insurance coverage be adhered to. During 2005 and 2004, the Utility was in compliance with required covenants.

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

Economic Factors and Next Year's Budget and Rates

The Utility's primary source of revenue is water sales. Water rates increased 9% on January 1, 2006. Budgeted revenue has been adjusted to reflect the increase in rates.

Operating expenses for 2006 are expected to increase modestly over the same expenditures in 2006 due to filling vacancies in the Distribution Department, increases in health insurance, contributions to the pension plan and other operating expense increases. Capital expenditures are expected to increase as the Utility is planning to complete the Prescott Creek main extension at an estimated cost of \$1,066,800; the Master Plan Update, Reservoir Inspection and the Third Street Pump Station upgrade design at an estimated cost of \$358,665 and replacement of water mains in corrosive soil locations at an estimated cost of \$143,000.

The Utility also plans to issue bonds of at least \$1.3 million during 2006.

Independent Auditor's Report

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the accompanying balance sheets of the Waterloo Water Works, a component unit of the City of Waterloo, Iowa, at December 31, 2005 and 2004, and the related statements of revenue, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Waterloo Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards and provisions require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Waterloo Water Works at December 31, 2005 and 2004, and the changes in its financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 23, 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 2 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

HOGAN - HANSEN

HOGAN - HANSEN
Waterloo, Iowa
February 23, 2006

Balance Sheets

At December 31, 2005 and 2004

	2005	2004
Assets		
Current Assets		
Cash	\$ 1,105,880	\$ 830,834
Time certificates of deposit.....	716,656	665,152
Receivables		
Trade accounts	739,345	656,463
Accrued interest	8,501	6,524
Notes.....	8,793	10,372
Prepaid expenses.....	27,728	23,469
Total Current Assets	<u>2,606,903</u>	<u>2,192,814</u>
Noncurrent Assets		
Restricted time certificates of deposit.....	383,344	434,848
Unamortized capital loan notes issuance costs.....	4,814	7,388
Notes receivable - long-term portion	50,501	74,117
Repair assessments receivable.....	126,341	119,907
Subtotal	<u>565,000</u>	<u>636,260</u>
Capital Assets		
Land	231,156	231,156
Pipes and valves.....	343,454	275,732
Buildings and improvements	1,708,661	1,706,706
Water supply system.....	3,682,347	3,682,347
Distribution system.....	14,524,357	14,191,228
Meters and equipment	1,482,681	1,482,681
Machinery and equipment.....	1,727,677	1,694,087
Construction in progress	301,188	—
Total Capital Assets	24,001,521	23,263,937
Less accumulated depreciation	(6,341,238)	(5,930,324)
Net Capital Assets	<u>17,660,283</u>	<u>17,333,613</u>
Total Noncurrent Assets	<u>18,225,283</u>	<u>17,969,873</u>
Total Assets	<u>\$ 20,832,186</u>	<u>\$ 20,162,687</u>

See accompanying notes to the financial statements.

	2005	2004
Liabilities and Net Assets		
Current Liabilities		
Current maturities of water revenue capital loan notes	\$ 60,000	\$ 210,000
Accounts payable	97,753	134,511
Accrued employee compensation	91,829	101,694
Net pension obligation	90,546	126,391
Customer deposits.....	19,034	12,010
Due to Other Governments		
City of Waterloo		
Garbage fees.....	308,163	303,034
Sewer fees	571,236	589,921
City of Raymond	12,498	12,500
Black Hawk County.....	<u>45,127</u>	<u>41,420</u>
Total Current Liabilities	1,296,186	1,531,481
Liabilities Payable From Restricted Assets	113,344	112,348
Obligations Under Capital Lease	23,561	34,613
Water Revenue Capital Loan Notes	<u>287,100</u>	<u>344,891</u>
Total Liabilities	<u>1,720,191</u>	<u>2,023,333</u>
Net Assets		
Invested in capital assets, net of related debt	17,289,622	16,401,373
Restricted for debt service.....	270,000	322,500
Unrestricted	<u>1,552,373</u>	<u>1,415,481</u>
Total Net Assets	<u>19,111,995</u>	<u>18,139,354</u>
Total Liabilities and Net Assets	<u>\$ 20,832,186</u>	<u>\$ 20,162,687</u>

Statements of Revenue, Expenses and Changes in Net Assets

Years Ended December 31, 2005 and 2004

	2005	2004
Operating Revenue		
Water sales.....	\$ 3,831,986	\$ 3,258,094
Metered water provided to the City of Waterloo	109,640	86,371
Fire protection.....	48,536	49,345
Billing and collection fees	100,402	99,462
Other sales and service.....	<u>102,843</u>	<u>93,177</u>
Total Operating Revenue	<u>4,193,407</u>	<u>3,586,449</u>
Operating Expenses		
Salaries and benefits	1,932,259	1,925,896
Contractual services.....	590,092	613,620
Commodities.....	475,455	499,567
Depreciation	<u>436,200</u>	<u>426,272</u>
Total Operating Expenses.....	<u>3,434,006</u>	<u>3,465,355</u>
Operating Income.....	<u>759,401</u>	<u>121,094</u>
Nonoperating Revenue (Expenses)		
Interest income.....	57,360	31,595
Interest expense.....	(30,934)	(42,593)
Amortization.....	(2,574)	(3,595)
Gain (loss) on disposal of assets.....	2,910	(328)
Billboard and antenna rent	<u>98,082</u>	<u>98,813</u>
Total Nonoperating Revenue	<u>124,844</u>	<u>83,892</u>
Change in Net Assets Before Contributions and Transfers	884,245	204,986
Capital contributions.....	198,036	65,071
Transfers to City of Waterloo.....	<u>(109,640)</u>	<u>(86,371)</u>
Change in Net Assets.....	972,641	183,686
Net Assets - Beginning of Year	<u>18,139,354</u>	<u>17,955,668</u>
Net Assets - End of Year.....	<u>\$ 19,111,995</u>	<u>\$ 18,139,354</u>

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2005 and 2004

	2005	2004
Cash Flows From Operating Activities		
Cash received from customers.....	\$ 3,921,668	\$ 3,344,287
Cash collected on behalf of primary government	9,711,344	9,729,691
Cash collected on behalf of other governments	314,998	295,355
Cash paid to primary government (less 1% collection fee)	(9,646,468)	(9,637,484)
Cash paid to other governments (less collection fee).....	(308,922)	(294,588)
Cash paid to or on behalf of employees	(1,977,969)	(1,881,740)
Cash paid to suppliers	(988,501)	(901,779)
Net Cash Provided by Operating Activities	<u>1,026,150</u>	<u>653,742</u>
Cash Flows From Noncapital Financing Activities		
Billboard and antenna rent	<u>98,082</u>	<u>98,813</u>
Cash Flows From Capital and Related Financing Activities		
Contributed capital.....	198,036	65,071
Collections on note receivable for water main, including interest (2005 - \$3,715; 2004 - \$5,948)	28,910	31,446
Repayments of water revenue capital loan notes.....	(210,000)	(205,000)
Interest paid on water revenue capital loan notes	(27,225)	(36,820)
Proceeds from sale of property and equipment.....	2,910	645
Repayments of obligations under capital lease	(11,052)	(22,812)
Interest paid on obligations under capital lease	(1,500)	(2,291)
Acquisition of capital assets	(484,850)	(227,347)
Acquisition of plant not in service	(396,083)	(362,968)
Net Cash Used in Capital and Related Financing Activities	<u>(900,854)</u>	<u>(760,076)</u>
Cash Flows From Investing Activities		
Proceeds from the sales and maturities of certificates of deposit ...	1,000,000	990,000
Purchase of certificates of deposit.....	(1,000,000)	(1,100,000)
Interest received on savings and certificates of deposits	51,668	22,227
Net Cash Provided by (Used in) Investing Activities	<u>51,668</u>	<u>(87,773)</u>
Net Increase (Decrease) in Cash	<u>275,046</u>	<u>(95,294)</u>
Cash - Beginning of Year	<u>830,834</u>	<u>926,128</u>
Cash - End of Year.....	<u>\$ 1,105,880</u>	<u>\$ 830,834</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 759,401	\$ 121,094
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	436,200	426,272
Water provided to the City of Waterloo, not billed	(109,640)	(86,371)
Pipes and valves used in operations.....	127,469	165,435
Change in Assets and Liabilities		
Increase in trade accounts and repair assessments receivable	(89,316)	(74,584)
(Increase) decrease in prepaid expenses.....	(4,259)	17,777
Increase (decrease) in accounts payable	(46,164)	28,196
Increase (decrease) in accrued employee compensation ...	(9,865)	22,145
Increase (decrease) in net pension obligation	(35,845)	22,011
Increase (decrease) in customer deposits, due to other governments and liabilities payable from restricted assets	<u>(1,831)</u>	<u>11,767</u>
Net Cash Provided by Operating Activities	<u>\$ 1,026,150</u>	<u>\$ 653,742</u>

See accompanying notes to the financial statements.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Reporting Entity

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

Measurement Focus and Basis of Accounting

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

Use of Estimates

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

Cash and Certificates of Deposit

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

Trade Accounts Receivable

Water sales are billed monthly or quarterly, depending upon the quantity of water used or if requested by the customer. Accordingly, water sales are billed monthly to the larger commercial accounts and certain multi-family residential customers, while most residential customers are billed quarterly. Water sales are estimated for the period from the previous billing to year end and are included in revenue and trade accounts receivable. Unbilled revenue included in receivables at December 31, 2005 and 2004 was \$466,727 and \$386,616, respectively.

Budgeting

The Utility is required to prepare a budget each year and submit it, subject to review by the City of Waterloo, to the State of Iowa. The Utility prepares its budget using the cash basis of accounting modified by reducing cash balances and receipts and disbursements by amounts held on behalf of the City of Waterloo and customer deposits. The Utility's 2005 and 2004 budget and comparison to cash basis activity is as follows:

	2005	2004
Business-Type Activity - Water		
Actual disbursements	\$ 4,425,058	\$ 3,944,927
Budgeted disbursements	<u>4,444,677</u>	<u>3,934,900</u>
Actual Disbursements Over (Under) Budget	<u>\$ (19,619)</u>	<u>\$ 10,027</u>

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Capital Assets

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

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

Depreciation expense for the years ended December 31, 2005 and 2004 was \$436,200 and \$426,272, respectively.

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

Operating Revenue

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

Restricted Resources

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

Unamortized Water Revenue Capital Loan Notes Issuance Costs

Costs to issue the 1999 and 2001 water revenue capital loan notes of \$14,176 and \$14,523, respectively, are amortized using the effective interest method over the life of the notes, seven and nine years, respectively. Accumulated amortization was \$23,885 and \$21,311 at December 31, 2005 and 2004, respectively. Amortization of note issue costs for 2005 and 2004 was \$2,574 and \$3,595, respectively.

Discount on Water Revenue Capital Loan Notes

Original discounts on the 1999 and 2001 water revenue capital loan notes of \$5,250 and \$8,750, respectively, are amortized using the effective interest method over the life of the notes, seven and nine years, respectively. Accumulated amortization at December 31, 2005 and 2004 was \$11,100 and \$9,731, respectively. Discount amortization for 2005 and 2004, which was added to interest expense, was \$1,369 and \$1,802, respectively.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Reacquisition Costs

Costs to reacquire 1989 water revenue bonds and 1994 water revenue capital loan notes of \$15,080 and \$1,872, respectively, are amortized using the effective interest method over the shorter of the remaining lives of the reacquired debt or newly issued debt, seven years and two years, respectively. Accumulated amortization at December 31, 2005 and 2004 was \$16,952 and \$16,112, respectively. Amortization of reacquisition costs for 2005 and 2004, which was added to interest expense was \$840 and \$1,680, respectively.

Cash and Cash Equivalents

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

(2) Cash Flow Statement Supplementary Information

Schedule of Noncash Investing and Financing Activities	2005	2004
Interest expense	\$ 30,934	\$ 42,593
Less noncash amortization of water revenue capital loan notes discount and reacquisition costs	<u>(2,209)</u>	<u>(3,482)</u>
Cash Paid for Interest	<u>\$ 28,725</u>	<u>\$ 39,111</u>
Total purchases of plant not in service	\$ 397,258	\$ 371,021
Less increase in plant not in service.....	(67,722)	(11,099)
Less plant not in service used in operations.....	<u>(127,469)</u>	<u>(165,435)</u>
Increase in Construction in Progress and Capital Assets in Service From Noncash Transfers of Plant Not in Service.....	<u>\$ 202,067</u>	<u>\$ 194,487</u>
Cost of capital asset acquisitions	\$ 490,981	\$ 225,044
Amounts Payable		
Current year	(8,231)	(2,100)
Prior year	<u>2,100</u>	<u>4,403</u>
Cash Paid for Acquisition of Capital Assets.....	<u>\$ 484,850</u>	<u>\$ 227,347</u>

(3) Deposits and Investments

The Utility's deposits in banks and credit unions at December 31, 2005 and 2004 are entirely covered by federal depository insurance, by the State Sinking Fund or are collateralized either with securities held by the Utility or by nontransferable letters of credit in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

Notes to the Financial Statements

(3) Deposits and Investments

The Utility is authorized by statute to invest public funds in obligations of the United States Government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees and the Treasurer of the State of Iowa; prime eligible bankers acceptances; certain high-rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The Utility's certificates of deposit are stated at cost which approximates fair value. Certificates of deposit are purchased with maturities of 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.

(4) Restricted Assets

Restricted assets represent monies set aside under terms of bond covenants and to provide security for deposits and advances. The composition of these funds at December 31, 2005 and 2004 was as follows:

	Restricted Asset	Corresponding Liability	Restricted Net Assets
2005			
Customer deposits.....	\$ 113,344	\$ 113,344	\$ —
Capital Loan Note Covenants			
Debt reserve	70,000	—	70,000
Debt capital improvement reserve	200,000	—	200,000
Total	<u>\$ 383,344</u>	<u>\$ 113,344</u>	<u>\$ 270,000</u>
2004			
Customer deposits.....	\$ 112,348	\$ 112,348	\$ —
Capital Loan Note Covenants			
Debt reserve	122,500	—	122,500
Debt capital improvement reserve	200,000	—	200,000
Total	<u>\$ 434,848</u>	<u>\$ 112,348</u>	<u>\$ 322,500</u>

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

Balance, January 1, 2004.....	\$ —
Monthly allocations during 2004	241,820
Interest payments made	(36,820)
Principal payments made	<u>(205,000)</u>
Balance, December 31, 2004	—
Monthly allocations during 2005	237,225
Interest payments made	(27,225)
Principal payments made	<u>(210,000)</u>
Balance, December 31, 2005	<u>\$ —</u>

Notes to the Financial Statements

(5) Notes Receivable

As part of a water main extension project which was completed in October, 1996, 86 residents in the area of South Kimball Avenue signed agreements to pay the Utility a \$5,500 participation fee for access to, and future water purchases from, the water main. The participants had two options: payment of the total fee up front by August 30, 1996 or payment of \$500 down and the remainder with a 15-year term promissory note. Terms of the agreements call for quarterly payments (billed with their water) of \$125.13, including interest at a rate of 5.82% through August, 2011. For any resident who waited until after August 30, 1996 to become a participant, an additional fee is being charged ranging from 1% to 1.5% per month and promissory notes are no longer being accepted. The participation fee increased to \$7,414 starting September, 1999. Note balances can be prepaid at any time without penalty.

Individual note balances were \$2,471 and \$2,816 at December 31, 2005 and 2004, respectively. There were 24 and 30 individual notes outstanding at December 31, 2005 and 2004, respectively.

(6) Capital Assets

Capital asset activity for the years ended December 31, 2005 and 2004 was as follows:

	Balance			Balance			Balance
	12-31-03	Increase	Decrease	12-31-04	Increase	Decrease	12-31-05
Capital Assets Not Being Depreciated							
Land.....	\$ 231,156	\$ —	\$ —	\$ 231,156	\$ —	\$ —	\$ 231,156
Pipes and valves.....	264,633	11,099	—	275,732	67,722	—	343,454
Construction in progress.....	—	—	—	—	301,188	—	301,188
Total Capital Assets Not Being Depreciated.....	495,789	11,099	—	506,888	368,910	—	875,798
Capital Assets Being Depreciated							
Buildings and improvements.	1,798,477	8,775	(100,546)	1,706,706	1,955	—	1,708,661
Water supply system.....	3,668,722	13,625	—	3,682,347	—	—	3,682,347
Distribution system	13,851,349	339,879	—	14,191,228	333,129	—	14,524,357
Meters and equipment	1,382,781	100,546	(646)	1,482,681	—	—	1,482,681
Machinery and equipment.....	1,667,411	62,374	(35,698)	1,694,087	58,876	(25,286)	1,727,677
Total Capital Assets Being Depreciated.....	22,368,740	525,199	(136,890)	22,757,049	393,960	(25,286)	23,125,723
Less Accumulated Depreciation for							
Buildings and improvements	(553,492)	(26,205)	3,450	(576,247)	(26,489)	—	(602,736)
Water supply system.....	(1,827,835)	(74,529)	—	(1,902,364)	(74,572)	—	(1,976,936)
Distribution system	(1,738,763)	(223,676)	—	(1,962,439)	(228,836)	—	(2,191,275)
Meters and equipment	(528,140)	(39,087)	645	(566,582)	(35,288)	—	(601,870)
Machinery and equipment.....	(890,474)	(62,775)	30,557	(922,692)	(71,015)	25,286	(968,421)
Total Accumulated Depreciation	(5,538,704)	(426,272)	34,652	(5,930,324)	(436,200)	25,286	(6,341,238)
Net Capital Assets Being Depreciated.....							
	16,830,036	98,927	(102,238)	16,826,725	(42,240)	—	16,784,485
Net Capital Assets	\$ 17,325,825	\$ 110,026	\$ (102,238)	\$ 17,333,613	\$ 326,670	\$ —	\$ 17,660,283

Notes to the Financial Statements

(7) Summary of Debt

	<u>Current Portion</u>		<u>Long-Term Portion</u>	
	2005	2004	2005	2004
Water Revenue Capital Loan Notes				
Series 1999B capital loan notes, Wells Fargo Bank Iowa, N.A. - paying and registered agent, due in annual payments ranging from \$140,000 to \$150,000 through December, 2005, plus interest semi-annually at 4.6%, secured by first lien on net revenue.	\$ —	\$ 150,000	\$ —	\$ —
Series 2001 capital loan notes, Wells Fargo Bank Iowa, N.A. - paying and registered agent, due in annual payments ranging from \$60,000 to \$80,000 through December, 2010, plus interest semi-annually at rates ranging from 4.9% to 5.1%, depending on maturity, secured by first lien on net revenue.	<u>60,000</u>	<u>60,000</u>	<u>290,000</u>	<u>350,000</u>
Subtotal	—	210,000	290,000	350,000
Less: Unamortized discount	—	—	(2,900)	(4,269)
Unamortized reacquisition costs	<u>—</u>	<u>—</u>	<u>—</u>	<u>(840)</u>
Total	<u>\$ 60,000</u>	<u>\$ 210,000</u>	<u>\$ 287,100</u>	<u>\$ 344,891</u>
Obligations Under Capital Lease				
John Deere Credit, backhoe lease, discounted at a rate of 4.25%, due in annual payments of \$12,552, through January, 2008.	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 23,561</u>	<u>\$ 34,613</u>

The Water Works paid the lease payment due in January, 2006 at the end of 2005. Accordingly, there is no current maturity of obligations under capital lease.

Interest expense for 2005 and 2004 includes \$27,225 and \$36,820 on the notes plus \$2,209 and \$3,482, respectively, for amortization. Interest expense for 2005 and 2004 also includes \$2,499 and \$2,291, respectively, incurred under capital lease obligations.

At December 31, 2005 annual maturities of long-term debt were as follows:

Year Ending December 31,	Principal	Interest	Total
2006.....	\$ 60,000	\$ 17,385	\$ 77,385
2007.....	65,000	14,445	79,445
2008.....	70,000	11,260	81,260
2009.....	75,000	7,830	82,830
2010.....	<u>80,000</u>	<u>4,080</u>	<u>84,080</u>
	<u>\$ 350,000</u>	<u>\$ 55,000</u>	<u>\$ 405,000</u>

Notes to the Financial Statements

(7) Summary of Debt

Debt indentures require that certain covenants relating to the maintenance and efficiency of the operating system, the rate structure, restrictions on borrowings, leasing or disposition of assets and minimum insurance coverage be adhered to. During 2005 and 2004, the Utility was in compliance with required covenants.

The following is a summary of the changes in debt for the years ended December 31, 2005 and 2004:

	Water Revenue Capital Loan Notes	Obligations Under Capital Lease
Balance - December 31, 2003.....	\$ 765,000	\$ 57,425
Retirements	<u>(205,000)</u>	<u>(22,812)</u>
Balance - December 31, 2004.....	560,000	34,613
Retirements	<u>(210,000)</u>	<u>(11,052)</u>
Balance - December 31, 2005	<u>\$ 350,000</u>	<u>\$ 23,561</u>

(8) Capital Leases

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

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

Class of Property	Asset Balance
Machinery and equipment	\$ 64,925
Less accumulated amortization	<u>(9,017)</u>
	<u>\$ 55,908</u>

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

Year Ending December 31,	
2006.....	\$ —
2007.....	12,552
2008.....	<u>12,551</u>
Total Minimum Lease Payments	25,103
Less amount representing interest	<u>1,542</u>
Present Value of Net Minimum Lease Payments.....	<u>\$ 23,561</u>

Notes to the Financial Statements

(9) Compensated Absences

The Utility's employees accumulate vacation days during the year based on the anniversary date of their employment. As of December 31, 2005 and 2004, \$40,754 and \$37,391, respectively, was accrued for unused vacation days.

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

(10) Related Party Transactions

The Utility provides customer file maintenance, meter reading, billing and collecting services for the City of Waterloo's (City) Sanitation (Garbage) and Sanitary Sewer Enterprise Funds and keeps 1% of cash collected as a service fee. During 2005 and 2004, the Utility recorded \$96,759 and \$95,967, respectively, as City service fees and forwarded approximately \$9,646,000 and \$9,637,000, respectively, to the City. At December 31, 2005, the Utility's payables to the City were \$308,163 and \$571,236 for garbage and sewer collections, respectively, compared to \$303,034 and \$589,921, respectively, at December 31, 2004, which have not been reduced for the Utility's City service fee. The Utility pays office expenses (data processing charges, postage and other expenses of the billing cycle) and passes approximately one-half of those costs on to the City. During 2005 and 2004, the Utility received approximately \$47,000 and \$40,000, respectively, from the City which reduced office expenses.

The Utility also provides metered and unmetered water to the City at no charge. Metered water furnished to the City is valued at equivalent sales rates and is included in the financial statements as water sales and transfers to the City. During the years ended December 31, 2005 and 2004, the Utility provided metered water to the City valued at approximately \$109,600 and \$86,400, respectively.

(11) Retirement Plan

Plan Description

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

Funding Policy

The contribution requirements of Plan members and the Utility are established and may be amended by the Utility. Plan member contributions are not currently required. The Utility is required to contribute amounts necessary to provide benefits based on the actuarial valuation. The amount contributed to the Plan during 2005 and 2004 was \$110,000 and \$50,000, respectively.

Notes to the Financial Statements

(11) Retirement Plan

Annual Pension Cost and Net Pension Obligation

The annual pension cost for 2005 was determined as part of the actuarial valuation using the January 1, 2005 aggregate actuarial method. This method does not identify or separately amortize unfunded actuarial accrued liabilities. The actuarial assumptions for 2004 and 2003 included (a) 8% investment rate of return (net of administrative expenses) and (b) projected salary increases of 3% per year, compounded annually and retirement at age 65. The actuarial valuation at January 1, 2005 assumes retirement at age 62 with 30 years of service. The assumptions did not include any postretirement benefits. The actuarial value of assets was determined using the current market value of investments.

Three-Year Trend Information

Year Ended	Annual Pension Cost (APC)			Percentage of APC Contributed	Net Pension Obligation
	Normal Cost	Interest	Total		
December 31, 2003	\$99,225	\$7,938	\$107,163	140%	\$104,380
December 31, 2004	58,945	13,066	72,011	69%	126,391
December 31, 2005	59,300	14,855	74,155	148%	90,546

(12) Risk Management

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

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

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the financial statements of the Waterloo Water Works as of and for the year ended December 31, 2005, and have issued our report thereon dated February 23, 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 assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in internal control over financial reporting that might be material weaknesses.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

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 that are required to be reported under *Government Auditing Standards*.

The following comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2005 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes. Prior year findings relative to statutory or other legal matters have been resolved.

05-CS-1 Official Depositories - A resolution naming official depositories has been approved by the Utility. The maximum deposit amounts stated in the resolution were exceeded during October, 2005 for one bank.

Finding - Chapter 12C of the Code of Iowa states that a written resolution shall distinctly name each depository approved and specify the amount that may be kept on deposit in each depository.

Auditor's Recommendation - Deposits in the named depository should not have been allowed to exceed the approved amount.

Utility's Response - A new depository resolution was approved that increased the maximum deposit amount.

Auditor's Conclusion - Response accepted.

05-CS-2 Budget - Operating cash disbursements during the year ended December 31, 2005 did not exceed the amounts budgeted.

05-CS-3 Questionable Disbursements - We noted no disbursements that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

05-CS-4 Travel Expense - No disbursements of the Utility's money for travel expenses of spouses of the Utility officials or employees were noted.

05-CS-5 Business Transactions - No business transactions between the Utility's officials or employees and the Utility were noted.

05-CS-6 Bond Coverage - Surety bond coverage of the Utility officials and employees is in accordance with statutory provisions and was reviewed and updated during the year. We recommend that the amount of coverage continue to be reviewed annually to insure that the coverage is adequate for current operations.

05-CS-7 Board Minutes - No transactions were found that we believe should have been included in the minutes but were not. Minutes of Trustees proceedings were published within 15 days as required by Chapter 372.13(6) of the Code of Iowa.

05-CS-8 Water Revenue Capital Loan Notes - No violations of water revenue capital loan note covenants were noted.

05-CS-9 Deposits and Investments - We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B or 12C of the Code of Iowa, except as noted in 05-CS-1 above.

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

HOGAN - HANSEN

HOGAN - HANSEN

Waterloo, Iowa
February 23, 2006