

KEOKUK MUNICIPAL WATER WORKS

**INDEPENDENT AUDITOR'S REPORT
FINANCIAL STATEMENTS AND
SUPPLEMENTAL INFORMATION
SCHEDULE OF FINDINGS**

JUNE 30, 2006

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KEOKUK MUNICIPAL WATER WORKS

Officials

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
Edward Johnstone	Trustee	November, 2011
Bruce Brandt	Trustee	November, 2007
Jeff Jeffers	Trustee	November, 2008
John Beard	Trustee	November, 2008
Mike Hausch	Trustee	November, 2011
Bill C. Cole	Manager	
Shari Dunagan	Office Manager	

KEOKUK MUNICIPAL WATER WORKS

JOHN A. RUSSELL, CPA PC
Certified Public Accountant

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Independent Auditor's Report

To the Board of Trustees
Keokuk Municipal Water Works
Keokuk, Iowa

We have audited the accompanying financial statements, listed as exhibits in the table of contents of this report, of the Keokuk Municipal Water Works, Keokuk, Iowa, as of and for the year ended June 30, 2006. These financial statements are the responsibility of Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards 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. An audit also includes 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 Keokuk Municipal Water Works as of June 30, 2006 and the changes in its net assets and cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 19, 2006 on our consideration of the Water Works' 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 internal control over financial reporting or 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.

Management's Discussion and Analysis and budgetary comparison information on pages 7 through 11 and 25 through 26 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We applied limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming an opinion on the financial statements referred to above taken as a whole. Other supplementary information included in Schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audits of the financial statements referred to above and, in our opinion, is fairly stated in all material respects in relation to the aforementioned financial statements taken as a whole.

John A. Russell CPA PC

October 19, 2006

KEOKUK MUNICIPAL WATER WORKS

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

2006 FINANCIAL HIGHLIGHTS

- The Keokuk Municipal Waterworks' operating revenues increased 10%, or \$ 464,703 from fiscal 2005 to fiscal 2006.
- The Keokuk Municipal Waterworks' operating expenses increased 7 % or \$ 247,448 in fiscal 2006 from fiscal 2005.
- The Keokuk Municipal Waterworks' net assets increased 3%, or \$ 519,586.00 from June 30, 2005 to June 30, 2006

USING THIS ANNUAL REPORT

The Keokuk Municipal Waterworks is governed by a Board of Trustees, appointed by the Mayor and approved by the City Council. The Keokuk Municipal Waterworks is organized as an Enterprise Fund. This discussion and analysis are intended to serve as an introduction to the Keokuk Municipal Waterworks basic financial statements. The annual report consists of a series of financial statements and other information as follows:

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

The Statement of Net Assets presents information on the Keokuk Municipal Waterworks; 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 Keokuk Municipal Waterworks is improving or deteriorating.

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

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

FINANCIAL ANALYSIS OF THE KEOKUK MUNICIPAL WATERWORKS

Statement Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the waterworks financial position. The Waterworks' net assets for fiscal 2006 totaled \$16,874,311. This compares to \$ 16,354,725 for fiscal 2005. A summary of the Waterworks' net assets is presented below.

	NET ASSETS	
	2006	2005
	Actual	Actual
Assets		
Unrestricted Cash	706,044	985,805
Restricted Cash	3,876,899	15,413,784
Property, Plant and Equipment	24,595,929	23,781,990
Unamortized Expense	208,544	274,842
Total	29,387,416	40,456,421
Liabilities		
Unrestricted Current	1,104,368	1,164,125
Restricted	498,737	447,571
Noncurrent	10,910,000	22,490,000
Total Liabilities	12,513,105	24,101,696
Total Net Assets	16,874,311	16,354,725

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Operating revenues are generated from the distribution and purifying of water. This accounts for 90% of our income. Other revenues are from interest and miscellaneous charges. A summary of revenues, expenses and changes in net assets for the year ended June 30, 2006 is presented below:

CHANGES IN NET ASSETS

	2006 Actual	2005 Actual
Operating Revenues		
Water Sales	4,992,361	4,559,008
Miscellaneous Charges & City	102,891	72,116
Service Charge & Penalties	38,967	38,392
 Total Operating Revenues	 5,134,219	 4,669,516
Operating Expense		
Plant	1,894,806	1,438,455
Distribution	254,976	298,365
Meter Shop	192,153	135,807
Office	886,537	1,022,157
 Operating Expense	 3,228,472	 2,894,784
Depreciation	754,881	812,653
Amortization	66,297	94,765
 Total Operating Expense	 4,049,650	 3,802,202
 Operating Income	 1,084,569	 867,314
Non-Operating Revenues (Expenses)		
Interest on Investments	416,984	247,121
Loss on Disposition of Equipment	-14,400	-0-
Capital Loan Note Int. Expense	-967,567	-1,059,104
Net Non-Operating Revenues (Exp)	-564,983	-811,983
 Increase in Net Assets	 519,586	 55,331
 Net Assets Beginning of Year	 16,354,725	 16,299,394
 Net Assets End of Year	 16,874,311	 16,354,725

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

In fiscal 2006, operating revenues increased by \$464,703. Operating expenses increased by \$247,448. This is due to chemical and energy cost increase.

STATEMENT OF CASH FLOWS

Cash flows are directly related to our pumpage, 93% of our income comes from water sales. Operating expenses account for 82% of our water sales income. The budget for FYE 6-30-06 was \$17,833,194. The budget was exceeded by \$380,742. This was due to early call of the 1995/96 Bond Refinancing. Total expenditures for the year totaled \$18,213,936, of that total \$10,980,000 was needed to call the 95/96 Bond issue.

CAPITAL ASSETS

At June 30, 2006, the Keokuk Municipal Waterworks had \$36,624,163 in capital assets. A summary of projects follows.

Distribution System:

- Water main at Tolmie Park Area
- Purchase of Hydrants

Office:

- Upgrade Electrical Service
- Replace Printer and Computers

Water Treatment Plant:

- Upgrading of filter system
- Purchase of Bobcat Loader

Capital expenditures totaled \$1,568,820., an increase of 145% over 2005.

LONG-TERM DEBT

At June 30, 2006, the Waterworks had \$ 11,510,000 in debt outstanding. This debt is from refinancing of the 1995 and 1996 Bonds in April 2004 and January 2005. See page 21 of the annual audit.

Refinancing reduced debt service payments by \$1,682,286. Economic gain was \$1,196,272

ECONOMIC FACTORS

The Keokuk Municipal Waterworks continued to improve its financial position during the current fiscal year. However, the current condition of the economy in the country and local area continues to be a concern for waterworks officials. Some of the realities that may potentially become challenges for the waterworks to meet are:

- Facilities at the waterworks require constant maintenance and upkeep
- Water regulations continue to change, in order to meet these new standards the waterworks must constantly upgrade and change, which could be a financial challenge.
- Due to the age of the distribution system, the Keokuk Municipal Waterworks repair and replacement of mains is on-going.
- Closing of businesses and declining population directly affect the income of the Keokuk Municipal Waterworks.

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

CONTACTING THE WATERWORKS FINANCIAL MANAGEMENT

This financial report is designed to provide our customers and creditors with a general overview of the waterworks finances and to show the waterworks additional financial information, contact the Keokuk Municipal Waterworks, 20 N. 4th Street, Keokuk, Iowa.

KEOKUK MUNICIPAL WATER WORKS

FINANCIAL STATEMENTS

KEOKUK MUNICIPAL WATER WORKS
Statement of Net Assets
June 30, 2006

Assets

Current unrestricted assets:			
Cash and cash equivalents		\$ (202,167)	
Certificate of deposit		210,000	
Interest receivable on investments		67,976	
Accounts receivable		568,356	
Prepaid expenses		<u>61,879</u>	
Total current unrestricted assets			\$ 706,044
Restricted assets:			
Sewer, garbage & landfill:			
Cash	\$ 124,597		
Accounts receivable	<u>181,140</u>	305,737	
Consumers water meter deposits:			
Cash	<u>127,545</u>	127,545	
Consumers sewer meter deposits:			
Cash	5,455		
Certificates of deposit	<u>60,000</u>	65,455	
Sinking fund:			
Cash	<u>307,355</u>	307,355	
Reserve fund:			
Guaranteed investment contracts	<u>1,218,470</u>	1,218,470	
Improvement fund:			
Certificate of deposit	<u>250,000</u>	250,000	
General regulatory and system improvement:			
Cash and cash equivalents	1,206		
Certificates of deposit	<u>1,600,000</u>	1,601,206	
Bond refunding trust account	<u>1,131</u>	<u>1,131</u>	
Total restricted assets			3,876,899
Property, plant and equipment:			
Land		364,766	
Buildings	240,506		
Less: accumulated depreciation	<u>(190,423)</u>	50,083	
Plant and tanks	29,609,551		
Less: accumulated depreciation	<u>(8,852,092)</u>	20,757,459	
Distribution system, meters and hydrants	5,345,100		
Less: accumulated depreciation	<u>(1,968,079)</u>	3,377,021	
Machinery and equipment	1,064,240		
Less: accumulated depreciation	<u>(1,017,640)</u>	46,600	
Total property, plant and equipment			24,595,929
Other assets:			
Unamortized bond expense (Note 1)			<u>208,544</u>
Total assets			<u>\$ 29,387,416</u>

See notes to financial statements.

Liabilities and net assets

Current liabilities (payable from unrestricted assets):

Accounts payable	\$	158,177	
State sales tax payable		4,189	
Accrued compensated absences (Note 1)		233,856	
Accrued interest on water revenue capital loan notes		108,146	
Current portion of long-term debt		600,000	
		<u> </u>	
Total unrestricted current liabilities	\$		1,104,368

Liabilities (payable from restricted assets):

Due to city - sewer & garbage charges		246,822	
Due to GRRW - landfill charges		58,915	
Consumer water meter deposits		127,545	
Consumer sewer meter deposits		65,455	
		<u> </u>	
Total Restricted Liabilities			498,737

Noncurrent liabilities:

Water revenue capital loan notes (Note 4)		11,510,000	
Less: Current portion of long-term debt		<u>(600,000)</u>	<u>10,910,000</u>

Total liabilities12,513,105**Net assets**

Invested in capital assets, net of related debt		13,085,929	
Restricted for water revenue capital loan notes (Note 4):			
Sinking fund		307,355	
Reserve fund		1,218,470	
Improvement fund		250,000	
Unrestricted		<u>2,012,557</u>	

Total net assets\$ 16,874,311

KEOKUK MUNICIPAL WATER WORKS
Statement of Revenues, Expenses and
Changes in Net Assets
Year Ended June 30, 2006

Operating revenues:	
Metered sales	\$ 4,989,952
Flat rate sales	2,409
Miscellaneous charges	102,891
Service charges and penalties	38,967
Total operating revenue	<u>5,134,219</u>
Operating expenses:	
Operating expenses (Schedule 1)	3,228,472
Depreciation	754,881
Amortization	66,297
Total operating expenses	<u>4,049,650</u>
Operating income	<u>1,084,569</u>
Non-operating revenues (expenses):	
Interest on investments	416,984
Loss on disposition of equipment	(14,400)
Capital loan note interest expense	(967,567)
Net non-operating revenues (expenses)	<u>(564,983)</u>
Change in net assets	519,586
Net assets, June 30, 2005	<u>16,354,725</u>
Net assets, June 30, 2006	<u>\$ 16,874,311</u>

See notes to financial statements.

KEOKUK MUNICIPAL WATER WORKS
Statement of Cash Flows
Year Ended June 30, 2006

Cash flows from operating activities:	
Cash received form customers-water	\$ 4,955,440
Cash received from customers for deposits & others	1,508,215
Cash received from other operating revenues	102,891
Cash payments to supplies for goods and services	(1,988,522)
Cash payments to employees for services	(1,188,737)
Cash payments to city and GRRWA	(1,484,145)
Net cash provided by operating activities	<u>1,905,142</u>
Cash flows from capital and related financing activities:	
Payments on revenue bonds	(12,664,987)
Purchase of property and equipment	(1,716,719)
Net cash (used) by capital and related financing activities	<u>(14,381,706)</u>
Cash flows from investing activities:	
Proceeds from maturities of certificates of deposit	3,250,000
Purchase of certificates of deposit	(3,070,000)
Interest received	398,742
Bond refunding trust maturities	11,192,376
Net cash provided by investing activities	<u>11,771,118</u>
Net (decrease) in cash and cash equivalents	(705,446)
Cash and cash equivalents, beginning of year	<u>1,069,437</u>
Cash and cash equivalents, end of year (includes restricted funds of \$566,158.)	<u>\$ 363,991</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	<u>\$ 1,084,569</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	821,178
Changes in assets and liabilities:	
(Increase) in accounts receivable, customers	(102,984)
(Increase) in prepaid expense	(6,450)
Increase in accounts payable	35,164
Increase in accrued expense	22,499
Increase in other liabilities	51,166
Total adjustments	<u>820,573</u>
Net cash provided by operating activities	<u>\$ 1,905,142</u>

See notes to financial statements.

KEOKUK MUNICIPAL WATER WORKS

Notes to Financial Statements

June 30, 2006

Note 1. Summary of Significant Accounting Policies

The Water Works is governed by a Board of Trustees appointed by the Mayor and approved by the City Council. The Board of Trustees has the responsibility for designated management and is accountable for fiscal matters relating to the Keokuk Municipal Water Works.

The Water Works' financial statements are prepared in conformity with U.S. generally accepted accounting principles as prescribed by the Government Accounting Standards Board.

A. Reporting Entity

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

B. Basis of Presentation

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

C. Measurement Focus and Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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

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

D. Assets, Liabilities and Net Assets

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

Cash, Investments and Cash Equivalents- The Water Works considers all short-term investments that are highly liquid to be cash equivalents. Cash equivalents are readily convertible to known amounts of cash and, at the date of purchase, have a maturity date no longer than three months. Cash investments not meeting the definition of cash equivalents at June 30, 2006 include certificates of deposit and guaranteed investment contracts in the amount of \$3,338,470.

Restricted Investments- Funds set aside for sewer, garbage and landfill fees collected for others, water and sewer meter deposits and bond sinking, bond improvement and bond reserve accounts.

Accounts Receivable- The Water Works grants credit to customers, substantially all of whom are located in Keokuk, Iowa. The risk of loss on the accounts receivable is the balance due at the time of default. Accounts receivable are considered past due after thirty days and charged off when management determines the account is uncollectible. Bad debts are charged to operations in the year in which the account is determined uncollectible. Because of the organization's policies in collecting deposits from its customers and its ability to deny continued service to customers with past due bills, management believes uncollectible accounts are negligible. If the reserve method of accounting for uncollectible accounts was used, it would not have a material affect on the financial statement; therefore, no allowance for uncollectible accounts has been recorded.

Inventories- Inventories which consist of supplies and repair materials are recognized as costs at the time they are purchased. Inventory items are negligible.

Property, Plant and Equipment- Property, plant and equipment are recorded at historical cost. Depreciation of all exhaustible capital assets is charged as an expense against operations. Repairs and maintenance are recorded as expenses; renewals and betterments are capitalized. The cost and accumulated depreciation of assets disposed of are deleted, with any gain or loss recorded in current operations. Interest has not been capitalized during the construction period on property, plant and equipment.

Depreciation has been calculated on each class of depreciable property using the straight-line method. Estimated useful lives are as follows:

Buildings and improvements	10-30 yrs
Water plant	10-50 yrs
Distribution system	15-80 yrs
Machinery and equipment	5-20 yrs

Amortization of Sludge Disposal Expense- On January 1, 1991, the Water Works entered into an agreement with the City of Keokuk to treat certain sludge waste in the city sewer system. The agreement is for a fifteen year period ending December 31, 2005 and required a prepaid charge in the amount of \$750,000 which is being amortized ratably over a 15 year period.

Amortization of Water Revenue Capital Loan Note- During the year ended June 30, 1996, the Water Works incurred costs of \$460,848, in connection with two Capital Loan note issuances. These costs are being ratably amortized on a monthly basis over the life of the Capital Loan notes until the first call date, April 1, 2006. The expense for the year ending June 30, 2006 was \$33,573. During the years ended June 30, 2004 and 2005, the Water Works incurred costs of \$216,268 in connection with the 2004A and 2005A Water Revenue Refunding Capital Loan Notes. These costs are being ratably amortized on a monthly basis over the life of the Capital Loan Notes until the first call date, April 1, 2013. The expense for the year June 30, 2006 was \$7,724.

Compensated Absences- Water Works employees accumulate a limited amount of earned but unused vacation and sick leave hours for subsequent use or for payment upon termination, retirement or death. The Water Works liability for accumulated vacation and sick leave has been computed based on rates of pay in effect at June 30, 2006.

E. Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information. During the year ended June 30, 2006, disbursements exceeded the amounts budgeted.

F. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported accounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2. Cash and Investments

The Water Works' deposits in banks at June 30, 2006 were entirely covered by federal depository insurance, or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Water Works 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 Water Works Board of Trustees; 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 Water Works had no investments meeting the disclosure requirements of Governmental Accounting Standards Board Statement in No. 3, as amended by statement 40.

Note 3. Pension and Retirement Benefits

The Water Works contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits 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 3.70% of their annual salary and the Water Works is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by state statute. The Water Works contribution to IPERS for the years ended June 30, 2006, 2005 and 2004 were \$46,735, \$43,189 and \$40,299 respectively, equal to the required contributions for each year.

Note 4. Water Revenue Capital Loan Notes Payable

On October 13, 1995, the Keokuk Municipal Water Works adopted a Resolution authorizing the issuance of \$9,045,000 Water Revenue Capital Loan Note Series 1995. These notes were redeemed on April 1, 2006 through the issuance of 2005A Water Revenue Refunding Capital Loan Notes.

On April 10, 1996, the Keokuk Municipal Water Works adopted a Resolution authorizing the issuance of \$5,955,000 Water Revenue Capital Loan Note Series 1996. These notes were redeemed, except for one note in the amount of \$5,000 on April 1, 2006 through the issuance of the 2004A Water Revenue Refunding Capital Loan Notes. The remaining note matures April 1, 2020 and has an interest rate of 6.5%.

On April 1, 2004, the Keokuk Municipal Water Works issued \$7,000,000 in Water Revenue Refunding Capital Loan Notes. The Water Works entered into an escrow agreement with Wells Fargo Bank, N.A. and deposited the proceeds from the refunding notes. The proceeds were used to advance refund \$6,650,000 of 1995 Water Revenue Capital Loan Notes on the call date of April 1, 2006. These notes mature semi-annually beginning October 1, 2006 through April 1, 2020 with interest rates from 1.90% to 4.55%. Notes maturing after April 1, 2013 may be called for redemption and paid before maturity on said date or any date thereafter at par plus accrued interest in whole or in part, in order of maturity.

On January 27, 2005, the Keokuk Municipal Water Works issued \$4,505,000 in Water Revenue Refunding Capital Loan Notes. The Water Works entered into an escrow agreement with Wells Fargo Bank, N.A. and deposited the proceeds from the refunding notes. The proceeds were used to advance refund \$4,330,000 of 1996 Water Revenue Capital Loan Notes on the call date of April 1, 2006. These notes mature semi-annually beginning October 1, 2006 through April 1, 2020 with interest rates from 2.65% to 5.00%. Notes maturing after April 1, 2013 may be called for redemption and paid before maturity on said date or any date thereafter at par plus accrued interest in whole or in part, in order of maturity.

Annual debt service requirements to maturity for Water Revenue Capital Loan Notes are as follows:

Year Ending June 30,	\$5,955,000 Water Revenue Capital Loan Notes Ser 1995		\$7,000,000 Water Revenue Refunding Capital Loan Notes Ser 2004A		\$4,505,000 Water Revenue Refunding Capital Loan Notes Ser 2005A		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
	2007	-	325	350,000	244,448	250,000	183,519	600,000
2008	-	325	420,000	236,940	260,000	176,445	680,000	413,710
2009	-	325	430,000	227,114	270,000	168,402	700,000	395,841
2010	-	325	445,000	215,920	275,000	159,492	720,000	375,737
2011	-	325	455,000	203,218	285,000	149,778	740,000	353,321
2012-2016	-	1,625	2,515,000	775,792	1,605,000	569,231	4,120,000	1,346,648
2017-2020	5,000	1,300	2,385,000	240,324	1,560,000	176,044	3,950,000	417,668
	<u>\$5,000</u>	<u>\$4,550</u>	<u>\$7,000,000</u>	<u>\$2,143,756</u>	<u>\$4,505,000</u>	<u>\$1,582,911</u>	<u>\$11,510,000</u>	<u>\$3,731,217</u>

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

A. Rate Covenant

The Water Works covenants to continue in effect rates for services rendered to be sufficient to produce Gross Revenues adequate to pay expenses of operation and maintenance and to maintain a balance of Net Revenues equal to at least 125% of the principal and interest on the notes as they become due.

B. Sinking Fund

Sufficient monthly transfers equal to 1/6 of the interest coming due and 1/12 of the principal coming due shall be deposited to the Sinking Fund and shall be used solely for the purpose paying principal and interest.

C. Reserve Fund

The Reserve Fund requirement is an amount equal to the lesser of (a) the maximum principal and interest coming due on the notes in any fiscal year, or (b) 10% of the stated principal of the notes. Amounts on deposit in the Reserve Fund shall be used solely for the purpose of paying principal and interest on the notes. The Reserve Fund is to be valued on April 1st of each year and whenever the amount on deposit is less than the Reserve Fund requirement, the Water Works is required to make monthly deposits in an amount equal to 25% of the amount required to be deposited in the Sinking Fund until the Reserve Fund has been restored.

D. Improvement Fund

The Improvement Fund requirement is \$250,000. Money on deposit in the Improvement Fund shall be used for the purpose of paying principal and interest on the notes when there are insufficient balances in the Sinking Fund and Reserve Fund. Funds may also be used to pay the costs of extraordinary maintenance expenses or repairs, renewals and replacement. Whenever it shall become necessary to so use money on deposit in the Improvement Fund, the Water Works shall deposit \$21,000 per month until the amount on deposit is restored to \$250,000.

Note 5. Risk Management

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

Note 6. Major Customers

Water sales to one major customer were \$3,502,667 for the year ended June 30, 2006 representing 70.2% of the total water sales for the year. At June 30, 2006, amounts due from this customer included in trade accounts receivable were \$338,276.

REQUIRED SUPPLEMENTAL INFORMATION

KEOKUK MUNICIPAL WATER WORKS
Statement of Revenues, Expenses and
Changes in Net Assets
Actual and Budgeted
Year Ended June 30, 2006

	Actual	Adjustment to Budgetary Basis
Operating revenues:		
Metered sales	\$ 4,989,952	\$ -
Flat rate sales	2,409	-
Miscellaneous charges	102,891	-
Service charges and penalties	38,967	-
Total operating revenue	5,134,219	-
Operating expenses:		
Operating expenses (Schedule 1)	3,228,472	-
Depreciation	754,881	-
Amortization	66,297	-
Total operating expenses	4,049,650	-
Operating income	1,084,569	-
Non-operating revenues (expenses):		
Interest on investments	416,984	-
Property, plant, and equipment	-	(1,716,719)
Loss on disposition of equipment	(14,400)	-
Capital loan note principal	-	(11,480,000)
Capital loan note interest expense	(967,567)	-
Net non-operating revenues (expenses)	(564,983)	(13,196,719)
Change in net assets	519,586	(13,196,719)
Net assets, June 30, 2005	16,354,725	-
Net assets, June 30, 2006	\$ 16,874,311	\$ (13,196,719)

Note: The Water Works budgets cash outlay debt principal payments and property plant and equipment purchases which are treated differently in accordance with GAAP.

See accompanying independent auditor's report.

Actual on Budgetary Basis	Budgeted Amounts		Final to net Variance
	Original	Final	
\$ 4,989,952	\$ 4,563,300	\$ 5,013,300	\$ (23,348)
2,409	9,700	9,700	(7,291)
102,891	65,000	65,000	37,891
38,967	39,800	39,800	(833)
<u>5,134,219</u>	<u>4,677,800</u>	<u>5,127,800</u>	<u>6,419</u>
3,228,472	3,009,258	3,189,259	(39,213)
754,881	835,234	835,234	80,353
66,297	94,766	94,766	28,469
<u>4,049,650</u>	<u>3,939,258</u>	<u>4,119,259</u>	<u>69,609</u>
<u>1,084,569</u>	<u>738,542</u>	<u>1,008,541</u>	<u>76,028</u>
416,984	125,000	125,000	291,984
(1,716,719)	(1,000,000)	(1,500,000)	(216,719)
-	-	-	(14,400)
(11,480,000)	(500,000)	(11,500,000)	20,000
(967,567)	(713,935)	(713,935)	(253,632)
<u>(13,761,702)</u>	<u>(2,088,935)</u>	<u>(13,588,935)</u>	<u>(172,767)</u>
(12,677,133)	(1,350,393)	(12,580,394)	(96,739)
<u>16,354,725</u>			
<u>\$ 3,677,592</u>			

See accompanying independent auditor's report.

SUPPLEMENTAL INFORMATION

Schedule 1

KEOKUK MUNICIPAL WATER WORKS
 Schedule of Operating Expenses - Budgeted and Actual
 For the Year Ended June 30, 2006

	<u>Budget</u>	<u>Actual</u>	Actual Over (Under) <u>Budget</u>
Plant Operation and Maintenance:			
Supervision labor	\$ 54,305	\$ 70,593	\$ 16,288
Maintenance labor	86,200	114,676	28,476
Operation labor	179,400	182,791	3,391
Laboratory labor	34,400	34,412	12
Social security and IPERS	51,303	53,554	2,251
Health insurance	85,000	86,526	1,526
Flood control	2,000	35	(1,965)
Purification supplies	724,091	710,724	(13,367)
Utilities	314,000	362,359	48,359
Plant maintenance	232,000	204,689	(27,311)
Supplies	45,000	47,373	2,373
Sludge disposal	2,000	18,555	16,555
Education and travel	7,000	6,854	(146)
Intake	4,000	1,665	(2,335)
Generator expense	7,000	-	(7,000)
	<u>1,827,699</u>	<u>1,894,806</u>	<u>67,107</u>
Distribution Maintenance:			
Supervision labor	40,800	40,789	(11)
Maintenance labor	35,252	36,362	1,110
Social security and IPERS	11,108	10,097	(1,011)
Health insurance	34,000	24,313	(9,687)
Main leaks	87,000	77,115	(9,885)
Valves	18,000	2,230	(15,770)
Maintenance	13,000	11,463	(1,537)
Building maintenance	1,000	1,248	248
Supplies	85,000	37,619	(47,381)
Hydrants	18,000	7,812	(10,188)
Storage	5,000	2,875	(2,125)
Education and travel	3,000	3,053	53
	<u>351,160</u>	<u>254,976</u>	<u>(96,184)</u>
Meter Maintenance:			
Supervision labor	40,800	40,835	35
Maintenance labor	60,300	58,961	(1,339)
Meter reading labor	3,000	3,270	270
Social security and IPERS	12,600	13,811	1,211
Health insurance	20,000	22,449	2,449
Meter parts	8,000	14,837	6,837
Shop supplies	23,000	35,935	12,935
Education and travel	1,500	2,055	555
	<u>169,200</u>	<u>192,153</u>	<u>22,953</u>

See accompanying independent auditor's report.

KEOKUK MUNICIPAL WATER WORKS
 Schedule of Operating Expenses - Budgeted and Actual
 For the Year Ended June 30, 2006

	<u>Budget</u>	<u>Actual</u>	<u>Actual Over (Under) Budget</u>
Administration:			
Management salaries	103,500	105,681	2,181
Office salaries	135,000	135,175	175
Board fees	1,500	1,400	(100)
Postage and shipping	25,000	21,846	(3,154)
Data processing expense	4,000	-	(4,000)
Office expense	60,000	39,162	(20,838)
Social Security and IPERS	28,700	31,459	2,759
Vehicle maintenance	15,000	16,467	1,467
Engineering and legal	116,300	162,880	46,580
Employee benefits	55,200	55,965	765
Insurance	70,000	79,437	9,437
Education and travel	5,000	2,937	(2,063)
Office building maintenance	20,000	9,930	(10,070)
To city in lieu of taxes	200,000	200,000	-
Increase in compensated absences	-	22,498	22,498
Bond fees	2,000	1,700	(300)
	<u>841,200</u>	<u>886,537</u>	<u>45,337</u>
Total operating expenses	<u>\$ 3,189,259</u>	<u>\$ 3,228,472</u>	<u>\$ 39,213</u>

See accompanying independent auditor's report.

Schedule 2

KEOKUK MUNICIPAL WATER WORKS
Statement of Changes in Assets Restricted
for Landfill, Sewer, and Garbage Charges
For the Year Ended June 30, 2006

	<u>Landfill Charges</u>	<u>Sewer Charges</u>	<u>Garbage Charges</u>	<u>Total</u>
Restricted asset balance, July 1, 2005	\$ 57,398	\$ 108,744	\$ 104,562	\$ 270,704
Revenues:				
Landfill service charges	218,031	-	-	218,031
Sewer service charges	-	754,831	-	754,831
Garbage service charges	-	-	554,768	554,768
Less: billing adjustments	(1,248)	(4,973)	(2,231)	(8,452)
	<u>274,181</u>	<u>858,602</u>	<u>657,099</u>	<u>1,789,882</u>
Expenditures:				
To the city of Keokuk & GRRW	<u>(215,266)</u>	<u>(733,252)</u>	<u>(535,627)</u>	<u>(1,484,145)</u>
Restricted asset balance, June 30, 2006	<u>\$ 58,915</u>	<u>\$ 125,350</u>	<u>\$ 121,472</u>	<u>\$ 305,737</u>
Restricted asset balance is composed of the following:				
Cash	\$ 18,334	\$ 59,098	\$ 47,165	\$ 124,597
Accounts receivable	40,581	66,252	74,307	181,140
	<u>\$ 58,915</u>	<u>\$ 125,350</u>	<u>\$ 121,472</u>	<u>\$ 305,737</u>

See accompanying independent auditor's report.

KEOKUK MUNICIPAL WATER WORKS
Statement of Changes in Assets Restricted for
Water Revenue Capital Loan Note Debt Service
For the Year Ended June 30, 2006

	Water Revenue Note Sinking Fund	Water Revenue Note Improvement Fund	Water Revenue Note Reserve Fund	Total
Restricted asset balance, July 1, 2005	\$ 308,030	\$ 250,000	\$ 1,218,470	\$ 1,776,500
Revenues:				
Transfers from operations	1,213,935	-	-	1,213,935
	<u>1,521,965</u>	<u>250,000</u>	<u>1,218,470</u>	<u>2,990,435</u>
Expenditures:				
Note principal payments	500,000	-	-	500,000
Note interest payments and fees	714,610	-	-	714,610
	<u>1,214,610</u>	<u>-</u>	<u>-</u>	<u>1,214,610</u>
Restricted asset balance, June 30, 2006	<u>\$ 307,355</u>	<u>\$ 250,000</u>	<u>\$ 1,218,470</u>	<u>\$ 1,775,825</u>

See accompanying independent auditor's report.

KEOKUK MUNICIPAL WATER WORKS
Scheduled Fixed Assets and Depreciation
For the Year Ended June 30, 2006

	Assets			Balance June 30, 2006
	Balance June 30, 2005	Additions	Deductions	
Land	\$ 364,766	\$ -	\$ -	\$ 364,766
Building	234,247	6,259	-	240,506
Plant and tanks:				
Water treatment plant	24,646,432	3,853	-	24,650,285
Intake	193,712	-	-	193,712
Sludge disposal facility	892,538	-	-	892,538
Tank painting	1,415,616	-	-	1,415,616
Filter	990,479	1,466,921	-	2,457,400
Total plant & tanks	<u>28,138,777</u>	<u>1,470,774</u>	<u>-</u>	<u>29,609,551</u>
Distribution system, meters and hydrants:				
Mains	4,279,022	23,589	-	4,302,611
Meters	767,095	-	-	767,095
Hydrants	241,443	33,951	-	275,394
Total dist. system, meters & hydrants	<u>5,287,560</u>	<u>57,540</u>	<u>-</u>	<u>5,345,100</u>
Machinery and equipment:				
General equipment	46,196	-	-	46,196
Office equipment	220,594	14,597	-	235,191
Shop equipment	53,727	-	-	53,727
Store & plant equipment	557,900	19,650	-	577,550
Transportation equipment	151,576	-	-	151,576
Total machinery & equipment	<u>1,029,993</u>	<u>34,247</u>	<u>-</u>	<u>1,064,240</u>
Grand total	<u>\$ 35,055,343</u>	<u>\$ 1,568,820</u>	<u>\$ -</u>	<u>\$ 36,624,163</u>

See accompanying independent auditor's report.

Allowance for Depreciation				
Balance June 30, 2005	Depreciation Taken	Eliminations	Balance June 30, 2006	Net Asset Value
\$ -	\$ -	\$ -	\$ -	\$ 364,766
182,245	8,178	-	190,423	50,083
7,192,352	520,290	-	7,712,642	16,937,643
122,650	3,874	-	126,524	67,188
435,471	17,850	-	453,321	439,217
388,989	70,810	-	459,799	955,817
82,346	17,460	-	99,806	2,357,594
<u>8,221,808</u>	<u>630,284</u>	<u>-</u>	<u>8,852,092</u>	<u>20,757,459</u>
1,253,902	53,909	-	1,307,811	2,994,800
531,815	23,289	-	555,104	211,991
100,828	4,336	-	105,164	170,230
<u>1,886,545</u>	<u>81,534</u>	<u>-</u>	<u>1,968,079</u>	<u>3,377,021</u>
45,981	86	-	46,067	129
215,708	3,166	-	218,874	16,317
53,588	40	-	53,628	99
536,987	21,566	-	558,553	18,997
130,491	10,027	-	140,518	11,058
<u>982,755</u>	<u>34,885</u>	<u>-</u>	<u>1,017,640</u>	<u>46,600</u>
<u>\$ 11,273,353</u>	<u>\$ 754,881</u>	<u>\$ -</u>	<u>\$ 12,028,234</u>	<u>\$ 24,595,929</u>

See accompanying independent auditor's report.

JOHN A. RUSSELL, CPA PC

Certified Public Accountant

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Keokuk, IA 52632

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FAX: 319-524-8557

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

(Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards)

To the Board of Trustees
Keokuk Municipal Water Works
Keokuk, Iowa

We have audited the financial statements of the Keokuk Municipal Water Works as of and for the year ended June 30, 2006, and have issued our report thereon dated October 19, 2006. We conducted our audit in accordance with U.S. generally accepted auditing standards 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 Keokuk Municipal Water Works' 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.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the 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 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 the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether the Keokuk Municipal Water Works' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, non-compliance of which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Water Works' 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 Water Works. 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 statutory comments have not been resolved.

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

We wish to thank the officials and employees of the Keokuk Municipal Water Works, Keokuk, Iowa, for their cooperation and courtesies extended to us during the course of our examination.

Sincerely,

A handwritten signature in black ink that reads "John H. Russell CPA PC". The signature is written in a cursive style with a large initial "J".

October 19, 2006

KEOKUK MUNICIPAL WATER WORKS

Schedule of Findings

Year Ended June 30, 2006

Findings Related to the General Purpose Financial Statements:

INSTANCES OF NON-COMPLIANCE:

No matters were reported.

REPORTABLE CONDITIONS:

No material weaknesses in the internal control over financial reporting were identified.

Other Findings Related to Statutory Reporting:

(1) Official Minutes- The Board of Trustees meets in regular monthly sessions, and in special session, when necessary to transact business of the utility. No transactions were found that we believe should have been approved in the Board minutes but were not.

(2) Certified Budget- Water Works' expenditures during the year ended June 30, 2006 exceeded amounts budgeted therefore.

Recommendation- The budget should have been amended in accordance with Chapter 384.18 of the Code of Iowa before disbursements were allowed to exceed the budget.

Response- The budget will be amended in the future, if applicable.

Conclusion- Response accepted.

(3) Official Depository Banks-The Water Works' official depository banks are:

	<u>Amount</u>
Keokuk Savings Bank & Trust Co., Keokuk, Iowa	3,500,000
State Central Savings Bank, Keokuk, Iowa	3,500,000
First Community Bank, Keokuk, Iowa	3,500,000

A resolution naming these banks as official depository banks has been adopted by the Board of Trustees. The maximum deposit amount, stated in the resolution, were not exceeded during the year ended June 30, 2006.

(4) Bond Coverage- Surety bond coverage of Water Works' officials and employees is in accordance with statutory provisions. However, the amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.

(5) Revenue Notes- The Water Works has compiled with the provisions of the revenue capital loan note resolution.

- (6) Travel Expense-No expenditures of Water Works' money for travel expenses of spouses of Water Works officials or employees were noted.
- (7) Business Transactions-No business transactions between the Water Works and Water Works' officials were noted.
- (8) Questionable Disbursements – We noted no disbursements that may not meet the requirements of public purpose as defined in a Attorney General's Opinion dated April 25, 1979.
- (9) Fixed Assets Records – A complete record of fixed assets is maintained; however, to facilitate the proper insurance, maintenance and safeguarding of these assets, an inventory of all property and equipment should be taken at least once a year and compared against the fixed asset records.
- (10) Deposits and Investments – No instances of noncompliance with the deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa and the Water Works' investment policy were noted.