

**WATERLOO WATER WORKS**

**WATERLOO, IOWA**

**DECEMBER 31, 2006**

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## Officials

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<b>Name</b>	<b>Title</b>	<b>Term Expires</b>
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, 2006**

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, 2006. 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 \$19.6 million at December 31, 2006. Of this amount, approximately \$1.1 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 \$343,273 and \$759,401 for the years ended December 31, 2006 and 2005, respectively.
- At December 31, 2006, the Utility's unrestricted cash, certificates of deposits and trade receivables of approximately \$1.9 million exceeded total current liabilities by approximately \$800,000. This excess is available for spending at the Utility's discretion.
- The Utility has capital loan notes outstanding of \$290,000 at December 31, 2006 which are reported net of unamortized discounts costs of \$1,977.

**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 \$19.6 million and \$19.1 million on December 31, 2006 and 2005, respectively.

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

	<b>2006</b>	<b>2005</b>
Current assets .....	\$ 2,058,288	\$ 2,606,903
Noncurrent, noncapital assets .....	580,373	565,000
Capital assets, net of accumulated depreciation .....	<u>18,488,781</u>	<u>17,660,283</u>
<b>Total Assets</b> .....	<b><u>21,127,442</u></b>	<b><u>20,832,186</u></b>
Current liabilities .....	1,151,246	1,296,186
Liabilities payable from restricted assets .....	113,271	113,344
Other long-term liabilities (net) .....	<u>235,054</u>	<u>310,661</u>
<b>Total Liabilities</b> .....	<b><u>1,499,571</u></b>	<b><u>1,720,191</u></b>
<b>Net Assets</b>		
Invested in capital assets (net of related debt) .....	18,186,751	17,289,622
Restricted .....	270,000	270,000
Unrestricted .....	<u>1,171,120</u>	<u>1,552,373</u>
<b>Total Net Assets</b> .....	<b><u>\$ 19,627,871</u></b>	<b><u>\$ 19,111,995</u></b>

**Net assets invested in capital assets** are by far the largest portion of the Utility's net assets, 93% at December 31, 2006, 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, 2006 and 2005, the Utility reported positive balances in all three categories of net assets.

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

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

	<b>2006</b>	<b>2005</b>
Operating revenue.....	\$ 4,472,211	\$ 4,193,407
Operating expenses .....	<u>4,128,938</u>	<u>3,434,006</u>
Operating Income .....	343,273	759,401
Net nonoperating revenue.....	178,899	124,844
Capital contributions.....	99,077	198,036
Transfers to City of Waterloo.....	<u>(105,373)</u>	<u>(109,640)</u>
Change in Net Assets .....	515,876	972,641
Net Assets - Beginning of Year .....	<u>19,111,995</u>	<u>18,139,354</u>
<b>Net Assets - End of Year.....</b>	<b><u>\$ 19,627,871</u></b>	<b><u>\$ 19,111,995</u></b>

**Operating revenue** is the Utility's primary source of revenue and is generated from water sales and other services to customers. For 2006, operating revenue increased \$278,804 from 2005 due primarily to an increase in water rates.

**Operating expenses** totaled \$4,128,938 for 2006, a \$694,932 increase from 2005. These expenses represent the Utility's costs to provide water and services to customers. Operating expenses included depreciation expense of \$448,325 and \$436,200 for the years ended December 31, 2006 and 2005, 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 \$54,055 between 2006 and 2005. Rent income totaled \$115,875 and \$98,082 for the years ended December 31, 2006 and 2005, respectively.

**Capital contributions** totaled \$99,077 and \$198,036 for years ended December 31, 2006 and 2005, 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 \$105,373 and \$109,640 for the years ended December 31, 2006 and 2005, 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, 2006 or 2005.

Actual cash receipts were approximately \$141,000 greater than budgeted. The majority of this variance was due to receipts over budget for water sales, miscellaneous sales and services and interest.

Actual cash disbursements were approximately \$777,500 less than budgeted due to lower than anticipated bond expenses and capital expenses, primarily related to later than anticipated starting of the Prescotts Creek Water Main Extension.

### **Capital Assets and Long-term Debt**

The Utility's investment in capital assets amounted to approximately \$18.5 million and \$17.6 million at December 31, 2006 and 2005, respectively, (net of accumulated depreciation of approximately \$6.6 million and \$6.3 million at December 31, 2006 and 2005, 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 2006 included the following:

- Installation of 1.75 miles of water mains.
- Purchase of one vehicle.
- Updated computer, security and safety equipment.
- Replaced 1,834 feet of water main on Castle Street and Drynan Drive.
- Continued progress on Master Plan Update Study and Reservoir Evaluation Study.
- Completed approximately 61% of Prescotts Creek 20-inch Water Main Extension Project.

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

	<b>2006</b>	<b>2005</b>
Land .....	\$ 231,156	\$ 231,156
Pipes and valves .....	432,086	343,454
Buildings and improvements .....	1,656,982	1,708,661
Water supply system .....	3,692,551	3,682,347
Distribution system .....	15,134,422	14,524,357
Meters and equipment.....	1,447,013	1,482,681
Machinery and equipment .....	1,635,006	1,727,677
Construction in progress .....	810,140	301,188
<b>Total</b> .....	<b><u>\$ 25,039,356</u></b>	<b><u>\$ 24,001,521</u></b>

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

At December 31, 2005, total Utility long-term debt was \$350,000 less unamortized discounts and reacquisition costs of \$2,900 for a net long-term debt of \$347,100. During 2006, the Utility repaid \$60,000 of principal and paid \$17,385 of interest on the debt and amortized to expense \$923 of discount costs. At December 31, 2006, total Utility long-term debt was \$290,000 less unamortized discounts of \$1,977 for a net long-term debt of \$288,023. Principal of \$65,000 and interest of \$14,445 is due during the year ending December 31, 2007.

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 2006 and 2005, the Utility was in compliance with required covenants.

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

### **Economic Factors and Next Year's Budget and Rates**

The Utility's primary source of revenue is water sales. Water rates are set to increase 9% on March 1, 2007. Budgeted revenue has been adjusted to reflect the increase in rates.

Operating expense for 2007 are expected to increase over the same expenditures in 2007 due to step increases for new employees, insurance premium increases, contributions to the pension plan and other operating expense increases. Capital expenditures are expected to increase as the Utility is planning to complete the Prescotts Creek Water Main Extension Project, the Midport Boulevard Water Main Extension Project and the Hess Road Water Main Extension Project, at an estimated total cost of \$1,718,500; complete the Master Plan Update and construct three test wells, at an estimated cost of \$410,000; and replacement of water mains in corrosive soil conditions and extension of water mains in developing areas, at an estimated cost of \$760,000.

The Utility will also be refunding the 2001 capital loan notes and issuing \$3.3 million of water revenue capital loan notes.

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# HOGAN • HANSEN

*A Professional Corporation*

Certified Public Accountants and Consultants

## Independent Auditor's Report

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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, 2006 and 2005, 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, 2006 and 2005, 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 April 25, 2007 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  
April 25, 2007

Steven K. Duggan    Dennis E. Hogan

Anne M. Halbmaier    Stephen J. Kos    Dale E. Minor    Lisa M. Wall    Susan M. Wilson    Karilyn A. Wood

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3128 Brockway Road, P.O. Box 240, Waterloo, IA 50704-0240 • (319) 233-5225 • FAX (319) 233-3188

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## Balance Sheets

At December 31, 2006 and 2005

	2006	2005
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents .....	\$ 736,361	\$ 1,105,880
Time certificates of deposit.....	466,729	716,656
Receivables		
Trade accounts .....	725,168	739,345
Accrued interest .....	8,331	8,501
Notes.....	8,542	8,793
Prepaid expenses.....	113,157	27,728
<b>Total Current Assets</b> .....	<b><u>2,058,288</u></b>	<b><u>2,606,903</u></b>
<b>Noncurrent Assets</b>		
Restricted time certificates of deposit.....	383,271	383,344
Unamortized capital loan notes issuance costs.....	3,282	4,814
Notes receivable - long-term portion .....	37,750	50,501
Repair assessments receivable.....	156,070	126,341
<b>Subtotal</b> .....	<b><u>580,373</u></b>	<b><u>565,000</u></b>
Capital Assets		
Land .....	231,156	231,156
Pipes and valves.....	432,086	343,454
Buildings and improvements.....	1,656,982	1,708,661
Water supply system.....	3,692,551	3,682,347
Distribution system.....	15,134,422	14,524,357
Meters and equipment .....	1,447,013	1,482,681
Machinery and equipment.....	1,635,006	1,727,677
Construction in progress .....	810,140	301,188
Total Capital Assets .....	25,039,356	24,001,521
Less accumulated depreciation .....	(6,550,575)	(6,341,238)
<b>Net Capital Assets</b> .....	<b><u>18,488,781</u></b>	<b><u>17,660,283</u></b>
<b>Total Noncurrent Assets</b> .....	<b><u>19,069,154</u></b>	<b><u>18,225,283</u></b>
<b>Total Assets</b> .....	<b><u>\$ 21,127,442</u></b>	<b><u>\$ 20,832,186</u></b>

See accompanying notes to the financial statements.

	<b>2006</b>	<b>2005</b>
<b>Liabilities and Net Assets</b>		
<b>Current Liabilities</b>		
Current maturities of water revenue capital loan notes .....	\$ 65,000	\$ 60,000
Accounts payable .....	88,521	97,753
Accrued employee compensation .....	107,526	91,829
Net pension obligation .....	—	90,546
Customer deposits.....	22,075	19,034
Due to Other Governments		
City of Waterloo		
Garbage fees.....	286,929	308,163
Sewer fees .....	529,235	571,236
City of Raymond .....	9,898	12,498
Black Hawk County.....	<u>42,062</u>	<u>45,127</u>
<b>Total Current Liabilities</b> .....	<b>1,151,246</b>	<b>1,296,186</b>
<b>Liabilities Payable From Restricted Assets</b> .....	<b>113,271</b>	<b>113,344</b>
<b>Obligations Under Capital Lease</b> .....	<b>12,031</b>	<b>23,561</b>
<b>Water Revenue Capital Loan Notes</b> .....	<b><u>223,023</u></b>	<b><u>287,100</u></b>
<b>Total Liabilities</b> .....	<b><u>1,499,571</u></b>	<b><u>1,720,191</u></b>
<b>Net Assets</b>		
Invested in capital assets, net of related debt .....	18,186,751	17,289,622
Restricted for debt service.....	270,000	270,000
Unrestricted .....	<u>1,171,120</u>	<u>1,552,373</u>
<b>Total Net Assets</b> .....	<b><u>19,627,871</u></b>	<b><u>19,111,995</u></b>
<b>Total Liabilities and Net Assets</b> .....	<b><u>\$ 21,127,442</u></b>	<b><u>\$ 20,832,186</u></b>

# Statements of Revenue, Expenses and Changes in Net Assets

Years Ended December 31, 2006 and 2005

	2006	2005
<b>Operating Revenue</b>		
Water sales.....	\$ 4,081,879	\$ 3,831,986
Metered water provided to the City of Waterloo .....	105,373	109,640
Fire protection.....	76,843	48,536
Billing and collection fees .....	100,880	100,402
Other sales and service.....	<u>107,236</u>	<u>102,843</u>
<b>Total Operating Revenue .....</b>	<b><u>4,472,211</u></b>	<b><u>4,193,407</u></b>
<b>Operating Expenses</b>		
Salaries and benefits .....	2,138,951	1,932,259
Contractual services.....	822,760	590,092
Commodities.....	718,902	475,455
Depreciation .....	<u>448,325</u>	<u>436,200</u>
<b>Total Operating Expenses.....</b>	<b><u>4,128,938</u></b>	<b><u>3,434,006</u></b>
<b>Operating Income.....</b>	<b><u>343,273</u></b>	<b><u>759,401</u></b>
<b>Nonoperating Revenue (Expenses)</b>		
Interest income.....	108,724	57,360
Interest expense.....	(20,328)	(30,934)
Amortization.....	(1,532)	(2,574)
Gain (loss) on disposal of assets.....	(23,840)	2,910
Billboard and antenna rent .....	<u>115,875</u>	<u>98,082</u>
<b>Total Nonoperating Revenue .....</b>	<b><u>178,899</u></b>	<b><u>124,844</u></b>
<b>Change in Net Assets Before Contributions and Transfers</b>	<b>522,172</b>	<b>884,245</b>
Capital contributions.....	99,077	198,036
Transfers to City of Waterloo.....	<u>(105,373)</u>	<u>(109,640)</u>
<b>Change in Net Assets.....</b>	<b>515,876</b>	<b>972,641</b>
Net Assets - Beginning of Year .....	<u>19,111,995</u>	<u>18,139,354</u>
<b>Net Assets - End of Year.....</b>	<b><u>\$ 19,627,871</u></b>	<b><u>\$ 19,111,995</u></b>

See accompanying notes to the financial statements.

## Statements of Cash Flows

Years Ended December 31, 2006 and 2005

	2006	2005
<b>Cash Flows From Operating Activities</b>		
Cash received from customers.....	\$ 4,253,536	\$ 3,921,668
Cash collected on behalf of primary government .....	9,701,121	9,711,344
Cash collected on behalf of other governments .....	306,250	314,998
Cash paid to primary government (less 1% collection fee) .....	(9,667,339)	(9,646,468)
Cash paid to other governments (less collection fee).....	(308,214)	(308,922)
Cash paid to or on behalf of employees .....	(2,213,800)	(1,977,969)
Cash paid to suppliers.....	(1,441,170)	(988,501)
<b>Net Cash Provided by Operating Activities .....</b>	<b><u>630,384</u></b>	<b><u>1,026,150</u></b>
<b>Cash Flows From Noncapital Financing Activities</b>		
Billboard and antenna rent .....	<b><u>115,875</u></b>	<b><u>98,082</u></b>
<b>Cash Flows From Capital and Related Financing Activities</b>		
Contributed capital.....	99,077	198,036
Collections on note receivable for water main, including interest (2006 - \$3,786; 2005 - \$3,715) .....	16,788	28,910
Repayments of water revenue capital loan notes.....	(60,000)	(210,000)
Interest paid on water revenue capital loan notes.....	(17,385)	(27,225)
Proceeds from sale of property and equipment.....	—	2,910
Repayments of obligations under capital lease .....	(11,530)	(11,052)
Interest paid on obligations under capital lease .....	(2,020)	(1,500)
Acquisition of capital assets .....	(1,093,905)	(484,850)
Acquisition of plant not in service .....	(401,911)	(396,083)
<b>Net Cash Used in Capital and Related Financing Activities .....</b>	<b><u>(1,470,886)</u></b>	<b><u>(900,854)</u></b>
<b>Cash Flows From Investing Activities</b>		
Proceeds from the sales and maturities of certificates of deposit ...	1,100,000	1,000,000
Purchase of certificates of deposit.....	(850,000)	(1,000,000)
Interest received on savings and certificates of deposits .....	105,108	51,668
<b>Net Cash Provided by Investing Activities.....</b>	<b><u>355,108</u></b>	<b><u>51,668</u></b>
<b>Net Increase (Decrease) in Cash.....</b>	<b><u>(369,519)</u></b>	<b><u>275,046</u></b>
Cash - Beginning of Year .....	<u>1,105,880</u>	<u>830,834</u>
<b>Cash - End of Year.....</b>	<b><u>\$ 736,361</u></b>	<b><u>\$ 1,105,880</u></b>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities</b>		
Operating income .....	\$ 343,273	\$ 759,401
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation .....	448,325	436,200
Water provided to the City of Waterloo, not billed .....	(105,373)	(109,640)
Pipes and valves used in operations.....	218,299	127,469
Change in Assets and Liabilities		
Increase in trade accounts and repair assessments receivable	(15,552)	(89,316)
Increase in prepaid expenses .....	(85,429)	(4,259)
Decrease in accounts payable.....	(32,378)	(46,164)
Increase (decrease) in accrued employee compensation ...	15,697	(9,865)
Decrease in net pension obligation.....	(90,546)	(35,845)
Decrease in customer deposits, due to other governments and liabilities payable from restricted assets	(65,932)	(1,831)
<b>Net Cash Provided by Operating Activities .....</b>	<b><u>\$ 630,384</u></b>	<b><u>\$ 1,026,150</u></b>

See accompanying notes to the financial statements.

# Notes to the Financial Statements

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## (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, 2006 and 2005 was \$434,889 and \$466,727, 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 2006 and 2005 budget and comparison to cash basis activity is as follows:

	2006	2005
<b>Business-Type Activity - Water</b>		
Actual disbursements .....	\$ 5,543,263	\$ 4,425,058
Budgeted disbursements .....	<u>6,320,767</u>	<u>4,444,677</u>
<b>Actual Disbursements Over (Under) Budget .....</b>	<b><u>\$ (777,504)</u></b>	<b><u>\$ (19,619)</u></b>

# Notes to the Financial Statements

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## (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, 2006 and 2005 was \$448,325 and \$436,200, 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 \$25,417 and \$23,885 at December 31, 2006 and 2005, respectively. Amortization of note issue costs for 2006 and 2005 was \$1,532 and \$2,574, 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, 2006 and 2005 was \$12,023 and \$11,100, respectively. Discount amortization for 2006 and 2005, which was added to interest expense, was \$923 and \$1,369, 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, 2006 and 2005 was \$16,952. Amortization of reacquisition costs for 2005, which was added to interest expense was \$840.

#### 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	2006	2005
Interest expense .....	\$ 20,328	\$ 30,934
Less noncash amortization of water revenue capital loan notes discount and reacquisition costs .....	(923)	(2,209)
<b>Cash Paid for Interest .....</b>	<b><u>\$ 19,405</u></b>	<b><u>\$ 28,725</u></b>
Total purchases of plant not in service .....	\$ 392,682	\$ 397,258
Less increase in plant not in service.....	(88,632)	(67,722)
Less plant not in service used in operations.....	(218,299)	(127,469)
<b>Increase in Construction in Progress and Capital Assets in Service From Noncash Transfers of Plant Not in Service.....</b>	<b><u>\$ 85,751</u></b>	<b><u>\$ 202,067</u></b>
Cost of capital asset acquisitions .....	\$ 1,126,280	\$ 490,981
Amounts Payable		
Current year .....	(40,606)	(8,231)
Prior year .....	8,231	2,100
<b>Cash Paid for Acquisition of Capital Assets.....</b>	<b><u>\$ 1,093,905</u></b>	<b><u>\$ 484,850</u></b>
<b>Loss on Disposal of Assets.....</b>	<b><u>\$ 23,840</u></b>	<b><u>\$ —</u></b>

### (3) Deposits and Investments

The Utility's deposits in banks and credit unions at December 31, 2006 and 2005 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 4.33% to 5.5%. 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, 2006 and 2005 was as follows:

	Restricted Asset	Corresponding Liability	Restricted Net Assets
<b>2006</b>			
Customer deposits.....	\$ 113,271	\$ 113,271	\$ —
Capital Loan Note Covenants			
Debt reserve .....	70,000	—	70,000
Debt capital improvement reserve .....	<u>200,000</u>	<u>—</u>	<u>200,000</u>
<b>Total .....</b>	<b><u>\$ 383,271</u></b>	<b><u>\$ 113,271</u></b>	<b><u>\$ 270,000</u></b>
<b>2005</b>			
Customer deposits.....	\$ 113,344	\$ 113,344	\$ —
Capital Loan Note Covenants			
Debt reserve .....	70,000	—	70,000
Debt capital improvement reserve .....	<u>200,000</u>	<u>—</u>	<u>200,000</u>
<b>Total .....</b>	<b><u>\$ 383,344</u></b>	<b><u>\$ 113,344</u></b>	<b><u>\$ 270,000</u></b>

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, 2005.....	\$ —
Monthly allocations during 2005 .....	237,225
Interest payments made .....	(27,225)
Principal payments made .....	<u>(210,000)</u>
Balance, December 31, 2005 .....	—
Monthly allocations during 2006 .....	77,385
Interest payments made .....	(17,385)
Principal payments made .....	<u>(60,000)</u>
<b>Balance, December 31, 2006 .....</b>	<b><u>\$ —</u></b>

## 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 \$2,104 and \$2,471 at December 31, 2006 and 2005, respectively. There were 22 and 24 individual notes outstanding at December 31, 2006 and 2005, respectively.

### (6) Capital Assets

Capital asset activity for the years ended December 31, 2006 and 2005 was as follows:

	Balance			Balance			Balance
	12-31-04	Increase	Decrease	12-31-05	Increase	Decrease	12-31-06
Capital Assets Not Being Depreciated							
Land.....	\$ 231,156	\$ —	\$ —	\$ 231,156	\$ —	\$ —	\$ 231,156
Pipes and valves.....	275,732	67,722	—	343,454	88,632	—	432,086
Construction in progress.....	—	301,188	—	301,188	508,952	—	810,140
Total Capital Assets Not Being Depreciated.....	506,888	368,910	—	875,798	597,584	—	1,473,382
Capital Assets Being Depreciated							
Buildings and improvements.	1,706,706	1,955	—	1,708,661	979	(52,659)	1,656,981
Water supply system.....	3,682,347	—	—	3,682,347	12,389	(2,185)	3,692,551
Distribution system .....	14,191,228	333,129	—	14,524,357	610,064	—	15,134,421
Meters and equipment .....	1,482,681	—	—	1,482,681	1,625	(37,293)	1,447,013
Machinery and equipment.....	1,694,087	58,876	(25,286)	1,727,677	78,018	(170,687)	1,635,008
Total Capital Assets Being Depreciated.....	22,757,049	393,960	(25,286)	23,125,723	703,075	(262,824)	23,565,974
Less Accumulated Depreciation for							
Buildings and improvements	(576,247)	(26,489)	—	(602,736)	(24,756)	49,609	(577,883)
Water supply system.....	(1,902,364)	(74,572)	—	(1,976,936)	(73,999)	1,943	(2,048,992)
Distribution system .....	(1,962,439)	(228,836)	—	(2,191,275)	(232,348)	—	(2,423,623)
Meters and equipment .....	(566,582)	(35,288)	—	(601,870)	(34,800)	35,914	(600,756)
Machinery and equipment.....	(922,692)	(71,015)	25,286	(968,421)	(82,422)	151,522	(899,321)
Total Accumulated Depreciation .....	(5,930,324)	(436,200)	25,286	(6,341,238)	(448,325)	238,988	(6,550,575)
Net Capital Assets Being Depreciated.....							
	16,826,725	(42,240)	—	16,784,485	254,750	(23,836)	17,015,399
<b>Net Capital Assets .....</b>	<b>\$ 17,333,613</b>	<b>\$ 326,670</b>	<b>\$ —</b>	<b>\$ 17,660,283</b>	<b>\$ 852,334</b>	<b>\$ (23,836)</b>	<b>\$ 18,488,781</b>

## Notes to the Financial Statements

### (7) Summary of Debt

	<u>Current Portion</u>		<u>Long-Term Portion</u>	
	2006	2005	2006	2005
<b>Water Revenue Capital Loan Notes</b>				
Series 2001 capital loan notes, Wells Fargo Bank Iowa, N.A. - paying and registered agent, due in annual payments ranging from \$65,000 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.	\$ 65,000	\$ 60,000	\$ 225,000	\$ 290,000
Less unamortized discount	<u>—</u>	<u>—</u>	<u>(1,977)</u>	<u>(2,900)</u>
<b>Total</b>	<b><u>\$ 65,000</u></b>	<b><u>\$ 60,000</u></b>	<b><u>\$ 223,023</u></b>	<b><u>\$ 287,100</u></b>

### 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>\$ 12,031</u>	<u>\$ 23,561</u>
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The Water Works paid the lease payment due in January, 2007 at the end of 2006. Accordingly, there is no current maturity of obligations under capital lease.

Interest expense for 2006 and 2005 includes \$17,385 and \$27,225 on the notes plus \$923 and \$2,209, respectively, for amortization. Interest expense for 2006 and 2005 also includes \$2,020 and \$2,499, respectively, incurred under capital lease obligations.

At December 31, 2006 annual maturities of long-term debt were as follows:

	Principal	Interest	Total
<b>Year Ending December 31,</b>			
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>
	<b><u>\$ 290,000</u></b>	<b><u>\$ 37,615</u></b>	<b><u>\$ 327,615</u></b>

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 2006 and 2005, the Utility was in compliance with required covenants.

## Notes to the Financial Statements

### (7) Summary of Debt

The following is a summary of the changes in debt for the years ended December 31, 2006 and 2005:

	<b>Water Revenue Capital Loan Notes</b>	<b>Obligations Under Capital Lease</b>
Balance - December 31, 2004.....	\$ 560,000	\$ 34,613
Retirements .....	<u>(210,000)</u>	<u>(11,052)</u>
Balance - December 31, 2005.....	350,000	23,561
Retirements .....	<u>(60,000)</u>	<u>(11,530)</u>
<b>Balance - December 31, 2006 .....</b>	<b><u>\$ 290,000</u></b>	<b><u>\$ 12,031</u></b>

### (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:

<b>Class of Property</b>	<b>Asset Balance</b>
Machinery and equipment .....	\$ 64,925
Less accumulated amortization .....	<u>(13,346)</u>
	<b><u>\$ 51,579</u></b>

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

<b>Year Ending December 31,</b> 2008.....	\$ 12,551
Less amount representing interest .....	<u>(520)</u>
<b>Present Value of Net Minimum Lease Payments.....</b>	<b><u>\$ 12,031</u></b>

### (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, 2006 and 2005, \$46,029 and \$40,754, 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.

## Notes to the Financial Statements

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### **(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 2006 and 2005, the Utility recorded \$97,017 and \$96,759, respectively, as City service fees and forwarded approximately \$9,667,000 and \$9,646,000, respectively, to the City. At December 31, 2006, the Utility's payables to the City were \$286,929 and \$529,235 for garbage and sewer collections, respectively, compared to \$308,163 and \$571,236, respectively, at December 31, 2005, 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 2006 and 2005, the Utility received approximately \$49,000 and \$47,000, 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, 2006 and 2005, the Utility provided metered water to the City valued at approximately \$105,300 and \$109,600, 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 2006 and 2005 was \$280,000 and \$110,000, respectively.

At December 31, 2006, the Utility reported prepaid pension expense of \$84,001 for the amount of the 2006 contribution in excess of the cumulative required minimum contribution. At December 31, 2005, the Utility reported a pension liability of \$90,546 for the difference between the 2005 pension contribution and the cumulative required minimum contribution.

#### **Annual Pension Cost and Net Pension Obligation**

The annual pension cost for 2006 was determined as part of the actuarial valuation using the January 1, 2006 aggregate actuarial method. This method does not identify or separately amortize unfunded actuarial accrued liabilities. The actuarial assumptions for 2005 and 2004 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, 2006 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.

## Notes to the Financial Statements

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### (11) Retirement Plan

#### Three-Year Trend Information

Year Ended	Annual Pension Cost (APC)			Percentage of APC Contributed	Net Pension Obligation (Asset)
	Normal Cost	Interest	Total		
December 31, 2004 .....	\$58,945	\$13,066	\$72,011	69%	\$126,391
December 31, 2005 .....	59,300	14,855	74,155	148%	90,546
December 31, 2006 .....	90,935	14,518	105,453	267%	(84,001)

### (12) Risk Management

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

### (13) Commitments and Subsequent Event

During 2006, the Utility approved contracts for capital asset improvements totaling approximately \$1.4 million which had not been completed by December 31, 2006. As of December 31, 2006, the Utility had incurred costs of approximately \$807,000 related to these contracts.

In February, 2007, the Utility refunded the 2001 capital loan notes and issued \$3.3 million of water revenue capital loan notes to pay for the costs of constructing water main extensions and other improvements to the Utility system, the construction of test wells for possible water supply expansion and the completion of a master plan system-wide analysis.

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

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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, 2006, and have issued our report thereon dated April 25, 2007. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Utility's internal control. Accordingly, we do not express an opinion on the effectiveness of the Utility's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Utility's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Utility's financial statements that is more than inconsequential will not be prevented or detected by the Utility's internal control.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Utility's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

### **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*.

Steven K. Duggan    Dennis E. Hogan  
Anne M. Halbmaier    Stephen J. Kos    Dale E. Minor    Lisa M. Wall    Susan M. Wilson    Karilyn A. Wood

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The following comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes. Prior year findings relative to statutory or other legal matters have been resolved.

- 06-CS-1 Budget** - Operating cash disbursements during the year ended December 31, 2006 did not exceed the amounts budgeted.
- 06-CS-2 Questionable Disbursements** - We noted no disbursements that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- 06-CS-3 Travel Expense** - No disbursements of the Utility's money for travel expenses of spouses of the Utility officials or employees was noted.
- 06-CS-4 Business Transactions** - No business transactions between the Utility's officials or employees and the Utility were noted.
- 06-CS-5 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.
- 06-CS-6 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.
- 06-CS-7 Water Revenue Capital Loan Notes** - No violations of water revenue capital loan note covenants were noted.
- 06-CS-8 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.

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  
April 25, 2007