WATERLOO WATER WORKS

WATERLOO, IOWA

DECEMBER 31, 2009

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Officials

Name	Title	Term Expires
Craig Caslavka	Chairman - Board of Trustees	January 12, 2010
Terry Kuntz	Vice-Chairman - Board of Trustees	January 12, 2012
Rodger Burris	Trustee	January 12, 2014
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, 2009

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, 2009. 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 $21.9 million at December 31, 2009. Of this amount, approximately $3.7 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 $1,303,470 and $774,369 for the years ended December 31, 2009 and 2008, respectively.

- At December 31, 2009, the Utility's unrestricted cash, certificates of deposits, trade receivables and prepaid expenses of approximately $4.9 million exceeded total current liabilities by approximately $3.5 million. This excess is available for spending at the Utility's discretion.

- The Utility has capital loan notes outstanding of $2,435,000 at December 31, 2009 which are reported net of unamortized discounts costs of $19,176.

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 11 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 12 through 20 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 $21.9 million and $20.6 million on December 31, 2009 and 2008, respectively.

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

	2009	**2008**
Current assets	$ 4,876,750	$ 3,780,844
Noncurrent, noncapital assets	730,920	1,289,302
Capital assets, net of accumulated depreciation	19,897,372	19,562,048
Total Assets	**25,505,042**	**24,632,194**
Current liabilities	1,421,550	1,463,442
Liabilities payable from restricted assets	123,386	120,194
Other long-term liabilities (net)	2,105,824	2,412,628
Total Liabilities	**3,650,760**	**3,996,264**
Net Assets		
Invested in capital assets, net of related debt	17,792,373	17,750,338
Restricted for debt service	330,000	918,291
Unrestricted	3,731,909	1,967,301
Total Net Assets	**$ 21,854,282**	**$ 20,635,930**

Net assets invested in capital assets are by far the largest portion of the Utility's net assets, 81% at December 31, 2009, 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, 2009 and 2008, 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:

	2009	2008
Operating revenue	$ 6,384,705	$ 5,519,247
Operating expenses	5,081,235	4,744,878
Operating Income	1,303,470	774,369
Net nonoperating revenue	56,301	69,465
Capital contributions	27,821	25,572
Transfers to City of Waterloo	(169,240)	(130,594)
Change in Net Assets	1,218,352	738,812
Net Assets - Beginning of Year	20,635,930	19,897,118
Net Assets - End of Year	**$ 21,854,282**	**$ 20,635,930**

Operating revenue is the Utility's primary source of revenue and is generated from water sales and other services to customers. For 2009, operating revenue increased $865,458 from 2008 due primarily to an increase in water rates.

Operating expenses totaled $5,081,235 for 2009, a $336,357 increase from 2008 due primarily to increases in wages, pension and other employee benefit costs and commodity costs. These expenses represent the Utility's costs to provide water and services to customers. Operating expenses included depreciation expense of $493,497 and $464,953 for the years ended December 31, 2009 and 2008, 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 decreased by $13,164 between 2009 and 2008. Rent income totaled $117,305 and $114,884 for the years ended December 31, 2009 and 2008, respectively.

Capital contributions totaled $27,821 and $25,572 for the years ended December 31, 2009 and 2008, 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 $169,240 and $130,594 for the years ended December 31, 2009 and 2008, 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, 2009 or 2008.

Actual cash receipts were approximately $56,000 greater than budgeted. The majority of this variance was due to receipts over budget for miscellaneous sales and services and "front footage" fees.

Actual cash disbursements were approximately $2.8 million less than budgeted due to lower than anticipated capital expenses, pumping and distribution expenses.

Capital Assets and Long-term Debt

The Utility's investment in capital assets amounted to approximately $19.9 million and $19.6 million at December 31, 2009 and 2008, respectively, (net of accumulated depreciation of approximately $7.9 million and $7.4 million at December 31, 2009 and 2008, 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 2009 included the following:

- Installation of 1.38 miles of water mains.
- Purchase of one vehicle.
- Updated computers, printers/scanner, software and street department equipment.
- Completion of Rainbow Drive 2008 Project, Water Main Extension Project and Linden Avenue Water Tower Rehabilitation Project.
- Electrical work in the garage.

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

	2009	2008
Land	$ 270,896	$ 270,896
Pipes and valves	605,022	666,005
Buildings and improvements	1,750,597	1,720,430
Water supply system	4,337,390	3,692,551
Distribution system	17,526,315	17,233,068
Meters and equipment	1,472,263	1,472,263
Machinery and equipment	1,753,260	1,699,866
Construction in progress	98,286	230,129
Total	**$ 27,814,029**	**$ 26,985,208**

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

At December 31, 2008, total Utility long-term debt was $2,730,000 less unamortized discounts of $22,372 for a net long-term debt of $2,707,628. Principal of $295,000 and interest of $105,500 was due during the year ending December 31, 2009. At December 31, 2009, total Utility long-term debt was $2,435,000 less unamortized discounts of $19,176 for a net long-term debt of $2,415,824. Principal of $310,000 and interest of $94,438 is due during the year ending December 31, 2010.

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 2009 and 2008, 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. Effective January 1, 2010, water meter minimum charges increased 10% and rate blocks increased approximately 10 cents per hundred cubic feet of water. Budgeted revenue has been adjusted to reflect the increase in rates.

Operating expense for 2010 is expected to increase over the same expenditures in 2009 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 repair the University Avenue water tower, continue work on the Shaulis Road and Mark's Park/US Bank Main Extension Projects, replace the Third Street River Crossing, test well development and land acquisition, continue implementation of GIS mapping and software systems and complete miscellaneous main replacement projects, all at an estimated cost of $3,376,000.

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Certified Public Accountants and Consultants

Independent Auditor's Report

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the accompanying balance sheets of the Waterloo Water Works, a component unit of the City of Waterloo, Iowa, at December 31, 2009 and 2008, 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, 2009 and 2008, 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 March 25, 2010 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 and the Schedule of Funding Progress on Pages 2 through 6 and 21 are not a required parts of the basic financial statements but are 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
March 25, 2010

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Balance Sheets

At December 31, 2009 and 2008

	2009	2008
Assets		
Current Assets		
Cash and cash equivalents	$ 3,114,479	$ 2,368,213
Certificates of deposit	560,000	360,000
Receivables		
Trade accounts	1,130,829	955,881
Accrued interest	3,500	8,191
Notes	8,781	8,722
Prepaid expenses	59,161	79,837
Total Current Assets	**4,876,750**	**3,780,844**
Noncurrent Assets		
Restricted cash and cash equivalents	—	588,291
Restricted certificates of deposit	460,000	460,000
Unamortized capital loan notes issuance costs	15,776	18,405
Notes receivable - long-term portion	7,717	17,366
Repair assessments receivable	247,427	205,240
Subtotal	**730,920**	**1,289,302**
Capital Assets		
Land	270,896	270,896
Pipes and valves	605,022	666,005
Buildings and improvements	1,750,597	1,720,430
Water supply system	4,337,390	3,692,551
Distribution system	17,526,315	17,233,068
Meters and equipment	1,472,263	1,472,263
Machinery and equipment	1,753,260	1,699,866
Construction in progress	98,286	230,129
Total Capital Assets	27,814,029	26,985,208
Less accumulated depreciation	(7,916,657)	(7,423,160)
Net Capital Assets	**19,897,372**	**19,562,048**
Total Noncurrent Assets	**20,628,292**	**20,851,350**
Total Assets	**$ 25,505,042**	**$ 24,632,194**

See accompanying notes to the financial statements.

	2009	2008
Liabilities and Net Assets		
Current Liabilities		
Current maturities of water revenue capital loan notes	$ 310,000	$ 295,000
Accounts payable	102,264	110,034
Accrued employee compensation	73,444	62,687
Customer deposits	29,565	51,356
Due to Other Governments		
City of Waterloo		
Garbage fees	307,670	320,140
Sewer fees	540,075	566,920
City of Raymond	11,389	10,793
Black Hawk County	47,143	46,512
Total Current Liabilities	**1,421,550**	**1,463,442**
Liabilities Payable From Restricted Assets	**123,386**	**120,194**
Water Revenue Capital Loan Notes	**2,105,824**	**2,412,628**
Total Liabilities	**3,650,760**	**3,996,264**
Net Assets		
Invested in capital assets, net of related debt	17,792,373	17,750,338
Restricted for debt service	330,000	918,291
Unrestricted	3,731,909	1,967,301
Total Net Assets	**21,854,282**	**20,635,930**
Total Liabilities and Net Assets	**$ 25,505,042**	**$ 24,632,194**

Statements of Revenue, Expenses and Changes in Net Assets

Years Ended December 31, 2009 and 2008

	2009	2008
Operating Revenue		
Water sales	$ 5,631,408	$ 4,765,783
Metered water provided to the City of Waterloo	169,240	130,594
Fire protection	88,278	83,475
Billing and collection fees	103,269	99,325
Other sales and service	392,510	440,070
Total Operating Revenue	**6,384,705**	**5,519,247**
Operating Expenses		
Salaries and benefits	2,793,683	2,554,122
Contractual services	753,170	773,254
Commodities	1,040,885	952,549
Depreciation	493,497	464,953
Total Operating Expenses	**5,081,235**	**4,744,878**
Operating Income	**1,303,470**	**774,369**
Nonoperating Revenue (Expenses)		
Interest income	50,321	81,156
Interest expense	(108,696)	(121,297)
Amortization	(2,629)	(4,320)
Loss on disposal of assets	—	(958)
Billboard and antenna rent	117,305	114,884
Total Nonoperating Revenue	**56,301**	**69,465**
Change in Net Assets Before Contributions and Transfers	**1,359,771**	**843,834**
Capital contributions	27,821	25,572
Transfers to City of Waterloo	(169,240)	(130,594)
Change in Net Assets	**1,218,352**	**738,812**
Net Assets - Beginning of Year	20,635,930	19,897,118
Net Assets - End of Year	**$ 21,854,282**	**$ 20,635,930**

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2009 and 2008

	2009	2008
Cash Flows From Operating Activities		
Cash received from customers	$ 5,879,982	$ 5,265,911
Cash collected on behalf of primary government	9,682,255	9,644,597
Cash collected on behalf of other governments	366,979	348,428
Cash paid to primary government (less 1% collection fee)	(9,625,013)	(9,547,127)
Cash paid to other governments (less collection fee)	(365,752)	(343,150)
Cash paid to or on behalf of employees	(2,764,386)	(2,636,063)
Cash paid to suppliers	(1,532,092)	(1,463,788)
Net Cash Provided by Operating Activities	**1,641,973**	**1,268,808**
Cash Flows From Noncapital Financing Activities		
Billboard and antenna rent	**117,305**	**114,884**
Cash Flows From Capital and Related Financing Activities		
Contributed capital	27,821	25,572
Collections on note receivable for water main, including interest (2009 - $1,230; 2008 - $1,789)	10,820	11,735
Repayments of water revenue capital loan notes	(295,000)	(285,000)
Interest paid on water revenue capital loan notes	(105,500)	(116,045)
Acquisition of capital assets	(889,804)	(606,574)
Acquisition of plant not in service	(203,422)	(345,956)
Net Cash Used in Capital and Related Financing Activities	**(1,455,085)**	**(1,316,268)**
Cash Flows From Investing Activities		
Proceeds from the sales and maturities of certificates of deposit	610,000	340,000
Purchase of certificates of deposit	(810,000)	(340,000)
Interest received on savings and certificates of deposits	53,782	79,367
Net Cash Provided by (Used in) Investing Activities	**(146,218)**	**79,367**
Net Increase in Cash	**157,975**	**146,791**
Cash and Cash Equivalents - Beginning of Year	2,956,504	2,809,713
Cash and Cash Equivalents- End of Year	**$ 3,114,479**	**$ 2,956,504**
Reconciliation of Cash to Specific Assets Included in the Balance Sheet		
Cash and cash equivalents	$ 3,114,479	$ 2,368,213
Restricted cash and cash equivalents	—	588,291
	$ 3,114,479	**$ 2,956,504**

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2009 and 2008

	2009	2008
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	$ 1,303,470	$ 774,369
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	493,497	464,953
Water provided to the City of Waterloo, not billed	(169,240)	(130,594)
Pipes and values used in operations	264,405	232,506
Change in Assets and Liabilities		
Increase in trade accounts and repair assessments receivable	(217,135)	(125,455)
(Increase) decrease in prepaid expenses	2,136	(29,653)
(Increase) decrease in prepaid pension	18,540	(18,540)
Increase (decrease) in accounts payable	(7,770)	48,160
Increase (decrease) in accrued employee compensation	10,757	(59,152)
Decrease in net pension obligation	—	(4,249)
Increase (decrease) in customer deposits, due to other governments and liabilities payable from restricted assets	(56,687)	116,463
Net Cash Provided by Operating Activities	**$ 1,641,973**	**$ 1,268,808**

See accompanying notes to the financial statements.

(1) Summary of Significant Accounting Policies and Other Matters

Reporting Entity

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

Measurement Focus and Basis of Accounting

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

Use of Estimates

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

Cash, Cash Equivalents 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. The Utility also has deposits in Iowa Public Agency Investment Trust money market accounts.

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, 2009 and 2008 was $621,750 and $552,551, 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 2009 and 2008 budget and comparison to cash basis activity is as follows:

	2009	2008
Business-Type Activity - Water		
Actual disbursements	$ 6,089,613	$ 5,683,363
Budgeted disbursements	8,893,027	7,736,246
Actual Disbursements Under Budget	**$ (2,803,414)**	**$ (2,052,883)**

(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	10 - 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, 2009 and 2008 was $493,497 and $464,953, 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 2007 water revenue capital loan notes of $27,060 are amortized using the effective interest method over the 11-year life of the notes. Amortization expense totaled $2,629 and $4,320 for the years ended December 31, 2009 and 2008, respectively.

Discount on Water Revenue Capital Loan Notes

Original discount on the 2007 water revenue capital loan notes of $32,894 is amortized using the effective interest method over the 11-year life of the notes. Discount amortization, which is included in interest expense, totaled $3,196 and $5,252 for the years ended December 31, 2009 and 2008, respectively.

Cash and Cash Equivalents

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

(2) Cash Flow Statement Supplementary Information

	2009	2008
Schedule of Noncash Investing and Financing Activities		
Interest expense	$ 108,696	$ 121,297
Less noncash amortization of water revenue capital loan notes discount	(3,196)	(5,252)
Cash Paid for Interest	**$ 105,500**	**$ 116,045**
Total purchases of plant not in service	$ 203,422	$ 345,956
Plus decrease in plant not in service	60,983	—
Less increase in plant not in service	—	(113,450)
Less plant not in service used in operations	(264,405)	(232,506)
Increase in Construction in Progress and Capital Assets in Service From Noncash Transfers of Plant Not in Service	**$ —**	**$ —**
Loss on Disposal of Assets	**$ —**	**$ 958**

(3) Deposits and Investments

The Utility's deposits in banks and credit unions at December 31, 2009 and 2008 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.

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 12 to 27 months and yields of 1.675% to 4.87%. Certain certificates of deposit are restricted to comply with debt covenants and to secure customer deposits.

The Utility's deposits in the Iowa Public Agency Investment Trust were valued at an amortized cost of $1,525,020, pursuant to Rule 2a-7 under the Investment Company Act of 1940. The deposits in the Iowa Public Agency Investment Trust are unrated for credit risk purposes.

(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, 2009 and 2008 was as follows:

	Restricted Asset	Corresponding Liability	Restricted Net Assets
2009			
Customer deposits	$ 123,386	$ 123,386	$ —
Capital Loan Note Covenants			
Debt reserve	330,000	—	330,000
Total	**$ 453,386**	**$ 123,386**	**$ 330,000**
2008			
Customer deposits	$ 120,194	$ 120,194	$ —
Capital Loan Note Covenants			
Debt reserve	330,000	—	330,000
Debt capital improvement reserve	588,291	—	588,291
Total	**$ 1,038,485**	**$ 120,194**	**$ 918,291**

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, 2008	$ —
Monthly allocations during 2008	401,045
Interest payments made	(116,045)
Principal payments made	(285,000)
Balance - December 31, 2008	—
Monthly allocations during 2009	400,500
Interest payments made	(105,500)
Principal payments made	(295,000)
Balance - December 31, 2009	**$ —**

(5) Notes Receivable

As part of a water main extension project which was completed in October, 1996, 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 $868 and $1,304 at December 31, 2009 and 2008, respectively. There were 19 and 20 individual notes outstanding at December 31, 2009 and 2008, respectively.

(6) Capital Assets

Capital asset activity for the years ended December 31, 2009 and 2008 was as follows:

	Balance 12-31-07	Increase	Decrease	Balance 12-31-08	Increase	Decrease	Balance 12-31-09
Capital Assets Not Being Depreciated							
Land	$ 231,156	$ 39,740	$ —	$ 270,896	$ —	$ —	$ 270,896
Pipes and valves	552,557	113,448	—	666,005	—	60,983	605,022
Construction in progress	1,604,192	459,447	1,833,510	230,129	800,702	932,545	98,286
Total Capital Assets Not Being Depreciated	2,387,905	612,635	1,833,510	1,167,030	800,702	993,528	974,204
Capital Assets Being Depreciated							
Buildings and improvements	1,661,896	58,534	—	1,720,430	30,167	—	1,750,597
Water supply system	3,692,551	—	—	3,692,551	644,839	—	4,337,390
Distribution system	15,411,191	1,821,877	—	17,233,068	293,247	—	17,526,315
Meters and equipment	1,460,043	12,220	—	1,472,263	—	—	1,472,263
Machinery and equipment	1,682,754	48,265	31,153	1,699,866	53,394	—	1,753,260
Total Capital Assets Being Depreciated	23,908,435	1,940,896	31,153	25,818,178	1,021,647	—	26,839,825
Less Accumulated Depreciation for							
Buildings and improvements	(599,499)	(22,341)	—	(621,840)	(25,324)	—	(647,164)
Water supply system	(2,123,407)	(74,415)	—	(2,197,822)	(85,524)	—	(2,283,346)
Distribution system	(2,661,618)	(245,902)	—	(2,907,520)	(258,585)	—	(3,166,105)
Meters and equipment	(634,626)	(38,182)	—	(672,808)	(38,034)	—	(710,842)
Machinery and equipment	(969,255)	(84,110)	30,195	(1,023,170)	(86,030)	—	(1,109,200)
Total Accumulated Depreciation	(6,988,405)	(464,950)	30,195	(7,423,160)	(493,497)	—	(7,916,657)
Net Capital Assets Being Depreciated	16,920,030	1,475,946	958	18,395,018	528,150	—	18,923,168
Net Capital Assets	**$ 19,307,935**	**$ 2,088,581**	**$ 1,834,468**	**$ 19,562,048**	**$ 1,328,852**	**$ 993,528**	**$ 19,897,372**

(7) Summary of Debt

	Current Portion		Long-Term Portion	
	2009	2008	2009	2008
Water Revenue Capital Loan Notes				
Series 2007 capital loan notes, Bankers Trust Company, N.A. - paying and registered agent, due in annual payments ranging from $310,000 to $390,000 through December, 2016, plus interest semi-annually at rates ranging from 3.75% to 4%, depending on maturity, secured by first lien on net revenue.	$ 310,000	$ 295,000	$ 2,125,000	$ 2,435,000
Less unamortized discount	—	—	(19,176)	(22,372)
Total	**$ 310,000**	**$ 295,000**	**$ 2,105,824**	**$ 2,412,628**

(7) Summary of Debt

The Water Works has pledged future gross revenue, net of specified operating expenses to repay $3,300,000 in water revenue capital loan notes issued in February, 2007. Proceeds from the notes provided for refunding of Series 2001 capital loan notes and costs of water main extensions and other improvements. The notes are payable solely from net revenue of the system and restricted cash held in the debt reserve account. Annual principal and interest payments are expected to be less than 80% of net revenue. The total principal and interest remaining to be paid is $2,831,665. For the current year, principal and interest paid and net revenue of the system were $400,500 and $1,961,964, respectively.

Interest expense for 2009 and 2008 includes $105,500 and $116,045 on the notes plus $3,196 and $5,252, respectively, for amortization.

At December 31, 2009 annual maturities of long-term debt were as follows:

	Principal	Interest	Total
Year Ending December 31,			
2010	$ 310,000	$ 94,438	$ 404,438
2011	320,000	82,812	402,812
2012	335,000	70,652	405,652
2013	345,000	57,923	402,923
2014	360,000	44,640	404,640
2015-16	765,000	46,200	811,200
	$ 2,435,000	**$ 396,665**	**$ 2,831,665**

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 2009 and 2008, the Utility was in compliance with required covenants

The following is a summary of the changes in debt for the years ended December 31, 2009 and 2008:

	Water Revenue Capital Loan Notes
Balance - January 1, 2008	$ 3,015,000
Retirements	(285,000)
Balance - December 31, 2008	2,730,000
Retirements	(295,000)
Balance - December 31, 2009	**$ 2,435,000**

(8) Compensated Absences

The Utility's employees accumulate vacation days during the year based on the anniversary date of their employment. As of December 31, 2009 and 2008, $40,579 and $38,411, 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.

(9) 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 2009 and 2008, the Utility recorded $96,557 and $95,772, respectively, as City service fees and forwarded approximately $9,625,000 and $9,547,000, respectively, to the City. At December 31, 2009, the Utility's payables to the City were $307,670 and $540,075 for garbage and sewer collections, respectively, compared to $320,140 and $566,920, respectively, at December 31, 2008, 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 2009 and 2008, the Utility received approximately $54,000 and $53,000, 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, 2009 and 2008, the Utility provided metered water to the City valued at approximately $169,200 and $130,500, respectively.

(10) Pension 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.

(10) Pension Plan

Annual Pension Cost and Net Pension Obligation

The Utility's annual pension cost and net pension (asset) obligation to the Plan for the year ended December 31, 2009:

Annual required contribution (ARC)	$ 369,877
Interest on net pension obligation	28,107
Annual Pension Cost	397,984
Contributions made	(379,444)
Decrease in Net Pension Asset	18,540
Net pension asset - beginning of year	(18,540)
Net Pension Obligation - End of Year	**$ —**

The annual pension cost for 2009 was determined as part of the actuarial valuation using the January 1, 2009 aggregate actuarial method. This method does not identify or separately amortize unfunded actuarial accrued liabilities. The actuarial assumptions for 2008 and 2007 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, 2009 assumes retirement at age 62 with 30 years of service. The assumptions did not include any postretirement benefits. The actuarial value of assets was determined using the current market value of investments

Three-Year Trend Information

	Annual Pension Cost (APC)			Percentage	Net Pension
Year Ended	**Normal Cost**	**Interest**	**Total**	**of APC Contributed**	**Obligation (Asset)**
December 31, 2007	$287,009	$16,241	$303,250	71%	$ 4,249
December 31, 2008	256,362	20,849	277,211	108%	(18,540)
December 31, 2009	369,877	28,107	397,984	95%	—

(11) Health Insurance

The Waterloo Water Works implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (OPEB) during the year ended December 31, 2008.

The Utility operates a single-employer retiree benefit plan which provides medical/prescription drug and dental benefits for retirees and their spouses. There are 36 active and no retired members in the plan at December 31, 2009.

Retirees under age 65 pay the same premium for the medical/prescription drug benefit as active employees, which results in an implicit subsidy, although management has determined any OPEB obligation would be immaterial to the financial statements.

(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) Subsequent Events

Management has evaluated subsequent events through March 25, 2010, the date which the financial statements were available to be issued.

Subsequent to December 31, 2009, the Utility entered into agreements to construct capital improvements. These agreements totaled approximately $1 million.

Subsequent to December 31, 2009, the Utility approved a pension contribution of $379,000 for 2010.

Required Supplementary Information

Schedule of Funding Progress

Year Ended December 31

Year Ended	Actuarial Valuation Date	Actuarial Value of Net Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2009	1/1/09	$3,527,489	$6,329,986	$2,802,497	55.7%	$1,374,782	203.9%
2008	1/1/08	3,881,341	5,998,293	2,116,952	64.7	1,356,797	156.0

The information presented in the required supplementary schedule was determined as part of the actuarial valuation as of January 1, 2009. Additional information follows:

1. The cost method used to determine the ARC is the Projected Unit Credit Actuarial Cost method.

2. Economic assumptions are as follows: 8% investment rate of return (net of administrative expenses); projected salary increases of 3% per year; compounded annually; and retirement at age 62.

3. The amortization method is closed, level dollar.

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

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the financial statements of the Waterloo Water Works as of and for the year ended December 31, 2009, and have issued our report thereon dated March 25, 2010. 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*.

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The following comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2009 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.

09-CS-1 **Budget** - Operating cash disbursements during the year ended December 31, 2009 did not exceed the amounts budgeted.

09-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.

09-CS-3 **Travel Expense** - No disbursements of the Utility's money for travel expenses of spouses of the Utility officials or employees was noted.

09-CS-4 **Business Transactions** - No business transactions between the Utility's officials or employees and the Utility were noted.

09-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.

09-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.

09-CS-7 **Water Revenue Capital Loan Notes** - No violations of water revenue capital loan note covenants were noted.

09-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
March 25, 2010