

Des Moines Water Works

Financial and Compliance Report
December 31, 2010

Contents

Independent Auditor's Report	1
Management's discussion and analysis	2 – 7
Basic financial statements	
Balance sheet	8 – 9
Statement of revenues, expenses and changes in net assets	10
Statement of cash flows	11 – 12
Statement of plan net assets	13
Statement of changes in plan net assets	14
Notes to basic financial statements	15 – 30
Required supplementary information	
Other postemployment benefit plan	31
Schedule of funding progress	32
Schedule of contributions from the employer	33
Note to required supplementary information	34
Compliance Section	
Schedule of expenditures of federal awards	35
Notes to schedule of expenditures of federal awards	36
Summary schedule of prior audit findings	37
Independent auditor's report on internal control over financial reporting and on compliance and other matters based on an audit of financial statements performed in accordance with <i>Government Auditing Standards</i>	38
Independent auditor's report on compliance with requirements that could have a direct and material effect on each major program and on internal control over compliance in accordance with OMB Circular A-133	39 – 40
Schedule of findings and questioned costs	41 – 42
Corrective action plan	43



Independent Auditor's Report

Board of Water Works Trustees
Des Moines Water Works
Des Moines, Iowa

We have audited the accompanying basic financial statements of Des Moines Water Works (Water Works) as of and for the year ended December 31, 2010, as listed in the table of contents. These financial statements are the responsibility of the Des Moines Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The pension trust fund statement of net assets and statement of changes in plan net assets were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 Des Moines Water Works as of December 31, 2010 and the changes in its financial position and its cash flows for the year 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 reports for the year ended December 31, 2010 dated June 21, 2011 on our consideration of Water Work's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of those reports are 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. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The Management's Discussion and Analysis on pages 2 through 7, other postemployment benefit plan schedule on page 31 and pension plan schedules on pages 32 through 34 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Water Work's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Nonprofit Organizations, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

McGladrey & Pullen, LLP

Davenport, Iowa
June 21, 2011

Des Moines Water Works

Management's Discussion and Analysis Year Ended December 31, 2010

Our Management's Discussion and Analysis (MD&A) of Des Moines Water Works' (Water Works) financial performance provides an overview of the utility's financial activities for the year ended December 31, 2010. Please consider this information in conjunction with the financial statements and the accompanying notes to basic financial statements that follow this section.

Overview of Business

The service area of the Water Works has expanded significantly since its emergence as a public water utility in 1919. In addition to serving customers within the City of Des Moines, Water Works provides wholesale water service based on long-term water contracts to surrounding municipalities and rural water districts, accounting for roughly 25 percent of total water revenues. This service area spans approximately 400 square miles, including most of Polk County and communities in eastern Dallas County and northern Warren County. The utility also provides billing and collection services on a contractual basis to wholesale customers and billing and collection services to the City of Des Moines for wastewater treatment, solid waste collection and the storm water utility.

As the utility's service area has expanded, so too has the need for water storage facilities, booster stations and additional treatment capacity to meet peak demand requirements. The most economical approach for the Water Works has involved utilizing these facilities to supply multiple customers. Contractual service users share in the cost of these joint-use facilities, which allows for meeting peak use demands and also allows some users to participate in lower off-peak or purchased capacity water rates. Financial participation in the construction of these facilities includes initial cash contributions or payments of debt service for the improvements and annual payment of operating and maintenance costs. Ownership of these facilities is maintained by the Water Works.

The water sources for the system are the Raccoon River, the Des Moines River, an underground infiltration gallery and wells along the Raccoon River near Maffitt Reservoir. These four sources are used to provide adequate supply in the most cost-effective combination. The utility operates two treatment plants, with one of those plants being operated remotely. An additional treatment plant is currently being developed in the northern segment of the utility's service area to meet growing demand in that area.

Governance of the Water Works is vested in a five-member Board appointed by the Mayor of the City of Des Moines with the approval of the City Council. Trustees serve for six-year staggered terms. The Board has complete control of Water Works' management and employs approximately 206 full-time and 12 part-time or seasonal employees.

The utility has adopted an annual activity-based budgeting methodology and performs an annual cost of service study to assist the Board in rate-setting policy.

Financial Highlights

- Water Works' net assets increased as a result of operations. As of December 31, 2010 and 2009, total assets were \$299,112,526 and \$295,960,262, respectively; total liabilities were \$87,295,842 and \$92,887,996, respectively, resulting in net assets of \$211,816,684 and \$203,072,266, respectively.
- In 2010, operating revenues of \$44,330,446 increased 7.82 percent over 2009, while operating expenses in 2010 increased 6.55 percent to \$38,366,261. Operating revenues of \$41,113,730 in 2009 increased 6.88 percent from 2008, while operating expenses increased approximately 3.04 percent to \$36,009,411.
- During the year, Water Works had operating income of \$5,964,185 and change in net assets of \$8,744,418. This compares to operating income of \$5,104,319 and change in net assets of \$11,649,821 reported in 2009.

Des Moines Water Works

Management's Discussion and Analysis Year Ended December 31, 2010

Overview of the Financial Statements

Management's Discussion and Analysis (MD&A) serves as an introduction to the financial statements, and the MD&A represents management's examination and analysis of the Water Work's financial condition and performance. The financial statements report information about the utility using full accrual accounting methods as utilized by similar entities in the private sector.

The balance sheet provides information about the Water Works' assets, liabilities and net assets, thereby measuring the Water Works' liquidity and solvency. Liquidity is a measure of the utility's ability to meet current obligations (those due within one year). Solvency is a similar concept, but measures the ongoing ability to meet obligations over a longer term.

The statement of revenues, expenses and changes in net assets presents the results of the Water Works' revenues and expenses over the course of the fiscal year and provides information about the utility's recovery of costs. Water rates are established by the Board of Trustees and are based on the utility's annual Cost of Service Study. The Cost of Service Study estimates annual revenue requirements through an analysis of operational and maintenance expenses, debt service requirements, anticipated capital needs and return on capital. The Study provides a core of information not only for the trustees and staff at Des Moines Water Works, but also for the customers ultimately affected by our decisions.

The statement of cash flows presents cash receipts, cash disbursements and net changes in cash resulting from operations, noncapital financing activities, capital and related financing and investing activities. This statement details where cash resources come from and how they are used.

The notes to basic financial statements provide required disclosures and other information that are essential to a full understanding of data provided in the statements. The notes supplement the basic financial statements by presenting information about the Water Works' accounting policies, significant account balances and activities, material risks, obligations, commitments and contingencies.

Condensed Financial Information

The following condensed financial information serves as key financial data and indicators for management, monitoring and planning.

Des Moines Water Works

Management's Discussion and Analysis Year Ended December 31, 2010

Condensed Balance Sheet Information

	2010	2009	% Change 2009 to 2010
Current assets	\$ 20,937,268	\$ 21,672,708	(3.39)%
Capital assets, net	263,496,657	252,246,879	4.46
Other noncurrent assets	14,678,601	22,040,675	(33.40)
Total assets	299,112,526	295,960,262	1.07
Current liabilities	13,735,396	14,119,218	(2.72)
Other noncurrent liabilities	15,183,446	16,218,778	(6.38)
Long-term debt	58,377,000	62,550,000	(6.67)
Total liabilities	87,295,842	92,887,996	(6.02)
Invested in capital assets, net of related debt	201,720,168	189,377,017	6.52
Restricted	19,426,970	23,751,056	(18.21)
Unrestricted	(9,330,454)	(10,055,807)	(7.21)
Total net assets	\$ 211,816,684	\$ 203,072,266	4.31

Condensed Revenues, Expenses and Changes in Net Assets

	2010	2009	% Change 2009 to 2010
Water sales	\$ 38,614,215	\$ 35,224,878	9.62%
Billing and collection services	1,250,614	1,009,751	23.85
Connection fees	267,034	425,167	(37.19)
Purchased capacity	1,276,293	1,311,808	(2.71)
Other sales and services	2,922,290	3,142,126	(7.00)
Total operating revenues	44,330,446	41,113,730	7.82
Investment income	297,062	551,818	(46.17)
Other	186,457	192,072	(2.92)
Capital contributions	2,841,825	6,466,848	(56.06)
Total revenues	47,655,790	48,324,468	(1.38)
Labor and benefits	16,730,625	15,510,531	7.87
Chemicals and power	5,703,687	5,987,666	(4.74)
Corporate Insurance	881,853	938,496	(6.04)
Purchased services	5,328,241	3,740,493	42.45
Materials, supplies and equipment	2,988,356	2,959,322	0.98
Depreciation	6,390,991	6,449,683	(0.91)
Other	342,508	423,220	(19.07)
Total operating expenses	38,366,261	36,009,411	6.55
Interest expense	608,768	606,254	0.41
(Gain) loss on sale of fixed assets	(63,657)	58,982	(207.93)
Total expenses	38,911,372	36,674,647	6.10
Change in net assets	8,744,418	11,649,821	(24.94)
Net assets, beginning of year	203,072,266	191,422,445	6.09
Net assets, end of year	\$ 211,816,684	\$ 203,072,266	4.31

Des Moines Water Works

Management's Discussion and Analysis Year Ended December 31, 2010

Financial Analysis

Current assets decreased 3.39 percent. Other noncurrent assets decreased approximately 33.40 percent. Both of these are as a result of spending bond proceeds on the development of the additional treatment plant and a tower and booster station on the east side of the service area. Offsetting these decreases is an increase of capital assets by 4.46 percent. Overall, total assets as of December 31, 2010 are approximately \$3,152,000 more than December 31, 2009.

Current liabilities decreased 2.72 percent. Construction payables decreased by \$961,216 due to an additional payable related to the I-235 project with the Iowa Department of Transportation being written down by \$600,000 and a receivable from the City of Des Moines for the Birdland Levee relocation in the amount of \$500,000 being netted against the payable.

Noncurrent liabilities include deferred revenue being amortized over a period of 10 to 20 years, the pension liability which will be paid through future pension contributions and the liability for other postretirement benefits. This shows the actuarial liability for providing health care benefits to retirees of Des Moines Water Works.

Long-term debt decreased 6.67 percent in 2010 due to the scheduled payment of the principal and the reclassification of \$4,173,000 of the scheduled 2011 debt service payments to short-term liabilities.

Water sales increased 9.62 percent. The increase is attributed to a rate increase effective May 1st for most service areas. Pumpage was relatively flat compared to the prior year.

Revenue for billing and collection services increased by 23.85 percent. The rate for billing and collecting services done for the City of Des Moines increased on July 1, 2009. Therefore 2010 is the first full year with the new rate. In addition, the City of Pleasant Hill began paying a monthly fee for billing and collection services beginning in January, 2010.

Connection fees decreased 37.19 percent or \$158,000. These fees can fluctuate widely from year to year depending on the level of development experienced within the utility's service areas.

Purchased capacity revenues decreased 2.71 percent. This represents the continued amortization of deferred revenue. This deferred revenue represents cash contributions to fund the new water treatment plant under construction and previous years' cash contributions from wholesale customers to fund the L.D. McMullen Water Treatment Facility. Financial participation in the construction of the plants allows users to participate in lower purchased capacity water rates. Deferred revenue balances are amortized to purchase capacity revenue over the length of the contract, generally 10 to 20 years.

Revenue from other sales and services decreased by 7.00 percent. Included in this line are numerous revenue items in the utility including reconnect fees, stop box repairs, distribution system repairs, lab testing, Botanical Center revenue, etc. The largest drivers of this decrease are a reduction in termination fees and stop box repairs. This can be partially attributed to a pre-termination courtesy call program reminding customers to pay their bill prior to termination.

Effective January 5, 2004, per 28E agreement with the City of Des Moines, Des Moines Water Works assumed management of operations of the Des Moines Botanical Center. Operations include room rentals, catering and café, gift shop and special events. Botanical Center revenues of \$762,179 are included in Water Works' financial results.

Labor and benefits increased 7.87 percent which is primarily due to wage rate increases and an increase in the pension funding expense.

Des Moines Water Works

Management's Discussion and Analysis Year Ended December 31, 2010

Chemicals and power decreased 4.74 percent due to a decrease in chemical costs of approximately \$273,000. Power costs were relatively flat from year to year.

Corporate insurance decreased by 6.04 percent due to lower premiums and broker fees.

Purchased services increased 42.45 percent or approximately \$1.6 million compared to 2009. Nearly \$1.3 million of the increase is related to expenses relating to the 2008 floods and was expected to be reimbursed by FEMA. The PILOT payment is also in this category and was \$612,680 in 2010. Offsetting these increases are lower expenses for residual removal at the McMullen Treatment Plant. This is due to timing and may vary from year to year.

Materials, supplies and equipment increased by less than one percent over 2009. This includes items such as postage, inventory items and repair parts for the maintenance of the treatment facilities, distribution system and fleet vehicles.

Other expenses decreased 19.07 percent due to decreased casualty losses of \$128,000. This amount fluctuates from year to year and 2009 was a relatively high year for casualty losses. Offsetting this decrease is higher bad debt expense in 2010.

Investment income decreased 46.17 percent due to lower investment balances due to spending of the bond proceeds on the new treatment plant and the eastside project consisting of a tower, booster station and feeder main.

Interest expense remained at relatively the same level as in 2009. Interest expense on the bond issues was \$154,000 lower in 2010. Additionally, the difference in interest expense to calculate the arbitrage liability was \$821,000 lower for 2010 than 2009. Offsetting this is the capitalized interest credit which was \$948,000 less than 2009. This entry reduced the amount of interest expense on the income statement and added it to the asset cost of the new treatment plant and the eastside project.

Capital contributions decreased 56.06 percent or \$3.8 million dollars. In 2010, contracts payable was written down approximately \$600,000 for the I-235 project. Income from FEMA reimbursable projects was recognized in the amount of \$1.7 million. Contributions recognized in 2009 included: contracts payable attributable to the I-235 project in the amount of approximately \$2.6 million being written down, funds were received from Altoona in the amount of \$2 million for their share of the joint eastside project and from Pleasant Hill in the amount of \$900,000 for capital infrastructure. There were no contributions of water mains from subdividers. These contributions can fluctuate widely from year to year, depending on the status of construction and the timing of inspections performed by Water Works' staff.

The aforementioned fluctuations result in an overall increase in net assets of 4.31 percent, the result of a 7.82 percent increase in operating revenues, an increase in operating expenses of 6.55 percent and a 53.88 percent decrease in nonoperating revenues.

Des Moines Water Works

Management's Discussion and Analysis Year Ended December 31, 2010

Capital Assets and Debt Administration

During 2010, net capital assets increased \$11,249,778 or 4.46 percent. In addition to replacing deteriorating water mains, the utility is building a water treatment plant in the northern part of the service area and an elevated tower, booster station and feeder mains on the east side of the service area. There were no significant changes to the condition of infrastructure assets, nor were there any changes made to standard service lives of those assets.

Water Works' long-term debt was \$62,550,000 and \$66,590,000 as of December 31, 2010 and 2009, respectively. The decrease is due to scheduled principal payments.

Economic Factors

Due to the Water Works' large concentration of residential customers, weather impacts revenue to a greater degree than do economic cycles. Water Works budgets revenues and expenses based on anticipated consumption for a "normal" weather year. Included in the 2011 budget is an increase in water availability charges and an increase in water rates for nearly all customers. This was based on the results of the annual cost of service study which indicated costs to serve those customers exceeded their water rates and availability charges.

Requests for Information

If the reader has questions or would like additional information, please direct the request to: Peggy Freese, Treasurer, 2201 George Flagg Parkway, Des Moines, Iowa 50321-1190.

Des Moines Water Works

Balance Sheet December 31, 2010

Assets

Current assets:

Cash	\$ 2,226,925
Restricted assets:	
Cash	7,485,605
Investments, water revenue bond reserve fund	2,078,655
Accounts receivable:	
Billed	3,410,562
Unbilled	1,284,927
Due from other governments	1,668,553
Other receivables	243,826
Inventory, materials and supplies	1,699,633
Prepaid expenses	838,582
Total current assets	<u>20,937,268</u>

Restricted assets, investments:

Water revenue bond reserve fund	9,813,687
Water revenue bond improvement fund	600,000
	<u>10,413,687</u>

Long-term investments:

Investment in land	624,562
Board designated funds, investments	2,928,091
	<u>3,552,653</u>

Capital assets:

Land	4,925,798
Construction-in-progress	56,928,361
Buildings, equipment and machinery	122,748,999
Supply system	43,591,494
Distribution system	159,744,655
	<u>387,939,307</u>
Accumulated depreciation	(124,442,650)
Capital assets, net	<u>263,496,657</u>

Bond issue costs and discounts:

Bond issue costs	168,380
Bond issue discounts	222,534
Bond issue costs and discounts	<u>390,914</u>

Other assets

Total assets	<u>\$ 299,112,526</u>
---------------------	-----------------------

See Notes to Basic Financial Statements.

Liabilities and Net Assets

Current liabilities:

Accounts payable	\$ 1,411,424
Accrued wages and benefits	565,172
Compensated absences	1,986,337
Deferred revenue	1,456,946
Special deposits	441,494
Construction payables	3,308,282
Water revenue bonds interest payable	209,549
Current portion of long-term debt	4,173,000
Fees collected for other entities	60,455
Other current liabilities, arbitrage	122,737
Total current liabilities	<u>13,735,396</u>

Noncurrent liabilities:

Long-term debt, less current installments	58,377,000
Compensated absences	606,107
Deferred revenue	11,879,462
Pension liability	105,837
Other postemployment benefits liability	2,592,040
Other noncurrent liabilities, arbitrage	-
Total noncurrent liabilities	<u>73,560,446</u>

Total liabilities87,295,842

Net assets:

Invested in capital assets, net of related debt	201,720,168
Restricted (bond indentures)	19,426,970
Unrestricted	(9,330,454)
Total net assets	<u>211,816,684</u>

Total liabilities and net assets\$ 299,112,526

Des Moines Water Works

Statement of Revenues, Expenses and Changes in Net Assets Year Ended December 31, 2010

Operating revenues:	
Water sales	\$ 39,890,508
Other sales and services	4,172,904
Connection fees	267,034
Total operating revenues	<u>44,330,446</u>
Operating expenses:	
Labor	11,734,643
Group insurance	1,754,517
Retirement benefits (including social security)	3,241,465
Purchased services	5,328,241
Corporate insurance	881,853
Materials, supplies and equipment	2,988,356
Chemicals	3,545,412
Utilities	2,158,275
Depreciation	6,390,991
Other	342,508
Total operating expenses	<u>38,366,261</u>
Operating income	<u>5,964,185</u>
Nonoperating revenue (expense):	
Investment income	297,062
Interest expense	(608,768)
Land use income	182,586
Gain (loss) on sale of capital assets	63,657
Other	3,871
Nonoperating revenue (expense), net	<u>(61,592)</u>
Income before capital contributions	5,902,593
Capital contributions	<u>2,841,825</u>
Change in net assets	8,744,418
Net assets, beginning of year	203,072,266
Net assets, end of year	<u>\$ 211,816,684</u>

See Notes to Basic Financial Statements.

Des Moines Water Works

Statement of Cash Flows
Year Ended December 31, 2010

Cash flows from operating activities:	
Cash received from customers	\$ 42,780,699
Cash paid to suppliers	(15,279,534)
Cash paid to employees and for payroll taxes	(15,597,072)
Net cash provided by operating activities	<u>11,904,093</u>
Cash flows from capital and related financing activities:	
Principal payments on long-term debt	(4,040,000)
Acquisition, construction and removal cost of capital assets	(16,322,419)
Proceeds from sale of capital assets	191,761
Contributions received	731,553
Interest paid	(2,470,311)
Net cash (used in) capital and related financing activities	<u>(21,909,416)</u>
Cash flows from investing activities:	
Proceeds from maturities of investments	39,049,906
Purchase of investments	(29,572,333)
Interest received	464,302
Land use income and other	186,457
Net cash provided by investing activities	<u>10,128,332</u>
Net increase in cash	123,009
Cash, beginning of year	<u>9,589,521</u>
Cash, end of year	<u>\$ 9,712,530</u>
Reconciliation of cash to the balance sheet:	
Cash	\$ 2,226,925
Restricted assets, cash	7,485,605
Total cash at end of year	<u>\$ 9,712,530</u>

(Continued)

Des Moines Water Works

Statement of Cash Flows (Continued) Year Ended December 31, 2010

Reconciliation of operating income to net cash provided by operating activities:

Operating income	\$ 5,964,185
Adjustments to reconcile operating income to net cash, depreciation	6,390,991
Change in:	
Accounts receivable, billed	52,283
Accounts receivable, unbilled	(154,217)
Other receivables	22,441
Inventories - materials and supplies	(107,741)
Prepaid expense	(64,268)
Other assets	112,117
Accounts payable	137,121
Accrued wages and benefits and compensated absences	507,519
Pension liability	(6,075)
Other postemployment benefit liability	632,108
Deferred revenue	(1,491,159)
Special deposits	86,596
Fees collected for other entities	(177,808)
Net cash provided by operating activities	<u>\$ 11,904,093</u>

Schedule of noncash capital and related financing activities:

Acquisition of capital assets through construction payables	\$ 309,782
Capitalized interest	1,631,235
Increase (decrease) in other receivables for sale of capital assets	(125,000)
Capital contributions through relief of construction payables forgiveness	651,434
Trade-in value towards assets purchased	39,550

Schedule of noncash investing activities, net depreciation of the fair value of investments

60,700

See Notes to Basic Financial Statements.

**Des Moines Water Works
Pension Plan**

**Statement of Plan Net Assets
December 31, 2010**

Assets

Investments, contracts with insurance companies, pooled
separate accounts \$ 37,698,280

Net assets held in trust for pension benefits \$ 37,698,280

See Notes to Basic Financial Statements.

**Des Moines Water Works
Pension Plan**

**Statement of Changes in Plan Net Assets
Year Ended December 31, 2010**

Additions:

Investment income:

Net appreciation in the fair value of pooled separate
accounts, interest and dividends (Note 2)

\$ 4,525,380

Employer contributions

1,541,866

Total additions

6,067,246

Deductions:

Benefit payments

1,996,442

Administrative expenses

61,212

Total deductions

2,057,654

Net increase

4,009,592

Net assets held in trust for pension benefits:

Beginning of year

33,688,688

End of year

\$ 37,698,280

See Notes to Basic Financial Statements.

Des Moines Water Works

Notes to Basic Financial Statements

Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies

Nature of business:

Des Moines Water Works (Water Works) is managed and controlled by the Board of Water Works Trustees of the City of Des Moines, Iowa (the Board), which exists under the provisions of Chapter 388 and other relevant statutes of the Code of Iowa. The five-member Board is appointed by the Mayor of Des Moines with the approval of the City Council. Trustees serve for six-year staggered terms.

Water Works is exempt from federal income tax pursuant to Internal Revenue Code Section 115 which provides for exemption of divisions of state and local governments.

Water Works provides water and other services to retail and wholesale customers in the City of Des Moines (the City) and surrounding communities.

In September 1993, the Governmental Accounting Standards Board (GASB) issued Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. The Statement provides that Water Works should apply all GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Statements and Interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) Opinions and Accounting Research Bulletins (ARB) of the Committee on Accounting Procedures. In addition, Water Works may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. Water Works has elected to not apply all FASB, APB and ARB materials issued after November 30, 1989.

Reporting entity:

Accounting principles generally accepted in the United States of America require the reporting entity include (1) the primary government, (2) organizations for which the primary government is financially accountable and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The Water Works has authority to issue bonded debt without the approval of another government. It has the right to sue and be sued, and has the right to buy, sell, lease or mortgage property in its own name. Based on these criteria, the Water Works is considered a primary government and there are no other organizations or agencies whose financial statements should be combined and presented with these financial statements.

Significant accounting policies:

Basis of accounting and measurement focus: The economic measurement focus and the accrual basis of accounting are used by the Water Works. Under the accrual basis of accounting, revenue is recognized when earned and expenses are recognized when the liability has been incurred. Under this basis of accounting, all assets and all liabilities associated with the operation of the Water Works are included in the balance sheet.

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

Des Moines Water Works

Notes to Basic Financial Statements

Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies (Continued)

Cash and investments: For the purpose of the statement of cash flows, Water Works considers cash balances maintained in demand deposit accounts at financial institutions to be cash. Excess cash invested temporarily in financial institutions is considered an investing activity and is not considered to be cash.

Investments as of December 31, 2010 were in U.S. government or agency obligations and are stated at fair value, based on quoted market prices.

Revenue recognition: Customers served by Water Works are billed on a monthly cyclical basis based on usage. Water Works accrues estimated unbilled water revenues for services rendered from the last billing date through year-end.

Operating revenues and expenses: Operating revenues include revenues resulting from the sale of water and related services. Operating expenses include expenses for water treatment, distribution, depreciation, customer service and sales, administrative and general. Nonoperating revenues and expenses include those derived from capital and related financing activities, noncapital financing activities and investing activities. Revenues from the sale of water are based on billing rates, which are applied to customer's consumption of water.

Transactions with the City of Des Moines: Water Works provides water service to the City without charge except for the Sewage Treatment Works, Des Moines International Airport and City golf courses. The value (computed at the commercial rate) of the service provided without charge was approximately \$719,591 in 2010.

Water Works has an agreement to pay the City a Payment in Lieu of Taxes (PILOT). This amount was calculated in 2009 by applying the City millage rate for police and fire to the value of buildings and land operated and controlled by Water Works located within the City at that time. The total PILOT payment was \$612,680 in 2010. Due to the change in methodology of computing the amount, no payment was due in 2009.

Water Works has also agreed to match annual contributions of the City (up to \$50,000) toward an industrial development corporation. Payments of \$50,000 were made in 2010.

Billings and collection agent services: Water Works serves as the billing and collection agent for fees related to sewage treatment, solid waste and storm water collection for certain political subdivisions (including the City). Separate accounting records are maintained by Water Works for these collection services. Fees collected not yet remitted by Water Works to the applicable entity totaled \$60,455 as of December 31, 2010. These fees have been reflected in Water Works' balance sheet and were remitted to the City and other political subdivisions subsequent to year-end. Processing fees billed to the City and other political subdivisions for billing and collection services provided by Water Works totaled approximately \$1,251,000 in 2010. The City's fees reflect only the incremental expenses incurred by Water Works to bill and collect the City's charges, rather than an equal sharing of the costs. Water Works bears the total cost of meter reading, cash processing and statement preparation and mailing.

Inventories: Inventories are stated at the lower of average cost or market. The costs of these materials and supplies are recorded as an expense at the time they are relieved from inventory for use.

Board designated funds: These assets are reserves held for any contingencies.

Des Moines Water Works

Notes to Basic Financial Statements

Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies (Continued)

Restricted assets, cash and investments: Water Works is required, under the water revenue bond resolutions, to reserve certain assets to provide for payment of the bonds and interest for protection of the bondholders, and for the improvement and extension of facilities. Disbursement of these assets is restricted by the purpose of the respective funds.

Capital assets: Capital assets are recorded at cost and depreciated utilizing the straight-line method over estimated useful lives as follows:

Buildings, equipment and machinery	3-85 years
Supply system	20-85 years
Distribution system	10-85 years

Expenditures for maintenance, repairs and minor replacements are charged to operations. Expenditures for major repairs and betterments are capitalized. Water Works' capitalization threshold is \$500. When capital assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts and any resulting gains or losses are included in the statement of revenues, expenses and changes in net assets. Included in capital assets are the interest capitalized during construction in accordance with accounting principles generally accepted in the United States of America. Capitalized interest was \$1,631,235 in 2010.

Net assets: Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction, or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. As of December 31, 2010, Water Works had unspent bond proceeds of \$550,977.

The Water Works' policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Rates: The Board has full authority to establish rates. As part of the rate-setting process, Water Works performs an annual Cost of Service Study to determine the cost of operations. This Study is based on a standard water industry model. Based upon the Study, rates are set to fund future operations. Costs related to operations and maintenance, depreciation based on estimated replacement cost of capital assets (which differs from depreciation expense recorded for financial reporting purposes), debt service and return on capital are factored into the rate design as well as demand factors from various customer classes.

Deferred revenue: During 1996 and years subsequent, Water Works entered into contractual agreements with other political subdivisions to sell treatment capacity to these entities. In exchange for purchasing these amounts of capacity, the political subdivisions will be able to purchase water at a lower wholesale water rate. Purchasers were offered the option of cash payment or participating in issues of water revenue bonds. For entities choosing to pay cash in advance, Water Works records these amounts as deferred revenue and amortizes the amounts into income over periods of 10 to 20 years. For entities participating in the bond issues, Water Works recognizes this revenue on a monthly basis as the entities are billed and as the principal and interest payments become due on the bonds. As of December 31, 2010, Water Works has \$13,155,755 of deferred revenue relating to contractual agreements and has recognized \$1,276,293 of revenue during 2010.

Des Moines Water Works

Notes to Basic Financial Statements

Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies (Continued)

Water Works received funds from FEMA for reimbursement for flooding damages that occurred in 2008. Water Works recognizes this revenue once it has been earned; that is, when expenses have been incurred. As of December 31, 2010, Water Works had deferred revenue relating to unearned FEMA funds of \$180,653.

Compensated absences: Vacation and personal leave are accrued as a liability as it is earned. Sick leave benefits do not vest; however, upon retirement, an employee may receive pay for 90 percent of his or her accumulated sick leave up to a maximum of 810 hours. The maximum payable to employees who are eligible for retirement has been recorded as a liability as well as an estimate for employees who are probable of becoming eligible in the future.

Debt financing costs and discounts: Costs incurred to issue water revenue bonds and the Water Revenue Capital Loan notes are capitalized. These costs, and the discounts on the water revenue bonds, are amortized over the terms of the bonds and note utilizing a method which approximates the effective interest method.

Fiduciary fund type: The Water Works also includes a pension trust fund, fiduciary fund type. Pension trust funds are accounted for in essentially the same manner as the enterprise fund, using the same measurement focus and basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. The Pension Trust Fund accounts for the assets of the Des Moines Water Works Pension Plan. This plan is included in the reporting entity due to the Water Works' significant administrative involvement and due to the Board of the Plan consisting of the Water Works' Board members.

Note 2. Cash and Investments

The Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, requires state and local governments to disclose certain risks. The disclosures required by GASB Statement No. 40 provide readers with information concerning the credit and interest risks associated with the Water Works' deposits and investments.

Authorized investments: Water Works is authorized to invest in obligations of the US government, its agencies and instrumentalities; certificates of deposit at federally insured Iowa depository institutions approved by the Code of Iowa, Chapter 12C; and repurchase agreements if the underlying collateral consists of obligations of the US government, its agencies and instrumentalities. The Water Works' investment policy prohibits investments in reverse repurchase agreements and futures and options contracts. In addition, investing pursuant to the following investment practices is prohibited: trading of securities for speculation of the realization of short-term trading gains; a contract providing for the compensation of an agent or fiduciary based upon the performance of the invested assets; or if a fiduciary or third party has failed to produce requested records within a reasonable time.

Des Moines Water Works

Notes to Basic Financial Statements

Note 2. Cash and Investments (Continued)

Interest rate risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. In an effort to limit exposure to fair value losses arising from interest rate risk, the Water Works' investment policy places maturity limitations on both operating funds and nonoperating funds. Operating funds are defined as those that are reasonably expected to be expended during the current budget year or within 15 months. Operating funds may only be invested in authorized instruments that mature within 397 days. Funds not identified as operating may be invested in investments with maturities longer than 397 days, but less than 1,726 days. All investments, however, shall have maturities that are consistent with the needs and uses of the utility.

Information about the sensitivity of the fair value of the Water Work's investments to market interest rate fluctuations is provided by the tables below for December 31, 2010:

Type	Fair Value					
	December 31, 2010	Within 3 Months	Within 6 Months	Within 9 Months	Within 12 Months	Over 12 Months
Federal Home Loan Bank	\$ 3,309,090	\$ 3,009,090	\$ -	\$ -	\$ -	\$ 300,000
Federal Home Loan Mortgage Corp.	2,279,297	-	-	-	-	2,279,297
Federal National Mortgage Assoc.	9,446,945	-	-	-	-	9,446,945
Federal Farm Credit Bank	385,101	385,101	-	-	-	-
	<u>\$ 15,420,433</u>	<u>\$ 3,394,191</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,026,242</u>

The Water Works also has an investment in land purchased with the intent to sell; however, no commitment for sale existed as of December 31, 2010. The land is recorded at the lower of cost or fair value at \$624,562 as of December 31, 2010.

Credit risk: Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

As of December 31, 2010, the Water Works' investments were rated as follows:

Type	S&P Rating	Moody's Rating
Federal Home Loan Bank	AAA	Aaa
Federal Home Loan Mortgage Corp.	AAA	Aaa
Federal National Mortgage Assoc.	AAA	Aaa
Federal Farm Credit Bank	AAA	Aaa

Concentration of credit risk: The policy defines diversification requirements for the Water Works' investments. Invested assets shall be diversified to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer or a specific class of security. Portfolio maturities shall be staggered in a way that avoids undue concentration of assets in a specific maturity sector. Liquidity practices shall be followed to ensure that funds required for the next disbursement date and next payroll date are covered through maturity investments, marketable US Treasury bills or cash on hand. Risks of market price volatility shall be controlled through maturity diversification so that aggregate price losses on investments with maturities approaching one year shall not be greater than coupon interest and investment income received from the balance of the portfolio.

Des Moines Water Works

Notes to Basic Financial Statements

Note 2. Cash and Investments (Continued)

More than 5 percent of the utility's investments are in the following investments:

Type	
Federal Home Loan Bank	21.46%
Federal Home Loan Mortgage Corp.	14.78
Federal National Mortgage Assoc.	61.26
Federal Farm Credit Bank	N/A

The Water Works' investments during the year did not vary substantially from those at year-end in amounts or level or risk.

Custodial credit risk: The custodial credit risk for deposits and investments is the risk that, in the event of the failure of a depository financial institution or counterparty (for example, broker-dealer) to a transaction, a government will not be able to recover deposits or will not be able to recover collateral securities or the value of investments that are in the possession of an outside party. Deposits in financial institutions as of December 31, 2010 and throughout the year are covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C, Code of Iowa. This Chapter provides additional assessments against the depositories to ensure there is no loss of public funds. Water Works' bank balances and book balances of deposits were \$11,611,919 and \$9,712,930, respectively, as of December 31, 2010. Water Works' investments were not exposed to custodial credit risk as of December 31, 2010.

Pension Plan Deposits and Investments

Deposits: As of December 31, 2010, the Plan held no deposits.

Investments: The Plan's investments in pooled separate accounts are stated at fair value based on quoted market prices of the investments held in each account as determined by Principal Life Insurance Company (Principal). Purchases and sales of securities are recorded on a trade date basis. Dividends are recorded on the ex-dividend date.

Asset allocation strategy: The Des Moines Water Works Pension Plan's Named Fiduciary asset allocation strategy shall identify target allocations to eligible asset classes and, where appropriate, suitable ranges within which each asset class can fluctuate as a percent of the total fund. Each asset class is to remain suitably invested at all times in either cash (or cash equivalents) or permitted securities within each class. The assets classes may be rebalanced from time to time to take advantage of tactical misvaluations across major asset classes or investment styles, or to align the current asset mix with strategic targets.

Authorized investments: The Des Moines Water Works Pension Plan's investment policy permits the Named Fiduciary to consider all asset classes allowed by ERISA as acceptable investment options and to select one or more customized investment portfolios and retain an investment manager to manage the assets of each such portfolio. The following assets classes are permitted for Plan investment options: Stable Value, Domestic Fixed Income, International or Foreign Fixed Income, Real Estate, Domestic Stock, International or Foreign Stock and Balanced/Asset allocation.

Des Moines Water Works

Notes to Basic Financial Statements

Note 2. Cash and Investments (Continued)

GASB Statement No. 40 requires plan investments to disclose an indication of the level of credit risk, concentration of credit risk and interest rate risk assumed by the Plan. These risk disclosures only pertain to fixed income investments. As of December 31, 2010, the Plan had investments listed in the tables below. Amounts are shown in dollars. Effective duration is shown in years. Investments held by the Plan were not subject to custodial credit risk or foreign currency risk.

	December 31, 2010 Fair Value	Effective Duration
Fixed income investments:		
Principal Core Plus Bond Account	\$ 5,964,196	5.17
Principal Bond and Mortgage Account	6,006,089	5.18
Principal Inflation Protection Account	2,387,274	7.55
Principal High Yield Account	1,641,280	4.11
U.S. Property Account	1,409,663	N/A
Total fair value of fixed income investments	<u>17,408,502</u>	
Other investments, nonfixed income investments	<u>20,289,778</u>	
Total investments	<u><u>\$ 37,698,280</u></u>	

Interest rate risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

Credit risk and concentration of credit risk: Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligations to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The pooled separate accounts held by the Plan are commingled pools, rather than individual securities. As a result, these investments are not rated. The U.S. Property Account is subject to investment and liquidity risk and other risks inherent in real estate such as those associated with general and local economic conditions. Therefore, an effective duration is not calculated for that account.

Des Moines Water Works

Notes to Basic Financial Statements

Note 3. Capital Assets

Capital assets activity for the year ended December 31, 2010 is as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated:				
Land	\$ 4,890,351	\$ 35,447	\$ -	\$ 4,925,798
Construction-in-progress	48,420,080	17,653,621	9,145,340	56,928,361
Total capital assets not being depreciated	53,310,431	17,689,068	9,145,340	61,854,159
Capital assets being depreciated:				
Buildings, equipment and machinery	121,154,478	1,837,212	242,691	122,748,999
Supply system	43,588,579	2,915	-	43,591,494
Distribution system	152,479,887	7,299,568	34,800	159,744,655
Total capital assets being depreciated	317,222,944	9,139,695	277,491	326,085,148
Less accumulated depreciation for:				
Buildings, equipment and machinery	63,928,259	2,963,243	233,561	66,657,941
Supply system	13,592,748	751,857	-	14,344,605
Distribution system	40,765,489	2,675,891	1,276	43,440,104
Total accumulated depreciation	118,286,496	6,390,991	234,837	124,442,650
Total capital assets being depreciated, net	198,936,448	2,748,704	42,654	201,642,498
Net capital assets	\$ 252,246,879	\$ 20,437,772	\$ 9,187,994	\$ 263,496,657

Des Moines Water Works

Notes to Basic Financial Statements

Note 4. Noncurrent Liabilities

As of December 31, 2010, Water Works' debt consists of Water Revenue Refunding Bonds, Series 2004 A & B and 2006; and Water Revenue Capital Loan Note, Series 2003 (through the Drinking Water State Revolving Fund (SRF)). Interest on these bonds and note is payable semiannually on June 1 and December 1, with principal payable on December 1. Series 2004 A & B mature on December 1, 2024 and 2017, respectively, and Series 2006 mature on December 1, 2026. The Series 2003 note matures on December 1, 2022. The bonds and note are redeemable at the option of Water Works prior to their maturity in whole or, from time to time, in part, in any order of maturity and within a maturity by lot, at a price of par plus accrued interest to call date.

Changes in long-term obligations for the year ended December 31, 2010 are as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Water Revenue Bonds:					
Series 2004 A & B	\$ 18,325,000	\$ -	\$ 1,750,000	\$ 16,575,000	\$ 1,800,000
Series 2006	46,550,000	-	2,180,000	44,370,000	2,260,000
Water Revenue Capital, Series 2003	1,715,000	-	110,000	1,605,000	113,000
Compensated absences	2,165,345	2,592,444	2,165,345	2,592,444	1,986,337
	<u>\$ 68,755,345</u>	<u>\$ 2,592,444</u>	<u>\$ 6,205,345</u>	<u>\$ 65,142,444</u>	<u>\$ 6,159,337</u>

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Refunding Bonds, Series 2004 A is as follows:

Maturing During Year Ending December 31:	Interest Rate	Annual Principal Payment	Annual Interest Payment	Total Annual Payment
2011	3.38%	\$ 290,000	\$ 212,269	\$ 502,269
2012	3.50	300,000	202,481	502,481
2013	3.75	315,000	191,981	506,981
2014	4.00	325,000	180,169	505,169
2015	4.00	340,000	167,169	507,169
2016-2020	4.00	1,905,000	621,844	2,526,844
2021-2024	4.00-4.25	1,865,000	199,788	2,064,788
		<u>\$ 5,340,000</u>	<u>\$ 1,775,701</u>	<u>\$ 7,115,701</u>

Des Moines Water Works

Notes to Basic Financial Statements

Note 4. Noncurrent Liabilities (Continued)

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Refunding Bonds, Series 2004 B is as follows:

Maturing During Year Ending December 31:	Interest Rate	Annual Principal Payment	Annual Interest Payment	Total Annual Payment
2011	3.00%	\$ 1,510,000	\$ 422,525	\$ 1,932,525
2012	3.25	1,570,000	377,225	1,947,225
2013	4.00	1,625,000	326,200	1,951,200
2014	4.00	1,710,000	261,200	1,971,200
2015	4.00	1,770,000	192,800	1,962,800
2016-2017	4.00	3,050,000	169,600	3,219,600
		<u>\$ 11,235,000</u>	<u>\$ 1,749,550</u>	<u>\$ 12,984,550</u>

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Refunding Bonds, Series 2006 is as follows:

Maturing During Year Ending December 31:	Interest Rate	Annual Principal Payment	Annual Interest Payment	Total Annual Payment
2011	4.00%	\$ 2,260,000	\$ 1,827,631	\$ 4,087,631
2012	4.00	2,355,000	1,737,231	4,092,231
2013	4.00	2,440,000	1,643,031	4,083,031
2014	4.00	2,540,000	1,545,431	4,085,431
2015	4.00	2,650,000	1,443,831	4,093,831
2016-2020	4.00	12,995,000	5,654,756	18,649,756
2021-2025	4.00	15,570,000	2,837,206	18,407,206
2026	4.00	3,560,000	155,750	3,715,750
		<u>\$ 44,370,000</u>	<u>\$ 16,844,867</u>	<u>\$ 61,214,867</u>

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Capital Loan Note is as follows:

Maturing During Year Ending December 31:	Interest Rate	Annual Principal Payment	Annual Interest Payment	Total Annual Payment
2011	3.00%	\$ 113,000	\$ 48,150	\$ 161,150
2012	3.00	116,000	44,760	160,760
2013	3.00	120,000	41,280	161,280
2014	3.00	124,000	37,680	161,680
2015	3.00	127,000	33,960	160,960
2016-2020	3.00	696,000	110,250	806,250
2021-2022	3.00	309,000	13,980	322,980
		<u>\$ 1,605,000</u>	<u>\$ 330,060</u>	<u>\$ 1,935,060</u>

Des Moines Water Works

Notes to Basic Financial Statements

Note 4. Noncurrent Liabilities (Continued)

The water revenue bond and water revenue capital loan note resolutions (Resolutions) provide that future water customer revenues, net of specified operating expenses of Water Works, are pledged for the purpose of paying Series 2003, Series 2004 and Series 2006 bonds. Proceeds from the bonds were used to provide additional infrastructure needs. The bonds are payable solely from customers net revenues. The Resolutions further require that sufficient monies be set aside to meet current expenses of Water Works. All remaining monies are to be segregated and restricted in separate special reserves. These special reserves are reflected as restricted assets on the balance sheet. The Resolutions also require the issuer maintain insurance coverage of a kind and in an amount which usually would be carried by private companies engaged in a similar kind of business. Water Works maintains fire and extended coverage insurance in the amount of \$323,920,822 per occurrence on building and contents; in addition, liability insurance is maintained.

A summary of the outstanding debt, principal and interest requirements are as follows:

	Issue Date	Year Maturing	Principal and Interest Remaining	Principal and Interest Paid in 2010	Annual Payments as a Percentage of Net Revenues
Water Revenue Bonds:					
Series 2004 A	12/1/2004	2024	\$ 7,115,701	\$ 506,531	4.10%
Series 2004 B	12/1/2004	2017	12,984,550	1,931,475	15.63%
Series 2006	3/1/2006	2026	61,214,867	4,094,831	33.14%
Water Revenue Capital,					
Series 2003	4/16/2003	2022	1,935,060	161,450	1.31%
			<u>\$ 83,250,178</u>	<u>\$ 6,694,287</u>	<u>54.18%</u>

Total customer net revenues were \$12,355,176. Annual principal and interest payments on the bonds are approximately 54 percent of net revenues.

Note 5. Pension Plan

Water Works has a noncontributory defined benefit single employer pension plan, established by the Board, called the Des Moines Water Works Pension Plan (the Plan). All full-time Water Works employees and employees who work at least 1,040 hours in a calendar year and work during two consecutive calendar quarters are eligible to participate in the Plan. Benefits vest after five years of continuous service and normal retirement is allowed at or after age 65. Early retirement is allowed without a reduction in benefits beginning at age 55 if the employee's combined years of service and age are 85 or greater and is allowed with reduced benefits for vested employees with less than 30 years of service beginning at age 55. The pension benefit formula is based upon a percent of average compensation and the number of years of service with Water Works. A participant's monthly accrued benefit is equal to 1.5 percent of their average monthly compensation times their years of continuous service with Water Works. Average monthly compensation is determined by taking the average monthly pay for the 60 consecutive full calendar months out of the 120 latest calendar months which give the highest average. The Plan also provides death and disability benefits to vested employees. The Plan Administrator is the Board of Trustees of Des Moines Water Works. The Plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to or calling the Water Works.

Des Moines Water Works

Notes to Basic Financial Statements

Note 5. Pension Plan (Continued)

Water Works' annual pension cost and net pension liability for fiscal year 2010 and the two preceding fiscal years are as follows:

	2010	2009	2008
Annual required contribution (ARC)	\$ 1,541,866	\$ 1,023,319	\$ 545,782
Interest	8,393	8,817	29,130
Adjustment to annual required contribution	(14,468)	(14,468)	(45,753)
Annual pension cost (APC)	1,535,791	1,017,668	529,159
Contributions made	1,541,866	1,023,319	800,000
Decrease in net pension liability	6,075	5,651	270,841
Net pension (liability), beginning of year	(111,912)	(117,563)	(388,404)
Net pension (liability), end of year	<u>\$ (105,837)</u>	<u>\$ (111,912)</u>	<u>\$ (117,563)</u>
Percentage of APC contributed	100.4%	100.6%	151.2%

The net pension obligation is the pension asset or (liability) that arises from cumulative differences between the ARC and actual employer contributions. The net pension benefit liability above was computed as part of the annual actuarial valuation performed as of January 1, 2011, 2010 and 2009 using the aggregate actuarial cost method. The aggregate actuarial cost method does not identify or separately amortize unfunded actuarial liabilities. There were no significant differences between December 31, 2010, 2009 and 2008 and January 1, 2011, 2010 and 2009, respectively, which would cause the actuarial valuations not to be representative as of December 31, 2010, 2009 and 2008. The actuarial assumptions used to compute the pension benefit liability included (a) 7.5 percent investment rate of return (net of administrative expenses) and (b) projected salary increases of 5.0 percent. These amounts were computed using the IRS Prescribed— Static Mortality, male and female, with a 3.0 percent cost of living factor increase included.

The Plan's funding policy provides for periodic employer contributions at rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate assets to pay benefits when due. However, as the Plan is exempt from ERISA funding requirements, any amount may be contributed to the Plan. The suggested employer contribution rates are determined using the aggregate cost method.

Amounts contributed to the Plan from Water Works are determined by the Board of Trustees of Des Moines Water Works. The contributions to the Plan in 2010 and 2009 were approximately 12.5 percent and 8.8 percent, respectively, of the total covered payroll in each year.

As of January 1, 2011, the most recent actuarial valuation date, the Plan was 81 percent funded. The actuarial accrued liability for benefits was \$47,774,843 and the actuarial value of assets was \$38,740,806, resulting in an unfunded actuarial accrued liability (UAAL) of \$9,034,037. The covered payroll (annual payroll of active employees covered by the Plan) was \$12,318,720 and the ratio of UAAL to covered payroll was 73 percent.

As of January 1, 2010, the Plan was 90 percent funded. The actuarial accrued liability for benefits was \$44,385,344 and the actuarial value of assets was \$39,789,839, resulting in an unfunded actuarial accrued liability (UAAL) of \$4,595,505. The covered payroll (annual payroll of active employees covered by the Plan) was \$11,694,902 and the ratio of UAAL to covered payroll was 39 percent.

Des Moines Water Works

Notes to Basic Financial Statements

Note 5. Pension Plan (Continued)

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, presents multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a period of several years. The aggregate actuarial cost method does not identify or separately amortize unfunded actuarial accrued liabilities. Information about the Plan's funded status and funding progress has been prepared using the entry age actuarial cost method and is intended to serve as a surrogate for the funded status and funding progress of the plan.

Note 6. Other Postemployment Benefits

Plan description: The Water Works sponsors a single-employer health care plan that provides certain postretirement health care benefits, in accordance with the policy established by the Board, to all employees who retire from Water Works after attaining age 55 with 5 years of service. As of December 31, 2010, 71 retirees receive postretirement health care benefits. Water Works provides a Medicare supplement or equivalent amount to all employees who retire after attaining age 55, if the sum of their age and years of service are at least 85 or for those who retire after attaining age 65 regardless of length of service. Employees who retire prior to attaining age 65 with the sum of their age and years of service less than 85 receive a discounted benefit as provided by the plan document. The plan does not issue a stand-alone financial report.

Funding policy: The health insurance plan contributions on behalf of employees are negotiated by management and the union and governed by the Water Work's union contracts.

The required contribution is based on projected pay-as-you-go financing requirements. For fiscal year 2010, the Water Works contributed \$144,592. Retirees receiving benefits contributed \$66,095. The Water Works offered a choice of three health insurance plans in 2010. The required contribution for active members and retirees under the age of 65 varied by the plan selected. Retirees over the age of 65 also contributed varying amounts based on the plan selected.

Annual OPEB Cost and Net OPEB Obligation: The Water Work's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance to the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The following table shows the components of the Water Work's annual OPEB cost for the year, the amount actuarially contributed to the plan and changes in the Water Work's annual OPEB obligation:

Annual required contribution	\$ 349,262
Interest on net OPEB obligation	29,873
Adjustment to annual required contribution	397,565
Annual OPEB cost (expense)	<u>776,700</u>
Contributions and payments made	144,592
Increase in net OPEB obligation	<u>632,108</u>
Net OPEB obligation - January 1, 2010	1,959,932
Net OPEB obligation - December 31, 2010	<u><u>\$ 2,592,040</u></u>

Des Moines Water Works

Notes to Basic Financial Statements

Note 6. Other Postemployment Benefits (Continued)

The Water Work's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligations for 2010, 2009 and 2008 follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
December 31, 2008	\$ 1,587,484	17%	\$ 1,324,347
December 31, 2009	776,700	18	1,959,932
December 31, 2010	776,700	19	2,592,040

Funded status and funding progress: Postemployment Benefit Obligations under GASB Statement No. 45 calculated as of December 31, 2008, the most recent valuation date, is as follows:

	Total	Members
Actuarial Accrued Liability		
Current retirees, beneficiaries and dependents	\$ (2,646,628)	85
Current active members	(5,489,938)	199
Total Actuarial Accrued Liability (AAL)	(8,136,566)	
OPEB Plan Assets	-	
Unfunded Actuarial Accrued Liability (UAAL)	(8,136,566)	

The covered payroll (annual payroll of active employees covered by the plan) for December 31, 2010 \$13,694,936. The ratio of the UAAL to the covered payroll for December 31, 2010 was 59 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the health care cost trend. Amounts determined regarding the funded status of the plan and annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial methods and assumptions: Projections and benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and included in the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2008 actuarial valuation date, the unit credit method was used. The actuarial assumptions included a 4.0 percent investment rate of return (net of administrative expenses) and an annual health care cost trend rate of 8.0 percent initially, grading down to 5.0 percent in 7 years. The Water Work's unfunded actuarial accrued liability is being amortized over 30 years. The remaining amortization period as of December 31, 2008, was 30 years.

Des Moines Water Works

Notes to Basic Financial Statements

Note 7. Risk Management

Water Works is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, errors and omissions, injuries to employees, natural disasters and malpractice.

Water Works purchases commercial insurance for property and casualty, workers' compensation, employee health, life and long-term disability insurance. During the last three years, settled claims have not exceeded insurance coverage.

Note 8. Commitments

Approximately \$7,486,000 related to 2010 contracts has been formally committed as of December 31, 2010. In addition, the Board has approved approximately \$15,760,000 of expenditures for capital acquisitions and improvements, all of which are expected to be expended in 2011.

In 1983, Water Works determined additional water resources would be required for future customer needs. As a result, the Board has contracted with the United States of America – Army Corps of Engineers, through the state of Iowa, for water supply storage in the Saylorville Reservoir Project continuing through the life of the project. Under the contract, Water Works is required to pay a portion of future major renovation costs of the project. Water Works also pays a portion of the annual operation and maintenance costs of the project. Water Works portion of the operation and maintenance costs was approximately \$114,000 in 2010. These amounts were both paid in 2010 due to the recalculation and subsequent billing of the costs by the Army Corps of Engineers.

On January 5, 2004, the Water Works and City of Des Moines, Iowa entered into a 28E Agreement for the operation, management and maintenance of the Botanical Center. The Water Works is responsible for the management and operation of the Botanical Center for the City. All revenues generated and expenses incurred for the operation are retained by Water Works. The agreement exists for an initial term of January 5, 2004 through December 31, 2009 and was renewed on January 1, 2010 for not more than three successive three-year terms.

For the year ended December 31, 2010, revenues generated by the Botanical Center were approximately \$762,000 and expenses were approximately \$1,033,000.

Note 9. Subsequent Events

In March 2011, Water Works issued Water Revenue Refunding Bonds, Series 2011, in the amount of \$10,250,000 for the purpose of refunding the outstanding 2004B bonds. Payments of principal and interest at 3 percent are payable through fiscal year 2017.

In April 2011, Water Works received written notification from the state of Iowa that the Federal Emergency Management Agency (FEMA) has deemed certain federal flood projects ineligible and funding will therefore be deobligated in the amount of approximately \$1 million. Management has determined repayment of these funds is possible, and is currently appealing the decision.

Des Moines Water Works

Notes to Basic Financial Statements

Note 10. New Governmental Accounting Standards Board (GASB) Statements

Water Works implemented the following GASB Statements during the year ended December 31, 2010:

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement provides guidance regarding how to identify, account for and report intangible assets. The new standard characterizes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature and has an initial useful life extending beyond a single reporting period. This Statement had no effect on Water Works in the current year.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement will improve how state and local governments report information about derivative instruments in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements. This Statement had no effect on Water Works in the current year.
- GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. This Statement provides guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It establishes requirements for recognizing and measuring the effects of the bankruptcy process on assets and liabilities, and for classifying changes in those items and related costs. This Statement had no effect on Water Works in the current year.

As of December 31, 2010, the GASB also had issued several Statements not yet implemented by the Water Works.

- GASB Statement No. 59, *Financial Instruments Omnibus*, issued June 2010, will be effective for the Water Works beginning with its year ending December 31, 2011. This Statement is intended to update and improve existing standards regarding financial reporting of certain financial instruments and external investment pools. Specifically, this Statement provides financial reporting guidance by emphasizing the applicability of SEC requirements to certain external investment pools, addressing the applicability of GASB 53, *Accounting and Financial Reporting for Derivative Instruments*, and applying the reporting provisions for interest-earning investment contracts of GASB 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, issued January 2011, will be effective for the Water Works beginning with its year ending December 31, 2012. This Statement is intended to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. This Statement incorporates into the GASB's authoritative literature the applicable guidance previously presented in the following pronouncements issued before November 30, 1989: FASB Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA's Committee on Accounting Procedure. By incorporating and maintaining this guidance in a single source, the GASB believes that GASB 62 reduces the complexity of locating and using authoritative literature needed to prepare state and local government financial reports.

The Water Works' management has not yet determined the effect these Statements will have on Water Works' financial statements.

Des Moines Water Works

**Required Supplementary Information
Other Postemployment Benefit Plan**

SCHEDULE OF FUNDING PROGRESS

Fiscal Year Ended	Actuarial Valuation Date	Actuarial Value of Net Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Over funded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
2008	12/31/06	\$ -	\$ 7,149,694	\$ (7,149,694)	- %	\$ 12,052,777	59.3%
2009	12/31/08	-	8,136,566	(8,136,566)	-	13,416,248	60.6
2010	12/31/08	-	8,136,566	(8,136,566)	-	13,694,936	59.4

Note: Fiscal year 2008 is the transition year for GASB Statement No. 45.

The information presented in the required supplementary schedule was determined as part of the actuarial valuation date as of December 31, 2008.

Additional information follows:

- a. The actuarial method used to determine the ARC is the unit credit method.
- b. There are no plan assets.
- c. The actuarial assumptions included: (1) 4 percent investment rate of return and (b) a health care cost trend rate of 8 percent initially, grading down to 5 percent in 7 years.
- d. The unfunded actuarial accrued liability is being amortized over 30 years.

See Note to Required Supplementary Information.

**Des Moines Water Works
Pension Plan**

**Required Supplementary Information
Schedule of Funding Progress**

Actuarial Valuation Date	(1) Actuarial Value of Assets	(2) Actuarial Accrued Liability (AAL)	(3) Unfunded AAL (UAAL) (2) - (1)	(4) Funded Ratio (1) / (2)	(5) Annual Covered Payroll	(6) UAAL as a Percentage of Payroll [(2) - (1)] / (5)
01/01/2005	\$ 32,738,546	\$ 32,738,546	\$ -	100.00%	\$ 10,688,495	- %
01/01/2006	35,987,086	35,987,086	-	100.00	10,826,006	-
01/01/2007	39,967,624	39,967,624	-	100.00	10,773,915	-
01/01/2008	43,038,338	40,236,733	(2,801,605)	107.00	11,058,383	(25)
01/01/2009	41,513,612	42,450,678	937,066	98.00	10,947,799	9
01/01/2010	39,789,839	44,385,344	4,595,505	90.00	11,694,902	39
01/01/2011	38,740,806	47,774,843	9,034,037	81.00	12,318,720	73

The Actuarial Required Contribution (ARC) is calculated using the aggregate actuarial cost method. Information in the above schedule is calculated using the entry age actuarial cost method as a surrogate for the funding progress of the Plan.

See Note to Required Supplementary Information.

**Des Moines Water Works
Pension Plan**

**Required Supplementary Information
Schedule of Contributions from the Employer**

Year Ended December 31:	Annual Required Contribution	Actual Contribution	Percentage Contribution
2004	\$ 896,193	\$ 800,000	89.27%
2005	941,548	896,000	95.16
2006	885,540	885,990	100.05
2007	679,631	825,000	121.39
2008	545,782	800,000	146.58
2009	1,023,319	1,023,319	100.00
2010	1,541,866	1,541,866	100.00

See Note to Required Supplementary Information.

Des Moines Water Works Pension Plan

Note to Required Supplementary Information

The information presented in the required supplementary schedule was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Actuarial valuation:

Frequency	Annual
Latest date	January 1, 2011
Cost method	Aggregate cost method

Amortization Not applicable under Aggregate Cost Method. The Aggregate Cost Method does not identify or separately amortize unfunded actuarial liabilities. They are amortized through normal cost.

Asset valuation method Fair value is adjusted by spreading the expected value minus the actual value over four years. The total actuarial value of assets falls within the applicable corridor limits.

Assumptions:

Investment rate of return	7.5%
Salary increases	5.0% annual increases until retirement
Retirement age	The later of meeting the rule of 85 or age 58, but not later than age 65.

Mortality IRS Prescribed Static Mortality table, male and female

Rate of withdrawal V Table from August 1992 Pension Forum, multiplied by 0.60

Cost of living 3.0% to project benefits and compensation limitations

In addition to the above assumptions, an estimate of the Plan's expenses is included in normal cost.

Des Moines Water Works

**Schedule of Expenditures of Federal Awards
Year Ended December 31, 2010**

Federal Grantor/Pass Through Grantor and Program Title	Federal CFDA Number	Pass Through/ Grantor Identifying Number	Federal Expenditures
U.S. Department of Homeland Security Passed Through State of Iowa Department of Homeland Security FEMA - Public Assistance	97.036	N/A	<u>\$ 1,040,824</u>

See Notes to Schedule of Expenditures of Federal Awards.

Des Moines Water Works

Notes to Schedule of Expenditures of Federal Awards Year Ended December 31, 2010

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Des Moines Water Works and is presented on the modified accrual basis of accounting. All federal financial assistance received directly from federal agencies, as well as federal financial assistance passed through other governmental agencies expended during the year, is included in the schedule. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments and Nonprofit Organizations*. Therefore, some amounts presented in the schedule may differ from amounts presented in or used in the preparation of the basic financial statements.

Note 2. Significant Accounting Policies

Revenue from federal awards is recognized when Des Moines Water Works has done everything necessary to establish its right to revenue and the revenue met the available criteria. Expenditures of federal awards are recognized in the accounting period when the liability is incurred and approved for reimbursement.

Note 3. Subsequent Events

In April 2011, Water Works received written notification from the state of Iowa that the Federal Emergency Management Agency (FEMA) has deemed certain federal flood projects ineligible and funding will therefore be deobligated in the amount of approximately \$1 million. Management has determined repayment of these funds, which are included in the schedule of expenditures of federal awards for the year ended December 31, 2010, is possible, and is currently appealing the decision.

Des Moines Water Works

**Summary Schedule of Prior Audit Findings
Year Ended December 31, 2010**

Number	Comment	Status	Corrective Action Plan or Other Explanation
None reported			



Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With Government Auditing Standards

Board of Water Works Trustees
Des Moines Water Works
Des Moines, Iowa

We have audited the basic financial statements of Des Moines Water Works as of and for the year ended December 31, 2010, and have issued our report thereon dated June 21, 2011. 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 Des Moines Water Works' 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 Des Moines Water Works' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Des Moines Water Works' internal control over financial reporting.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

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

We noted certain matters that we have reported to management in a separate letter dated June 21, 2011.

This report is intended solely for the information and use of management, the Board of Water Works Trustees, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

McGladrey & Pullen, LLP

Davenport, Iowa
June 21, 2011



**Independent Auditor's Report on Compliance With Requirements
That Could Have a Direct and Material Effect on
Each Major Program and on Internal Control Over
Compliance In Accordance With OMB Circular A-133**

Board of Water Works Trustees
Des Moines Water Works
Des Moines, Iowa

Compliance

We have audited Des Moines Water Works' compliance with the types of compliance requirements described in the Office of Management and Budget (OMB) Circular A-133, *Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended December 31, 2010. Des Moines Water Works' major federal program is identified in the summary of auditor's results section of the accompanying *schedule of findings and questioned costs*. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of Des Moines Water Works' management. Our responsibility is to express an opinion on Des Moines Water Works' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Des Moines Water Works' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Des Moines Water Works' compliance with those requirements.

In our opinion, Des Moines Water Works complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2010.

Internal Control over Compliance

Management of Des Moines Water Works is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Des Moines Water Works' internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Des Moines Water Works' internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying schedule of findings and questioned costs as item 10-III-A. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Des Moines Water Works' response to the finding identified in our audit is described in the accompanying *schedule of findings and questioned costs*. We did not audit Des Moines Water Works' response and, accordingly, we express no opinion on it.

We noted certain matters that we have reported to management in a separate letter dated June 21, 2011.

This report is intended solely for the information and use of management, the Board of Water Works Trustees, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

McGladrey & Pullen, LLP

Davenport, Iowa
June 21, 2011

Des Moines Water Works

Schedule of Findings and Questioned Costs Year Ended December 31, 2010

I. Summary of the Independent Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified?
- Significant deficiency(ies) identified?
- Noncompliance material to financial statements noted?

- Yes No
 Yes None Reported
 Yes No

Federal Awards

Internal control over major programs:

- Material weakness(es) identified?
- Significant deficiency(ies) identified?

- Yes No
 Yes None Reported

Type of auditor's report issued on compliance for major programs: Unqualified

- Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133?

- Yes No

Identification of major program:

CFDA Number	Name of Federal Program or Cluster
97.036	FEMA - Public Assistance

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee?

- Yes No

(Continued)

Des Moines Water Works

Schedule of Findings and Questioned Costs (Continued) Year Ended December 31, 2010

II. Findings Related to the Financial Statement Audit as Required to be Reported in Accordance with Generally Accepted Government Auditing Standards

A. Significant Deficiencies in Internal Control

No matters reported

B. Instances of Noncompliance

No matters reported

III. Findings and Questioned Costs for Federal Awards

A. Significant Deficiency in Administering Federal Awards

**U.S. Department of Homeland Security
Passed Through State of Iowa Department of Homeland Security (CFDA 97.036)
Federal Award Year: 2010**

10-III-A

Finding: Des Moines Water Works does not have an adequate system to ensure that vendors used for the program were not suspended or debarred from participation in federal programs.

Criteria: The Office of Management and Budget Circular A-133 dictates when a nonfederal entity enters into a contract or purchase order with an entity (vendor), the nonfederal entity must verify the entity is not suspended or debarred from participation in federal programs/grants when expending \$25,000 or more in a year with a vendor.

Condition: Des Moines Water Works did not ensure that vendors used were not suspended or debarred from participation in federal programs.

Context: Des Moines Water Works had one vendor representing approximately \$980,000 of 2010 federal expenditures.

Effect: Federal compliance requirements may not be met.

Cause: Personnel were not aware of this requirement.

Recommendation: We recommend Des Moines Water Works ensure vendors used have not been suspended or debarred prior to entering into contracts or purchase orders for all transactions (federal and nonfederal).

Response: When Des Moines Water Works takes bids for FEMA projects, a listing of vendors bidding on the project will be provided to finance staff. Finance staff will perform a search on the EPLS.gov website to verify the vendors are not debarred or suspended. We will also print a screen shot that will show the date that the verification took place.

B. Instances of Noncompliance

No matters reported.

Des Moines Water Works

Corrective Action Plan Year Ended December 31, 2010

Current Number	Comment	Corrective Action Plan	Anticipated Date of Completion	Contact Person
Findings Related to Financial Statements:				
No matters reported				
Findings Related to Federal Awards:				
Significant Deficiencies in Administering Federal Awards				
10-III-A	Des Moines Water Works does not have an adequate system to ensure that vendors used for the program were not suspended or debarred from participation in federal programs.	See response and corrective action plan at 10-III-A.	November 30, 2011	Peggy Freese



Peggy Freese, Director of Finance
Des Moines Water Works
Des Moines, Iowa

In connection with our audit of the financial statements of Des Moines Water Works as of and for the year ended December 31, 2010, we identified deficiencies in internal control over financial reporting (control deficiencies).

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 and correct misstatements on a timely basis. A deficiency in design exists when a control necessary to meet the control objective is missing, or when an existing control is not properly designed so that even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

We have separately communicated to you and the Board an identified deficiency that we determined to be a significant deficiency. Certain control deficiencies that have been previously communicated to you, in writing, by us or by others within your organization are not repeated herein.

Following are descriptions of other identified control deficiencies that we determined did not constitute significant deficiencies or material weaknesses:

Interest Earned on Federal Grant Funds: The OMB Circular A-133 requires the interest earned by local government grantees and subgrantees on advances be submitted promptly, but at least quarterly, to the Federal agency. In our testing of the single audit major program, we noted Des Moines Water Works is not tracking interest earned on advances of federal funds. The OMB identifies a threshold of \$250, and we estimated interest earned of approximately \$350, using Des Moines Water Work's applicable interest rates, which is in excess of this amount. We recommend Des Moines Water Works monitor interest earnings on advance cash received and remit interest earned to the U.S. Treasury.

Journal Entries: During the audit, we identified amounts of accrued liabilities, contributed capital and receivables that were not properly recorded in Des Moines Water Work's financial statements, as well as adjustments to the Schedule of Expenditures of Federal Awards. Adjustments were subsequently made by Des Moines Water Works to properly record these amounts in the financial statements. We recommend Des Moines Water Works implement procedures to ensure all transactions are properly accounted for and recorded in the financial statements, including the reporting of federal expenditures.

This communication is intended solely for the information and use of management, the Board of Water Works Trustees and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Davenport, Iowa
June 21, 2011