

WATERLOO WATER WORKS

WATERLOO, IOWA

DECEMBER 31, 2011

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Officials

Name	Title	Term Expires
Terry Kuntz	Chairman - Board of Trustees	January 12, 2012
Rodger Burris	Vice-Chairman - Board of Trustees	January 12, 2014
Mary Potter	Trustee	January 12, 2016
Dennis Clark, PE	Secretary, Treasurer and General Manager	Indefinite
Rick Wilberding	Assistant Treasurer and Distribution Manager	Indefinite
Mary Ratkovich	Assistant Treasurer and Office Manager	Indefinite
Tim Robbins	Water Production Manager	Indefinite

**Waterloo Water Works
Management's Discussion and Analysis
December 31, 2011**

The Waterloo Water Work's (Utility) discussion and analysis is designed to offer readers of the Utility's financial statements a narrative overview and analysis of the financial activities of the Utility for the year ended December 31, 2011. Readers are encouraged to read the Management's Discussion and Analysis in conjunction with the Utility's financial statements, which begin on Page 8.

Financial Highlights

- The Utility's assets exceeded its liabilities by \$25.6 million at December 31, 2011. Of this amount, approximately \$6 million may be used to meet ongoing obligations to the citizens and creditors. The remaining net assets are invested in capital assets or are restricted for debt repayment.
- The operating revenue of the Utility exceeded operating expenses by \$1,897,281 and \$1,656,936 for the years ended December 31, 2011 and 2010, respectively.
- At December 31, 2011, the Utility's unrestricted cash, certificates of deposits, trade receivables and prepaid expenses of approximately \$7.4 million exceeded total current liabilities by approximately \$5.6 million. This excess is available for spending at the Utility's discretion.
- The Utility has capital loan notes outstanding of \$1,805,000 at December 31, 2011 which are reported net of unamortized discounts costs of \$12,784.

Overview of the Financial Statements

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

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

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

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

The basic financial statements can be found on Pages 8 through 11 of this report.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. Notes are considered to be an integral part of financial statements prepared in accordance with generally accepted accounting principles. The notes to the financial statements can be found on Pages 12 through 21 of this report.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. The Utility's assets exceeded its liabilities by \$25.6 million and \$23.4 million on December 31, 2011 and 2010, respectively.

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

	2011	2010
Current assets.....	\$ 7,350,428	\$ 5,819,373
Noncurrent, noncapital assets	850,746	777,406
Capital assets, net of accumulated depreciation	<u>20,693,071</u>	<u>20,456,108</u>
Total Assets	<u>28,894,245</u>	<u>27,052,887</u>
Current liabilities	1,750,186	1,712,990
Liabilities payable from restricted assets	131,816	126,401
Other long-term liabilities (net)	<u>1,457,216</u>	<u>1,789,020</u>
Total Liabilities	<u>3,339,218</u>	<u>3,628,411</u>
Net Assets		
Invested in capital assets, net of related debt	19,218,071	18,661,108
Restricted for debt service.....	330,000	330,000
Unrestricted	<u>6,006,956</u>	<u>4,433,368</u>
Total Net Assets	<u>\$ 25,555,027</u>	<u>\$ 23,424,476</u>

Net assets invested in capital assets are by far the largest portion of the Utility's net assets, 75% at December 31, 2011, and reflect its net investment in capital assets (e.g., land, buildings, machinery, equipment, meters and water supply system). The Utility uses these capital assets to provide water and services to the citizens; consequently, these assets are not available for future spending.

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

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

At both December 31, 2011 and 2010, the Utility reported positive balances in all three categories of net assets.

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

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

	2011	2010
Operating revenue	\$ 7,306,939	\$ 6,874,842
Operating expenses	5,409,658	5,217,906
Operating Income	<u>1,897,281</u>	<u>1,656,936</u>
Net nonoperating revenue	427,118	131,350
Capital contributions	70,745	6,898
Transfers to City of Waterloo	<u>(264,593)</u>	<u>(224,990)</u>
Change in Net Assets.....	2,130,551	1,570,194
Net Assets - Beginning of Year	<u>23,424,476</u>	<u>21,854,282</u>
Net Assets - End of Year	<u>\$ 25,555,027</u>	<u>\$ 23,424,476</u>

Operating revenue is the Utility’s primary source of revenue and is generated from water sales and other services to customers. For 2011, operating revenue increased \$432,097 from 2010 due primarily to a 5% increase in water rates.

Operating expenses totaled \$5,409,658 for 2011, a \$191,752 increase from 2010 due primarily to increases in wages and other employee benefit costs and contractual costs. These expenses represent the Utility’s costs to provide water and services to customers. Operating expenses included depreciation expense of \$550,415 and \$514,421 for the years ended December 31, 2011 and 2010, respectively.

Net nonoperating revenue includes interest income and expense, government grants, amortization of debt issuance costs, losses on disposals of assets and rent from leasing space for billboards and antennas. Net nonoperating revenue increased by \$295,768 between 2011 and 2010 due primarily to an increase in government grants associated with repairs from the 2008 flood damage. Rent income totaled \$135,440 and \$125,698 for the years ended December 31, 2011 and 2010, respectively.

Capital contributions totaled \$70,745 and \$6,898 for the years ended December 31, 2011 and 2010, respectively. These contributions are received as “front footage” fees as property is developed with resulting taps into the Utility’s water distribution system.

Transfers to City of Waterloo of \$264,593 and \$224,990 for the years ended December 31, 2011 and 2010, respectively, are equal to the value of metered water provided to the City at no charge. Operating revenue includes an amount equal to the transfer. The Utility also provides unmetered water to the City at no charge. However, no reasonable estimate of the value of the unmetered water can be made. Therefore, the value of unmetered water is not included in the financial statements.

Budgetary Highlights

Each year, the Board of Trustees adopts a budget using the modified cash basis of accounting which differs from the accrual basis of accounting used for the accompanying financial statements. The Utility’s original budget was not amended during either of the years ended December 31, 2011 or 2010.

Actual cash receipts were approximately \$839,693 less than budgeted. The majority of this variance was due to less grant money being received due to the cost of the Third Street River Crossing Water Main Project being less than what was budgeted.

Actual cash disbursements were approximately \$5 million less than budgeted due to lower than anticipated capital expenses, distribution expenses and administrative and general expenses.

Capital Assets and Long-term Debt

The Utility's investment in capital assets amounted to approximately \$20.7 million and \$20.5 million at December 31, 2011 and 2010, respectively, (net of accumulated depreciation of approximately \$8.9 million and \$8.4 million at December 31, 2011 and 2010, respectively). This investment in capital assets includes land; buildings and improvements; water supply and distribution systems; meters; machinery; and equipment.

Major capital asset construction and acquisition during 2011 included the following:

- Installation of 0.3 miles of water mains.
- Purchase of three vehicles.
- Updated computer equipment and street department equipment.
- Completion of the Third Street River Crossing Water Main Project.
- Re-roofing the Third Street Reservoir.

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

	2011	2010
Land	\$ 270,896	\$ 270,896
Pipes and valves	463,403	567,816
Buildings and improvements	1,754,291	1,759,882
Water supply system	5,198,291	5,056,525
Distribution system	18,560,971	17,818,746
Meters and equipment	1,468,956	1,472,263
Machinery and equipment	1,761,904	1,778,798
Construction in progress	100,829	146,966
Total	<u>\$ 29,579,541</u>	<u>\$ 28,871,892</u>

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

At December 31, 2010, total Utility long-term debt was \$2,125,000 less unamortized discounts of \$15,980 for a net long-term debt of \$2,109,020. At December 31, 2011, total Utility long-term debt was \$1,805,000 less unamortized discounts of \$12,784 for a net long-term debt of \$1,792,216. Principal of \$335,000 and interest of \$70,653 is due during the year ending December 31, 2011.

Debt indentures require that certain covenants relating to the maintenance and efficiency of the operating system, the rate structure, restrictions on borrowings, leasing or disposition of assets and minimum insurance coverage be adhered to. During 2011 and 2010, the Utility was in compliance with required covenants.

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

Economic Factors and Next Year's Budget and Rates

The Utility's primary source of revenue is water sales. Effective January 1, 2012, water meter minimum charges increased 8% and rate blocks increased approximately 8 cents per hundred cubic feet of water. Budgeted revenue has been adjusted to reflect the increase in rates.

Operating expense for 2012 is expected to increase over the same expenditures in 2011 due to step increases for new employees, insurance premium increases, contributions to the pension plan and other operating expense increases. Capital expenditures are expected to increase as the Utility is planning to continue work on the Shaulis Road and Dewitt Road water main extensions, continue work on the Highway 63 North water main replacements, continue work on Kimball Avenue water tower rehabilitation, continue implementation of GIS mapping and software systems and complete miscellaneous main replacement projects, partially in conjunction with the City of Waterloo's Street Reconstruction Program, all at an estimated cost of \$4,611,000.

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Certified Public Accountants and Consultants

Independent Auditor's Report

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the accompanying balance sheets of the Waterloo Water Works, a component unit of the City of Waterloo, Iowa, at December 31, 2011 and 2010, and the related statements of revenue, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Waterloo Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Waterloo Water Works at December 31, 2011 and 2010, and the changes in its financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 17, 2012 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The accompanying Management's Discussion and Analysis and the schedule of funding progress on Pages 2 through 6 and 22 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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Waterloo, Iowa
April 17, 2012

Balance Sheets

At December 31, 2011 and 2010

	2011	2010
Assets		
Current Assets		
Cash and cash equivalents	\$ 5,758,307	\$ 4,055,236
Certificates of deposit	210,000	410,000
Receivables		
Trade accounts	1,303,502	1,266,773
Accrued interest	993	3,500
Notes	—	8,754
Prepaid expenses	77,626	75,110
Total Current Assets	<u>7,350,428</u>	<u>5,819,373</u>
Noncurrent Assets		
Restricted certificates of deposit	480,000	480,000
Unamortized capital loan notes issuance costs	10,518	13,147
Repair assessments receivable	360,228	284,259
Subtotal	<u>850,746</u>	<u>777,406</u>
Capital Assets		
Land	270,896	270,896
Pipes and valves	463,403	567,816
Buildings and improvements	1,754,291	1,759,882
Water supply system	5,198,291	5,056,525
Distribution system	18,560,971	17,818,746
Meters and equipment	1,468,956	1,472,263
Machinery and equipment	1,761,904	1,778,798
Construction in progress	100,829	146,966
Total Capital Assets	29,579,541	28,871,892
Less accumulated depreciation	(8,886,470)	(8,415,784)
Net Capital Assets	<u>20,693,071</u>	<u>20,456,108</u>
Total Noncurrent Assets	<u>21,543,817</u>	<u>21,233,514</u>
Total Assets	<u>\$ 28,894,245</u>	<u>\$ 27,052,887</u>

See accompanying notes to the financial statements.

	2011	2010
Liabilities and Net Assets		
Current Liabilities		
Current maturities of water revenue capital loan notes	\$ 335,000	\$ 320,000
Accounts payable	55,924	72,819
Accrued employee compensation	100,092	85,538
Customer deposits.....	33,661	39,374
Due to Other Governments		
City of Waterloo		
Garbage fees.....	340,312	323,219
Sewer fees	688,394	682,937
Storm water fees	140,027	136,718
City of Raymond	11,197	11,278
Black Hawk County.....	<u>45,579</u>	<u>41,107</u>
Total Current Liabilities	1,750,186	1,712,990
Liabilities Payable From Restricted Assets	131,816	126,401
Water Revenue Capital Loan Notes	<u>1,457,216</u>	<u>1,789,020</u>
Total Liabilities	<u>3,339,218</u>	<u>3,628,411</u>
 Net Assets		
Invested in capital assets, net of related debt	19,218,071	18,661,108
Restricted for debt service.....	330,000	330,000
Unrestricted	<u>6,006,956</u>	<u>4,433,368</u>
Total Net Assets	<u>25,555,027</u>	<u>23,424,476</u>
 Total Liabilities and Net Assets	 <u>\$ 28,894,245</u>	 <u>\$ 27,052,887</u>

Statements of Revenue, Expenses and Changes in Net Assets

Years Ended December 31, 2011 and 2010

	2011	2010
Operating Revenue		
Water sales.....	\$ 6,326,524	\$ 6,020,552
Metered water provided to the City of Waterloo	264,593	224,990
Fire protection.....	99,688	96,661
Billing and collection fees	130,078	116,531
Other sales and service.....	<u>486,056</u>	<u>416,108</u>
Total Operating Revenue	<u>7,306,939</u>	<u>6,874,842</u>
Operating Expenses		
Salaries and benefits	2,946,287	2,841,467
Contractual services.....	832,438	793,061
Commodities.....	1,080,518	1,068,957
Depreciation	<u>550,415</u>	<u>514,421</u>
Total Operating Expenses.....	<u>5,409,658</u>	<u>5,217,906</u>
Operating Income.....	<u>1,897,281</u>	<u>1,656,936</u>
Nonoperating Revenue (Expenses)		
Interest income.....	45,877	46,212
Interest expense.....	(86,008)	(97,633)
Government grants.....	351,835	59,702
Amortization.....	(2,629)	(2,629)
Loss on disposal of fixed assets.....	(17,397)	—
Billboard and antenna rent	<u>135,440</u>	<u>125,698</u>
Total Nonoperating Revenue	<u>427,118</u>	<u>131,350</u>
Change in Net Assets Before Contributions and Transfers	2,324,399	1,788,286
Capital contributions.....	70,745	6,898
Transfers to City of Waterloo.....	<u>(264,593)</u>	<u>(224,990)</u>
Change in Net Assets.....	2,130,551	1,570,194
Net Assets - Beginning of Year	<u>23,424,476</u>	<u>21,854,282</u>
Net Assets - End of Year.....	<u>\$ 25,555,027</u>	<u>\$ 23,424,476</u>

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2011 and 2010

	2011	2010
Cash Flows From Operating Activities		
Cash received from customers	\$ 6,805,835	\$ 6,363,163
Cash collected on behalf of primary government	12,850,460	11,657,386
Cash collected on behalf of other governments	350,432	370,501
Cash paid to primary government (less 1% collection fee)	(12,697,718)	(11,249,637)
Cash paid to other governments (less collection fee).....	(354,824)	(365,546)
Cash paid to or on behalf of employees	(2,924,993)	(2,867,514)
Cash paid to suppliers	<u>(1,501,047)</u>	<u>(1,541,973)</u>
Net Cash Provided by Operating Activities	<u>2,528,145</u>	<u>2,366,380</u>
Cash Flows From Noncapital Financing Activities		
Billboard and antenna rent	<u>135,440</u>	<u>125,698</u>
Cash Flows From Capital and Related Financing Activities		
Contributed capital.....	70,745	6,898
Collections on note receivable for water main, including interest (2011 - \$0; 2010 - \$733)	8,754	8,477
Repayments of water revenue capital loan notes.....	(320,000)	(310,000)
Interest paid on water revenue capital loan notes	(82,812)	(94,437)
Acquisition of capital assets	(909,187)	(1,110,363)
Government grants received	351,835	59,702
Acquisition of plant not in service	<u>(328,233)</u>	<u>(287,077)</u>
Net Cash Used in Capital and Related Financing Activities	<u>(1,208,898)</u>	<u>(1,726,800)</u>
Cash Flows From Investing Activities		
Proceeds from the maturities of certificates of deposit.....	530,000	640,000
Purchase of certificates of deposit.....	(330,000)	(510,000)
Interest received on savings and certificates of deposits	<u>48,384</u>	<u>45,479</u>
Net Cash Provided by (Used in) Investing Activities	<u>248,384</u>	<u>175,479</u>
Net Increase in Cash	1,703,071	940,757
Cash and Cash Equivalents - Beginning of Year	<u>4,055,236</u>	<u>3,114,479</u>
Cash and Cash Equivalents- End of Year	<u>\$ 5,758,307</u>	<u>\$ 4,055,236</u>

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2011 and 2010

	2011	2010
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 1,897,281	\$ 1,656,936
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	550,415	514,421
Water provided to the City of Waterloo, not billed	(264,593)	(224,990)
Pipes and values used in operations.....	432,645	324,283
Change in Assets and Liabilities		
Increase in trade accounts and repair assessments receivable.....	(112,698)	(172,776)
(Increase) decrease in prepaid expenses.....	(9,256)	22,192
(Increase) decrease in prepaid pension.....	6,740	(38,141)
Decrease in accounts payable.....	(16,895)	(29,445)
Increase in accrued employee compensation.....	14,554	12,094
Increase in customer deposits, due to other governments and liabilities payable from restricted assets	<u>29,952</u>	<u>301,806</u>
Net Cash Provided by Operating Activities	<u>\$ 2,528,145</u>	<u>\$ 2,366,380</u>

See accompanying notes to the financial statements.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Reporting Entity

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

Measurement Focus and Basis of Accounting

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

Use of Estimates

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

Cash, Cash Equivalents and Certificates of Deposit

The Utility's deposits at year end were entirely insured or collateralized with securities held by the Utility or by their agents in the Utility's name or by nontransferable letters of credit. The Utility also has deposits in Iowa Public Agency Investment Trust money market accounts.

Trade Accounts Receivable

Water sales are billed monthly or quarterly, depending upon the quantity of water used or if requested by the customer. Accordingly, water sales are billed monthly to the larger commercial accounts and certain multi-family residential customers, while most residential customers are billed quarterly. Water sales are estimated for the period from the previous billing to year end and are included in revenue and trade accounts receivable. Unbilled revenue included in receivables at December 31, 2011 and 2010 was \$713,875 and \$678,832, respectively.

Budgeting

The Utility is required to prepare a budget each year and submit it, subject to review by the City of Waterloo, to the State of Iowa. The Utility prepares its budget using the cash basis of accounting modified by reducing cash balances and receipts and disbursements by amounts held on behalf of the City of Waterloo and customer deposits. The Utility's 2011 and 2010 budget and comparison to cash basis activity is as follows:

	2011	2010
Business-Type Activity - Water		
Actual disbursements	\$ 6,484,715	\$ 6,545,486
Budgeted disbursements.....	<u>11,468,967</u>	<u>9,503,685</u>
Actual Disbursements Under Budget.....	<u>\$ (4,984,252)</u>	<u>\$ (2,958,199)</u>

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Capital Assets

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

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

Depreciation expense for the years ended December 31, 2011 and 2010 was \$550,415 and \$514,421, respectively.

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

Operating Revenue

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

Restricted Resources

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

Unamortized Water Revenue Capital Loan Notes Issuance Costs

Costs to issue the 2007 water revenue capital loan notes of \$27,060 are amortized using the straight-line method over the 11-year life of the notes. Amortization expense totaled \$2,629 for each of the years ended December 31, 2011 and 2010.

Discount on Water Revenue Capital Loan Notes

Original discount on the 2007 water revenue capital loan notes of \$32,894 is amortized using the straight-line method over the 11-year life of the notes. Amortization expense computed under the straight-line method was not materially different than amortization expense computed using the effective interest method. Discount amortization, which is included in interest expense, totaled \$3,196 for both of the years ended December 31, 2011 and 2010.

Notes to the Financial Statements

(1) Summary of Significant Accounting Policies and Other Matters

Cash and Cash Equivalents

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

(2) Cash Flow Statement Supplementary Information

	2011	2010
Schedule of Noncash Investing and Financing Activities		
Interest expense	\$ 86,008	\$ 97,633
Less noncash amortization of water revenue capital loan notes discount.....	<u>(3,196)</u>	<u>(3,196)</u>
Cash Paid for Interest	<u>\$ 82,812</u>	<u>\$ 94,437</u>
Plant Not in Service Used in Operations.....	<u>\$ 432,645</u>	<u>\$ 324,283</u>

(3) Deposits and Investments

The Utility's deposits in banks and credit unions at December 31, 2011 and 2010 are entirely covered by federal depository insurance, by the State Sinking Fund or are collateralized either with securities held by the Utility or by nontransferable letters of credit in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

The Utility's certificates of deposit are stated at cost which approximates fair value. Certificates of deposit are purchased with maturities of 12 to 28 months and yields of 1.49% to 2.43%. Certain certificates of deposit are restricted to comply with debt covenants and to secure customer deposits.

The Utility's deposits in the Iowa Public Agency Investment Trust were valued at an amortized cost of \$1,527,006, pursuant to Rule 2a-7 under the Investment Company Act of 1940. The deposits in the Iowa Public Agency Investment Trust are unrated for credit risk purposes.

Notes to the Financial Statements

(4) Restricted Assets

Restricted assets represent monies set aside under terms of bond covenants and to provide security for deposits and advances. The composition of these funds at December 31, 2011 and 2010 was as follows:

	Restricted Asset	Corresponding Liability	Restricted Net Assets
2011			
Customer deposits.....	\$ 131,816	\$ 131,816	\$ —
Capital Loan Note Covenants			
Debt reserve	<u>330,000</u>	<u>—</u>	<u>330,000</u>
Total	<u>\$ 461,816</u>	<u>\$ 131,816</u>	<u>\$ 330,000</u>
2010			
Customer deposits.....	\$ 126,401	\$ 126,401	\$ —
Capital Loan Note Covenants			
Debt reserve	<u>330,000</u>	<u>—</u>	<u>330,000</u>
Total	<u>\$ 456,401</u>	<u>\$ 126,401</u>	<u>\$ 330,000</u>

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

Balance - January 1, 2010.....	\$ —
Monthly allocations during 2010	404,437
Interest payments made	(94,437)
Principal payments made	<u>(310,000)</u>
Balance - December 31, 2010.....	—
Monthly allocations during 2011	402,812
Interest payments made	(82,812)
Principal payments made	<u>(320,000)</u>
Balance - December 31, 2011	<u>\$ —</u>

(5) Notes Receivable

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

Individual note balances were \$8,754 at December 31, 2010. The notes were paid off in 2011.

Notes to the Financial Statements

(6) Capital Assets

Capital asset activity for the years ended December 31, 2011 and 2010 was as follows:

	Balance 12-31-09	Increase	Decrease	Balance 12-31-10	Increase	Decrease	Balance 12-31-11
Capital Assets Not Being Depreciated							
Land	\$ 270,896	\$ —	\$ —	\$ 270,896	\$ —	\$ —	\$ 270,896
Pipes and valves	605,022	—	37,206	567,816	—	104,413	463,403
Construction in progress	98,286	1,011,372	962,692	146,966	700,247	746,384	100,829
Total Capital Assets Not Being Depreciated	974,204	1,011,372	999,898	985,678	700,247	850,797	835,128
Capital Assets Being Depreciated							
Buildings and improvements	1,750,597	9,285	—	1,759,882	—	5,591	1,754,291
Water supply system ...	4,337,390	719,135	—	5,056,525	141,766	—	5,198,291
Distribution system	17,526,315	292,431	—	17,818,746	742,225	—	18,560,971
Meters and equipment	1,472,263	—	—	1,472,263	—	3,307	1,468,956
Machinery and equipment	1,753,260	40,832	15,294	1,778,798	73,407	90,301	1,761,904
Total Capital Assets Being Depreciated	26,839,825	1,061,683	15,294	27,886,214	957,398	99,199	28,744,413
Less Accumulated Depreciation for							
Buildings and improvements	(647,164)	(27,581)	—	(674,745)	(28,274)	(3,646)	(699,373)
Water supply system ...	(2,283,346)	(115,876)	—	(2,399,222)	(144,170)	—	(2,543,392)
Distribution system	(3,166,105)	(248,400)	—	(3,414,505)	(256,745)	—	(3,671,250)
Meters and equipment	(710,842)	(38,034)	—	(748,876)	(37,957)	(2,458)	(784,375)
Machinery and equipment	(1,109,200)	(84,530)	(15,294)	(1,178,436)	(83,269)	(73,625)	(1,188,080)
Total Accumulated Depreciation	(7,916,657)	(514,421)	(15,294)	(8,415,784)	(550,415)	(79,729)	(8,886,470)
Net Capital Assets Being Depreciated	18,923,168	547,262	—	19,470,430	406,983	19,470	19,857,943
Net Capital Assets	\$ 19,897,372	\$ 1,558,634	\$ 999,898	\$ 20,456,108	\$ 1,107,230	\$ 870,267	\$ 20,693,071

(7) Summary of Debt

	Current Portion		Long-Term Portion	
	2011	2010	2011	2010
Water Revenue Capital Loan Notes				
Series 2007 capital loan notes, Bankers Trust Company, N.A. - paying and registered agent, due in annual payments ranging from \$335,000 to \$390,000 through December, 2016, plus interest semi-annually at rates ranging from 3.75% to 4%, depending on maturity, secured by first lien on net revenue.	\$ 335,000	\$ 320,000	\$ 1,470,000	\$ 1,805,000
Less unamortized discount	—	—	(12,784)	(15,980)
Total	\$ 335,000	\$ 320,000	\$ 1,457,216	\$ 1,789,020

Notes to the Financial Statements

(7) Summary of Debt

The Water Works has pledged future gross revenue, net of specified operating expenses to repay \$3,300,000 in water revenue capital loan notes issued in February, 2007. Proceeds from the notes provided for refunding of Series 2001 capital loan notes and costs of water main extensions and other improvements. The notes are payable solely from net revenue of the system and restricted cash held in the debt reserve account. Annual principal and interest payments are expected to be less than 80% of net revenue. The total principal and interest remaining to be paid is \$2,024,415. For the current year, principal and interest paid and net revenue of the system were \$402,812 and \$2,960,822, respectively.

Interest expense for 2011 and 2010 includes \$82,812 and \$94,437 on the notes plus \$3,196 each for 2011 and 2010, for amortization.

At December 31, 2011 annual maturities of long-term debt were as follows:

	Principal	Interest	Total
Year Ending December 31,			
2012.....	\$ 335,000	\$ 70,652	\$ 405,652
2013.....	345,000	57,923	402,923
2014.....	360,000	44,640	404,640
2015.....	375,000	30,600	405,600
2016.....	390,000	15,600	405,600
	<u>\$ 1,805,000</u>	<u>\$ 219,415</u>	<u>\$ 2,024,415</u>

Debt indentures require that certain covenants relating to the maintenance and efficiency of the operating system, the rate structure, restrictions on borrowings, leasing or disposition of assets and minimum insurance coverage be adhered to. During 2011 and 2010, the Utility was in compliance with required covenants

The following is a summary of the changes in debt for the years ended December 31, 2011 and 2010:

	Water Revenue Capital Loan Notes
Balance - January 1, 2010.....	\$ 2,435,000
Retirements	<u>310,000</u>
Balance - December 31, 2010.....	2,125,000
Retirements	<u>320,000</u>
Balance - December 31, 2011	<u>\$ 1,805,000</u>

Notes to the Financial Statements

(8) Compensated Absences

The Utility's employees accumulate vacation days during the year based on the anniversary date of their employment. As of December 31, 2011 and 2010, \$58,704 and \$45,040, respectively, was accrued for unused vacation days

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

(9) Related Party Transactions

The Utility provides customer file maintenance, meter reading, billing and collecting services for the City of Waterloo's (City) Sanitation (Garbage) and Sanitary Sewer Enterprise Funds and keeps 1% of cash collected as a service fee. During 2011 and 2010, the Utility recorded \$126,883 and \$112,621, respectively, as City service fees and forwarded approximately \$12,700,000 and \$11,250,000, respectively, to the City. At December 31, 2011, the Utility's payables to the City were \$340,312 and \$688,394 for garbage and sewer collections, respectively, compared to \$323,219 and \$682,937, respectively, at December 31, 2010, which have not been reduced for the Utility's City service fee. During 2010, the Utility also began collecting storm water fees for the City in exchange for a 1% service fee. At December 31, 2011 and 2010, the Utility's payable to the City for storm water fee collections was \$140,027 and \$136,718, respectively. The Utility pays office expenses (data processing charges, postage and other expenses of the billing cycle) and passes approximately one-half of those costs on to the City. During 2011 and 2010, the Utility received approximately \$67,000 and \$65,000, respectively, from the City which reduced office expenses.

The Utility also provides metered and unmetered water to the City at no charge. Metered water furnished to the City is valued at equivalent sales rates and is included in the financial statements as water sales and transfers to the City. During the years ended December 31, 2011 and 2010, the Utility provided metered water to the City valued at approximately \$265,000 and \$225,000, respectively.

(10) Pension Plans

The Utility contributes to the Waterloo Water Works Pension Plan (Plan) and the Iowa Public Employees Retirement System (IPERS).

Waterloo Water Works Pension Plan

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

Notes to the Financial Statements

(10) Pension Plans

The contribution requirements of the Plan members (employees) and the Utility are established and may be amended by the Utility. Mandatory contributions to the Plan are equal to the IPERS rate effective January 1 of the previous year. During 2009, plan members contributions were not required and the Utility made all the required contributions. Beginning January 1, 2010, plan members were required to contribute one-third of the full contribution rate of 4.1% and the Utility paid the rest of the required contribution. As of January 1, 2011, plan members are required to contribute two-thirds of the full contribution rate of 4.3% and beginning January 1, 2012, plan members will be required to contribute all of the mandatory contributions. The vesting period also changed from 12 years to 4 years as of January 1, 2010

Annual Pension Cost and Net Pension Obligation

The Utility's annual pension cost and net pension (asset) obligation to the Plan for the year ended December 31, 2011:

Annual required contribution (ARC).....	\$ 355,004
Interest on net pension obligation.....	<u>28,400</u>
Annual Pension Cost	383,404
Contributions made	<u>(376,664)</u>
Decrease in Net Pension Asset	(6,740)
Net pension asset - beginning of year	<u>38,141</u>
Net Pension Asset - End of Year	<u>\$ 31,401</u>

The annual pension cost for 2011 was determined as part of the actuarial valuation using the January 1, 2011 projected unit credit cost method. The actuarial assumptions included (a) 8% investment rate of return (net of administrative expenses) and (b) projected salary increases of 3% per year, compounded annually and retirement at age 62 with 30 years of service. The assumptions did not include any postretirement benefits. The actuarial value of assets was determined using the current market value of investments

Three-Year Trend Information

Year Ended	Annual Pension Cost (APC)			Percentage of APC Contributed	Net Pension Obligation (Asset)
	Normal Cost	Interest	Total		
December 31, 2009	\$ 369,877	\$ 28,107	\$ 397,984	95%	\$ —
December 31, 2010	331,182	26,495	357,677	111	(38,141)
December 31, 2011	355,004	28,400	383,404	98	(31,401)

Iowa Public Employees Retirement System (IPERS)

Effective February 20, 2008, all new employees enter the Iowa Public Employees Retirement System instead of the Waterloo Water Works Pension Plan. IPERS is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, IA 50306-9117.

Notes to the Financial Statements

(10) Pension Plans

Plan members were required to contribute 4.5% of their annual covered salary from January 1, 2011 to June 30, 2011 and 5.38% of their annual covered salary from July 1, 2011 to December 1, 2011. The Utility was required to contribute 6.95% of covered salary from January 1, 2011 to June 30, 2011 and 8.07% of covered salary from July 1, 2011 to December 1, 2011. Contribution requirements are established by state statute. The Utility's contributions to IPERS for the years ended December 31, 2011 and 2010 were \$43,676 and \$35,136, respectively, equal to the required contributions each year.

(11) Health Insurance

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

The Utility operates a single-employer retiree benefit plan which provides medical/prescription drug and dental benefits for retirees and their spouses. There are 33 active and no retired members in the plan at December 31, 2011.

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

(12) Risk Management

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

(13) Commitments

During 2011, the Utility began work on the water main extension projects and other various projects. At December 31, 2011, the Utility had incurred costs of \$100,889 with \$224,770 expected to be expended in 2012.

Notes to the Financial Statements

(14) Subsequent Events

Management has evaluated subsequent events through April 17, 2012, the date which the financial statements were available to be issued.

Subsequent to December 31, 2011, the Utility approved a pension contribution of \$417,000 for 2012.

Subsequent to December 31, 2011, the Utility approved bids for the Kimball Avenue Water Tower Rehabilitation Project for \$746,550 and Shaulis Road East Water Main Extension Project for \$287,469.

Required Supplementary Information

Schedule of Pension Plan Funding Progress

Year Ended December 31

Year Ended	Actuarial Valuation Date	Actuarial Value of Net Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2008	1/1/08	\$ 3,881,341	\$ 5,998,293	\$ 2,116,952	64.7%	\$ 1,356,797	156.0%
2009	1/1/09	3,527,489	6,329,986	2,802,497	55.7	1,374,782	203.9
2010	1/1/10	4,099,112	6,544,272	2,445,160	62.6	1,306,209	187.2
2011	1/1/11	4,231,215	6,759,005	2,527,790	62.6	1,248,200	202.5

The information presented in the required supplementary schedule was determined as part of the actuarial valuation as of January 1, 2011. Additional information follows:

1. The cost method used to determine the ARC is the Projected Unit Credit Cost method.
2. Economic assumptions are as follows: 8% investment rate of return (net of administrative expenses); projected salary increases of 3% per year; compounded annually; and retirement at age 62.
3. The amortization method is closed, level dollar.

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

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the financial statements of the Waterloo Water Works as of and for the year ended December 31, 2011, and have issued our report thereon dated April 17, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Utility's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Utility's internal control. Accordingly, we do not express an opinion on the effectiveness of the Utility's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance all such deficiencies have been identified. However, as described below, we identified a deficiency in internal control over financial reporting we consider to be a material weakness.

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 a combination of deficiencies, in internal control such that there is a reasonable possibility a material misstatement of the Utility's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency in internal control listed below as 11-IC-1 to be a material weakness.

11-IC-1 Pipes, Fittings and Meters Used for Capital Assets

Auditor's Finding - The Utility maintains a supply of pipes, fittings and meters for use in repairing or replacing the water system infrastructure. Internal controls are in place to account for the assets purchased and used for repairs and replacements. A perpetual listing of the items is maintained and periodic physical counts are conducted. At December 31, 2011, we attempted to reconcile the cost basis of the items from the beginning-of-the-year balance, adding the items purchased and deducting the items used, to arrive at the end-of-the-year cost basis. The priced total based upon the physical count at year end was approximately \$60,000 less than our reconciled balance. The Utility was unable to determine the reason for this difference.

Auditor's Recommendation - The Utility has internal controls in place over the acquisition and use of pipes, fittings and meters and certain periodic reconciliations and physical counts are being completed. However, we recommend that those procedures be reviewed and modified to perform periodic reconciliations similar to our audit procedures and follow up on variances in a timely manner. We further recommend that when physical counts are being performed, the department employees be provided with a listing of the items that does not include the number of units expected to be on hand. This will force the employees to count each item and to write down the number of units counted.

Utility's Response - We are reviewing our policies and procedures to ensure that the pipes, fittings and meters supply items are reconciled periodically throughout the year and that our counting procedures are proper. We performed a full count at the end of March, 2012 and prepared a reconciliation of the count to the general ledger activity since January 1. We determined that as of March 31, 2012, the general ledger was now understated when compared to the physical count. Therefore, we believe that the count at December 31, 2011 likely contained errors which led to the variance at year end. We have adjusted the accounting records as of March 31, 2012 to agree with the physical count. We will perform another physical count at the end of April and will reconcile the count to the general ledger to determine if the error has been corrected.

Auditor's Conclusion - Response accepted.

Compliance and Other Matters

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

The following comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2011 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

- 11-CS-1 Budget** - Operating cash disbursements during the year ended December 31, 2011 did not exceed the amounts budgeted.
- 11-CS-2 Questionable Disbursements** - We noted no disbursements that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.
- 11-CS-3 Travel Expense** - No disbursements of the Utility's money for travel expenses of spouses of the Utility officials or employees was noted.
- 11-CS-4 Business Transactions** - No business transactions between the Utility's officials or employees and the Utility were noted.
- 11-CS-5 Bond Coverage** - Surety bond coverage of the Utility officials and employees is in accordance with statutory provisions and was reviewed and updated during the year. We recommend that the amount of coverage continue to be reviewed annually to insure that the coverage is adequate for current operations.
- 11-CS-6 Board Minutes** - No transactions were found that we believe should have been included in the minutes but were not. Minutes of Trustees proceedings were published within 15 days as required by Chapter 372.13(6) of the Code of Iowa.
- 11-CS-7 Water Revenue Capital Loan Notes** - No violations of water revenue capital loan note covenants were noted.
- 11-CS-8 Deposits and Investments** - We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B or 12C of the Code of Iowa.

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

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Waterloo, Iowa
April 17, 2012