MARION WATER DEPARTMENT
A COMPONENT UNIT OF THE
CITY OF MARION, IOWA

MARION, IOWA

JUNE 30, 2012

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Officials

Name	Title	Term Expires
	(Before January 1, 2012)	
Robert A. Anderson	Chairperson	November 1, 2014
Mary Ann McComas	Trustee	November 1, 2012
Gregory O. Hapgood	Trustee	November 1, 2016
Todd R. Steigerwaldt	General Manager	Indefinite
	(After January 1, 2012)	
Gregory O. Hapgood	Chairperson	December 31, 2016
Robert A. Anderson	Trustee	December 31, 2014
Mary Ann McComas	Trustee	December 31, 2012
John D. McIntosh	Trustee	December 31, 2012
John C. Bender	Trustee	December 31, 2014
Todd R. Steigerwaldt	General Manager	Indefinite

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Independent Auditor's Report

To the Board of Trustees
Marion Water Department
Marion, Iowa

We have audited the accompanying financial statements of the Marion Water Department, a component unit of the City of Marion, Iowa, as of June 30, 2012 which collectively comprise the Marion Water Department's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Marion Water Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Marion Water Department as of June 30, 2012, and the changes in financial position and cash flows, where applicable, 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 report dated February 1, 2013 on our consideration of the Marion Water Department'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 considered in assessing the results of our audit.

2750 First Avenue, NE, Suite 150, Cedar Rapids, IA 52402-4800 • (319) 366-8267 • Fax (319) 366-8301 • E-Mail cr@hoganhansen.com
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The accompanying Management's Discussion and Analysis and schedule of funding progress for the retiree health plan on pages 4 through 7 and 21 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board which considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the required supplementary information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Hogan - Hansen

HOGAN - HANSEN

Cedar Rapids, Iowa
February 1, 2013

Management's Discussion and Analysis

As management of the Marion Water Department, we offer readers of the Department's financial statements this narrative and analysis of the financial statements of the Marion Water Department for the fiscal year ended June 30, 2012, with a comparison to the prior fiscal year's results. We encourage readers to consider this information in conjunction with the Department's financial statements which follow.

FINANCIAL HIGHLIGHTS

The assets of the Marion Water Department exceeded its liabilities at the close of June 30, 2012 by $16,506,930 (net assets). Of this amount, $2,571,157 (unrestricted net assets) may be used to meet the Department's ongoing obligations to citizens and creditors.

The Department's net assets increased by $2,007,089 for the year ended June 30, 2012.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Marion Water Department's basic financial statements. The Department is a single-purpose enterprise component unit of the City of Marion, Iowa. The Department 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. The Department also bills customers for sewer and garbage charges for the City of Marion. The Department remits all sewer and garbage fees collected to the City of Marion and charges the City an administrative fee for performing this service. As a result, the Department prepares financial statements in a manner similar to a private-sector business.

The statement of net assets presents information on all of the Department'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 Department is improving or deteriorating.

The statement of revenue, expenses and changes in net assets presents information showing how the Department'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 statement of cash flows presents information showing major sources and uses of cash by four types of activities. The activities are operating; noncapital financing; capital and related financing; and investing. Also included is a schedule which reconciles income from operations to net cash provided by operating activities.

The basic financial statements can be found on pages 8 through 10 of this report.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. Notes are considered to be an integral part of financial statements prepared in accordance with generally accepted accounting principles. The notes to the financial statements can be found on pages 11 through 20 of this report.

FINANCIAL ANALYSIS

Statements of Net Assets

This section discusses and analyzes significant differences between this and the prior fiscal year. The following is a summary of the composition of net assets at June 30:

	2012	2011 (Restated - Note 15)
Cash and cash equivalents	$ 3,078,404	$ 3,634,518
Other assets	743,461	695,921
Capital assets	16,704,624	14,521,507
Total Assets	**20,526,489**	**18,851,946**
Current liabilities	707,559	892,205
Long-term liabilities	3,312,000	3,459,900
Total Liabilities	**4,019,559**	**4,352,105**
Net Assets		
Invested in capital assets, net of debt	13,935,773	12,520,156
Unrestricted	2,571,157	1,979,685
Total Net Assets	**$ 16,506,930**	**$ 14,499,841**

Net assets invested in capital assets are by far the largest portion of the Department's net assets, 84% at June 30, 2012, and reflect its net investment in capital assets (e.g., land, water plant distribution system and equipment). The Utility uses these capital assets to provide water and services to the citizens; consequently, these assets are not available for future spending.

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

Net assets increased mainly due to capital contributions of new subdivisions totaling $949,965 for the fiscal year 2012 as well as an increase in water sales resulting from increased usage. At both June 30, 2012 and 2011, the Department reported positive balances in all categories of net assets.

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

Statement of Revenue, Expenses and Changes in Net Assets

The following is a summary of the changes in net assets for the years ended June 30:

	2012	2011 (Restated - Note 15)
Operating revenue	$ 3,308,167	$ 3,036,161
Operating expenses	2,283,723	2,196,502
Net Operating Income	1,024,444	839,659
Net nonoperating revenue (expense)	(12,320)	74,520
Net capital contributions	994,965	429,736
Changes in Net Assets	2,007,089	1,343,915
Net Assets - Beginning of Year	14,499,841	13,155,926
Net Assets - End of Year	**$ 16,506,930**	**$ 14,499,841**

Operating revenue is the Department's primary source of revenue and is generated from water sales and other services to customers. For 2012, operating revenue increased $272,006 from 2011.

Operating expenses totaled $2,283,723 for 2012, an $87,221 increase from 2011. These expenses represent the Department's costs to provide water and services to customers. Operating expenses included depreciation expense of $441,995 and $403,459 for the years ended June 30, 2012 and 2011, respectively.

Net nonoperating revenue includes interest income, insurance recoveries, rent from leasing space and debt service payments. Net nonoperating revenue decreased by $86,840 between 2012 and 2011. The decrease was due mainly to a decrease in insurance recoveries as well as a loss on disposal of fixed assets.

Capital contributions of $949,965 were received from contractors due to subdivision development. The Department also received $45,000 of land from the City of Marion which will be used for a future well site. The Department had originally purchased this land.

BUDGETARY HIGHLIGHTS

Each year, the City Council adopts a budget using the cash basis of accounting which differs from the accrual basis of accounting used for the accompanying financial statements. The Department's budget is included in the total business-type activities budget of the City.

CAPITAL ASSETS AND LONG-TERM DEBT

The Department's investment in capital assets amounted to approximately $16.7 million and $14.5 million at June 30, 2012 and 2011, respectively, (net of accumulated depreciation of approximately $4.2 million and $3.8 million at June 30, 2012 and 2011, respectively). This investment in capital assets includes land, construction in progress, buildings, wells and towers, distribution system, equipment and vehicles.

The following is a summary of the capital assets, at cost, at June 30:

	2012	**2011 (Restated - Note 15)**
Land	$ 474,126	$ 429,126
Construction in progress	3,752,730	2,558,352
Building, wells and towers	2,035,586	2,026,926
Distribution system	14,040,018	12,680,054
Equipment and vehicles	650,358	650,358
Accumulated depreciation	(4,248,194)	(3,823,309)
Total	**$ 16,704,624**	**$ 14,521,507**

The following table reconciles the change in capital assets:

	2012	2011 (Restated - Note 15)
Beginning balance	$ 14,521,507	$ 11,430,136
Additions	1,422,656	1,105,658
Retirements - net of depreciation	(36,922)	—
Transfer in (out) of capital assets	45,000	(45,000)
Depreciation	(441,995)	(403,459)
Construction in progress, net	1,194,378	2,434,172
Ending Balance	**$ 16,704,624**	**$ 14,521,507**

Long-Term Debt

At June 30, 2012, the Department had a $3,373,000 note outstanding, compared to $3,500,000 last year, as shown below.

Outstanding Debt at Year End

	June 30, 2012	June 30, 2011
SRF Loan Payable	**$ 3,373,000**	**$ 3,500,000**

Debt decreased as a result of principal payments made on the SRF construction loan.

ECONOMIC FACTORS

The unemployment rate for Linn County at June 30, 2012 was 5.4%, which is where it was the previous year and less than the national unemployment rate of 8.2%.

Retail sales are also reported on a fiscal year, April 1 to March 31, basis. For fiscal year 2011 (April 1, 2011 to March 31, 2012), retail sales were $341 million for Marion and $3.528 billion for Linn County. For fiscal year 2011, retail sales were $329 million for Marion and $3.425 billion for Linn County.

The total value of building permits for fiscal year 2012 was approximately $36.7 million, which is down from the fiscal year 2011 amount of $37.7 million.

NEXT YEAR'S BUDGET AND RATES

The Marion Water Board of Trustees has established a FY 2012-13 budget with 5% adjustment in water rates and 9.15% increase in monthly meter service charge for meters greater than 1" in size. The Board of Trustees, under provisions of Section 388 of the Code of Iowa, establishes and approves the budget for the Department. As a component unit of the City of Marion, the Department's budget is filed for record as part of the City of Marion's budget.

FINANCIAL INFORMATION CONTACT

The Department's financial statements are designed to present users (citizens, customers and prospective customers) with a general overview of the Department's finances and to demonstrate the Department's accountability. If you have questions about the report or need additional financial information, please contact the Marion Water Department General Manager, City Hall, 1225 - 6th Avenue, Suite 150, Marion, Iowa 52302.

Basic Financial Statements

Statement of Net Assets

As of June 30, 2012

Assets	
Current Assets	
Cash and cash equivalents	$ 2,366,012
Receivables (net of allowance for uncollectible amounts)	
Trade accounts	159,350
Accrued interest	5
Unbilled revenue	416,372
Inventories	136,234
Total Current Assets	**3,077,973**
Restricted Assets	
Bond issuance costs (net of accumulated amortization - $3,500)	**31,500**
Capital Assets	
Land	474,126
Construction in progress	3,752,730
Buildings, wells and towers	2,035,586
Distribution system	14,040,018
Equipment and vehicles	650,358
Totals	20,952,818
Less accumulated depreciation	(4,248,194)
Total Capital Assets	**16,704,624**
Restricted Assets	
Cash - customer deposits	108,243
Cash equivalents - loan proceeds restricted for capital projects	604,149
Total Restricted Assets	**712,392**
Total Assets	**$ 20,526,489**
Liabilities and Net Assets	
Current Liabilities	
Accounts payable	$ 347,188
Self-insured premiums and estimated claims	22,253
Accrued interest	5,406
Accrued expenses	39,649
Compensated absences	53,820
Current maturities of SRF loan payable	131,000
Total Current Liabilities	**599,316**
Liabilities Payable From Restricted Assets - Customer Deposits	**108,243**
Long-Term Liabilities	
SRF loan payable	3,242,000
Net OPEB liability	70,000
Total Long-Term Liabilities	**3,312,000**
Total Liabilities	**4,019,559**
Net Assets	
Invested in capital assets, net of related debt	13,935,773
Unrestricted	2,571,157
Total Net Assets	**16,506,930**
Total Liabilities and Net Assets	**$ 20,526,489**

See accompanying notes to the financial statements

Statement of Revenue, Expenses and Changes in Net Assets

Year Ended June 30, 2012

Operating Revenue	
Water sales	$ 2,986,761
Billing and collection fees	98,788
Other sales and services	194,644
Miscellaneous	27,974
Total Operating Revenue	**3,308,167**
Operating Expenses	
Salaries and benefits	884,606
Contractual services	844,816
Commodities	105,901
Depreciation	441,995
Other	6,405
Total Operating Expenses	**2,283,723**
Operating Income	**1,024,444**
Nonoperating Revenue (Expenses)	
Interest income	21,824
Lease and rental fees, net of expense	13,278
Amortization of bond issue costs	(1,750)
Loan servicing fee	(8,750)
Loss on disposal of fixed assets	(36,922)
Total Nonoperating Revenue (Expenses)	**(12,320)**
Change in Net Assets Before Contributions	**1,012,124**
Capital contributions	949,965
Capital contributions to primary government	45,000
Change in Net Assets	**2,007,089**
Net Assets - Beginning of Year, as Restated	14,499,841
Net Assets - End of Year	**$ 16,506,930**

See accompanying notes to the financial statements.

Statement of Cash Flows

Year Ended June 30, 2012

Cash Flows From Operating Activities	
Cash received from customers	$ 3,214,642
Cash collected on behalf of primary government	4,923,761
Cash paid to primary government	(4,923,761)
Cash paid to employees	(887,212)
Cash paid to suppliers	(966,379)
Net Cash Provided by Operating Activities	**1,361,051**
Cash Flows From Noncapital Financing Activities	
Lease and rental fees received	**13,278**
Cash Flows From Capital and Related Financing Activities	
Acquisition of capital assets	(1,749,759)
Repayment of long-term debt	(127,000)
Interest paid on SRF loan	(68,251)
Bond service and fees paid	(8,750)
Net Cash Used in Capital and Related Financing Activities	**(1,953,760)**
Cash Flows From Investing Activities	
Interest received on savings and certificates of deposit	**23,317**
Net Decrease in Cash	**(556,114)**
Cash - Beginning of Year	3,634,518
Cash - End of Year	**$ 3,078,404**
Reconciliation of Operating Income to Net Cash Provided by Operating Activities	
Operating income	$ 1,024,444
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities	
Depreciation	441,995
Increase in trade accounts and unbilled revenue receivable	(96,403)
Decrease in inventories	45,620
Decrease in accounts payable	(54,877)
Decrease in accrued expenses	(2,606)
Increase in liabilities payable from restricted assets	2,878
Net Cash Provided by Operating Activities	**$ 1,361,051**
Reconciliation of Cash to Specific Assets Included on the Balance Sheet	
Cash and cash equivalents	$ 2,366,012
Restricted cash	712,392
	$ 3,078,404

See accompanying notes to the financial statements.

(1) Summary of Significant Accounting Policies and Other Matters

Reporting Entity

The Marion Water Department (Department) is a municipal utility that is a political subdivision and component unit of the City of Marion, Iowa, located in Linn County. The Department provides water to customers within the City. The Department is governed by a Board of Trustees appointed by the City of Marion, Iowa, City Council and is managed by an administrator. All activities with which the Board has oversight responsibility are included in the financial statements. These financial statements of the Department are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

Measurement Focus and Basis of Accounting

The Department 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.

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

The Department distinguishes operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with the Department's principal ongoing operations. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

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.

Trade Accounts Receivable

Utility sales are billed bimonthly. Payment is due within 20 days of billing. After proper notice, unless other arrangements are made by the customer, service may be discontinued to customers with unpaid bills 30 days or more past due. Uncollected accounts are normally written off against water sales after 90 days. Historically, account balances written off have not been material. Department management estimates that all trade accounts receivable as shown on the balance sheet will be collectible.

Unbilled Revenue Receivable

Sales of water used from the time of the last meter reading prior to June 30 that have not been billed and the resulting receivable is not included in trade receivables. The Department estimates unbilled revenue based on the proportion of unbilled days in June to the number of days in the billing period times the amount billed in July. The result is reported as unbilled revenue receivable.

(1) Summary of Significant Accounting Policies and Other Matters

The following accounting policies are followed in preparing the financial statements:

Cash - For purposes of the statement of cash flows, the Department considers all highly liquid debt instruments purchased with original maturities of three months or less to be cash equivalents.

Inventories - Inventories are valued at cost using the first-in/first-out method and consist of materials and supplies. Inventories are recorded as expenses when consumed rather than when purchased.

Restricted Assets - Restricted assets are customer deposits restricted for application to unpaid customer accounts or for refund to customers.

Capital Assets - Capital assets consist of property, equipment and vehicles and infrastructure assets (e.g. buildings, wells, towers and distribution system which are immovable and of value only to the Department). Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation. The costs of normal maintenance and repair not adding to the value of the asset or materially extending asset lives are not capitalized. Reportable capital assets are defined by the Department as assets with initial, individual costs in excess of $5,000.

Capital assets of the Department are depreciated using the straight-line method over the following estimated useful lives.

Asset Class	**Estimated Useful Lives**
Buildings, wells and towers	10 - 40 Years
Distribution system..	5 - 50 Years
Equipment and vehicles	5 - 10 Years

Compensated Absences - Department employees accumulate a limited amount of earned but unused vacation hours for subsequent use or for payment upon termination, death or retirement. In addition, Department employees who elect an early separation agreement at retirement may receive the benefits outlined as follows: three and one-half months of salary as well as the equivalent of two years of health insurance coverage paid by the Department.

Operating Revenue - The Department defines operating revenue as revenue derived from the sale of water billing and collection fees and other sales and services provided to customers. Nonoperating revenue is defined as anything other than revenue from the sale of water.

Budgeting - The Department's budget is included as part of the City's budget and is prepared on the cash basis of accounting. Disbursements are for legal budget compliance, combined for all City proprietary activities. Budget amounts for capital outlay, debt service and transfers out are presented on a combined basis only. The Utility's budget and comparison to cash basis activity is as follows:

Business-Type Activity - Water	
Actual disbursements..	$ 2,331,145
Budgeted disbursements...	4,692,330
Actual Disbursements Under Budget	**$ (2,361,185)**

(1) Summary of Significant Accounting Policies and Other Matters

Restricted Resources - The Department first applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. Unrestricted resources are used once the restricted resources have been depleted.

(2) Cash Flow Statement Supplementary Information

Schedule of Noncash Investing and Financing Activities

Amortization of Bond Issue Costs	**$ 1,750**

Cost of capital asset acquisitions	$ 2,662,034
Amounts Payable	
Current year	(241,224)
Prior year	391,961
Contributed capital	(994,965)
Capitalized interest	(68,047)
Cash Paid for Acquisition of Capital Assets	**$ 1,749,759**

(3) Deposits and Investments

The Department's deposits are entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Department 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 Department had no investments meeting the disclosure requirements of GASB Statement No. 3, as amended by Statement No. 40.

(4) Restricted Assets

Restricted assets represent monies set aside to provide security for deposits and advances. At June 30, 2012, $108,243 of cash was restricted for customer deposits or for refunds to customers.

(5) Capital Assets

Capital asset activity for the year was as follows:

	Balance Beginning of Year	Increases	Decreases	Balance End of Year
Business-Type Activities				
Capital Assets Not Being Depreciated				
Land	$ 429,126	$ 45,000	$ —	$ 474,126
Construction in progress (as restated - Note 15)	2,558,352	1,459,451	265,073	3,752,730
Total Capital Assets Not Being Depreciated	2,987,478	1,504,451	265,073	4,226,856
Capital Assets Being Depreciated				
Buildings, wells and towers	2,026,926	8,660	—	2,035,586
Distribution system	12,680,054	1,413,996	54,032	14,040,018
Equipment and vehicles	650,358	—	—	650,358
Total Capital Assets Being Depreciated	15,357,338	1,422,656	54,032	16,725,962
Less Accumulated Depreciation for				
Buildings, wells and towers	860,003	43,439	—	903,442
Distribution system	2,679,445	343,393	17,110	3,005,728
Equipment and vehicles	283,861	55,163	—	339,024
Total Accumulated Depreciation	3,823,309	441,995	17,110	4,248,194
Net Capital Assets Being Depreciated	11,534,029	980,661	36,922	12,477,768
Net Capital Assets	**$ 14,521,507**	**$ 2,485,112**	**$ 301,995**	**$ 16,704,624**

(6) Long-Term Liabilities

A summary of changes in long-term liabilities for the year ended June 30, 2012 is as follows:

	Balance Beginning of Year	Increases	Decreases	Balance End of Year	Due Within One Year	Interest Rate
SRF loan payable - construction	$ 3,500,000	$ —	$ 127,000	$ 3,373,000	$ 131,000	3.0%
Net OPEB liability	86,900	—	16,900	70,000	—	N/A
Total	**$ 3,586,900**	**$ —**	**$ 143,900**	**$ 3,443,000**	**$ 131,000**	

SRF Loan Payable

In August, 2009, the Department obtained a $150,750 State Revolving Fund Planning and Design Loan from the Iowa Finance Authority for the purpose of paying the costs of planning and designing improvements to the Municipal Waterworks System. The loan was interest free and payable in full in August, 2012.

(6) Long-Term Liabilities

In October, 2010, the Department, through the City of Marion, issued water revenue bonds (Build America Bonds) in the amount of $3.5 million to repay the planning loan and fund the remaining costs of the planning and designing and constructing improvements and extensions to the Municipal Waterworks System. In December, 2010, the Build America Bond agreement was to draw all remaining funds and place them in the custody of an escrow agent.

The loan bears interest at 3%, of which 1.05% is reimbursed to the Department through the Build America Bond program. The agreement also requires the Department to annually pay a 0.25% servicing fee on the outstanding principal balance. At June 30, 2012, of the $3,500,000 authorized, the Department had received $2,895,851, which included a $35,000 loan initiation fee and $121,000 to pay off the planning and design loan. The remaining balance of $604,149 is being held in trust, and the Department will request the remaining funds as the project progresses.

The loan is payable in semiannual installments and is payable in full in June, 2031; however, the repayment schedule has not been finalized since the Department has not fully completed the project. Annual principal and interest payments on the bonds are expected to be paid from net receipts. Total principal and interest remaining to be paid on the bonds is $4,093,564. For the current year, principal paid, interest paid and total customer net receipts were $127,000, $68,250 and $1,466,439, respectively.

The resolution providing for the issuance of the water revenue bonds (Build America Bonds) includes the following provisions:

a. The bond is payable from the net revenue of the Utility.

b. Produce and maintain net revenue at a level not less than 110% of the amount of principal and interest due during the fiscal year.

c. Sufficient monthly transfers shall be made to the water revenue bond sinking fund for the purpose of making principal and interest payments when due.

Annual debt service requirements to maturity for the water revenue bonds at June 30, 2012 are as follows:

Year Ending June 30,	Principal	Net Interest (After Build America Bond Reimbursement - 1.05%)
2013	$ 131,000	$ 65,774
2014	135,000	63,219
2015	140,000	60,587
2016	144,000	57,857
2017	149,000	55,048
2018-2022	821,000	229,710
2023-2027	963,000	144,300
2028-2031	890,000	44,069
Total	**$ 3,373,000**	**$ 720,564**

(7) Retirement Plan

Plan Description
The Department contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa 50306-9117.

Plan members are required to contribute 5.38% of their annual salary and the employer is required to contribute 8.07% of annual covered payroll. Contribution requirements are established by state statute. The Utility's contribution to IPERS for the years ended June 30, 2012, 2011 and 2010 were $60,102, $52,456 and $49,471, respectively, equal to the required contributions for each year.

Deferred Compensation Plan
The Department offers its employees a deferred compensation plan under Internal Revenue Code Section 457. The plan allows Department employees to defer a portion of their current salary until future years. The employee becomes eligible to withdraw funds upon termination, retirement, death or unforeseeable emergency.

The Department deposits all amounts of compensation deferred under the plan to the fiduciary designated by the employee.

(8) Other Postemployment Benefits (OPEB)

Plan Description
The Department operates a single-employer retiree benefit plan which provides medical/prescription drug benefits for retirees and their spouses in combination with the City of Marion. There are 12 active and 3 retired department members in the plan. Participants must be age 55 or older at retirement.

The medical/prescription drug coverage is provided through a fully insured plan with Wellmark. Retirees under age 65 pay the same premium for the medical/prescription drug benefit as active employees, which results in an implicit subsidy and an OPEB liability.

Funding Policy
The contribution requirements of plan members are established and may be amended by the Department. The Department currently finances the retiree benefit plan on a pay-as-you-go basis.

Annual OPEB Cost and Net OPEB Obligation
The Department's annual OPEB cost is calculated based on the annual required contribution (ARC), an amount actuarially determined in accordance with GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years.

(8) Other Postemployment Benefits (OPEB)

The following table shows the components of the Department's share of annual OPEB cost for June 30, 2012, the amount actually contributed to the plan and changes in the Department's share of net OPEB obligation:

Annual required contribution	$ 34,756
Interest on net OPEB obligation	1,007
Adjustment to annual required contribution	(47,888)
Annual OPEB Cost	(12,125)
Contributions made	(4,775)
Decrease in Net OPEB Obligation	(16,900)
Net OPEB Obligation - Beginning of Year	86,900
Net OPEB Obligation - End of Year	**$ 70,000**

For calculation of the net OPEB obligation, the actuary has set the transition day as July 1, 2008. The end-of-year net OPEB obligation was calculated by the actuary as the cumulative difference between the actuarially determined funding requirements and the actual contributions for the year ended June 30, 2012.

The Department's share of the annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation are summarized as follows:

Year Ended June 30,	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
2010	$ 27,552	0%	$ 55,713
2011	31,187	0	86,900
2012	(12,125)	0	70,000

Funded Status and Funding Progress

As of July 1, 2010, the most recent actuarial valuation date for the period of July 1, 2010 through June 30, 2012, the actuarial accrued liability was $309,000, with no actuarial value of assets, resulting in an unfunded actuarial accrued liability (UAAL) of $309,000. The covered payroll (annual payroll of active employees covered by the plan) was approximately $745,000, and the ratio of the UAAL to the covered payroll was 41%. As of June 30, 2012, there were no trust fund assets.

Actuarial Methods and Assumptions

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 healthcare cost trend. Actuarially determined amounts 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 in the section following the Notes to Financial Statements, will present 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.

(8) Other Postemployment Benefits (OPEB)

Projections of benefits for financial reporting purposes are based on the plan as understood by the employer and the plan members and include 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.

As of the July 1, 2010 actuarial valuation date, the frozen entry age actuarial cost method was used. The actuarial assumptions includes a 2.5% discount rate based on the Department's funding policy. The projected annual health cost trend rate is 6%.

Mortality rates are from the 94 Group Annuity Mortality Table Projected to 2000, applied on a gender-specific basis. Annual retirement was assumed at the rate of retirement by attained age after becoming eligible to retire and continue health coverage and termination probabilities were assumed at a modest rate for active employees while no turnover was assumed after the benefit start date.

The UAAL is being amortized as a level percentage of projected payroll expense on an open basis over 30 years.

(9) Compensated Absences

Department employees accumulate vacation and sick leave hours for subsequent use or, in the case of the accumulated vacation pay, for payment upon termination, retirement or death. The accumulations are not recognized as disbursements by the Department until used or paid in its cash basis records. The Department's liability for earned compensated absences payable to employees as accrued to the GAAP basis financial statements at June 30, 2012 was as follows:

Type of Benefit	Amount
Vacation	$ 53,820

This liability has been computed based on rates of pay and rates for payroll taxes and IPERS as of June 30, 2012. Sick leave is payable when used. No amounts of sick leave were accrued at June 30, 2012.

(10) Related Party Transactions

The Department bills and collects for sewer and garbage services provided for the City of Marion to its residents. During the year ended June 30, 2012, the Department collected and remitted to the City of Marion $3,448,753 for sewer, $1,354,052 for garbage service and $120,956 for urban forest. Fees earned by the Department from the City of Marion during the year for this service totaled $98,788, of which $8,125 was receivable at June 30, 2012.

(11) Local Government Risk Pool

Health Insurance

The Department has chosen to participate in the City of Marion's risk financing program for risks associated with the employee's health insurance plan. The Department self-funds health insurance claims arising from the Department's employees to a stop-loss insured amount of $30,000 per participant and a 125% aggregate stop-loss amount based on the "pure premiums" amount multiplied by the number of single and family contracts covered during the contract year. The total cost of these benefits is transferred from the Water Fund based upon the number of employees and the type of plan (single or family) chosen by the employee. Amounts charged are approximately $426 per month single and $1,065 per month family which is an amount based on past claim history. Employees pay $15 per month single and $30 per month family. The amount transferred will be adjusted over a reasonable period of time so that the Medical Benefits Fund receipts and disbursements are approximately equal. Claims paid totaled $114,881 during the year ended June 30, 2012. At June 30, 2012, the Department's share of estimated claims incurred but unpaid was approximately $18,500 based upon an actuarial determination.

Iowa Municipalities Workers' Compensation Association

The Department obtains its workers' compensation coverage through the City of Marion, which is a member in the Iowa Municipal Workers' Compensation Association (IMWCA). The Association is a local government risk-sharing pool whose approximately 500 members include various municipal and county governments throughout the State of Iowa. The Pool was formed in July, 1981 to formulate, develop and administer, on behalf of the member governments, a program of joint self-insurance to stabilize costs related to members' workers' compensation liabilities. Program components include claims management, member education and loss control services. There have been no reductions in insurance coverage from prior years.

Each member pays annual premiums determined by using applicable standard rates for the exposure to risk and applicable experience modification factors of the National Council on Compensation Insurance. Each member may be subject to additional premiums to pay its pro rata share of claims which exceeds the Association's resources available to pay such claims. A distribution to members may also be made if the Association has excess monies remaining after payment of claims and expenses.

The Department's premium contributions to the Association are recorded as expenditures from its operating funds at the time of payment to the risk pool. Premiums paid to the Association for the year ended June 30, 2012 were $13,815.

The Association uses reinsurance and excess risk-sharing agreements to reduce its exposure to large losses. Claims exceeding $750,000 are reinsured in an amount not to exceed $2,000,000 per occurrence.

Members may withdraw from the Association at any time provided they provide assets for settlement of all pending claims.

(12) Risk Management

The Department is exposed to various risks of loss related to torts; theft; damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. Settled claims from these risks have not exceeded commercial insurance coverage in the past fiscal year.

(13) Commitments

Construction
The Department is involved in construction of capital assets and agreements to purchase capital assets. At June 30, 2012, the Department was committed to approximately $6,000 in construction and purchase agreements.

(14) Subsequent Events

Management has evaluated subsequent events through February 1, 2013, the date which the financial statements were available to be issued.

Subsequent to June 30, 2012, the Department entered into various agreements to purchase capital assets totaling approximately $285,000.

(15) Prior Period Restatement

During the year ended June 30, 2012, management determined that net assets and capital assets not being depreciated were incorrect due to construction in process being understated $46,633 as of June 30, 2011. The correction for this error had the following effect on net assets at July 1, 2011. The error correction had no effect on the change in net assets for the year ended June 30, 2012.

	Net Assets	Capital Assets Not Being Depreciated
Balance - June 30, 2011, as previously reported	$ 14,453,208	$ 2,511,719
Restatement for capital assets	46,633	46,633
Balance - July 1, 2011, as Restated.........................	**$ 14,499,841**	**$ 2,558,352**

Required Supplementary Information

Schedule of Funding Progress for the Retiree Health Plan

Year Ended June 30,	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
2009	7-1-08	$ —	$ 293,077	$ 293,077	0%	$ 771,000	38%
2010	7-1-08	—	293,077	293,077	0	752,000	39
2011	7-1-10	—	309,000	309,000	0	777,000	40
2012	7-1-10	—	309,000	309,000	0	745,000	41

See Note 8 in the accompanying Notes to the Financial Statements for the plan description, funding policy, annual OPEB cost and net OPEB obligation, funded status and funding progress.

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

To the Board of Trustees
Marion Water Department
Marion, Iowa

We have audited the accompanying financial statements of the Marion Water Department, as of and for the year ended June 30, 2012, and have issued our report thereon dated February 1, 2013. 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
The management of the Marion Water Department is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Marion Water Department'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 our opinion on the effectiveness of the Marion Water Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Marion Water Department's internal control over financial reporting.

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 that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control over financial reporting we consider to be material weaknesses.

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 Marion Water Department's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiencies in internal control described in Part I of the accompanying schedule of findings as Items 12-I-R-1, 12-I-R-2, 12-I-R-3 and 12-I-R-4 to be material weaknesses.

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

Comments involving statutory and other legal matters about the Marion Water Department's operations for the year ended June 30, 2012 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Marion Water Department. 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.

The Marion Water Department's responses to the findings identified in our audit are described in the accompanying schedule of findings. While we have expressed our conclusions on the Department's responses, we did not audit the Marion Water Department's responses and, accordingly, we express no opinion on them.

This report, a public record by law, is intended solely for the information and the use of the officials and customers of the Marion Water Department and other parties to whom the Marion Water Department may report. This report is not intended to be and should not be used by anyone other than these specified parties.

Hogan - Hansen

HOGAN - HANSEN

Cedar Rapids, Iowa
February 1, 2013

<u>Part I: Findings Related to the Financial Statements</u>

12-I-R-1 Segregation of Duties

<u>Prior Year Finding and Recommendation</u> - One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. We noted that certain functions are not entirely segregated.

With a limited number of office employees, segregation of duties is difficult. However, the Department management should review its control procedures to obtain the maximum internal control possible under the circumstances, segregate duties to the extent possible with existing personnel and utilize administrative personnel to provide additional control through review of financial transactions and reports.

<u>Current Year Finding</u> - We found the same condition existed. We reiterate our prior year recommendation.

<u>Department’s and City's Response</u> - The City Council and Board of Trustees are aware of the condition. We will review procedures and make changes when appropriate.

<u>Auditor's Conclusion</u> - Response accepted.

12-I-R-2 Financial Statement Preparation

<u>Prior Year Finding and Recommendation</u> - The Department does not have a system of internal controls that fully prepares financial statements and disclosures that are fairly presented in conformity with generally accepted accounting principles. As is inherent in many organizations of this size, the Department has management and employees who, while knowledgeable and skillful, do not have the time to maintain the current knowledge and expertise to fully apply generally accepted accounting principles in preparing the financial statements and the related disclosures. The Department should obtain additional knowledge through reading relevant accounting literature and attending local professional education courses.

<u>Current Year Finding</u> - We found the same condition existed. We reiterate our prior year recommendation.

<u>Department’s Response</u> - The Department is aware of the condition and will consider obtaining additional knowledge where cost effective but will continue to rely on its audit firm for assistance with drafting the financial statements and disclosures.

<u>Auditor’s Conclusion</u> - Response accepted.

12-I-R-3 Recording of SRF Loan Proceeds and Escrow Account

Prior Year Finding and Recommendation - Through our testing of cash and loans payable, we noted that the Department had not recorded proceeds of the SRF loan that are being held in escrow at Wells Fargo Bank. The Department should implement procedures to ensure all assets and liabilities of the Department are recorded in the Department's general ledger.

Current Year Finding - We found that the same condition existed. We reiterate our prior year recommendation.

Department's Response - The Department will review its internal controls and make changes to ensure that all assets and liabilities are identified and recorded in a timely manner.

Auditor's Conclusion - Response accepted.

12-I-R-4 Inventory Valuation

Finding - During our testing of inventory, we noted that the Department had not updated the price of units on hand thus understating the inventory value.

Auditor's Recommendation - The Department should update the inventory spreadsheet throughout the year as items are used and ordered. The spreadsheet should be reviewed by a second person annually.

Department's Response - The Department will consider a process to update the inventory spreadsheet as items are purchased and to use the lower of actual cost or market to value the items.

Auditor's Conclusion - Response accepted.

Part II: Findings Related to Statutory Reporting

12-II-A **Budget** - Operating cash disbursements during the year ended June 30, 2012 did not exceed the amounts budgeted.

12-II-B **Questionable Disbursements** - We noted a disbursement that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979 since the public benefits to be derived were not clearly documented. The disbursement was as follows:

Paid to	Purpose	Amount
Cedar Memorial	Flowers	$54

According to the Attorney General's opinion, it is possible for such disbursements to meet the test of serving a public purpose under certain circumstances, although such items will certainly be subject to a deserved close scrutiny. The line to be drawn between a proper and an improper purpose is very thin.

Auditor's Recommendation - The Trustees should determine and document the public purpose served by these types of disbursements before authorizing any further payments. If this practice is continued, the Department should establish written policies and procedures, including the requirement for proper documentation.

Department's Response - It has been the Department's policy to show compassion and send flowers if an employee or employee's immediate family member dies. The Department will continue this policy.

Auditor's Conclusion - Response accepted.

12-II-C **Travel Expense** - No disbursements of Department money for travel expenses of spouses of the Department officials or employees were noted.

12-II-D **Business Transactions** - No business transactions between the Department's officials or employees and the Department were noted.

12-II-E **Bond Coverage** - Surety bond coverage of Department officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to ensure that the coverage is adequate for current operations.

12-II-F **Board of Trustee Minutes** - No transactions were found that we believe should have been approved in the Trustee minutes that were not.

12-II-G **Deposits and Investments** - No instances of noncompliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Department's investment policy were noted.

12-II-H **Revenue Bonds**

Prior Year Finding and Recommendation - The provisions of the water revenue bonds require the Department to establish an account to be known as the "Water Revenue Bond Sinking Fund" which requires monthly amounts be set aside equal to 1/6th of the installment of interest coming due on the next succeeding interest installment date and an amount equal to 1/12th of the installment of principal coming due on such bonds on the next succeeding principal payment date until the full amount of such installment is on deposit in the sinking fund.

The Department failed to make these monthly transfers.

We recommend that the Department make monthly transfers to the sinking fund.

Current Year Finding - The Department failed to make all the required monthly transfers. Approximately $24,000 was not transferred to the sinking fund as required. We reiterate our prior year recommendation.

Department's Response - The Department will make transfers in accordance with the loan agreement.

Auditor's Conclusion - Response accepted.