

WATERLOO WATER WORKS

WATERLOO, IOWA

DECEMBER 31, 2012

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Officials

Name	Title	Term Expires
Terry Kuntz	Chairman - Board of Trustees	January 12, 2018
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, 2012**

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, 2012. Readers are encouraged to read the Management's Discussion and Analysis in conjunction with the Utility's financial statements, which begin on page 9.

Financial Highlights

- The Utility's assets exceeded its liabilities by \$27.4 million at December 31, 2012. Of this amount, approximately \$5.7 million may be used to meet ongoing obligations to the citizens and creditors. The remaining net assets are invested in capital assets or are restricted for debt repayment.
- The operating revenue of the Utility exceeded operating expenses by \$2,067,652 and \$1,897,281 for the years ended December 31, 2012 and 2011, respectively.
- At December 31, 2012, the Utility's unrestricted cash, certificates of deposits, trade receivables and prepaid expenses of approximately \$7 million exceeded total current liabilities by approximately \$5.3 million. This excess is available for spending at the Utility's discretion.
- The Utility has capital loan notes outstanding of \$1,470,000 at December 31, 2012 which are reported net of unamortized discounts costs of \$9,588.

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 position present information on all of the Utility's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position 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 position present information showing how the Utility's net position changed during the year. All changes in net position 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 9 through 12 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 13 through 22 of this report.

Financial Analysis

As noted earlier, net position may serve over time as a useful indicator of an entity's financial position. The Utility's assets exceeded its liabilities by \$27.4 million and \$25.6 million on December 31, 2012 and 2011, respectively.

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

	2012	2011
Current assets.....	\$ 6,996,078	\$ 7,368,612
Noncurrent, noncapital assets.....	816,414	832,562
Capital assets, net of accumulated depreciation	<u>22,513,736</u>	<u>20,693,071</u>
Total Assets	<u>30,326,228</u>	<u>28,894,245</u>
Current liabilities	1,660,604	1,750,186
Liabilities payable from restricted assets.....	138,941	131,816
Other long-term liabilities (net)	<u>1,115,412</u>	<u>1,457,216</u>
Total Liabilities	<u>2,914,957</u>	<u>3,339,218</u>
Net Position		
Invested in capital assets, net of related debt	21,373,736	19,218,071
Restricted for debt service	330,000	330,000
Unrestricted	<u>5,707,535</u>	<u>6,006,956</u>
Total Net Position	<u>\$ 27,411,271</u>	<u>\$ 25,555,027</u>

Net investment in capital assets are by far the largest portion of the Utility's net position, 78% at December 31, 2012, 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 component of net position represent resources that are subject to external restrictions on how they may be used.

Unrestricted component of net position 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.

As of both December 31, 2012 and 2011, the Utility reported positive balances in all three categories of net position.

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 position for the years ended December 31:

	2012	2011
Operating revenue	\$ 7,869,430	\$ 7,306,939
Operating expenses.....	5,801,778	5,409,658
Operating Income.....	<u>2,067,652</u>	<u>1,897,281</u>
Net nonoperating revenue.....	93,476	427,118
Capital contributions	35,841	70,745
Transfers to City of Waterloo.....	<u>(340,725)</u>	<u>(264,593)</u>
Change in Net Position.....	1,856,244	2,130,551
Net Position - Beginning of Year	<u>25,555,027</u>	<u>23,424,476</u>
Net Position - End of Year	<u>\$ 27,411,271</u>	<u>\$ 25,555,027</u>

Operating revenue is the Utility’s primary source of revenue and is generated from water sales and other services to customers. For 2012, operating revenue increased \$562,491 from 2011 due primarily to a 7.5% increase in water rates, which offset the increasing expenses described below.

Operating expenses totaled \$5,801,778 for 2012, a \$392,120 increase from 2011 due primarily to increases in wages and other employee benefit costs, contractual costs and commodities costs. These expenses represent the Utility’s costs to provide water and services to customers. Operating expenses included depreciation expense of \$566,449 and \$550,415 for the years ended December 31, 2012 and 2011, 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 decreased by \$333,642 between 2012 and 2011 due primarily to receiving no government grants in 2012. Rent income totaled \$119,265 and \$135,440 for the years ended December 31, 2012 and 2011, respectively.

Capital contributions totaled \$35,841 and \$70,745 for the years ended December 31, 2012 and 2011, 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 \$340,725 and \$264,593 for the years ended December 31, 2012 and 2011, 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, 2012 or 2011.

Actual cash receipts were \$422,191 more than budgeted. The majority of this variance was due to the Waterloo and surrounding areas experiencing warm and dry weather during the summer.

Actual cash disbursements were approximately \$2.5 million less than budgeted due to lower than anticipated capital expenses and capital projects budgeted to begin in 2012 which were delayed for various reasons.

Capital Assets and Long-Term Debt

The Utility's investment in capital assets amounted to approximately \$22.5 million and \$20.7 million at December 31, 2012 and 2011, respectively, (net of accumulated depreciation of approximately \$9.4 million and \$8.9 million at December 31, 2012 and 2011, 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 2012 included the following:

- Installation of 2.68 miles of water mains.
- Purchase of three vehicles.
- Street reconstruction projects.
- Substantially completion of the Shaulis Road Water Main Project.
- Rehabilitation of the Kimball Avenue water tower.

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

	2012	2011
Land.....	\$ 270,896	\$ 270,896
Pipes and valves.....	462,865	463,403
Buildings and improvements	1,754,291	1,754,291
Water supply system.....	6,038,874	5,198,291
Distribution system.....	19,960,281	18,560,971
Meters and equipment	1,468,956	1,468,956
Machinery and equipment.....	1,832,847	1,761,904
Construction in progress	106,067	100,829
Total	<u>\$ 31,895,077</u>	<u>\$ 29,579,541</u>

Additional information about the Utility's capital assets can be found in Note 5 to the financial statements.

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. At December 31, 2012 total Utility long-term debt was \$1,470,000 less unamortized discounts of \$9,588 for a net long-term debt of \$1,460,412. Principal of \$345,000 and interest of \$57,923 is due during the year ending December 31, 2013.

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 2012 and 2011, the Utility was in compliance with required covenants.

Additional information about the Utility's long-term debt can be found in Notes 4 and 6 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, 2013, water meter minimum charges increased 6% and rate blocks increased approximately 7 cents per hundred cubic feet of water. Budgeted revenue has been adjusted to reflect the increase in rates.

Operating expense for 2013 is expected to increase over the same expenditures in 2012 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 Dewitt Road water main extensions, continue work on the Highway 63 North water main replacements, the Ranchero Road water main extension, well number 19 variable frequency drive and replacement standby power project, 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 \$3,940,000.

Independent Auditor's Report

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

Report on the Financial Statements

We have audited the accompanying statements of net position of the Waterloo Water Works, a component unit of the City of Waterloo, Iowa, as of December 31, 2012 and 2011, and the related statements of revenue, expenses and changes in net position and cash flows for the years then ended.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions 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 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making these risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Waterloo Water Works as of December 31, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Other Reporting Requirement by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 4, 2013 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 considered in assessing the results of our audits.

Other Matters

The accompanying Management's Discussion and Analysis and the schedule of funding progress on pages 2 through 6 and 23 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

Waterloo, Iowa
April 4, 2013

Statements of Net Position

As of December 31, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents.....	\$ 5,531,540	\$ 5,758,307
Certificates of deposit.....	111,059	228,184
Receivables		
Trade accounts.....	1,279,751	1,303,502
Accrued interest.....	1,018	993
Prepaid expenses.....	<u>72,710</u>	<u>77,626</u>
Total Current Assets	<u>6,996,078</u>	<u>7,368,612</u>
Noncurrent Assets		
Restricted certificates of deposit.....	468,941	461,816
Unamortized capital loan notes issuance costs	7,889	10,518
Repair assessments receivable	<u>339,584</u>	<u>360,228</u>
Subtotal	<u>816,414</u>	<u>832,562</u>
Capital Assets		
Land.....	270,896	270,896
Pipes and valves.....	462,865	463,403
Buildings and improvements	1,754,291	1,754,291
Water supply system.....	6,038,874	5,198,291
Distribution system.....	19,960,281	18,560,971
Meters and equipment	1,468,956	1,468,956
Machinery and equipment.....	1,832,847	1,761,904
Construction in progress	<u>106,067</u>	<u>100,829</u>
Total Capital Assets.....	31,895,077	29,579,541
Less accumulated depreciation.....	<u>(9,381,341)</u>	<u>(8,886,470)</u>
Net Capital Assets	<u>22,513,736</u>	<u>20,693,071</u>
Total Noncurrent Assets	<u>23,330,150</u>	<u>21,525,633</u>
Total Assets	<u>\$ 30,326,228</u>	<u>\$ 28,894,245</u>

See accompanying notes to the financial statements.

	2012	2011
Liabilities and Net Position		
Current Liabilities		
Current maturities of water revenue capital loan notes	\$ 345,000	\$ 335,000
Accounts payable	76,926	55,924
Accrued employee compensation.....	111,010	100,092
Customer deposits.....	36,970	33,661
Due to Other Governments		
City of Waterloo		
Garbage fees.....	322,179	340,312
Sewer fees	588,782	688,394
Storm water fees	127,696	140,027
City of Raymond	12,196	11,197
Black Hawk County.....	<u>39,845</u>	<u>45,579</u>
Total Current Liabilities	1,660,604	1,750,186
Liabilities Payable From Restricted Assets	138,941	131,816
Water Revenue Capital Loan Notes	<u>1,115,412</u>	<u>1,457,216</u>
Total Liabilities	<u>2,914,957</u>	<u>3,339,218</u>
Net Position		
Invested in capital assets, net of related debt	21,373,736	19,218,071
Restricted for debt service	330,000	330,000
Unrestricted	<u>5,707,535</u>	<u>6,006,956</u>
Total Net Position	<u>27,411,271</u>	<u>25,555,027</u>
Total Liabilities and Net Position	<u>\$ 30,326,228</u>	<u>\$ 28,894,245</u>

Statements of Revenue, Expenses and Changes in Net Position

Years Ended December 31, 2012 and 2011

	2012	2011
Operating Revenue		
Water sales	\$ 6,789,602	\$ 6,326,524
Metered water provided to the City of Waterloo	340,725	264,593
Fire protection	101,851	99,688
Billing and collection fees	130,435	130,078
Other sales and service	<u>506,817</u>	<u>486,056</u>
Total Operating Revenue	<u>7,869,430</u>	<u>7,306,939</u>
Operating Expenses		
Salaries and benefits	3,111,159	2,946,287
Contractual services	872,574	832,438
Commodities	1,251,596	1,080,518
Depreciation	<u>566,449</u>	<u>550,415</u>
Total Operating Expenses	<u>5,801,778</u>	<u>5,409,658</u>
Operating Income	<u>2,067,652</u>	<u>1,897,281</u>
Nonoperating Revenue (Expenses)		
Interest income	50,688	45,877
Interest expense	(73,848)	(86,008)
Government grants	—	351,835
Amortization	(2,629)	(2,629)
Loss on disposal of fixed assets	—	(17,397)
Billboard and antenna rent	<u>119,265</u>	<u>135,440</u>
Total Nonoperating Revenue	<u>93,476</u>	<u>427,118</u>
Change in Net Position Before Contributions and Transfers	2,161,128	2,324,399
Capital contributions	35,841	70,745
Transfers to City of Waterloo	<u>(340,725)</u>	<u>(264,593)</u>
Change in Net Position	1,856,244	2,130,551
Net Position - Beginning of Year	<u>25,555,027</u>	<u>23,424,476</u>
Net Position - End of Year	<u>\$ 27,411,271</u>	<u>\$ 25,555,027</u>

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2012 and 2011

	2012	2011
Cash Flows From Operating Activities		
Cash received from customers	\$ 7,443,337	\$ 6,805,835
Cash collected on behalf of primary government	12,703,831	12,850,460
Cash collected on behalf of other governments	352,441	350,432
Cash paid to primary government (less 1% collection fee).....	(12,700,835)	(12,697,718)
Cash paid to other governments (less collection fee).....	(357,176)	(354,824)
Cash paid to or on behalf of employees.....	(3,068,840)	(2,924,993)
Cash paid to suppliers	<u>(1,712,537)</u>	<u>(1,501,047)</u>
Net Cash Provided by Operating Activities	<u>2,660,221</u>	<u>2,528,145</u>
Cash Flows From Noncapital Financing Activities		
Billboard and antenna rent.....	<u>119,265</u>	<u>135,440</u>
Cash Flows From Capital and Related Financing Activities		
Contributed capital.....	35,841	70,745
Collections on note receivable for water main, including interest (2012 - \$0; 2011 - \$733).....	—	8,754
Repayments of water revenue capital loan notes	(335,000)	(320,000)
Interest paid on water revenue capital loan notes	(70,652)	(82,812)
Acquisition of capital assets.....	(2,387,652)	(909,187)
Government grants received	—	351,835
Acquisition of plant not in service.....	<u>(409,453)</u>	<u>(328,233)</u>
Net Cash Used in Capital and Related Financing Activities	<u>(3,166,916)</u>	<u>(1,208,898)</u>
Cash Flows From Investing Activities		
Proceeds from the maturities of certificates of deposit.....	250,000	530,000
Purchase of certificates of deposit	(140,000)	(330,000)
Interest received on savings and certificates of deposits	<u>50,663</u>	<u>48,384</u>
Net Cash Provided by Investing Activities	<u>160,663</u>	<u>248,384</u>
Net Increase (Decrease) in Cash	(226,767)	1,703,071
Cash and Cash Equivalents - Beginning of Year	<u>5,758,307</u>	<u>4,055,236</u>
Cash and Cash Equivalents- End of Year	<u>\$ 5,531,540</u>	<u>\$ 5,758,307</u>

See accompanying notes to the financial statements.

Statements of Cash Flows

Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 2,067,652	\$ 1,897,281
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities		
Depreciation	566,449	550,415
Water provided to the City of Waterloo, not billed	(340,725)	(264,593)
Pipes and values used in operations	409,991	432,645
Change in Assets and Liabilities		
(Increase) decrease in trade accounts and repair assessments receivable	44,395	(112,698)
Increase in prepaid expenses	(26,485)	(9,256)
Decrease in prepaid pension.....	31,401	6,740
Increase (decrease) in accounts payable	28,127	(16,895)
Increase in accrued employee compensation.....	10,918	14,554
Increase (decrease) in customer deposits, due to other governments and liabilities payable from restricted assets	(131,502)	29,952
Net Cash Provided by Operating Activities	<u>\$ 2,660,221</u>	<u>\$ 2,528,145</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 trade accounts receivable at December 31, 2012 and 2011 was \$706,174 and \$713,875, 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 2012 and 2011 budget and comparison to cash basis activity is as follows:

	2012	2011
Business-Type Activity - Water		
Actual disbursements	\$ 8,308,841	\$ 6,484,715
Budgeted disbursements	<u>10,811,291</u>	<u>11,468,967</u>
Actual Disbursements Under Budget	<u>\$ (2,502,450)</u>	<u>\$ (4,984,252)</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, 2012 and 2011 was \$566,449 and \$550,415, 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, 2012 and 2011.

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, 2012 and 2011.

Classification Changes

Certain items in the 2011 financial statements have been reclassified to conform with the current year presentation. These reclassifications had no net effects on the financial statements.

Notes to the Financial Statements

(2) Cash Flow Statement Supplementary Information

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.

	2012	2011
Schedule of Noncash Investing and Financing Activities		
Interest expense.....	\$ 73,848	\$ 86,008
Less noncash amortization of water revenue capital loan notes discount	<u>(3,196)</u>	<u>(3,196)</u>
Cash Paid for Interest	<u>\$ 70,652</u>	<u>\$ 82,812</u>
Plant Not in Service Used in Operations	<u>\$ 409,991</u>	<u>\$ 432,645</u>

(3) Deposits and Investments

The Utility's deposits in banks and credit unions as of December 31, 2012 and 2011 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 29 months and yields of 0.90% to 1.69%. 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 \$1,527,185, 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, 2012 and 2011 was as follows:

	Restricted Asset	Corresponding Liability	Restricted Net Position
2012			
Customer deposits.....	\$ 138,941	\$ 138,941	\$ —
Capital Loan Note Covenants			
Debt reserve	<u>330,000</u>	<u>—</u>	<u>330,000</u>
Total	<u>\$ 468,941</u>	<u>\$ 138,941</u>	<u>\$ 330,000</u>
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>

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, 2011	\$ —
Monthly allocations during 2011	402,812
Interest payments made	(82,812)
Principal payments made	<u>(320,000)</u>
Balance - December 31, 2011	—
Monthly allocations during 2012	405,652
Interest payments made	(70,652)
Principal payments made	<u>(335,000)</u>
Balance - December 31, 2012	<u>\$ —</u>

Notes to the Financial Statements

(5) Capital Assets

Capital asset activity for the years ended December 31, 2012 and 2011 was as follows:

	Balance 12-31-10	Increase	Decrease	Balance 12-31-11	Increase	Decrease	Balance 12-31-12
Capital Assets Not Being Depreciated							
Land	\$ 270,896	\$ —	\$ —	\$ 270,896	\$ —	\$ —	\$ 270,896
Pipes and valves	567,816	—	104,413	463,403	—	538	462,865
Construction in progress	146,966	700,247	746,384	100,829	54,271	49,033	106,067
Total Capital Assets Not Being Depreciated	985,678	700,247	850,797	835,128	54,271	49,571	839,828
Capital Assets Being Depreciated							
Buildings and improvements	1,759,882	—	5,591	1,754,291	—	—	1,754,291
Water supply system ...	5,056,525	141,766	—	5,198,291	840,583	—	6,038,874
Distribution system	17,818,746	742,225	—	18,560,971	1,399,310	—	19,960,281
Meters and equipment	1,472,263	—	3,307	1,468,956	—	—	1,468,956
Machinery and equipment	1,778,798	73,407	90,301	1,761,904	142,521	71,578	1,832,847
Total Capital Assets Being Depreciated	27,886,214	957,398	99,199	28,744,413	2,382,414	71,578	31,055,249
Less Accumulated Depreciation for							
Buildings and improvements	(674,745)	(28,274)	(3,646)	(699,373)	(28,197)	—	(727,570)
Water supply system ...	(2,399,222)	(144,170)	—	(2,543,392)	(154,747)	—	(2,698,139)
Distribution system	(3,414,505)	(256,745)	—	(3,671,250)	(265,281)	—	(3,936,531)
Meters and equipment.	(748,876)	(37,957)	(2,458)	(784,375)	(37,651)	—	(822,026)
Machinery and equipment	(1,178,436)	(83,269)	(73,625)	(1,188,080)	(80,573)	(71,578)	(1,197,075)
Total Accumulated Depreciation	(8,415,784)	(550,415)	(79,729)	(8,886,470)	(566,449)	(71,578)	(9,381,341)
Net Capital Assets Being Depreciated	19,470,430	406,983	19,470	19,857,943	1,815,965	—	21,673,908
Net Capital Assets	\$ 20,456,108	\$ 1,107,230	\$ 870,267	\$ 20,693,071	\$ 1,870,236	\$ 49,571	\$ 22,513,736

(6) Summary of Debt

	Current Portion		Long-Term Portion	
	2012	2011	2012	2011
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 \$345,000 to \$390,000 through December, 2016, plus interest semi-annually at rates ranging from 3.8% to 4%, depending on maturity, secured by first lien on net revenue.	\$ 345,000	\$ 335,000	\$ 1,125,000	\$ 1,470,000
Less unamortized discount	—	—	(9,588)	(12,784)
Total	\$ 345,000	\$ 335,000	\$ 1,115,412	\$ 1,457,216

Notes to the Financial Statements

(6) 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 \$1,618,763. For the current year, principal and interest paid and net revenue of the system were \$405,652 and \$2,801,425, respectively.

Interest expense for 2012 and 2011 includes \$70,652 and \$82,812 on the notes plus \$3,196 each for 2012 and 2011, for amortization.

As of December 31, 2012 annual maturities of long-term debt were as follows:

	Principal	Interest	Total
Year Ending December 31,			
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>\$ 1,470,000</u>	<u>\$ 148,763</u>	<u>\$ 1,618,763</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 2012 and 2011, the Utility was in compliance with required covenants.

The following is a summary of the changes in debt for the years ended December 31, 2012 and 2011:

	Water Revenue Capital Loan Notes
Balance - January 1, 2011	\$ 2,125,000
Retirements	<u>320,000</u>
Balance - December 31, 2011	1,805,000
Retirements	<u>335,000</u>
Balance - December 31, 2012	<u>\$ 1,470,000</u>

Notes to the Financial Statements

(7) Compensated Absences

The Utility's employees accumulate vacation days during the year based on the anniversary date of their employment. As of December 31, 2012 and 2011, \$58,335 and \$58,704, respectively, was accrued for unused vacation days.

The Utility has a sick time policy for all 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.

(8) 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 2012 and 2011, the Utility recorded \$127,080 and \$126,883, respectively, as City service fees and forwarded approximately \$12,700,000 during both 2012 and 2011 to the City. As of December 31, 2012 and 2011, the Utility's payables to the City were \$1,038,657 and \$1,168,733, for garbage, sewer and storm water collections, 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 2012 and 2011, the Utility received approximately \$69,000 and \$67,000, 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, 2012 and 2011, the Utility provided metered water to the City valued at approximately \$340,000 and \$265,000, respectively.

(9) 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

(9) 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 were 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, 2012:

Annual recommended contribution (ARC)	\$ 392,305
Interest on net pension obligation	31,384
Annual Pension Cost per Actuary	<u>\$ 423,689</u>
Utility's contribution made during the year	\$ 423,689
Expensing of prior year prepaid contribution	31,401
Amount Recorded to Expense	<u>\$ 455,090</u>
Employee Contributions Made During the Year	<u>\$ 48,938</u>
Total Utility and Employee Contributions Made During the Year	<u>\$ 472,627</u>

The Utility's Board of Trustees have approved contributions to the Plan in excess of the annual pension cost as determined by the actuary in an effort to eliminate over time the unfunded pension liability as computed by the actuary.

The annual pension cost for 2012 was determined as part of the actuarial valuation using the January 1, 2012 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.

Management

Three-Year Trend Information

Year Ended	Annual Pension Cost (APC)			Percentage of APC Contributed	Net Pension Obligation (Asset)
	Normal Cost	Interest	Total		
December 31, 2010	\$ 331,182	\$ 26,495	\$ 357,677	111%	\$ (38,141)
December 31, 2011	355,004	28,400	383,404	98	(31,401)
December 31, 2012	392,305	31,384	423,689	100	—

Notes to the Financial Statements

(9) Pension Plans

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.

Plan members were required to contribute 5.38% of their annual covered salary from January 1, 2012 to June 30, 2012 and 5.78% of their annual covered salary from July 1, 2012 to December 1, 2012. The Utility was required to contribute 8.07% of covered salary from January 1, 2012 to June 30, 2012 and 8.67% of covered salary from July 1, 2012 to December 1, 2012. Contribution requirements are established by state statute. The Utility's contributions to IPERS for the years ended December 31, 2012 and 2011 were \$56,189 and \$43,676, respectively, equal to the required contributions each year.

(10) 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 34 active and no retired members in the plan at December 31, 2012.

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.

(11) 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.

(12) Commitments

During 2011, the Utility began work on the water main extension projects and other various projects. As of December 31, 2012, the Utility expects the remaining costs of \$168,496 to be expended in 2013.

Notes to the Financial Statements

(13) Subsequent Events

Management has evaluated subsequent events through April 4, 2013, the date which the financial statements were available to be issued.

Subsequent to December 31, 2012, the Utility approved a pension contribution of \$463,500 for 2013.

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
2012	1/1/12	4,240,705	6,928,260	2,687,555	61.2	1,105,893	243.0

The information presented in the required supplementary schedule was determined as part of the actuarial valuation as of January 1, 2012. 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.

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

Board of Trustees
Waterloo Water Works
Waterloo, Iowa

We have audited the accompanying financial statements of the Waterloo Water Works as of and for the year ended December 31, 2012, and have issued our report thereon dated April 4, 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

In planning and performing our audit of the financial statements, we considered the Waterloo Water Works' internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances of the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Waterloo Water Works' internal control. Accordingly, we do not express an opinion on the effectiveness of the Utility's internal control.

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 that a material misstatement of the Utility's financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

The following comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2012 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.

- 12-CS-1 Budget** - Operating cash disbursements during the year ended December 31, 2012 did not exceed the amounts budgeted.
- 12-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.
- 12-CS-3 Travel Expense** - No disbursements of the Utility's money for travel expenses of spouses of the Utility officials or employees was noted.
- 12-CS-4 Business Transactions** - No business transactions between the Utility's officials or employees and the Utility were noted.
- 12-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.
- 12-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.
- 12-CS-7 Water Revenue Capital Loan Notes** - No violations of water revenue capital loan note covenants were noted.
- 12-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.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Water Water Works' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

HOGAN - HANSEN

HOGAN - HANSEN

Waterloo, Iowa
April 4, 2013