

B29946

STATE BOARD OF ACCOUNTS
302 West Washington Street
Room E418
INDIANAPOLIS, INDIANA 46204-2769

ANNUAL FINANCIAL REPORT

2006

WATER AND WATER RECLAMATION UTILITIES

CITY OF VALPARAISO

PORTER COUNTY, INDIANA



FILED
06/06/2007

TABLE OF CONTENTS

<u>Description</u>	<u>Page</u>
Officials	2
Independent Auditor's Report.....	3
Statement of Net Assets.....	4
Statement of Revenues, Expenses and Other Changes in Fund Net Assets	5
Statement of Cash Flows	6
Notes to Financial Statements	7-17
Supplementary Information: Schedule of Funding Progress	18
Audit Results and Comments: Compensation and Benefits.....	19
Leave Policy	19
Delinquent Water Reclamation (Wastewater) Accounts	19-20
Rates and Contracts for Construction.....	20
Exit Conference	21
Official Response	22-23

OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Clerk-Treasurer	Sharon Emerson Swihart	01-01-04 to 12-31-07
Mayor	Jon Costas	01-01-04 to 12-31-07
President of the Board of Public Works and Safety	Jon Costas	01-01-04 to 12-31-07
President of the Utilities Board	John Barkley	01-01-06 to 12-31-07
Utilities Director	John Hardwick	01-01-06 to 12-31-07
Utilities Controller	Richard S. Freeman	01-01-06 to 12-31-07



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INDEPENDENT AUDITOR'S REPORT

TO: THE OFFICIALS OF THE WATER AND WATER RECLAMATION
UTILITIES, CITY OF VALPARAISO, PORTER COUNTY, INDIANA

We have audited the accompanying financial statements of the business-type activities of the Water and Water Reclamation Utilities, departments of the City of Valparaiso, as of and for the year ended December 31, 2006. These financial statements are the responsibility of the Utilities' 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. 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.

As discussed in Note I, the financial statements of the Water and Water Reclamation Utilities, City of Valparaiso, are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the business-type activities of the City that is attributable to the transactions of the Utilities. They do not purport to, and do not, present fairly the financial position of the City of Valparaiso as of December 31, 2006, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities for the Water and Water Reclamation Utilities, as of December 31, 2006, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Utilities have not presented Management's Discussion and Analysis that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

STATE BOARD OF ACCOUNTS

April 10, 2007

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
STATEMENT OF NET ASSETS
December 31, 2006

<u>Assets</u>	<u>Water</u>	<u>Water Reclamation</u>
Current assets:		
Cash and cash equivalents	\$ 530,581	\$ 826,240
Accounts receivable	260,994	373,043
Other receivable	110,176	-
Interfund receivable	-	151,494
Inventories	123,828	172,555
Prepaid items	<u>23,754</u>	<u>17,117</u>
Total current assets	<u>1,049,333</u>	<u>1,540,449</u>
Noncurrent assets:		
Restricted cash, cash equivalents and investments:		
Improvement	3,367,456	-
Customer deposits	233,470	-
Revenue bond covenant account	846,822	525,000
Reserve for SRF loan	-	1,846,246
Collection held for others	199,264	-
Tank painting and maintenance	846,304	-
Construction account	<u>694,019</u>	<u>-</u>
Total restricted assets	<u>6,187,335</u>	<u>2,371,246</u>
Deferred charges	<u>61,762</u>	<u>-</u>
Capital assets:		
Land, improvements to land and construction in progress	910,908	3,705,611
Other capital assets (net of accumulated depreciation)	<u>37,526,097</u>	<u>40,801,340</u>
Total capital assets	<u>38,437,005</u>	<u>44,506,951</u>
Total noncurrent assets	<u>44,686,102</u>	<u>46,878,197</u>
Total assets	<u>45,735,435</u>	<u>48,418,646</u>
<u>Liabilities</u>		
Current liabilities:		
Accounts payable	81,833	272,677
Accrued wages and benefit payable	69,301	52,780
Compensated absences payable	10,211	3,880
Taxes payable	14,284	-
Unearned revenue:		
Advances for construction	689,131	-
Current liabilities payable from restricted assets:		
Customer deposits	232,459	-
Revenue bonds payable	340,000	-
Loans payable	-	751,000
Accrued interest payable	82,197	232,798
Interfund payables:		
Interfund services provided and used	<u>199,264</u>	<u>-</u>
Total current liabilities	<u>1,718,680</u>	<u>1,313,135</u>
Noncurrent liabilities:		
Compensated absences payable	163,748	85,152
Revenue bonds payable (net of unamortized discounts)	7,111,677	-
Loans payable	<u>-</u>	<u>13,575,000</u>
Total noncurrent liabilities	<u>7,275,425</u>	<u>13,660,152</u>
Total liabilities	<u>8,994,105</u>	<u>14,973,287</u>
<u>Net Assets</u>		
Invested in capital assets, net of related debt	30,985,328	30,467,799
Restricted for debt service	846,822	2,371,246
Restricted for other purposes	5,340,513	-
Unrestricted	<u>(431,333)</u>	<u>606,314</u>
Total net assets	<u>\$ 36,741,330</u>	<u>\$ 33,445,359</u>

The notes to the financial statements are an integral part of this statement.

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
STATEMENT OF REVENUES, EXPENSES AND OTHER CHANGES IN FUND NET ASSETS
As Of And For The Year Ended December 31, 2006

	<u>Water</u>	<u>Water Reclamation</u>
Operating revenues:		
Metered water revenue:		
Residential	\$ 2,619,855	\$ -
Commercial	587,048	-
Industrial	205,010	-
Public authorities	217,249	-
Water reclamation collection and treatment revenue	-	5,674,013
Fire protection revenue	564,961	-
Penalties	16,040	57,338
Other revenue	<u>80,310</u>	<u>118,631</u>
 Total operating revenues	 <u>4,290,473</u>	 <u>5,849,982</u>
Operating expenses:		
Treatment expense - operations and maintenance	664,343	1,819,307
Transmission and distribution	989,071	1,161,003
Pumping - operations and maintenance	764,593	39,331
Customer accounts	512,467	-
Administration and general	702,038	1,331,234
Depreciation	796,227	2,061,633
Payments in lieu of taxes	200,663	-
Taxes	51,350	-
Miscellaneous expenses	<u>67,050</u>	<u>-</u>
 Total operating expenses	 <u>4,747,802</u>	 <u>6,412,508</u>
 Operating loss	 <u>(457,329)</u>	 <u>(562,526)</u>
Nonoperating revenues (expenses):		
Interest and investment revenue	281,896	108,908
Rent	53,655	-
Miscellaneous revenue	321,576	-
Interest expense	(336,946)	(568,182)
Amortization expense	(9,212)	-
Miscellaneous expense	<u>(39,026)</u>	<u>-</u>
 Total nonoperating revenues	 <u>271,943</u>	 <u>(459,274)</u>
 Loss before contributions	 (185,386)	 (1,021,800)
Capital contributions	<u>2,026,066</u>	<u>-</u>
 Change in net assets	 1,840,680	 (1,021,800)
Total net assets - beginning	<u>34,900,650</u>	<u>34,467,159</u>
Total net assets - ending	<u>\$ 36,741,330</u>	<u>\$ 33,445,359</u>

The notes to the financial statements are an integral part of this statement.

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
STATEMENT OF CASH FLOWS
As Of And For The Year Ended December 31, 2006

	<u>Water</u>	<u>Water Reclamation</u>
Cash flows from operating activities:		
Receipts from customers and users	\$ 4,212,599	\$ 5,883,373
Payments to suppliers, contractors, and employees	<u>(3,923,352)</u>	<u>(4,137,421)</u>
Net cash provided by operating activities	<u>289,247</u>	<u>1,745,952</u>
Cash flows from noncapital financing activities:		
Nonoperating receipts	375,231	-
Nonoperating expenses	<u>(39,026)</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>336,205</u>	<u>-</u>
Cash flows from capital and related financing activities:		
Capital contributions	2,026,066	-
Acquisition and construction of capital assets	(3,150,340)	(259,668)
Principal paid on capital debt	(395,304)	(723,000)
Interest paid on capital debt	(339,833)	(579,930)
Advances for construction	21,133	-
Contractor escrow	<u>(197,515)</u>	<u>-</u>
Net cash used by capital and related financing activities	<u>(2,035,793)</u>	<u>(1,562,598)</u>
Cash flows from investing activities:		
Interest received	<u>281,896</u>	<u>108,908</u>
Net increase (decrease) in cash and cash equivalents	(1,128,445)	292,262
Cash and cash equivalents, January 1	<u>7,846,361</u>	<u>2,905,224</u>
Cash and cash equivalents, December 31	<u>\$ 6,717,916</u>	<u>\$ 3,197,486</u>
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	<u>\$ (457,329)</u>	<u>\$ (562,526)</u>
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation expense	796,227	2,061,633
(Increase) decrease in assets:		
Accounts receivable	4,466	184,885
Other receivables	(83,248)	-
Interfund receivables	-	(151,494)
Inventories	(2,143)	139,857
Prepaid items	12,907	(17,117)
Increase (decrease) in liabilities:		
Accounts payable	(138,924)	94,349
Accrued wages payable	(22,095)	7,521
Compensated absences payable	173,959	(11,156)
Taxes payable	376	-
Interfund services provided or used	4,143	-
Customer deposits	<u>908</u>	<u>-</u>
Total adjustments	<u>746,576</u>	<u>2,308,478</u>
Net cash provided by operating activities	<u>\$ 289,247</u>	<u>\$ 1,745,952</u>
Noncash investing, capital and financing activities:		
Capital asset transferred from construction work in progress to capital assets	\$ 2,600,426	\$ 11,233,560
Capital assets acquired through accounts payable	5,473	-

The notes to the financial statements are an integral part of this statement.

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

The financial statements reflect only the activity of the Utilities and are not intended to present fairly the position of the City of Valparaiso (City), and the results of its operations and cash flows of its enterprise funds. The Utilities, whose operations are controlled by the City, represents a substantial portion of the City's enterprise funds.

B. Fund Financial Statements

Business-type activity financial statements consist of the Statement of Net Assets; Statement of Revenues, Expenses, and Other Changes in Fund Net Assets; and the Statement of Cash Flows. Business-type activities rely to a significant extent on fees and charges for support.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The accounts of the business-type activity are maintained and the financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

Proprietary funds distinguish operating revenues from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the enterprise funds are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

D. Assets, Liabilities and Net Assets or Equity

1. Deposits and Investments

The Utilities cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

State statute (IC 5-13-9) authorizes the Utilities to invest in securities, including but not limited to, federal government securities, repurchase agreements, and certain money market mutual funds. Certain other statutory restrictions apply to all investments made by local governmental units.

Nonparticipating certificates of deposit, demand deposits and similar nonparticipating negotiable instruments that are not reported as cash and cash equivalents are reported as investments at cost.

Debt securities are reported at fair value. Debt securities are defined as securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

Open-end mutual funds are reported at fair value.

Money market investments that mature within one year or less at the date of their acquisition are reported at amortized cost. Other money market investments are reported at fair value.

Investment income, including changes in the fair value of investments, is reported as revenue in the operating statement.

2. Inventories and Prepaid Items

All inventories are valued at cost using the first in/first out (FIFO) method.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

3. Restricted Assets

Certain proceeds of the revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets balance sheet because their use is limited by applicable bond covenants.

4. Capital Assets

Capital assets, which include property, plant, and equipment, are reported in the financial statements.

Capital assets are reported at actual or estimated historical cost based on appraisals or deflated current replacement cost. Contributed or donated assets are reported at estimated fair value at the time received.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets are as follows:

	Capitalization Threshold	Depreciation Method
Water Utility:		
Buildings	\$ 500	2% Composite rate
Improvements other than buildings	500	2% Composite rate
Machinery and equipment	500	2% Composite rate
Water Reclamation Utility:		
Buildings	5,000	Straight-line 50 years
Improvement other than buildings	5,000	Straight-line 50 years
Sewer lines	5,000	Straight-line 100 years
Treatment center	5,000	Straight-line 20 years
Pumping equipment	5,000	Straight-line 20 years
Transportation equipment	5,000	Straight-line 5 years
Office furniture and equipment	5,000	Straight-line 10 years
Machinery and equipment	5,000	Straight-line 10 years

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities is included as part of the capitalized value of the assets constructed.

5. Compensated Absences

The Utilities are in the process of adopting the City's compensated absences policy, which includes all leave as paid time off. Paid time off may be used for vacation, sick, family illness, and personal business. Paid time off is accrued on the first day of the month following an employee's hire date. Utility employees earn paid time off at rates from 84 to 264 hours per year based upon the number of years of service and regularly scheduled hours worked.

Upon termination of employment, an employee may be paid for unused accrued paid time off. The maximum paid time off an employee will be eligible to receive is 210 hours for an employee who regularly is scheduled to work 35 hours per week and 240 hours for an employee who is regularly scheduled to work 40 hours per week.

A liability is reported by the utilities for paid time off.

6. Long-Term Obligations

Long-term debt and other long-term obligations are reported as liabilities in the statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

II. Detailed Notes on All Funds

A. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 5-13-8-1 allows a political subdivision of the State of Indiana to deposit public funds in a financial institution only if the financial institution is a depository eligible to receive state funds and has a principal office or branch that qualifies to receive public funds of the political subdivision. The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

B. Capital Assets

Capital asset activity for the year ended December 31, 2006, was as follows:

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

	Beginning Balance	Increases	Decreases	Ending Balance
Water Utility:				
Capital assets, not being depreciated:				
Land	\$ 186,588	\$ 101,694	\$ -	\$ 288,282
Construction in progress	<u>1,838,432</u>	<u>1,384,620</u>	<u>2,600,426</u>	<u>622,626</u>
 Total capital assets, not being depreciated	 <u>2,025,020</u>	 <u>1,486,314</u>	 <u>2,600,426</u>	 <u>910,908</u>
 Capital assets, being depreciated:				
Buildings	3,985,439	37,457	-	4,022,896
Improvements other than buildings	22,898,715	3,654,702	21,950	26,531,467
Machinery and equipment	<u>12,912,837</u>	<u>577,765</u>	<u>25,205</u>	<u>13,465,397</u>
 Totals	 <u>39,796,991</u>	 <u>4,269,924</u>	 <u>47,155</u>	 <u>44,019,760</u>
 Less accumulated depreciation for:				
Buildings	323,687	79,797	-	403,484
Improvements other than buildings	4,104,721	457,974	21,950	4,540,745
Machinery and equipment	<u>1,316,183</u>	<u>258,456</u>	<u>25,205</u>	<u>1,549,434</u>
 Totals	 <u>5,744,591</u>	 <u>796,227</u>	 <u>47,155</u>	 <u>6,493,663</u>
 Total capital assets, being depreciated, net	 <u>34,052,400</u>	 <u>3,473,697</u>	 <u>-</u>	 <u>37,526,097</u>
 Total capital assets, net	 <u>\$ 36,077,420</u>	 <u>\$ 4,960,011</u>	 <u>\$ 2,600,426</u>	 <u>\$ 38,437,005</u>
 Water Reclamation Utility:				
Capital assets, not being depreciated:				
Land	\$ 575,914	\$ -	\$ -	\$ 575,914
Construction in progress	<u>14,363,257</u>	<u>-</u>	<u>11,233,560</u>	<u>3,129,697</u>
 Total capital assets, not being depreciated	 <u>14,939,171</u>	 <u>-</u>	 <u>11,233,560</u>	 <u>3,705,611</u>
 Capital assets, being depreciated:				
Buildings	17,954,447	-	-	17,954,447
Improvements other than buildings	11,138,399	-	-	11,138,399
Sewer lines	11,287,609	11,281,335	-	22,568,944
Treatment center	16,870,648	-	-	16,870,648
Pumping equipment	3,302,281	-	-	3,302,281
Transportation equipment	1,283,300	-	-	1,283,300
Office furniture and equipment	15,241	-	-	15,241
Machinery and equipment	<u>985,462</u>	<u>211,893</u>	<u>-</u>	<u>1,197,355</u>
 Totals	 <u>62,837,387</u>	 <u>11,493,228</u>	 <u>-</u>	 <u>74,330,615</u>

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

	Beginning Balance	Increases	Decreases	Ending Balance
Water Reclamation Utility (continued):				
Capital assets, being depreciated continued:				
Less accumulated depreciation for:				
Buildings	1,991,191	222,768	-	2,213,959
Improvements other than buildings	9,617,137	112,876	-	9,730,013
Sewer lines	6,365,770	359,089	-	6,724,859
Treatment center	8,274,897	843,532	-	9,118,429
Pumping equipment	1,207,664	98,546	-	1,306,210
Transportation equipment	221,336	165,114	-	386,450
Office furniture and equipment	1,315,542	256,660	-	1,572,202
Machinery and equipment	2,474,105	3,048	-	2,477,153
 Totals	<u>31,467,642</u>	<u>2,061,633</u>	<u>-</u>	<u>33,529,275</u>
 Total capital assets, being depreciated, net	<u>31,369,745</u>	<u>9,431,595</u>	<u>-</u>	<u>40,801,340</u>
 Total capital assets, net	<u>\$ 46,308,916</u>	<u>\$ 9,431,595</u>	<u>\$ 11,233,560</u>	<u>\$ 44,506,951</u>

C. Construction Commitments

Construction work in progress is composed of the following:

Project	Total Project Authorized	Expended to December 31, 2006	Committed
Water Utility:			
Distribution Valparaiso Street Proffit's dam	\$ 324,211 <u>392,847</u>	\$ 356,377 <u>266,249</u>	\$ - <u>126,598</u>
 Totals	<u>\$ 717,058</u>	<u>\$ 622,626</u>	<u>\$ 126,598</u>
 Water Reclamation Utility:			
West side sewer	<u>\$ 3,300,180</u>	<u>\$ 3,129,697</u>	<u>\$ 170,483</u>

D. Interfund Balances and Activity

Interfund Receivables and Payables

The composition of interfund balances as of December 31, 2006, is as follows:

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

Due To	Due From Water Utility
Water Reclamation Utility	\$ 151,494
Storm Water Utility	18,230
Trash Utility	23,004
Other governmental entities	6,536
Total	\$ 199,264

Interfund balances resulted from the time lag between the dates that payments between funds are made to distribute utility collections.

E. Long-Term Liabilities

1. Revenue Bonds

The Utilities issue bonds to be paid by income derived from the acquired or constructed assets. Revenue bonds outstanding at year end are as follows:

Purpose	Interest Rates	Amount
2002 Waterworks Utility revenue bonds - improvements	3.5% to 5.0%	\$ 7,535,000

Revenue bonds debt service requirements to maturity are as follows:

Year Ended December 31	Water Utility	
	Principal	Interest
2007	\$ 340,000	\$ 325,812
2008	350,000	313,825
2009	365,000	301,488
2010	375,000	288,394
2011	395,000	274,046
2012-2016	2,230,000	1,114,052
2017-2021	2,825,000	553,973
2022	655,000	24,625
Totals	\$ 7,535,000	\$ 3,196,215

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Loan Payable

The Water Reclamation Utility has entered into a State Revolving Fund Loan (SRF). Annual debt service requirements to maturity for the loan are as follows:

Year Ended December 31	Water Reclamation Utility	
	Principal	Interest
2007	\$ 751,000	\$ 551,460
2008	781,000	521,878
2009	812,000	491,127
2010	844,000	459,147
2011	877,000	425,919
2012-2016	4,931,000	1,583,595
2017-2021	5,330,000	533,052
Totals	<u>\$ 14,326,000</u>	<u>\$ 4,566,178</u>

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2006, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Water Utility:					
Revenue bonds payable	\$ 7,865,000	\$ -	\$ 330,000	\$ 7,535,000	\$ 340,000
Capital lease	65,304	-	65,304	-	-
Total long-term liabilities	<u>\$ 7,930,304</u>	<u>\$ -</u>	<u>\$ 395,304</u>	<u>\$ 7,535,000</u>	<u>\$ 340,000</u>
Water Reclamation Utility:					
SRF loan payable	<u>\$ 15,049,000</u>	<u>\$ -</u>	<u>\$ 723,000</u>	<u>\$ 14,326,000</u>	<u>\$ 751,000</u>

F. Restricted Assets

The balances of restricted asset accounts in the enterprise funds are as follows:

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

	Water	Water Reclamation
Improvement account	\$ 3,367,456	\$ -
Customer deposits	233,470	-
Revenue bond covenant account	846,822	525,000
Tank painting and maintenance account	846,304	-
Construction account	694,019	-
Collection held for others	199,264	-
Reserve for SRF loan	-	1,846,246
	\$ 6,187,335	\$ 2,371,246
Total restricted assets		

G. Change in Reporting

On January 10, 2006, the City Council approved an ordinance combining the Water and the Water Reclamation Utilities and creating the Valparaiso Utilities Board. Prior to 2006 the Water Reclamation financial statement presentation was included with the City as a department using the cash basis of accounting.

For the year ended December 31, 2006, the financial statements were prepared on the accrual basis of accounting to more appropriately reflect the financial activity of the Water Reclamation Utility and the combination of the reporting of the two utilities.

III. Other Information

A. Risk Management

The Utilities are exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); and natural disasters.

The risks of torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents (excluding postemployment benefits); and natural disasters are covered by commercial insurance from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years. There were no significant reductions in insurance by major category of risk. Risk financing is not utilized for the other risks of loss.

B. Subsequent Events

In November of 2006, the Utilities Board approved issuing Water Reclamation Revenue Bonds in the amount of \$10,810,000. The proceeds of the bonds will be used to finance the cost of equipment and future additions, extensions, and improvements to the Water Reclamation treatment and collection process. The bonds will be repaid over 21 years and the interest rate will range from 3.7% to 4.4%. As of April 10, 2007, the bonds have not yet been issued nor has it been determined when the bonds will be issued.

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

To generate revenue sufficient to repay the principal and interest for the 2007 revenue bonds, the Utilities Board approved a three phase rate increase for the Water Reclamation Utility. The first phase is effective February 1, 2007, and includes a 10% increase based on the quantity of water used and the size of the meter. The second phase is effective July 1, 2008, and includes an 8% increase. The third phase is effective January 1, 2010, and includes a 4% increase.

C. Rate Structure

The current rate structures for the Utilities were approved by the City Council on September 23, 2002.

D. Pension Plans

1. Agent Multiple-Employer Defined Benefit Pension Plan

Public Employees' Retirement Fund

Plan Description

The City, including the Utility, contributes to the Indiana Public Employees' Retirement Fund (PERF), a defined benefit pension plan. PERF is an agent multiple-employer public employee retirement system, which provides retirement benefits to plan members and beneficiaries. All full-time employees are eligible to participate in the defined benefit plan. State statutes (IC 5-10.2 and 5-10.3) govern, through the PERF Board, most requirements of the system and give the Utility authority to contribute to the plan. The PERF retirement benefit consists of the pension provided by employer contributions plus an annuity provided by the member's annuity savings account. The annuity savings account consists of member's contributions, set by state statute at 3% of compensation, plus the interest credited to the member's account. The employer may elect to make the contributions on behalf of the member.

PERF administers the plan and issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. The report may be obtained by contacting:

Public Employees' Retirement Fund
Harrison Building, Room 800
143 West Market Street
Indianapolis, IN 46204
Ph. (317) 233-4162

Funding Policy and Annual Pension Cost

The contribution requirements of plan members for PERF are established by the Board of Trustees of PERF. The City's annual pension cost and related information, as provided by the actuary, is presented in this note.

Information to segregate the assets/liabilities and the actuarial study figures between the City and the Utilities is not available. Therefore, the liability for Net Pension Obligation (NPO) is considered an obligation of the City as a whole and is not presented as an asset/liability of the proprietary funds.

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

Actuarial Information for the Above Plan

	PERF
Annual required contribution	\$ 224,138
Interest on net pension obligation	(18,874)
Adjustment to annual required contribution	21,508
Annual pension cost	226,772
Contributions made	304,735
Decrease in net pension obligation	(77,963)
Net pension obligation, beginning of year	(260,332)
Net pension obligation, end of year	\$ (338,295)
Contribution rates:	
Utilities	5.25%
Plan members	3%
Actuarial valuation date	07-01-05
Actuarial cost method	Entry age
Amortization method	Level percentage of projected payroll, closed
Amortization period	40 years
Amortization period (from date)	07-01-97
Asset valuation method	4 year smoothed market

Actuarial Assumptions

Investment rate of return	7.25%
Projected future salary increases:	
Total	5%
Attributed to inflation	4%
Attributed to merit/seniority	1%
Cost-of-living adjustments	2%

Three Year Trend Information

	Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
PERF	06-30-03	\$ 327,305	79%	\$ (188,792)
	06-30-04	229,357	131%	(260,332)
	06-30-05	226,772	133%	(338,295)

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
NOTES TO FINANCIAL STATEMENTS
(Continued)

2. Defined Contribution Pension Plan

Water Utility and Water Reclamation Utility Pension

Plan Description

The Utility has a defined contribution pension plan administered by Centier Bank as authorized by Indiana Code 8-1.5-3-7. The plan provides retirement, disability, and death benefits to plan members and beneficiaries. The plan was established by written agreement between the governing board of the unit and the plan administrator. The plan administrator issues a publicly available financial report that includes financial statements and required supplementary information of the plan. That report may be obtained by contacting:

Centier Bank
701 East 83rd Ave. Suite 12
Merrville, Indiana 46410
Ph. 219-660-4391

Funding Policy and Annual Pension Cost

The plan provides for up to 6% salary contribution by the employee to be matched 100% by the employer. The employee can also make an additional voluntary contribution as allowable by applicable IRS rules. The additional contribution is not matched by the employer. Employer and employee contributions to the plan were \$137,583.49 and \$281,853.89, respectively.

WATER AND WATER RECLAMATION UTILITIES
 CITY OF VALPARAISO
 REQUIRED SUPPLEMENTARY INFORMATION
 SCHEDULE OF FUNDING PROGRESS

Public Employees Retirement Fund

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Excess of Assets Over (Unfunded) AAL (a-b)	Funded Ratio (a/b)	Covered Payroll (c)	Excess (Unfunded) AAL as a Percentage of Covered Payroll ((a-b)/c)
07-01-03	\$ 5,865,333	\$ 5,769,600	\$ 95,733	102%	\$ 5,151,538	2%
07-01-04	5,941,880	5,530,432	411,448	107%	5,560,436	7%
07-01-05	6,183,377	6,211,667	(28,290)	100%	5,668,109	(0%)

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
AUDIT RESULTS AND COMMENTS

COMPENSATION AND BENEFITS

Employees receive additional compensation which is not included in the salary resolution. For example, employees received \$500 for "safety" job functions, or \$1,500 for signing reports. Also changes are made to the compensation amounts without prior approval. For example, the employees who received \$500 for "safety" job functions received an increase effective with the June 16, 2006, pay period, but the increase was not approved by the Board.

All compensation and benefits paid to officials and employees must be included in the labor contract, salary ordinance, resolution or salary schedule adopted by the governing body unless otherwise authorized by statute. Compensation should be made in a manner that will facilitate compliance with state and federal reporting requirements. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

LEAVE POLICY

A formal leave policy was not presented for audit. The Utilities are working on formalizing a paid "time-off" policy.

Each governmental unit should adopt written policy regarding the accrual and use of leave time and compensatory time and the payment of overtime. Negotiated labor contracts approved by the governing board would be considered as written policy. The policy should conform to the requirements of all state and federal regulatory agencies. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

DELINQUENT WATER RECLAMATION (WASTEWATER) ACCOUNTS

The Utility approved a policy whereby delinquent accounts are turned over to the attorney for collection. Delinquent Water Reclamation (Wastewater) fees and penalties are not recorded with the County Recorder, which would result in a lien against the property nor are they certified to the County Auditor which would result in the delinquent fees being billed with the property taxes.

Indiana Code 36-1-3-6 states in part: "(a) If there is a constitutional or statutory provision requiring a specific manner for exercising a power, a unit wanting to exercise the power must do so in that manner."

Indiana Code 36-9-23-33 states in part:

"(b) Except as provided in subsection (l), the officer charged with the collection of fees and penalties assessed under this chapter shall enforce their payment. As often as the officer determines is necessary in a calendar year, the officer shall prepare either of the following:

- (1) a list of the delinquent fees and penalties that are enforceable under this section, which must include the following:

- (A) the name or names of the owner or owners of each lot or parcel of real property on which fees are delinquent;

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
AUDIT RESULTS AND COMMENTS
(Continued)

- (B) a description of the premises, as shown by the records of the county auditor;
and
 - (C) the amount of the delinquent fees, together with the penalty; or
- (2) an individual instrument for each lot or parcel of real property on which the fees are delinquent."

"(c) The officer shall record a copy of each list or each individual instrument with the county recorder. . . ."

"(e) Using the lists and instruments prepared under subsection (b) and recorded under subsection (c), the officer shall, not later than ten (10) days after the list or each individual instrument is recorded under subsection (c), certify to the county auditor a list of the liens that remain unpaid for collection in the next May. . . ."

RATES AND CONTRACTS FOR CONSTRUCTION

The Water Utility charges fees to developers and other customers for the costs associated with installing mains and services requiring extension of water lines. The rates charged are based upon estimates provided by local excavators who will be performing the work as subcontractors of the Utility as well as costs of meters, labor for the installation of the meters, and overhead (administration, engineering, and inspections). These charges have not been approved by the Utility Services Board, nor has an Ordinance been established by the City Council. Furthermore, the contracts for excavating and installation of the lines are being entered into by the Superintendent on behalf of the Water Utility. The contracts have not been approved by the Utility Services Board.

Indiana Code 8-1.5-3-4 (a) states in part: "The board has general supervisory powers over the utilities under its control, with responsibility for the detailed supervision of each utility to be vested in its superintendent, who is responsible to the board for the business and technical operation of the utility. The board shall: . . .

- (7) recommend to the legislative body reasonable and just rates and charges for services to the patrons of each utility; . . .
- (10) award contracts for:
 - (A) the purchase of capital equipment;
 - (B) the construction of capital improvements; or
 - (C) other property or purposes that are necessary for the full and efficient construction, management, and operation of each utility; . . ."

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
EXIT CONFERENCE

The contents of this report were discussed on April 4, 2007, with Jon Costas, Mayor; and Sharon Emerson Swihart, Clerk-Treasurer.

The contents of this report were discussed on April 10, 2007, with John Hardwick, Utilities Director; John Barkley, President of the Utilities Board; and Richard S. Freeman, Utilities Controller.

The official response has been made a part of this report and may be found on pages 22 and 23.

LANGER & LANGER

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April 25, 2007

VIA FAX 1(219) 881-1340

STATE BOARD OF ACCOUNTS
Attention: Michelle

Re: Valparaiso City Utilities - State Board of Accounts 2007

Dear Michelle:

This letter follows our conversation of last week relative to your exit conference with my client, the Valparaiso City Utilities, relating to the ability of the Valparaiso City Utilities to charge rates based upon sub-contractor involvement in water line extensions, and related services.

Having reviewed your comments, it appears that Indiana Code §8-1.5-4-4 provides the Valparaiso City Utilities the power and authority to enter into contracts for services. Previous to your inquiry, the Utility Board has assigned the responsibility to oversee water main extension projects, including the ability to sign contracts on behalf of the Board as manager of the utility. It follows that if the Utility Board has the right to enter into contracts such as those described, it also would have the authority to delegate responsibility for oversight to its utility manager.

The Valparaiso City Utilities has never operated under the supervision of the Utility Services Board as it recognizes, as has the Indiana State Board of Accounts previously recognized, that it operates under the authority granted to it pursuant to Indiana Code §8-1.5-4-4.

ACCIDENTS, PERSONAL INJURY & WRONGFUL DEATH
FAMILY LAW: DIVORCE • CUSTODY • VISITATION • SUPPORT
MEDICAL, HOSPITAL & NURSING HOME MALPRACTICE
REAL ESTATE, CONTRACTS & LANDLORD/TENANT LAW
APPELLATE PRACTICE

STATE BOARD OF ACCOUNTS

Attention: Michelle

April 25, 2007

----- page two

I will be returning from vacation on May 4, 2007. Hopefully, we can have a discussion relative to the contents of this letter at that time. I look forward to speaking with you.

Very truly yours,

LANGER & LANGER

Michael A. Langer / ajj

Michael A. Langer

MAL:ajj

fax: Mr. John Hardwick