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

EXAMINATION REPORT
OF
WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
PORTER COUNTY, INDIANA

January 1, 2009 to December 31, 2009



FILED
09/28/2010

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OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Clerk-Treasurer	Sharon Emerson Swihart	01-01-08 to 12-31-11
Mayor	Jon Costas	01-01-08 to 12-31-11
President of the Board of Public Works	Jon Costas	01-01-08 to 12-31-11
President of the Utilities Board	Bradley Dolezal	01-01-09 to 12-31-10
Utilities Director	John Hardwick	01-01-09 to 12-31-10
Utilities Controller	Richard S. Freeman	01-01-09 to 12-31-10



STATE OF INDIANA
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INDEPENDENT ACCOUNTANT'S REPORT

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

Except as discussed in following two paragraphs, we have examined 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, 2009. The Utilities' management is responsible for the financial statements presented herein. Our responsibility is to express an opinion based on our examination.

The financial statements presented for the Water Utility include an interfund payable in the amount of \$164,617. A corresponding interfund receivable is included in the Water Reclamation financial statements in the amount of \$24,568. The financial statements do not include any additional interfund receivables for the difference of \$140,049. The notes to the financial statements lack any disclosures relating to interfund receivable/payables. The financial statements also include adjustments to the total net assets balances - a reduction to net assets balances of \$129,699 and an addition of \$33,231. The notes to the financial statements lack any disclosure or explanation for the adjustments. The cash and cash equivalents balance, as of January 1, 2009, used in the presentation of cash flows is \$349,669 less than the cash and cash equivalents balance that was reported as of December 31, 2008, due to the exclusion of a combined cash account.

The capital asset balance reported in the financial statements for the Water Reclamation Utility does not include the value of the infrastructure transferred to the Utility from various developers. Additionally, changes were made to asset classifications which affect the depreciation expense determination. The related accumulated depreciation balance was not adjusted for the change in estimate. The dollar value by which the capital assets, depreciation, and related net assets may be misstated, due to the lack of inclusion of infrastructure and change in depreciation estimate, is not known.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the financial statement presented herein and performing such other procedures as we considered necessary in the circumstances. We believe that our examination 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, 2009, 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.

INDEPENDENT ACCOUNTANT'S REPORT
(Continued)

In our opinion, except for the lack of disclosures relating to adjustments and account balances reported in the Water Utility, and the value of the infrastructure not being reported and change in classification of assets which affected the depreciation calculations in the Water Reclamation Utility, 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, 2009, 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 Water and Water Reclamation 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

July 15, 2010

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
STATEMENT OF NET ASSETS
December 31, 2008 and December 31, 2009

<u>Assets</u>	2009 (Per Unit)	
	Water	Water Reclamation
Current assets:		
Cash and cash equivalents	\$ 1,023,548	\$ 1,007,511
Accounts receivable (net of allowance)	370,597	679,723
Other receivables	25,915	-
Collections held for others	102,140	-
Interfund receivables:		
Interfund receivable for services provided and used	-	24,568
Inventories	128,004	178,844
Prepaid items	1,449	1,446
	1,651,653	1,892,092
Total current assets		
Noncurrent assets:		
Restricted cash, cash equivalents and investments:		
Revenue bond covenant account	845,091	770,520
Improvement	-	831,767
Reserve for SRF loan	-	924,349
Construction account	-	2,443,544
Tank painting and maintenance	116,181	-
Customer deposits	225,844	-
Deferred debits	40,670	109,155
Total restricted assets	1,227,786	5,079,335
Capital assets:		
Land, improvements to land and construction in progress	648,092	9,536,801
Other capital assets (net of accumulated depreciation)	43,978,982	38,109,339
Total capital assets	44,627,074	47,646,140
Total noncurrent assets	45,854,860	52,725,475
Total assets	\$ 47,506,513	\$ 54,617,567
<u>Liabilities</u>		
Current liabilities:		
Accounts payable	\$ 154,469	\$ 187,543
Interfund payables:		
Interfund payable for services provided and used	164,617	-
Taxes payable	21,113	-
Advances for construction	23,723	-
Accrued wages	40,445	29,653
Accrued benefits payable	49,056	-
Compensated absences	6,990	4,707
Current liabilities payable from restricted assets:		
Customer deposits payable	216,180	-
Revenue bonds payable	375,000	40,000
SRF loan	-	844,000
Leases payable	-	56,189
Accrued interest payable	72,966	407,301
Total current liabilities	1,124,559	1,569,393
Noncurrent liabilities:		
Revenue bonds payable (net of unamortized discounts and deferred amount on refunding)	6,037,428	10,868,105
SRF loan payable	-	11,138,000
Compensated absences payable	153,339	103,273
Total noncurrent liabilities	6,190,767	22,109,378
Total liabilities	\$ 7,315,326	\$ 23,678,771
<u>Net Assets</u>		
Invested in capital assets, net of related debt	\$ 38,255,321	\$ 24,240,915
Restricted for debt service	845,091	1,694,869
Restricted for other purposes	444,165	3,299,879
Unrestricted	646,610	1,703,133
Total net assets	\$ 40,191,187	\$ 30,938,796

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 CHANGES IN FUND NET ASSETS
As Of And For The Year Ended December 31, 2009

	2009 (Per Unit)	
	Water	Water Reclamation
Operating revenues:		
Metered water revenue:		
Residential	\$ 2,130,901	\$ -
Commercial	706,939	-
Industrial	164,405	-
Multiple family dwellings	663,491	-
Public authorities	111,286	-
Water reclamation collection and treatment revenue	-	6,844,648
Fire protection revenue	570,866	-
Penalties	17,899	60,232
Other water revenue	571,095	-
Other	-	152,001
	4,936,882	7,056,881
 Total operating revenues	 4,936,882	 7,056,881
Operating expenses:		
Transmission and distribution	1,079,430	-
Pumping - operations and maintenance	751,044	65,059
Treatment and disposal - operations and maintenance	657,028	-
Customer accounts	603,632	-
Administration and general	868,173	1,085,300
Reclaimed water treatment - operations and maintenance	-	2,064,601
Reclaimed water distribution - operations and maintenance	-	999,130
Depreciation	1,013,338	2,812,998
In lieu of taxes	334,644	342,968
Miscellaneous expenses	134,042	599
	5,441,331	7,370,655
 Total operating expenses	 5,441,331	 7,370,655
Operating income (loss)	(504,449)	(313,774)
Nonoperating revenues (expenses):		
Interest and investment revenue	2,338	10,735
Interest expense	(298,294)	(983,705)
Amortization expense	(18,419)	(9,459)
Miscellaneous expense	(11,594)	(1)
	(325,969)	(982,430)
 Total nonoperating revenues (expenses)	 (325,969)	 (982,430)
Income (loss) before contributions and transfers	(830,418)	(1,296,204)
Capital contributions	520,641	-
Change in net assets	(309,777)	(1,296,204)
Total net assets - beginning	40,597,432	32,227,190
Total net assets - adjustment - advances for construction	(129,699)	-
Total net assets - adjustment	33,231	7,810
Total net assets - ending	\$ 40,191,187	\$ 30,938,796

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
ENTERPRISE FUNDS
As Of And For The Year Ended December 31, 2009

	2009 (Per Unit)	
	Water	Water Reclamation
Cash flows from operating activities:		
Receipts from customers and users	\$ 4,982,122	\$ 6,961,358
Payments to suppliers and contractors	<u>(4,608,180)</u>	<u>(5,171,142)</u>
Net cash provided by operating activities	<u>373,942</u>	<u>1,790,216</u>
Cash flows from noncapital financing activities:		
Nonoperating expense	<u>(11,598)</u>	<u>(8)</u>
Net cash provided (used) by noncapital financing activities	<u>(11,598)</u>	<u>(8)</u>
Cash flows from capital and related financing activities:		
Capital contributions	520,641	-
Acquisition and construction of capital assets	(2,352,814)	(1,945,042)
Principal paid on capital debt	(365,000)	(842,000)
Interest paid on capital debt	(301,487)	(999,248)
Principal paid on capital lease	<u>-</u>	<u>(56,187)</u>
Net cash provided (used) by capital and related financing activities	<u>(2,498,660)</u>	<u>(3,842,477)</u>
Cash flows from investing activities:		
Interest received	<u>2,338</u>	<u>26,328</u>
Net cash provided (used) by investing activities	<u>2,338</u>	<u>26,328</u>
Net increase in cash and cash equivalents	(2,133,978)	(2,025,941)
Cash and cash equivalents, January 1	<u>4,344,642</u>	<u>8,003,632</u>
Cash and cash equivalents, December 31	<u>\$ 2,210,664</u>	<u>\$ 5,977,691</u>
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income	\$ (471,219)	\$ (305,964)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation expense	1,013,338	2,812,998
Amortization		
(Increase) decrease in assets:		
Accounts receivable	(97,822)	(250,156)
Other receivables	(21,555)	-
Inventories	(20,167)	7,352
Prepaid items	9,771	4,014
Increase (decrease) in liabilities:		
Accounts payable	(193,372)	(561,522)
Taxes payable	21,113	-
Accrued wages payable	(54,094)	(55,525)
Accrued benefits payable	31,378	-
Compensated absence payable	1,475	(15,614)
Interfund payables	164,617	154,633
Customer deposits	<u>(9,521)</u>	<u>-</u>
Total adjustments	<u>845,161</u>	<u>2,096,180</u>
Net cash provided by operating activities	<u>\$ 373,942</u>	<u>\$ 1,790,216</u>

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 Utility, 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 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.

Enterprise funds distinguish operating receipts and disbursements from nonoperating items. Operating receipts and disbursements generally result from providing services and producing and delivering goods in connection with an enterprise fund's principal ongoing operations. The principal operating receipts of the enterprise funds are charges to customers for sales and services. Operating disbursements for enterprise funds include the cost of sales and services and administrative costs. All receipts and disbursements not meeting this definition are reported as nonoperating receipts and disbursements.

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.

The deferred compensation plan amounts are invested with insurance carriers. The insurance carriers offer a range of investments and the participants choose how their earnings are invested.

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

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	Estimated Useful Life
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
Improvements other than buildings	5,000	Straight-line	50 years
Distribution and collection systems:			
Sewer lines	5,000	Straight-line	100 years
Treatment center	5,000	Straight-line	20 years
Machinery and Equipment:			
Pumping equipment	5,000	Straight-line	20 years
Transportation equipment	5,000	Straight-line	5 years
Office furniture and equipment	5,000	Straight-line	5 years
Machinery and equipment	5,000	Straight-line	10 years

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.

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

5. Compensated Absences

The policy on compensated absences, which includes all leave as paid time-off, was adopted by the Utilities on July 31, 2007. 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 rates from 96 to 264 hours per year based upon the number of years of service and regularly scheduled work hours.

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 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 and Investments

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 Utilities do not have a deposit policy for custodial credit risk. At December 31, 2009, the Water and Water Reclamation Utilities had deposit balances in the amount of \$2,210,664 and \$5,977,691, respectively, which 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, 2009, 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	\$ 318,281	\$ 146,194	\$ -	\$ 464,475
Construction in progress	130,260	53,357	-	183,617
Total capital assets, not being depreciated	<u>448,541</u>	<u>199,551</u>	<u>-</u>	<u>648,092</u>
Capital assets, being depreciated:				
Buildings	4,033,186	91,908	25,303	4,099,791
Improvements other than buildings	30,269,111	1,768,023	30,737	32,006,397
Machinery and equipment	16,364,495	332,173	108,582	16,588,086
Totals	<u>50,666,792</u>	<u>2,192,104</u>	<u>164,622</u>	<u>52,694,274</u>
Less accumulated depreciation for:				
Buildings	(564,605)	(67,172)	25,303	(657,080)
Improvements other than buildings	(5,609,726)	(471,337)	30,737	(6,111,800)
Machinery and equipment	(1,547,518)	(290,312)	108,582	(1,946,412)
Totals	<u>(7,721,849)</u>	<u>(828,821)</u>	<u>164,622</u>	<u>(8,715,292)</u>
Total capital assets, being depreciated, net	<u>42,944,943</u>	<u>1,363,283</u>	<u>329,244</u>	<u>43,978,982</u>
Total capital assets, net	<u>\$ 43,393,484</u>	<u>\$ 1,562,834</u>	<u>\$ 329,244</u>	<u>\$ 44,627,074</u>
Water Reclamation Utility:				
Capital assets, not being depreciated:				
Land	\$ 575,915	\$ -	\$ -	\$ 575,915
Construction in progress	8,161,838	799,048	-	8,960,886
Total capital assets, not being depreciated	<u>8,737,753</u>	<u>799,048</u>	<u>-</u>	<u>9,536,801</u>
Capital assets, being depreciated:				
Buildings	17,954,447	-	-	17,954,447
Improvements other than buildings	11,166,273	944,395	-	12,110,668
Machinery and equipment	7,491,412	-	398,921	7,092,491
Distribution and collection systems	42,941,624	-	267,290	42,674,334
Totals	<u>79,553,756</u>	<u>944,395</u>	<u>666,211</u>	<u>79,831,940</u>
Less accumulated depreciation for:				
Buildings	(2,932,137)	(359,089)	-	(3,291,226)
Improvements other than buildings	(10,175,549)	(222,787)	-	(10,398,336)
Machinery and equipment	(6,921,209)	(687,297)	-	(7,608,506)
Distribution and collection systems	(18,880,707)	(1,543,826)	-	(20,424,533)
Totals	<u>(38,909,602)</u>	<u>(2,812,999)</u>	<u>-</u>	<u>(41,722,601)</u>
Total capital assets, being depreciated, net	<u>40,644,154</u>	<u>(1,868,604)</u>	<u>666,211</u>	<u>38,109,339</u>
Total capital assets, net	<u>\$ 49,381,907</u>	<u>\$ (1,069,556)</u>	<u>\$ 666,211</u>	<u>\$ 47,646,140</u>

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

C. Construction Commitments

Construction work in progress is composed of the following:

Water Utility

<u>Project</u>	<u>Total Project Authorized</u>	<u>Expended to December 31, 2009</u>	<u>Committed</u>
GIS-GPS	\$ 184,260	\$ 183,617	\$ 643

Water Reclamation Utility

<u>Project</u>	<u>Total Project Authorized</u>	<u>Expended to December 31, 2009</u>	<u>Committed</u>
Phase II Plant Expansion	\$ 8,597,397	\$ 7,619,470	\$ 977,927
Hertiage Valley Lift Station	960,000	954,682	5,318
Main Control Building	391,899	355,144	36,755
Supervisory Contol and Data Acquisition (SCADA)	35,600	31,590	4,010
Totals	\$ 9,984,896	\$ 8,960,886	\$ 1,024,010

D. Interfund Balances and Activity

Collections Held for Others

Interfund balances consists of collections made by the Water Utility for services provided by the City and Water Reclamation Utility. The collections are held at year end are due to the time lag between the dates the collections are received and the distribution of the collections is made to the respective funds. The composition of interfund balances as of December 31, 2009, is as follows:

<u>Due To</u>	<u>Due From</u>	<u>2009</u>
Storm Water Utility	Water Utility	40,085
General Fund (City)	Water Utility	63,261
Water Utility	Other Governmental Entities	1,206

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

E. Leases

Capital Leases

The Water Reclamation Utility has entered into a capital lease for a vacuum truck. Future minimum lease payments and present values of the net minimum lease payments under the capital lease as of December 31, 2009, are as follows:

<u>Year</u>	<u>Amount</u>
2010	\$ 58,336
Less amount representing interest	<u>2,147</u>
Present value of net minimum lease payments	<u><u>\$ 56,189</u></u>

Assets acquired through capital leases still in effect are as follows:

	<u>Water Reclamation Utility</u>
Machinery and equipment	\$ 264,750
Accumulated depreciation	<u>(52,950)</u>
Total	<u><u>\$ 211,800</u></u>

F. 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:

<u>Purpose</u>	<u>Interest Rates</u>	<u>Balance at December 31</u>	<u>Less: Unamortized Discount</u>	<u>Amount</u>
2007 Water Utility: Improvements	4.0% - 5.0%	<u>\$ 6,480,000</u>	<u>\$ 67,572</u>	<u>\$ 6,412,428</u>
2002 Water Reclamation Utility: Improvements	3.5% - 5.0%	<u>\$ 10,970,000</u>	<u>\$ 61,895</u>	<u>\$ 10,908,105</u>

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

Revenue bonds debt service requirements to maturity are as follows:

	<u>Water Utility</u>		<u>Water Reclamation Utility</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2010	\$ 375,000	\$ 288,393	\$ 40,000	\$ 505,550
2011	395,000	274,046	10,000	504,250
2012	410,000	258,493	20,000	503,750
2013	425,000	241,887	20,000	502,950
2014	445,000	224,148	20,000	502,150
2015-2019	2,565,000	802,263	100,000	2,498,050
2020-2024	1,865,000	165,860	4,980,000	2,156,350
2025-2029	-	-	5,780,000	570,838
Totals	<u>\$ 6,480,000</u>	<u>\$ 2,255,090</u>	<u>\$ 10,970,000</u>	<u>\$ 7,743,888</u>

2. Loan Payable

The Water Reclamation Utility has entered into a loan agreement (State Revolving Loan Fund (SRF)). Annual debt service requirements to maturity for the loan, including interest of \$3,001,713, are as follows:

	<u>Principal</u>	<u>Interest</u>
2010	\$ 844,000	\$ 459,147
2011	877,000	425,919
2012	911,000	391,385
2013	947,000	355,505
2014	985,000	318,201
2015-2019	5,537,000	977,730
2020-2024	1,881,000	73,826
Totals	<u>\$ 11,982,000</u>	<u>\$ 3,001,713</u>

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2009, was as follows:

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

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Water Utility:					
Revenue bonds payable	\$ 6,845,000	\$ -	\$ 365,000	\$ 6,480,000	\$ 375,000
Less: discount	<u>(72,817)</u>	<u>-</u>	<u>5,245</u>	<u>(67,572)</u>	<u>-</u>
Net revenue bonds payable	<u>6,772,183</u>	<u>-</u>	<u>370,245</u>	<u>6,412,428</u>	<u>375,000</u>
Compensated absences	<u>158,854</u>	<u>1,475</u>	<u>-</u>	<u>160,329</u>	<u>6,990</u>
Total long-term liabilities	<u>\$ 6,931,037</u>	<u>\$ 1,475</u>	<u>\$ 370,245</u>	<u>\$ 6,572,757</u>	<u>\$ 381,990</u>
Water Reclamation Utility:					
Revenue bonds payable	\$ 11,000,000	\$ -	\$ 30,000	\$ 10,970,000	\$ 40,000
Less: discount	<u>(65,318)</u>	<u>-</u>	<u>3,423</u>	<u>(61,895)</u>	<u>-</u>
Net revenue bonds payable	<u>10,934,682</u>	<u>-</u>	<u>33,423</u>	<u>10,908,105</u>	<u>40,000</u>
Loans payable	12,794,000	-	812,000	11,982,000	844,000
Capital lease	112,376	-	56,187	56,189	56,189
Compensated absences	<u>123,594</u>	<u>-</u>	<u>15,614</u>	<u>107,980</u>	<u>4,707</u>
Total long-term liabilities	<u>\$ 23,964,652</u>	<u>\$ -</u>	<u>\$ 917,224</u>	<u>\$ 23,054,274</u>	<u>\$ 944,896</u>

G. Restricted Assets

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

	<u>Water Utility</u>	<u>Water Reclamation Utility</u>
Revenue bond covenant account	\$ 845,091	\$ 770,520
Improvement	-	831,767
Reserve for SRF loan	-	924,349
Tank painting and maintenance fund	116,181	-
Construction account	-	2,443,544
Customer deposits	<u>225,844</u>	<u>-</u>
Total restricted assets	<u>\$ 1,187,116</u>	<u>\$ 4,970,180</u>

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

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; 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 4 years. There were no significant reductions in insurance by major category of risk.

Medical Benefits to Employees, Retirees, and Dependents (excluding postemployment benefits)

The Utilities participate in the City's established risk financing fund for risks associated with medical benefits to employees, retirees, and dependents. The risk financing fund is accounted for in the City's Employee Benefit Plan Fund and the City's Health Claim Fund, internal service funds of the City, where assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of coverage provided by the fund. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past three years. Employee contributions and utility payments are receipted directly into the Employee Benefit Plan, and transfers from the General Fund are made as needed.

B. Subsequent Events

Water Utility:

On December 14, 2009, the City Council approved a water rate increase effective January 1, 2010.

On April 27, 2010, \$2,250,000 of Waterworks Revenue Bonds, Series 2010 were sold. The bond proceeds will be used to pay the costs of certain additions, extensions and improvements to the City's municipal waterworks, and for the issuance costs of the bonds.

Water Reclamation Utility:

On January 1, 2010, the third phase of a rate increase takes effect, which was approved by the City Council on December 18, 2006. The third phase is a 4% increase. A 10% and 8% increase went into effect on February 1, 2007, and July 1, 2008, respectively.

On January 13, 2010, the Utility purchased a combination excavator and sewer cleaner through a capital lease. The cost of the equipment was \$235,000, and it was financed at an interest rate of 3.49%. The first payment is due January 13, 2011, with the final payment due on January 13, 2014.

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

C. Rate Structure

1. Water Utility

The current rate structure was approved by the City Council on December 14, 2009.

2. Water Reclamation Utility

The current rate structure was approved by the City Council on December 18, 2006.

D. Pension Plan

Defined Contribution Pension Plan

Plan Description

The Water Utility has a defined contribution pension plan administered by Centier Bank as authorized by Indiana Code 8-1.5-3-7. The employees of both the Water and Water Reclamation Utilities participate in the plan, which provides retirement, disability, and death benefits to plan members and beneficiaries. The plan was established by written agreement between the governing board of the Utilities 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
4th Floor Wealth Management
600 East 84th Avenue
Merrillville, IN 46410-6366
Phone 219-755-6110

Funding Policy and Annual Pension Cost

The plan provides for up to 6% salary contributions per pay by the employees to be matched 100% by the employer. The employee can also make additional voluntary contributions allowable by applicable IRS rules. The additional contribution is not matched by the employer. Employer and employee contributions to the plan were \$147,401.24 and \$242,873.29, respectively.

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

CAPITAL ASSET RECORDS

Water Utility

The new computer software allows for the user to maintain detailed capital asset records by asset number and item. Additionally, a report called a "Fixed Asset Master Report," which lists all of the assets and the cost associated with each asset can be generated. The last page of the Fixed Asset Master Report provides totals by Capital Asset Classification (land, buildings, etc.) with an overall total. The totals by classification, as well as the overall total, do not agree to the balance of the capital asset accounts in the general ledger. The total capital assets reported in the general ledger exceeds the Fixed Asset Master Report by \$3,878,309.

The Controller maintains a capital asset report by classification in excel (a commercially packaged computer spreadsheet software). This report has been developed based upon the detailed capital assets records from the former computer software and some manually maintained records. He then incorporated the additions and disposals of assets from July 2009 to December 2009 from the new computer software. It was this report that was used to verify the capital assets reported in the general ledger. The general ledger balance exceeds this report by \$45,315.

Officials are working on reconciling the capital asset records of the Water Utility. It is important that the discrepancy between the Fixed Asset Master Report and the General Ledger be resolved as officials plan to rely upon the Fixed Asset Master Report as the detailed record of capital assets. Officials believe that, when the former software data was converted, not all capital assets were converted. Also, not all of the assets maintained manually (outside of the former software) were entered into the new software.

Water Reclamation

A detailed record of capital assets has not been maintained for the Water Reclamation Utility. A summary by classification is maintained in Excel which agrees to the general ledger in total, but not by category. Specifically, construction in progress per the summary in Excel exceeds the balance reported in the general ledger by \$395,401. This essentially means that, within the general ledger, \$395,401 of the construction in progress has been classified as a completed asset for which depreciation expense should be computed. Furthermore, the summary classification maintained in Excel is the basis for computing depreciation expense. The Water Reclamation Utility computes depreciation expense using composite rates which differ by classification. For example, the composite rate for sewer lines is 1%, while the composite rate for treatment center is 5%. A comparison was made of the prior audit period ending balances by classification to the current period beginning balances, and differences were noted. The most material differences were reclassifying over \$10,000,000 in sewer lines to treatment center. Since depreciation is computed on the beginning balance of the capital assets, this resulted in over \$400,000 of additional depreciation expense in the 2009. No adjusting entry was made to correct prior years depreciation; nor could explanation be provided for the change in classification.

Donated infrastructure is not recorded as capital assets. Commercial and residential contractors receive permits and approvals to install sewer lines and mains. When the work is completed and inspected, the completed project is submitted to the Utility Board for acceptance. Once accepted, the Utility Board agrees to maintain the infrastructure as well as take ownership of the assets; however, this infrastructure is not recorded in the records of the Utility. The value of these assets not recorded in the records of the Utility is not known; therefore, the report was qualified.

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

Every governmental unit should have a complete inventory of all capital assets owned which reflects their acquisition value. Such inventory should be recorded in the Capital Assets Ledger, City and Town Form 211, or properly approved form, as applicable. A complete inventory should be taken every year for good internal control and for verifying account balances carried in the accounting records. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

Accounting records and other public records must be maintained in a manner that will support accurate financial statements. Anything other than an unqualified opinion on the Independent Auditors Report on the financial statements may have adverse financial consequences with the possibility of an increase in interest rate cost to the taxpayers of the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

FINANCIAL STATEMENTS

On the Statement of Net Assets, the Water Utility reports \$140,149 in excess of amounts due to the Water Reclamation Utility. Based upon the information provided for audit, as well as information in the Notes to the Financial Statements, it could not be determined as to which funds the Water Utility owes this amount.

On the Statement of Revenues, Expenses and Changes in Fund Net Assets, adjustments are made to the Total Net Assets balance, but it is unclear as to whether or not the adjustment is being made to the beginning or ending balance of net assets. None of the adjustments are explained in the Notes to Financial Statements. The Water Utility Adjustment amount of \$33,231 and the Water Reclamation Adjustment of \$7,810 are both netted to the Operating Income in the Statement of Cash Flows.

On the Statement of Cash Flows, the Cash and Cash Equivalents, January 1, for the Water Utility does not agree to the balance of Cash and Cash Equivalents reported in the prior year, as of December 31, 2008. The balance reported as of December 31, 2008 was \$4,694,311. The balance reported January 1, 2009, is \$4,344,642. This difference of \$349,669 does not agree to the adjustments made to the Fund Net Assets, and is not explained in the Notes to the Financial Statements. The difference is due to the exclusion of a "combining" cash account used by the Utility to deposit all collections, which are subsequently transferred to the respective entities due the collections.

Other immaterial discrepancies were also noted in the financial statements.

Accounting records and other public records must be maintained in a manner that will support accurate financial statements. Anything other than an unqualified opinion on the Independent Auditors Report on the financial statements may have adverse financial consequences with the possibility of an increase in interest rate cost to the taxpayers of the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
EXIT CONFERENCE

The contents of this report were discussed on July 15, 2010, with Richard S. Freeman, Utilities Controller; Sharon Emerson Swihart, Clerk-Treasurer; Bill Oeding, City Administrator; John Hardwick, Utilities Director; and Jon Costas, Mayor. The official response has been made a part of this report and may be found on pages 21 through 25.



Valparaiso City Utilities

205 Billings Street
Valparaiso, Indiana 46383-3699

"Water is our Most Valuable Natural Resource"

July 28, 2010

Indiana State Board of Accounts
302 W. Washington
Indianapolis, IN 46204

Re: "OFFICIAL RESPONSE" to 2009 Examination Results and Comments

To Whom It May Concern:

Valparaiso City Utilities, comprised of the Water and Water Reclamation/Sewer Departments, appreciates the examination performed by the Indiana State Board of Accounts ("State") and we are pleased to submit responses to the issues raised by the State and outline our expected course of action to resolve the issues.

For the purposes of this letter, we are referring to the "Independent Accountants Report" and the "Examination Results and Comments" portions of the examination. Our comments are limited to the following two issues:

1. Capital Asset Records
2. Financial Statements

CAPITAL ASSET RECORDS

Water Department:

Finding (summarized): Capital asset subsidiary ledger detail did not agree to the general ledger detail.

Response: This finding did not result in a qualification of the opinion and we interpret this to mean that while the utility has some process improvements to complete, the overall data is within acceptable parameters. As part of the conversion to the new computerized accounting system on June 30, 2009, the utility had to convert manual ledgers into the computer software. This process is materially complete and the exceptions noted by the examiner

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Fax: (219) 477-4254

E-Mail: dfreeman@valpo.us

Visit our website at www.valparaisoutilities.org

have been addressed. Each year an effort will be made to ensure that a complete reconciliation exists between the general and subsidiary ledgers with regard to capital assets.

Water Reclamation/Sewer Department:

Finding: The capital asset records reported in the financial statements for the Water Reclamation Utility does not include the value of the infrastructure transferred to the Utility from various developers. Additionally, changes were made to asset classifications which affect the depreciation expense determination. The related accumulated depreciation balance was not adjusted for the change in estimate. It is not known as to the dollar value by which the capital assets, depreciation, and related net assets may be misstated due to the lack of inclusion of infrastructure and change in depreciation estimate.

Response: We note that the lack of reporting related to donated infrastructure resulted in a qualification to the examiner's opinion. This item has been addressed as of the date of this letter. Historically, contributed items have been captured in written records but had not been journalized into the general ledger and the capital asset listings. It should be noted that the records of the Water Reclamation Department, until recently, were maintained elsewhere and historical accrual type adjustments of this nature were never addressed. In the few years that this office has taken responsibility for these records, we have recognized that a complete analysis of the capital asset data is necessary. Going forward, the Water Reclamation Department will recognize the acquisition value of the contributions from developers in the period they are acquired and maintain the capital records of those contributions. Additionally, the department will endeavor to research for historical contributions and make an adjustment to recognize those items.

With regard to the change in depreciation estimate, this will also be evaluated and addressed in 2010. As a result of the conversion to a computerized and integrated accounting information system, the department has additional options for the collection, storage and reporting of data. Since the conversion happened on June 30, 2009, the department has not had the opportunity to address this issue. No adjustments were posted to the 2009 financials for classification changes because the evaluation project is not complete.

FINANCIAL STATEMENTS

Finding: The financial statements presented for the Water Utility include an interfund payable in the amount of \$164,617. A corresponding interfund receivable is included in the Water Reclamation financial statements in the amount of \$24,568. The financial statements do not include any additional interfund receivables for the difference of \$140,049. The notes to the financial statements lack any disclosures relating to the interfund receivable/payables. The financial statements also include adjustments to the total net assets balances. A reduction to net assets balances of \$129,699, and the addition of \$33,231. The notes to the financial statements lack any disclosure/explanation for the adjustments. The cash and cash equivalents balance as of January 1, 2009 used in the presentation of cash flows is \$349,669 less than the cash and cash equivalents balance that was reported as of December 31, 2008, due to the exclusion of a combined cash account.

Response: In general, we agree that that these items should have been covered in the notes to the financial statements. This is the first year that the utility has been solely responsible for the notes to the financial statements and it was a huge endeavor. Had the notes been included, they would have addressed these issues as follows:

Variance between interfund receivables/payables:

The variance is attributable to dollars accumulated over the years that need to be distributed to a combination of the water utility, water reclamation department, nature works conservancy district, stormwater utility and for city trash services. To our knowledge, this has never been noted or excepted in previous audits and was not addressed until the utility converted to the new software system. At that time, we recognized that the dollars in the Combined Account (as discussed throughout this report) were never carried on the financial statements of the utilities and an adjustment was made to roll in the cash balance of the account offset by the liabilities associated with the cash balance. The \$140,049 represents dollars that are recognized as owed to other funds, but the breakdown has not been computed. As of the date of this report, the utilities are working to analyze the total amount and develop a methodology to allocate the dollars and distribute them. This will be complete in 2010.

Adjustments to Net Assets:

The adjustments made to net assets are related to the following:

The \$129,699 adjustment to water net assets is related to advances for construction included on the 2008 examination prepared by the State. The unit has no detail of this amount and could not verify the information previously reported. For this reason, the amount is adjusted. This adjustment has to do with beginning net assets.

The \$33,231 adjustment to water net assets is, we believe, related to customer meter deposits and a journal entry that was double counted during conversion. Previously, a portion of the meter deposits were maintained in handwritten ledgers that, during conversion, were incorporated into the utility trial balance. This adjustment has to do with beginning net assets.

The \$7,810 adjustment to Water Reclamation net assets is related to the beginning net assets. The primary reason for the adjustment had to do with conversion differences for items extracted from the old AS400 system and manual ledgers and converting them into the new computerized accounting system. During the conversion, we found outstanding accounts payable without supporting detail and a correction of a transaction that affected 2008 financials. The aggregate adjustment of \$7,810 was posted as an adjustment to beginning net assets.

Beginning Cash Balance Discrepancy:

Historically, the utilities maintained the combined cash account outside of their general ledger. The State has, historically, added the combined account to the unit's submitted totals in order to present the overall financial position of the utilities. During conversion the utilities recognized that incorporating the combined account would better reflect the overall operations of the utility. For this reason, the account was journalized into the ledger as part of the June 30, 2009 conversion. Since the combined account was not incorporated until June 30, 2009, the beginning balances between the unit's ledger and the examiner's ending workpapers would not agree. The unit elected to not restate January 2009 through June 2009 as it would have created significant work to restate interim monthly reports. As of December 31, 2009, the combined account is successfully integrated and reconciled on a monthly basis as part of the overall financial position of the utilities.

We trust this letter has been responsive to the Independent Accountant's Report and the Examination Results and Comments. Please include and print this written response when issuing the final Annual Report for 2009.

Regards,

Handwritten signature of Richard S. Freeman in cursive script.

Richard S. Freeman
Valparaiso City Utilities
Controller

cc: Sharon Emerson Swihart – City of Valparaiso, Clerk-Treasurer
cc: Michelle Janosky – Indiana State Board of Accounts, Field Examiner
cc: Daniel A. Hedden, Principal – Umbaugh
cc: Brad Dolezal – President of the Utilities Board
cc: John Hardwick – Utilities Director