

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

ANNUAL FINANCIAL REPORT

2012

WATER AND WATER RECLAMATION UTILITIES

CITY OF VALPARAISO

PORTER COUNTY, INDIANA



FILED
11/13/2014

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SCHEDULE OF OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Clerk-Treasurer	Sharon Emerson Swihart	01-01-12 to 12-31-15
Mayor	Jon Costas	01-01-12 to 12-31-15
President of the Board of Public Works and Safety	Jon Costas	01-01-12 to 12-31-15
President of the Common Council	Jan Dick	01-01-12 to 12-31-14
President of the Utilities Board	Bradley Dolezal David Bengs	01-01-12 to 06-30-12 07-01-12 to 06-30-15
Director of Utilities	John Hardwick Steve Poulos	01-01-12 to 09-10-12 09-11-12 to 12-31-14
Controller of Utilities	Richard Freeman Alina Hahn	01-01-12 to 07-26-13 07-27-13 to 12-31-14



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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Water and Water Reclamation Utilities (Utilities), departments of the City of Valparaiso, as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Utilities' basic financial statements, as listed in the Table of Contents.

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 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 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 those risk assessments, the auditor considers internal control relevant to the Utilities' 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 Utilities' internal control. Accordingly, we express no such opinion. An audit 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 our audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

INDEPENDENT AUDITOR'S REPORT
(Continued)

Basis for Qualified Opinion

The Utilities' financial statements do not report Other Post-Employment Benefits (OPEB) Payable and do not disclose descriptive information about each OPEB plan in which they participate, including the funding policy followed and other required information. The Utilities have not performed an analysis of the future costs associated with Other Post-Employment Benefits in order to report any liability as required by accounting principles generally accepted in the United States of America.

Qualified Opinion

In our opinion, except for the effects of the matter described in the "*Basis for Qualified Opinion*" paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Utilities of the City of Valparaiso, as of December 31, 2012, and the respective changes in financial position and, where applicable, cash flows thereof and for the year then ended in accordance with accounting principles generally accepted in the United States of America.


Emphasis of Matter

As discussed in Note I, the financial statements of the Water and Water Reclamation Utilities, departments of the City of Valparaiso, are intended to present the financial position, and the changes in financial position and, where applicable, cash flows of only that portion of the business-type activities of the City of Valparaiso that are 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, 2012, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.


Paul D. Joyce, CPA
State Examiner

September 9, 2014

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
STATEMENT OF NET POSITION
December 31, 2012

<u>Assets</u>	2012	
	Water	Water Reclamation
Current assets:		
Cash and cash equivalents	\$ 1,092,513	\$ 1,106,598
Accounts receivable (net of allowance)	359,764	465,320
Other receivables	72,121	-
Collections held for others	135,685	-
Interfund receivables:		
Interfund receivable for services provided and used	-	17,756
Inventories	103,211	191,628
Prepaid items	1,015	864
Total current assets	1,764,309	1,782,166
Noncurrent assets:		
Restricted cash, cash equivalents and investments:		
Revenue bond covenant account	978,062	854,116
Improvement	700,482	1,205,081
Reserve for SRF loan	-	953,160
Construction account	376,495	-
Customer deposits	212,550	-
Total restricted assets	2,267,589	3,012,357
Capital assets:		
Land, improvements to land and construction in progress	380,590	719,790
Other capital assets (net of accumulated depreciation)	45,535,462	44,345,178
Total capital assets	45,916,052	45,064,968
Deferred outflows of resources:		
Deferred debits	90,778	91,942
Total noncurrent assets	48,274,419	48,169,267
Total assets	50,038,728	49,951,433
<u>Liabilities</u>		
Current liabilities:		
Accounts payable	57,274	141,129
Interfund payables:		
Interfund payable for services provided and used	17,756	-
Taxes payable	19,823	-
Advances for construction	15,148	-
Accrued wages and benefits payable	49,205	42,515
Compensated absences	7,213	4,994
Current liabilities payable from restricted assets:		
Customer deposits payable	209,802	-
Revenue bonds payable	445,000	20,000
SRF loan	-	1,004,000
Capital leases payable	59,727	105,504
Accrued interest payable	87,961	381,358
Total current liabilities	968,909	1,699,500
Noncurrent liabilities:		
Revenue bonds payable (net of unamortized discounts and deferred amount on refunding)	6,975,709	10,828,373
SRF loan payable	-	9,541,080
Capital leases payable	61,852	84,065
Compensated absences payable	158,231	109,540
Total noncurrent liabilities	7,195,792	20,563,058
Total liabilities	8,164,701	22,262,558
<u>Net Assets</u>		
Invested in capital assets, net of related debt	38,373,764	23,481,946
Restricted for debt service	978,062	1,807,276
Restricted for other purposes	1,425,212	1,222,837
Unrestricted	1,096,989	1,176,816
Total net assets	\$ 41,874,027	\$ 27,688,875

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 POSITION
As of and for the Year Ended December 31, 2012

	2012	
	Water	Water Reclamation
Operating revenues:		
Metered water revenue:		
Residential	\$ 2,630,363	\$ -
Commercial	841,273	-
Industrial	226,634	-
Multiple family dwellings	783,591	-
Public authorities	139,626	-
Water reclamation collection and treatment revenue	-	6,791,241
Fire protection revenue	770,882	-
Penalties	54,616	59,843
Other water revenue	702,065	-
Other	-	290,361
	<u>6,149,050</u>	<u>7,141,445</u>
Total operating revenues		
Operating expenses:		
Transmission and distribution	1,152,359	-
Pumping - operations and maintenance	767,304	62,428
Treatment and disposal - operations and maintenance	608,593	-
Customer accounts	670,400	-
Administration and general	832,579	1,258,815
Reclaimed water treatment - operations and maintenance	-	2,027,432
Reclaimed water distribution - operations and maintenance	-	1,049,842
Depreciation	1,092,207	3,104,609
Miscellaneous expenses	145,757	-
	<u>5,269,199</u>	<u>7,503,126</u>
Total operating expenses		
Operating income (loss)	<u>879,851</u>	<u>(361,681)</u>
Nonoperating revenues (expenses):		
Interest and investment revenue	5,837	3,943
Miscellaneous revenue	115,117	-
Interest expense	(348,048)	(916,532)
Amortization expense	(15,082)	(9,518)
	<u>(242,176)</u>	<u>(922,107)</u>
Total nonoperating revenues (expenses)		
Income (loss) before contributions and transfers	<u>637,675</u>	<u>(1,283,788)</u>
Contributions and transfers:		
Capital contributions	1,042,294	-
In lieu of taxes	(334,643)	(346,845)
	<u>707,651</u>	<u>(346,845)</u>
Total contributions and transfers		
Change in net assets	1,345,326	(1,630,633)
Total net assets - beginning	<u>40,528,701</u>	<u>29,319,508</u>
Total net assets - ending	<u>\$ 41,874,027</u>	<u>\$ 27,688,875</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, 2012

	2012	
	Water	Water Reclamation
Cash flows from operating activities:		
Receipts from customers and users	\$ 6,197,874	\$ 7,158,733
Payments to employees, suppliers and contractors	<u>(4,186,719)</u>	<u>(4,619,792)</u>
Net cash provided by operating activities	<u>2,011,155</u>	<u>2,538,941</u>
Cash from noncapital financing activities:		
Nonoperating receipts	115,117	-
In lieu of taxes	<u>(334,643)</u>	<u>(346,845)</u>
Net cash provided (used) by noncapital financing activities	<u>(219,526)</u>	<u>(346,845)</u>
Cash flows from capital and related financing activities:		
Capital contributions	1,042,294	-
Acquisition and construction of capital assets	(2,200,663)	(2,315,704)
Loan proceeds	-	1,196,812
Principal paid on capital debt	(430,000)	(986,000)
Interest paid on capital debt	(354,241)	(917,400)
Principal paid on capital lease	<u>(57,697)</u>	<u>(103,224)</u>
Net cash provided (used) by capital and related financing activities	<u>(2,000,307)</u>	<u>(3,125,516)</u>
Cash flows from investing activities:		
Interest received	<u>5,837</u>	<u>3,943</u>
Net cash provided (used) by investing activities	<u>5,837</u>	<u>3,943</u>
Net increase in cash and cash equivalents	(202,841)	(929,477)
Cash and cash equivalents, January 1	<u>3,562,943</u>	<u>5,048,432</u>
Cash and cash equivalents, December 31	<u>\$ 3,360,102</u>	<u>\$ 4,118,955</u>
Reconciliation of operating income to net cash provided (used) by operating activities:		
Operating income (loss)	<u>\$ 879,851</u>	<u>\$ (361,681)</u>
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation expense	1,092,207	3,104,609
(Increase) decrease in assets:		
Accounts receivable	(14,816)	17,288
Other receivables	63,640	-
Inventories	1,494	23,880
Prepaid items	(2)	149
Increase (decrease) in liabilities:		
Accounts payable	(29,160)	(162,066)
Taxes payable	3,096	-
Accrued wages and benefits payable	7,725	4,541
Compensated absence payable	7,857	5,952
Customer deposits	(737)	-
Retainage payable	-	(93,731)
Total adjustments	<u>1,131,304</u>	<u>2,900,622</u>
Net cash provided by operating activities	<u>\$ 2,011,155</u>	<u>\$ 2,538,941</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 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 Position; 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.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the enterprise fund statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their enterprise funds, subject to this same limitation. The Utilities have elected not to follow subsequent private-sector guidance.

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.

When both restricted and unrestricted resources are available for use, the Utilities' policy is to use restricted resources first, then unrestricted resources as they are needed.

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.

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

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 a bank. The bank offers a range of investments and the participants choose how their earnings are invested.

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 enterprise fund revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the Statement of Net Position because their use is limited by applicable bond covenants.

The financial statements report \$2,267,589 and \$3,012,357 for the Water and Water Reclamation Utilities, respectively, of restricted net assets, of which all is restricted by enabling legislation.

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:

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

	Capitalization Threshold	Depreciation Method
Water Utility:		
Buildings	\$ 5,000	2% Composite rate
Improvements other than buildings	5,000	2% Composite rate
Machinery and equipment	5,000	2% Composite rate
Water Reclamation Utility:		
Buildings	5,000	2% Composite rate
Improvements other than buildings	5,000	5% Composite rate
Distribution and collection systems:		
Sewer lines	5,000	1% Composite rate
Treatment center	5,000	5% Composite rate
Machinery and Equipment:		
Pumping equipment	5,000	5% Composite rate
Transportation equipment	5,000	20% Composite rate
Office furniture and equipment	5,000	20% Composite rate
Machinery and equipment	5,000	10% Composite rate

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 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. Utilities 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 Position. 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.

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

E. Rounding Differences

The financial statements may contain immaterial differences due to rounding of amounts when the statements were compiled. These differences are considered trivial and do not affect the overall presentation of the financial statements.

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, 2012, the Water and Water Reclamation Utilities had deposit balances in the amount of \$3,360,102 and \$4,118,955, respectively.

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, 2012, was as follows:

<u>2012</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Water Utility:				
Capital assets, not being depreciated:				
Land	\$ 338,282	\$ 42,308	\$ -	\$ 380,590
Construction in progress	255,467	44,811	(300,278)	-
Total capital assets, not being depreciated	<u>593,749</u>	<u>87,119</u>	<u>(300,278)</u>	<u>380,590</u>
Capital assets, being depreciated:				
Buildings	4,342,396	-	-	4,342,396
Improvements other than buildings	32,949,627	1,847,670	(225,016)	34,572,281
Machinery and equipment	17,340,574	308,021	(50,654)	17,597,941
Totals	<u>54,632,597</u>	<u>2,155,691</u>	<u>(275,670)</u>	<u>56,512,618</u>
Less accumulated depreciation for:				
Buildings	(808,685)	(86,848)	-	(895,533)
Improvements other than buildings	(7,156,251)	(658,993)	225,016	(7,590,228)
Machinery and equipment	(2,195,683)	(346,366)	50,654	(2,491,395)
Totals	<u>(10,160,619)</u>	<u>(1,092,207)</u>	<u>275,670</u>	<u>(10,977,156)</u>
Total capital assets, being depreciated, net	<u>44,471,978</u>	<u>1,063,484</u>	<u>-</u>	<u>45,535,462</u>
Total capital assets, net	<u>\$ 45,065,727</u>	<u>\$ 1,150,603</u>	<u>\$ (300,278)</u>	<u>\$ 45,916,052</u>

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

<u>2012</u>	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Water Reclamation Utility:				
Capital assets, not being depreciated:				
Land	\$ 575,915	\$ -	\$ -	\$ 575,915
Construction in progress	<u>1,462,628</u>	<u>2,355,761</u>	<u>(3,674,514)</u>	<u>143,875</u>
Total capital assets, not being depreciated	<u>2,038,543</u>	<u>2,355,761</u>	<u>(3,674,514)</u>	<u>719,790</u>
Capital assets, being depreciated:				
Buildings	21,173,908	1,975	-	21,175,883
Improvements other than buildings	12,406,403	-	-	12,406,403
Machinery and equipment	10,223,522	39,316	(51,540)	10,211,298
Distribution and collection systems	<u>47,082,193</u>	<u>3,644,706</u>	<u>-</u>	<u>50,726,899</u>
Totals	<u>90,886,026</u>	<u>3,685,997</u>	<u>(51,540)</u>	<u>94,520,483</u>
Less accumulated depreciation for:				
Buildings	(4,073,792)	(423,518)	-	(4,497,310)
Improvements other than buildings	(10,888,677)	(248,128)	-	(11,136,805)
Machinery and equipment	(9,328,258)	(1,035,533)	-	(10,363,791)
Distribution and collection systems	<u>(22,779,969)</u>	<u>(1,397,430)</u>	<u>-</u>	<u>(24,177,399)</u>
Totals	<u>(47,070,696)</u>	<u>(3,104,609)</u>	<u>-</u>	<u>(50,175,305)</u>
Total capital assets, being depreciated, net	<u>43,815,330</u>	<u>581,388</u>	<u>(51,540)</u>	<u>44,345,178</u>
Total capital assets, net	<u>\$ 45,853,873</u>	<u>\$ 2,937,149</u>	<u>\$ (3,726,054)</u>	<u>\$ 45,064,968</u>

Depreciation expense was charged to functions/programs of the Utilities as follows:

	<u>2012</u>
Water	<u>\$ 1,092,207</u>
Water Reclamation	<u>\$ 3,104,609</u>

C. Construction Commitments

Construction work in progress is composed of the following:

<u>Water Reclamation</u>	<u>2012</u>	
<u>Project</u>	<u>Expended to December 31</u>	<u>Committed</u>
Update of IU limits	\$ 2,340	\$ 2,340
Knobe Creek (Smith Ditch Project)	41,750	41,750
Remodel & new maint. & Storage Facility	2,038	2,038
Co-digestion scoping study	<u>97,747</u>	<u>97,747</u>
Totals	<u>\$ 143,875</u>	<u>\$ 143,875</u>

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

D. Interfund Balances and Activity

Interfund Receivables and Payables

The composition of interfund balances as of December 31, 2012, is as follows:

Interfund Receivable	Interfund Payable	2012
Water Reclamation Utility	Water Utility	<u>\$ 17,756</u>

Interfund balances resulted from the time lag between the dates that (1) interfund loans are repaid, (2) interfund goods and services are provided or reimbursable expenditures occur, (3) transactions are recorded in the accounting system, and (4) payments between funds are made.

E. Leases

Capital Leases

The Water Utility has entered into a capital lease for a Vactor Hydro Excavator, and the Water Reclamation Utility entered into capital leases for a Tandem Dump Truck and a Vactor Truck. Future minimum lease payments and present values of the net minimum lease payments under these capital leases as of December 31, 2012, are as follows:

	Water Utility	Water Reclamation Utility
2013	\$ 64,040	\$ 109,646
2014	64,040	85,813
Total minimum lease payments	128,080	195,459
Less amount representing interest	6,501	5,890
Present value of net minimum lease payments	\$ 121,579	\$ 189,569

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

	Water Utility	Water Reclamation Utility
Machinery and equipment	\$ 235,000	\$ 397,059
Accumulated depreciation	(14,100)	(172,344)
Totals	\$ 220,900	\$ 224,715

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

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:

Purpose	Interest Rates	Balance at December 31	Less: Unamortized (Premium) Discount	Amount
Water Utility:				
2002 Water Utility: Improvements	4.0% - 5.0%	\$ 5,300,000	\$ 51,672	\$ 5,248,328
2010 Water Utility: Improvements	1% - 4.25%	<u>2,200,000</u>	<u>27,619</u>	<u>2,172,381</u>
Totals		<u>\$ 7,500,000</u>	<u>\$ 79,291</u>	<u>\$ 7,420,709</u>
Water Reclamation Utility:				
2007 Water Reclamation Utility: Improvements	3.5% - 5.0%	<u>\$ 10,900,000</u>	<u>\$ 51,627</u>	<u>\$ 10,848,373</u>

Revenue bonds debt service requirements to maturity are as follows:

	Water		Water Reclamation	
	Principal	Interest	Principal	Interest
2013	\$ 445,000	\$ 330,968	\$ 20,000	\$ 502,950
2014	465,000	312,829	20,000	502,150
2015	485,000	293,290	20,000	501,350
2016	505,000	272,125	20,000	500,525
2017	535,000	249,220	20,000	499,625
2018-2022	3,065,000	841,105	2,095,000	2,440,413
2023-2027	2,000,000	194,029	7,825,000	1,261,325
2028-2032	<u>-</u>	<u>-</u>	<u>880,000</u>	<u>22,000</u>
Totals	<u>\$ 7,500,000</u>	<u>\$ 2,493,566</u>	<u>\$ 10,900,000</u>	<u>\$ 6,230,338</u>

2. Loans Payable

The Water Reclamation Utility has entered into various loan agreements (State Revolving Loan Fund (SRF)). Annual debt service requirements to maturity for the loans (based upon having drawn down all of the funds), including interest of \$2,260,688, are as follows:

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

	Water Reclamation Utility	
	Principal	Interest
2013	\$ 1,004,000	\$ 404,841
2014	1,043,000	365,600
2015	1,084,000	324,843
2016	1,127,000	282,478
2017	1,171,000	238,433
2018-2022	4,582,000	507,586
2023-2027	424,000	106,526
2028-2032	393,000	30,381
Totals	\$ 10,828,000	\$ 2,260,688

As of December 31, 2012, \$282,920 of available loan funds had not been drawn down. The liability reported in the financial statements for loans payable is based upon the actual funds drawn as of December 31, 2012.

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2012, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Water Utility:					
Revenue bonds payable:					
Water Utility	\$ 7,930,000	\$ -	\$ 430,000	\$ 7,500,000	\$ 445,000
Less deferred amount on refunding	86,697	-	7,406	79,291	-
Total revenue bonds payable	7,843,303	-	422,594	7,420,709	445,000
Capital lease	179,275	-	57,696	121,579	59,727
Compensated absences	157,587	7,857	-	165,444	7,213
Total long-term liabilities	\$ 8,180,165	\$ 7,857	\$ 480,290	\$ 7,707,732	\$ 511,940
Water Reclamation Utility:					
Revenue bonds payable:					
Wastewater Utility	\$ 10,920,000	\$ -	\$ 20,000	\$ 10,900,000	\$ 20,000
Less deferred amount on refunding	55,049	-	3,422	51,627	-
Total revenue bonds payable	10,864,951	-	16,578	10,848,373	20,000
Loans payable	10,314,268	1,196,812	966,000	10,545,080	1,004,000
Capital lease	292,793	-	103,224	189,569	105,504
Compensated absences	108,582	5,952	-	114,534	4,994
Total long-term liabilities	\$ 21,580,594	\$ 1,202,764	\$ 1,085,802	\$ 21,697,556	\$ 1,134,498

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

G. Restricted Assets

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

	Water Utility	Water Reclamation Utility
Revenue bond covenant account	\$ 978,062	\$ 854,116
Improvement	700,482	1,205,081
Reserve for SRF loan	-	953,160
Construction account	376,495	-
Customer deposits	212,550	-
 Total restricted assets	 \$ 2,267,589	 \$ 3,012,357

H. Revenues Pledged

Water Utility Revenues Pledged

The Utility has pledged future water revenues, net of specified operating expenditures, to repay revenue bonds issued in 2002 and 2010, respectively. Proceeds from the bonds provided financing for waterworks improvements. The bonds are payable solely from water net revenues and are payable through 2022 and 2026, respectively. Annual principal and interest payments are expected to require less than 13 percent of net revenues. The total principal and interest remaining to be paid on the bonds is \$9,993,566. Principal and interest paid for the current year and total net revenues were \$777,900 and \$6,149,050, respectively.

Water Reclamation Utility Revenues Pledged

The Utility has pledged future wastewater revenues, net of specified operating expenditures, to repay revenue bonds issued in 2007. Proceeds from the bonds provided financing for wastewater collection and treatment system improvements. The bonds are payable solely from wastewater net revenues and are payable through 2027. Annual principal and interest payments are expected to require less than 7 percent of net revenues. The total principal and interest remaining to be paid on the bonds is \$17,130,338. Principal and interest paid for the current year total net revenues were \$523,750 and \$7,141,445, respectively.

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.

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

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 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.

Medical Benefits to Employees, Retirees, and Dependents (Excluding Postemployment Benefits)

For the first eight months of 2012, the Utilities participated 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 Utilities payments are receipted directly into the Employee Benefit Plan, and transfers from the General Fund are made as needed.

Because of excessive costs for the plan described above, the City (including the Utilities) decided to offer other medical insurance alternatives on January 1, 2013. Covered participants were given a choice of either a Health Savings Account (HSA) with a high deductible or a Traditional PPO.

From September 1, 2012 through the end of the year, the City (including the Utilities) was insured by a traditional PPO plan.

B. Rate Structure

1. Water Utility

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

2. Water Reclamation Utility

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

C. 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

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

Funding Policy and Annual Pension Cost

The plan provides for up to 6 percent salary contributions per pay by the employees to be matched 100 percent 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 \$176,486 and \$262,627, respectively.

D. Subsequent Events

Refunding of Debt

On December 5, 2013, the Water Utility sold \$4,930,000 Waterworks Refunding Bonds to refund the outstanding 2002 Waterworks Revenue Bonds which had an outstanding December 31, 2012 balance of \$5,300,000 and an outstanding balance of \$4,875,000 as of December 5, 2013.

On December 19, 2013, the Water Reclamation Utility sold \$8,245,000 Sewage Works Refunding Revenue Bonds, to refund the outstanding 2000 State Revolving Fund Loan which had an outstanding December 31, 2012 balance of \$9,350,000 and an outstanding balance of \$8,403,000 as of December 19, 2013.

Rate increases

On November 25, 2013, ordinances were approved to increase both water and sewer rates. The water rates will increase in three phases starting on January 1, 2014, when rates will increase by 19.01 percent. On July 1, 2014, the rate will increase by 10.76 percent and the final phase will increase rates by 2.79 percent on January 1, 2016. The sewer rates will increase on the same schedule but will increase by 18 percent, 8 percent, and 4 percent, respectively.

Capital Assets

During 2014, utility management performed an inventory of capital assets and retired any assets below the capital asset threshold. This process is estimated to result in capital asset retirements of \$1 million in water capital assets and \$6 million in sewer capital assets.

Pratt

On September 17, 2013, Pratt Paper, a recycled paper and packaging company, announced plans to locate a paper mill in Valparaiso, Indiana. The mill will be a heavy water user at 1.3 million gallons per day and will discharge approximately .75 million gallons per day of sewage. Estimated revenues for both water and sewer are \$1.6 million per year and will be realized in the summer of 2015.

2014 Water and Water Reclamation Bond Issues

The Board of Directors of the Valparaiso City Utilities has approved resolutions recommending the issuance of water and sewer bonds in 2014. It was recommended that waterworks revenue bonds in an amount not to exceed \$18 million be issued to assist in the funding of various water improvement projects such as additional wells, SCADA upgrades, filters, and piping. The sewage works revenue bonds were also recommended in an amount not to exceed \$2.6 million for improvements to the sanitary sewer collection system and treatment plant. These improvements include a new pump station, wet well, influent pumps, and piping.

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

Sublease of Public Works Building

A sublease between the City of Valparaiso and Valparaiso City Utilities has been approved for the Public Works building located at 1855 Joliet Road, Valparaiso, Indiana. The maximum annual rent to be paid during the term of the sublease shall not exceed \$139,000. The maximum term of the sublease is 17 years.

2014 PILOT Increases

On November 26, 2013, the Board of Directors of the Valparaiso City Utilities approved the 2014 budgets which include annual PILOT payments totaling \$759,643 for water and \$771,845 for sewer.

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

INTERNAL CONTROLS

Financial Statement Reporting

The Utilities have not established internal controls to ensure note disclosures in the financial statements are accurate.

The Controller prepares the notes to the financial statements. The notes are not reviewed by any other member of management including the governing board. For 2012, the capital assets reported in the notes to the financial statements (prior to audit adjustments) for the Water Utility and Water Reclamation Utility exceeded the amounts reported in the financial statements by \$264,019 and \$118,219, respectively. The audit adjustments were provided to the Controller, so the notes could be accurately presented.

Bank Account Reconciliations

The bank account reconciliations for the Water Utility funds are prepared by the accountant/employee of the Water Reclamation Utility. The Controller for the Water Utility indicated that he reviews the bank reconciliations for the Water Utility accounts, but there was no documentation presented for audit supporting that the reconciliations were reviewed. Also, the bank reconciliations for the Combined Account, which contains both the Water Utility funds and the Water Reclamation Utility funds, are not reviewed by anyone other than the accountant that prepares the reconciliations.

Capital Assets

Internal controls over capital assets are ineffective for ensuring capital asset records are complete and accurate. Per Resolution No. 2009-15, "A Resolution Concerning the Capital Asset Policy" states: "All capital assets will be inventoried no less than every year. . . ." An inventory of capital assets has not been performed for several years; thus, the capital asset balance reported in the financial statements has not been reconciled to items on hand and in use at the Utilities. Detailed capital asset records include numerous items which are most likely no longer on hand or in service. For example, the records include vehicles from the 1970's and 1980's.

Controls are also ineffective for providing assurances for the proper accounting treatment of leases and disposals of assets. Lease payments made during the current audit period were capitalized for payments made for a copy machine and postage meter. These payments were capitalized based upon a directive of the former Superintendent of Utilities. By capitalizing operating lease payments, the Utilities are overstating the balance of the capital assets, and understating expenses. Additionally, they are not reporting in accordance with Generally Accepted Accounting Principles.

When assets are disposed of by the Utilities entries made to record the disposals are posted directly to the Net Assets (Retained Earnings) bypassing the recognition of trade-in values on newly acquired assets, and the removal of the related accumulated depreciation. These erroneous entries are subsequently reported in the financial statements as prior period adjustments.

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

Governmental units should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets, and all forms of information processing are necessary for proper internal control. Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

ERRORS ON CLAIMS

At the Water and Water Reclamation Utilities, disbursements for which a purchase order (claim) was not prepared, were not included on the claim docket for approval by the Utilities Service Board. Such disbursements included payroll and related withholding remittances approximately (\$3,574,317), bond and interest remittances via EFTs (totaling \$2,674,814), and remittance to vendors which were reimbursed from State Revolving Loan funds (totaling \$1,196,813).

Indiana Code 5-11-10-1.6 states in part:

"(b) As used in this section, 'claim' means a bill or an invoice submitted to a governmental entity for goods or services."

(c) The fiscal officer of a governmental entity may not draw a warrant or check for payment of a claim unless:

- (1) there is a fully itemized invoice or bill for the claim;
- (2) the invoice or bill is approved by the officer or person receiving the goods and services;
- (3) the invoice or bill is filed with the governmental entity's fiscal officer;
- (4) the fiscal officer audits and certifies before payment that the invoice or bill is true and correct; and
- (5) payment of the claim is allowed by the governmental entity's legislative body or the board or official having jurisdiction over allowance of payment of the claim."

WATER AND WATER RECLAMATION UTILITIES
CITY OF VALPARAISO
EXIT CONFERENCE

The contents of this report were discussed on July 9, 2013, with Steve Poulos, Director of Utilities; Richard Freeman, Controller of Utilities; David Bengs, President of the Utilities Board; and Sharon Emerson Swihart, Clerk-Treasurer.

The contents of this report were discussed on September 9, 2014, with Steve Poulos, Director of Utilities; Alina Hahn, Controller of Utilities; David Bengs, President of the Utilities Board; Lori Schroeder, AP/Payroll Coordinator; Mary Woodworth, Customer Service and Billing Manager; and Peggy Busse, Administrative Assistant.