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

EXAMINATION REPORT
OF

WATER UTILITY
CITY OF HAMMOND
LAKE COUNTY, INDIANA

January 1, 2009 to December 31, 2009



FILED
10/06/2010

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OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Controller	Robert Lendi, CPA	01-01-09 to 12-31-10
Mayor	Thomas M. McDermott, Jr.	01-01-08 to 12-31-11
President of the Board of Public Works and Safety	William J. O'Connor	01-01-09 to 12-31-10
President of the Common Council	Homero Hinojosa Anthony Higgs	01-01-09 to 12-31-09 01-01-10 to 12-31-10
Office Manager	Deborah Van Meter	01-01-09 to 12-31-10
Chief Executive Operator of the Water Utility	Edward Krusa	01-01-09 to 12-31-10
President of the Utility Service Board	Sharon Daniels	01-01-09 to 12-31-10



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF THE WATER UTILITY, CITY OF HAMMOND, LAKE COUNTY, INDIANA

We have examined the accompanying financial statements of the business-type activities of the Water Utility, a department of the City of Hammond, as of and for the year ended December 31, 2009. The Utility's management is responsible for the financial statements presented herein. Our responsibility is to express an opinion based on our examination.

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 Utility, City of Hammond, 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 Utility. They do not purport to, and do not, present fairly the financial position of the City of Hammond 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.

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 Utility, 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 Utility provides postemployment health insurance benefits to eligible retirees. The Water Utility has not provided an actuarial study to determine the Water Utility's annual postemployment benefit costs in accordance with GASB Statement 45.

The Water Utility has 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 22, 2010

WATER UTILITY
CITY OF HAMMOND
STATEMENT OF NET ASSETS
December 31, 2009

Assets

Current assets:	
Cash and cash equivalents	\$ 3,811,925
Accounts receivable	735,016
Inventories	410,227
Prepaid items	106,283
Due from State	<u>277</u>
Total current assets	<u>5,063,728</u>
Noncurrent assets:	
Restricted cash, cash equivalents and investments:	
Customer deposits	797,543
Capital Improvement Fund	<u>3,598,528</u>
Total restricted cash, cash equivalents and investments	4,396,071
Capital assets:	
Land, land rights, and construction in progress	5,725,564
Other capital assets (net of accumulated depreciation)	<u>31,006,034</u>
Total capital assets	<u>36,731,598</u>
Total noncurrent assets	<u>41,127,669</u>
Total assets	<u>46,191,397</u>

Liabilities

Current liabilities:	
Accounts payable	90,883
Accrued payroll and withholding payable	172,164
Taxes payable	23,336
PERF payable	66,060
Redevelopment loan payable	1,415,153
Current liabilities payable from restricted assets:	
Customer deposits	<u>797,656</u>
Total current liabilities	<u>2,565,252</u>
Noncurrent liabilities:	
Compensated absences	<u>129,719</u>
Total liabilities	<u>2,694,971</u>

Net Assets

Invested in capital assets	36,731,598
Restricted for customer deposits	797,543
Restricted for capital improvements	3,598,528
Unrestricted	<u>2,368,757</u>
Total net assets	<u>\$ 43,496,426</u>

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

WATER UTILITY
CITY OF HAMMOND
STATEMENT OF REVENUES, EXPENSES, AND OTHER CHANGES IN FUND NET ASSETS
As Of And For The Year Ended December 31, 2009

Operating revenues:	
Metered water revenue:	
Residential	\$ 1,663,991
Commercial	6,325,668
Other water revenue	<u>455,771</u>
Total operating revenues	<u>8,445,430</u>
Operating expenses:	
Water Treatment:	
Salaries and wages	846,688
Employee pensions and benefits	89,632
Purchased power	1,025,563
Chemicals	1,056,202
Materials and supplies	160,987
Contractual services	524,844
Insurance	324,081
Miscellaneous	3,138
Transmission and Distribution:	
Salaries and wages	957,476
Employee pensions and benefits	105,606
Materials and supplies	697,089
Contractual services	136,081
Transportation expense	44,463
Insurance	628,236
Miscellaneous	3,158
Customer Accounts:	
Salaries and wages	606,764
Employee pensions and benefits	50,375
Contractual services	197,803
Transportation expense	8,348
Insurance	222,388
Bad debt expense	10,663
Miscellaneous	667
Administrative and General:	
Salaries and wages	685,457
Employee pensions and benefits	41,633
Materials and supplies	188,291
Insurance	300,071
Taxes	299,915
Depreciation	1,361,414
Miscellaneous	<u>192,681</u>
Total operating expenses	<u>10,769,714</u>
Operating loss	<u>(2,324,284)</u>
Nonoperating revenues:	
Interest and investment revenue	223,328
Port Authority intergovernmental agreement	<u>1,300,000</u>
Total nonoperating revenues	<u>1,523,328</u>
Income before contributions and transfers	(800,956)
Capital contributions	4,485,086
Transfers to City	<u>(615,000)</u>
Change in net assets	3,069,130
Total net assets - beginning	<u>40,427,296</u>
Total net assets - ending	<u>\$ 43,496,426</u>

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

WATER UTILITY
CITY OF HAMMOND
STATEMENT OF CASH FLOWS
As Of And For The Year Ended December 31, 2009

Cash flows from operating activities:	
Receipts from customers and users	\$ 8,491,488
Payments to suppliers and contractors	(6,005,908)
Payments to employees	<u>(3,342,467)</u>
Net cash provided (used) by operating activities	<u>(856,887)</u>
Cash flows from noncapital financing activities:	
Transfers from Port Authority	1,300,000
Transfers to City	<u>(615,000)</u>
Net cash provided (used) by noncapital financing activities	<u>685,000</u>
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(2,150,064)
Proceeds from loan from Redevelopment Commission	1,500,000
Repayment of principal on loan from Redevelopment Commission	<u>(84,847)</u>
Net cash provided (used) by capital and related financing activities	<u>(734,911)</u>
Cash flows from investing activities:	
Interest received	<u>223,328</u>
Net increase in cash and cash equivalents	(683,470)
Cash and cash equivalents, January 1	<u>8,891,466</u>
Cash and cash equivalents, December 31	<u>\$ 8,207,996</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	<u>\$ (2,324,284)</u>
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation expense	1,361,414
Bad debt expense	10,663
Miscellaneous nonoperating revenue	-
(Increase) decrease in assets:	
Accounts receivable	46,058
Inventories	6,762
Prepaid items	(6,170)
Due from city	500
Increase (decrease) in liabilities:	
Accounts payable	(2,896)
Accrued payroll and withholding payable	27,342
Taxes payable	2,915
PERF payable	6,071
Due to Sanitary	(56)
Due to Refuse	(3,972)
Customer deposits payable	13,930
Compensated absences	<u>4,836</u>
Total adjustments	<u>1,467,397</u>
Net cash provided (used) by operating activities	<u>\$ (856,887)</u>
Noncash investing, capital and financing activities:	
Contributions of capital assets from government	\$ 4,485,086
Deletion of obsolete capital assets	(161,993)

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

WATER UTILITY
CITY OF HAMMOND
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

The financial statements reflect only the activity of the Utility and are not intended to present fairly the position of the City of Hammond (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 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.

Enterprise funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an enterprise 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 and administrative costs. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, the Utility's 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 Utility's 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 Utility 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.

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.

WATER UTILITY
CITY OF HAMMOND
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 in both government-wide and fund financial statements.

3. Restricted Assets

Assets totaling \$3,598,528, of the Water Utility are classified as restricted assets on the Statement of Net Assets balance sheet because these assets are restricted for capital improvements for the Filtration Plant Envelope Repair Project.

The financial statements report \$797,543 of restricted net assets for customer deposits. Customer deposits are assets on hand that are refundable upon termination of customer services.

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:

	<u>Capitalization Threshold</u>	<u>Depreciation Method</u>	<u>Estimated Useful Life</u>
Source and supply	\$ 5,000	Straight-line	15 years
Distribution lines	5,000	Straight-line	15 years
Pumping equipment	5,000	Straight-line	5 to 10 years
Treatment equipment	5,000	Straight-line	5 to 10 years
General building	15,000	Straight-line	20 to 50 years
General equipment	2,000	Straight-line	5 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.

5. Compensated Absences

- a. Sick Leave – Utility employees earn sick leave at the rate of 3/4 day per month. Unused sick leave may be accumulated to a maximum of 75 days. Upon separation of employment, accumulated sick leave is paid to employees that have been employed at least 10 years at the rate of one day's pay for every four unused accumulated sick days or after 15 years of employment at the rate of one day's pay for every two unused accumulated sick days.

WATER UTILITY
CITY OF HAMMOND
NOTES TO FINANCIAL STATEMENTS
(Continued)

- b. Vacation Leave – Utility employees earn vacation leave at rates from 5 days to 30 days per year based upon the number of years of service. Vacation leave does not accumulate from year to year. However, unused vacation leave is paid to employees through cash payments upon separation of employment.
- c. Personal Leave – Utility employees earn personal leave at the rate of 1/4 day per month, if employed on January 1 of that year. Personal leave does not accumulate from year to year. Unused personal leave is added to accumulated sick leave to a maximum of 75 days. Unused personal leave is not paid to employees upon separation from employment.

No liability is reported for vacation and personal leave.

II. Detailed Notes on All Funds

A. Deposits and Investments

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 Utility does not have a deposit policy for custodial credit risk. At December 31, 2009, the Utility had deposit balances in the amount of \$8,207,996.

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, 2009, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	\$ 134,466	\$ -	\$ -	\$ 134,466
Construction in progress	3,084,971	2,506,127	-	5,591,098
Total capital assets, not being depreciated	<u>3,219,437</u>	<u>2,506,127</u>	<u>-</u>	<u>5,725,564</u>
Capital assets, being depreciated:				
Source and supply	1,783,703	-	-	1,783,703
Distribution lines	38,689,499	3,302,122	158,493	41,833,128
Pumping equipment	8,910,022	747,380	-	9,657,402
Treatment equipment	11,143,328	-	-	11,143,328
General building	647,555	-	-	647,555
General equipment	1,324,078	79,521	3,500	1,400,099
Totals	<u>62,498,185</u>	<u>4,129,023</u>	<u>161,993</u>	<u>66,465,215</u>

WATER UTILITY
CITY OF HAMMOND
NOTES TO FINANCIAL STATEMENTS
(Continued)

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, being depreciated (continued):				
Less accumulated depreciation for:				
Source and supply	1,120,271	76,418	-	1,196,689
Distribution lines	19,620,973	605,421	158,493	20,067,901
Pumping equipment	3,642,955	438,308	-	4,081,263
Treatment equipment	8,087,908	115,738	-	8,203,646
General building	809,593	18,691	-	828,284
General equipment	978,060	106,838	3,500	1,081,398
Totals	<u>34,259,760</u>	<u>1,361,414</u>	<u>161,993</u>	<u>35,459,181</u>
Total capital assets, being depreciated, net	<u>28,238,425</u>	<u>2,767,609</u>	-	<u>31,006,034</u>
Total capital assets, net	<u>\$ 31,457,862</u>	<u>\$ 5,273,736</u>	\$ -	<u>\$ 36,731,598</u>

C. Construction Commitments

Construction work in progress is composed of the following:

Project	2009		
	Total Project Authorized	Expended to December 31,	Committed
Schliecher subdivision phase 1	\$ 74,360	\$ 69,454	\$ 4,906
New 12 million gallon water storage tanks	253,015	78,303	174,712
Whiting hook up	224,009	46,799	177,210
Filter to waste line	34,000	30,000	4,000
Scada system	170,000	20,594	149,406
New 6 mg tank and pump station	3,534,503	3,506,714	27,789
Two new storage tanks and pump station	1,622,883	1,537,488	85,395
Water filtration plant exterior envelope restoration	3,558,607	166,423	3,392,184
New intake	135,600	135,323	277
Totals	<u>\$ 9,606,977</u>	<u>\$ 5,591,098</u>	<u>\$ 4,015,879</u>

D. Short-Term Liabilities

The Utility may use short-term notes and loans to finance a variety of public projects, including a loan from the Hammond Redevelopment Commission.

Short-term debt activity for the year ended December 31, 2009, was as follows:

2009	Beginning Balance	Issued/ Draws	Redeemed Repayments	Ending Balance
Hammond Redevelopment Commission loan payable	<u>\$ -</u>	<u>\$ 1,500,000</u>	<u>\$ 84,847</u>	<u>\$ 1,415,153</u>

WATER UTILITY
CITY OF HAMMOND
NOTES TO FINANCIAL STATEMENTS
(Continued)

E. Customer Deposit Cash/Payable

At December 31, 2009, the customer deposit cash did not agree with the customer deposit payable by \$113 due to a timing delay in transferring operating cash to customer deposit cash.

F. Restricted Assets

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

		<u>2009</u>
Customer deposits	\$	797,543
Capital improvement		<u>3,598,528</u>
Total restricted assets	\$	<u><u>4,396,071</u></u>

G. Transfers to the City

Interfund transfers at December 31, 2009, were as follows:

<u>Transfer From</u>	<u>Transfer To</u>	<u>2009</u>
Water Utility	City General fund	<u><u>\$ 615,000</u></u>

III. Other Information

A. Risk Management

The Utility is 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.

Unemployment Compensation

The City (including the Utility) has chosen to establish a risk financing fund for risks associated with unemployment compensation claims. The risk financing fund is accounted for in the City's Unemployment Compensation Fund (an internal service fund of the City) where assets are set aside for claim settlements and the Utility reimburses the City from the Utility's Unemployment Compensation Account. The total charge allocated to each of the funds is based on each fund's actual number of employees which have had claims. Claim expenditures and liabilities of the

WATER UTILITY
CITY OF HAMMOND
NOTES TO FINANCIAL STATEMENTS
(Continued)

fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends, including frequency and amounts of pay outs, and other economic and social factors.

B. Intergovernmental Agreement

The Port Authority and the Hammond Water Utility entered into an intergovernmental Agreement dated June 20, 1996, to which the Port Authority agreed to distribute embarkation fees to the Water Utility. The Port Authority agreed to distribute the lesser of (a) one-third of the embarkation fee received by the Port Authority in the most recent ended prior calendar quarter, or (b) \$375,000 quarterly to a maximum of \$12,000,000. The Water Utility received \$1,300,000, in 2009. As of December 31, 2009, the Port Authority had distributed a total of \$12,000,000 to the Water Utility which resulted in the completion of the agreement.

C. Other Postemployment Benefits

Single-Employer Defined Benefit Healthcare Plan

Plan Description

The Utility provides postemployment benefits (medical, dental, vision and life insurance) to eligible retirees and their spouses.

Funding Policy

The contribution requirements of plan members for the Seniors Choice Healthcare Plan are established by the Utility's Board. The required contribution is based on projected pay-as-you-go financing requirements, with an additional amount to prefund benefits as determined annually by the governing board. For the year ended December 31, 2009, the Utility contributed \$78,114, to the plan. Plan members receiving benefits contributed \$12,633, or approximately 16% of the total premiums, through their required contribution of \$20 to \$104 per month.

Annual OPEB Cost and Net OPEB Obligation

The Utility's annual other postemployment benefit (OPEB) cost (expense) has not been calculated.

D. Rate Structure

The current rate structure was approved by the Indiana Regulatory Commission on June 18, 1985. The Utility has approximately 26,000 customers.

E. Agent Services

The Utility provides billing and collection services for the City and Sanitary District of Hammond, and as such act as their agent.

WATER UTILITY
CITY OF HAMMOND
NOTES TO FINANCIAL STATEMENTS
(Continued)

F. Customer Cities

The Utility sells water to ten neighboring cities and towns. Revenues attributable to these cities and towns for 2009 are as follows:

City	Metered Revenue
Burnham	\$ 122,853
Calumet City	1,000,224
Chicago Heights	1,690,362
Ford Heights	33,322
Griffith	312,586
Highland	697,860
Lansing	1,299,982
Lynwood	36,109
Munster	638,658
South Holland	24,251
Total	\$ 5,856,207

G. Filtration Plant Exterior Envelope Repair Project Financing

In 2008, the Utility started the Filtration Plant Envelope Repair Project, with an estimated total cost of \$3,558,607. To assist in the financing of the filtration plant upgrade, the Hammond Redevelopment Commission awarded the Utility a \$1,000,000 grant in 2008. On April 27, 2009, the Hammond Redevelopment Commission gave the Utility a \$1,500,000 interest free loan that has been extended to mature on April 27, 2011. The Utility anticipates making a \$500,000 payment in 2010.

The Utility was also awarded a State Revolving Fund Forgivable Loan, financed with American Recovery and Reinvestment Act (ARRA) funds for \$1,072,682. A stipulation of the forgivable loan (grant) is that local funds will be used for project costs before the State Drinking Water Revolving Funds can be used. At December 31, 2009, the project costs paid from Utility funds totaled \$166,423.

H. 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

WATER UTILITY
CITY OF HAMMOND
NOTES TO FINANCIAL STATEMENTS
(Continued)

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 three percent 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

PERF members are required to contribute three percent of their annual covered salary. The Utility is required to contribute at an actuarially determined rate; the current rate is six and a half percent (6.5%) of annual covered payroll. The contribution requirements of plan members and the Utility are established and may be amended by the PERF Board of Trustees.

Information to segregate the assets/liabilities and the actuarial study figures between the City and the Utilities is not available. For 2009, the Utility's annual pension cost was \$191,559.

WATER UTILITY
CITY OF HAMMOND
EXIT CONFERENCE

The contents of this report were discussed on April 27, 2010, with Sharon Daniels, President of the Utility Service Board; Edward Krusa, Chief Executive Operator of the Water Utility; and Deborah Van Meter, Office Manager. Our examination disclosed no material items that warrant comment at this time.