B39088

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

EXAMINATION REPORT

OF

WATER UTILITY
CITY OF MICHIGAN CITY
LAPORTE COUNTY, INDIANA

January 1, 2010 to December 31, 2010

FILED
08/22/2011

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OFFICIALS

Office	Official	Term
Controller	John J. Schaefer	01-01-10 to 12-31-11
Mayor	Charles E. Oberlie	01-01-08 to 12-31-11
President of the Utility Board of Directors	Larry J. Jordan, III	01-01-10 to 12-31-11
President of the Common Council	Marc Espar	01-01-10 to 12-31-11
Office Manager	Ronald Plamowski	01-01-10 to 12-31-11
Superintendent of the Water Utilities	Randall E. Russell	01-01-10 to 12-31-11

STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF THE WATER UTILITY, CITY OF
MICHIGAN CITY, LAPORTE COUNTY, INDIANA

We have examined the accompanying financial statements of the business-type activities of the Water Utility (Utility), a department of the City of Michigan City, as of and for the year ended December 31, 2010. 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 Michigan City, 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 Michigan City as of December 31, 2010, 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, 2010, 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 Schedule of Funding Progress, as listed in the Table of Contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not examine the information and express no opinion on it.

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

August 4, 2011

WATER UTILITY
CITY OF MICHIGAN CITY
STATEMENT OF NET ASSETS
December 31, 2010

Assets	
Current assets:	
Cash and cash equivalents	$ 1,481,637
Accounts receivable (net of allowance)	524,762
Inventories	326,962
Total current assets	2,333,361
Noncurrent assets:	
Restricted cash, cash equivalents and investments:	
Improvement cash and investments	3,733,263
Bond and interest cash and investments	404,068
Customer deposits cash and investments	492,958
Pension assets	54,126
Total restricted assets:	4,684,415
Deferred charges	181,127
Capital assets:	
Land, improvements to land and construction in progress	132,794
Other capital assets (net of accumulated depreciation)	45,034,881
Total capital assets	45,167,675
Total noncurrent assets	50,033,217
Total assets	52,366,578
Liabilities	
Current liabilities:	
Accounts payable	58,840
Account wages payable	80,116
Taxes payable	20,545
Unearned revenue	19,032
Current liabilities payable from restricted assets:	
Customer deposits	483,119
Revenue bonds payable	800,000
Loans payable	40,000
Accrued interest payable	125,861
Total current liabilities	1,627,513
Noncurrent liabilities:	
Revenue bonds payable (net of unamortized discounts and deferred amount on refunding)	4,619,099
Loans payable	6,004,916
Advances for construction	49,176
Total noncurrent liabilities	10,673,191
Total liabilities	12,300,704
Net Assets	
Invested in capital assets, net of related debt	33,703,660
Restricted for debt service	404,068
Restricted for capital outlay	3,733,263
Restricted for other purposes	438,832
Unrestricted	1,786,051
Total net assets	$ 40,065,874

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

WATER CITY
CITY OF MICHIGAN CITY
STATEMENT OF REVENUES, EXPENSES AND OTHER CHANGES IN FUND NET ASSETS
As Of And For The Year Ended December 31, 2010

Operating revenues:	
Metered water revenue:	
Residential	$ 3,461,042
Industrial	1,120,233
Fire protection revenue	1,154,121
Penalties	35,341
Sales for resale	392,416
Other revenue	231,649
Total operating revenues	6,394,802
Operating expenses:	
Source of supply - operations and maintenance	564,225
Treatment expense - operations and maintenance	691,334
Transmission and distribution	1,017,093
Customer accounts	327,625
Administration and general	891,770
In lieu of tax	441,844
Gross income tax	202,265
Depreciation	1,185,600
Total operating expenses	5,321,756
Operating income	1,073,046
Nonoperating revenues (expenses):	
Interest and investment revenue	80,584
Amortization of bond issue costs	(53,366)
Interest expense	(389,414)
Total nonoperating revenues (expenses)	(362,196)
Income before contributions	710,850
Capital Contributions	151,805
Change in net assets	862,655
Total net assets - beginning	39,203,219
Total net assets - ending	$ 40,065,874

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

WATER CITY
CITY OF MICHIGAN CITY
STATEMENT OF CASH FLOWS
ENTERPRISE FUNDS
As Of And For The Year Ended December 31, 2010

Cash flows from operating activities:	
Receipts from customers and users	$ 5,507,167
Payments to suppliers and contractors	(1,470,367)
Payments to employees	(2,231,811)
Interfund services provided	780,891
Interfund services used	(441,844)
Net cash provided by operating activities	2,144,036
Cash flows from capital and related financing activities:	
Capital contriutions	151,805
Acquisition and construction of capital assets	(873,006)
Principal paid on revenue bonds	(775,000)
Principal paid on state revolving fund loan	(40,000)
Interest paid on revenue bonds	(222,671)
Interest paid on state revolving fund loan	(176,172)
Refund on customer advances for construction	(2,947)
Net cash used by capital and related financing activities	(1,937,991)
Cash flows from investing activities:	
Interest received	80,584
Net increase in cash and cash equivalents	286,629
Cash and cash equivalents, January 1	5,825,297
Cash and cash equivalents, December 31	$ 6,111,926
Reconciliation of operating income to net cash provided (used) by operating activities:	
Operating income	$ 1,073,046
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Depreciation expense	1,185,600
(Increase) decrease in assets:	
Accounts receivable	(31,958)
Prepaid items	654
Inventories	(47,978)
Pension assets	20,634
Increase (decrease) in liabilities:	
Accounts payable	6,266
Accued wages payable	12,009
Taxes payable	549
Unearned revenue	(69,412)
Customer deposits	(5,374)
Total adjustments	1,070,990
Net cash provided by operating activities	$ 2,144,036
Noncash investing, capital and financing activities:	
Completed work in progress projects transferred to capital assets	$ 564,239
Capital assets purchase through beginning accouts payable	50,270
Trade in value on disposal	3,500

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

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 Michigan City (City), and the results of its operations and cash flows of its enterprise funds. The Utility, whose operations are controlled by the Utility Board of Directors, per Indiana Code 8-1.5-4-1.5(b), 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.

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 Utility has elected not to follow subsequent private-sector guidance.

Enterprise funds distinguish operating revenues 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, administrative expenses, and depreciation on capital assets. 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 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.

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

2. Inventories and Prepaid Items

All inventories are valued at cost using the first in/first out (FIFO) method. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

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

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 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
Buildings	$ 500	Composite	2%
Improvements other than buildings	500	Composite	2%
Machinery and equipment	500	Composite	2%
Transportation equipment	500	Composite	2%

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 8 days per month. Unused sick leave may be accumulated to a maximum of 180 days. Accumulated sick leave is not paid to employees upon termination.

b. Vacation Leave – Utility employees earn vacation leave at rates from 5 days to 20 days per year based upon the number of years of service. Vacation leave does not accumulate from year or year.

c. Personal Leave – Utility employees earn personal leave at the rate of 2 days per year. Personal leave does not accumulate from year to year.

No liability is reported for vacation, sick, and personal leave.

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

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, 2010, the Utility had deposit balances in the amount of $6,192,459.

B. Capital Assets

Capital asset activity for the year ended December 31, 2010, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets, not being depreciated:				
Land	$ 91,291	$ -	$ -	$ 91,291
Construction in progress	145,126	460,617	564,240	41,503
Total capital assets, not being depreciated	236,417	460,617	564,240	132,794
Capital assets, being depreciated:				
Buildings	20,372,483	295,412	23,443	20,644,452
Improvements other than buildings	32,702,793	372,559	548,183	32,527,169
Machinery and equipment	6,210,608	312,158	105,771	6,416,995
Totals	59,285,884	980,129	677,397	59,588,616

	Beginning Balance	Increases	Decreases	Ending Balance
Less accumulated depreciation for :				
Buildings	4,884,256	407,450	541,183	4,750,523
Improvements other than buildings	8,234,828	654,056	57,352	8,831,532
Machinery and equipment	872,678	124,094	25,092	971,680
Totals	13,991,762	1,185,600	623,627	14,553,735
Total capital assets, being depreciated, net	45,294,122	(205,471)	53,770	45,034,881
Total capital assets, net	$ 45,530,539	$ 255,146	$ 618,010	$ 45,167,675

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

Business-type activities:	
Water	$ 1,185,600

C. Construction Commitments

Construction work in progress is composed of the following:

Project	Expended to December 31, 2010	Committed
Highway 20 Main Extension	$ 10,193	$ 544,526
Pahs Road Booster Station (VFD Project)	31,310	227,692
Totals	$ 41,503	$ 393,556

D. Long-Term Liabilities

1. Revenue Bonds

The Utility issues 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: Deferral on Refunding	Revenue Bonds
2004 Waterworks refunding revenue bonds	3.5% to 3.75%	$ 5,600,000	$ 180,901	$ 5,419,099

Revenue bonds debt service requirements to maturity are as follows:

Year Ended December 31	Water Utility Principal	Water Utility Interest
2011	$ 800,000	$ 195,369
2012	830,000	167,106
2013	870,000	137,706
2014	905,000	106,794
2015	945,000	73,500
2016-2017	1,250,000	43,031
Totals	$ 5,600,000	$ 723,506

2. Loan Payable

The Utility has entered into a State Revolving Fund Loan. Annual debt service requirements to maturity for the loan, including Interest of $1,577,430, are as follows:

Year Ended December 31	Water Utility Principal	Water Utility Interest
2011	$ 40,000	$ 175,013
2012	40,000	173,853
2013	30,000	172,765
2014	30,000	171,895
2015	25,000	171,100
2016-2020	4,110,000	661,115
2021-2022	1,769,916	51,689
Totals	$ 6,044,916	$ 1,577,430

3. Advance Refunding

In 2004, the Utility defeased revenue bonds of 1995, by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments of the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Utility's financial statements. The following outstanding bonds, at December 31, 2010, were considered defeased:

$ 5,680,000

4. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2010, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Water Utility:					
Revenue bonds payable:	$ 6,375,000	$ -	$ 775,000	$ 5,600,000	$ 800,000
Less deferred amount on refunding	210,236	-	29,335	180,901	-
Total revenue bonds payable	6,164,764	-	745,665	5,419,099	800,000
Loan payable	6,084,916	-	40,000	6,044,916	40,000
Advances for Construction	52,123	-	2,947	49,176	-
Total long-term liabilities	$ 12,301,803	$ -	$ 788,612	$ 11,513,191	$ 840,000

E. Restricted Assets

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

Improvement cash and investment	$ 3,733,263
Bond and interest cash and investments	404,068
Customer deposits cash and investments	492,958
Pension Assets	54,126
Total restricted assets	$ 4,684,415

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; 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.

Medical Benefits to Employees and Dependents

The Utility has chosen to participate in a risk financing fund of the City of Michigan City for risks associated with medical benefits to employees and dependents. The risk financing fund is accounted for in the City's Health and Health Insurance Funds, internal service funds, where

assets are set aside for claim settlements. An excess policy through commercial insurance covers individual claims in excess of $150,000 per year. Settled claims resulting from this risk did not exceed commercial insurance coverage in the past three years. A premium is charged to each fund that accounts for payroll expenditures. The total charge allocated to each of the funds is calculated using trends in actual claims experience. Provisions are also made for unexpected and unusual claims.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported (IBNRs).

Information to segregate the assets and liabilities figures between the City, Utilities, and the Port Authority is not available and therefore considered an obligation of the City. Thus, claim liabilities cannot be reasonably estimated for the Utility, separate from the City.

B. Rate Structure

The current rate structure was approved by the Indiana Utility Regulatory Commission on March 31, 2004. The Utility has 12,516 customers.

C. Pension Plan

Plan Description

The Utility has a defined contribution pension plan administered by McKready and Keene, Inc., as authorized by Indiana Code 8-1.5-3-7. The plan provides retirement, disability, and death benefits to plan members and beneficiaries. The plan was established by written agreement between the governing board of the Utility 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:

McKready and Keene, Inc.
7941 Castleway Drive
P.O. Box 50460
Indianapolis, IN 46250-0460
Ph. (317) 849-4333

Funding Policy and Annual Pension Cost

The contribution requirements of plan members are established by the written agreement between the governing board of the Utility and the Plan Administrator. Plan members are required to contribute 3% of the annual covered salary. The Utility is required to contribute at an actuarially determined rate. The current rate is 0% of the annual covered payroll. Employer and employee contributions to the plan were $0.00 and $52,479, respectively.

Actuarial Information for the Above Plan

Annual required contribution	$	19,687
Interest on net pension obligation		(4,486)
Adjustment to annual required contribution		5,433
Increase in net pension obligation		20,634
Net pension obligation, beginning of year		(74,760)
Net pension obligation, end of year	$	(54,126)

Contribution rates:	
Utility	0%
Plan members	3%
Actuarial valuation date	01-01-11
Actuarial cost method	Entry age normal cost
Amortization method	Ten year level funding
Amortization period	30 years

Actuarial Assumptions

Investment rate of return	6.00%
Projected future salary increases:	4.00%

Three Year Trend Information

Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
12-31-08	$ 1,835	0.0%	$ (142,977)
12-31-09	68,217	0.0%	(74,760)
12-31-10	20,634	0.0%	(54,126)

WATER UTILITY
CITY OF MICHIGAN CITY
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULE OF FUNDING PROGRESS

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Assets Over Unfunded AAL (a-b)	Funded Ratio (a/b)	Covered Payroll (c)	Unfunded AAL as a Percentage of Covered Payroll ((a-b)/c)
01-01-06	$ 7,897,062	$ 3,353,155	$ 4,543,907	236%	$ 1,489,584	305%
01-01-07	8,341,097	3,640,098	4,700,999	229%	1,651,726	285%
01-01-08	8,923,668	5,910,351	3,013,317	151%	1,664,817	181%
01-01-09	7,534,128	6,175,000	1,359,128	122%	1,687,915	81%
01-01-10	8,601,372	6,560,416	2,040,956	131%	1,728,340	118%
01-01-11	9,243,455	6,113,433	3,130,022	151%	1,819,252	172%

The Schedule of Funding Progress, presented as RSI for the above plan following the Notes to the Financial Statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

WATER UTILITY
CITY OF MICHIGAN CITY
EXIT CONFERENCE

The contents of this report were discussed on July 11, 2011, with Randall E. Russell, Superintendent of the Water Utilities; and Ronald Plamowski, Office Manager. Our examination disclosed no material items that warrant comment at this time.

The contents of this report were discussed on August 4, 2011, with John J. Schaefer, Controller; Charles E. Oberlie, Mayor; and Marc Espar, President of the Common Council. Our examination disclosed no material items that warrant comment at this time.