★Roll Call Number

Agenda Item Number
37

Date September 24, 2007

Receipt of Des Moines Water Works' 2006 Audit Reports.

Moved by ________________ to receive and file.

| COUNCIL ACTION | YEAS | NAYS | PASS | ABSENT |
|---|---|---|---|---|
| COWNIE | | | | |
| COLEMAN | | | | |
| HENSLEY | | | | |
| KIERNAN | | | | |
| MAHAFFEY | | | | |
| MEYER | | | | |
| VLASSIS | | | | |
| TOTAL | | | | |

MOTION CARRIED APPROVED

______________________________ Mayor

CERTIFICATE

I, DIANE RAUH, City Clerk of said City hereby certify that at a meeting of the City Council of said City of Des Moines, held on the above date, among other proceedings the above was adopted.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my seal the day and year first above written.

______________________________ City Clerk

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DES MOINES

WATER WORKS

**DES MOINES WATER WORKS**
Board of Water Works Trustees
L.D. McMullen, Ph.D., P.E., CEO and General Manager

2201 George Flagg Parkway • Des Moines, Iowa 50321-1190 • (515) 283-8755 • www.dmww.com

September 7, 2007

Ms. Diane Rauh, City Clerk
City of Des Moines
East 1st & Locust Street
Des Moines, IA 50307

SUBJECT: Des Moines Water Works - 2006 Audit Reports

Dear Diane:

Audited financial statements and accompanying reports for Des Moines Water Works for the 2006 calendar year are enclosed. These reports were prepared by McGladrey & Pullen. The enclosed information was presented and received by the Board of Water Works Trustees at their meeting held July 24, 2007.

Sue Huppert, DMWW Board Chair, has asked that you please distribute a copy to the Mayor and to each City Council member.

Sincerely,

Peggy Freese

Peggy Freese, CPA
*Director of Finance*

Enclosures

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# Des Moines Water Works

Financial Report
12.31.2006

## Contents

McGladrey & Pullen
Certified Public Accountants

**Independent Auditor's Report**

Board of Water Works Trustees
Des Moines Water Works
Des Moines, Iowa

We have audited the accompanying basic financial statements of Des Moines Water Works (Water Works) as of and for the year ended December 31, 2006, as listed in the table of contents. These financial statements are the responsibility of the Des Moines Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the financial position of Des Moines Water Works as of December 31, 2006 and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 1, 2007, on our consideration of Water Work's internal control over financial reporting and our tests of compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

McGladrey & Pullen, LLP is a member firm of RSM International -
an affiliation of separate and independent legal entities.

The Management's Discussion and Analysis on pages 3 through 7 and pension plan schedule on pages 29 and 30 is not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

McGladrey & Pullen, LLP

Davenport, Iowa
June 1, 2007

Des Moines Water Works

**Management's Discussion and Analysis**
**Year Ended December 31, 2006**

Our Management's Discussion and Analysis (MD&A) of Des Moines Water Works' (Water Works) financial performance provides an overview of the utility's financial activities for the years ended December 31, 2006 and 2005. Please consider this information in conjunction with the financial statements and the accompanying notes to basic financial statements that follow this section.

## Overview of Business

The service area of the Water Works has expanded significantly since its emergence as a public water utility in 1919. In addition to serving customers within the City of Des Moines, Water Works provides wholesale water service based on long-term water contracts to surrounding municipalities and rural water districts, accounting for roughly 25 percent of total water revenues. This service area spans approximately 400 square miles, including most of Polk County and communities in eastern Dallas County and northern Warren County. The utility also provides billing and collection services on a contractual basis to wholesale customers and billing and collection services to the City of Des Moines for wastewater treatment, solid waste collection and the storm water utility.

As the utility's service area has expanded, so too has the need for water storage facilities, booster stations and additional treatment capacity to meet peak demand requirements. The most economical approach for the Water Works has involved utilizing these facilities to supply multiple customers. Contractual service users share in the cost of these joint-use facilities, which allows for meeting peak use demands and also allows some users to participate in lower off-peak or purchased capacity water rates. Financial participation in the construction of these facilities includes initial cash contributions or payments of debt service for the improvements and operating and maintenance costs. Ownership of these facilities is maintained by the Water Works.

The water sources for the system are the Raccoon River and Des Moines River, an underground infiltration gallery, and wells along the Raccoon River near Maffitt Reservoir. These four sources are used to provide adequate supply in the most cost-effective combination. The utility operates two treatment plants, with one of those plants being operated remotely. An additional treatment plant is currently being developed in the northern segment of the utility's service area to meet growing demand in that area.

Governance of the Water Works is vested in a five-member Board appointed by the Mayor of the City of Des Moines with approval of the City Council. Trustees serve for six-year staggered terms. The Board has complete control of Water Works' management, and employs approximately 215 full-time and 15 part-time or seasonal employees.

The utility has adopted an annual activity-based budgeting methodology and performs an annual cost of service study to assist the Board in rate-setting policy.

## Financial Highlights

- Water Works' net assets increased as a result of operations. As of December 31, 2006 and 2005, total assets were $290,201,832 and $229,668,231, respectively, and total liabilities were $109,306,723 and $61,009,355, respectively, resulting in net assets of $180,895,109 and $168,658,876, respectively.
- Operating revenues of $39,659,080 increased 13.25 percent over 2005, while operating expenses increased approximately 4.47 percent to $34,591,868.
- During the year, Water Works had operating income of $5,067,212 and change in net assets of $12,236,233. This compares to operating income of $1,907,125 and change in net assets of $3,184,462 reported in 2005.

Des Moines Water Works

## Management's Discussion and Analysis
## Year Ended December 31, 2006

### Overview of the Financial Statements

Management's Discussion and Analysis (MD&A) serves as an introduction to the financial statements, and the MD&A represents management's examination and analysis of the Water Work's financial condition and performance. The financial statements report information about the utility using full accrual accounting methods as utilized by similar entities in the private sector.

The balance sheet provides information about the Water Works' assets, liabilities and net assets, thereby measuring the Water Works' liquidity and solvency. Liquidity is a measure of the utility's ability to meet current obligations (those due within one year). Solvency is a similar concept, but measures the ongoing ability to meet obligations over a longer term.

The statement of revenues, expenses and changes in net assets presents the results of the Water Works' revenues and expenses over the course of the fiscal year and provides information about the utility's recovery of costs. Water rates are established by the Board of Trustees and are based on the utility's annual Cost of Service Study. The Cost of Service Study estimates annual revenue requirements through an analysis of operational and maintenance expenses, debt service requirements, anticipated capital needs, and return on capital. The Study provides a core of information not only for the trustees and staff at Des Moines Water Works, but also for the customers ultimately affected by our decisions.

The statement of cash flows presents cash receipts, cash disbursements and net changes in cash resulting from operations, noncapital financing activities, capital and related financing activities and investing activities. This statement details where cash resources come from and how they are used.

The notes to basic financial statements provide required disclosures and other information that are essential to a full understanding of data provided in the statements. The notes supplement the basic financial statements by presenting information about the Water Works' accounting policies, significant account balances and activities, material risks, obligations, commitments, and contingencies.

### Condensed Financial Information

The following condensed financial information serves as the key financial data and indicators for management, monitoring and planning.

### Condensed Balance Sheet Information

| | 2006 | 2005 | % Change |
|---|---|---|---|
| Current assets | $ 38,185,510 | $ 7,515,627 | 408.08% |
| Capital assets, net | 216,030,583 | 198,755,238 | 8.69 |
| Other noncurrent assets | 35,985,739 | 23,397,366 | 53.80 |
| **Total assets** | 290,201,832 | 229,668,231 | 26.36 |
| Current liabilities | 16,679,862 | 14,063,412 | 18.60 |
| Other noncurrent liabilities | 18,346,861 | 19,755,943 | (7.13) |
| Long-term debt | 74,280,000 | 27,190,000 | 173.19 |
| **Total liabilities** | 109,306,723 | 61,009,355 | 79.16 |
| Invested in capital assets, net of related debt | 180,520,412 | 167,080,017 | 8.04 |
| Restricted | 17,136,157 | 19,372,427 | (11.54) |
| Unrestricted | (16,761,460) | (17,793,568) | (5.80) |
| **Total net assets** | $ 180,895,109 | $ 168,658,876 | 7.26 |

| | 2006 | 2005 | % Change |
|---|---|---|---|
| Water sales | $ 33,964,194 | $ 30,001,396 | 13.21% |
| Billing and collection services | 892,455 | 807,839 | 10.47 |
| Connection fees | 591,950 | 500,542 | 18.26 |
| Purchased capacity | 1,321,967 | 968,347 | 36.52 |
| Other sales and services | 2,888,514 | 2,740,760 | 5.39 |
| **Total operating revenues** | 39,659,080 | 35,018,884 | 13.25 |
| Investment income | 3,001,447 | 517,567 | 479.91 |
| Other | 166,722 | 173,043 | (3.65) |
| Capital contributions | 6,904,658 | 2,116,739 | 226.19 |
| **Total revenues** | 49,731,907 | 37,826,233 | 31.47 |
| Labor and benefits | 13,146,601 | 13,566,345 | (3.09) |
| Chemicals and power | 5,100,647 | 4,162,646 | 22.53 |
| Insurance | 940,458 | 899,619 | 4.54 |
| Purchased services | 3,179,056 | 2,559,800 | 24.19 |
| Materials, supplies and equipment | 3,127,030 | 3,003,276 | 4.12 |
| Depreciation | 8,891,789 | 8,734,782 | 1.80 |
| Other | 206,287 | 185,291 | 11.33 |
| **Total operating expenses** | 34,591,868 | 33,111,759 | 4.47 |
| Interest expense | 2,903,806 | 1,530,012 | 89.79 |
| **Total expenses** | 37,495,674 | 34,641,771 | 8.24 |
| **Change in net assets** | 12,236,233 | 3,184,462 | 284.25 |
| Net assets, beginning of year | 168,658,876 | 165,474,414 | 1.92 |
| Net assets, end of year | $ 180,895,109 | $ 168,658,876 | 7.26 |

## Condensed Revenues, Expenses and Changes in Net Assets
## Financial Analysis

Current assets increased 408.08 percent. Other noncurrent assets increased approximately 53.80 percent. Both of these are a result of receiving $52,435,000 in water revenue bond proceeds which were not all spent as of December 31, 2006.

Current liabilities increased 18.60 percent due to increases in construction contracts payable of $1,350,182. The current portion of long-term debt also increased due to the issuance of Water Revenue Bonds, Series 2006. Fees collected for other entities also increased $102,022 over 2005 due to the timing of year-end remittances.

Noncurrent liabilities include deferred revenue being amortized over a period of 10 to 20 years. Noncurrent liabilities include the pension liability which will be paid through future pension contributions.

Long-term debt increased 173.19 percent in 2006 due to the issuance of the Water Revenue Bonds, Series 2006.

Water sales increased 13.21 percent. Two retail service areas, Southeast Polk and Runnells, were added in 2006. Both of these areas previously purchased water on a wholesale basis. In addition, debt service reimbursement increased $2.6 million due to the issuance of Water Revenue Bonds, Series 2006.

Connection fees increased 18.26 percent due to more connection fees after the takeover of the Southeast Polk Rural Water District. These fees can fluctuate widely from year to year depending on the level of development experienced within the utility's service areas.

Purchased capacity revenues increased 36.52 percent as a result of the continued amortization of deferred revenue. This deferred revenue represents current year cash contributions to fund the Saylorville Water Treatment Plant and previous years' cash contributions from wholesale customers to fund the Maffitt Water Treatment Plant. Financial participation in the construction of the plants allows users to participate in lower purchased capacity water rates. Deferred revenue balances are amortized to purchase capacity revenue over the length of the contract, generally 10 to 20 years.

Effective January 5, 2004, per 28E agreement with the City of Des Moines, Des Moines Water Works assumed management of operations of the Des Moines Botanical Center. Operations include room rentals, catering and café, gift shop, and special events. Botanical Center revenues of $684,642 and $492,942 for 2006 and 2005, respectively, are included in Water Works' financial results.

Chemicals and power increased 22.53 percent due to an increase in chemical costs.

Purchased services increased 24.19 percent compared to 2005 due to repairs to the Botanical Center dome and service line installations in the Southeast Polk service area.

Other expenses increased 11.33 percent due to an increase in casualty losses of $10,569 over 2005. Loss on bad debt decreased $17,511 from 2005.

Investment income increased 479.91 percent due to higher investment balances as a result of funds received from the issuance of the 2006 Series Bonds and slightly higher investment returns. Interest expense increased 89.79 percent in 2006 primarily due to the interest due on the Water Revenue Bonds Series 2006.

Capital contributions increased 226.19 percent in 2006 due to funds received from Polk County in the purchase of the Southeast Polk Rural Water District. All other capital contributions of $1,795,062 in 2006 are related to contributions of water mains by subdividers. These contributions can fluctuate widely from year to year, depending on the status of construction and the timing of inspections performed by Water Works' staff.

The aforementioned fluctuations result in an overall increase in net assets of 7.26 percent, the result of a 13.25 percent increase in operating revenues, an increase in operating expenses of 4.47 percent, and a 258.80 percent increase in nonoperating revenues.

## Capital Assets and Debt Administration

During 2006, net capital assets increased $17,275,345 or 8.69 percent. In addition to replacing deteriorating water mains, the utility is responsible for relocating mains affected by the I-235 freeway expansion project. The utility is also engaged in a multi-year capital project to implement radio frequency meter reading for all customers within the City of Des Moines. There were no significant changes to the condition of infrastructure assets, nor were there any changes made to standard service lives of those assets.

Water Works' long-term debt was $79,050,000 and $31,788,000 as of December 31, 2006 and 2005, respectively. The increase was due to the issuance of the Water Revenue Bonds, Series 2006.

## Economic Factors

Due to the Water Works' large concentration of residential customers, weather impacts revenue to a greater degree than do economic cycles. Water Works budgets revenues and expenses based on anticipated consumption for a "normal" weather year. A water rate increase of 15.3 percent was budgeted for 2006 for one class of wholesale customer. This was based on the results of the annual cost of service study which indicated costs to serve those customers exceeded their water rates.

## Requests for Information

If the reader has questions or would like additional information, please direct the request to: Peggy Freese, Treasurer, 2201 George Flagg Parkway, Des Moines, Iowa 50321-1190.

Des Moines Water Works

**Balance Sheet**
**December 31, 2006**

| | |
|---|---|
| **Assets** | |
| Current assets: | |
| Cash | $ 1,452,914 |
| Restricted assets: | |
| Cash | 1,759,264 |
| Investments, water revenue bond reserve fund | 27,885,273 |
| Accounts receivable: | |
| Billed | 3,484,132 |
| Unbilled | 1,093,455 |
| Other receivables | 474,224 |
| Inventory, materials and supplies | 1,241,741 |
| Prepaid expenses | 794,507 |
| **Total current assets** | 38,185,510 |
| Restricted assets, investments (Notes 2 and 4): | |
| Water revenue bond reserve fund | 29,826,367 |
| Water revenue bond improvement fund | 600,000 |
| | 30,426,367 |
| Long-term investments: | |
| Investment in land | 624,562 |
| Board designated funds, investments (Note 2) | 4,029,879 |
| | 4,654,441 |
| Capital assets (Note 3): | |
| Land | 4,911,351 |
| Construction-in-progress | 13,872,969 |
| Buildings, equipment and machinery | 118,022,971 |
| Supply system | 39,643,628 |
| Distribution system | 138,399,220 |
| | 314,850,139 |
| Accumulated depreciation | (98,819,556) |
| **Capital assets, net** | 216,030,583 |
| Bond issue costs, discount and deferral | 605,082 |
| Other assets | 299,849 |
| **Total assets** | $ 290,201,832 |

See Notes to Basic Financial Statements.

**Liabilities and Net Assets**

| | |
|---|---|
| Current liabilities: | |
| Accounts payable | $ 2,801,027 |
| Accrued wages and benefits | 422,181 |
| Compensated absences (Note 4) | 1,283,031 |
| Deferred revenue (Note 1) | 1,330,632 |
| Special deposits | 105,712 |
| Construction payables | 5,352,632 |
| Water revenue bonds interest payable | 273,397 |
| Current portion of long-term debt (Note 4) | 4,770,000 |
| Fees collected for other entities | 341,250 |
| **Total current liabilities** | 16,679,862 |
| Long-term debt, less current installments (Note 4) | 74,280,000 |
| Compensated absences (Note 4) | 731,103 |
| Deferred revenue (Note 1) | 17,058,120 |
| Pension liability (Note 5) | 557,638 |
| | 92,626,861 |
| **Total liabilities** | 109,306,723 |
| Net assets: | |
| Invested in capital assets, net of related debt | 180,520,412 |
| Restricted (bond indentures) | 17,136,157 |
| Unrestricted | (16,761,460) |
| **Total net assets** | 180,895,109 |
| **Total liabilities and net assets** | $ 290,201,832 |

Des Moines Water Works

**Statement of Revenues, Expenses and Changes in Net Assets**
**Year Ended December 31, 2006**

| | |
|---|---|
| Operating revenues: | |
| Water sales | $ 35,286,161 |
| Other sales and services | 3,780,969 |
| Connection fees | 591,950 |
| **Total operating revenues** | 39,659,080 |
| Operating expenses: | |
| Labor | 9,956,210 |
| Insurance | 940,458 |
| Group insurance | 1,369,792 |
| Pension benefits (including social security) | 1,820,599 |
| Purchased services | 3,179,056 |
| Materials, supplies and equipment | 3,127,030 |
| Chemicals | 2,673,600 |
| Utilities, net | 2,427,047 |
| Depreciation | 8,891,789 |
| Other | 206,287 |
| **Total operating expenses** | 34,591,868 |
| **Operating income** | 5,067,212 |
| Nonoperating revenue (expense): | |
| Investment income | 3,001,447 |
| Interest expense | (2,903,806) |
| Land use income | 162,132 |
| Other | 4,590 |
| **Nonoperating revenue (expense), net** | 264,363 |
| **Income before contributions** | 5,331,575 |
| Capital contributions | 6,904,658 |
| **Change in net assets** | 12,236,233 |
| Net assets, beginning of year | 168,658,876 |
| Net assets, end of year | $ 180,895,109 |

See Notes to Basic Financial Statements.

Des Moines Water Works

## Statement of Cash Flows
**Year Ended December 31, 2006**

| | |
|---|---|
| Cash flows from operating activities: | |
| Cash received from customers | $ 37,983,371 |
| Cash paid to suppliers | (11,168,903) |
| Cash paid to employees and for payroll taxes | (13,981,547) |
| **Net cash provided by operating activities** | 12,832,921 |
| Cash flows from capital and related financing activities: | |
| Proceeds from long-term debt | 52,435,000 |
| Principal payments on long-term debt | (5,173,000) |
| Acquisition, construction and removal cost of capital assets | (23,021,890) |
| Contributions received | 5,109,596 |
| Interest paid | (3,215,563) |
| **Net cash provided by capital and related financing activities** | 26,134,143 |
| Cash flows from investing activities: | |
| Proceeds from maturities of investments | 127,005,089 |
| Purchase of investments | (167,840,750) |
| Interest received | 2,765,656 |
| Land use income and other | 166,722 |
| **Net cash used in investing activities** | (37,903,283) |
| **Net increase in cash** | 1,063,781 |
| Cash, beginning of year | 2,148,397 |
| Cash, end of year | $ 3,212,178 |
| Reconciliation of cash to the balance sheet: | |
| Cash | $ 1,452,914 |
| Restricted assets, cash | 1,759,264 |
| **Total cash at end of year** | $ 3,212,178 |

(Continued)

**Statement of Cash Flows (Continued)**
**Year Ended December 31, 2006**

| | | |
|---|---|---|
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | $ | 5,067,212 |
| Adjustments to reconcile operating income to net cash, depreciation | | 8,891,789 |
| Change in: | | |
| Accounts receivable, billed | | (355,829) |
| Accounts receivable, unbilled | | (132,739) |
| Other receivables | | (40,198) |
| Inventories - materials and supplies | | (205,085) |
| Prepaid expense | | 32,480 |
| Other assets | | 70,651 |
| Accounts payable | | 616,722 |
| Accrued wages and benefits and compensated absences | | 130,914 |
| Pension liability | | (25,402) |
| Deferred revenue | | (1,312,216) |
| Special deposits | | (7,400) |
| Fees collected for other entities | | 102,022 |
| **Net cash provided by operating activities** | $ | 12,832,921 |
| | | |
| Schedule of noncash capital and related financing activities: | | |
| Contributions of water mains from contractors in aid of construction | $ | 1,795,062 |
| Acquisition of capital assets through construction payables | | 1,350,182 |
| | | |
| Schedule of noncash investing activities, net depreciation of the fair value of investments | | 15,332 |

See Notes to Basic Financial Statements.

Des Moines Water Works
Pension Plan

**Statement of Plan Net Assets**
**December 31, 2006**

| | | |
|---|---|---|
| **Assets** | | |
| Investments, contracts with insurance companies, pooled separate accounts | $ | 42,053,324 |
| Employer contributions receivable | | 221,385 |
| | | 42,274,709 |
| **Liabilities** | | - |
| **Net assets held in trust for pension benefits** | $ | 42,274,709 |

See Notes to Basic Financial Statements.

**Des Moines Water Works**
**Pension Plan**

**Statement of Changes in Plan Net Assets**
**Year Ended December 31, 2006**

| | | |
|---|---|---|
| Additions: | | |
| Investment income: | | |
| Net appreciation in the fair value of pooled separate accounts, interest and dividends (Note 2) | $ | 4,985,894 |
| Gain on sale of stock | | 323,002 |
| Employer contributions | | 885,990 |
| **Total additions** | | 6,194,886 |
| Deductions: | | |
| Benefit payments | | 1,549,594 |
| Administrative expenses | | 67,174 |
| **Total deductions** | | 1,616,768 |
| **Net increase** | | 4,578,118 |
| Net assets held in trust for pension benefits: | | |
| Beginning of year | | 37,696,591 |
| End of year | $ | 42,274,709 |

See Notes to Basic Financial Statements.

## Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies

**Nature of business:**

Des Moines Water Works (Water Works) is managed and controlled by the Board of Water Works Trustees of the City of Des Moines, Iowa (the Board), which exists under the provisions of Chapter 388 and other relevant statutes of the Code of Iowa. The five-member Board is appointed by the Mayor of Des Moines with the approval of the City Council. Trustees serve for six-year staggered terms.

Water Works is exempt from federal income tax pursuant to Internal Revenue Code Section 115 which provides for exemption of divisions of state and local governments.

Water Works provides water and other services to retail and wholesale customers in the City of Des Moines (the City) and surrounding communities.

In September 1993, the Governmental Accounting Standards Board (GASB) issued Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting.* The Statement provides that Water Works should apply all GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Statements and Interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) Opinions and Accounting Research Bulletins (ARB) of the Committee on Accounting Procedures. In addition, Water Works may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. Water Works has elected to not apply all FASB, APB, and ARB materials issued after November 30, 1989.

**Reporting entity:**

Accounting principles generally accepted in the United States of America require that the reporting entity include (1) the primary government, (2) organizations for which the primary government is financially accountable and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The Water Works has authority to issue bonded debt without the approval of another government. It has the right to sue and be sued, and has the right to buy, sell, lease or mortgage property in its own name. Based on these criteria, the Water Works is considered a primary government and there are no other organizations or agencies whose financial statements should be combined and presented with these financial statements.

**Significant accounting policies:**

Basis of accounting and measurement focus: The economic measurement focus and the accrual basis of accounting are used by the Water Works. Under the accrual basis of accounting, revenue is recognized when earned and expenses are recognized when the liability has been incurred. Under this basis of accounting, all assets and all liabilities associated with the operation of the Water Works are included in the balance sheet.

Accounting estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies (Continued)

Cash and investments: For the purpose of the statement of cash flows, Water Works considers cash balances maintained in demand deposit accounts at financial institutions to be cash. Excess cash invested temporarily in financial institutions is considered an investing activity and is not considered to be cash.

Investments as of December 31, 2006 were in U.S. government or agency obligations and are stated at fair value, based on quoted market prices.

Revenue recognition: Customers served by Water Works are billed on a monthly cyclical basis based on usage. Water Works accrues estimated unbilled water revenues for services rendered from the last billing date through year-end.

Operating revenues and expenses: Operating revenues include revenues resulting from the sale of water and related services. Operating expenses include expenses for water treatment, distribution, depreciation, customer service, and sales, administrative and general. Nonoperating revenues and expenses include those derived from capital and related financing activities, noncapital financing activities and investing activities. Revenues from the sale of water are based on billing rates, which are applied to customer's consumption of water.

Transactions with the City of Des Moines: Water Works provides water service to the City without charge except for the Sewage Treatment Works, Des Moines International Airport and City golf courses. The value (computed at the commercial rate) of the service provided without charge was approximately $660,282 and $646,432 in 2006 and 2005, respectively.

Water Works has an agreement to pay the City a Payment in Lieu of Taxes (PILOT). This amount was calculated in 1998 by applying the City millage rate for police and fire to the value of buildings and land operated and controlled by Water Works located within the City at that time. Total PILOT payments were $234,000 in 2006 and 2005.

Water Works has also agreed to match annual contributions of the City (up to $50,000) toward an industrial development corporation. Payments of $50,000 were made in 2006 and 2005.

Billings and collection agent services: Water Works serves as the billing and collection agent for fees related to sewage treatment, solid waste, and storm water collection for certain political subdivisions (including the City). Separate accounting records are maintained by Water Works for these collection services. Fees collected not yet remitted by Water Works to the applicable entity totaled $341,250 and $239,228 as of December 31, 2006 and 2005, respectively. These fees have been reflected in Water Works' balance sheet and were remitted to the City and other political subdivisions subsequent to year-end. Processing fees billed to the City and other political subdivisions for billing and collection services provided by Water Works totaled approximately $892,000 and $808,000 in 2006 and 2005, respectively. The City's fees reflect only the incremental expenses incurred by Water Works to bill and collect the City's charges, rather than an equal sharing of the costs. Water Works bears the total cost of meter reading, cash processing and statement preparation and mailing.

Inventories: Inventories are stated at the lower of average cost or market. The costs of these materials and supplies are recorded as an expense at the time they are relieved from inventory for use.

## Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies (Continued)

Restricted assets, cash and investments: Water Works is required, under the water revenue bond resolutions, to reserve certain assets to provide for payment of the bonds and interest for protection of the bondholders, and for the improvement and extension of facilities. Disbursement of these assets is restricted by the purpose of the respective funds.

Capital assets: Capital assets are recorded at cost and depreciated utilizing the straight-line method over estimated useful lives as follows:

| | |
|---|---|
| Buildings, equipment and machinery | 3-85 years |
| Supply system | 20-85 years |
| Distribution system | 10-85 years |

Expenditures for maintenance, repairs and minor replacements are charged to operations. Expenditures for major repairs and betterments are capitalized. Water Works' capitalization threshold is $500. When capital assets are retired or otherwise disposed, the cost and related accumulated depreciation are removed from the accounts and any resulting gains or losses are included in the statement of revenues, expenses and changes in net assets. Included in capital assets are the interest capitalized during construction in accordance with accounting principles generally accepted in the United States of America. Capitalized interest was a negative $44,236 in the current year.

Net assets: Net assets represent the difference between assets and liabilities in the financial statements. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balance of any long-term debt used for acquisition, construction, or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. As of December 31, 2006, Water Works had unspent bond proceeds of $42,934,747.

The Water Works' policy is to first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

Rates: The Board has full authority to establish rates. As part of the rate-setting process, Water Works performs an annual Cost of Service Study to determine the cost of operations. This Study is based on a standard water industry model. Based upon the Study, rates are set to fund future operations. Costs related to operations and maintenance, depreciation based on estimated replacement cost of capital assets (which differs from depreciation expense recorded for financial reporting purposes), debt service and return on capital are factored into the rate design as well as demand factors from various customer classes.

Deferred revenue: During 1996 and years subsequent, Water Works entered into contractual agreements with other political subdivisions to sell treatment capacity to these entities. In exchange for purchasing these amounts of capacity, the political subdivisions will be able to purchase water at a lower wholesale water rate. Purchasers were offered the option of cash payment or participating in issues of water revenue bonds. For entities choosing to pay cash in advance, Water Works records these amounts as deferred revenue and amortizes the amounts into income over periods of ten to twenty years. For entities participating in the bond issues, Water Works recognizes this revenue on a monthly basis as the entities are billed and as the principal and interest payments become due on the bonds. As of December 31, 2006, Water Works has $18,388,752 of deferred revenue and has recognized $6,595,968 of revenue during 2006.

## Note 1. Nature of Business, Reporting Entity and Significant Accounting Policies (Continued)

Compensated absences: Vacation and personal leave are accrued as a liability as it is earned. Sick leave benefits do not vest; however, upon retirement an employee may receive pay for 90 percent of his or her accumulated sick leave up to a maximum of 810 hours. The maximum payable to employees who are eligible for retirement has been recorded as a liability as well as an estimate for employees who are probable of becoming eligible in the future.

Debt financing costs and discounts: Costs incurred to issue water revenue bonds and the Water Revenue Capital Loan note are capitalized. These costs, and the discounts on the water revenue bonds, are amortized over the terms of the bonds and note utilizing a method which approximates the effective interest method.

Fiduciary fund type: The Water Works also includes a pension trust fund, fiduciary fund type. Pension trust funds are accounted for in essentially the same manner as the enterprise fund, using the same measurement focus and basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan. The Pension Trust Fund accounts for the assets of the Des Moines Water Works Pension Plan. This plan is included in the reporting entity due to the Water Works' significant administrative involvement and due to the Board of the Plan consisting of the Water Works' Board members.

## Note 2. Cash and Investments

The Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures,* requires state and local governments to disclose certain risks. The disclosures required by GASB Statement No. 40 provide readers with information concerning the credit and interest risks associated with the Water Works' deposits and investments.

Authorized investments: Water Works is authorized to invest in obligations of the US government, its agencies and instrumentalities; certificates of deposit at federally insured Iowa depository institutions approved by the Code of Iowa, Chapter 12C; and repurchase agreements if the underlying collateral consists of obligations of the US government, its agencies and instrumentalities. The Water Works' investment policy prohibits investments in reverse repurchase agreements and futures and options contracts. In addition, investing pursuant to the following investment practices is prohibited: trading of securities for speculation of the realization of short-term trading gains; a contract providing for the compensation of an agent or fiduciary based upon the performance of the invested assets or if a fiduciary or third party has failed to produce requested records within a reasonable time.

Interest rate risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. In an effort to limit exposure to fair value losses arising from interest rate risk, the Water Works' investment policy places maturity limitations on both operating funds and nonoperating funds. Operating funds are defined as those that are reasonably expected to be expended during the current budget year or within 15 months. Operating funds may only be invested in authorized instruments that mature within 397 days. Funds not identified as operating may be invested in investments with maturities longer than 397 days, but less than 1,726 days. All investments, however, shall have maturities that are consistent with the needs and uses of the utility.

## Note 2. Cash and Investments (Continued)

Information about the sensitivity of the fair value of the Water Work's investments to market interest rate fluctuations is provided by the table below. All investments held by Water Works have maturity dates within twelve months of December 31, 2006.

| Type | Fair Value December 31, 2006 | Within 3 Months | Within 6 Months | Within 9 Months | Within 12 Months |
|---|---|---|---|---|---|
| Federal Farm Credit Bank | $ 530,662 | $ - | $ - | $ 530,662 | $ - |
| Federal Farm Credit Bank Discount Notes | 2,540,160 | - | 1,963,800 | - | 576,360 |
| Federal Home Loan Bank | 15,989,700 | 7,579,809 | 6,869,539 | 1,291,254 | 249,098 |
| Federal Home Loan Bank Discount Notes | 3,012,763 | 3,012,763 | - | - | - |
| Federal Home Loan Mortgage Corp. | 3,616,150 | 3,616,150 | - | - | - |
| Federal Home Loan Mortgage Corp. Discount Notes | 9,841,844 | 8,923,300 | 918,544 | - | - |
| Farmer Mac Discount Note | 1,954,240 | 1,954,240 | - | - | - |
| PEFCO Finance Corp. | 513,667 | - | 513,667 | - | - |
| Federal National Mortgage Assoc. | 20,768,853 | 17,934,332 | 2,436,269 | 398,252 | - |
| Federal National Mortgage Assoc. Discount Note | 3,573,480 | 3,573,480 | - | - | - |
| | $ 62,341,519 | $ 46,594,074 | $ 12,701,819 | $ 2,220,168 | $ 825,458 |

The Water Works also has an investment in land purchased with the intent to sell; however, no commitment for sale exists as of December 31, 2006. The land is recorded at the lower of cost or market at $624,562.

Credit risk: Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization.

As of December 31, 2006, the Water Works' investments were rated as follows:

| Type | S&P Rating | Moody's Rating |
|---|---|---|
| Federal Farm Credit Bank | AAA | Aaa |
| Federal Farm Credit Bank Discount Notes | A-1+ | Prime-1 |
| Federal Home Loan Bank | AAA | Aaa |
| Federal Home Loan Bank Discount Notes | A-1+ | Prime-1 |
| Federal Home Loan Mortgage Corp. | AAA | Aaa |
| Federal Home Loan Mortgage Corp. Discount Notes | A-1+ | Prime-1 |
| Farmer Mac Discount Note | Not rated | Not rated |
| PEFCO Finance Corp. | AAA | Aaa |
| Federal National Mortgage Assoc. | AAA | Aaa |
| Federal National Mortgage Assoc. Discount Note | A-1+ | Prime-1 |

## Note 2. Cash and Investments (Continued)

Concentration of credit risk: The policy defines diversification requirements for the Water Works' investments. Invested assets shall be diversified to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer or a specific class of security. Portfolio maturities shall be staggered in a way that avoids undue concentration of assets in a specific maturity sector. Liquidity practices shall be followed to ensure that funds required for the next disbursement date and next payroll date are covered through maturity investments, marketable US Treasury bills or cash on hand. Risks of market price volatility shall be controlled through maturity diversification so that aggregate price losses on investments with maturities approaching one year shall not be greater than coupon interest and investment income received from the balance of the portfolio.

More than 5 percent of the utility's investments are in the following investments:

| Type | Percent of Total |
|---|---|
| Federal Home Loan Bank | 25.65% |
| Federal Home Loan Mortgage Corporation | 5.80 |
| Federal Home Loan Mortgage Corporation Discount Notes | 15.79 |
| Federal National Mortgage Association | 33.31 |
| Federal National Mortgage Association Discount Note | 5.73 |

The Water Works' investments during the year did not vary substantially from those at year-end in amounts or level or risk.

Custodial credit risk: The custodial credit risk for deposits and investments is the risk that, in the event of the failure of a depository financial institution or counterparty (for example, broker-dealer) to a transaction, a government will not be able to recover deposits or will not be able to recover collateral securities or value of investments that are in the possession of an outside party. Deposits in financial institutions as of December 31, 2006 and throughout the year are covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C, Code of Iowa. This Chapter provides additional assessments against the depositories to ensure there is no loss of public funds. Water Works' bank balances and book balances of deposits were $4,933,847 and $3,212,178 as of December 31, 2006, respectively. Water Works' investments were not exposed to custodial credit risk as of December 31, 2006.

### Pension Plan Deposits and Investments

Deposits: As of December 31, 2006, the Plan held no deposits.

Investments: The Plan's investments in pooled separate accounts are stated at fair value based on quoted market prices of the investments held in each account as determined by Principal Life Insurance Company (Principal). Purchases and sales of securities are recorded on a trade date basis. Dividends are recorded on the exdividend date.

## Note 2. Cash and Investments (Continued)

Asset allocation strategy: The Des Moines Water Works Pension Plan's named fiduciary asset allocation strategy shall identify target allocations to eligible asset classes and, where appropriate, suitable ranges within which each asset class can fluctuate as a percent of the total fund. Each asset class is to remain suitably invested at all times in either cash (or cash equivalents) or permitted securities within each class. The assets classes may be rebalanced from time to time to take advantage of tactical misvaluations across major asset classes or investment styles, or to align the current asset mix with strategic targets.

Authorized investments: The Des Moines Water Works Pension Plan's investment policy permits the Named Fiduciary to consider all asset classes allowed by ERISA as acceptable investment options and to select one or more customized investment portfolios and retain an investment manager to manage the assets of each such portfolio. The following assets classes are permitted for Plan investment options: Stable Value, Domestic Fixed Income, International or Foreign Fixed Income, Real Estate, Domestic Stock, International or Foreign Stock and Balanced/Asset allocation.

GASB Statement No. 40 requires plan investments to disclose an indication of the level of credit risk, concentration of credit risk and interest rate risk assumed by the Plan. These risk disclosures only pertain to fixed income investments. As of December 31, 2006, the Plan had investments listed in the table below. Amounts are shown in dollars. Effective duration is shown in years. Investments held by the Plan were not subject to custodial credit risk or foreign currency risk.

| | Fair Value | Effective Duration |
|---|---|---|
| Fixed income investments: | | |
| Bond and mortgage account | $ 10,690,457 | 4.70 |
| Inflation protection account | 750,889 | 6.49 |
| High yield account | 777,494 | 3.20 |
| Preferred securities account | 770,671 | 5.38 |
| **Total fair value of fixed income investments** | 12,989,511 | |
| Other investments | 29,063,813 | |
| **Total investments** | $ 42,053,324 | |

Interest rate risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

## Note 2. Cash and Investments (Continued)

Credit risk and concentration of credit risk: Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligations to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The pooled separate accounts held by the Plan are commingled pools, rather than individual securities. As a result, these investments are not rated.

## Note 3. Capital Assets

Capital assets activity for the year ended December 31, 2006 is as follows:

| | Beginning Balance | Increases | Decreases | Ending Balance |
|---|---|---|---|---|
| Capital assets not being depreciated: | | | | |
| Land | $ 4,835,402 | $ 75,949 | $ - | $ 4,911,351 |
| Construction-in-progress | 11,552,484 | 15,994,536 | 13,674,051 | 13,872,969 |
| **Total capital assets not being depreciated** | 16,387,886 | 16,070,485 | 13,674,051 | 18,784,320 |
| Capital assets being depreciated: | | | | |
| Buildings, equipment and machinery | 116,088,644 | 1,934,327 | - | 118,022,971 |
| Supply system | 39,344,208 | 299,420 | - | 39,643,628 |
| Distribution system | 116,862,267 | 21,536,953 | - | 138,399,220 |
| **Total capital assets being depreciated** | 272,295,119 | 23,770,700 | - | 296,065,819 |
| Less accumulated depreciation for: | | | | |
| Buildings, equipment and machinery | 48,372,867 | 5,911,770 | - | 54,284,637 |
| Supply system | 10,690,968 | 716,259 | - | 11,407,227 |
| Distribution system | 30,863,932 | 2,263,760 | - | 33,127,692 |
| **Total accumulated depreciation** | 89,927,767 | 8,891,789 | - | 98,819,556 |
| **Total capital assets being depreciated, net** | 182,367,352 | 14,878,911 | - | 197,246,263 |
| **Net capital assets** | $ 198,755,238 | $ 30,949,396 | $ 13,674,051 | $ 216,030,583 |

## Note 4. Noncurrent Liabilities

As of December 31, 2006, Water Works' debt consists of Revenue Refunding Bonds, Series 2001; Water Revenue Refunding Bonds, Series 2004 A & B and 2006; and Water Revenue Capital Loan Note, Series 2003 (through the Drinking Water State Revolving Fund (SRF)). Interest on these bonds and note is payable semiannually on June 1 and December 1, with principal payable on December 1. Series 2001 bonds mature on December 1, 2007 and Series 2004 A & B mature on December 1, 2024 and 2017, respectively, and Series 2006 mature on December 1, 2026. The Series 2003 note matures on December 1, 2022. The bonds and note are redeemable at the option of Water Works prior to their maturity in whole or, from time to time, in part, in any order of maturity and within a maturity by lot, at a price of par plus accrued interest to call date.

On March 1, 2006 Des Moines Water Works issued $52,435,000 Water Revenue Bonds, Series 2006. Interest is due on December 1 and June 1, commencing December 1, 2006. Principal is due on December 1, commencing on December 1, 2006 through 2026 in annual installments of $575,000 to $3,560,000. The bonds maturing on or after December 1, 2015, are callable at the option of the Water Works on any date on or after December 1, 2014, at a price of par plus accrued interest.

The bond proceeds will be used to finance capital improvements relating to the construction of a new Saylorville Water Treatment Plant ($36,105,000), construction and renovation of water lines in the Pleasant Hill suburb ($9,880,000) and purchase of the Southeast Polk Rural Water System ($6,450,000). Water Works purchased the Southeast Polk Rural Water System on April 3, 2006 for approximately $11,482,000.

Changes in long-term obligations for the year ended December 31, 2006 are as follows:

| | Beginning Balance | Additions | Reductions | Ending Balance | Amounts Due Within One Year |
|---|---|---|---|---|---|
| Water Revenue Bonds: | | | | | |
| Series 2001 | $ 5,595,000 | $ - | $ 3,325,000 | $ 2,270,000 | $ 2,270,000 |
| Series 2004 A & B | 24,070,000 | - | 1,175,000 | 22,895,000 | 1,230,000 |
| Series 2006 | - | 52,435,000 | 575,000 | 51,860,000 | 1,170,000 |
| Water Revenue Capital, Series 2003 | 2,123,000 | - | 98,000 | 2,025,000 | 100,000 |
| Compensated absences | 1,912,217 | 2,014,134 | 1,912,217 | 2,014,134 | 1,283,031 |
| | $ 33,700,217 | $ 54,449,134 | $ 7,085,217 | $ 81,064,134 | $ 6,053,031 |

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Refunding Bonds, Series 2001 is as follows:

| Maturing During Year Ending December 31: | Interest Rate | Annual Principal Payment | Annual Interest Payment | Total Annual Payment |
|---|---|---|---|---|
| 2007 | 3.40% | $ 2,270,000 | $ 81,720 | $ 2,351,720 |

## Note 4. Noncurrent Liabilities (Continued)

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Refunding Bonds, Series 2004 A is as follows:

| Maturing During Year Ending December 31: | Interest Rate | Annual Principal Payment | Annual Interest Payment | Total Annual Payment |
|---|---|---|---|---|
| 2007 | 3.00% | $ 260,000 | $ 245,531 | $ 505,531 |
| 2008 | 3.00 | 265,000 | 237,731 | 502,731 |
| 2009 | 3.00 | 275,000 | 229,781 | 504,781 |
| 2010 | 3.25 | 285,000 | 221,531 | 506,531 |
| 2011 | 3.375 | 290,000 | 212,269 | 502,269 |
| 2012-2016 | 3.50 - 4.00 | 1,630,000 | 895,369 | 2,525,369 |
| 2017-2021 | 4.00 | 1,990,000 | 545,644 | 2,535,644 |
| 2022-2024 | 4.125 - 4.25 | 1,430,000 | 122,419 | 1,552,419 |
| | | $ 6,425,000 | $ 2,710,275 | $ 9,135,275 |

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Refunding Bonds, Series 2004 B is as follows:

| Maturing During Year Ending December 31: | Interest Rate | Annual Principal Payment | Annual Interest Payment | Total Annual Payment |
|---|---|---|---|---|
| 2007 | 2.50% | $ 970,000 | $ 579,575 | $ 1,549,575 |
| 2008 | 3.00 | 1,380,000 | 550,475 | 1,930,475 |
| 2009 | 3.00 | 1,420,000 | 509,075 | 1,929,075 |
| 2010 | 3.00 | 1,465,000 | 466,475 | 1,931,475 |
| 2011 | 3.00 | 1,510,000 | 422,525 | 1,932,525 |
| 2012-2016 | 3.25 - 4.00 | 8,535,000 | 1,279,425 | 9,814,425 |
| 2017 | 4.00 | 1,190,000 | 47,600 | 1,237,600 |
| | | $ 16,470,000 | $ 3,855,150 | $ 20,325,150 |

A summary of the aggregate principal and interest requirement outstanding for the Water Revenue Refunding Bonds, Series 2006 is as follows:

| Maturing During Year Ending December 31: | Interest Rate | Annual Principal Payment | Annual Interest Payment | Total Annual Payment |
|---|---|---|---|---|
| 2007 | 4.00% | $ 1,170,000 | $ 2,127,231 | $ 3,297,231 |
| 2008 | 4.00 | 2,030,000 | 2,080,431 | 4,110,431 |
| 2009 | 4.00 | 2,110,000 | 1,999,231 | 4,109,231 |
| 2010 | 4.00 | 2,180,000 | 1,914,831 | 4,094,831 |
| 2011 | 4.00 | 2,260,000 | 1,827,631 | 4,087,631 |
| 2012-2016 | 4.00 | 12,750,000 | 7,707,356 | 20,457,356 |
| 2017-2021 | 4.00 | 13,080,000 | 5,131,550 | 18,211,550 |
| 2022-2026 | 4.00 | 16,280,000 | 2,178,331 | 18,458,331 |
| | | $ 51,860,000 | $ 24,966,592 | $ 76,826,592 |

## Note 4. Noncurrent Liabilities (Continued)

A summary of the aggregate principal and interest requirements outstanding for the Water Revenue Capital Loan Note is as follows:

| Maturing During Year Ending December 31: | Interest Rate | Annual Principal Payment | Annual Interest Payment | Total Annual Payment |
|---|---|---|---|---|
| 2007 | 3.00% | $ 100,000 | $ 60,750 | $ 160,750 |
| 2008 | 3.00 | 103,000 | 57,750 | 160,750 |
| 2009 | 3.00 | 107,000 | 54,660 | 161,660 |
| 2010 | 3.00 | 110,000 | 51,450 | 161,450 |
| 2011 | 3.00 | 113,000 | 48,150 | 161,150 |
| 2012-2016 | 3.00 | 618,000 | 187,830 | 805,830 |
| 2017-2021 | 3.00 | 717,000 | 83,370 | 800,370 |
| 2022 | 3.00 | 157,000 | 4,710 | 161,710 |
| | | $ 2,025,000 | $ 548,670 | $ 2,573,670 |

The water revenue bond and water revenue capital loan note resolutions (Resolutions) provide that net revenue (as defined in the Resolutions) of Water Works is pledged for the purpose of paying Series 2001, Series 2003, Series 2004 and Series 2006 bonds. The Resolutions further require that sufficient monies be set aside to meet current expenses of Water Works. All remaining monies are to be segregated and restricted in separate special reserves. These special reserves are reflected as restricted assets on the balance sheet. The Resolutions also require that the issuer maintain insurance coverage of a kind and in an amount which usually would be carried by private companies engaged in a similar kind of business. Water Works maintains fire and extended coverage insurance in the amount of $260,468,233 per occurrence on building and contents; in addition, liability insurance is maintained.

## Note 5. Pension Plan

Water Works has a noncontributory defined benefit single employer pension plan, established by the Board, called the Des Moines Water Works Pension Plan (the Plan). All full-time Water Works employees and employees who work at least 1,040 hours in a calendar year or work during two consecutive calendar quarters are eligible to participate in the Plan. Benefits vest after five years of continuous service and normal retirement is allowed at or after age 65. Early retirement is allowed without a reduction in benefits beginning at age 55 if the employee's combined years of service and age are 85 or greater and is allowed with reduced benefits for vested employees with less than 30 years of service beginning at age 55. The pension benefit formula is based upon a percent of average compensation and the number of years of service with Water Works. A participant's monthly accrued benefit is equal to 1.5% of their average monthly compensation times their years of continuous service with Water Works. Average monthly compensation is determined by taking the average of monthly compensation for those five consecutive years which give the highest average out of the latest 10 years of service. The Plan also provides death and disability benefits to vested employees. The Plan Administrator is the Board of Trustees of Des Moines Water Works. The Plan issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to or calling the Water Works.

## Note 5. Pension Plan (Continued)

Water Works' annual pension cost and net pension liability for the three years ended 2006 were as follows:

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| Annual required contribution (ARC) | $ 885,540 | $ 941,548 | $ 896,193 |
| Interest | 43,728 | 41,917 | 36,084 |
| Adjustment to annual required contribution | (68,680) | (63,315) | (54,822) |
| **Annual pension cost (APC)** | 860,588 | 920,150 | 877,455 |
| Contributions made | 885,990 | 896,000 | 800,000 |
| **(Increase) decrease in net pension liability** | 25,402 | (24,150) | (77,455) |
| Net pension (liability), beginning of year | (583,040) | (558,890) | (481,435) |
| Net pension (liability), end of year | $ (557,638) | $ (583,040) | $ (558,890) |
| Percentage of APC contributed | 103.0% | 97.4% | 91.1% |

The net pension obligation is the pension asset or (liability) that arises from cumulative differences between the ARC and actual employer contributions. The net pension benefit liability above was computed as part of the annual actuarial valuation performed as of January 1, 2006 using the aggregate actuarial cost method. The aggregate actuarial cost method does not identify or separately amortize unfunded actuarial liabilities. The actuarial assumptions used to compute the pension benefit liability included (a) 7.5 percent investment rate of return (net of administrative expenses) and (b) projected salary increases of 5.0 percent. These amounts were computed using the RP-2000 Mortality Table with a 3.0 percent cost of living factor increase included.

## Note 6. Postretirement Health Care Benefits

Water Works provides certain postretirement health care benefits, in accordance with the policy established by the Board, to all employees who retire from Water Works after attaining age 55. As of December 31, 2006, 64 retirees receive postretirement health care benefits. Water Works provides a Medicare supplement or equivalent amount to all employees who retire after attaining age 55, if the sum of their age and years of service are at least 85 or for those who retire after attaining age 65 regardless of length of service. Employees who retire prior to attaining age 65 with the sum of their age and years of service less than 85 receive a discounted benefit as provided by the plan document. Water Works recognizes the cost of providing postretirement health care benefits by expensing the annual insurance premiums which were approximately $112,317 and $100,804 for 2006 and 2005, respectively.

## Note 7. Risk Management

Water Works is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, errors and omissions, injuries to employees, natural disasters and malpractice.

Water Works purchases commercial insurance for property and casualty, workers' compensation, employee health, life and dental insurance. During the last three years, settled claims have not exceeded insurance coverage.

## Note 8. Commitments

Approximately $9,726,167 related to 2006 contracts has been formally committed as of December 31, 2006. In addition, the Board has approved approximately $18,600,000 of expenditures for capital acquisitions and improvements, all of which are expected to be expended in 2007.

In 1983, Water Works determined additional water resources would be required for future customer needs. As a result, the Board has contracted with the United States of America – Army Corps of Engineers, through the state of Iowa, for water supply storage in the Saylorville Reservoir Project continuing through the life of the project. Under the contract, Water Works is required to pay a portion of future major renovation costs of the project. Water Works also pays a portion of the annual operation and maintenance costs of the project. Water Works' portion of operation and maintenance costs was approximately $6,300 in 2006 and 2005.

On January 5, 2004, the Water Works and City of Des Moines, Iowa entered into a 28E Agreement for the operation, management and maintenance of the Botanical Center. The Water Works is responsible for the management and operation of the Botanical Center for the City. All revenues generated and expenses incurred for the operation are retained by Water Works. The agreement exists for an initial term of January 5, 2004 through December 31, 2009 and may renew on and after January 1, 2010 for not more than three successive three-year terms. Water Works and the City Council will meet jointly no later than July 1, 2007 to evaluate the agreement and determine if it will continue.

For the years ended December 31, 2006 and 2005, revenues generated by the Botanical Center were approximately $685,000 and $492,000, respectively. Expenses were approximately $877,000 and $900,000, respectively.

## Note 9. New Governmental Accounting Standards Board (GASB) Statements

Water Works implemented the following GASB Statements during the year ended December 31, 2006:

- GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation*, an amendment of GASB Statement No. 34. This Statement establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation. The adoption of this Statement had no effect on Water Works in the current year.

- GASB Statement No. 47, *Accounting for Termination Benefits*. This Statement establishes accounting standards for termination benefits. In financial statements prepared on the accrual basis of accounting, employers should recognize a liability and expense for voluntary termination benefits (early retirement incentives) when the offer is accepted and the amount can be estimated. A liability for involuntary termination benefits (severance benefits) should be recognized when a plan of termination has been approved by those with the authority to commit the government to the plan, the plan has been communicated to the employees and the amount can be estimated. The adoption of this Statement had no effect on Water Works in the current year.

As of December 31, 2006, the GASB also had issued several statements not yet implemented by the Water Works. The statements which might impact Water Works are as follows:

- GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, issued April 2004, will be effective for Water Works beginning with its year ending December 31, 2007. This Statement establishes uniform financial reporting standards for other postemployment benefit plans (OPEB plans) and supercedes existing guidance.

## Note 9. New Governmental Accounting Standards Board (GASB) Statements (Continued)

- GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* issued June 2004, will be effective for Water Works beginning with its year ending December 31, 2008. This Statement establishes standards for the measurement, recognition and display of other postemployment benefits expenses and related liabilities or assets, note disclosures and, if applicable, required supplementary information in the financial reports.

- GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, issued September 2006, is effective for Water Works beginning with its year ending December 31, 2007. This Statement establishes accounting and financial reporting standards for transactions in which a government receives, or is entitled to, resources in exchange for future cash flows generated by collecting specific receivables or specific future revenues. It also provides disclosure requirements for a government that pledges or commits future cash flows from a specific revenue source. In addition this Statement establishes accounting and financial reporting standards for intra-entity transfers of assets and future revenues.

- GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, issued November 2006, will be effective for Water Works beginning with its year ending December 31, 2008. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities, such as site assessments and cleanups. This standard requires the government to estimate the components of expected pollution remediation outlays and determine whether the outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired.

The Water Works' management has not yet determined the effect these Statements will have on Water Works' financial statements.

Des Moines Water Works
Pension Plan

Required Supplementary Information
Schedule of Contributions from the Employer

| Year Ended December 31: | Annual Required Contribution | Actual Contribution | Percentage Contribution |
|---|---|---|---|
| 2000 | $ 629,754 | $ 547,685 | 86.97% |
| 2001 | 793,691 | 478,000 | 60.22 |
| 2002 | 735,168 | 466,000 | 63.39 |
| 2003 | 931,470 | 735,000 | 78.91 |
| 2004 | 896,193 | 800,000 | 89.27 |
| 2005 | 941,548 | 896,000 | 95.16 |
| **2006** | **885,540** | **885,990** | **100.05** |

See Note to Required Supplementary Information.

Des Moines Water Works
Pension Plan

## Note to Required Supplementary Information

The information presented in the required supplementary schedule was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

| | |
|---|---|
| Actuarial valuation: | |
| Frequency | Annual |
| Latest date | January 1, 2007 |
| Cost method | Aggregate cost method |
| Amortization | Not applicable under Aggregate Cost Method. The Aggregate Cost Method does not identify or separately amortize unfunded actuarial liabilities. They are amortized through normal cost. |
| Asset valuation method | Fair value is adjusted by spreading the expected value minus the actual value over four years. The total actuarial value of assets falls within the applicable corridor limits. |
| Assumptions: | |
| Investment rate of return | 7.5% |
| Salary increases | 5.0% annual increases until retirement |
| Retirement age | The later of meeting the rule of 85 or age 58, but not later than age 65. |
| Mortality | RP-2000 Combined Mortality Table, male and female, projected to 2005 with scale AA. |
| Rate of withdrawal | V Table from August 1992 Pension Forum, multiplied by 0.60 |
| Cost of living | 3.0% to project benefits and compensation limitations |

In addition to the above assumptions, an estimate of the Plan's expenses is included in normal cost.

Since the Plan uses the Aggregate Cost Method, a schedule of funding progress is not required as that method does not identify or separately amortize unfunded actuarial liabilities.