

RACINE WATER UTILITY
Racine, Wisconsin

FINANCIAL STATEMENTS
December 31, 2006 and 2005

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Independent Auditor's Report

Board of Commissioners
Racine Water Utility
Racine, Wisconsin

We have audited the accompanying statements of net assets, the related statements of revenues, expenses and changes in net assets, and cash flows of the Racine Water Utility, an enterprise fund of the City of Racine, as of and for the years ended December 31, 2006 and 2005, which collectively comprise Racine Water Utility's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 audits provide a reasonable basis for our opinion.

As discussed in the summary of significant accounting policies, the financial statements present only the Racine Water Utility and do not purport to, and do not, present fairly the financial position of the City of Racine, Wisconsin, as of December 31, 2006 and 2005, and the changes in its financial position and cash flows, where applicable, for the years 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 financial position of the Racine Water Utility as of December 31, 2006 and 2005, and the results of its operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Racine Water Utility has not presented the management's discussion and analysis that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be a part of, the basic financial statements.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplemental information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is presented fairly, in all material respects, in relation to the basic financial statements taken as a whole.

Clifton Gunderson LLP

Racine, Wisconsin
June 15, 2007

**RACINE WATER UTILITY
STATEMENTS OF NET ASSETS
December 31, 2006 and 2005**

ASSETS

	<u>2006</u>	<u>2005</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,201,300	\$ 1,890,580
Investments	2,566,834	2,473,955
Accrued interest receivable	5,338	8,554
Accounts receivable, less allowance for doubtful accounts of \$65,900 in 2006 and \$70,000 in 2005	2,866,582	3,010,366
Delinquent billings receivable - tax roll	1,192,424	1,025,262
Due from other funds	1,874,097	1,822,722
Inventories	249,861	267,221
Prepaid expenses	<u>8,788</u>	<u>4,085</u>
Total current assets	<u>10,965,224</u>	<u>10,502,745</u>
RESTRICTED ASSETS		
Cash and cash equivalents	1,182,858	3,657,809
Investments	8,313,725	17,291,294
Accrued interest receivable	<u>79,851</u>	<u>111,588</u>
Total restricted assets	<u>9,576,434</u>	<u>21,060,691</u>
CAPITAL ASSETS		
Utility plant in service	145,019,023	109,325,298
Less accumulated depreciation	<u>27,681,085</u>	<u>24,833,988</u>
Net depreciated value	117,337,938	84,491,310
Land	2,973,172	2,973,172
Construction in progress	<u>182,355</u>	<u>24,036,507</u>
Total capital assets	<u>120,493,465</u>	<u>111,500,989</u>
OTHER ASSETS		
Unamortized bond issue costs	399,187	426,175
Acquisition deposit	1,202,478	-
Special assessment certificate	<u>-</u>	<u>5,894</u>
Total other assets	<u>1,601,665</u>	<u>432,069</u>
TOTAL ASSETS	<u>\$142,636,788</u>	<u>\$143,496,494</u>

LIABILITIES AND NET ASSETS

	<u>2006</u>	<u>2005</u>
CURRENT LIABILITIES		
Accounts payable	\$ 354,011	\$ 666,509
Due to other funds	3,347,757	3,867,948
Advances from other funds	25,535	23,480
Accrued liabilities	<u>208,230</u>	<u>357,696</u>
Total current liabilities	<u>3,935,533</u>	<u>4,915,633</u>
 CURRENT LIABILITIES - PAYABLE FROM RESTRICTED ASSETS		
Accounts payable	1,730,855	2,165,466
Accrued interest payable	658,931	682,560
Current portion of long-term debt	<u>3,272,406</u>	<u>3,159,259</u>
Total current liabilities - payable from restricted assets	<u>5,662,192</u>	<u>6,007,285</u>
 NONCURRENT LIABILITIES		
Accrued compensated absences	506,050	477,868
Long term debt	57,393,535	59,766,275
Advances from other funds	<u>904,861</u>	<u>930,395</u>
Total noncurrent liabilities	<u>58,804,446</u>	<u>61,174,538</u>
Total liabilities	<u>68,402,171</u>	<u>72,097,456</u>
 NET ASSETS		
Invested in capital assets, net of related debt	64,059,676	63,562,575
Restricted	3,942,450	3,890,613
Unrestricted	<u>6,232,491</u>	<u>3,945,850</u>
Total net assets	<u>74,234,617</u>	<u>71,399,038</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$142,636,788</u>	 <u>\$143,496,494</u>

These financial statements should be read only in connection with
the accompanying notes to financial statements.

RACINE WATER UTILITY
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
OPERATING REVENUES	<u>\$ 15,692,460</u>	<u>\$ 14,747,897</u>
OPERATING EXPENSES		
Operation and maintenance	8,659,966	8,078,059
Depreciation	3,102,169	2,389,922
Taxes	<u>266,712</u>	<u>236,527</u>
Total operating expenses	<u>12,028,847</u>	<u>10,704,508</u>
OPERATING INCOME	<u>3,663,613</u>	<u>4,043,389</u>
NONOPERATING REVENUE (EXPENSES)		
Investment earnings	900,949	693,824
Interest expense	(2,362,400)	(1,940,209)
Amortization of bond discount, issue cost and refunding loss	(58,515)	(75,967)
Other Income	<u>7,770</u>	<u>7,410</u>
Total nonoperating revenue (expense)	<u>(1,512,196)</u>	<u>(1,314,942)</u>
Income before capital contributions and transfers	<u>2,151,417</u>	<u>2,728,447</u>
CAPITAL CONTRIBUTIONS		
Residential equivalent connection fees	1,333,704	1,432,170
Capital grants	-	1,135,727
Developer donations	<u>1,347,168</u>	<u>2,026,888</u>
Total capital contributions	<u>2,680,872</u>	<u>4,594,785</u>
TRANSFERS OUT	<u>(1,996,710)</u>	<u>(1,828,347)</u>
CHANGE IN NET ASSETS	2,835,579	5,494,885
NET ASSETS, BEGINNING OF YEAR	<u>71,399,038</u>	<u>65,904,153</u>
NET ASSETS, END OF YEAR	<u>\$ 74,234,617</u>	<u>\$ 71,399,038</u>

These financial statements should be read only in connection with
the accompanying notes to the financial statements.

RACINE WATER UTILITY
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from customers and users	\$15,625,477	\$ 14,485,688
Paid to suppliers	(6,436,170)	(4,779,597)
Paid to employees	<u>(3,425,930)</u>	<u>(2,806,596)</u>
Net cash provided by operating activities	<u>5,763,377</u>	<u>6,899,495</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Advances from other funds	(23,479)	(21,719)
Interest on advances	(49,287)	(49,856)
Transfers out	<u>(1,996,710)</u>	<u>(1,828,347)</u>
Net cash used in noncapital financing activities	<u>(2,069,476)</u>	<u>(1,899,922)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of utility plant	(11,182,089)	(12,787,216)
Acquisition deposit	(1,202,478)	-
Principal paid on long-term debt	(3,159,259)	(18,314,686)
Proceeds from issuance of long-term debt	868,140	8,783,885
Interest paid on long-term debt	(2,336,742)	(1,806,266)
Proceeds from REC and other fees	1,333,704	1,432,170
Capital grants	<u>-</u>	<u>3,474,100</u>
Net cash used in noncapital financing activities	<u>(15,678,724)</u>	<u>(19,218,013)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(38,961,846)	(46,565,387)
Sale of investments	47,846,536	58,481,782
Investment income received	<u>935,902</u>	<u>655,867</u>
Net cash provided by investing activities	<u>9,820,592</u>	<u>12,572,262</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,164,231)	(1,646,178)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>5,548,389</u>	<u>7,194,567</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 3,384,158</u>	<u>\$ 5,548,389</u>
Unrestricted	\$ 2,201,300	\$ 1,890,579
Restricted	<u>1,182,858</u>	<u>3,657,810</u>
Total	<u>\$ 3,384,158</u>	<u>\$ 5,548,389</u>

	<u>2006</u>	<u>2005</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 3,663,613	\$ 4,043,390
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation expense	3,209,360	2,389,922
Depreciation charged to other funds	(107,191)	-
Bad debt expense	31,093	-
Nonoperating revenue	7,770	-
Effects of changes in operating assets and liabilities:		
Accounts receivable	(54,471)	(704,180)
Prepaid expenses	(4,703)	3,361
Due from other funds	(51,375)	441,970
Inventories	17,360	(20,612)
Other assets	5,894	(7,241)
Compensated absences	28,182	48,008
Accounts payable	(312,498)	(611,991)
Accrued liabilities	(149,466)	110,153
Due to other funds	(520,191)	1,206,715
	<u>\$ 5,763,377</u>	<u>\$ 6,899,495</u>
Net cash provided by operating activities	<u>\$ 5,763,377</u>	<u>\$ 6,899,495</u>

NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES

Estimated cost of utility plant installed or financed by developers or customers were \$1,347,168 and \$2,026,888 in 2006 and 2005, respectively.

These financial statements should be read only in connection with the accompanying notes to financial statements.

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Racine Water Utility is an Enterprise Fund of the City of Racine. These financial statements present the financial position, results of operations and cash flows of the Racine Water Utility only and do not include transactions of any other City funds. The Racine Water Utility provides retail water service to the City of Racine, Villages of Elmwood Park and North Bay and the Village of Mount Pleasant. Wholesale service is provided to the Village of Sturtevant. The North Park Sanitary Utility and Caledonia Water Utility No.1, both in the Village of Caledonia, are also provided wholesale water service by the Racine Water Utility. The Utility has the responsibility to determine and levy water user charges in order to apportion all operation and maintenance expenses and debt service charges in its service territory.

The Utility is managed by seven Commissioners. Rates are established and approved by the Public Service Commission of Wisconsin. Retail customers are billed based on readings from individual meters. Wholesale customers are billed based on master meter readings. The Utility has the authority to finance its operations through the use of a user charge.

The significant accounting principles and policies utilized by the utility are described below.

BASIS OF ACCOUNTING

The Utility prepares its financial statements in accordance with generally accepted accounting principles for enterprise funds as formulated by the Government Accounting Standards Board. The financial statements reflect the full accrual method of accounting whereby revenues are recognized when earned and expenses are recorded as liabilities when incurred. The Utility applies all applicable Statements and Interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board (APB) Opinions and Accounting Research Bulletins issued on or before November 30, 1989 unless they conflict Government Accounting Standards Board (GASB) pronouncements. The Utility has elected not to follow the FASB and APB Standards after November 30, 1989.

USE OF ESTIMATES IN PREPARING FINANCIAL STATEMENTS

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

CASH EQUIVALENTS

For purposes of reporting cash flows, cash equivalents include any highly liquid investments purchased with a maturity of three months or less when acquired.

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INVESTMENTS

Investments are stated at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties. Fair value is determined by quoted market prices. No investments are reported at amortized cost.

ACCOUNTS RECEIVABLE

Accounts receivable is composed of charges to customers for water services and receivables for sundry bill charges that cannot be attached to the property. The year-end balance includes unpaid charges and a year-end estimate of the receivables that will be billed in the first quarter of the subsequent year.

Customer accounts receivable are stated at invoice plus accrued interest. Unpaid accounts over twenty days bear interest at 1% per month. Sundry bill charges bear no interest.

Interest continues to accrue on customer delinquent accounts until it is placed in the tax roll at which time a 10% penalty is assessed to the account. Payments to an accounts receivable are applied to specific invoices identified on the customer's remittance advice or, if unspecified, to the earliest unpaid invoices.

The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management's best estimate of sundry bill charges that will not be collected. The allowance for doubtful accounts is based on management's assessment of the collectability of specific customer accounts and the aging of the accounts receivable. All accounts or portions thereof deemed to be uncollectible or to require an excessive collection cost are written off to the allowance for doubtful accounts.

INVENTORIES

Inventories of materials and supplies are stated at the lower of cost or market with cost determined on a first in, first out (FIFO) basis.

PREPAID EXPENSES

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses in the financial statements.

RESTRICTED ASSETS

Mandatory segregations of assets are presented as restricted assets. Such segregations are required by bond agreements and other external parties. Current liabilities payable from these restricted assets are so classified.

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

OPERATIONS

Metered service sales to customers are billed at rates determined by the Public Service Commission. Most customers, with exception of industrial, are billed every three months for services rendered. Industrial customers are billed monthly. The month billed is dependent on the district in which the customer resides. All delinquent water accounts receivable balances less than \$7,500 at the time of the property tax lien date are placed on the customer's tax bill and collected through the normal collection process.

CAPITAL ASSETS

Capital assets are generally defined by the Utility as assets with an initial, individual cost of more than \$1,000 and estimated useful life in excess of one year.

Capital assets of the Utility are recorded at cost or the fair market value at the time of contribution to the Utility. Major outlays for utility plant are capitalized as projects are constructed. Interest incurred during the construction phase is reflected in the capitalized value of the capital assets constructed, net of interest earned on the invested proceeds over the same period. Capital assets in service are depreciated using composite rates developed by the Public Service Commission to the capital asset balances except for vehicles and power equipment which are depreciated on a per unit basis.

LONG-TERM OBLIGATIONS

Long-term debt and other obligations are reported as Utility liabilities. Bond premiums and discounts as well as issuance costs are deferred and amortized over the life of the bonds using the straight-line method. Gains or losses on prior refundings are amortized over the remaining life of the old debt or the life of the new debt, which ever is shorter.

COMPENSATED ABSENCES

Vacation is recorded as expense when paid. Vacation pay is earned on a monthly basis during the calendar year and is forfeited if not taken by the end of the year. Sick leave is earned at a rate of one day per month. Unused sick pay is allowed to accumulate to 156 working days. In general, upon death, retirement or total disability, an employee is entitled to a sum equal to 50% of total such leave accumulated up to a maximum of 140 days. Accumulated sick leave earned but not taken and any salary related benefits thereon have been reported as accrued compensated absences.

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

REVENUES AND EXPENSES

The Utility distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. The principal operating revenues of the Utility are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

TRANSFERS

Transfers include the payment in lieu of taxes to the municipality.

EQUITY CLASSIFICATIONS

Equity is classified as net assets and displayed in three components.

- a. Invested in capital assets, net of related debt – Consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets less any unspent debt proceeds.
- b. Restricted net assets – Consists of net assets with constraints placed on their use by 1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments or, 2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net assets – All other net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

COMPARATIVE DATA

Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

NOTE 2 - CASH AND INVESTMENTS

The Utility had the following deposits and investments as of December 31, 2006 and 2005.

	<u>2006</u>	<u>2005</u>
Petty cash	\$ 1,400	\$ 1,400
Demand deposits	3,382,758	5,546,989
Certificate of deposit	100,000	-
U.S. Government agency securities	<u>10,780,559</u>	<u>19,765,249</u>
	<u>\$ 14,264,717</u>	<u>\$ 25,313,638</u>

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)

	<u>2006</u>	<u>2005</u>
Reconciliation to the financial statements		
Per statement of net assets		
Unrestricted cash and cash equivalents	\$ 2,201,300	\$ 1,890,580
Unrestricted investments	2,566,834	2,473,955
Restricted cash and cash equivalents	1,182,858	3,657,809
Restricted investments	<u>8,313,725</u>	<u>17,291,294</u>
Total Cash and Investments	<u>\$ 14,264,717</u>	<u>\$ 25,313,638</u>

Deposits in each local and area bank are insured by the FDIC in the amount of \$100,000 for interest bearing accounts and \$100,000 for noninterest bearing accounts.

Bank accounts are also insured by the State Deposit Guarantee Fund in the amount of \$400,000. However, due to the relatively small size of the Guarantee Fund in relationship to the total deposits covered and other legal implications, recovery of material principal losses may not be significant to individual entities. This coverage has not been considered for custodial credit risk below.

Investment Policy

The Utility has not adopted a formal investment policy; however, the Utility invests in accordance with Wisconsin State Statutes. Under state statute, investments are limited to:

- Time deposits in any credit union, bank, savings bank, trust company, or savings and loan association;
- Bonds or securities of any county, city, drainage Utility, vocational, technical, and adult education (VTAE) Utility, village, town or school Utility of the state;
- Bonds or securities issued or guaranteed by the Federal government; and
- The state local government investment pool.
- Any security maturing in seven years or less and having the highest or second highest rating category of a nationally recognized rating agency.
- Securities of an open-end management investment company or investment trust subject to various conditions and investment options.
- Repurchase agreements with public depositories with certain conditions.

Custodial Credit Risk for Deposits

Custodial credit risk for deposits is the risk that in the event of the failure of a depository financial institution, the Utility will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Utility does not have a formal policy addressing this type of deposit risk.

As of December 31, 2006 and 2005, the Utility's carrying value of the deposits was \$3,382,758 and \$5,546,989 as compared to bank balances of \$3,778,798, and \$5,826,842, respectively. Of the bank balances at December 31, 2006 and 2005, \$100,000, was covered by federal depository insurance. The remaining balances at December 31, 2006 and 2005 were collateralized by securities held by the bank or its correspondent bank but not in the Utility's name.

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 2 - DEPOSITS AND INVESTMENTS (CONTINUED)

Custodial Credit Risk for Investments

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the Utility will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Utility does not have a formal policy addressing this type of investment risk.

As of December 31, 2006 and 2005, the Utility's carrying value of the investments were \$10,880,559 and \$19,765,249 for 2006 and 2005, respectively. Of the investment balances at December 31, 2006 and 2005, \$100,000, was covered by federal depository insurance. The remaining balances at December 31, 2006 and 2005 were collateralized by securities are held by an agent in the Utility's name.

Credit Risk

Credit risk is the risk that, an issuer or other counterparty to an investment will not fulfill its obligations to the Utility. The Utility does not have a formal policy addressing this type of investment risk.

The Utility invests solely in U.S. government agency obligations. These types of investments are explicitly guaranteed by the U.S. government and are not considered subjected to credit risk. As of December 31, 2006 and 2005, the Utility had \$10,780,559 and \$19,765,249, respectively, in these types of investments.

Concentration of Credit Risk

Concentration of credit risk refers to risk of loss attributed to the Utility investment in a single issuer. The Utility does not have a formal policy addressing this type of investment risk. As of December 31, 2006 and 2005, the Utility invests solely in U.S. government agency securities which are not considered subject to credit risk.

Interest Rate Risk

Interest rate risk is the risk that, changes in interest rates will adversely affect the fair value of an investment. The Utility does not have a formal policy addressing this type of investment risk. As of December 31, 2006 and 2005, the Utility had the following investments and maturities.

2006		
Type of Investment	Fair Value	Average Maturities
U.S. Government agency securities	\$ 10,780,559	180 days
Certificate of deposit	100,000	8 months
2005		
Type of Investment	Fair Value	Average Maturities
U.S. Government agency securities	\$ 19,765,249	180 days

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 3 - RESTRICTED ASSETS

Certain proceeds of the Utility's revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets because their use is limited by applicable bond covenants. The following revenue bond accounts are reported as restricted assets:

Bond redemption fund – Used to segregate resources accumulated for debt service payments over the next twelve months.

Reserve fund – Used to report resources set aside to make up potential future deficiencies in the redemption account.

Depreciation fund – Used to report resources set aside to fund plant renewals and replacement or make up potential future deficiencies in the redemption account.

Impact fund – REC and other fees – Used to report resources set aside to fund future projects designed to serve future growth of the utility.

A summary of restricted assets is as follows:

	<u>2006</u>	<u>2005</u>
Cash and investments:		
Improvement fund	\$ 1,325,270	\$ 12,946,313
Bond reserve fund	3,610,406	3,653,818
Redemption fund	3,061,885	3,068,774
Depreciation fund	780,885	783,369
REC and other fees	<u>718,137</u>	<u>496,829</u>
Total cash and investments	<u>9,496,583</u>	<u>20,949,103</u>
Accrued interest receivable:		
Improvement fund	1,612	52,987
Bond reserve fund	37,765	29,286
Redemption fund	39,091	27,063
Depreciation fund	<u>1,383</u>	<u>2,252</u>
Total accrued interest receivable	<u>79,851</u>	<u>111,588</u>
Total	<u><u>\$ 9,576,434</u></u>	<u><u>\$ 21,060,691</u></u>

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 4 - CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2006 and 2005 was as follows:

	2006			Ending Balance
	Beginning Balance	Increases	Decreases	
Capital assets not being depreciated:				
Land	\$ 2,973,172	\$ -	\$ -	\$ 2,973,172
Construction in progress	<u>24,036,507</u>	<u>14,203,249</u>	<u>(38,057,401)</u>	<u>182,355</u>
Total capital assets not being depreciated	<u>27,009,679</u>	<u>14,203,249</u>	<u>(38,057,401)</u>	<u>3,155,527</u>
Capital assets being depreciated:				
Buildings and system	22,754,491	15,869,744	-	38,624,235
Improvements other than buildings	65,516,354	8,662,089	(122,696)	74,055,747
Machinery and equipment	<u>21,054,453</u>	<u>11,616,322</u>	<u>(331,734)</u>	<u>32,339,041</u>
Total capital assets being depreciated	<u>109,325,298</u>	<u>36,148,155</u>	<u>(454,430)</u>	<u>145,019,023</u>
Less accumulated depreciation for:				
Buildings and system	(4,846,529)	(792,165)	-	(5,638,694)
Improvements other than buildings	(10,206,645)	(1,126,487)	122,696	(11,210,436)
Machinery and equipment	<u>(9,780,814)</u>	<u>(1,382,875)</u>	<u>331,734</u>	<u>(10,831,955)</u>
Total accumulated depreciation	<u>(24,833,988)</u>	<u>(3,301,527)</u>	<u>454,430</u>	<u>(27,681,085)</u>
Total capital assets being depreciated, net	<u>84,491,310</u>	<u>32,846,628</u>	<u>-</u>	<u>117,337,938</u>
Capital assets, net	<u>\$111,500,989</u>	<u>\$ 47,049,877</u>	<u>\$(38,057,401)</u>	<u>\$ 120,493,465</u>

RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 4 - CAPITAL ASSETS (CONTINUED)

	2005			
	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending Balance</u>
Capital assets not being depreciated:				
Land	\$ 2,973,172	\$ -	\$ -	\$ 2,973,172
Construction in progress	<u>14,786,688</u>	<u>16,923,386</u>	<u>7,673,567</u>	<u>24,036,507</u>
Total capital assets not being depreciated	<u>17,759,860</u>	<u>16,923,386</u>	<u>7,673,567</u>	<u>27,009,679</u>
Capital assets being depreciated:				
Buildings and system	21,675,619	1,078,872	-	22,754,491
Improvements other than buildings	59,819,102	6,150,634	(453,382)	65,516,354
Machinery and equipment	<u>20,594,644</u>	<u>634,000</u>	<u>(174,191)</u>	<u>21,054,453</u>
Total capital assets being depreciated	<u>102,089,365</u>	<u>7,863,506</u>	<u>(627,573)</u>	<u>109,325,298</u>
Less accumulated depreciation for:				
Buildings and system	(4,271,452)	(575,077)	-	(4,846,529)
Improvements other than buildings	(9,638,608)	(1,021,419)	453,382	(10,206,645)
Machinery and equipment	<u>(9,027,824)</u>	<u>(927,181)</u>	<u>174,191</u>	<u>(9,780,814)</u>
Total accumulated depreciation	<u>(22,937,884)</u>	<u>(2,523,677)</u>	<u>627,573</u>	<u>(24,833,988)</u>
 Total capital assets being depreciated, net	<u>79,151,481</u>	<u>5,339,829</u>	<u>-</u>	<u>84,491,310</u>
 Capital assets, net	<u>\$ 96,911,341</u>	<u>\$ 22,263,215</u>	<u>\$ 7,673,567</u>	<u>\$ 111,500,989</u>

NOTE 5 - LONG-TERM DEBT

Long-term debt activity for the years ended December 31, 2006 and 2005 was as follows:

	2006				
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Revenue bonds:					
Bonds payable	\$38,560,000	\$ -	\$ 1,945,000	\$36,615,000	\$ 2,010,000
Safe Drinking Water Fund loans	23,813,079	868,140	1,214,259	23,466,960	1,283,834
Add (subtract) deferred amounts					
For:					
(Discounts)/premiums	796,119	-	42,649	753,470	42,649
Refundings – gains/(losses)	<u>(243,664)</u>	<u>-</u>	<u>(74,175)</u>	<u>(169,489)</u>	<u>(64,077)</u>
Total revenue bonds	62,925,534	868,140	3,127,733	60,665,941	3,272,406
Compensated absences	477,868	28,182	-	506,050	-
Advances from other funds	<u>953,875</u>	<u>-</u>	<u>23,479</u>	<u>930,396</u>	<u>25,535</u>
 Total long-term liabilities	<u>\$64,357,277</u>	<u>\$ 896,322</u>	<u>\$ 3,151,212</u>	<u>\$62,102,387</u>	<u>\$ 3,297,941</u>

RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005

NOTE 5 - LONG-TERM DEBT (CONTINUED)

	2005				
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Revenue bonds:					
Bonds payable	\$56,305,000	\$ -	\$17,745,000	\$38,560,000	\$ 1,944,900
Safe Drinking Water Fund loans	15,598,880	8,783,885	569,686	23,813,079	1,214,359
Add (subtract) deferred amounts					
For:					
(Discounts)/premiums	838,768	-	42,649	796,119	-
Refundings – gains/(losses)	<u>(333,595)</u>	<u>-</u>	<u>(89,931)</u>	<u>(243,664)</u>	<u>-</u>
Total revenue bonds	72,409,053	8,783,885	18,267,404	62,925,534	3,159,259
Compensated absences	429,860	48,008	-	477,868	-
Advances from other funds	<u>975,594</u>	<u>-</u>	<u>21,719</u>	<u>953,875</u>	<u>23,480</u>
Total long-term liabilities	<u>\$73,814,507</u>	<u>\$ 8,831,893</u>	<u>\$18,289,123</u>	<u>\$64,357,277</u>	<u>\$ 3,182,739</u>

Revenue bonds at December 31, 2006 and 2005 is comprised of the following:

	2006				
	<u>Date of Issue</u>	<u>Final Maturity</u>	<u>Interest Range</u>	<u>Original Indebtedness</u>	<u>Balance 12/31/06</u>
Revenue Bonds					
Mortgage Revenue Bonds	02/01/95	09/01/07	5.90-6.60%	\$ 5,000,000	\$ 180,000
Mortgage Revenue Refunding Bonds	04/15/01	09/01/15	4.00-5.375%	6,235,000	5,005,000
Mortgage Revenue Bonds	10/01/01	09/01/21	3.50-5.25%	11,460,000	10,100,000
Safe Drinking Water Loan	02/10/99	05/01/18	2.640%	12,594,655	8,345,405
Mortgage Revenue Bonds	11/01/04	09/01/24	2.50-5.00%	22,140,000	21,330,000
Safe Drinking Water Loan	12/22/04	05/01/24	2.365%	<u>14,882,948</u>	<u>15,121,555</u>
Total long-term debt				<u>\$72,312,603</u>	<u>\$60,081,960</u>

	2005				
	<u>Date of Issue</u>	<u>Final Maturity</u>	<u>Interest Range</u>	<u>Original Indebtedness</u>	<u>Balance 12/31/05</u>
Revenue Bonds					
Mortgage Revenue Bonds	02/01/95	09/01/07	5.90-6.60%	\$ 5,000,000	\$ 355,000
Mortgage Revenue Refunding Bonds	04/15/01	09/01/15	4.00-5.375%	6,235,000	5,500,000
Mortgage Revenue Bonds	10/01/01	09/01/21	3.50-5.25%	11,460,000	10,565,000
Safe Drinking Water Loan	02/10/99	05/01/18	2.640%	12,594,655	8,930,131
Mortgage Revenue Bonds	11/01/04	09/01/24	2.50-5.00%	22,140,000	22,140,000
Safe Drinking Water Loan	12/22/04	05/01/24	2.365%	<u>14,882,948</u>	<u>14,882,948</u>
Total long-term debt				<u>\$72,312,603</u>	<u>\$62,373,079</u>

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 5 - LONG-TERM DEBT (CONTINUED)

The debt service requirements for all debt outstanding as of December 31, 2006 is as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 3,293,834	\$ 2,249,759	\$ 5,543,593
2008	3,395,847	2,139,986	5,535,833
2009	3,518,661	2,029,049	5,547,710
2010	3,302,295	1,913,061	5,215,356
2011	3,401,771	1,799,539	5,201,310
2012-2016	18,301,953	7,038,275	25,340,228
2017-2021	17,015,843	3,522,442	20,538,285
2022-2026	<u>7,851,756</u>	<u>572,421</u>	<u>8,424,177</u>
Total	<u>\$ 60,081,960</u>	<u>\$ 21,264,532</u>	<u>\$ 81,346,492</u>

There are a number of limitations and restrictions contained in the various bond indentures and loan agreements. The Utility believes it is in compliance with all significant limitations, restrictions, including federal arbitrage regulations.

In prior years, the Utility defeased certain mortgage revenue bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased rates and bonds are not included in the Utility financial statements. At December 31, 2006, \$3,385,000 of the bonds outstanding are considered defeased. The bonds are callable on September 1, 2007.

NOTE 6 - NET ASSETS

The following is the detail of capital assets, net of related debt and restricted net assets.

	<u>2006</u>	<u>2005</u>
Invested in capital assets, net of related debt:		
Capital assets, net of accumulated depreciation	\$ 120,493,465	\$ 111,500,989
Less long-term debt outstanding	(56,433,789)	(58,719,261)
Plus unspent capital related debt proceeds	<u>-</u>	<u>10,780,847</u>
Total invested in capital assets net of related debt	<u>\$ 64,059,676</u>	<u>\$ 63,562,575</u>
Restricted net assets:		
Bond redemption fund	\$ 3,100,976	\$ 2,979,499
Depreciation fund	782,268	785,621
Rec fees	<u>718,137</u>	<u>808,052</u>
Total restricted net assets	4,601,381	4,573,172
Less: accrued interest payable from restricted assets	<u>658,931</u>	<u>682,559</u>
Restricted net assets	<u>\$ 3,942,450</u>	<u>\$ 3,890,613</u>

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 7 - EMPLOYEE RETIREMENT SYSTEM

The Water Utility participates in the Wisconsin Retirement System (“WRS”) as part of the City of Racine Group of employees. The Utility’s contributions were \$346,015 and \$320,109 for 2006 and 2005, respectively. Information regarding the plan can be found in the City of Racine financial statements for the years ended December 31, 2006 and 2005. Information related solely to the Water Utility is not available from WRS.

NOTE 8 - INTERFUND RECEIVABLES/PAYABLES

At December 31, 2006 and 2005, the Utility had the following interfund receivables and payables with affiliated entities:

	<u>2006</u>	<u>2005</u>
City of Racine		
Due from City of Racine - total	\$ 1,259,100	\$ 1,239,200
Due to City of Racine	(1,958,241)	(2,378,706)
Delinquent billings receivable - tax roll	1,056,460	906,172
 Racine Wastewater Utility		
Due from Wastewater Utility	614,997	583,522
Due to Wastewater Utility	(1,389,516)	(1,489,242)
 Interfund Advances		
	<u>2006</u>	<u>2005</u>
Advance from City of Racine - total	\$ <u>(930,396)</u>	\$ <u>(953,875)</u>

The following repayment schedule has been established for advances made to the Racine Water Utility for the Utility’s percentage of the pension liability.

2007	\$ 74,023
2008	75,366
2009	76,552
2010	78,053
2011	79,256
2012-2016	419,073
2017-2021	460,735
2022-2024	<u>197,182</u>
Subtotal	1,460,240
Less amount representing interest	<u>529,844</u>
	930,396
Current portion	<u>25,535</u>
Long-term portion	<u>\$ 904,861</u>

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 9 - RISK MANAGEMENT

The Utility is exposed to various risks of losses including general liability, property and casualty, workers' compensation, and employee health and accident. The Utility is involved in an intergovernmental insurance commission for general liability and auto insurance. There is a \$175,000 self-insured retention for each occurrence with this agreement. The Utility purchases commercial insurance for property and casualty claims.

The Utility participates in the City of Racine self-insurance plan for employee health insurance benefits. The plan is responsible for a specified amount of covered claims. Claims in excess of that amount are covered by purchased insurance. At December 31, 2006 and 2005, the Utility has accrued a liability of \$86,000 and \$83,000 respectively, to cover future claims.

In the ordinary course of conducting business, the Utility occasionally becomes involved in legal proceedings relating to contracts, environmental issues, or other matters. While any proceedings or litigation has an element of uncertainty, management of the Utility believes that the outcome of any pending or threatened actions will not have a material adverse effect on the business or financial condition of the Utility.

NOTE 10 - CAPITALIZED INTEREST

The Utility capitalizes interest on the financing of major asset additions. Total interest costs capitalized as utility plant net of investment earnings was \$0 and \$407,337 in 2006 and 2005, respectively. Total interest costs incurred were \$0 and \$2,347,547 in 2006 and 2005, respectively.

NOTE 11 - COMMITMENTS

During the year, the Utility entered into contract agreements with various companies to perform professional services and construction activities. At December 31, 2006, contracts with these entities totaled \$24,895,225 of which \$23,166,407 was paid and \$1,728,818 is committed for future services and construction activities to be performed.

NOTE 12 - MAJOR CUSTOMERS

One major customer accounted for 25.2% of gross sales aggregating \$3,941,468 and 21% of gross sales aggregating \$3,022,948 in 2006 and 2005, respectively. Total accounts receivable from this customer totaled \$236,575 and \$311,485, respectively.

**RACINE WATER UTILITY
NOTES TO FINANCIAL STATEMENTS
December 31, 2006 and 2005**

NOTE 13 - INTERGOVERNMENTAL RETAIL WATER SERVICE AGREEMENT

The Racine Water Utility entered into an intergovernmental retail water service agreement with the City of Racine and Village of Mount Pleasant. The agreement was reached to provide an equitable allocation of the cost expansion of existing and future water service facilities, which are necessary to continue providing high quality, reliable water service, and allow for future growth needs. Projects designed to serve future growth are funded through the water rates, contract connection charges and contract front-foot charges for new mains installed in the City and Village that will directly and substantially serve future growth and development. Costs to remedy existing deficiencies in the water system would be recovered through the water sales.

The residential equivalent connection (REC) fees are deposited in an interest-bearing segregated account and are restricted to pay for future growth costs. REC fees are recorded as revenue when received.

The REC fee activity for year ended December 31, 2006 is as follows:

Beginning Balance	REC Fees Received	Front Foot Receipts	Interest Earned	Total Disbursements	Ending Balance
\$ 496,829	1,178,527	152,130	49,140	(1,158,489)	\$ 718,137

NOTE 14 - SUBSEQUENT EVENT

On April 2, 2007, the Racine Water Utility issued waterworks system mortgage revenue bonds in the amount of \$18,980,000 with interest rates ranging from 4.00% to 4.750%. The maturity date of this bond is September 1, 2026. The proceeds from the sale of the bonds will be used to advance refund a portion of the Utility's outstanding \$11,460,000 waterworks system mortgage revenue bonds dated October 1, 2001. Additionally, the proceeds from the sale of the bonds will be used for financing various extension, replacement, repair and improvement projects throughout the water treatment and distribution system; acquiring wholesale customer assets; and acquiring vehicles and equipment.

Effective January 1, 2007, the Racine Water Utility purchased the assets to the Village of Sturtevant Water Utility. The payment of \$1,202,478, related to the purchase of the Village of Sturtevant Water Utility was paid December 28, 2006. This payment is reported on the Statement of Net Assets, under Other Assets, called Acquisition Deposit.

This information is an integral part of the accompanying financial statements.

SUPPLEMENTAL INFORMATION

RACINE WATER UTILITY
SCHEDULES OF OPERATING INCOME
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
OPERATING REVENUES		
Sales of water:		
Metered sales to general customers:		
Residential	\$ 5,549,981	\$ 5,361,952
Commercial	2,002,598	1,790,534
Industrial	4,418,653	4,104,302
Public authorities	<u>412,886</u>	<u>325,186</u>
Total metered sales	<u>12,384,118</u>	<u>11,581,974</u>
Unmetered sales	69,804	90,081
Private fire protection	235,647	207,262
Public fire protection	1,324,412	1,305,030
Sales for resale	<u>1,202,211</u>	<u>1,147,501</u>
Total sales of water	<u>2,832,074</u>	<u>2,749,874</u>
Other operating revenues:		
Forfeited discounts	259,988	218,548
Miscellaneous service revenues	65,423	65,871
Search revenues	26,760	-
Other water revenues	<u>124,097</u>	<u>131,630</u>
Total other operating revenues	<u>476,268</u>	<u>416,049</u>
Total operating revenues	<u>15,692,460</u>	<u>14,747,897</u>
OPERATING EXPENSES		
Operation and maintenance expenses:		
Personnel services	2,958,631	2,854,604
Contractual services	3,093,112	2,725,382
Materials and supplies	727,047	701,168
Administrative and general	<u>1,881,176</u>	<u>1,796,905</u>
Total operation and maintenance expenses	<u>8,659,966</u>	<u>8,078,059</u>
Depreciation	3,102,169	2,389,922
Taxes	<u>266,712</u>	<u>236,527</u>
Total operating expenses	<u>12,028,847</u>	<u>10,704,508</u>
OPERATING INCOME	<u>\$ 3,663,613</u>	<u>\$ 4,043,389</u>

RACINE WATER UTILITY
SCHEDULES OF OPERATION AND MAINTENANCE EXPENSES
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
OPERATING EXPENSES		
Personnel services	<u>\$ 2,958,631</u>	<u>\$ 2,854,604</u>
Contractual services		
Equipment maintenance	124,009	70,099
Building Maintenance	87,684	91,097
Vehicle maintenance	33,635	22,107
Telephone	20,185	16,632
Natural gas	197,211	155,262
Electric services	689,134	594,784
Water and wastewater services	934,205	882,879
Auto hire	7,365	7,028
Street repairs	318,737	286,805
Main Maintenance	115,176	16,849
Meter maintenance	1,363	3,200
Professional services	307,873	289,866
Computer maintenance	49,794	51,104
Water storage maintenance	<u>206,741</u>	<u>237,670</u>
Total contractual services	<u>3,093,112</u>	<u>2,725,382</u>
Materials and supplies		
Operational chemicals	262,643	275,100
Pipe and fittings	78,123	44,476
Meter parts	7,449	9,357
Gasoline and diesel fuel	72,881	66,904
Office supplies	25,274	24,166
Custodial supplies	10,323	11,727
Laboratory supplies	24,817	23,351
Equipment supplies	56,778	45,420
Building supplies	38,287	59,240
Construction and meter supplies	34,193	32,489
Street repair supplies	70,469	64,125
Postage	23,842	24,422
Safety supplies	16,071	14,255
Computer supplies	<u>5,897</u>	<u>6,136</u>
Total materials and supplies	<u>727,047</u>	<u>701,168</u>

RACINE WATER UTILITY
SCHEDULES OF OPERATION AND MAINTENANCE EXPENSES
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
OPERATING EXPENSES (continued)		
Administrative and general		
Property and liability insurance	\$ 84,654	\$ 122,738
Workers compensation insurance	198,064	147,263
Health insurance	1,081,096	1,012,763
Life insurance	19,688	21,100
Wisconsin retirement	346,015	320,109
Education	35,475	29,986
Dues, publications, and travel	24,970	28,301
Office rent	22,611	21,593
Stormwater fees	4,211	4,532
PSC expenses	33,299	88,520
Bad debt expense	31,093	-
	<u>1,881,176</u>	<u>1,796,905</u>
 Total administrative and general expenses	 <u>1,881,176</u>	 <u>1,796,905</u>
 Total operating expense	 <u>\$ 8,659,966</u>	 <u>\$ 8,078,059</u>