

CITY OF MILWAUKEE – WATER WORKS

Basic Financial Statements

December 31, 2014 and 2013

(With Independent Auditors' Report Thereon)

CITY OF MILWAUKEE – WATER WORKS

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INDEPENDENT AUDITORS' REPORT

Common Council
City of Milwaukee, Wisconsin - Milwaukee Water Works
Milwaukee, Wisconsin

Report on the Financial Statements

We have audited the accompanying financial statements of the Milwaukee Water Works, an enterprise fund of the City of Milwaukee, Wisconsin, as of and for the years ended December 31, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the entity's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Milwaukee Water Works as of December 31, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis-of-Matter

As discussed in Note 1, the financial statements present only the Milwaukee Water Works and do not purport to, and do not, present fairly the financial position of the City of Milwaukee, Wisconsin, as of December 31, 2014 and 2013, 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.

Other Matters

Required Supplementary Information

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

Accounting principles generally accepted in the United States of America require that the management's discussion on pages 3 through 13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Milwaukee, Wisconsin
September 29, 2015

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2014 and 2013

(Unaudited)

The management of the City of Milwaukee – Water Works (Water Works) offers readers of the organization’s basic financial statements this narrative overview and analysis of the Water Works’ basic financial statements for the fiscal years ended December 31, 2014 and 2013. Readers are encouraged to consider the information presented here in conjunction with the financial information.

The mission of the Water Works is to provide safe, reliable, and aesthetically pleasing drinking water to the City of Milwaukee and customers in suburban communities.

Financial Highlights

Year ended December 31, 2014

- Total revenues increased by 3.5% in 2014, from \$85.3 million in 2013 to \$88.3 million in 2014.
- Total expenses increased by 5.5% in 2014, from \$68.7 million in 2013 to \$72.5 million in 2014.
- As of December 31, 2014, the Water Works’ outstanding debt consisted of \$10.9 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and \$12.7 million in general obligation bonds for a total of \$23.6 million.
- The Water Works is an enterprise fund within the primary government of the City of Milwaukee and as such is not subject to property taxes. In place of property taxes, the Water Works contributes to the City’s tax levy by making a payment in lieu of taxes (PILOT). The PILOT was \$12.4 million both in 2014 and 2013 and is reported in the accompanying Statement of Revenues, Expenses, and Changes in Fund Net Position as transfers out.

Year ended December 31, 2013

- Total revenues decreased by 3.2% in 2013, from \$88.1 million in 2012 to \$85.3 million in 2013.
- Total expenses increased by 3.2% in 2013, from \$66.6 million in 2012 to \$68.7 million in 2013.
- As of December 31, 2013, the Water Works’ outstanding debt consisted of \$10.8 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and \$15.9 million in general obligation bonds for a total of \$26.7 million.
- The PILOT was \$12.4 million in 2013 and \$11.9 million in 2012.

Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the basic financial statements of the Water Works. The basic financial statements comprise two components: 1) the basic financial statements and 2) notes to the basic financial statements, which explain in more detail some of the information in the basic financial statements.

Required Basic Financial Statements

The basic financial statements report information about the Water Works using accounting methods similar to those used by private sector companies. These statements provide both long-term and short-term information about the Water Works’ overall financial status.

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(Unaudited)

The statement of net position presents information on all of the Water Works' assets and liabilities, with the difference between the two reported as net position. This statement provides information about the nature and the amounts of investments in resources (assets) and the obligations to Water Works' creditors (liabilities). It provides one way to measure financial health by providing the basis for evaluating the capital structure and assessing the liquidity and financial flexibility of the Water Works. However, one will need to consider other nonfinancial factors, such as changes in economic conditions, population and industrial/commercial customer growth, and new or changed government legislation.

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in fund net position. This statement measures the results of operations over the past year and can be used to determine whether the Water Works has successfully recovered all of its costs through user fees and other charges.

The final required financial statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, financing, and investing activities. This statement identifies sources and uses of cash, as well as the change in the cash balance during the reporting period.

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Management’s Discussion and Analysis

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Financial Analysis of the Water Works

Statement of Net Position

A summary of assets, liabilities, and net position as of December 31, 2014, 2013, and 2012 is as follows:

Table A-1

Condensed Summary of Net Position

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Assets:			
Current assets	\$ 50,169,201	47,862,924	49,913,573
Net capital assets	428,758,744	412,295,147	403,835,151
Total assets	<u>478,927,945</u>	<u>460,158,071</u>	<u>453,748,724</u>
Liabilities:			
Current liabilities	47,220,554	30,016,304	30,093,957
Noncurrent liabilities	24,806,002	26,992,406	25,672,583
Total liabilities	<u>72,026,556</u>	<u>57,008,710</u>	<u>55,766,540</u>
Net Position:			
Net investment in capital assets	405,166,630	385,576,885	374,444,457
Restricted for debt service	929,903	770,377	705,525
Unrestricted net position	804,856	16,802,099	22,832,202
Total net position	<u>\$ 406,901,389</u>	<u>403,149,361</u>	<u>397,982,184</u>

Net position may, over time, serve as a useful indicator of an entity’s financial position. In the case of the Water Works, assets exceeded liabilities by \$406.9 million and \$403.1 million at December 31, 2014 and 2013, respectively.

In Table A-1, it can be seen that the largest portion of the Water Works’ net position (99.6% and 95.7% as of December 31, 2014 and 2013, respectively) reflects the net investment in capital assets (e.g., water mains, buildings, machinery, and equipment). Also, as shown in Table A-3, the Water Works’ water main system makes up approximately 56% and 58% of the capital assets as of December 31, 2014 and December 31, 2013, respectively. The Water Works uses these capital assets to provide safe, reliable, and aesthetically pleasing drinking water to its 861,000 customer base that lives in the City of Milwaukee and surrounding communities.

The Water Works net investment in capital assets is reported net of related debt. The resources to repay this debt must be provided from operating and non-operating activities as the capital assets themselves are not intended to be used to liquidate these liabilities.

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Unrestricted net assets of the Water Works represents current assets such as cash on hand for operation, cash held in local government investment pool, accounts receivable and inventory of materials. Unrestricted net position has dropped to only 0.2 % of total net position in 2014 from 4.2% in 2013.

As can be seen in Table A-1, net investment in capital assets increased by \$19.6 million and \$11.1 million during the years ended December 31, 2014 and 2013, respectively. The increase in net investment in capital assets in 2014 is mainly attributable to significant completion and capitalization of two major capital projects for approximately \$6.05 million and \$5.1 million, respectively, with an accompanying decrease of \$3.1 million in total debt. These projects are the multiyear Automated Meter Reading (AMR) project and the Grange Backup Power project. Similarly, the AMR and the Florist Backup Power projects were major projects that were not financed with debt and were capitalized in 2013 for approximately \$5.5 million each, with an accompanying decrease of \$2.7 million in total debt. The amounts of contributed capital were \$0.4 million in 2014 and \$0.9 million in 2013. Due to completion of several major State of Wisconsin DOT, Milwaukee County, and Metropolitan Milwaukee Sewerage District projects, in prior years, a continued decrease or no significant increase in contributions has been experienced by the Water Works starting in 2010 and thereafter.

Statement of Revenues, Expenses, and Changes in Net Position

While the summary of net position (Table A-1) shows the amount of net position, as of the end of each respective year, the summary of revenues, expenses, and changes in fund net position (Table A-2) exhibits the nature and source of the changes.

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Management’s Discussion and Analysis

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(Unaudited)

Table A-2

Condensed Summary of Revenues, Expenses, and Changes in Fund Net Position

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating revenue	\$ 88,012,611	85,034,086	88,122,036
Nonoperating revenue	293,795	298,488	13,692
Total revenues	<u>88,306,406</u>	<u>85,332,574</u>	<u>88,135,728</u>
Depreciation expense	16,864,383	14,482,173	14,110,051
Other operating expenses	54,769,000	53,266,175	50,655,891
Nonoperating expenses	907,524	980,149	1,805,276
Total expenses	<u>72,540,907</u>	<u>68,728,497</u>	<u>66,571,218</u>
Income before capital contributions and transfers	15,765,499	16,604,077	21,564,510
Capital contributions	383,727	958,268	744,749
Transfers to the City of Milwaukee	(12,397,198)	(12,395,168)	(11,891,211)
Changes in net position	3,752,028	5,167,177	10,418,048
Net position – beginning of year	<u>403,149,361</u>	<u>397,982,184</u>	<u>387,564,136</u>
Net position – end of year	<u>\$ 406,901,389</u>	<u>403,149,361</u>	<u>397,982,184</u>

Year ended December 31, 2014

A review of Table A-2 shows that total revenues increased by \$3.0 million, or 3.5% in 2014 and total expenses increased by \$3.8 million, or 5.5%. These results may be explained as follows:

Revenues

- Operating revenues increased by \$3.0 million in 2014. This moderate increase in revenue reflects a rate increase implemented in November 2014 despite a continuing trend of drop in water sales or consumption in 2014. Even though the rate increase was for 11.4%, the impact was not significant for the year because it was introduced in late November. Table A-4 shows the sale of water (in billion gallons) for the last five years. According to this table, the sale of water for most customer classes has consistently dropped from year to year since 2010. It should also be noted that 2014 sales represents the lowest figures for the residential, commercial and public authority customer categories and thus total consumption. The sale of water has gone down for residential, commercial and public authority customer categories by .9 billion gallons, whereas sale to industrial and wholesale customers increased by .3 billion gallons resulting in a net decrease in total water sale of .6 billion gallons from 2013 to 2014. The mild summer experienced in 2014 also contributed to this decline in water sales.
- Non-operating revenues mainly consist of rental income from antenna contracts, and also include miscellaneous fees for service and branch tapping, interest income and other revenues such as from sale of

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nonutility properties. Miscellaneous non-operating revenues for 2014 and 2013 stayed almost the same with a less than 2% or less than \$5,000 decrease in 2014. There has been no significant change in interest income in relation to total non-operating revenue.

Expenses

- Operating expenses, excluding depreciation, increased by 2.8% to \$54.8 in 2014 from \$53.3 million in 2013. This is a combination of increases in two expense categories, namely transmission and distribution expenses and billing and collection expenses and decreases in administration and general expenses and water treatment expenses. While the increases were by 21.8% and 8.3% respectively the decreases were by 11.8% and 9.7% respectively. Increase in distribution expenses was mainly due to increase in water main breaks and high level of hydrant and other repairs and maintenance caused by the harsh winter experienced in 2014. The winter of 2013-2014 was extraordinarily harsh with extended periods of cold and deep penetration of frost into the ground. Between December 1, 2013 and March 31, 2014, staff responded to over 4,000 calls related to winter conditions, 661 of which were water main breaks, 509 of which were burst water meters and 154 were frozen services. During the same period the previous year, 345 water main breaks occurred, 126 meters burst and no services froze. In May 2014, the utility experienced a leak on a 72" steel pipeline that necessitated the shutdown of the Howard Avenue Water Treatment plant and caused an additional 82 water main breaks.

Billing and collections expenses were impacted by increases in ongoing Enquesta maintenance cost due to adding new services to accommodate wireless tablets introduced in 2014 and other projects related to new PSC requirements and implementation of a new rate structure. Decrease in administrative and general expenses was due to making one actuarial contribution to the Employees' Retirement System (ERS) in 2014 as opposed to making two contributions in 2013. Treatment expenses decreased due to the fact that major repair work performed in 2013 to a 60" wash water line and maintenance of treatment equipment was completed and no such expenses were reported in 2014. An 8.5% decrease in cost of chemicals used in 2014 also contributed to the decrease in treatment expenses. Pumping expenses went down by 5.1% as well in 2014.

- Non-operating expenses, which is made up of mainly interest expense, decreased by \$72,625 in 2014 or by 7.4%. This decrease was effected by a reduction of debt from \$26.7 million in 2013 to \$23.6 million in 2014.

Year ended December 31, 2013

A review of Table A-2 shows that total revenues decreased by \$2.8 million, or 3.2% in 2013 where as total expenses increased by \$2.1 million, or 3.2%. These results may be explained as follows:

Revenues

- Operating revenues decreased by \$3.1 million in 2013. This decrease in revenue reflects a significant drop in water sales or consumption in 2013 which lowered revenues despite the implementation of a simplified rate increase of 3% in June, 2013. The sale of water has gone down significantly for residential,

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industrial and public authority customer categories, resulting in a total decrease of over 2.4 billion gallons of water from 2012 to 2013. The consistent drop in the sale of water over the last several years, as shown in Table A-4, was even more exacerbated by the cool and wet summer Milwaukee experienced in 2013.

- Miscellaneous non-operating revenues for 2013 increased by \$290,000, from 2012. In 2012, no miscellaneous non-operating revenues were reported because the revenues were offset against a \$1.0 million loss that resulted from the transfer of Lincoln Yard, a nonutility property, to the City and reported as part of miscellaneous non-operating expenses. There has been no significant change in interest income.

Expenses

- Operating expenses, excluding depreciation, increased by 5.1% to \$53.3 in 2013 from \$50.7 million in 2012. This is a combination of increases in two expense categories, namely administration and general expenses and water treatment expenses and decreases in other categories. Administration and general expenses increased by \$2.8 million in 2013. The main reason for the increase in this category is the payment of additional actuarial contributions that the Water Works has to make to the Employees’ Retirement System (ERS). Treatment expenses increased by 11.5% or \$1.5 million. Increase in Treatment expenses was the result of repair work performed to a 60” wash water line and maintenance of treatment equipment. Billing and collection expenses experienced only a 3.2% decrease. Transmission and Distribution System expenses decreased by 8% or \$1.6 million to \$19.1 million in 2013. There was a decrease in cost of repairing pavement cuts associated with water main breaks. Pumping expenses remained about the same in 2013 as in 2012.
- Non-operating expenses decreased by \$825,000 in 2013 or by 45.7%. The main reason for this reduction is that there is no loss on transfer of assets in 2013 as was reported in 2012. In 2012, there was a net loss of \$630,000 on transfer of assets that was part of non-operating expenses. Also, interest expense, which makes up the most significant portion of non-operating expenses, decreased by 16.6% from \$1.2 million in 2012 to \$980,000 in 2013. This decrease was mainly due to reduction of debt in 2013 as a result of \$3.9 million principal payments made.

Capital Assets and Debt Administration

Capital Assets

The Water Works calculates depreciation based on composite groups of assets within a given category and the average useful life. These categories are building and improvements, transmission and distribution system, and machinery and equipment. Each group’s depreciation is then calculated using a rate authorized by the latest Public Services Commission of Wisconsin (PSC) rate order.

As of December 31, 2014, the Water Works investment in capital assets, net of accumulated depreciation, increased by \$16.5 million or 4.0% to \$428.8 million. Transmission and distribution system assets and machinery and equipment increased by \$3.0 million and \$10.9 million, respectively, and construction in progress increased by \$15.6 million. The increase in transmission and distribution system assets is mainly due to installation of

CITY OF MILWAUKEE – WATER WORKS

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(Unaudited)

water mains. The increase in machinery and equipment reflects a combination of increases in Automated Meter Reading (AMR) equipment, Texas Booster Station upgrade and Grange backup power projects and hydrants. The increase in construction in progress is due to the undertaking of several projects in 2014. The major contributors to the increase are the Linnwood backup power project (\$7.3 million), Riverside Pumps (\$1.8 million), Linnwood ozone project (\$1.7 million) and new water mains (\$1.8 million). There is no change in nonutility property from 2013.

As of December 31, 2013, the Water Works investment in capital assets, net of accumulated depreciation, increased by \$8.5 million or 2.1% to \$412.3 million. Transmission and distribution system assets and machinery and equipment increased by \$7.0 million and \$10.4 million, respectively, and construction in progress decreased by \$1.7 million. The increase in transmission and distribution system assets is mainly due to installation of water mains. The increase in machinery and equipment is due to the multi-year project of Automated Meter Reading (AMR) equipment and Florist Booster Station upgrade. Construction in progress decreased due to the completion and capitalization of these same projects in 2013. There is no change in nonutility property from 2012.

Capital Assets

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Capital assets:			
Land	\$ 1,410,560	1,410,560	1,363,077
Buildings	29,055,664	29,055,664	27,267,641
Transmission and distribution system	369,921,899	366,896,973	359,862,298
Machinery and equipment	236,061,456	225,137,719	214,764,110
Construction in progress	23,376,435	7,746,607	9,415,583
Nonutility property	4,308,994	4,308,994	4,308,994
	<u>664,135,008</u>	<u>634,556,517</u>	<u>616,981,703</u>
Total capital assets			
Less accumulated depreciation	<u>(235,376,264)</u>	<u>(222,261,370)</u>	<u>(213,146,552)</u>
Net capital assets	<u>\$ 428,758,744</u>	<u>412,295,147</u>	<u>403,835,151</u>

Investment Administration

As an enterprise fund within the primary government of the City of Milwaukee, the Water Works does not have a direct investment plan. As such, cash not in use for day-to-day operation is invested through the City of Milwaukee, primarily in the State of Wisconsin’s LGIP and/or other types of investment instruments as determined by the City Treasurer. As of December 31, 2014 and 2013, the City Treasurer held cash and cash equivalents of \$11.2 million and \$9.1 million, respectively, on behalf of the Water Works that consisted of LGIP investments and cash accounts.

CITY OF MILWAUKEE – WATER WORKS

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(Unaudited)

Debt Administration

Debt service is administered by the Public Debt Commission and can only be initiated through Council resolution with approval from the Commissioner of Public Works (or his designee, the Superintendent of Water Works).

The Water Works continues to make its regularly scheduled payments on its bonds per the amortization schedule for each bond.

As of December 31, 2014 and 2013, the Water Works debt consisted of \$10.9 million and \$10.8 million, respectively, in revenue bonds through the State of Wisconsin Safe Drinking Water Loan program, and \$12.7 million and \$15.9 million, respectively, in general obligation bonds for a total indebtedness of \$23.6 million and \$26.7 million, as of December 31, 2014 and 2013, respectively.

Economic Factors

Volume of water sold decreased by 0.6 billion gallons and 2.4 billion gallons in 2014 and 2013 respectively. Both 2014 and 2013 had cool and wet summers. As shown in Table A-4, there has been a steady decline in water volume sold in the four years preceding 2014, with the exception of 2012, for all customer categories except industrial and wholesale customers. Increases of 0.1 and 0.2 billion gallons, respectively, were experienced by both industrial and wholesale customers in 2014 thus narrowing down the decline from 2013 to 2014. However, it should be noted that volume of water sold to all customers dropped by 7.7% over the last five years. Table A-5 shows, graphically, the volume of water sold to different categories of customers over the last 20 years. As can be observed in the graph, there is a continuing decline in the sale of water to all customer categories over the 20-year period.

Collaborative efforts continued with the City of Milwaukee Department of City Development, the Milwaukee Redevelopment Corp., the M7 Water Council and FaB Wisconsin to retain and recruit commercial customers through publications, websites, and meetings with businesses.

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Table A-4

Sale of Water

	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>
			(In billion of gallons)		
Customer class:					
Residential	10.1	10.3	11.0	10.8	10.8
Commercial	7.0	7.5	7.9	7.5	7.7
Industrial	3.4	3.3	3.6	3.8	4.0
Public authority	<u>1.8</u>	<u>2.0</u>	<u>2.0</u>	<u>2.2</u>	<u>2.2</u>
Subtotal	22.3	23.1	24.5	24.3	24.7
Wholesale	<u>7.6</u>	<u>7.4</u>	<u>8.4</u>	<u>7.9</u>	<u>7.7</u>
Total	<u><u>29.9</u></u>	<u><u>30.5</u></u>	<u><u>32.9</u></u>	<u><u>32.2</u></u>	<u><u>32.4</u></u>

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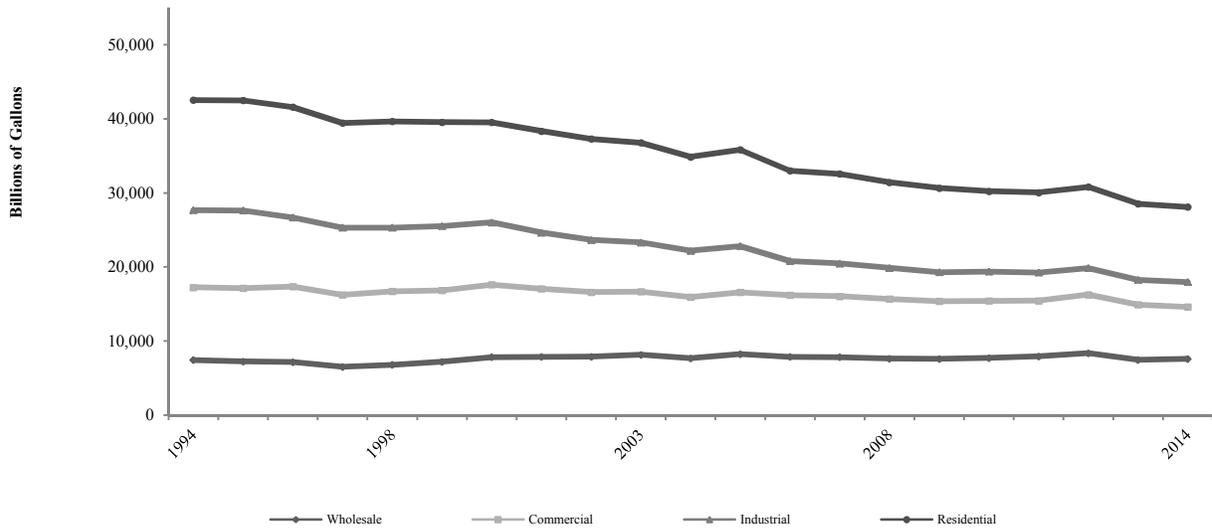
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Table A-5

Volume of Water Sold by Customer Class



Contacting Water Works Financial Management

This financial report is designed to provide a general overview of the Water Works’ finances to its customers, creditors, and anyone who has an interest in the Water Works’ operations. If you have questions about this report or need additional information, contact the Water Works’ Superintendent, Carrie Lewis, 841 N. Broadway, Room 409, Milwaukee, Wisconsin 53202.

Subsequent Events

In February 2015, the City of Milwaukee made a change to the way contributions are made to the Employees’ Retirement System. Effective February 1, 2015, all general city employee members are required to contribute a percentage of their annual earnable compensation equal to 5.5%. The City will no longer be required to contribute the actuarially determined amount. The City Charter assigns the authority to establish and amend contribution requirements.

Water Works’ 2015 capital budget includes a substantial increase in funding for water main replacements, essential to the long term sustainability of the system and ensuring that the Water Works can fulfill its mission of providing high quality, healthy drinking water to its customers. Water Works is projecting main replacements of a minimum of 15 miles every year starting in 2016, triple the amount that has been replaced in recent years.

CITY OF MILWAUKEE – WATER WORKS

Statements of Net Position

December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 10,286,042	8,292,688
Restricted cash and cash equivalents	929,903	770,377
Accounts receivable, net	16,392,001	16,407,912
Unbilled accounts receivable	13,613,000	12,402,000
Due from other funds	4,280,596	6,619,499
Inventory of materials and supplies	2,571,687	2,650,009
Prepaid items	2,085,980	711,421
Other assets	9,992	9,018
Total current assets	<u>50,169,201</u>	<u>47,862,924</u>
Noncurrent assets:		
Water plant in service, net	401,712,785	400,739,869
Construction work in process	23,376,434	7,746,607
Other property, net	3,669,525	3,808,671
Total noncurrent assets	<u>428,758,744</u>	<u>412,295,147</u>
Total assets	<u>478,927,945</u>	<u>460,158,071</u>
Liabilities:		
Current liabilities:		
Accounts payable	6,533,193	6,120,450
Interest payable	153,623	178,574
Accrued wages	615,649	1,396,748
Compensated absences	1,207,271	1,250,930
Due to other funds	34,865,223	16,684,774
Long-term debt due within one year	3,845,595	4,384,828
Total current liabilities	<u>47,220,554</u>	<u>30,016,304</u>
Noncurrent liabilities:		
General obligation bonds payable	10,197,314	12,761,148
Revenue bonds payable	9,549,205	9,572,286
Net other postemployment benefits obligation	5,059,483	4,658,972
Total noncurrent liabilities	<u>24,806,002</u>	<u>26,992,406</u>
Total liabilities	<u>72,026,556</u>	<u>57,008,710</u>
Net position:		
Net investment in capital assets	405,166,630	385,576,885
Restricted for debt service	929,903	770,377
Unrestricted	804,856	16,802,099
Total net position	<u>\$ 406,901,389</u>	<u>403,149,361</u>

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS
 Statements of Revenues, Expenses, and Changes in Fund Net Position
 Years ended December 31, 2014 and 2013

	2014	2013
Operating revenues:		
Water sales	\$ 72,525,458	70,256,803
Fire protection service	7,448,991	7,255,701
Charges for shared services	5,337,161	4,943,669
Other	2,701,001	2,577,913
Total operating revenues	88,012,611	85,034,086
Operating expenses:		
Administrative and general	7,857,968	8,897,562
Billing and collection	2,903,057	2,680,428
Transmission and distribution	23,227,764	19,067,860
Water pumping	7,492,125	7,898,704
Water treatment	13,288,086	14,721,621
Depreciation	16,864,383	14,482,173
Total operating expenses	71,633,383	67,748,348
Operating income	16,379,228	17,285,738
Nonoperating revenues (expenses):		
Interest income	7,442	8,630
Interest expense	(907,524)	(980,149)
Miscellaneous	286,353	289,858
Total nonoperating expenses, net	(613,729)	(681,661)
Income before capital contributions and transfers	15,765,499	16,604,077
Capital contributions	383,727	958,268
Transfers to the City of Milwaukee	(12,397,198)	(12,395,168)
Increase (decrease) in net position	3,752,028	5,167,177
Net position – beginning of year	403,149,361	397,982,184
Net position – end of year	\$ 406,901,389	403,149,361

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2014 and 2013

	<u>2014</u>	<u>2013</u>
Cash flows from operating activities:		
Receipts from customers and users	\$ 81,788,839	80,856,587
Receipts from interfund services provided	5,337,160	4,943,669
Payments to suppliers	(29,771,857)	(22,881,686)
Payments to employees	(20,872,075)	(20,841,693)
Payments (to) from other funds	<u>14,777,091</u>	<u>(1,067,905)</u>
Net cash provided by operating activities	<u>51,259,158</u>	<u>41,008,972</u>
Cash flows from noncapital financing activities:		
Miscellaneous nonoperating revenue (expense)	286,353	289,858
Transfers to other funds	<u>(12,397,198)</u>	<u>(12,395,168)</u>
Net cash provided by noncapital financing activities	<u>(12,110,845)</u>	<u>(12,105,310)</u>
Cash flows from capital and related financing activities:		
Acquisition of property, plant, and equipment	(32,944,252)	(21,983,900)
Proceeds from bonds, notes, and revenue bonds	1,311,125	5,342,796
Retirement of bonds, notes, and revenue bonds	(4,384,828)	(7,951,681)
Interest paid	<u>(984,918)</u>	<u>(1,083,379)</u>
Net cash used in capital and related financing activities	<u>(37,002,873)</u>	<u>(25,676,164)</u>
Cash flows from investing activity:		
Interest income	<u>7,442</u>	<u>10,062</u>
Net cash provided by investing activity	<u>7,442</u>	<u>10,062</u>
Net decrease in cash and cash equivalents	2,152,882	3,237,560
Cash and cash equivalents – beginning of year	<u>9,063,063</u>	<u>5,825,503</u>
Cash and cash equivalents – end of year	<u>\$ 11,215,945</u>	<u>9,063,063</u>
Cash and cash equivalents at year-end consist of:		
Unrestricted cash and cash equivalents	\$ 10,286,042	8,292,686
Restricted cash and cash equivalents	<u>929,903</u>	<u>770,377</u>
Total cash and cash equivalents	<u>\$ 11,215,945</u>	<u>9,063,063</u>

(Continued)

CITY OF MILWAUKEE – WATER WORKS
 Statements of Cash Flows
 Years ended December 31, 2014 and 2013

	2014	2013
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 16,379,228	17,285,738
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	16,864,383	14,482,173
Changes in assets and liabilities:		
Receivables	(1,195,089)	464,093
Due from/to other funds resulting from operations	20,519,352	6,811,708
Inventory of materials and supplies	78,322	(42,148)
Prepaid items	(1,374,559)	(155,875)
Other assets	(975)	4,088
Noncapital accounts payable	412,743	1,473,963
Accrued wages and compensated absences	(824,758)	259,831
Net other postemployment benefits obligation	400,511	425,401
Net cash provided by operating activities	\$ 51,259,158	41,008,972
Noncash activities:		
During the year, water mains and related property installed by others were deeded to the Water Works in the amount of	\$ 383,727	958,268

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

(1) Summary of Significant Accounting Policies

The City of Milwaukee – Water Works (Water Works) is an enterprise fund within the primary government of the City of Milwaukee (the City). The Water Works provides water to residents and commercial enterprises in the metropolitan Milwaukee area. The basic financial statements of the Water Works have been prepared in accordance with U.S. generally accepted accounting principles (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB) modified for certain requirements of the Public Service Commission of Wisconsin (PSC). The PSC regulates rates charged to customers and other practices of the Water Works. To facilitate the understanding of data included in the basic financial statements, summarized below are the significant accounting policies:

(a) Reporting Entity

As defined by U.S. GAAP, the financial reporting entity consists of a primary government as well as its component units, which are legally separate organizations for which the elected officials of the primary government are financially accountable. Financial accountability is defined as:

- (1) Appointment of a voting majority of the component unit's board and either:
 - (a) the ability to impose will by the primary government; or
 - (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
- (2) Fiscal dependency on the primary government.

Based on the application of these criteria, the Water Works has no component units and is not a component unit of any other entity. However, because the Water Works is not legally separate from the City, it is included in the basic financial statements of the City as an enterprise fund.

(b) Basis of Accounting

The accompanying basic financial statements were prepared on the accrual basis of accounting and the economic resources measurement focus. Revenues from operations, investments, and other sources are recognized in the accounting period in which they are earned. Revenues for water sales are recognized when water services are rendered. Unbilled water services are accrued as receivables and revenue at year-end. Expenses (including depreciation and amortization) of providing services to the public are recognized in the period they are incurred.

Nonexchange transactions, in which the Water Works receives value without directly giving equal value in return, include contributions and grants. On an accrual basis, revenue from contributions and grants is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements and expenditure requirements. Timing requirements specify the year when the resources are required to be used or the fiscal year when use is first permitted. Expenditure requirements specify the year in which the resources are provided to the Water Works on a reimbursement basis.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

(c) Cash Equivalents

Cash equivalents represent all highly liquid investments purchased with original maturities of three months or less, are stated at cost or amortized cost, which approximates fair value, and are invested with the City Treasurer. The City Treasurer manages a cash and investment pool to maximize return on funds while providing liquidity to meet day-to-day obligations. The Water Works' equity in the City's investment pool is considered to be a cash equivalent, since the Water Works can deposit or effectively withdraw cash at anytime without prior notice or penalty.

(d) 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 accounts receivable balance is stated net of allowance for doubtful accounts of \$593,794 and \$782,941 as of December 31, 2014 and 2013, respectively. The accounts receivable year-end balance includes actual unpaid charges. The unbilled accounts receivable balance consists of an estimate of the 2014 receivables that will be billed in the first quarter of 2015.

(e) Inventory of Materials and Supplies

Inventories of materials and supplies are stated at lower of moving average cost or market, based upon perpetual record-keeping systems and periodic cycle counts of quantities on hand.

(f) Investments

The City Treasurer is responsible for managing all of the Water Works' investments pursuant to the City's investment policy and Wisconsin Statutes. Wisconsin Statutes permit the City to invest funds not immediately needed in any of the following:

- Time deposits maturing within three years in any credit union, bank, savings bank, trust company or savings and loan association which are authorized to transact business in the State of Wisconsin.
- Bonds or securities issued or guaranteed by the Federal government.
- Bonds or securities of any county, city, drainage district, technical college district, village, town or school district of the State of Wisconsin, as well as bonds issued by a local exposition district, a local professional baseball park district, or the University of Wisconsin Hospitals and Clinics Authority.
- Local Government Investment Pool – Investment Fund of the State of Wisconsin.
- Repurchase agreements with public depositories, if the agreement is secured by federal bonds or securities.
- Any security which matures or which may be tendered for purchase at the option of the holder within not more than seven years of the date on which it is acquired, if that security has a rating which is the highest or second highest rating category assigned by Standard & Poor's Corporation, Moody's Investors Service, Inc. or other similar nationally recognized rating

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

agency or if that security is senior to, or on a parity with, a security of the same issuer which has such a rating.

- Securities of open-end management investment companies or investment trusts (mutual funds) if the portfolio is limited to (a) bonds and securities issued by the federal government or a commission, board or other instrumentality of the federal government, (b) bonds that are guaranteed as to principal and interest by the federal government or a commission, board or other instrumentality of the federal government, and (c) repurchase agreements that are fully collateralized by these bonds or securities.

Investments are reported at fair value based on quoted market prices. The Local Government Investment Pool is an external investment pool administered by the State of Wisconsin. The fair value of the Water Works' investment in the fund is the same as the value of the pooled shares. Although not subject to direct regulatory oversight, the fund is administered in accordance with the provisions of Section 25.50 of the Wisconsin Statutes.

(g) Capital Assets

Capital assets are defined by the Water Works as assets with an initial, individual cost of more than \$2,000 and an estimated useful life in excess of a year. Capital assets are capitalized at cost when purchased or constructed. Donated capital assets are recorded at their estimated fair value at the date of donation. Intangible assets not specifically excluded by its scope provisions will be classified as capital assets. Costs of depreciable property retired are removed from utility plant accounts and are charged to accumulated depreciation. Maintenance and repair costs are charged to operations as incurred and renewals and improvements are added to the asset accounts. Depreciation is provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Building and improvements	31 – 59 years
Transmission and distribution systems	45 – 77 years
Machinery and equipment	4 – 30 years

(h) Bond Premiums, Issuance Costs, and Deferred Amounts on Refunding

Bond premiums and deferred amounts on refunding are deferred and amortized over the life of the bonds using the effective-interest method. Bonds payable are reported net of the applicable bond premium and deferred amounts on refunding. Bond issuance costs are reported as expenses in the year incurred.

(i) Net Position

Equity is displayed in three components as follows:

Net Investment in Capital Assets, – This consists of capital assets, net of accumulated depreciation, less the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

Restricted – This consists of amounts that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, it is the Water Works’ policy to use restricted resources first, and then unrestricted resources when they are needed. The Water Works has restricted net position of \$929,903 and \$770,377 at December 31, 2014 and 2013, respectively. The restriction of net position is related to the debt service reserve requirements of the revenue bonds.

Unrestricted – This consists of net position that do not meet the definition of “restricted” or “investment in capital assets.” When restricted and unrestricted resources are available for the same purpose, it is the Water Works’ policy to use the restricted resources first.

(j) *Vacation Benefits*

Vacation benefits are recorded as expenses over the periods the benefits accrue to the employees.

(k) *Sick Leave*

The liability for sick leave has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. Upon retirement, employees receive a portion of their unused sick leave, in accordance with the Code of Ordinances. Upon retirement, employees are generally entitled to payment of accumulated sick leave up to a maximum of 30 days. At December 31, 2014 and 2013, accumulated sick leave earned but not taken was approximately \$3,862,804 and \$4,108,474 respectively. Accumulated sick leave is determined on the basis of current salary rate. The amount of accumulated sick leave to be forfeited upon termination and retirement is not available and would reduce this amount.

(l) *Classification of Revenues and Expense*

The Water Works classifies its revenues and expenses as either operating or nonoperating.

Operating revenue includes activities that have the characteristics of exchange transactions including sales of water supplied to city, suburban, and commercial users. Nonoperating revenue includes activities that have the characteristics of nonexchange transactions, such as contributions and most Federal, State, and local grants and contracts.

Operating expenses include the costs of operating the water utility, administrative expenses, and depreciation on capital assets. All expenses not meeting this definition, including interest expense, are reported as nonoperating expenses.

(m) *Taxes*

Payments in lieu of property taxes are recognized as a transfer in the year billed by the City.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

(n) *Estimates*

The preparation of basic financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from this estimate.

(o) *New Accounting Pronouncements Implemented*

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which reclassifies certain items that were previously reported as assets and liabilities as deferred outflows of resources, or current period outflows and inflows. The City implemented this Statement beginning with the year ending December 31, 2013. Implementation of the Statement did not have a significant impact on its financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of previous pronouncements. The City implemented this Statement beginning with the year ending December 31, 2013. Implementation of the Statement did not have a significant impact on its financial statements.

In July 2012, the GASB issued Statement No. 67, *Financial Reporting for Pension Plans*. This Statement replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*. The objective of this statement is to enhance note disclosures and RSI for both defined benefit and defined contribution pension plans. This Statement also requires the presentation of new information about annual moneyweighted rates of return in the notes to the financial statements and in 10-year RSI schedules. The City implemented this Statement beginning with the year ending December 31, 2014. Implementation of the Statement did not have a significant impact on its financial statements.

In July 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Government Employers* and Statement No. 50, *Pension Disclosures*. This statement requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability and to more comprehensively and comparably measure the annual costs of pension benefits. This Statement also enhances accountability and transparency through revised and new note disclosures and RSI. The City will implement this Statement beginning with the year ending December 31, 2015. The City has not analyzed the potential impact of the Statement on its financial statements.

In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. The objective of this Statement is to provide guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. The City implemented this Statement beginning with the year ending December 31, 2013. Implementation of the Statement did not have a significant impact on its financial statements.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

In April 2013, the GASB issued Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this statement is to enhance the information disclosed about a government's obligations and risk exposure from extending nonexchange financial guarantees. The City implemented this Statement beginning with the year ending December 31, 2013. Implementation of the Statement did not have a significant impact on its financial statements.

In November 2013, the GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*. The objective of this Statement is to improve accounting and financial reporting by addressing an issue in Statement No. 68, *Accounting and Financial Reporting for Pensions*, concerning transition provisions related to certain pension contributions made to defined benefit pension plans prior to implementation of that Statement by employers and nonemployer contributing entities. The City will implement this Statement beginning with the year ending December 31, 2015. The City has not analyzed the potential impact of the Statement on its financial statements.

In February 2015, the GASB issued Statement No. 72, *Fair value measurement and application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The City will implement this Statement beginning with the year ending December 31, 2015. The City has not analyzed the potential impact of the Statement on its financial statements.

(2) Deposits and Investments

As of December 31, 2014 and 2013, the Water Works' deposits and investments were as follows:

	<u>2014</u>	<u>2013</u>
Local Government Investment Pool	\$ 4,606,637	4,083,880
Deposits and cash on hand	<u>6,609,308</u>	<u>4,979,183</u>
Total	<u>\$ 11,215,945</u>	<u>9,063,063</u>

(a) Custodial Credit Risk – Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the Water Works' deposits may not be returned. Per Common Council, the City Treasurer shall require collateralization of certificates of time deposit (including interest checking) at financial institutions when the total amount of such certificates of deposit with any institution exceeds the combined

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

insured limit of \$650,000. As of December 31, 2014 and 2013, the Water Works' deposits were not subject to custodial credit risk as they were either insured or collateralized by securities held in the pledging bank's trust department in the City's name.

(b) Interest Rate Risk

Interest rate risk is the risk that the fair value of the Water Works' investments will decrease as a result of an increase in interest rates. The City's investment policy does not explicitly limit investment maturities. However, the City manages its exposure to interest risk based on the anticipated cash flow needs of the City. The maturities for the Water Works' deposits and investments are less than one year and are invested by the City Treasurer.

(c) Credit Risk

Credit risk is the risk that the City will not recover its investments due to the ability of the counterparty to fulfill its obligations. Wisconsin Statutes expressly limit the City to invest in certain allowable investments. The City's investment policy generally does not further limit its investment choices. The Water Works' investment in the Wisconsin Local Government Investment Pool is not rated by a nationally recognized rating agency.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

(3) Capital Assets

Capital asset activity for the year ended December 31, 2014 was as follows:

	Balance December 31, 2013	Additions	Deletions	Adjustments	Balance December 31, 2014
Capital assets not being depreciated:					
Land and land improvements	\$ 1,410,560				1,410,560
Nonutility property, land	654,868				654,868
Construction in progress	<u>7,746,607</u>	<u>33,528,748</u>	<u>(17,898,920)</u>		<u>23,376,435</u>
Total capital assets not being depreciated	<u>9,812,035</u>	<u>33,528,748</u>	<u>(17,898,920)</u>	—	<u>25,441,863</u>
Capital assets being depreciated					
Buildings	29,055,664				29,055,664
Transmission and distribution system	366,896,973	3,056,065	(31,139)		369,921,899
Machinery and equipment	225,137,719	14,842,855	(3,919,118)		236,061,456
Nonutility property	<u>3,654,126</u>		—		<u>3,654,126</u>
Total capital assets being depreciated	<u>624,744,482</u>	<u>17,898,920</u>	<u>(3,950,257)</u>	—	<u>638,693,145</u>
Less accumulated depreciation:					
Buildings	17,750,523	917,714			18,668,237
Transmission and distribution system	94,989,609	4,935,071	(45,515)		99,879,165
Machinery and equipment	109,020,915	11,140,263	(3,843,121)	(128,665)	116,189,392
Nonutility property	<u>500,323</u>	<u>139,147</u>			<u>639,470</u>
Total accumulated depreciation	\$ <u>222,261,370</u>	<u>17,132,195</u>	<u>(3,888,636)</u>	<u>(128,665)</u>	<u>235,376,264</u>
Total capital assets being depreciated, net	<u>402,483,112</u>	<u>766,725</u>	<u>(61,621)</u>	<u>128,665</u>	<u>403,316,881</u>
Total capital assets, net	\$ <u><u>412,295,147</u></u>	<u><u>34,295,473</u></u>	<u><u>(17,960,541)</u></u>	<u><u>128,665</u></u>	<u><u>428,758,744</u></u>

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

Capital asset activity for the year ended December 31, 2013 was as follows:

	Balance December 31, 2012	Additions	Deletions	Transfers	Balance December 31, 2013
Capital assets not being depreciated:					
Land and land improvements	\$ 1,363,077			47,483	1,410,560
Nonutility property, land	654,868				654,868
Construction in progress	<u>9,415,583</u>	<u>22,564,772</u>	<u>(24,233,748)</u>		<u>7,746,607</u>
Total capital assets not being depreciated	<u>11,433,528</u>	<u>22,564,772</u>	<u>(24,233,748)</u>	<u>47,483</u>	<u>9,812,035</u>
Capital assets being depreciated					
Buildings	27,267,641	1,815,115	(377,588)	350,496	29,055,664
Transmission and distribution system	359,862,298	7,637,298	(602,623)		366,896,973
Machinery and equipment	214,764,110	14,781,335	(4,407,726)		225,137,719
Nonutility property	<u>3,654,126</u>		<u>—</u>		<u>3,654,126</u>
Total capital assets being depreciated	<u>605,548,175</u>	<u>24,233,748</u>	<u>(5,387,937)</u>	<u>350,496</u>	<u>624,744,482</u>
Less accumulated depreciation:					
Buildings	17,152,015	884,550	(519,688)	233,646	17,750,523
Transmission and distribution system	90,741,556	4,864,369	(616,316)		94,989,609
Machinery and equipment	104,891,804	8,733,254	(4,604,143)		109,020,915
Nonutility property	<u>361,177</u>	<u>139,146</u>			<u>500,323</u>
Total accumulated depreciation	<u>213,146,552</u>	<u>14,621,319</u>	<u>(5,740,147)</u>	<u>233,646</u>	<u>222,261,370</u>
Total capital assets being depreciated, net	\$ <u>392,401,623</u>	<u>9,612,429</u>	<u>352,210</u>	<u>116,850</u>	<u>402,483,112</u>
Total capital assets, net	\$ <u><u>403,835,151</u></u>	<u><u>32,177,201</u></u>	<u><u>(23,881,538)</u></u>	<u><u>164,333</u></u>	<u><u>412,295,147</u></u>

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

(4) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations for the year ended December 31, 2014 were as follows:

	Balance December 31, 2013	Additions	Deletions	Balance December 31, 2014	Due within one year
General obligation bonds	\$ 15,791,002	—	(3,121,153)	12,669,849	2,511,389
Unamortized premiums	91,299	—	(52,445)	38,854	
Deferred amount on refundings				—	
Revenue bonds	10,835,961	1,311,125	(1,263,675)	10,883,411	1,334,206
Other postemployment benefits	4,658,972	400,511	—	5,059,483	
Total	\$ <u>31,377,234</u>	<u>1,711,636</u>	<u>(4,437,273)</u>	<u>28,651,597</u>	<u>3,845,595</u>

Changes in long-term obligations for the year ended December 31, 2013 were as follows:

	Balance December 31, 2012	Additions	Deletions	Balance December 31, 2013	Due within one year
General obligation bonds	\$ 18,727,352	—	(2,936,350)	15,791,002	3,121,153
Extendable municipal					
commercial paper	4,000,000		(4,000,000)	—	
Unamortized premiums	165,316	—	(74,017)	91,299	—
Deferred amount on refundings	(10,471)	—	10,471	—	—
Revenue bonds	6,508,497	5,342,796	(1,015,332)	10,835,961	1,263,675
Other postemployment benefits	4,233,571	425,401	—	4,658,972	—
Total	\$ <u>33,624,265</u>	<u>5,768,197</u>	<u>(8,015,228)</u>	<u>31,377,234</u>	<u>4,384,828</u>

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2014 and 2013

(b) General Obligation Bonds

The City issues general obligation bonds to provide funds for the acquisition and construction of the water plant and related equipment (water system). General obligation bonds are secured by the full faith and unlimited taxing power of the City. The bonds for the Water Works will be retired by revenues from water services or, if the revenues are not sufficient, by future tax levies. The original amount of general obligation bonds issued in years prior to 2014 was \$33,718,771.

(c) Extendable Municipal Commercial Paper

During 2012, the City began issuing extendable municipal commercial paper promissory notes which are not general obligations of the City; the notes are limited obligations of the City of Milwaukee payable from proceeds of the sale of notes or refunding notes issued to refinance the notes. The notes do not represent or constitute a debt of the City within the meaning of any constitutional or statutory limitations. During 2012, the City issued \$4,000,000 of extendable municipal commercial paper for the Water Works which was used to finance capital improvements of the water system, and which are included in the long-term obligations table in note 4(a) above.

During 2013, the City retired \$4,000,000 of extendable municipal commercial paper for the Water Works which was used to finance capital improvements of the water system, and which are included in the long-term obligations table in note 4(a) above.

General obligation bonds outstanding at December 31, 2014 and 2013 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance at December 31	
				2014	2013
Refunding E	2015 to 2019	4.50% to 5.00%	\$ 3,125,658	181,885	576,869
Refunding C, D, F, G, J, & K	2015 to 2016	5.00% to 5.25%	17,953,357	2,542,321	4,418,061
Refunding 2006 N9, Refd C&D	2015	4.25% to 5.00%	114,756	643	16,072
2009 N1	2015 to 2019	3.00% to 5.00%	150,000	75,000	90,000
2009 B2	2020 to 2024	4.00% to 5.00%	75,000	75,000	75,000
2010-N1	2015 to 2020	2.50% to 5.00%	450,000	270,000	315,000
2010-B5	2021 to 2025	1.50% to 5.00%	225,000	225,000	225,000
2011-N3	2015 to 2021	4.00% to 5.00%	7,750,000	5,425,000	6,200,000
2011-B4	2021 to 2026	4.00% to 5.00%	3,875,000	3,875,000	3,875,000
Total			\$ 33,718,771	12,669,849	15,791,002

(d) Revenue Bonds

In December 1998, Water Works issued a revenue bond, in the amount of \$19,358,172, to the State of Wisconsin Safe Drinking Water Loan Program. This bond supports loans to the Water Works for water quality capital projects, or reimbursement for capital expenditures related to water quality, up to the face value of the bond. The revenue bond borrowing authority was closed in 2004, and the final loan amount was \$17,559,378. Loan covenants provide for the monthly escrow of revenues to

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repay the debt plus interest. Regardless of loan proceeds disbursement, the final maturity of the revenue bonds is May 1, 2018.

In December 2013, Water Works issued a revenue bond, in the amount of \$7,823,139, to the State of Wisconsin Safe Drinking Water Loan Program. This bond supports loans to the Water Works for specific Water Works capital projects, or reimbursement for capital expenditures related to those Water Works specific capital projects, up to the face value of the bond. Loan covenants provide for the monthly escrow of revenues to repay the debt plus interest. Regardless of loan proceeds disbursement, the final maturity of the revenue bonds is May 1, 2033.

In October 2014, Water Works issued a revenue bond, in the amount of \$8,548,447, to the State of Wisconsin Safe Drinking Water Loan Program. This bond supports loans to the Water Works for specific Water Works capital projects, or reimbursement for capital expenditures related to those Water Works specific capital projects, up to the face value of the bond. Loan covenants provide for the monthly escrow of revenues to repay the debt plus interest. Regardless of loan proceeds disbursement, the final maturity of the revenue bonds is May 1, 2034.

Revenue bonds outstanding at December 31, 2014 and 2013 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance at December 31	
				2014	2013
SDW Bond 4851-02	2015 to 2018	2.64%	\$ 17,559,378	4,451,029	5,493,165
SDW Bond 4851-08	2015 to 2033	1.93	6,221,748	6,000,209	5,342,796
SDW Bond 4851-23	2015 to 2034	1.93	5,342,796	432,173	—
Total			\$ 29,123,922	10,883,411	10,835,961

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(e) Debt Service Requirements

The maturities of the outstanding principal and related interest requirements as of December 31, 2014 are as follows:

Year:	General obligation bonds		Revenue bonds	
	Principal	Interest	Principal	Interest
2015	\$ 2,511,389	616,947	1,334,206	225,296
2016	1,816,828	487,436	1,386,593	190,728
2017	856,010	395,307	1,421,135	155,750
2018	857,211	352,626	1,456,549	119,889
2019	858,411	309,810	305,701	98,792
2020 – 2024	4,174,994	920,250	1,619,077	402,521
2025 – 2029	1,595,006	78,625	1,781,030	239,010
2030 – 2034	—	—	1,579,120	62,801
Total	\$ 12,669,849	3,161,001	10,883,411	1,494,787

(5) Revenue Bond Debt Covenants

Fiscal year:	Gross revenues	Debt coverage expenses	Net revenue available for debt service	Debt service requirements			Coverage
				Principal	Interest	Total	
2013	85,042,716	65,661,343	19,381,373	1,263,675	216,267	1,479,942	13.10
2014	88,020,053	67,166,198	20,853,855	1,334,206	225,296	1,559,502	13.37

Gross revenues are defined as total revenues plus interest income. Debt coverage expenses are defined as total operating expenses, including payment in lieu of taxes (PILOT), minus depreciation.

The revenue bonds debt service coverage ratio requirement is the greater of 1.1 or the highest debt service coverage ratio with respect to any other debt obligations payable from the revenues of the water system.

At December 31, 2014 and 2013, there were no other debt obligations payable from the revenues of the water system.

(6) Retirement Plan and Other Postemployment Benefits

(a) Pension Benefits

Plan Description – The City makes contributions to the Employees’ Retirement System of the City of Milwaukee (the System), a cost-sharing multiple-employer defined benefit pension plan, on behalf of all eligible City employees. The System provides retirement, disability, and death benefits to plan members and beneficiaries. The City Charter assigns the authority to establish and amend benefit provisions. The System issues a publicly available financial report that includes basic financial

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statements and required supplementary information for the System. That report may be obtained by writing to the Employees' Retirement System of the City of Milwaukee, 789 North Water Street, Suite 300, Milwaukee, WI 53202.

Funding Policy – Plan members are required to contribute, or have contributed on their behalf, a percentage of their annual earnable compensation equal to 5.5%, 7.0%, 7.0%, and 7.0% for general City employees, police officers, firefighters, and elected officials, respectively. New hires who are not sworn police/fire must pay 1.6% of pensionable earnings for eight years to fund the cost of benefit escalators due to the Global Pension Settlement. The City is required to contribute the actuarially determined amount. The City Charter assigns the authority to establish and amend contribution requirements. The Water Works' contribution to the System for the years ended December 31, 2014, 2013, and 2012 was \$353,891, \$692,843, and \$961,031 respectively, and is equal to the required contributions on behalf of the plan members for the year.

(b) Other Postemployment Benefits

The City provides other postemployment benefits (OPEB) to its retirees for health and life insurance.

Plan Description – The City provides a single-employer defined benefit healthcare plan and life insurance administered by both the City and Milwaukee's Employee Retirement System (MERS). The City provides medical insurance benefits for substantially all retirees in accordance with terms set forth in labor contracts or by Common Council resolution. Retirees are eligible to enroll in any of the group plans offered by the City. Aside from the basic plan, this includes a Health Maintenance Organization (HMO) plan currently offered to active employees. The City provides full health insurance coverage to general City employees who retire at age 55, but less than age 65, with 30 years of creditable service or age 60, but less than age 65, with 15 years of creditable service until the age of 65. Management employees retiring beginning in 2004 at age 55, but less than 65, pay a portion of health insurance the same as active management employees. In accordance with a "percentage formula" as provided in labor agreements, the City provides between 65% and 100% of the cost of the basic plan coverage for firefighters and police officers who retire with 25 years of creditable service and having attained at least the age of 52 but less than 60. Upon reaching the age of 60 but prior to the age of 65, the City provides full health insurance coverage for firefighters and police officers with single enrollment status. The City contribution for firefighters and police officers between the ages of 60 and 65 with family enrollment status is the greater of 100% of the cost of single enrollment in the basic plan or an amount determined using the "percentage formula." The "percentage formula" used to determine the City contribution in the labor agreements is based on the amount of unused sick leave at retirement.

After attaining the age of 65 and having completed a minimum of 15 years of creditable service, all retirees are eligible to enroll in a "subsidized plan" for medical insurance. Under this plan, the City contributes 25% of the base rate toward retirees enrolled in the basic plan, while the retiree pays 75% of the base rate and 100% of the major medical rate. For those retirees enrolled in an HMO, the City contributes a 25% subsidy of the applicable HMO premium.

In addition to medical insurance, the City allows its employees to continue life insurance coverage under the Group Life Insurance Plan offered to active employees in accordance with Section 350-25 of the Code of Ordinances. The base amount of coverage for general City employees is equal to the

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employee’s annual basic salary rounded to the next higher thousand dollars. The base amount of coverage for firefighters and police officers is equal to one and one-half the employee’s annual basic salary to the next higher thousand dollars.

General City employees retiring at age 55 or older with 20 years of service or at age 60 regardless of years of service and covered under the group life insurance plan at retirement are eligible to continue coverage at the level on the date prior to their date of retirement. Firefighters and police officers retiring at age 52 or older with 20 years of service or at age 57 regardless of years of service and covered under the group life insurance plan at retirement are eligible to continue coverage up to their base amount of coverage on the date prior to their date of retirement. Prior to age 65, all retirees are required to pay the full premium rates as established by the insurance carrier, less an adjustment for estimated dividends. The rates established are group rates applied consistently to all employees, without regard to age or health. Upon reaching the age of 65, those retirees still part of the group life plan have their coverage reduced in accordance with the reduction schedule in effect on their last day physically at work, with the City assuming all future premiums.

Funding Policy – The contribution of plan members and the Water Works is established and may be amended by the City. The required contribution for medical and life insurance for retirees is based on a pay-as-you-go financing. Medical benefits provided through the basic healthcare plan are self-insured. For 2014, the Water Works paid approximately \$1,558,585 and \$24,000, respectively, toward medical and life insurance for retirees. For 2013, the Water Works paid approximately \$1,152,752 and \$36,000, respectively, toward medical and life insurance for retirees.

Annual OPEB Cost and Net OPEB Obligation – The Water Works’ annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the Water Works’ annual OPEB cost for the year, the amount actually contributed to the plan (pay-as-you-go basis), and the changes in the Water Works’ net OPEB obligation for the years ended December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Annual required contribution (ARC)	\$ 1,965,073	1,600,772
Interest on net OPEB obligation	192,515	142,946
Adjustment to ARC	<u>(174,492)</u>	<u>(129,565)</u>
Annual OPEB cost	1,983,096	1,614,153
Contributions made	<u>1,582,585</u>	<u>1,188,752</u>
Increase in net OPEB obligation	(400,511)	(425,401)
Net OPEB obligation at beginning of year	<u>(4,658,972)</u>	<u>(4,233,571)</u>
Net OPEB obligation at end of year	\$ <u>(5,059,483)</u>	<u>(4,658,972)</u>

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The Water Works annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2014, 2013 and 2012 were as follows:

	<u>Employer contribution</u>		<u>Net OPEB obligation</u>
	<u>Annual OPEB cost</u>	<u>Percentage contributed</u>	
Year ended December 31:			
2014	\$ 1,983,096	79.8%	\$ 5,059,483
2013	1,614,152	73.6	4,658,972
2012	1,774,727	73.0	4,233,571

Funded Status and Funding Progress – As of January 1, 2013, the most recent actuarial valuation date, the actuarial accrued liability for benefits related to all City employees was \$888,982,700 and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of \$888,982,700. Of this amount, it was estimated that 4% is attributable to Water Works. The covered payroll (annual payroll of all active City employees covered by the plan) was \$382,794,900 and the ratio of the UAAL to the covered payroll was 232.2%. The covered payroll for Water Works employees was \$15,630,518.

Actuarial valuations of an ongoing plan involve estimates of value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend amounts determined regarding the funded status of the plan, and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations, and new estimates are made about the future.

Actuarial Methods and Assumptions – The retiree healthcare valuation was based on the projected unit credit (PUC) cost method. The PUC method produces an explicit normal cost and actuarial accrued liability. The normal cost and actuarial accrued liability are directly proportional to the employee’s service. That is, the normal cost equals the present value of future benefits divided by projected service at retirement, and the actuarial accrued liability equals the present value of benefits multiplied by the ratio of service at valuation date to projected service at retirement. Depending on the demographic characteristics of the current group and new entrants in the future, this method could produce stable annual costs, in the aggregate, when expressed as a percentage of pay.

The OPEB valuation uses a discount rate assumption of 4.5% based on the City’s projected short-term investment rate of return. The healthcare cost trends rate is 8.0% initially, and reduced by decrements to the ultimate rate of 4.5% after 10 years. The actuarial assumption for wage inflation is 3.0%. The amortization of the unfunded actuarial accrued liability is based on a level percentage of pay over a 30-year open amortization period.

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(7) Related-Party Transactions

A summary of significant revenue and expense transactions between the City and Water Works for 2014 and 2013 is shown below:

	<u>2014</u>	<u>2013</u>
Revenues (receipts from the City) – water consumption	\$ 479,640	447,758
Transfer from Parking Fund - Lincoln Yards Installment	27,229	27,229
Total Revenues from the City	<u>\$ 506,869</u>	<u>474,987</u>
Expenses (payments to the City):		
Payment in lieu of taxes and other transfers	\$ 12,397,198	12,395,168
Employee fringe benefits	6,491,947	6,795,844
Administrative services	905,617	927,235
Electrical equipment maintenance	665,653	610,370
Motor vehicle usage and maintenance	1,153,508	1,001,272
Street repairs	3,497,759	3,139,994
All other services	6,269,535	5,973,181
Total payments to the City	<u>\$ 31,381,217</u>	<u>30,843,064</u>

The Water Works also acts as a billing and collection agent for sewer and other municipal charges and is reimbursed for costs incurred in providing such billing services.

The City purchases the delinquent water and sewer accounts receivables of the Water Works at the unpaid amounts. Any subsequent uncollectible accounts are absorbed by the City.

The Water Works has an annual maximum contingent liability of \$200,000 for general liability claims. Claims in excess of this amount, if any, are the liability of the City.

(8) Regulatory Agency

PSC reporting requirements and the timing of the reports give rise to differences between revenues and expenses that are included in the PSC reports and these basic financial statements. The major categories of these differences are as follows: (1) the PSC recognizes the amortization of Contributions in Aid of Construction (CIAC) deferred credits over a 20-year period and (2) some expenses are recognized in different years due to the timing of the PSC report and this report.

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The effect of such differences on net income is as follows for the years ended December 31, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
	(In thousands)	(In thousands)
Increase in net assets as shown in accompanying financial statements	\$ 3,752	5,167
Amortization of deferred credits resulting from Contributions in Aid of Construction (CIAC) reclassification	811	811
Donated Property	—	(164)
OPEB, Adjust PSC Estimate to Actual Amount	—	(55)
Net income as shown on PSC reports	<u>\$ 4,563</u>	<u>5,759</u>

(9) Commitments and Contingencies

The Water Works is generally committed under the terms of various contracts for construction of improvements and additions to the Water Works’ system. Contract terms provide for partial payments as construction progresses with specified retention to assure full contract compliance. Open commitments on such contracts as of December 31, 2014 totaled \$8,199,143. The Water Works, as an enterprise fund of the City, is exposed to various risks of losses related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employee or natural disaster. The City manages its risks internally and sets aside funds as needed for reasonably estimated current claim settlements and unfavorable judgements through annual appropriations and supplemental appropriations. Current settlements are paid for by the General Fund. The Water Works, as an enterprise fund of the City, participates in this coverage.

(10) Transfers and Interfund Balances

At December 31, 2014 and 2013, the Water Works has recorded a due from other funds of \$4,280,596 and \$6,619,499, respectively, which in part represents cash held by the general obligation debt fund of the City on behalf of Water Works for the 2014 and 2013 respective principal and interest payments on its general obligation bonds. The remaining balance represents the amount owed to the Water Works as a result of regular advance and reimbursement activities. At December 31, 2014 and 2013, the Water Works has recorded a due to the City (General and Sewer Funds) of \$34,865,223 and \$16,684,774, respectively, for sewer maintenance and other municipal fees collected by the Water Works. The Water Works transfers funds to the City (general fund) for PILOT. In 2014 and 2013, the PILOT transfers to the City were \$12,397,198 and \$12,395,168, respectively.

(11) Subsequent Events

In February 2015, – The City made a change to the contributions to the Employees’ Retirement System of the City of Milwaukee (the System), a cost-sharing multiple-employer defined benefit pension plan, on behalf of all eligible City employees. Effective February 1, 2015, all general city employee members are required to contribute a percentage of their annual earnable compensation equal to 5.5%. The City will no longer be required to contribute the actuarially determined amount. The City Charter assigns the authority to establish and amend contribution requirements.