



CITY OF MILWAUKEE – WATER WORKS

Financial Statements

December 31, 2007 and 2006

(With Independent Auditors' Report Thereon)

CITY OF MILWAUKEE – WATER WORKS

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KPMG LLP
777 East Wisconsin Avenue
Milwaukee, WI 53202

Independent Auditors' Report

The Honorable Members of the Common Council
City of Milwaukee:

We have audited the accompanying basic financial statements of the City of Milwaukee – Water Works (Water Works), an enterprise fund of the City of Milwaukee, Wisconsin, as of and for the years ended December 31, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of the Water Works' 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting of the Water Works. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 note 1, the financial statements present only the 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, 2007 and 2006, and the changes in its financial position for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the City of Milwaukee – Water Works as of December 31, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 2 through 11 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Milwaukee, Wisconsin
July 30, 2008

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2007 And 2006

(Unaudited)

The management of the City of Milwaukee – Water Works (Water Works) offers readers of the organization's financial statements this narrative overview and analysis of the Water Works' financial statements for the fiscal years ended December 31, 2007 and 2006. 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, 2007

- Total revenues increased by 4.47% in 2007, from \$71.3 million in 2006 to \$74.5 million in 2007.
- Total expenses increased by 6.87% in 2007, from \$58.1 million in 2006 to \$62.1 million in 2007.
- As of December 31, 2007, the Water Works' outstanding debt consisted of \$11.2 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and \$20.3 million in general obligation bonds for a total of \$31.5 million. As of December 31, 2006, total outstanding debt was \$35.8 million, consisting of \$12.1 million in revenue bonds and \$23.7 million in general obligation bonds.
- 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 \$7.8 million in 2007 and \$7.5 million in 2006, and is reported in the accompanying statement of revenues, expenses, and changes in fund net assets as transfers out.

Year ended December 31, 2006

- Total revenues decreased by 2.35% in 2006, from \$73.0 million in 2005 to \$71.3 million in 2006.
- Total expenses decreased by 0.27% in 2006, from \$58.2 million in 2005 to \$58.1 million in 2006.
- As of December 31, 2006, the Water Works' outstanding debt consisted of \$12.1 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and \$23.7 million in general obligation bonds for a total of \$35.8 million. As of December 31, 2005, total outstanding debt was \$41.3 million, consisting of \$12.9 million in revenue bonds and \$28.4 million in general obligation bonds.
- The payment in lieu of taxes (PILOT) was \$7.5 million in 2006 and \$7.7 million in 2005.

Overview of the 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 are comprised of two components: 1) the financial statements and 2) notes to the financial statements, which explain in more detail some of the information in the financial statements.

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Required Financial Statements

The 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.

The statement of net assets presents information on all of the Water Works' assets and liabilities, with the difference between the two reported as net assets. 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 assets. 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.

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2007 And 2006

(Unaudited)

Financial Analysis of the Water Works

Statement of Net Assets

A summary of assets, liabilities, and net assets as of December 31, 2007, 2006, and 2005 is as follows:

Table A – 1

Condensed Summary of Net Assets

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Assets:			
Current assets	\$ 58,927,767	59,607,231	58,670,375
Net capital assets	<u>377,097,848</u>	<u>370,714,337</u>	<u>365,522,302</u>
Total assets	<u>436,025,615</u>	<u>430,321,568</u>	<u>424,192,677</u>
Liabilities:			
Current liabilities	20,466,996	17,868,179	16,524,444
Noncurrent liabilities	<u>27,789,165</u>	<u>31,546,306</u>	<u>35,780,698</u>
Total liabilities	<u>48,256,161</u>	<u>49,414,485</u>	<u>52,305,142</u>
Net assets:			
Invested in capital assets, net of related debt	345,572,042	334,937,406	324,203,338
Restricted for debt service	643,510	632,047	620,880
Unrestricted net assets	<u>41,553,902</u>	<u>45,337,630</u>	<u>47,063,317</u>
Total net assets	<u>\$ 387,769,454</u>	<u>380,907,083</u>	<u>371,887,535</u>

Net assets 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 \$387.8 million and \$380.9 million at December 31, 2007 and 2006, respectively.

In Table A-1, it can be seen that the largest portion of the Water Works' net assets (89% and 88% as of December 31, 2007 and 2006, respectively) reflects the investment in capital assets (e.g., water mains, buildings, machinery and equipment) net of related debt. Also, as shown in Table A-3, the Water Works' water main system makes up approximately 57% of the capital assets as of December 31, 2007 and 56% as of December 31, 2006. The Water Works uses these capital assets to provide safe, reliable, and aesthetically pleasing drinking water to its 850,000-customer base that lives in the City of Milwaukee and surrounding communities.

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

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The remaining net assets (11% and 12% as of December 31, 2007 and 2006, respectively) are unrestricted and represent current assets (e.g., cash on hand for operation, cash held in the local government investment pool, accounts receivable, and inventory and materials).

As can be seen in Table A-1, capital assets net of related debt increased by \$10.6 million and \$10.7 million during the years ended December 31, 2007 and 2006, respectively. The increases in capital assets net of related debt in both 2007 and 2006 were mainly due to a combination of the reduction in related debt, the completion and capitalization of capital projects, and the receipt of contributed capital. The increases in net capital assets were \$6.4 million and \$5.2 million in 2007 and 2006, respectively. The amounts of contributed capital were \$2.2 million and \$3.2 million in 2007 and 2006, respectively, with a decrease of 32.5% from 2006 to 2007. Contributed capital for the last five years has averaged \$2.3 million. The 2007 contribution of \$2.2 million is consistent with this average. In 2006, three major projects related to work on the Marquette interchange resulted in a higher than average contributed capital for the year.

Statement of Revenues, Expenses, and Changes in Fund Net Assets

While the summary of net assets (Table A-1) shows the amount of net assets, the summary of revenues, expenses, and changes in fund net assets (Table A-2) provides answers as to the nature and source of the changes.

Table A – 2
Condensed Summary of Revenues, Expenses, and Changes in Fund Net Assets

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Operating revenue	\$ 72,503,901	69,460,043	71,518,280
Nonoperating revenue	2,010,930	1,865,572	1,525,883
Total revenues	<u>74,514,831</u>	<u>71,325,615</u>	<u>73,044,163</u>
Depreciation expense	12,942,632	12,519,592	12,000,434
Other operating expenses	47,747,704	43,904,503	44,284,191
Nonoperating expenses	1,373,735	1,650,071	1,945,467
Total expenses	<u>62,064,071</u>	<u>58,074,166</u>	<u>58,230,092</u>
Income before capital contributions and transfers	12,450,760	13,251,449	14,814,071
Capital contributions	2,178,360	3,228,913	1,850,214
Transfers out	<u>(7,766,749)</u>	<u>(7,460,814)</u>	<u>(7,667,741)</u>
Changes in net assets	6,862,371	9,019,548	8,996,544
Net assets beginning of year	<u>380,907,083</u>	<u>371,887,535</u>	<u>362,890,991</u>
Net assets end of year	\$ <u>387,769,454</u>	<u>380,907,083</u>	<u>371,887,535</u>

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Year ended December 31, 2007

A review of Table A-2 shows that operating revenues increased by \$3.0 million, or 4.38%, and total expenses increased by \$4.0 million, or 6.87%. These results may be explained as follows:

Revenues

- Operating revenues increased by \$3.0 million in 2007 primarily due to the water rate increase of 6% that was effective June 2007, partially offset by a decrease in water consumption (sold) by 435 million gallons. The wet summer in 2007 has impacted consumption. Table A-4 shows the sale of water (in billions gallons) for the last five years. According to this table, the sale of water for all customer class has consistently dropped from year to year except in 2005.
- Nonoperating revenues, which mainly consist of interest income, also include miscellaneous fees for service and branch tapping and rental income for antenna contracts. Nonoperating revenues for 2007 increased by \$1.1 million, or 7.8%, from 2006. The average interest rates on investments in the Local Government Investment Pool (LGIP) with the State of Wisconsin, where most of the Water Works' funds are invested, were 5.02% and 4.9% for 2007 and 2006, respectively, resulting in no significant impact. The minor increase in nonoperating revenues resulted from increases in the rates for service and branch tapping, as well as the renewal of antenna space rental contracts at higher rates.

Expenses

- Operating expenses, excluding depreciation, increased by \$3.8 million, or 8.8%, in 2007. This is a combination of different categories of expenses. Treatment and transmission and distribution expenses increased by \$1.1 million and \$1.8 million, respectively. Major repair projects, such as roofing at both plants and chimney rebuilding at the Linnwood Plant, were undertaken in 2007. Increased service repairs and cross connection inspections and rent for the Water Distribution facilities at Tower were the main reasons for increased distribution cost. Administrative expenses increased by \$.6 million, which among other things, is attributable to rising health insurance expenses and other postemployment benefits (OPEB) expense recognized in 2007.
- Nonoperating expenses, which consist mainly of interest expense, decreased by \$.3 million in both 2007 and 2006. These decreases were primarily due to declining principal balances of outstanding debt.

Year ended December 31, 2006

A review of Table A-2 shows that operating revenues decreased by \$2.1 million, or 2.9%, and total expenses remained almost the same as the 2005 level with only a 0.27% decrease in 2006 to \$58.1 million. These results may be explained as follows:

Revenues

- Operating revenues decreased by \$2.1 million in 2006 primarily due to a decrease in water consumption (sold) by 3 billion gallons. The main reason for this decrease was the loss of one of the Water Works' largest industrial customers (Red Star Yeast) in 2006, due to a move from Milwaukee. The impact of this

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move on the Water Works' revenue was a reduction of about \$1.1 million, in addition, the cool and wet summer in 2006 has impacted consumption, thereby reducing water revenues.

- Nonoperating revenues for 2006 increased by \$.3 million, or 22.3%, from 2005. This is a result of the increase in interest rates on investments in the Local Government Investment Pool (LGIP) with the State of Wisconsin, from 4.06% at the end of 2005 to 5.25% at the end of 2006.

Expenses

- Operating expenses, excluding depreciation, decreased by \$.4 million, or 0.86%, in 2006. Treatment and transmission and distribution expenses decreased by \$.9 million and \$.5 million, respectively, due to the fact that no major projects were undertaken in 2006 for these categories. On the other hand, administrative expenses increased by \$1.1 million, of which \$.9 million is attributed to rent on the new combined Water Distribution facility.
- Nonoperating expenses, decreased by \$.3 million in 2006 and \$.4 million in 2005. These decreases were primarily due to declining principal balances of outstanding debt.

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, 2007, the Water Works investment in capital assets, net of accumulated depreciation, amounted to \$377.1 million. This represents an increase of \$6.4 million from December 31, 2006. Transmission and distribution system assets increased by \$11.6 million and construction in progress increased by \$3.1 million. The increase in construction in progress is due to initiation of capital projects in 2007 that were not completed as of December 31, 2007. The combination of these two items, offset by an increase in accumulated depreciation of \$8.9 million, primarily resulted in the \$6.4 million increase.

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As of December 31, 2006, the Water Works investment in capital assets was \$370.7 million (net of accumulated depreciation). This is an increase of \$5.2 million from December 31, 2005. The increase is a net of an increase in investment in transmission and distribution assets and a decrease in construction in progress. A large number of projects were completed and capitalized in 2006 as well.

Table A – 3
Capital Assets

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Capital assets			
Land	\$ 1,280,630	1,280,630	1,541,856
Buildings	21,291,679	20,693,584	22,851,934
Transmission and distribution system	318,139,222	306,507,308	295,103,517
Machinery and equipment	201,182,478	201,262,299	197,870,747
Construction in progress	12,249,080	9,144,994	11,524,958
Nonutility property	<u>5,603,586</u>	<u>5,603,586</u>	<u>3,018,679</u>
Total capital assets	559,746,675	544,492,401	531,911,691
Less accumulated depreciation	<u>(182,648,827)</u>	<u>(173,778,064)</u>	<u>(166,389,389)</u>
Net capital assets	<u>\$ 377,097,848</u>	<u>370,714,337</u>	<u>365,522,302</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 Local Government Investment Pool (LGIP) and/or other types of investment instruments as determined by the City Treasurer. As of December 31, 2007 and 2006, the City Treasurer held cash and cash equivalents of \$29.2 million and \$31.8 million, respectively, on behalf of the Water Works that consisted of certificates of deposit, LGIP investments, and cash accounts.

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. All bond debt covenants have been met.

As of December 31, 2007 and 2006, the Water Works debt consisted of \$11.2 and \$12.1 million, respectively, in revenue bonds through the State of Wisconsin Safe Drinking Water Loan program and \$20.3 million and \$23.7 million, respectively, in general obligation bonds for a total indebtedness of \$31.5 million and \$35.8 million, respectively.

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Economic Factors

A 6% rate increase was implemented in June 2007. This rate increase resulted in a \$3.0 million, or 4.38%, increase in operating revenue for 2007, despite a reduction in consumption. In 2006, a rate increase of 3.4%, which represented a cost of living adjustment, was effective for water sold after September 1, 2006. The impact of this increase on 2006 revenues was not significant.

As shown in Table A-4, there has been a steady decline in water volume sold. In 2007, there were about .5 billion fewer gallons of water sold than in 2006. Over the last five years, the volume of water sold to industrial customers has dropped by 33.3%, where as the drop in total water sold to all customers is 11.4%. Table A-5 shows, graphically, the volume of water sold to different categories of customers over the last twenty years. As can be observed in the graph, there is a significant decline in the sale of water to industrial customers and a moderate reduction in the residential category. In 2006, the Water Works' lost one of its largest industrial customers (Red Star Yeast) due to a move out of the City. This resulted in about a billion gallons reduction in volume of water sold or about \$1.1 million in revenues.

Expansion of the water service area is under consideration in two places. The City of New Berlin has requested an expansion of the water service area to include the "middle third" of their community, an area that is outside the Great Lakes basin but water is returned to Lake Michigan through the regional wastewater authority. It is projected that this would approximately double the water sold to that community. Passage of the Great Lakes Compact by the State of Wisconsin is required before this request will be considered by the City of Milwaukee. A feasibility study is underway to evaluate the direct supply of Milwaukee water to the Village of Elm Grove (Village), for an estimate of 1.1 million gallons per day (0.4 billion gallons per year). If this water sale was approved, it would not occur until after the Village constructed a distribution system.

In an effort to increase water sales, the Water Works collaborated with the City of Milwaukee – Department of City Development to retain and recruit commercial customers who use Milwaukee water in processing or product. As a result, Cintas Corporation, a commercial laundry and distribution center, broke ground in November 2006 and water service was connected in July 2007. At full operation, the plant is expected to use 120,000 gallons of water per day and will generate about \$42,000 in revenue annually to the water utility.

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The Water Marketing Specialist joined the new M7 regional Water Council in October 2007. The group’s mission is to preserve and promote the region’s Lake Michigan freshwater resource as an economic development advantage for water-intensive industries and research. Plans in late 2007 called for developing a global public relations and marketing plan to promote Milwaukee’s freshwater resources with the firm CKPR.

Table A – 4

Sale of Water

(billion gallons)

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Customer class:					
Residential	12.1	12.2	13.0	12.7	13.5
Commercial	8.2	8.3	8.4	8.3	8.5
Industrial	4.4	4.6	6.2	6.2	6.6
Public authority	2.4	2.4	2.6	2.4	2.6
Subtotal	<u>27.1</u>	<u>27.5</u>	<u>30.2</u>	<u>29.6</u>	<u>31.2</u>
Wholesale	<u>7.8</u>	<u>7.9</u>	<u>8.2</u>	<u>7.7</u>	<u>8.2</u>
Total	<u><u>34.9</u></u>	<u><u>35.4</u></u>	<u><u>38.4</u></u>	<u><u>37.3</u></u>	<u><u>39.4</u></u>

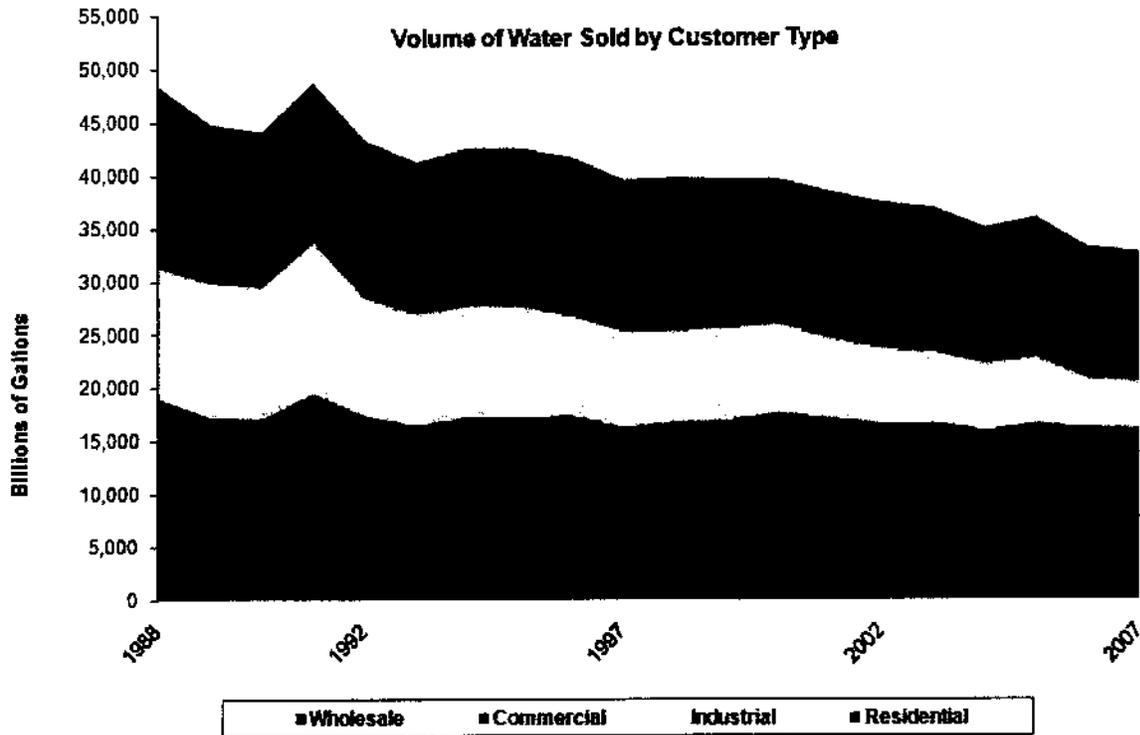
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Table A-5



Contacting Water Works financial management

This financial report is designed to provide a general overview of the Water Works' finances to our customers, creditors and any one 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 401, Milwaukee, Wisconsin 53202.

CITY OF MILWAUKEE – WATER WORKS

Statements of Net Assets

December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 28,538,815	31,177,353
Restricted cash and cash equivalents	643,510	632,047
Accounts receivable, net	12,599,871	10,720,388
Unbilled accounts receivable	9,769,917	9,620,726
Accrued interest	131,353	171,788
Due from other funds	4,702,423	4,920,698
Inventory of materials and supplies	2,345,026	2,208,921
Prepaid items	93,686	21,126
Other assets	103,166	134,184
Total current assets	<u>58,927,767</u>	<u>59,607,231</u>
Noncurrent assets:		
Water plant in service, net	362,171,375	358,796,901
Construction work in process	12,249,080	9,144,994
Other property, net	2,677,393	2,772,442
Total noncurrent assets	<u>377,097,848</u>	<u>370,714,337</u>
Total assets	<u>436,025,615</u>	<u>430,321,568</u>
Liabilities:		
Current liabilities:		
Accounts payable	3,325,896	3,165,412
Interest payable	345,337	376,147
Accrued wages	1,453,151	971,252
Net other postemployment benefits obligation	790,290	—
Compensated absences	1,024,999	1,034,009
Due to other funds	9,790,683	8,021,167
Due to other governments	—	69,567
Long-term debt due within one year	3,736,640	4,230,625
Total current liabilities	<u>20,466,996</u>	<u>17,868,179</u>
Noncurrent liabilities:		
General obligation bonds payable	17,473,864	20,339,704
Revenue bonds payable	10,315,301	11,206,602
Total noncurrent liabilities	<u>27,789,165</u>	<u>31,546,306</u>
Total liabilities	<u>48,256,161</u>	<u>49,414,485</u>
Net assets:		
Invested in capital assets, net of related debt	345,572,042	334,937,406
Restricted for debt service	643,510	632,047
Unrestricted	41,553,902	45,337,630
Total net assets	<u>\$ 387,769,454</u>	<u>380,907,083</u>

See accompanying notes to financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Revenues, Expenses, and Changes in Fund Net Assets

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Operating revenues:		
Water sales	\$ 59,301,224	56,516,900
Fire protection service	6,233,880	5,953,376
Charges for shared services	5,049,792	5,224,031
Other	<u>1,919,005</u>	<u>1,765,736</u>
Total operating revenues	<u>72,503,901</u>	<u>69,460,043</u>
Operating expenses:		
Administrative and general	6,634,072	6,051,486
Billing and collection	2,677,720	2,232,989
Transmission and distribution	18,872,592	17,099,476
Water pumping	7,057,252	7,104,246
Water treatment	12,506,068	11,416,306
Depreciation	<u>12,942,632</u>	<u>12,519,592</u>
Total operating expenses	<u>60,690,336</u>	<u>56,424,095</u>
Operating income	11,813,565	13,035,948
Nonoperating revenues (expenses):		
Interest income	1,707,141	1,689,654
Interest expense	(1,373,735)	(1,650,071)
Miscellaneous	<u>303,789</u>	<u>175,918</u>
Income before capital contributions and transfers	12,450,760	13,251,449
Capital contributions	2,178,360	3,228,913
Transfers out	<u>(7,766,749)</u>	<u>(7,460,814)</u>
Increase in net assets	6,862,371	9,019,548
Net assets – beginning of year	<u>380,907,083</u>	<u>371,887,535</u>
Net assets – end of year	<u>\$ 387,769,454</u>	<u>380,907,083</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Receipts from customers and users	\$ 70,997,854	69,575,287
Cash receipts from other funds	—	5,490,506
Payments to suppliers	(17,761,797)	(17,625,793)
Payments to employees	(24,178,027)	(22,154,541)
Payments to other funds	<u>(5,995,123)</u>	<u>(4,372,363)</u>
Net cash provided by operating activities	<u>23,062,907</u>	<u>30,913,096</u>
Cash flows from noncapital financing activities:		
Miscellaneous nonoperating revenue	303,789	175,918
Transfer to other funds	<u>(7,766,749)</u>	<u>(7,460,814)</u>
Net cash used in noncapital financing activities	<u>(7,462,960)</u>	<u>(7,284,896)</u>
Cash flows from capital and related financing activities:		
Acquisition of property, plant, and equipment	(14,318,926)	(15,286,715)
Retirement of bonds, notes, and revenue bonds	(4,230,625)	(5,538,267)
Interest paid	<u>(1,425,046)</u>	<u>(1,687,652)</u>
Net cash used in capital and related financing activities	<u>(19,974,597)</u>	<u>(22,512,634)</u>
Cash flows from investing activities:		
Interest income	<u>1,747,575</u>	<u>1,653,299</u>
Net cash provided by investing activities	<u>1,747,575</u>	<u>1,653,299</u>
Net increase (decrease) in cash and cash equivalents	<u>(2,627,075)</u>	<u>2,768,865</u>
Cash and cash equivalents – beginning of year	<u>31,809,400</u>	<u>29,040,535</u>
Cash and cash equivalents – end of year	<u>\$ 29,182,325</u>	<u>\$ 31,809,400</u>
Cash and cash equivalents at year end consist of:		
Unrestricted cash and cash equivalents	\$ 28,538,815	31,177,353
Restricted cash and cash equivalents	<u>643,510</u>	<u>632,047</u>
Total cash and cash equivalents	<u>\$ 29,182,325</u>	<u>\$ 31,809,400</u>

(Continued)

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 11,813,565	13,035,948
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	12,942,632	12,519,592
Changes in assets and liabilities:		
Receivables	(2,028,674)	(299,293)
Due from/to other funds	(414,680)	5,490,506
Inventory of materials and supplies	(136,105)	317,287
Prepaid items	(72,560)	(9,729)
Other assets	31,018	221,596
Accounts payable	454,822	(403,489)
Accrued wages and compensated absences	472,889	40,678
Net cash provided by operating activities	<u>\$ 23,062,907</u>	<u>30,913,096</u>
Noncash activities:		
During the year, water mains and related property installed by others were deeded to the Water Works in the amount of	\$ 2,178,360	30,913,096

See accompanying notes to financial statements.

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(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 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 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 financial statements of the City as an enterprise fund.

(b) Basis of Accounting

The accompanying financial statements were prepared on the accrual basis of accounting. 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.

Non-exchange 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 Financial Statements

December 31, 2007 and 2006

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the GASB. The Water Works also has the option of following subsequent private-sector guidance, subject to this same limitation. The Water Works has elected not to follow subsequent private-sector guidance.

(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 \$70,720 and \$155,370 as of December 31, 2007 and 2006, respectively. The year-end balance includes actual unpaid charges and a year-end estimate of the 2007 receivables that will be billed in the first quarter of 2008.

(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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

- 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 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 Pooled - Investment Fund 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. 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	45 – 58 years
Transmission and distribution systems	64 – 110 years
Machinery and equipment	6 – 56 years

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

Bond premiums, issuance costs, and deferred amounts on refundings 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 refundings. Bond issuance costs are reported as deferred charges (other assets).

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(i) Net Assets

Equity is displayed in three components as follows:

Invested in Capital Assets, Net of Related Debt – 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.

Restricted – This consists of net assets 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, generally 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 assets of \$643,510 and \$632,047 at December 31, 2007 and 2006, respectively. The restriction of net assets is related to the debt service requirements of the revenue bonds.

Unrestricted – This consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt”.

(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 labor contracts and Section 350-38 of 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, 2007 and 2006, accumulated sick leave earned but not taken was approximately \$4,654,078 and \$4,654,393, 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. Payments for sick leave to retirees were immaterial to the financial statements for the years ended December 31, 2007 and 2006.

(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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(m) Taxes

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

(n) Estimates

The preparation of 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 financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. An estimate included herein is the allowance for doubtful accounts receivable. Actual results could differ from this estimate.

(o) New Accounting Pronouncements

The City implemented Governmental Accounting Standards Board (GASB) Statement No. 45, *Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (OPEB), during the year ended December 31, 2007. This statement establishes uniform financial reporting standards for other post employment benefits. This standard was implemented prospectively. As a result, there was no effect to the beginning net assets (as of January 1, 2007) in the Water Works' financial statements for the net OPEB obligation.

The City implemented Governmental Accounting Standards Board (GASB) issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, during the year ended December 31, 2007. This statement establishes criteria that governments will use to ascertain whether the proceeds received should be reported as revenue or as a liability. This statement includes a provision that stipulates that governments should not revalue assets that are transferred between financial reporting entity components. This statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions. There was no effect to the Water Works' financial statements as a result of implementing this standard.

In November 2006, the Governmental Accounting Standards Board (GASB) issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The City, including Water Works, will implement GASB Statement No. 49 beginning with the year ending December 31, 2008.

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(2) Deposits and Investments

As of December 31, 2007 and 2006, the Water Works' deposits and investments were as follows:

	<u>2007</u>	<u>2006</u>
Local Government Investment Pool	\$ 6,630,025	5,069,752
Deposits and Cash on Hand	<u>22,552,300</u>	<u>26,739,648</u>
Total	<u>\$ 29,182,325</u>	<u>31,809,400</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 insured limit of \$500,000. As of December 31, 2007 and 2006, 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 with 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.

(d) Concentration of Credit Risk

As of December 31, 2007 and 2006, there are no investments that are considered to be a concentration of credit risk.

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(3) Capital Assets

Capital asset activity for the year ended December 31, 2007 was as follows:

	Balance January 1, 2007	Additions	Deletions	Transfers	Balance December 31, 2007
Capital assets not being depreciated:					
Land and land improvements	\$ 1,280,630	—	—	—	1,280,630
Non utility property, land	287,281	—	—	—	287,281
Construction in progress	9,144,994	28,707,111	(25,603,025)	—	12,249,080
Total capital assets not being depreciated	10,712,905	28,707,111	(25,603,025)	—	13,816,991
Capital assets being depreciated:					
Buildings	20,693,584	620,531	(22,436)	—	21,291,679
Transmission and distribution system	306,507,308	12,371,657	(739,743)	—	318,139,222
Machinery and equipment	201,262,299	3,261,971	(3,341,792)	—	201,182,478
Non utility property	5,316,305	—	—	—	5,316,305
Total capital assets being depreciated	533,779,496	16,254,159	(4,103,971)	—	545,929,684
Less accumulated depreciation:					
Buildings	13,545,352	665,750	(223,198)	—	13,987,904
Transmission and distribution system	73,155,372	3,518,423	(727,056)	—	75,946,739
Machinery and equipment	84,246,196	8,780,549	(3,238,754)	—	89,787,991
Non utility property	2,831,144	95,049	—	—	2,926,193
Total accumulated depreciation	173,778,064	13,059,771	(4,189,008)	—	182,648,827
Total capital assets, being depreciated, net	360,001,432	3,194,388	85,037	—	363,280,857
Total capital assets, net	\$ 370,714,337	31,901,499	(25,517,988)	—	377,097,848

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

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

	<u>Balance January 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Transfers</u>	<u>Balance December 31, 2006</u>
Capital assets not being depreciated:					
Land and land improvements	\$ 1,541,856	—	—	(261,226)	1,280,630
Non utility property, land	26,055	—	—	261,226	287,281
Construction in progress	<u>11,524,958</u>	<u>30,884,881</u>	<u>(33,264,845)</u>	—	<u>9,144,994</u>
Total capital assets not being depreciated	<u>13,092,869</u>	<u>30,884,881</u>	<u>(33,264,845)</u>	—	<u>10,712,905</u>
Capital assets being depreciated:					
Buildings	22,851,934	172,721	(7,390)	(2,323,681)	20,693,584
Transmission and distribution system	295,103,517	12,428,369	(1,024,578)	—	306,507,308
Machinery and equipment	197,870,747	7,538,045	(4,146,493)	—	201,262,299
Non utility property	<u>2,992,624</u>	—	—	<u>2,323,681</u>	<u>5,316,305</u>
Total capital assets being depreciated	<u>518,818,822</u>	<u>20,139,135</u>	<u>(5,178,461)</u>	—	<u>533,779,496</u>
Less accumulated depreciation:					
Buildings	14,198,507	720,922	(38,141)	(1,335,936)	13,545,352
Transmission and distribution system	70,874,026	3,386,578	(1,105,232)	—	73,155,372
Machinery and equipment	79,870,764	8,412,092	(4,036,660)	—	84,246,196
Non utility property	<u>1,446,092</u>	<u>49,116</u>	—	<u>1,335,936</u>	<u>2,831,144</u>
Total accumulated depreciation	<u>166,389,389</u>	<u>12,568,708</u>	<u>(5,180,033)</u>	—	<u>173,778,064</u>
Total capital assets, being depreciated, net	<u>352,429,433</u>	<u>7,570,427</u>	<u>1,572</u>	—	<u>360,001,432</u>
Total capital assets, net	<u>\$ 365,522,302</u>	<u>38,455,308</u>	<u>(33,263,273)</u>	—	<u>370,714,337</u>

CITY OF MILWAUKEE - WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(4) Long -Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations for the year ended December 31, 2007 were as follows:

	<u>Balance January 1, 2007</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance December 31, 2007</u>	<u>Due within one year</u>
General obligation bonds	\$ 23,257,062	—	(3,362,249)	19,894,813	2,845,339
Unamortized premiums	1,139,471	—	(196,426)	943,045	—
Deferred amount on refundings	(694,580)	—	175,925	(518,655)	—
Revenue bonds	<u>12,074,978</u>	<u>—</u>	<u>(868,376)</u>	<u>11,206,602</u>	<u>891,301</u>
Total	<u>\$ 35,776,931</u>	<u>—</u>	<u>(4,251,126)</u>	<u>31,525,805</u>	<u>3,736,640</u>

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

	<u>Balance January 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance December 31, 2006</u>	<u>Due within one year</u>
General obligation bonds	\$ 27,949,288	114,756	(4,806,982)	23,257,062	3,362,249
Unamortized premiums	1,339,343	—	(199,872)	1,139,471	—
Deferred amount on refundings	(890,686)	—	196,106	(694,580)	—
Revenue bonds	<u>12,921,019</u>	<u>—</u>	<u>(846,041)</u>	<u>12,074,978</u>	<u>868,376</u>
Total	<u>\$ 41,318,964</u>	<u>114,756</u>	<u>(5,656,789)</u>	<u>35,776,931</u>	<u>4,230,625</u>

(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. 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 prior years was \$57,019,019. There were no general obligation bonds issued during the year ended December 31, 2007. During the year ended December 31, 2006, general obligation bonds totaling \$114,756 were issued for a current refunding of existing general obligation bonds.

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

General obligation bonds outstanding at December 31, 2007 and 2006 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance December 31, 2007	Balance December 31, 2006
Refunding C&D	2008 to 2015	5.83%	\$ 4,851,248	1,185,168	1,821,629
G	2008 to 2012	4.93	4,212,000	—	280,861
J	2008 to 2012	4.78	8,718,000	—	580,455
K	2008 to 2013	4.64	18,044,000	1,202,340	2,404,680
Refunding E	2008 to 2019	4.49	3,125,658	2,230,640	2,635,229
Refunding C,D,F,G,J, & K	2008 to 2016	5.00 to 5.25	17,953,357	15,161,909	15,419,452
Refunding 2006 N9, Refd C&D	2011 to 2015	4.25 to 5.00	114,756	114,756	114,756
Total			\$ 57,019,019	19,894,813	23,257,062

(c) Revenue Bonds

In December of 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 repay the debt plus interest. Regardless of loan proceeds disbursement, the final maturity of the revenue bonds is May 1, 2018. Revenue bonds outstanding at December 31, 2007 and 2006 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance at December 31, 2007	Balance at December 31, 2006
SDW-1	2008 to 2018	2.64%	\$ 4,873,153	3,110,104	3,351,099
SDW-2	2008 to 2018	2.64	1,618,213	1,032,762	1,112,789
SDW-3	2008 to 2018	2.64	5,001,067	3,191,740	3,439,061
SDW-4	2008 to 2018	2.64	4,148,305	2,647,497	2,852,646
SDW-5	2008 to 2018	2.64	1,918,640	1,224,499	1,319,383
Total			\$ 17,559,378	11,206,602	12,074,978

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(d) Debt Service Requirements

The maturities of the outstanding principal and related interest requirements as of December 31, 2007 are as follows:

	General Obligation Bonds		Revenue Bonds	
	Principal	Interest	Principal	Interest
Year:				
2008	\$ 2,845,339	958,677	891,301	284,089
2009	1,989,325	850,311	914,832	260,248
2010	2,491,847	753,165	938,984	235,778
2011	2,965,418	634,404	963,773	210,661
2012	2,490,532	493,501	989,216	184,882
2013 – 2017	7,066,730	807,833	5,351,875	513,259
2018 – 2022	45,622	2,311	1,156,621	15,267
Totals	\$ 19,894,813	4,500,202	11,206,602	1,704,184

(e) Advance Refundings

In prior years, the Water Works defeased certain general obligation and 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 bonds are not included in the Water Works' financial statements. At December 31, 2007, \$6,011,696 of bonds were considered to be defeased.

(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	
2006	\$ 71,149,697	51,365,317	19,784,380	868,376	307,317	1,175,693	16.83
2007	74,211,042	55,514,453	18,696,589	891,302	284,089	1,175,391	15.91

Gross revenues are defined as total revenues plus interest income. Debt coverage expenses is 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, 2007 and 2006, there were no other debt obligations payable from the revenues of the water system.

CITY OF MILWAUKEE – WATER WORKS

Notes to Financial Statements

December 31, 2007 and 2006

(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 financial 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%, 6%, 7% and 7% 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 8 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, 2007, 2006, and 2005 was \$983,438, \$976,658, and \$1,090,298, 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.

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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 employee’s annual basic salary 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 Waterworks are 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 health care plan are self-insured. For 2007, the Water Works and its plan members receiving benefits paid approximately \$985,000 and \$40,000, 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 thirty years.

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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:

Annual required contribution (ARC)	\$ 1,815,000
Interest on net OPEB obligation	—
Adjustment to ARC	—
Annual OPEB cost	<u>1,815,000</u>
Contributions made	<u>1,025,000</u>
Increase in net OPEB obligation	(790,000)
Net OPEB obligation at January 1, 2007	—
Net OPEB obligation at December 31, 2007	<u>\$ (790,000)</u>

The Water Works annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2007 were as follows:

	<u>Employer contribution</u>		
	<u>Annual OPEB cost</u>	<u>Percentage contributed</u>	<u>Net OPEB obligation</u>
Year ended December 31:			
2007	\$ 1,815,000	56.5%	\$ 790,000

Funded Status and Funding Progress. As of January 1, 2007, the most recent actuarial valuation date, the actuarial accrued liability for benefits related to all City employees was \$806,300,000, and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of \$806,300,000. Of this amount, it was estimated that 3% is attributable to Water Works. The covered payroll (annual payroll of all active City employees covered by the plan) was \$412,700,000 and the ratio of the UAAL to the covered payroll was 195.4%. The covered payroll for Water Works employees was \$17,800,000.

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

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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-terms investment rate of return. The healthcare cost trends rate is 10% initially, and reduced by decrements to the ultimate rate of 4.5% after 10 years.

(7) Related-Party Transactions

A summary of significant revenue and expense transactions between the City and Water Works for 2007 and 2006 is shown below:

	<u>2007</u>	<u>2006</u>
Revenues (receipts from the City) – water consumption	\$ 326,202	339,833
Expenses (payments to the City):		
Payment in lieu of taxes	\$ 7,766,749	7,460,814
Employee fringe benefits	6,797,836	6,458,949
Administrative services	950,003	904,442
Electrical equipment maintenance	373,159	476,929
Motor vehicle usage and maintenance	715,733	745,764
Street repairs	2,361,188	2,257,253
All other services	5,591,816	3,979,690
Total payments to the City	\$ <u>24,556,484</u>	<u>22,283,841</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 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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December 31, 2007 and 2006

The effect of such differences on net income are as follows for the years ended December 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
	<u>(Thousands of dollars)</u>	
Increase in net assets as shown in accompanying financial statements	\$ 6,862	9,019
Amortization of deferred credits resulting from Contributions in Aid of Construction (CIAC) reclassification	811	811
Administrative service charge from another City department, timing difference	258	—
Interest expense timing difference	<u>—</u>	<u>3</u>
Net income as shown on PSC reports	<u>\$ 7,931</u>	<u>9,833</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, 2007 totaled \$5,497,779.

(10) Transfers and Inter-Fund Balances

At December 31, 2007 and 2006, the Water Works has recorded a due from other funds of \$4,702,423 and \$4,920,698, respectively, which in part represents cash held by the general obligation debt fund of the City on behalf of Water Works for the 2008 and 2007 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, 2007 and 2006, the Water Works has recorded a due to the City (General and Sewer Funds) of \$9,790,683 and \$8,021,167, respectively, for sewer maintenance and other municipal fees collected by the Water Works.

The Water Works transfers funds to the City (general fund) for payments in lieu of taxes (PILOT). In 2007 and 2006, the PILOT transfers to the City were \$7,766,749 and \$7,460,814, respectively.