

CITY OF MILWAUKEE – WATER WORKS

Basic Financial Statements

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

CITY OF MILWAUKEE – WATER WORKS

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KPMG LLP
Suite 1500
777 East Wisconsin Avenue
Milwaukee, WI 53202-5337

Independent Auditors' Report

The Honorable Members of the Common Council
City of Milwaukee, Wisconsin:

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, 2010 and 2009, as listed in the table of contents. These basic financial statements are the responsibility of the Water Works' management. Our responsibility is to express an opinion on these basic 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 basic 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 basic 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 basic 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, 2010 and 2009, 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, 2010 and 2009, 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 10 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 29, 2011

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2010 and 2009

(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, 2010 and 2009. 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, 2010

- Total revenues increased by 0.43% in 2010, from \$73.2 million in 2009 to \$73.5 million in 2010.
- Total expenses increased by 0.03% in 2010, from \$67.95 million in 2009 to \$67.97 million in 2010.
- As of December 31, 2010, the Water Works' outstanding debt consisted of \$8.5 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and \$13.7 million in general obligation bonds for a total of \$22.2 million. As of December 31, 2009, total outstanding debt was \$25 million, consisting of \$9.4 million in revenue bonds and \$15.6 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 \$10.1 million in 2010 and \$9.4 million in 2009, and is reported in the accompanying statement of revenues, expenses, and changes in fund net assets as transfers out.

Year ended December 31, 2009

- Total revenues decreased by 1.59% in 2009, from \$74.4 million in 2008 to \$73.2 million in 2009.
- Total expenses increased by 5.24% in 2009, from \$64.6 million in 2008 to \$67.9 million in 2009.
- As of December 31, 2009, the Water Works' outstanding debt consisted of \$9.4 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and \$15.6 million in general obligation bonds for a total of \$25 million. As of December 31, 2008, total outstanding debt was \$27.7 million, consisting of \$10.3 million in revenue bonds and \$17.4 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 PILOT. The PILOT was \$9.4 million in 2009 and \$8.7 million in 2008, and is reported in the accompanying statement of revenues, expenses, and changes in fund net assets as transfers out.

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.

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2010 and 2009

(Unaudited)

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.

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, 2010 and 2009

(Unaudited)

Financial Analysis of the Water Works

Statement of Net Assets

A summary of assets, liabilities, and net assets as of December 31, 2010, 2009, and 2008 is as follows:

TABLE A-1

Condensed Summary of Net Assets

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Assets:			
Current assets	\$ 37,099,120	38,565,544	50,198,462
Net capital assets	402,177,931	393,982,108	383,759,830
Total assets	<u>439,277,051</u>	<u>432,547,652</u>	<u>433,958,292</u>
Liabilities:			
Current liabilities	35,658,450	19,556,085	19,291,030
Noncurrent liabilities	21,296,580	23,992,630	24,855,577
Total liabilities	<u>56,955,030</u>	<u>43,548,715</u>	<u>44,146,607</u>
Net assets:			
Invested in capital assets, net of related debt	379,969,164	368,944,097	356,000,096
Restricted for debt service	679,746	667,351	655,275
Unrestricted net assets	1,673,110	19,387,489	33,156,314
Total net assets	<u>\$ 382,322,020</u>	<u>388,998,937</u>	<u>389,811,685</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 \$382.3 million and \$389.0 million at December 31, 2010 and 2009, respectively.

In Table A-1, it can be seen that the largest portion of the Water Works’ net assets (99.6% and 95.0% as of December 31, 2010 and 2009, 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 59.0% and 58.0% of the capital assets as of December 31, 2010 and 2009, 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 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.

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2010 and 2009

(Unaudited)

The remaining net assets (0.4% and 5.0% as of December 31, 2010 and 2009, 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 \$11.0 million and \$12.9 million during the years ended December 31, 2010 and 2009, respectively. The increases in capital assets net of related debt in both 2010 and 2009 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 \$8.2 million and \$10.2 million for 2010 and 2009, respectively. The amounts of contributed capital were \$0.9 million and \$3.4 million in 2010 and 2009, respectively. The decrease in contributions in 2010 is due to completion of less number of big projects as opposed to 2009, where several major State of Wisconsin DOT, Milwaukee County, Metropolitan Milwaukee Sewerage District projects were completed.

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>2010</u>	<u>2009</u>	<u>2008</u>
Operating revenue	\$ 73,473,353	73,069,176	73,537,077
Nonoperating revenue	59,833	151,417	863,898
Total revenues	<u>73,533,186</u>	<u>73,220,593</u>	<u>74,400,975</u>
Depreciation expense	13,433,958	13,327,877	13,117,101
Other operating expenses	53,611,194	53,579,608	50,263,851
Nonoperating expenses	921,318	1,039,361	1,181,231
Total expenses	<u>67,966,470</u>	<u>67,946,846</u>	<u>64,562,183</u>
Income before capital contributions and transfers	5,566,716	5,273,747	9,838,792
Capital contributions	910,324	3,353,404	899,576
Transfers out	(13,153,957)	(9,439,899)	(8,696,137)
Changes in net assets	<u>(6,676,917)</u>	<u>(812,748)</u>	<u>2,042,231</u>
Net assets – beginning of year	<u>388,998,937</u>	<u>389,811,685</u>	<u>387,769,454</u>
Net assets – end of year	<u>\$ 382,322,020</u>	<u>388,998,937</u>	<u>389,811,685</u>

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2010 and 2009

(Unaudited)

Year ended December 31, 2010

A review of Table A-2 shows that operating revenues increased by \$0.4 million, or 0.55% in 2010 and total expenses in 2010 remained almost the same as 2009, at \$67.9 million. These results may be explained as follows:

Revenues

- Operating revenues increased by \$0.4 million in 2010. This slight increase in revenue, despite consistent decrease in water consumption, is due to a full year impact of a cost of living rate increase that was implemented late in 2009. However, as of December 31, 2010, the Public Service Commission had not yet ruled on the full rate increase requested in September 2009. 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 all customer class, except industrial, which stayed about the same from 2009 to 2010, has consistently dropped from year to year since 2006.
- Nonoperating revenues, which mainly consist of interest income, also include miscellaneous fees for service and branch tapping and rental income from antenna contracts. Nonoperating revenues for 2010 decreased by \$0.9 thousand, or 60.48%, from 2009. This decrease is explained by the continued decline in interest income in 2010. 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 only 0.20% and 0.48% for 2010 and 2009, respectively, resulting in a significant decrease in interest income in 2010. In addition to the falling interest rates, there has been a decreasing trend in cash and cash equivalents. At the end of 2010, cash and cash equivalents decreased by \$3.0 million, from \$7.2 million at the end of 2009 to \$4.2 million at the end of 2010, which indicates that much less funds were available for investment in the LGIP in 2010.

Expenses

- Operating expenses, excluding depreciation, stayed almost the same as 2009 at \$53.6 million, or a mere 0.06% increase in 2010. This is a combination of different categories of expenses. While most expense categories decreased or stayed about the same as 2009, there was a major increase in administrative and general expenses and a decrease in transmission and distribution expenses in 2010. Administrative and general expenses increased by \$1.9 million and transmission and distribution expenses decreased by \$2.1 million. The main causes of increase in administrative and general expenses is rising cost of healthcare and other fringe benefits such as additional actuarial contributions for pension costs. Transmission and distribution expenses decreased by \$2.1 million in 2010 due to consolidation of services and other efficiency improvement measures taken. Treatment expenses increased by \$0.5 million mainly due to rising cost of chemicals.
- Nonoperating expenses, which consist mainly of interest expense, decreased by \$0.1 million both in 2010 and 2009. These decreases were due to declining principal balances of outstanding debt.

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2010 and 2009

(Unaudited)

Year ended December 31, 2009

A review of Table A-2 shows that operating revenues decreased by \$0.5 million, or 0.64%, and total expenses increased by \$3.4 million, or 5.24%. These results may be explained as follows:

Revenues

- Operating revenues decreased by \$0.5 million in 2009 primarily due to a large decrease in water consumption (sale) by 754 million gallons. This decrease in consumption is partly explained by the cool summer in Milwaukee in 2009. 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 all customer class has consistently dropped from year to year since 2005.
- Nonoperating revenues, which mainly consist of interest income, also include miscellaneous fees for service and branch tapping and rental income from antenna contracts. Nonoperating revenues for 2009 decreased by \$0.7 million, or 82.47%, from 2008. A big part of this decrease is explained by the continued decline in interest income in 2009. The average interest rates on investments in the LGIP with the State of Wisconsin, where most of the Water Works' funds are invested, were only 0.48% and 2.46% for 2009 and 2008, respectively, resulting in a significant decrease in interest income in 2009. In addition to the falling interest rates, cash and cash equivalents at the end of 2009 decreased by \$12.4 million, from \$19.6 million at the end of 2008 to \$7.2 at the end of 2009, which indicates that much less funds were available for investment in the LGIP in 2009.

Expenses

- Operating expenses, excluding depreciation, increased by \$3.3 million, or 6.6%, in 2009. This is a combination of different categories of expenses. Treatment and transmission and distribution expenses increased by \$0.6 million and \$2.6 million, respectively. Rising cost of chemicals was the main cause of the increase in treatment expenses, whereas increased service repairs and cross-connection inspections attributed to the increase in transmission and distribution cost. Increase in cost of energy also resulted in a \$0.6 million increase in pumping expenses for 2009.
- Nonoperating expenses, which consist mainly of interest expense, decreased by \$0.1 million and \$0.2 million in 2009 and 2008, respectively. These decreases were 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, 2010, the Water Works investment in capital assets, net of accumulated depreciation, amounted to \$402.2 million. This represents an increase of \$8.2 million from December 31, 2009. Transmission and distribution system assets increased by \$17.4 million and construction in progress decreased by \$2.9 million.

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2010 and 2009

(Unaudited)

The decrease in construction in progress is due to capitalization of capital projects that were completed as of December 31, 2010. The combination of these two items, offset by an increase in accumulated depreciation of \$11.2 million, primarily resulted in the \$8.2 million increase.

As of December 31, 2009, the Water Works’ investment in capital assets, net of accumulated depreciation, amounted to \$394.0 million. This represents an increase of \$10.2 million from December 31, 2008. Transmission and distribution system assets increased by \$7.4 million and construction in progress increased by \$4.7 million. The increase in construction in progress is mainly driven by an increase in the number of large projects undertaken in 2009, such as the Backup Power and Howard Clearwell projects.

**Table A-3
Capital Assets**

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Capital assets:			
Land	\$ 1,367,127	1,280,630	1,280,630
Buildings	25,406,006	24,135,468	21,291,679
Transmission and distribution system	355,873,188	338,510,006	331,142,631
Machinery and equipment	206,449,773	202,027,194	201,582,454
Construction in progress	12,716,715	15,635,072	10,974,570
Nonutility property	5,346,893	6,164,236	6,164,236
Total capital assets	<u>607,159,702</u>	<u>587,752,606</u>	<u>572,436,200</u>
Less accumulated depreciation	<u>(204,981,771)</u>	<u>(193,770,498)</u>	<u>(188,676,370)</u>
Net capital assets	<u>\$ 402,177,931</u>	<u>393,982,108</u>	<u>383,759,830</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, 2010 and 2009, the City Treasurer held cash and cash equivalents of \$4.2 million and \$7.2 million, respectively, on behalf of the Water Works that consisted of certificates of deposit, LGIP investments, and cash accounts. The decrease in cash and cash equivalents in 2010 is primarily due to the use of cash to fund capital projects.

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).

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2010 and 2009

(Unaudited)

The Water Works continues to make its regularly scheduled payments on its bonds. All bond debt covenants have been met.

As of December 31, 2010 and 2009, the Water Works debt consisted of \$8.5 million and \$9.4 million, respectively, in revenue bonds through the State of Wisconsin Safe Drinking Water Loan program and \$13.7 million and \$15.6 million, respectively, in general obligation bonds for a total indebtedness of \$22.2 million and \$25.0 million, respectively.

Economic Factors

Volume of water sold dropped by 903 million and 754 million gallons in 2010 and 2009, respectively, from the previous year. As shown in Table A-4, there has been a steady decline in water volume sold. Over the last five years, the volume of water sold to industrial customers has dropped by 36.40%, even though there was slight increase of 1.24% in 2010. Volume of water sold to all customers dropped by 15.60% 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 significant decline in the sale of water to both residential and industrial customer categories.

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

Table A-4
Sale of Water

(In billion of gallons)

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Customer class:					
Residential	10.8	11.4	11.5	12.1	12.2
Commercial	7.7	7.8	8.0	8.2	8.3
Industrial	4.0	3.9	4.2	4.4	4.6
Public authority	2.2	2.6	2.7	2.5	2.4
Subtotal	24.7	25.7	26.4	27.2	27.5
Wholesale	7.7	7.6	7.7	7.9	7.9
Total	<u>32.4</u>	<u>33.3</u>	<u>34.1</u>	<u>35.1</u>	<u>35.4</u>

CITY OF MILWAUKEE – WATER WORKS

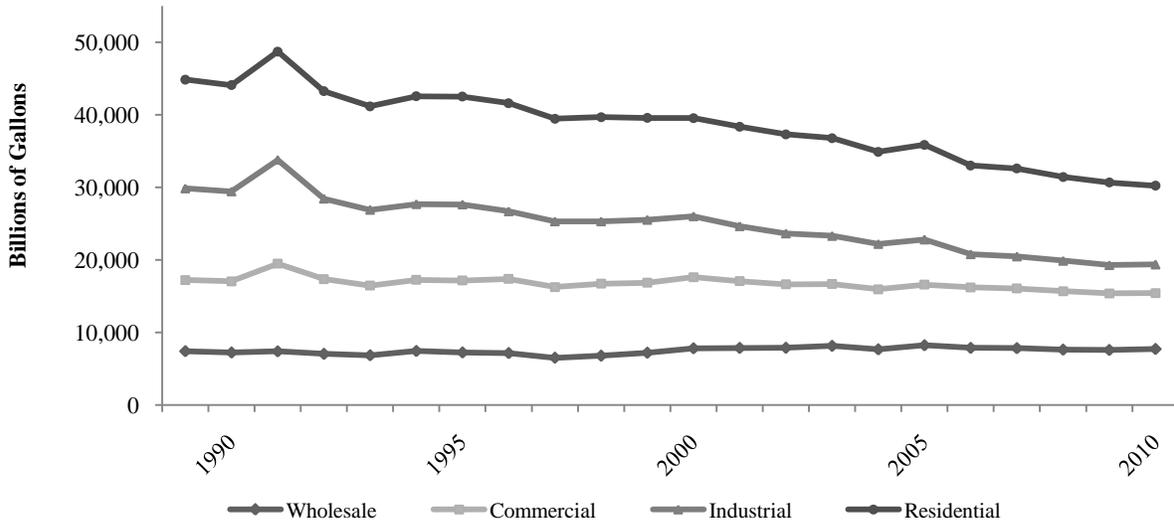
Management’s Discussion and Analysis

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(Unaudited)

Table A-5

Volume of Water Sold by Customer Type



Subsequent Events

On February 8, 2011, the Milwaukee Water Works implemented new rates and rules authorized by the Public Service Commission. The overall effect of this change is to increase water rates by 20.8%.

The City issued two new debt series [N3 and B4] on June 9, 2011 on behalf of the Water Works. The Water Works’ received \$7,750,000 from 2011 Series N3 and \$3,875,000 from 2011 Series B4, for a total new debt of \$11,625,000.

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 401, Milwaukee, Wisconsin 53202.

CITY OF MILWAUKEE – WATER WORKS

Statements of Net Assets

December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 3,494,416	6,564,562
Restricted cash and cash equivalents	679,746	667,351
Accounts receivable, net	14,527,719	14,092,150
Unbilled accounts receivable	9,771,194	9,882,143
Accrued interest	1,714	3,686
Due from other funds	5,143,297	4,446,286
Inventory of materials and supplies	2,632,666	2,615,443
Prepaid items	590,003	39,701
Other assets	258,365	254,222
Total current assets	<u>37,099,120</u>	<u>38,565,544</u>
Noncurrent assets:		
Water plant in service, net	384,690,328	373,171,634
Construction work in process	12,716,715	15,635,072
Other property, net	4,770,888	5,175,402
Total noncurrent assets	<u>402,177,931</u>	<u>393,982,108</u>
Total assets	<u>439,277,051</u>	<u>432,547,652</u>
Liabilities:		
Current liabilities:		
Accounts payable	5,093,009	3,848,700
Interest payable	246,531	280,118
Accrued wages	1,113,416	1,241,606
Compensated absences	1,328,771	1,247,921
Due to other funds	23,887,534	9,491,910
Long-term debt due within one year	3,989,190	3,445,830
Total current liabilities	<u>35,658,451</u>	<u>19,556,085</u>
Noncurrent liabilities:		
General obligation bonds payable	10,721,863	13,130,695
Revenue bonds payable	7,497,713	8,461,486
Net other postemployment benefits obligation	3,077,004	2,400,449
Total noncurrent liabilities	<u>21,296,580</u>	<u>23,992,630</u>
Total liabilities	<u>56,955,031</u>	<u>43,548,715</u>
Net assets:		
Invested in capital assets, net of related debt	379,969,164	368,944,097
Restricted for debt service	679,746	667,351
Unrestricted	1,673,110	19,387,489
Total net assets	<u>\$ 382,322,020</u>	<u>388,998,937</u>

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Revenues, Expenses, and Changes in Fund Net Assets
Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Operating revenues:		
Water sales	\$ 59,370,884	59,050,827
Fire protection service	6,606,852	6,421,357
Charges for shared services	5,254,303	5,408,308
Other	2,241,314	2,188,684
	<u>73,473,353</u>	<u>73,069,176</u>
Operating expenses:		
Administrative and general	7,947,534	6,053,923
Billing and collection	2,823,674	2,819,299
Transmission and distribution	20,380,620	22,482,821
Water pumping	7,607,561	7,883,807
Water treatment	14,851,805	14,339,758
Depreciation	13,433,958	13,327,877
	<u>67,045,152</u>	<u>66,907,485</u>
Operating income	<u>6,428,201</u>	<u>6,161,691</u>
Nonoperating revenues (expenses):		
Interest income	15,343	88,291
Interest expense	(921,318)	(1,039,361)
Miscellaneous	44,490	63,126
	<u>(861,485)</u>	<u>(887,944)</u>
Income before capital contributions and transfers	5,566,716	5,273,747
Capital contributions	910,324	3,353,404
Transfers out	<u>(13,153,957)</u>	<u>(9,439,899)</u>
Decrease in net assets	<u>(6,676,917)</u>	<u>(812,748)</u>
Net assets – beginning of year	<u>388,998,937</u>	<u>389,811,685</u>
Net assets – end of year	<u>\$ 382,322,020</u>	<u>388,998,937</u>

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Receipts from customers and users	\$ 68,385,219	67,380,760
Receipts from interfund services provided	5,254,303	5,408,308
Payments to suppliers	(7,533,528)	(22,063,500)
Payments to employees	(25,470,536)	(24,860,144)
Payments to other funds	<u>(5,941,830)</u>	<u>(4,603,633)</u>
Net cash provided by operating activities	<u>34,693,628</u>	<u>21,261,791</u>
Cash flows from noncapital financing activities:		
Miscellaneous nonoperating revenue	44,490	63,126
Transfer to other funds	<u>(13,153,957)</u>	<u>(9,439,899)</u>
Net cash used in noncapital financing activities	<u>(13,109,467)</u>	<u>(9,376,773)</u>
Cash flows from capital and related financing activities:		
Acquisition of property, plant, and equipment	(20,875,079)	(20,529,949)
Proceeds from bonds, notes, and revenue bonds	675,000	225,000
Retirement of bonds, notes, and revenue bonds	(3,445,830)	(2,904,157)
Interest paid	<u>(1,013,319)</u>	<u>(1,115,043)</u>
Net cash used in capital and related financing activities	<u>(24,659,228)</u>	<u>(24,324,149)</u>
Cash flows from investing activities:		
Interest income	<u>17,316</u>	<u>118,937</u>
Net cash provided by investing activities	<u>17,316</u>	<u>118,937</u>
Net decrease in cash and cash equivalents	(3,057,751)	(12,320,194)
Cash and cash equivalents – beginning of year	<u>7,231,913</u>	<u>19,552,107</u>
Cash and cash equivalents – end of year	<u>\$ 4,174,162</u>	<u>7,231,913</u>
Cash and cash equivalents at year end consist of:		
Unrestricted cash and cash equivalents	\$ 3,494,416	6,564,562
Restricted cash and cash equivalents	<u>679,746</u>	<u>667,351</u>
Total cash and cash equivalents	<u>\$ 4,174,162</u>	<u>7,231,913</u>

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 6,428,201	6,161,691
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	13,433,958	13,327,877
Changes in assets and liabilities:		
Receivables	(324,620)	(703,370)
Due from/to other funds	13,698,613	1,369,595
Inventory of materials and supplies	(17,223)	(284,448)
Prepaid items	(550,302)	407,600
Other assets	(4,143)	31,409
Accounts payable	1,399,931	518,822
Accrued wages and compensated absences	(47,342)	(386,575)
Net other postemployment benefits obligation	676,555	819,190
Net cash provided by operating activities	<u>\$ 34,693,628</u>	<u>21,261,791</u>
Noncash activities:		
During the year, water mains and related property installed by others were deeded to the Water Works in the amount of	\$ 910,324	3,353,404

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

(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. 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, 2010 and 2009

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 \$23,797 and \$25,482 as of December 31, 2010 and 2009, respectively. The accounts receivable year-end balance includes actual unpaid charges. The unbilled accounts receivable balance consists of an estimate of the 2009 receivables that will be billed in the first quarter of 2010.

(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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

- 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 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. 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 Refunding

Bond premiums, issuance costs, 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 deferred charges (other assets).

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

(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, 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 \$679,746 and \$667,351 at December 31, 2010 and 2009, 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, 2010 and 2009, accumulated sick leave earned but not taken was approximately \$4,691,521 and \$4,830,462, 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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

(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 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. An estimate included herein is the allowance for doubtful accounts receivable. Actual results could differ from this estimate.

(o) New Accounting Pronouncements

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. The City, including Water Works, implemented this Statement beginning with the year ended December 31, 2010, and the implementation of the Statement did not have a significant impact on its basic financial statements.

In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. The City, including Water Works, implemented this Statement beginning with the year ended December 31, 2010, and the implementation of the Statement did not have a significant impact on its basic financial statements.

In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. This Statement addresses service concession arrangements, which are a type of public-private partnership. The Water Works will implement this Statement beginning with the year ending December 31, 2012. The Water Works does not expect the implementation of the Statement to have a significant impact on its basic financial statements.

(2) Deposits and Investments

As of December 31, 2010 and 2009, the Water Works' deposits and investments were as follows:

	<u>2010</u>	<u>2009</u>
Local Government Investment Pool	\$ 701,547	4,624,766
Deposits and cash on hand	<u>3,472,615</u>	<u>2,607,147</u>
Total	<u>\$ 4,174,162</u>	<u>7,231,913</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

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

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 \$650,000. As of December 31, 2010 and 2009, 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, 2010 and 2009, there are no investments that are considered to be a concentration of credit risk.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

(3) Capital Assets

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

	Balance January 1, 2010	Additions	Deletions	Transfers	Balance December 31, 2010
Capital assets not being depreciated:					
Land and land improvements	\$ 1,280,630	—	—	86,497	1,367,127
Nonutility property, land	654,868	—	—	—	654,868
Construction in progress	15,635,072	21,916,276	(24,834,633)	—	12,716,715
Total capital assets not being depreciated	<u>17,570,570</u>	<u>21,916,276</u>	<u>(24,834,633)</u>	<u>86,497</u>	<u>14,738,710</u>
Capital assets being depreciated:					
Buildings	24,135,468	539,692	—	730,846	25,406,006
Transmission and distribution system	338,510,006	18,162,332	(799,150)	—	355,873,188
Machinery and equipment	202,027,194	6,132,609	(1,710,030)	—	206,449,773
Nonutility property	5,509,368	—	—	(817,343)	4,692,025
Total capital assets being depreciated	<u>570,182,036</u>	<u>24,834,633</u>	<u>(2,509,180)</u>	<u>(86,497)</u>	<u>592,420,992</u>
Less accumulated depreciation:					
Buildings	14,580,948	774,956	—	618,259	15,974,163
Transmission and distribution system	80,928,392	3,851,239	(801,849)	—	83,977,782

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

	Balance January 1, 2010	Additions	Deletions	Transfers	Balance December 31, 2010
Machinery and equipment	\$ 97,272,324	8,981,320	(1,626,267)	(173,557)	104,453,820
Nonutility property	988,834	205,431	—	(618,259)	576,006
Total accumulated depreciation	193,770,498	13,812,946	(2,428,116)	(173,557)	204,981,771
Total capital assets being depreciated, net	376,411,538	11,021,687	(81,064)	87,060	387,439,221
Total capital assets, net	\$ 393,982,108	32,937,963	(24,915,697)	173,557	402,177,931

Capital asset activity for the year ended December 31, 2009 was as follows:

	Balance January 1, 2009	Additions	Deletions	Transfers	Balance December 31, 2009
Capital assets not being depreciated:					
Land and land improvements	\$ 1,280,630	—	—	—	1,280,630
Nonutility property, land	654,868	—	—	—	654,868
Construction in progress	10,974,570	22,967,296	(18,306,794)	—	15,635,072
Total capital assets not being depreciated	12,910,068	22,967,296	(18,306,794)	—	17,570,570

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

	Balance January 1, 2009	Additions	Deletions	Transfers	Balance December 31, 2009
Capital assets being depreciated:					
Buildings	\$ 21,291,679	2,994,385	(150,596)	—	24,135,468
Transmission and distribution system	331,142,631	8,527,695	(1,160,320)	—	338,510,006
Machinery and equipment	201,582,454	6,784,714	(6,339,974)	—	202,027,194
Nonutility property	<u>5,509,368</u>	—	—	—	<u>5,509,368</u>
Total capital assets being depreciated	<u>559,526,132</u>	<u>18,306,794</u>	<u>(7,650,890)</u>	—	<u>570,182,036</u>
Less accumulated depreciation:					
Buildings	14,663,223	720,820	(803,095)	—	14,580,948
Transmission and distribution system	78,323,384	3,770,086	(1,165,078)	—	80,928,392
Machinery and equipment	94,906,358	8,836,971	(6,471,005)	—	97,272,324
Nonutility property	<u>783,405</u>	<u>205,429</u>	—	—	<u>988,834</u>
Total accumulated depreciation	<u>188,676,370</u>	<u>13,533,306</u>	<u>(8,439,178)</u>	—	<u>193,770,498</u>
Total capital assets being depreciated, net	<u>370,849,762</u>	<u>4,773,488</u>	<u>788,288</u>	—	<u>376,411,538</u>
Total capital assets, net	\$ <u><u>383,759,830</u></u>	<u><u>27,740,784</u></u>	<u><u>(17,518,506)</u></u>	—	<u><u>393,982,108</u></u>

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

(4) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations for the year ended December 31, 2010 were as follows:

	Balance January 1, 2010	Additions	Deletions	Balance December 31, 2010	Due within one year
General obligation bonds	\$ 15,285,149	675,000	(2,506,847)	13,453,302	3,025,417
Unamortized premiums	569,267	—	(163,520)	405,747	—
Deferred amount on refundings	(216,874)	—	105,106	(111,768)	—
Revenue bonds	9,400,469	—	(938,984)	8,461,485	963,773
Other postemployment benefits	2,400,449	676,555	—	3,077,004	—
Total	\$ <u>27,438,460</u>	<u>1,351,555</u>	<u>(3,504,245)</u>	<u>25,285,770</u>	<u>3,989,190</u>

Changes in long-term obligations for the year ended December 31, 2009 were as follows:

	Balance January 1, 2009	Additions	Deletions	Balance December 31, 2009	Due within one year
General obligation bonds	\$ 17,049,474	225,000	(1,989,325)	15,285,149	2,506,847
Unamortized premiums	750,904	—	(181,637)	569,267	—
Deferred amount on refundings	(355,945)	—	139,071	(216,874)	—
Revenue bonds	10,315,301	—	(914,832)	9,400,469	938,983
Other postemployment benefits	1,581,259	819,190	—	2,400,449	—
Total	\$ <u>29,340,993</u>	<u>1,044,190</u>	<u>(2,946,723)</u>	<u>27,438,460</u>	<u>3,445,830</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 (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 2009 was \$26,045,019. During the years ended December 31, 2010 and 2009, the City issued \$675,000 and \$225,000, respectively, of general obligation bonds, which were used for capital improvement of the water system.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

General obligation bonds outstanding at December 31, 2010 and 2009 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance December 31 2010	2009
Refunding C&D	2010	6.00%	\$ 4,851,248	—	259,728
Refunding E	2011 to 2019	4.50% to 5.00%	3,125,658	1,290,001	1,557,726
Refunding C, D, F, G, J, & K	2011 to 2016	5.00% to 5.25%	17,953,357	11,163,545	13,127,939
Refunding 2006 N9, Refd C&D	2011 to 2015	4.25% to 5.00%	114,756	114,756	114,756
2009 N1	2011 to 2019	3.00% to 5.00%	150,000	135,000	150,000
2009 B2	2020 to 2024	4.00% to 5.00%	75,000	75,000	75,000
2010-N1	2011 to 2020	2.50% to 5.00%	450,000	450,000	—
2010-B5	2021 to 2027	1.50% to 5.00%	225,000	225,000	—
Total			\$ 26,945,019	13,453,302	15,285,149

(c) **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 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, 2010 and 2009 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance at December 31 2010	2009
SDW-1	2011 to 2018	2.64%	\$ 4,873,153	2,348,267	2,608,859
SDW-2	2011 to 2018	2.64	1,618,213	779,782	866,315
SDW-3	2011 to 2018	2.64	5,001,067	2,409,906	2,677,337
SDW-4	2011 to 2018	2.64	4,148,305	1,998,979	2,220,808
SDW-5	2011 to 2018	2.64	1,918,640	924,551	1,027,150
Total			\$ 17,559,378	8,461,485	9,400,469

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

(d) Debt Service Requirements

The maturities of the outstanding principal and related interest requirements as of December 31, 2010 are as follows:

Year:	General obligation bonds		Revenue bonds	
	Principal	Interest	Principal	Interest
2011	\$ 3,025,418	674,192	963,773	210,662
2012	2,550,532	531,376	989,216	184,882
2013	2,161,350	394,941	1,015,331	158,422
2014	2,346,153	284,277	1,042,136	131,263
2015	1,736,389	171,322	1,069,649	103,388
2016 – 2020	1,348,460	165,779	3,381,380	135,453
2021 – 2025	285,000	33,900	—	—
Total	\$ 13,453,302	2,255,787	8,461,485	924,070

(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	
2009	73,157,467	63,019,507	10,137,960	938,983	235,778	1,174,761	8.63
2010	73,488,697	66,765,151	6,723,546	963,773	210,661	1,174,434	5.73

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, 2010 and 2009, 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 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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2010 and 2009

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%, 6.0%, 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, 2010, 2009, and 2008 was \$1,049,289, \$1,057,472, and \$981,372, 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 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.

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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 2010, the Water Works paid approximately \$1,383,000 and \$13,000, respectively, toward medical and life insurance for retirees. For 2009, the Water Works paid approximately \$1,100,000 and \$13,000, 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, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
Annual required contribution (ARC)	\$ 2,057,785	1,920,918
Interest on net OPEB obligation	95,123	71,821
Adjustment to ARC	<u>(80,723)</u>	<u>(60,944)</u>
Annual OPEB cost	2,072,185	1,931,795
Contributions made	<u>1,395,630</u>	<u>1,112,605</u>
Increase in net OPEB obligation	(676,555)	(819,190)
Net OPEB obligation at beginning of year	<u>(2,400,449)</u>	<u>(1,581,259)</u>
Net OPEB obligation at end of year	\$ <u><u>(3,077,004)</u></u>	\$ <u><u>(2,400,449)</u></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 2010, 2009 and 2008 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:				
2010	\$ 2,072,185	67.4%	\$	3,077,004
2009	1,931,795	57.6		2,400,449
2008	1,902,839	58.4		1,581,259

Funded Status and Funding Progress – As of January 1, 2009, the most recent actuarial valuation date, the actuarial accrued liability for benefits related to all City employees was \$959,600,000, and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of \$959,600,000. 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 \$419,800,000, and the ratio of the UAAL to the covered payroll was 229%. The covered payroll for Water Works employees was \$17,500,000.

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 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 9.0% initially, and reduced by decrements to the ultimate rate of 4.5% after 10 years. The actuarial assumption for wage inflation is 3.5%. 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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Notes to Basic Financial Statements

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(7) Related-Party Transactions

A summary of significant revenue and expense transactions between the City and Water Works for 2010 and 2009 is shown below:

	<u>2010</u>	<u>2009</u>
Revenues (receipts from the City) – water consumption	\$ 399,351	345,756
Expenses (payments to the City):		
Payment in lieu of taxes and other transfers	13,153,957	9,439,899
Employee fringe benefits	9,255,757	7,046,724
Administrative services	908,473	1,046,607
Electrical equipment maintenance	1,100,400	616,599
Motor vehicle usage and maintenance	849,167	863,132
Street repairs	2,659,236	3,499,055
All other services	6,212,300	6,424,914
Total payments to the City	<u>\$ 34,139,290</u>	<u>28,936,930</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, 2010 and 2009:

	<u>2010</u>	<u>2009</u>
	(In thousands)	
Increase in net assets as shown in accompanying financial statements	\$ (6,677)	(812)
Amortization of deferred credits resulting from Contributions in Aid of Construction (CIAC) reclassification	811	811
Nonexchange transfer	3,000	—
Special assessment receipt, timing difference	<u>—</u>	<u>(58)</u>
Net income as shown on PSC reports	<u>\$ (2,866)</u>	<u>(59)</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, 2010 totaled \$8,088,182.

(10) Transfers and Interfund Balances

At December 31, 2010 and 2009, the Water Works has recorded a due from other funds of \$5,143,297 and \$4,446,286, respectively, which in part represents cash held by the general obligation debt fund of the City on behalf of Water Works for the 2010 and 2009 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, 2010 and 2009, the Water Works has recorded a due to the City (General and Sewer Funds) of \$23,887,534 and \$9,491,910, 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 2010 and 2009, the PILOT transfers to the City were \$10,153,957 and \$9,439,899, respectively. In addition, in 2010, the Water Works transferred \$3,000,000 to the City's general fund as a nonexchange transaction. No such payment was made in 2009.

(11) Subsequent Events

On February 8, 2011, the Milwaukee Water Works implemented new rates and rules authorized by the Public Service Commission. The overall effect of this change is to increase water rates by 20.8%.

On June 9, 2011, the City issued \$93,625,000 of general obligation promissory notes, series 2011 N3, for the purpose of financing various public improvements and fiscal requirements of the City, and for the purpose of current refunding of certain outstanding obligations of the City. The bonds mature on May 15 of each year beginning 2012 until 2021. Interest is payable on May 15 and November 15 commencing November 15, 2011. Water Works received \$7,750,000 from this issuance.

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On June 9, 2011, the City issued \$28,890,000 of general obligation corporate purpose bonds, series 2011 B4, for the purpose of financing various public improvements and fiscal requirements of the City, and for the purpose of current refunding of certain outstanding obligations of the City. The bonds mature on May 15 of each year beginning 2022 until 2028. Interest is payable on May 15 and November 15 commencing November 15, 2011. Water Works received \$3,875,000 from this issuance.