



CITY OF MILWAUKEE – WATER WORKS

Basic Financial Statements

December 31, 2011 and 2010

(With Independent Auditors' Report Thereon)

CITY OF MILWAUKEE – WATER WORKS

Table of Contents

	Page
Independent Auditors' Report	1
Management's Discussion and Analysis	3
Basic Financial Statements:	
Statements of Net Assets	12
Statements of Revenues, Expenses, and Changes in Fund Net Assets	13
Statements of Cash Flows	14
Notes to Basic Financial Statements	16



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 (the City), as of and for the years ended December 31, 2011 and 2010, 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, 2011 and 2010, 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, 2011 and 2010, 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.



U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Milwaukee, Wisconsin
July 30, 2012

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2011 and 2010

(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, 2011 and 2010. 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, 2011

- Total revenues increased by 15.38% in 2011, from \$73.5 million in 2010 to \$84.8 million in 2011.
- Total expenses increased by 1.76% in 2011, from \$68.0 million in 2010 to \$69.2 million in 2011.
- As of December 31, 2011, the Water Works’ outstanding debt consisted of \$7.5 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and \$22.3 million in general obligation bonds for a total of \$29.8 million. As of December 31, 2010, total outstanding debt was \$22.2 million, consisting of \$8.5 million in revenue bonds and \$13.7 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 \$11.2 million in 2011 and \$10.1 million in 2010, and is reported in the accompanying statement of revenues, expenses, and changes in fund net assets as transfers out.

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 PILOT amounted to \$10.1 million in 2010 and \$9.4 million in 2009.

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, 2011 and 2010

(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, 2011 and 2010

(Unaudited)

Financial Analysis of the Water Works

Statement of Net Assets

A summary of assets, liabilities, and net assets as of December 31, 2011, 2010, and 2009 is as follows:

Table A-1

Condensed Summary of Net Assets

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assets:			
Current assets	\$ 42,489,598	37,099,120	38,565,544
Net capital assets	<u>402,123,710</u>	<u>402,177,931</u>	<u>393,982,108</u>
Total assets	<u>444,613,308</u>	<u>439,277,051</u>	<u>432,547,652</u>
Liabilities:			
Current liabilities	27,831,747	35,658,451	19,556,085
Noncurrent liabilities	<u>29,217,425</u>	<u>21,296,580</u>	<u>23,992,630</u>
Total liabilities	<u>57,049,172</u>	<u>56,955,031</u>	<u>43,548,715</u>
Net assets:			
Invested in capital assets, net of related debt	372,346,156	379,969,164	368,944,097
Restricted for debt service	692,467	679,746	667,351
Unrestricted net assets	<u>14,525,513</u>	<u>1,673,110</u>	<u>19,387,489</u>
Total net assets	<u>\$ 387,564,136</u>	<u>382,322,020</u>	<u>388,998,937</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 \$387.6 million and \$382.3 million at December 31, 2011 and 2010, respectively.

In Table A-1, it can be seen that the largest portion of the Water Works’ net assets (96.1% and 99.4% as of December 31, 2011 and 2010, 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% of the capital assets as of December 31, 2011 and 2010. 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, 2011 and 2010

(Unaudited)

Most of the remaining net assets (3.9% and 0.6% as of December 31, 2011 and 2010, 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 decreased by \$7.6 million and increased by \$11.0 million during the years ended December 31, 2011 and 2010, respectively. The decrease in capital assets net of related debt in 2011 is mainly due to a new debt of \$11.6 million issued in 2011 for various capital improvements. The increase in 2010 was due to a combination of the reduction in related debt, the completion and capitalization of capital projects, and the receipt of contributed capital. There was no significant change in net capital assets in 2011 whereas net capital assets increased by \$8.2 million in 2010. The amounts of contributed capital were \$0.7 million and \$0.9 million in 2011 and 2010, respectively. The continued decrease in contributions both in 2011 and 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) exhibits the nature and source of the changes.

Table A-2

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenue	\$ 84,393,483	73,473,353	73,069,176
Nonoperating revenue	448,060	59,833	151,417
Total revenues	<u>84,841,543</u>	<u>73,533,186</u>	<u>73,220,593</u>
Depreciation expense	14,066,822	13,433,958	13,327,877
Other operating expenses	54,062,167	53,611,194	53,579,608
Nonoperating expenses	1,066,588	921,318	1,039,361
Total expenses	<u>69,195,577</u>	<u>67,966,470</u>	<u>67,946,846</u>
Income before capital contributions and transfers	15,645,966	5,566,716	5,273,747
Capital contributions	747,013	910,324	3,353,404
Transfers out	(11,150,863)	(13,153,957)	(9,439,899)
Changes in net assets	5,242,116	(6,676,917)	(812,748)
Net assets – beginning of year	<u>382,322,020</u>	<u>388,998,937</u>	<u>389,811,685</u>
Net assets – end of year	<u>\$ 387,564,136</u>	<u>382,322,020</u>	<u>388,998,937</u>

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

Year ended December 31, 2011

A review of Table A-2 shows that operating revenues increased by \$10.9 million, or 14.86% in 2011 and total expenses in 2011 increased by \$1.2 million, or 1.81%. These results may be explained as follows:

Revenues

- Operating revenues increased by \$10.9 million in 2011. This increase in revenue, despite consistent decrease in water consumption, is due to a 20.8% conventional rate increase implemented in February of 2011. Table A-4 shows the sale of water (in billion gallons) for the last five years. According to this table, the sale of water for most customer classes has consistently dropped from year to year since 2007.
- Nonoperating revenues mainly consist of interest income, and also include miscellaneous fees for service and branch tapping, rental income from antenna contracts and other revenues such as from sale of nonutility properties. Nonoperating revenues for 2011 increased by \$388 thousand, or 649%, from 2010. This increase is mainly a result of a rare sale of a nonutility property. In 2011, the Water Works sold the decommissioned Menomonee Valley Pumping Station to the State of Wisconsin. A continued decline in interest income was experienced in both 2011 and 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 0.14% and 0.20% for 2011 and 2010, respectively, resulting in a further decrease in interest income in 2011. In addition to the falling interest rates, there has been a decreasing trend in cash and cash equivalents. Cash and cash equivalents decreased slightly, from \$4.2 million at the end of 2010 to \$4.0 million at the end of 2011.

Expenses

- Operating expenses, excluding depreciation, increased by 0.84% to \$54.1 million in 2011 from \$53.6 million in 2010. This is a combination of increases and decreases in different categories of expenses. Most expense categories decreased or stayed about the same as 2010. Administrative and general expenses decreased by \$1.5 million or 19% in 2011. The main reason for this decrease was that, in 2011, the Water Works was not required to pay any additional actuarial contributions for pension costs as was the case in 2010. There were 6.4% and 15% increases in transmission and distribution expenses and pumping expenses, respectively, in 2011. Cost of electric power, which is part of pumping expenses, increased in 2011 as a result of expiration of credits (Point Beach credits) that used to reduce the cost of energy. The cost of decommissioning of the Menomonee Valley Booster Station also contributed to the increase in pumping expenses. Transmission and distribution expenses increased due to a higher number of water main breaks experienced in 2011, 547 versus 436 in 2010. The cost of painting the Greenfield tank was also a major part of the increase in transmission and distribution expenses in 2011.
- Nonoperating expenses, which consist mainly of interest expense, increased by 15.8% from \$921 thousand in 2010 to \$1.1 million in 2011. This increase was mainly due to new debt issued in 2011.

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2011 and 2010

(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.
- 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 LGIP with the State of Wisconsin were only 0.20% and 0.48% for 2010 and 2009, respectively, resulting in a significant decrease in interest income in 2010. 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. 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 in both 2010 and 2009. 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, 2011, the Water Works investment in capital assets, net of accumulated depreciation, remained almost the same, at \$402.1 million, as that of 2010. Transmission and distribution system assets and machinery and equipment increased by \$1.1 million and \$6.9 million, respectively, and construction in progress decreased by \$9.9 million. The decrease in construction in progress is due to capitalization of capital projects that were completed as of December 31, 2011 and also reclassification of some charges to operating expenses. The

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

increase in machinery & equipment represents the completion and capitalization of the backup power project at the Riverside Pumping Station for a total of over \$6.0 million. Nonutility property increased by \$0.7 million as a result of the final addition to the Kilbourn Reservoir Park development.

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. 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.

**Table A-3
Capital Assets**

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Capital assets:			
Land	\$ 1,363,077	1,367,127	1,280,630
Buildings	27,258,906	25,406,006	24,135,468
Transmission and distribution system	357,017,568	355,873,188	338,510,006
Machinery and equipment	213,309,827	206,449,773	202,027,194
Construction in progress	2,829,311	12,716,715	15,635,072
Nonutility property	6,076,558	5,346,893	6,164,236
Total capital assets	607,855,247	607,159,702	587,752,606
Less accumulated depreciation	(205,731,537)	(204,981,771)	(193,770,498)
Net capital assets	\$ <u>402,123,710</u>	<u>402,177,931</u>	<u>393,982,108</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, 2011 and 2010, the City Treasurer held cash and cash equivalents of \$4.1 million and \$4.2 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.

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

As of December 31, 2011 and 2010, the Water Works debt consisted of \$7.5 million and \$8.5 million, respectively, in revenue bonds through the State of Wisconsin Safe Drinking Water Loan program and \$22.3 million and \$13.7 million, respectively, in general obligation bonds for a total indebtedness of \$29.8 million and \$22.2 million, respectively.

Economic Factors

Volume of water sold dropped by 188 million and 903 million gallons in 2011 and 2010, 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 13.6%. Volume of water sold to all customers dropped by 8.3% 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 all customer categories over the 20-year period.

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.

The PSC has designed an Economic Development Rate (EDR), also known as the WAVE Rate (Water Attracting Valued Employers), to encourage business growth. The Water Works is authorized to offer discounted water rates to new and existing business customers for a period of five years in exchange for increased water usage and living-wage job creation and retention. The Water Works is marketing this concept to area businesses.

Table A-4
Sale of Water

	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
	(In billion of gallons)				
Customer class:					
Residential	10.8	10.8	11.4	11.5	12.1
Commercial	7.5	7.7	7.8	8.0	8.2
Industrial	3.8	4.0	3.9	4.2	4.4
Public authority	2.2	2.2	2.6	2.7	2.5
Subtotal	24.3	24.7	25.7	26.4	27.2
Wholesale	7.9	7.7	7.6	7.7	7.9
Total	<u>32.2</u>	<u>32.4</u>	<u>33.3</u>	<u>34.1</u>	<u>35.1</u>

CITY OF MILWAUKEE – WATER WORKS

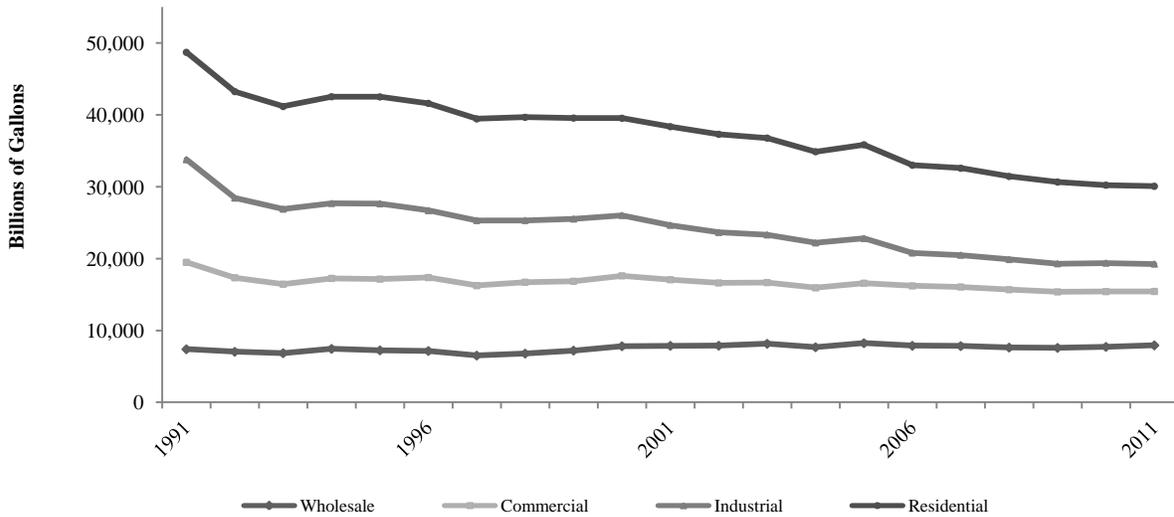
Management’s Discussion and Analysis

December 31, 2011 and 2010

(Unaudited)

Table A-5

Volume of Water Sold by Customer Type



Subsequent Events

In January 2012, the Water Works transferred the Lincoln Distribution Yard to the City of Milwaukee (Parking Fund). This facility was taken out of utility service in 2006 due to consolidation of distribution facilities at the Tower DPW-Headquarters. The Parking Fund has agreed to pay the Water Works \$27,228. Annually over the next 10 years for this property and facility. The Lincoln Yard facility had been part of MWW’s nonutility property as of 2006.

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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets:		
Current assets:		
Cash and cash equivalents	\$ 3,360,324	3,494,416
Restricted cash and cash equivalents	692,467	679,746
Accounts receivable, net	17,074,763	14,527,719
Unbilled accounts receivable	11,976,000	9,771,194
Accrued interest	1,139	1,714
Due from other funds	6,480,792	5,143,297
Inventory of materials and supplies	2,571,944	2,632,666
Prepaid items	121,948	590,003
Other assets	210,221	258,365
Total current assets	<u>42,489,598</u>	<u>37,099,120</u>
Noncurrent assets:		
Water plant in service, net	393,983,168	384,690,328
Construction work in process	2,829,310	12,716,715
Other property, net	5,311,232	4,770,888
Total noncurrent assets	<u>402,123,710</u>	<u>402,177,931</u>
Total assets	<u>444,613,308</u>	<u>439,277,051</u>
Liabilities:		
Current liabilities:		
Accounts payable	4,303,713	5,093,009
Interest payable	246,771	246,531
Accrued wages	1,251,566	1,275,490
Compensated absences	1,079,086	1,166,697
Due to other funds	16,635,863	23,887,534
Long-term debt due within one year	4,314,748	3,989,190
Total current liabilities	<u>27,831,747</u>	<u>35,658,451</u>
Noncurrent liabilities:		
General obligation bonds payable	18,954,309	10,721,863
Revenue bonds payable	6,508,497	7,497,713
Net other postemployment benefits obligation	3,754,619	3,077,004
Total noncurrent liabilities	<u>29,217,425</u>	<u>21,296,580</u>
Total liabilities	<u>57,049,172</u>	<u>56,955,031</u>
Net assets:		
Invested in capital assets, net of related debt	372,346,156	379,969,164
Restricted for debt service	692,467	679,746
Unrestricted	14,525,513	1,673,110
Total net assets	<u>\$ 387,564,136</u>	<u>382,322,020</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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Water sales	\$ 69,943,592	59,370,884
Fire protection service	6,920,730	6,606,852
Charges for shared services	5,084,729	5,254,303
Other	<u>2,444,432</u>	<u>2,241,314</u>
Total operating revenues	<u>84,393,483</u>	<u>73,473,353</u>
Operating expenses:		
Administrative and general	6,474,096	7,947,534
Billing and collection	2,703,710	2,823,674
Transmission and distribution	21,687,762	20,380,620
Water pumping	8,748,474	7,607,561
Water treatment	14,448,125	14,851,805
Depreciation	<u>14,066,822</u>	<u>13,433,958</u>
Total operating expenses	<u>68,128,989</u>	<u>67,045,152</u>
Operating income	<u>16,264,494</u>	<u>6,428,201</u>
Nonoperating revenues (expenses):		
Interest income	12,427	15,343
Interest expense	(1,066,588)	(921,318)
Miscellaneous	<u>435,633</u>	<u>44,490</u>
Total nonoperating expenses, net	<u>(618,528)</u>	<u>(861,485)</u>
Income before capital contributions and transfers	15,645,966	5,566,716
Capital contributions	747,013	910,324
Transfers out	<u>(11,150,863)</u>	<u>(13,153,957)</u>
Increase (decrease) in net assets	5,242,116	(6,676,917)
Net assets – beginning of year	<u>382,322,020</u>	<u>388,998,937</u>
Net assets – end of year	<u>\$ 387,564,136</u>	<u>382,322,020</u>

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Receipts from customers and users	\$ 75,008,235	68,385,219
Receipts from interfund services provided	5,084,728	5,254,303
Payments to suppliers	(27,871,091)	(21,466,575)
Payments to employees	(24,132,829)	(25,470,536)
Payments to other funds	(4,219,168)	(5,941,830)
Net cash provided by operating activities	<u>23,869,875</u>	<u>20,760,581</u>
Cash flows from noncapital financing activities:		
Miscellaneous nonoperating revenue	435,633	44,490
Interfund borrowings	3,539,636	1,975,909
Net cash provided by noncapital financing activities	<u>3,975,269</u>	<u>2,020,399</u>
Cash flows from capital and related financing activities:		
Acquisition of property, plant, and equipment	(34,481,957)	(22,071,898)
Proceeds from bonds, notes, and revenue bonds	11,625,000	675,000
Retirement of bonds, notes, and revenue bonds	(3,989,190)	(3,445,830)
Interest paid	(1,133,370)	(1,013,319)
Net cash used in capital and related financing activities	<u>(27,979,517)</u>	<u>(25,856,047)</u>
Cash flows from investing activity:		
Interest income	13,002	17,316
Net cash provided by investing activity	<u>13,002</u>	<u>17,316</u>
Net decrease in cash and cash equivalents	(121,371)	(3,057,751)
Cash and cash equivalents – beginning of year	<u>4,174,162</u>	<u>7,231,913</u>
Cash and cash equivalents – end of year	<u>\$ 4,052,791</u>	<u>4,174,162</u>
Cash and cash equivalents at year-end consist of:		
Unrestricted cash and cash equivalents	\$ 3,360,324	3,494,416
Restricted cash and cash equivalents	692,467	679,746
Total cash and cash equivalents	<u>\$ 4,052,791</u>	<u>4,174,162</u>

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 16,264,494	6,428,201
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	14,066,822	13,433,958
Changes in assets and liabilities:		
Receivables	(4,751,850)	(324,620)
Due from/to other funds resulting from operations	(2,063,297)	(78,812)
Inventory of materials and supplies	60,722	(17,223)
Prepaid items	468,055	(550,302)
Other assets	48,144	(4,143)
Noncapital accounts payable	(789,295)	1,244,309
Accrued wages and compensated absences	(111,535)	(47,342)
Net other postemployment benefits obligation	677,615	676,555
Net cash provided by operating activities	<u>\$ 23,869,875</u>	<u>20,760,581</u>
Noncash activities:		
During the year, water mains and related property installed by others were deeded to the Water Works in the amount of	\$ 747,013	910,324

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

(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, 2011 and 2010

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 \$607,922 and \$23,797 as of December 31, 2011 and 2010, respectively. The accounts receivable year-end balance includes actual unpaid charges. The unbilled accounts receivable balance consists of an estimate of the 2010 receivables that will be billed in the first quarter of 2011.

(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, 2011 and 2010

- 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. Intangible assets not specifically excluded by its scope provisions will be classified as capital assets. Costs of depreciable property retired are removed from utility plant accounts and are charged to accumulated depreciation. Maintenance and repair costs are charged to operations as incurred and renewals and improvements are added to the asset accounts. Depreciation is provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Building and improvements	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, 2011 and 2010

(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 \$692,467 and \$679,746 at December 31, 2011 and 2010, respectively. The restriction of net assets is related to the debt service reserve 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, 2011 and 2010, accumulated sick leave earned but not taken was approximately \$4,149,329 and \$4,691,521, 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, 2011 and 2010

(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. Actual results could differ from this estimate.

(o) New Accounting Pronouncements

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, 2011 and 2010, the Water Works’ deposits and investments were as follows:

	<u>2011</u>	<u>2010</u>
Local Government Investment Pool	\$ 828,028	701,547
Deposits and cash on hand	<u>3,224,763</u>	<u>3,472,615</u>
Total	<u>\$ 4,052,791</u>	<u>4,174,162</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 \$650,000. As of December 31, 2011 and 2010, 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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

(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.

(3) Capital Assets

Capital asset activity for the year ended December 31, 2011 was as follows:

	Balance December 31, 2010	Additions	Deletions	Transfers	Balance December 31, 2011
Capital assets not being depreciated:					
Land and land improvements	\$ 1,367,127	—	(4,050)	—	1,363,077
Nonutility property, land	654,868	—	—	—	654,868
Construction in progress	12,716,715	34,364,638	(44,252,042)	—	2,829,311
Total capital assets not being depreciated	14,738,710	34,364,638	(44,256,092)	—	4,847,256
Capital assets being depreciated:					
Buildings	25,406,006	2,055,580	(202,680)	—	27,258,906
Transmission and distribution system	355,873,188	24,644,844	(23,500,464)	—	357,017,568
Machinery and equipment	206,449,773	17,551,618	(10,691,564)	—	213,309,827
Nonutility property	4,692,025	729,665	—	—	5,421,690
Total capital assets being depreciated	592,420,992	44,981,707	(34,394,708)	—	603,007,991
Less accumulated depreciation:					
Buildings	15,974,163	833,028	(306,475)	—	16,500,716
Transmission and distribution system	83,977,782	4,637,147	(2,373,018)	—	86,241,911
Machinery and equipment	104,453,820	8,596,648	(10,826,884)	—	102,223,584

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

	Balance December 31, 2010	Additions	Deletions	Transfers	Balance December 31, 2011
Nonutility property	\$ 576,006	189,320	—	—	765,326
Total accumulated depreciation	204,981,771	14,256,143	(13,506,377)	—	205,731,537
Total capital assets being depreciated, net	387,439,221	30,725,564	(20,888,331)	—	397,276,454
Total capital assets, net	\$ 402,177,931	65,090,202	(65,144,423)	—	402,123,710

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	17,570,570	21,916,276	(24,834,633)	86,497	14,738,710
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	570,182,036	24,834,633	(2,509,180)	(86,497)	592,420,992
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
Machinery and equipment	97,272,324	8,981,320	(1,626,267)	(173,557)	104,453,820

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

	Balance January 1, 2010	Additions	Deletions	Transfers	Balance December 31, 2010
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

(4) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations for the year ended December 31, 2011 were as follows:

	Balance December 31, 2010	Additions	Deletions	Balance December 31, 2011	Due within one year
General obligation bonds	\$ 13,453,302	11,625,000	(3,025,418)	22,052,884	3,325,532
Unamortized premiums	405,747	—	(136,951)	268,796	—
Deferred amount on refundings	(111,768)	—	69,929	(41,839)	—
Revenue bonds	8,461,485	—	(963,772)	7,497,713	989,216
Other postemployment benefits	3,077,004	2,108,136	(1,430,521)	3,754,619	—
Total	\$ 25,285,770	13,733,136	(5,486,733)	33,532,173	4,314,748

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	2,072,185	(1,395,630)	3,077,004	—
Total	\$ 27,438,460	2,747,185	(4,899,875)	25,285,770	3,989,190

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

(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 2010 was \$26,720,019. During the years ended December 31, 2011 and 2010, the City issued \$11,625,000 and \$675,000, respectively, of general obligation bonds, which were used for capital improvement of the water system.

General obligation bonds outstanding at December 31, 2011 and 2010 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance at December 31	
				2011	2010
Refunding E	2012 to 2019	4.50% to 5.00%	\$ 3,125,658	1,023,477	1,290,001
Refunding C, D, F, G, J, & K	2012 to 2016	5.00% to 5.25%	17,953,357	8,506,760	11,163,545
Refunding 2006 N9, Refd C&D	2012 to 2015	4.25% to 5.00%	114,756	72,647	114,756
2009 N1	2012 to 2019	3.00% to 5.00%	150,000	120,000	135,000
2009 B2	2020 to 2024	4.00% to 5.00%	75,000	75,000	75,000
2010-N1	2012 to 2020	2.50% to 5.00%	450,000	405,000	450,000
2010-B5	2021 to 2025	1.50% to 5.00%	225,000	225,000	225,000
2011-N3	2012 to 2021	4.00% to 5.00%	7,750,000	7,750,000	—
2011-B4	2021 to 2026	4.00% to 5.00%	3,875,000	3,875,000	—
Total			\$ 33,718,771	22,052,884	13,453,302

(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, 2011 and 2010 were as follows:

Series	Maturity	Interest rates	Original	Principal	
				Balance at December 31	
				2011	2010
SDW-1	2012 to 2018	2.64%	\$ 4,873,153	2,080,797	2,348,267
SDW-2	2012 to 2018	2.64	1,618,213	690,964	779,782
SDW-3	2012 to 2018	2.64	5,001,067	2,135,415	2,409,906
SDW-4	2012 to 2018	2.64	4,148,305	1,771,293	1,998,979
SDW-5	2012 to 2018	2.64	1,918,640	819,244	924,551
Total			\$ 17,559,378	7,497,713	8,461,485

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

(d) Debt Service Requirements

The maturities of the outstanding principal and related interest requirements as of December 31, 2011 are as follows:

Year:	General obligation bonds		Revenue bonds	
	Principal	Interest	Principal	Interest
2012	\$ 3,325,532	1,089,376	989,216	184,882
2013	2,936,350	918,066	1,015,332	158,422
2014	3,121,153	768,652	1,042,136	131,263
2015	2,511,389	616,947	1,069,649	103,388
2016	1,816,828	487,436	1,097,887	74,776
2017 – 2021	4,241,632	1,550,943	2,283,493	60,677
2022 – 2025	4,100,000	505,675	—	—
Total	\$ 22,052,884	5,937,095	7,497,713	713,408

(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	
2010	\$ 73,488,697	66,765,151	6,723,546	963,772	210,661	1,174,433	5.73
2011	84,405,910	65,213,030	19,192,880	989,216	184,882	1,174,098	16.35

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, 2011 and 2010, 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

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

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%, 6.0%, 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, 2011, 2010, and 2009 was \$940,303, \$1,049,289 and \$1,057,472, 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

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

firefighters and police officers is equal to one and one-half the employee’s annual basic salary to the next higher thousand dollars.

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

Funding Policy – The contribution of plan members and the Water Works is established and may be amended by the City. The required contribution for medical and life insurance for retirees is based on a pay-as-you-go financing. Medical benefits provided through the basic healthcare plan are self-insured. For 2011, the Water Works paid approximately \$1,394,500 and \$36,000, respectively, toward medical and life insurance for retirees. For 2010, the Water Works paid approximately \$1,383,000 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, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
Annual required contribution (ARC)	\$ 2,085,548	2,057,785
Interest on net OPEB obligation	143,052	95,123
Adjustment to ARC	<u>(120,464)</u>	<u>(80,723)</u>
Annual OPEB cost	2,108,136	2,072,185
Contributions made	<u>1,430,521</u>	<u>1,395,630</u>
Increase in net OPEB obligation	(677,615)	(676,555)
Net OPEB obligation at beginning of year	<u>(3,077,004)</u>	<u>(2,400,449)</u>
Net OPEB obligation at end of year	<u>\$ (3,754,619)</u>	<u>(3,077,004)</u>

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

The Water Works annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2011, 2010 and 2009 were as follows:

	Employer contribution			Net OPEB obligation
	Annual OPEB cost	Percentage contributed		
Year ended December 31:				
2011	\$ 2,108,136	67.9%	\$	3,754,619
2010	2,072,185	67.4		3,077,004
2009	1,931,795	57.6		2,400,449

Funded Status and Funding Progress – As of January 1, 2011, the most recent actuarial valuation date, the actuarial accrued liability for benefits related to all City employees was \$916,400,000 and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of \$916,400,000. 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 \$407,800,000 and the ratio of the UAAL to the covered payroll was 225%. The covered payroll for Water Works employees was \$16,300,000.

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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

(7) Related-Party Transactions

A summary of significant revenue and expense transactions between the City and Water Works for 2011 and 2010 is shown below:

	<u>2011</u>	<u>2010</u>
Revenues (receipts from the City) – water consumption	\$ 375,223	399,351
Expenses (payments to the City):		
Payment in lieu of taxes and other transfers	\$ 11,150,863	13,153,957
Employee fringe benefits	8,151,069	9,255,757
Administrative services	925,941	908,473
Electrical equipment maintenance	456,320	1,100,400
Motor vehicle usage and maintenance	886,952	849,167
Street repairs	3,221,553	2,659,236
All other services	5,910,135	6,212,300
Total payments to the City	\$ <u>30,702,833</u>	<u>34,139,290</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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2011 and 2010

The effect of such differences on net income is as follows for the years ended December 31, 2011 and 2010:

	<u>2011</u>	<u>2010</u>
	(In thousands)	
Increase in net assets as shown in accompanying financial statements	\$ 5,242	(6,677)
Amortization of deferred credits resulting from Contributions in Aid of Construction (CIAC) reclassification	811	811
Nonexchange transfer	—	3,000
Sale of property	<u>(293)</u>	<u>—</u>
Net income as shown on PSC reports	<u>\$ 5,760</u>	<u>(2,866)</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, 2011 totaled \$3,931,140.

(10) Transfers and Interfund Balances

At December 31, 2011 and 2010, the Water Works has recorded a due from other funds of \$6,480,792 and \$5,143,297, respectively, which in part represents cash held by the general obligation debt fund of the City on behalf of Water Works for the 2011 and 2010 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, 2011 and 2010, the Water Works has recorded a due to the City (General and Sewer Funds) of \$16,635,863 and \$23,887,534, 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 2011 and 2010, the PILOT transfers to the City were \$11,150,863 and \$10,153,957, respectively. In 2010, the Water Works transferred \$3,000,000 to the City’s general fund as a nonexchange transaction.

(11) Subsequent Events

In January 2012, the Water Works transferred the Lincoln Distribution Yard to the City of Milwaukee (Parking Fund). This facility was taken out of utility service in 2006 due to consolidation of Distribution facilities at the Tower DPW-Headquarters. The Parking Fund has agreed to pay the Water Works \$27,228.58 annually over the next 10 years for this property and facility. The Lincoln Yard facility had been part of the Water Work’s nonutility property as of 2006.