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Public Service Commission of Wisconsin
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Exhibit 2.59
Docket No. 3720-WR-107
Witness: Eric Rothstein
July 19, 2010

CITY OF MILWAUKEE – WATER WORKS

Financial Statements

December 31, 2008 and 2007

(With Independent Auditors' Report Thereon)

CITY OF MILWAUKEE – WATER WORKS

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KPMG LLP
777 East Wisconsin Avenue
Milwaukee, WI 53202

Independent Auditors' Report

The Honorable Members of the Common Council
City of Milwaukee:

We have audited the accompanying basic financial statements of the City of Milwaukee – Water Works (Water Works), an enterprise fund of the City of Milwaukee, Wisconsin, as of and for the years ended December 31, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting of the Water Works. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Water Works and do not purport to, and do not, present fairly the financial position of the City of Milwaukee, Wisconsin, as of December 31, 2008 and 2007, 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, 2008 and 2007, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

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

KPMG LLP

Milwaukee, Wisconsin
July 30, 2009

KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2008 and 2007

(Unaudited)

The management of the City of Milwaukee – Water Works (Water Works) offers readers of the organization's financial statements this narrative overview and analysis of the Water Works' financial statements for the fiscal years ended December 31, 2008 and 2007. 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, 2008

- Total revenues decreased by 0.15% in 2008, from $74.5 million in 2007 to $74.4 million in 2008.
- Total expenses increased by 4.03% in 2008, from $62.1 million in 2007 to $64.6 million in 2008.
- As of December 31, 2008, the Water Works' outstanding debt consisted of $10.3 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program and $17.4 million in general obligation bonds for a total of $27.7 million. As of December 31, 2007, total outstanding debt was $31.5 million, consisting of $11.2 million in revenue bonds and $20.3 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 $8.7 million in 2008 and $7.8 million in 2007, and is reported in the accompanying statement of revenues, expenses, and changes in fund net assets as transfers out.

Year ended December 31, 2007

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

  The Water Works is an enterprise fund within the primary government of the City of Milwaukee and as such is not subject to property taxes. In place of property taxes, the Water Works contributes to the City's tax levy by making a payment in lieu of taxes (PILOT). The PILOT was $7.8 million in 2007 and $7.5 million in 2006, and is reported in the accompanying statement of revenues, expenses, and changes in fund net assets as transfers out.

Overview of the Financial Statements

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

(Continued)

Required Financial Statements

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

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

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

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

Financial Analysis of the Water Works

Statement of Net Assets

A summary of assets, liabilities, and net assets as of December 31, 2008, 2007, and 2006 is as follows:

Table A-1

Condensed Summary of Net Assets

	2008	2007	2006
Assets:			
Current assets	$ 50,198,462	58,927,767	59,607,231
Net capital assets	383,759,830	377,097,848	370,714,337
Total assets	433,958,292	436,025,615	430,321,568
Liabilities:			
Current liabilities	19,291,030	20,466,996	17,868,179
Noncurrent liabilities	24,855,577	27,789,165	31,546,306
Total liabilities	44,146,607	48,256,161	49,414,485
Net assets:			
Invested in capital assets, net of related debt	356,000,096	345,572,042	334,937,406
Restricted for debt service	655,275	643,510	632,047
Unrestricted net assets	33,156,314	41,553,902	45,337,630
Total net assets	$ 389,811,685	387,769,454	380,907,083

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 $389.8 million and $387.8 million at December 31, 2008 and 2007, respectively.

In Table A-1, it can be seen that the largest portion of the Water Works' net assets (91% and 89% as of December 31, 2008 and 2007, 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 58% and 57% of the capital assets as of December 31, 2008 and 2007, respectively. The Water Works uses these capital assets to provide safe, reliable, and aesthetically pleasing drinking water to its 860,000-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.

The remaining net assets (9% and 11% as of December 31, 2008 and 2007, 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).

(Continued)

As can be seen in Table A-1, capital assets net of related debt increased by $10.4 million and $10.6 million during the years ended December 31, 2008 and 2007, respectively. The increases in capital assets net of related debt in both 2008 and 2007 were mainly due to a combination of the reduction in related debt, the completion and capitalization of capital projects, and the receipt of contributed capital. The increases in net capital assets were $6.7 million and $6.4 million for 2008 and 2007, respectively. The amounts of contributed capital were $0.9 million and $2.2 million in 2008 and 2007, respectively, with a decrease of 59% from 2007 to 2008. The drop in contributions in 2008 is due to completion of major projects related to work on the Marquette Exchange in 2007.

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

		2008	2007	2006
Operating revenue	$	73,537,077	72,503,901	69,460,043
Nonoperating revenue		863,898	2,010,930	1,865,572
Total revenues		74,400,975	74,514,831	71,325,615
Depreciation expense		13,117,101	12,942,632	12,519,592
Other operating expenses		50,263,851	47,747,704	43,904,503
Nonoperating expenses		1,181,231	1,373,735	1,650,071
Total expenses		64,562,183	62,064,071	58,074,166
Income before capital contributions and transfers		9,838,792	12,450,760	13,251,449
Capital contributions		899,576	2,178,360	3,228,913
Transfers out		(8,696,137)	(7,766,749)	(7,460,814)
Changes in net assets		2,042,231	6,862,371	9,019,548
Net assets – beginning of year		387,769,454	380,907,083	371,887,535
Net assets – end of year	$	389,811,685	387,769,454	380,907,083

Year ended December 31, 2008

A review of Table A-2 shows that operating revenues increased by $1.0 million, or 1.42%, and total expenses increased by $2.5 million, or 4.03%. These results may be explained as follows:

Revenues

- Operating revenues increased by $1.0 million in 2008 primarily due to the full year effect of the water rate increase of 6% that was effective June 2007, partially offset by a large decrease in water consumption (sale) by 963 million gallons. This decrease in consumption is partly explained by the cool summer in Milwaukee in 2008. Table A-4 shows the sale of water (in billions gallons) for the last five years. According to this table, the sale of water for all customer class has consistently dropped from year to year except in 2005.
- Nonoperating revenues, which mainly consist of interest income, also include miscellaneous fees for service and branch tapping and rental income from antenna contracts. Nonoperating revenues for 2008 decreased by $1.1 million, or 57%, from 2007. A big part of this decrease is explained by the decline in interest income in 2008. 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 2.46% and 5.02% for 2008 and 2007, respectively, resulting in a huge drop in interest income in 2008. In addition to the falling interest rates, investments at the end of 2008 decreased by $9.6 million from $29.2 million at the end of 2007 to $19.6 at the end of 2008, which indicates that less funds were available for investment in 2008.

Expenses

- Operating expenses, excluding depreciation, increased by $2.5 million, or 5.27%, in 2008. This is a combination of different categories of expenses. Treatment and transmission and distribution expenses increased by $1.2 million and $1.0 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 had a slight impact ($0.2 million increase) in pumping expenses for 2008.
- Nonoperating expenses, which consist mainly of interest expense, decreased by $0.2 million and $0.3 million in 2008 and 2007, respectively. These decreases were primarily due to declining principal balances of outstanding debt.

(Continued)

Year ended December 31, 2007

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

Revenues

- Operating revenues increased by $3.0 million in 2007 primarily due to the water rate increase of 6% that was effective June 2007, partially offset by a decrease in water consumption (sold) by 435 million gallons. The wet summer in 2007 has impacted consumption. Table A-4 shows the sale of water (in billions gallons) for the last five years.
- Nonoperating revenues, which mainly consist of interest income, also include miscellaneous fees for service and branch tapping and rental income for antenna contracts. Nonoperating revenues for 2007 increased by $0.1 million, or 7.8%, from 2006. The average interest rates on investments in the Local Government Investment Pool (LGIP) with the State of Wisconsin, where most of the Water Works' funds are invested, were 5.02% and 4.9% for 2007 and 2006, respectively, resulting in no significant impact. The minor increase in nonoperating revenues resulted from increases in the rates for service and branch tapping, as well as the renewal of antenna space rental contracts at higher rates.

Expenses

- Operating expenses, excluding depreciation, increased by $3.8 million, or 8.8%, in 2007. This is a combination of different categories of expenses. Treatment and transmission and distribution expenses increased by $1.1 million and $1.8 million, respectively. Major repair projects, such as roofing at both plants and chimney rebuilding at the Linnwood Plant, were undertaken in 2007. Increased service repairs and cross connection inspections and rent for the Water Distribution facilities at Tower were the main reasons for increased distribution cost. Administrative expenses increased by $0.6 million, which among other things, is attributable to rising health insurance expenses and other postemployment benefits (OPEB) expense recognized in 2007.

  Nonoperating expenses, which consist mainly of interest expense, decreased by $0.3 million in both 2007 and 2006. These decreases were primarily due to declining principal balances of outstanding debt.

Capital Assets and Debt Administration

Capital Assets

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

As of December 31, 2008, the Water Works investment in capital assets, net of accumulated depreciation, amounted to $383.8 million. This represents an increase of $6.7 million from December 31, 2007. Transmission and distribution system assets increased by $13.0 million and construction in progress decreased by $1.3 million. The decrease in construction in progress is due to capitalization of capital projects that were completed as of December 31, 2008. The combination of these two items, offset by an increase in accumulated depreciation of $6.0 million, primarily resulted in the $6.7 million increase.

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

Table A-3

Capital Assets

	2008	2007	2006
Capital assets:			
Land	$ 1,280,630	1,280,630	1,280,630
Buildings	21,291,679	21,291,679	20,693,584
Transmission and distribution system	331,142,631	318,139,222	306,507,308
Machinery and equipment	201,582,454	201,182,478	201,262,299
Construction in progress	10,974,570	12,249,080	9,144,994
Nonutility property	6,164,236	5,603,586	5,603,586
Total capital assets	572,436,200	559,746,675	544,492,401
Less accumulated depreciation	(188,676,370)	(182,648,827)	(173,778,064)
Net capital assets	$ 383,759,830	377,097,848	370,714,337

Investment Administration

As an enterprise fund within the primary government of the City of Milwaukee, the Water Works does not have a direct investment plan. As such, cash not in use for day-to-day operation is invested through the City of Milwaukee, primarily in the State of Wisconsin's Local Government Investment Pool (LGIP) and/or other types of investment instruments as determined by the City Treasurer. As of December 31, 2008 and 2007, the City Treasurer held cash and cash equivalents of $19.6 million and $29.2 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 2008 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).

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

As of December 31, 2008 and 2007, the Water Works debt consisted of $10.3 million and $11.2 million, respectively, in revenue bonds through the State of Wisconsin Safe Drinking Water Loan program and $17.4 million and $20.3 million, respectively, in general obligation bonds for a total indebtedness of $27.7 million and $31.5 million, respectively.

Economic Factors

A 6% rate increase was implemented in June 2007. In 2008, the impact of this rate change was experienced for the full year resulting in $1.0 million, or 1.42%, increase in operating revenue. However, the increase due to the rate change was offset by the decline in water consumption. Volume of water sold dropped by 962,973 million gallons in 2008.

As shown in Table A-4, there has been a steady decline in water volume sold. There were about 1 billion and 0.5 billion fewer gallons sold in 2008 and 2007, respectively, than the previous year. Over the last five years, the volume of water sold to industrial customers has dropped by 36.7%, whereas the drop in total water sold to all customers is 13.7%. Table A-5 shows, graphically, the volume of water sold to different categories of customers over the last twenty years. As can be observed in the graph, there is a significant decline in the sale of water to industrial customers and a moderate reduction in the residential category.

The City of Milwaukee executed a water service agreement with the City of New Berlin to expand the New Berlin water service area to include the "middle third" of their community, an area that is outside the Great Lakes basin but water is returned to Lake Michigan through the regional wastewater authority. It is projected that this would approximately double the water sold to that community. The Wisconsin Department of Natural Resources is considering the "Application for Diversion," which would need to be approved before water could start flowing to the enlarged service area.

Collaborative efforts were completed 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. Independently, the Milwaukee Water Works provided customized information to 30 companies that inquired about water service.

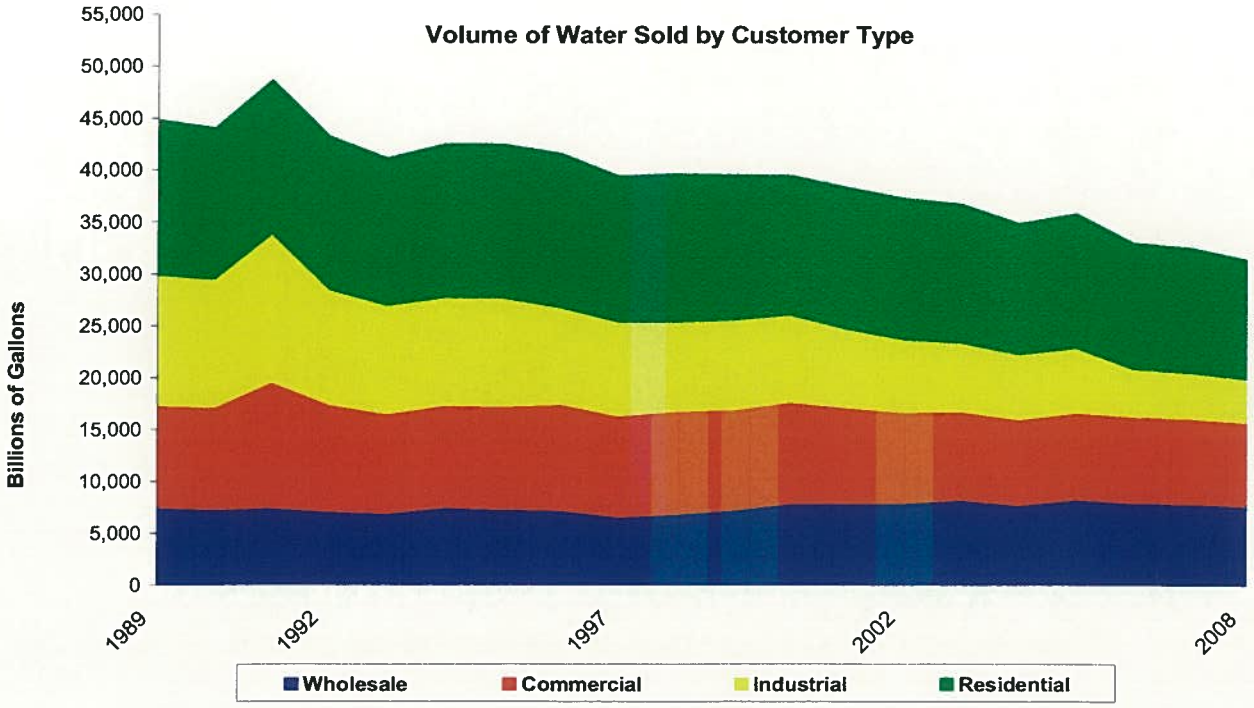
Table A-4

Sale of Water

(In billion of gallons)

	2008	2007	2006	2005	2004
Customer class:					
Residential	11.5	12.1	12.2	13.0	12.7
Commercial	8.0	8.2	8.3	8.4	8.3
Industrial	4.2	4.4	4.6	6.2	6.2
Public authority	2.6	2.4	2.4	2.6	2.4
Subtotal	26.3	27.1	27.5	30.2	29.6
Wholesale	7.6	7.8	7.9	8.2	7.7
Total	33.9	34.9	35.4	38.4	37.3

Table A-5



(Continued)

Contacting Water Works Financial Management

This financial report is designed to provide a general overview of the Water Works' finances to our customers, creditors, and any one who has an interest in the Water Works' operations. If you have questions about this report or need additional information, contact the Water Works' Superintendent, Carrie Lewis, 841 N. Broadway, Room 401, Milwaukee, Wisconsin 53202.

CITY OF MILWAUKEE – WATER WORKS

Statements of Net Assets

December 31, 2008 and 2007

	2008	2007
Assets:		
Current assets:		
Cash and cash equivalents	$ 18,896,832	28,538,815
Restricted cash and cash equivalents	655,275	643,510
Accounts receivable, net	13,602,981	12,599,871
Unbilled accounts receivable	9,667,942	9,769,917
Accrued interest	34,332	131,353
Due from other funds	4,277,173	4,702,423
Inventory of materials and supplies	2,330,995	2,345,026
Prepaid items	447,301	93,686
Other assets	285,631	103,166
Total current assets	50,198,462	58,927,767
Noncurrent assets:		
Water plant in service, net	367,404,429	362,171,375
Construction work in process	10,974,570	12,249,080
Other property, net	5,380,831	2,677,393
Total noncurrent assets	383,759,830	377,097,848
Total assets	433,958,292	436,025,615
Liabilities:		
Current liabilities:		
Accounts payable	3,663,076	3,325,896
Interest payable	313,234	345,337
Accrued wages	1,768,428	1,453,151
Compensated absences	1,107,674	1,024,999
Due to other funds	7,953,202	9,790,683
Long-term debt due within one year	2,904,157	3,736,640
Total current liabilities	17,709,771	19,676,706
Noncurrent liabilities:		
General obligation bonds payable	15,455,108	17,473,864
Revenue bonds payable	9,400,469	10,315,301
Net other postemployment benefits obligation	1,581,259	790,290
Total noncurrent liabilities	26,436,836	28,579,455
Total liabilities	44,146,607	48,256,161
Net assets:		
Invested in capital assets, net of related debt	356,000,096	345,572,042
Restricted for debt service	655,275	643,510
Unrestricted	33,156,314	41,553,902
Total net assets	$ 389,811,685	387,769,454

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, 2008 and 2007

	2008	2007
Operating revenues:		
Water sales	$ 59,625,929	59,301,224
Fire protection service	6,383,787	6,233,880
Charges for shared services	5,399,613	5,049,792
Other	2,127,748	1,919,005
Total operating revenues	73,537,077	72,503,901
Operating expenses:		
Administrative and general	6,631,263	6,634,072
Billing and collection	2,788,727	2,677,720
Transmission and distribution	19,874,617	18,872,592
Water pumping	7,271,559	7,057,252
Water treatment	13,697,685	12,506,068
Depreciation	13,117,101	12,942,632
Total operating expenses	63,380,952	60,690,336
Operating income	10,156,125	11,813,565
Nonoperating revenues (expenses):		
Interest income	669,909	1,707,141
Interest expense	(1,181,231)	(1,373,735)
Miscellaneous	193,989	303,789
Total nonoperating revenues (expenses), net	(317,333)	637,195
Income before capital contributions and transfers	9,838,792	12,450,760
Capital contributions	899,576	2,178,360
Transfers out	(8,696,137)	(7,766,749)
Increase in net assets	2,042,231	6,862,371
Net assets – beginning of year	387,769,454	380,907,083
Net assets – end of year	$ 389,811,685	387,769,454

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Receipts from customers and users	$ 73,074,788	70,997,854
Payments to suppliers	(19,611,285)	(17,761,797)
Payments to employees	(24,060,485)	(24,178,027)
Payments to other funds	(6,610,109)	(5,995,123)
Net cash provided by operating activities	22,792,909	23,062,907
Cash flows from noncapital financing activities:		
Miscellaneous nonoperating revenue	193,989	303,789
Transfer to other funds	(8,696,137)	(7,766,749)
Net cash used in noncapital financing activities	(8,502,148)	(7,462,960)
Cash flows from capital and related financing activities:		
Acquisition of property, plant, and equipment	(19,708,504)	(14,318,926)
Retirement of bonds, notes, and revenue bonds	(3,736,640)	(4,230,625)
Interest paid	(1,242,765)	(1,425,046)
Net cash used in capital and related financing activities	(24,687,909)	(19,974,597)
Cash flows from investing activities:		
Interest income	766,930	1,747,575
Net cash provided by investing activities	766,930	1,747,575
Net decrease in cash and cash equivalents	(9,630,218)	(2,627,075)
Cash and cash equivalents – beginning of year	29,182,325	31,809,400
Cash and cash equivalents – end of year	$ 19,552,107	29,182,325
Cash and cash equivalents at year end consist of:		
Unrestricted cash and cash equivalents	$ 18,896,832	28,538,815
Restricted cash and cash equivalents	655,275	643,510
Total cash and cash equivalents	$ 19,552,107	29,182,325

(Continued)

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2008 and 2007

		2008	2007
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	10,156,125	11,813,565
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation		13,117,101	12,942,632
Changes in assets and liabilities:			
Receivables		(901,135)	(2,028,674)
Due from/to other funds		(80,286)	(414,680)
Inventory of materials and supplies		14,031	(136,105)
Prepaid items		(353,615)	(72,560)
Other assets		(182,465)	31,018
Accounts payable		625,201	454,822
Accrued wages and compensated absences		397,952	472,889
Net cash provided by operating activities	$	22,792,909	23,062,907
Noncash activities:			
During the year, water mains and related property installed by others were deeded to the Water Works in the amount of	$	899,576	2,178,360

See accompanying notes to basic financial statements.

(1) Summary of Significant Accounting Policies

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

(a) Reporting Entity

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

(1) Appointment of a voting majority of the component unit's board and either

(a) the ability to impose will by the primary government or

(b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or

(2) Fiscal dependency on the primary government.

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

(b) Basis of Accounting

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

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.

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 $39,267 and $70,720 as of December 31, 2008 and 2007, respectively. The year-end balance includes actual unpaid charges and a year-end estimate of the 2008 receivables that will be billed in the first quarter of 2009.

(e) Inventory of Materials and Supplies

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

(f) Investments

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

- Time deposits maturing within three years in any credit union, bank, savings bank, trust company or savings and loan association which are authorized to transact business in the State of Wisconsin.
- Bonds or securities issued or guaranteed by the Federal government.
- Bonds or securities of any county, city, drainage district, technical college district, village, town or school district of the State of Wisconsin, as well as bonds issued by a local exposition district, a local professional baseball park district, or the University of Wisconsin Hospitals and Clinics Authority.
- Local Government Investment Pool – Investment Fund of the State of Wisconsin.
- Repurchase agreements with public depositories, if the agreement is secured by federal bonds or securities.

(Continued)

- Any Security which matures or which may be tendered for purchase at the option of the holder within not more than seven years of the date on which it is acquired, if that security has a rating which is the highest or second highest rating category assigned by Standard & Poor's Corporation, Moody's Investors Service, Inc. or other similar nationally recognized rating agency or if that security is senior to, or on a parity with, a security of the same issuer which has such a rating.
- Securities of open-end management investment companies or investment trusts (mutual funds) if the portfolio is limited to (a) bonds and securities issued by the federal government or a commission, board or other instrumentality of the federal government, (b) bonds that are guaranteed as to principal and interest by the federal government or a commission, board or other instrumentality of the federal government, and (c) repurchase agreements that are fully collateralized by these bonds or securities.

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

(g) Capital Assets

Capital assets are defined by the Water Works as assets with an initial, individual cost of more than $2,000 and an estimated useful life in excess of a year. Capital assets are capitalized at cost when purchased or constructed. Donated capital assets are recorded at their estimated fair value at the date of donation. Costs of depreciable property retired are removed from utility plant accounts and are charged to accumulated depreciation. Maintenance and repair costs are charged to operations as incurred and renewals and improvements are added to the asset accounts. Depreciation is provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Building and improvements	45 – 58 years
Transmission and distribution systems	64 – 110 years
Machinery and equipment	6 – 56 years

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

Bond premiums, issuance costs, and deferred amounts on refundings are deferred and amortized over the life of the bonds using the effective-interest method. Bonds payable are reported net of the applicable bond premium and deferred amounts on refundings. Bond issuance costs are reported as deferred charges (other assets).

(i) Net Assets

Equity is displayed in three components as follows:

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

Restricted – This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the Water Works' policy to use restricted resources first, and then unrestricted resources when they are needed. The Water Works has restricted net assets of $655,275 and $643,510 at December 31, 2008 and 2007, 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, 2008 and 2007, accumulated sick leave earned but not taken was approximately $4,680,378 and $4,654,078, respectively. Accumulated sick leave is determined on the basis of current salary rate. The amount of accumulated sick leave to be forfeited upon termination and retirement is not available and would reduce this amount. Payments for sick leave to retirees were immaterial to the financial statements for the years ended December 31, 2008 and 2007.

(l) Classification of Revenues and Expense

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

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

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

(m) Taxes

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

(n) Estimates

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

(o) New Accounting Pronouncements

The City, including Water Works, implemented Governmental Accounting Standards Board (GASB) issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* during the year ended December 31, 2008. This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. There was no effect to the Water Works' financial statements as a result of implementing this standard.

In June 2007, the Governmental Accounting Standards Board (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, will implement this Statement beginning with the year ended December 31, 2010, however Water Works does not expect the implementation of the Statement to have a significant impact on its 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, will implement this Statement beginning with the year ended December 31, 2010, however Water Works does not expect the implementation of the Statement to have a significant impact on its financial statements.

(2) Deposits and Investments

As of December 31, 2008 and 2007, the Water Works' deposits and investments were as follows:

		2008	2007
Local Government Investment Pool	$	3,182,553	6,630,025
Deposits and cash on hand		16,369,554	22,552,300
Total	$	19,552,107	29,182,325

(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, 2008 and 2007, 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, 2008 and 2007, there are no investments that are considered to be a concentration of credit risk.

(3) Capital Assets

Capital asset activity for the year ended December 31, 2008 was as follows:

	Balance January 1, 2008	Additions	Deletions	Transfers	Balance December 31, 2008
Capital assets not being depreciated:					
Land and land improvements	$ 1,280,630	—	—	—	1,280,630
Nonutility property, land	287,281	—	—	367,587	654,868
Construction in progress	12,249,080	17,121,829	(18,396,339)	—	10,974,570
Total capital assets not being depreciated	13,816,991	17,121,829	(18,396,339)	367,587	12,910,068
Capital assets being depreciated:					
Buildings	21,291,679	—	—	—	21,291,679
Transmission and distribution system	318,139,222	14,261,289	(1,257,880)	—	331,142,631
Machinery and equipment	201,182,478	4,135,050	(3,735,074)	—	201,582,454
Nonutility property	5,316,305	2,524,619	(1,963,969)	(367,587)	5,509,368
Total capital assets being depreciated	545,929,684	20,920,958	(6,956,923)	(367,587)	559,526,132
Less accumulated depreciation:					
Buildings	13,987,904	675,319	—	—	14,663,223
Transmission and distribution system	75,946,739	3,643,861	(1,267,216)	—	78,323,384
Machinery and equipment	89,787,991	8,797,921	(3,679,554)	—	94,906,358
Non utility property	2,926,193	193,421	(2,336,209)	—	783,405
Total accumulated depreciation	182,648,827	13,310,522	(7,282,979)	—	188,676,370
Total capital assets, being depreciated, net	363,280,857	7,610,436	326,056	(367,587)	370,849,762
Total capital assets, net	$ 377,097,848	24,732,265	(18,070,283)	—	383,759,830

(Continued)

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

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

(Continued)

(4) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations for the year ended December 31, 2008 were as follows:

	Balance January 1, 2008	Additions	Deletions	Balance December 31, 2008	Due within one year
General obligation bonds	$ 19,894,813	—	(2,845,339)	17,049,474	1,989,325
Unamortized premiums	943,045	—	(192,141)	750,904	—
Deferred amount on refundings	(518,655)	—	162,710	(355,945)	—
Revenue bonds	11,206,602	—	(891,301)	10,315,301	914,832
Total	$ 31,525,805	—	(3,766,071)	27,759,734	2,904,157

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

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

(b) General Obligation Bonds

The City issues general obligation bonds to provide funds for the acquisition and construction of the water plant and related equipment. General obligation bonds are secured by the full faith and unlimited taxing power of the City. The bonds for the Water Works will be retired by revenues from water services or, if the revenues are not sufficient, by future tax levies. The original amount of general obligation bonds issued in prior years was $44,089,019. There were no general obligation bonds issued during the years ended December 31, 2008 and 2007.

(Continued)

General obligation bonds outstanding at December 31, 2008 and 2007 were as follows:

Series	Maturity	Interest rates	Original	Principal Balance December 31, 2008	Principal Balance December 31, 2007
Refunding C&D	2009 to 2010	6.00%	$ 4,851,248	669,892	1,185,168
K	2008	5.00	18,044,000	—	1,202,340
Refunding E	2009 to 2019	4.25 to 5.00	3,125,658	1,827,852	2,230,640
Refunding C, D, F, G, J, & K	2009 to 2016	5.00 to 5.25	17,953,357	14,436,974	15,161,909
Refunding 2006 N9, Refd C&D	2011 to 2015	4.25 to 5.00	114,756	114,756	114,756
Total			$ 44,089,019	17,049,474	19,894,813

(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, 2008 and 2007 were as follows:

Series	Maturity	Interest rates	Original	Principal Balance at December 31, 2008	Principal Balance at December 31, 2007
SDW-1	2009 to 2018	2.64%	$ 4,873,153	2,862,746	3,110,104
SDW-2	2009 to 2018	2.64	1,618,213	950,624	1,032,762
SDW-3	2009 to 2018	2.64	5,001,067	2,937,889	3,191,740
SDW-4	2009 to 2018	2.64	4,148,305	2,436,932	2,647,497
SDW-5	2009 to 2018	2.64	1,918,640	1,127,110	1,224,499
Total			$ 17,559,378	10,315,301	11,206,602

(d) *Debt Service Requirements*

The maturities of the outstanding principal and related interest requirements as of December 31, 2008 are as follows:

	General obligation bonds		Revenue bonds	
	Principal	Interest	Principal	Interest
Year:				
2009	$ 1,989,325	850,311	914,832	260,248
2010	2,491,847	753,165	938,984	235,778
2011	2,965,418	634,404	963,773	210,661
2012	2,490,532	493,501	989,216	184,882
2013	2,101,350	359,316	1,015,331	158,422
2014 – 2018	4,987,591	450,243	5,493,165	370,104
2019 – 2023	23,411	585	—	—
Totals	$ 17,049,474	3,541,525	10,315,301	1,420,095

(5) Revenue Bond Debt Covenants

	Gross revenues	Debt coverage expenses	Net revenue available for debt service	Debt service requirements			Coverage
				Principal	Interest	Total	
Fiscal year:							
2007	$ 74,211,042	55,514,453	18,696,589	891,302	284,089	1,175,391	15.91
2008	74,206,986	58,959,988	15,246,998	914,832	260,248	1,175,080	12.98

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, 2008 and 2007, 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 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.

(Continued)

Funding Policy – Plan members are required to contribute, or have contributed on their behalf, a percentage of their annual earnable compensation equal to 5.5%, 6%, 7% and 7% for general City employees, police officers, firefighters, and elected officials, respectively. New hires who are not sworn police/fire must pay 1.6% of pensionable earnings for 8 years to fund the cost of benefit escalators due to the Global Pension Settlement. The City is required to contribute the actuarially determined amount. The City Charter assigns the authority to establish and amend contribution requirements. The Water Works' contribution to the System for the years ended December 31, 2008, 2007, and 2006 was $981,372, $983,438, and $976,658, 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.

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

Funding Policy. The contribution of plan members and the Waterworks are established and may be amended by the City. The required contribution for medical and life insurance for retirees is based on a pay-as-you-go financing. Medical benefits provided through the basic health care plan are self-insured. For 2008, the Water Works and its plan members receiving benefits paid approximately $1,082,000 and $30,000, respectively, toward medical and life insurance for retirees. For 2007, the Water Works and its plan members receiving benefits paid approximately $985,000 and $40,000, respectively, toward medical and life insurance for retirees.

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

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, 2008 and 2007:

		2008	2007
Annual required contribution (ARC)	$	1,898,613	1,815,000
Interest on net OPEB obligation		35,550	—
Adjustment to ARC		(31,324)	—
Annual OPEB cost		1,902,839	1,815,000
Contributions made		1,111,870	1,024,710
Increase in net OPEB obligation		(790,969)	(790,290)
Net OPEB obligation at beginning of year		(790,290)	—
Net OPEB obligation at end of year	$	(1,581,259)	(790,290)

The Water Works annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2008 and 2007 were as follows:

	Employer contribution		
	Annual OPEB cost	Percentage contributed	Net OPEB obligation
Year ended December 31:			
2008	$ 1,902,839	58.4%	$ 1,581,259
2007	1,815,000	56.5	790,290

Funded Status and Funding Progress. As of January 1, 2007, the most recent actuarial valuation date, the actuarial accrued liability for benefits related to all City employees was $880,700,000, and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of $880,700,000. 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 $425,400,000 and the ratio of the UAAL to the covered payroll was 207%. The covered payroll for Water Works employees was $17,700,000.

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

(7) Related-Party Transactions

A summary of significant revenue and expense transactions between the City and Water Works for 2008 and 2007 is shown below:

		2008	2007
Revenues (receipts from the City) – water consumption	$	364,240	326,202
Expenses (payments to the City):			
Payment in lieu of taxes	$	8,696,137	7,766,749
Employee fringe benefits		6,837,472	6,797,836
Administrative services		862,730	950,003
Electrical equipment maintenance		443,497	373,159
Motor vehicle usage and maintenance		950,068	715,733
Street repairs		3,382,344	2,361,188
All other services		6,278,799	5,591,816
Total payments to the City	$	27,451,047	24,556,484

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

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

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

(8) Regulatory Agency

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

(Continued)

The effect of such differences on net income is as follows for the years ended December 31, 2008 and 2007:

		2008	2007
		(In thousands)	
Increase in net assets as shown in accompanying financial statements	$	2,042	6,862
Amortization of deferred credits resulting from Contributions in Aid of Construction (CIAC) reclassification		811	811
Contributions in Aid of Construction, timing difference		(189)	—
Administrative service charge from another City department, timing difference		—	258
Net income as shown on PSC reports	$	2,664	7,931

(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, 2008 totaled $8,056,345.

(10) Transfers and Inter-Fund Balances

At December 31, 2008 and 2007, the Water Works has recorded a due from other funds of $4,277,173 and $4,702,423, respectively, which in part represents cash held by the general obligation debt fund of the City on behalf of Water Works for the 2008 and 2007 respective principal and interest payments on its general obligation bonds. The remaining balance represents the amount owed to the Water Works as a result of regular advance and reimbursement activities. At December 31, 2008 and 2007, the Water Works has recorded a due to the City (General and Sewer Funds) of $7,953,202 and $9,790,683, respectively, for sewer maintenance and other municipal fees collected by the Water Works.

The Water Works transfers funds to the City (general fund) for payments in lieu of taxes (PILOT). In 2008 and 2007, the PILOT transfers to the City were $8,696,137 and $7,766,749, respectively.