

CITY OF CLEVELAND, OHIO



**DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**REPORT ON AUDITS OF FINANCIAL STATEMENTS
For the years ended December 31, 2008 and 2007**

CITY OF CLEVELAND, OHIO

**DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

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Mary Taylor, CPA

Auditor of State

INDEPENDENT ACCOUNTANTS' REPORT

Division of Water
Department of Public Utilities
City of Cleveland
Cuyahoga County
601 Lakeside Avenue
Cleveland, Ohio 44114

To the Honorable Frank G. Jackson, Mayor, Members of Council, and the Audit Committee:

We have audited the accompanying basic financial statements of the Division of Water, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, (the Division) as of and for the years ended December 31, 2008 and December 31, 2007, as listed in the table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express opinions 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 audits to reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 opinions.

As described in Note A, the financial statements present only the financial position and the changes in financial position and cash flows of the Division and do not purport to, and do not, present fairly the financial position of the City of Cleveland as of December 31, 2008 and December 31, 2007, and the respective changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Division of Water, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, as of December 31, 2008 and December 31, 2007, and the respective changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Division of Water
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City of Cleveland
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Independent Accountants' Report
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Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information accounting principles generally accepted in the United States of America requires. 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.

A handwritten signature in black ink that reads "Mary Taylor". The signature is written in a cursive, flowing style.

Mary Taylor, CPA
Auditor of State

June 25, 2009

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS

GENERAL

As management of the City of Cleveland's (the City) Department of Public Utilities, Division of Water (the Division), we offer readers of the Division's financial statements this narrative overview and analysis of the financial activities of the Division for the years ended December 31, 2008 and 2007. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 16.

The Division was created in 1853 and charged with the responsibility of collecting, treating, pumping and distributing potable water and providing related water service to customers within its service areas. The Division operates a major public water supply system, the eighth largest in the United States, serving not only the City, but also 70 suburban municipalities in Cuyahoga, Medina, Summit and Geauga counties. The Division is an emergency standby provider for systems in three other counties. The present service area covers over 640 square miles and serves over 1.5 million people. In 2008, the aggregate metered consumption of water in the City constituted 34% of the total metered consumption in the service area, while consumption in the direct service communities and master meter communities constituted 57% and 9%, respectively.

COMPARISON OF CURRENT YEAR'S AND PRIOR YEARS' DATA

FINANCIAL HIGHLIGHTS

- The assets of the Division exceeded its liabilities (net assets) by \$996,292,000, \$955,602,000 and \$900,779,000 at December 31, 2008, 2007 and 2006, respectively. Of these amounts, \$247,760,000, \$252,494,000 and \$243,388,000 (unrestricted net assets) at December 31, 2008, 2007 and 2006, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.
- In 2008, the operating revenues of the Division increased by \$1,553,000 due to a rate increase of approximately 7.3%, which was partially offset by a decrease in billed consumption of 4.50%. Billed consumption decreased in several major users, such as Ford Motor Company, North East Ohio Regional Sewer District, Cuyahoga Metropolitan Housing Authority and Cleveland Clinic Foundation, due to a decrease of needed services. In 2007 the operating revenues of the Division increased by \$30,650,000 due to a combined rate increase of approximately 5.5%, a quarterly service charge of \$7 and an increase in billed consumption of 1.92%. Billed consumption increased in several major users, such as Mittal Steel, Ford Motor Company, North East Ohio Regional Sewer District and Stouffer Company, due to an increase of needed services.
- The Division's overall net assets increased by \$40,690,000, \$54,823,000 and \$19,992,000 in 2008, 2007 and 2006, respectively.
- The Division had increases in capital assets, net of accumulated depreciation, of \$34,219,000, \$65,679,000 and \$67,540,000 and in 2008, 2007 and 2006, respectively. The major additions during these years were related to the continuing renovation projects at the Morgan, Baldwin and Nottingham sites.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

FINANCIAL HIGHLIGHTS (Continued)

- The total long-term debt of the Division decreased by \$25,909,000 in 2008. This decrease is attributed to \$24,796,000, of debt retired and \$99,480,000 debt defeased which was offset by the issuance of \$90,800,000 Series Q Bonds and the receipts of two Ohio Water Development Authority loans totaling \$7,567,000. The total long-term debt of the Division increased by \$116,037,000 in 2007. This increase is attributed to the issuance of \$143,570,000 Series O and \$135,410,000 Series P Water Revenue Bonds and the receipt of five Ohio Water Development Authority Loans totaling \$10,923,000, which was offset by \$21,546,000 of debt retired and \$152,320,000 debt defeased. In 2006, the total long-term debt decreased by \$1,937,000. This decrease is attributed to \$20,209,000 of debt retired and \$11,770,000 of debt defeased, which was offset by the receipt of four Ohio Water Development Authority Loans totaling \$30,042,000.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Division's basic financial statements. The accompanying financial statements present financial information for the City's Division of Water Fund, in which the City accounts for the operations of the Department of Public Utilities Division of Water.

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Division of Water Fund is considered an enterprise fund because the operations of the Division are similar to a private-sector business enterprise. Accordingly, in accounting for the activities of the Division, the economic resources measurement focus and the accrual basis of accounting is used. This is similar to businesses in the private sector.

The basic financial statements of the Division can be found on pages 16 - 21 of this report.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 22 - 40 of this report.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION

Provided below is condensed balance sheet information for the Division as of December 31, 2008, 2007 and 2006:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands)		
Assets:			
Capital assets, net	\$ 1,360,889	\$ 1,326,670	\$ 1,260,991
Restricted assets	304,530	316,814	222,739
Unamortized bond issuance costs	6,081	7,097	5,704
Current assets	<u>308,050</u>	<u>313,085</u>	<u>292,640</u>
 Total assets	 <u>1,979,550</u>	 <u>1,963,666</u>	 <u>1,782,074</u>
 Net Assets and Liabilities:			
Net Assets:			
Invested in capital assets, net of related debt	649,739	613,294	573,657
Restricted for debt service	98,793	89,814	83,734
Unrestricted	<u>247,760</u>	<u>252,494</u>	<u>243,388</u>
Total net assets	996,292	955,602	900,779
Liabilities:			
Long-term obligations	897,518	931,062	810,767
Current liabilities	<u>85,740</u>	<u>77,002</u>	<u>70,528</u>
Total liabilities	983,258	1,008,064	881,295
Total net assets and liabilities	<u>\$ 1,979,550</u>	<u>\$ 1,963,666</u>	<u>\$ 1,782,074</u>

Total Assets: The Division's investment in capital assets as of December 31, 2008 amounted to \$1,360,889,000 (net of accumulated depreciation) which is an increase of \$34,219,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had net additions of \$54,869,000, buildings, structures and improvements had net additions \$4,977,000 and furniture, fixtures, equipment and vehicles had net additions of \$74,111,000. Also, net construction in progress decreased by \$59,027,000 due to the finish of several major projects: electric power backups, Morgan filter improvements and Baldwin plant improvements.

The Division's investment in capital assets as of December 31, 2007 amounted to \$1,326,670,000 (net of accumulated depreciation) which is an increase of \$65,679,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had net additions of \$27,822,000, buildings, structures and improvements had net additions of \$8,697,000 and furniture, fixtures, equipment and vehicles had net additions of \$8,940,000. Also, net construction in progress increased by \$56,937,000 due to continuing renovations to the Morgan, Baldwin and Nottingham plants.

The reduction in restricted assets of \$12,284,000 is mainly attributed to the plant enhancement projects that decreased cash and investment balances.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

The decrease in current assets of \$5,035,000 was primarily due to additions of \$36,822,000 in cash and cash equivalents, \$5,883,000 in accounts receivable and \$845,000 in unbilled revenue, offset by a decrease of \$45,618,000 in investments at fair value and \$2,826,000 in current restricted cash and cash equivalents.

Capital Assets: The Division's investment in capital assets, as of December 31, 2008 amounted to \$1,360,889,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was approximately 2.6%. The Division's investment in capital assets, as of December 31, 2007 amounted to \$1,326,670,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for 2007 was approximately 5.2%. A summary of the activity in the Division's capital assets during the years ended December 31, 2008 and 2007 is as follows:

	Balance January 1, 2008	Additions	Reductions	Balance December 31, 2008
(In thousands)				
Land	\$ 5,463	\$	\$	\$ 5,463
Land improvements	16,973			16,973
Utility plant	1,084,014	56,712	(1,843)	1,138,883
Buildings, structures and improvements	213,217	4,977		218,194
Furniture, fixtures, equipment and vehicles	140,220	75,177	(1,066)	214,331
Construction in progress	372,829	74,559	(133,586)	313,802
Total	1,832,716	211,425	(136,495)	1,907,646
Less: Accumulated depreciation	(506,046)	(41,857)	1,146	(546,757)
Capital assets, net	<u>\$ 1,326,670</u>	<u>\$ 169,568</u>	<u>\$ (135,349)</u>	<u>\$ 1,360,889</u>

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

	Balance January 1, 2007	Additions	Reductions	Balance December 31, 2007
	(In thousands)			
Land	\$ 5,463	\$	\$	\$ 5,463
Land improvements	16,973			16,973
Utility plant	1,056,192	29,377	(1,555)	1,084,014
Buildings, structures and improvements	204,520	8,697		213,217
Furniture, fixtures, equipment and vehicles	131,280	10,432	(1,492)	140,220
Construction in progress	315,892	104,750	(47,813)	372,829
Total	1,730,320	153,256	(50,860)	1,832,716
Less: Accumulated depreciation	(469,329)	(38,994)	2,277	(506,046)
Capital assets, net	<u>\$ 1,260,991</u>	<u>\$ 114,262</u>	<u>\$ (48,583)</u>	<u>\$ 1,326,670</u>

Major events during 2008 affecting the Division's capital assets included the following:

- The construction, renovations, and plant enhancements on the Morgan, Baldwin and Nottingham facilities and the rehabilitation of water mains amounted to \$64,000,000. The major programs are: Security Enhancements Program, Plant Enhancement Program, Electrical Power Reliability Program, the Customer Information System, the purchase of office equipment and vehicles for \$45,000,000 and water main rehabilitation for \$6,200,000.

Major events during 2007 affecting the Division's capital assets included the following:

- The construction, renovations, and plant enhancements on the Morgan, Baldwin and Nottingham facilities and the rehabilitation of water mains amounted to \$90,780,000. The major programs are: Security Enhancements Program, Plant Enhancement Program, Electrical Power Reliability Program, the coordinated Graphical Information System, the purchase of office equipment and vehicles for \$1,100,000 and water main rehabilitation for \$7,050,000.

Additional information on the Division's capital assets, including commitments made for future capital expenditures, can be found in Notes A and D to the basic financial statements.

Liabilities: In 2008, the factors for the Division's net decrease in long-term obligations of \$33,544,000 is attributed to the receipt of Ohio Water Development Authority Loans of \$7,567,000, the issuance of \$90,800,000 of new bonds, a decrease in the unamortized discount and premium of \$2,036,000 and a decrease in long-term accrued wages and benefits of \$21,000. These amounts were offset by \$24,796,000 of debt retirement, \$99,480,000 of debt defeased and a decrease in unamortized loss of debt refunding of \$2,304,000.

**CITY OF CLEVELAND, OHIO
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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

In 2007, the factors for the Division's net increase in long-term obligations of \$120,295,000 is attributed to the receipt of Ohio Water Development Authority Loans of \$10,923,000, issuances of \$278,980,000 of new bonds, an increase in the unamortized discount and premium of \$10,009,000 and a decrease in long-term accrued wages and benefits of \$209,000. These amounts were offset by \$21,546,000 of debt retirement, \$152,320,000 of debt defeased and an increase in unamortized loss of debt refunding of \$2,170,000. There was also an increase in the current portion of long-term obligations of \$3,372,000.

Current Liabilities: In 2008, total current liabilities increased by \$8,738,000. The significant components of the change were increases to the current portion of long-term debt of \$7,882,000, accounts payable of \$389,000, current portion of accrued wages and benefits of \$630,000, accrued interest of \$2,982,000 and customer deposits and other liabilities of \$309,000. These increases were offset by reductions of \$2,825,000 payable from restricted assets and \$629,000 due to other City of Cleveland departments, divisions or funds. There was also an increase in the current portion of long-term obligations of \$7,882,000.

In 2007, total current liabilities increased by \$6,474,000. The significant components of the change were increases to the current portion of long-term debt of \$3,372,000, payable from restricted assets of \$879,000, accounts payable of \$647,000, due to other City of Cleveland departments, divisions or funds of \$589,000 and accrued wages and benefits of \$1,068,000. These increases were offset by reductions of \$51,000 in accrued interest payable and customer deposits and other liabilities of \$30,000.

Long-term Debt: At the end of 2008, the Division had total long-term debt outstanding of \$945,953,000. All bonds and notes are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

At the end of 2007, the Division had total long-term debt outstanding of \$971,862,000. All bonds and notes are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2008 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	Balance January 1, 2008	Debt Issued	Debt Defeased	Debt Retired	Balance December 31, 2008
	(In thousands)				
Water Revenue Bonds:					
Series G, 1993	\$ 107,760	\$	\$	\$	\$ 107,760
Series H, 1996	14,280			(6,290)	7,990
Series I, 1998	16,655		(7,005)	(6,120)	3,530
Series J, 2001	56,240			(2,855)	53,385
Series K, 2002	65,740			(4,135)	61,605
Series L, 2002	90,000		(90,000)		-
Series M, 2004	172,335				172,335
Series N, 2005	64,480			(260)	64,220
Series O, 2007	143,570		(2,475)		141,095
Series P, 2007	135,410				135,410
Series Q, 2008		90,800			90,800
Ohio Water Development Authority Loans	105,392	7,567		(5,136)	107,823
Total	\$ 971,862	\$ 98,367	\$ (99,480)	\$ (24,796)	\$ 945,953

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2007 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	Balance January 1, 2007	Debt Issued	Debt Defeased	Debt Retired	Balance December 31, 2007
	(In thousands)				
Water Revenue Bonds:					
Series G, 1993	\$ 121,275	\$	\$ (12,290)	\$ (1,225)	\$ 107,760
Series H, 1996	14,470			(190)	14,280
Series I, 1998	161,875		(140,030)	(5,190)	16,655
Series J, 2001	63,345			(7,105)	56,240
Series K, 2002	69,725			(3,985)	65,740
Series L, 2002	90,000				90,000
Series M, 2004	172,335				172,335
Series N, 2005	64,480				64,480
Series O, 2007		143,570			143,570
Series P, 2007		135,410			135,410
Ohio Water Development Authority Loans	98,320	10,923		(3,851)	105,392
Total	\$ 855,825	\$ 289,903	\$ (152,320)	\$ (21,546)	\$ 971,862

The bond ratings for the Division's outstanding revenue bonds are as follows:

Moody's		Standard & Poor's
Investors Service	Standard & Poor's	
Aa2	AA	

The ratio of net revenue available for debt service to debt service requirements (revenue bond coverage) is a useful indicator of the Division's debt position to management, customers and creditors. The Division's revenue bond coverage for 2008, 2007 and 2006 was 166%, 234%, and 172%, respectively.

Additional information on the Division's long-term debt can be found in Note B on pages 25 - 32.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

Net Assets: Net assets serve as a useful indicator of a government's financial position. In the case of the Division, assets exceed liabilities by \$996,292,000, \$955,602,000 and \$900,779,000 at December 31, 2008, 2007 and 2006, respectively.

Of the Division's net assets, \$649,739,000, or 65% and \$613,294,000, or 64% at December 31, 2008 and 2007, respectively, reflects its investment in capital assets (e.g., land, buildings, utility plant, machinery and equipment), net of accumulated depreciation, less any related, still-outstanding debt used to acquire those assets. The Division uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Division's net assets, \$98,793,000, or 10% and \$89,814,000, or 9% at December 31, 2008 and 2007, respectively, represents resources that are subject to external restrictions. These funds are set aside for the payment of revenue bonds or represent unspent bond proceeds relating to capital projects. The remaining balance of unrestricted net assets, \$247,760,000, or 25% and \$252,494,000, or 27% at December 31, 2008 and 2007, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

**CONDENSED STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS INFORMATION**

The Division's operations during 2008 and 2007 increased its net assets by \$40,690,000 and \$54,823,000, respectively. The following table identifies the key elements of the Division's results of operations as of and for the years ended December 31, 2008, 2007 and 2006:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
	(In thousands)		
Operating revenues	\$ 242,181	\$ 240,628	\$ 209,978
Operating expenses	<u>185,690</u>	<u>179,203</u>	<u>170,461</u>
Operating income	<u>56,491</u>	<u>61,425</u>	<u>39,517</u>
Non-operating revenue (expense):			
Investment income	10,479	17,364	13,925
Interest expense	(27,633)	(25,541)	(33,690)
Amortization of bond issuance costs, premiums and discounts	1,267	729	637
Workers' compensation refund	16	47	11
Gain (Loss) on disposal of capital assets	<u>(12)</u>	<u></u>	<u>(894)</u>
Total non-operating revenue (expense), net	<u>(15,883)</u>	<u>(7,401)</u>	<u>(20,011)</u>
Income (loss) before other contributions	40,608	54,024	19,506
Capital and other contributions	<u>82</u>	<u>799</u>	<u>486</u>
Increase in net assets	40,690	54,823	19,992
Net assets, beginning of year	<u>955,602</u>	<u>900,779</u>	<u>880,787</u>
Net assets, end of year	<u>\$ 996,292</u>	<u>\$ 955,602</u>	<u>\$ 900,779</u>

Operating revenue: In 2008, total operating revenues increased by \$1,553,000 due to an increase of water service rates of approximately 7.3% which was partially offset by a decrease in billed consumption of 4.50%. Billed consumption decreased in several major users, such as Ford Motor Company, North East Ohio Regional Sewer District, Cuyahoga Metropolitan Housing Authority and Cleveland Clinic Foundation.

In 2007, total operating revenues increased by \$30,650,000 due to an increase of water service rates of approximately 5.5%, a quarterly service charge of \$7 and an increase in billed consumption of 1.92%. Billed consumption increased in several major users, such as Mittal Steel, Ford Motor Company, North East Ohio Regional Sewer District and Stouffer Company.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

**CONDENSED STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS INFORMATION (Continued)**

Operating expenses: In 2008, the overall increase in operating expenses of \$6,487,000 was due to a \$2,645,000 increase in operations expense, \$978,000 increase in maintenance expenses and \$2,864,000 increase for depreciation expense.

In 2007, the overall increase in operating expenses of \$8,742,000 was due to a \$5,850,000 increase in operations expense, \$1,481,000 increase in maintenance expenses and \$1,411,000 increase for depreciation expense.

Non-operating revenue (expense): The major changes were a decrease of \$6,885,000 in investment income (attributed to declining interest rates) and an increase of \$2,092,000 in interest expense.

In 2007, total net non-operating revenue (expense) decreased by \$12,610,000, primarily due to an increase of \$3,439,000 in investment income and a decrease of \$8,149,000 in interest expense.

**FACTORS EXPECTED TO IMPACT THE DIVISION'S FUTURE
FINANCIAL POSITION OR RESULTS OF OPERATIONS**

Water rate increases will continue to have a positive impact on the financial position of the Division:

CLEVELAND - PER MCF (Thousand cubic feet)			CLEVELAND - PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2008	\$10.63	\$4.72	\$22.73	\$4.72
January 1, 2009	\$11.59	\$5.15	\$24.78	\$5.15
January 1, 2010	\$12.58	\$5.59	\$26.90	\$5.59

DIRECT SERVICE SUBURBS - PER MCF (Thousand cubic feet)			DIRECT SERVICE SUBURBS-PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2008	\$17.54-\$23.17	\$7.79-\$10.29	\$37.50-\$49.55	\$7.79-\$10.29
January 1, 2009	\$18.54-\$24.57	\$8.24-\$10.92	\$39.65-\$52.53	\$8.24-\$10.92
January 1, 2010	\$19.50-\$25.91	\$8.66-\$11.52	\$41.70-\$55.41	\$8.66-\$11.52

Legislation was passed in June 2006 for annual rate increases thru 2010 which will increase operating revenue to adequately cover anticipated operating expenditures.

**CITY OF CLEVELAND, OHIO
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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

**FACTORS EXPECTED TO IMPACT THE DIVISION'S FUTURE
FINANCIAL POSITION OR RESULTS OF OPERATIONS (Continued)**

Effective February 12, 2009, the City issued \$54,735,000 Water Revenue Bonds, Series R, 2009 and \$26,295,000 Water Revenue Bonds, Series S, 2009. These bonds were issued to refund a portion of the outstanding Water Revenue Bonds, Series M, 2004. The Series M Bonds were refunded in order to address the increased interest rates incurred on the bonds as a result of the downgrade of the bond insurer and liquidity facility provider. The Series R and Series S Bonds were issued as weekly variable rate demand bonds. The Series R Bonds are secured by a direct pay letter of credit issued by BNP Paribas while the Series S Bonds are secured by the letter of credit provided by Allied Irish Banks, p.l.c.. In conjunction with the issuance of the Series R and S Bonds, the City issued \$84,625,000 Water Revenue Bonds, Series T, 2009 effective February 25, 2009. These bonds, which are fixed rate bonds, refunded the remaining portion of the outstanding Series M Bonds. At the time of the refundings, the interest rate swaps associated with the Series M Bonds were transferred to the Series R and Series S Bonds with the remaining portion being assigned to the Series Q Bonds issued in 2008.

ADDITIONAL INFORMATION

This financial report is designed to provide a general overview of the Division's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of the Finance Director, City Hall, Room 104, 601 Lakeside Avenue, Cleveland, Ohio 44114.

BASIC FINANCIAL STATEMENTS

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES

DIVISION OF WATER

BALANCE SHEETS

December 31, 2008 and 2007

	<i>(In thousands)</i>	
	2008	2007
ASSETS		
CAPITAL ASSETS		
Land	\$ 5,463	\$ 5,463
Land improvements	16,973	16,973
Utility plant	1,138,883	1,084,014
Buildings, structures and improvements	218,194	213,217
Furniture, fixtures, equipment and vehicles	214,331	140,220
	<u>1,593,844</u>	<u>1,459,887</u>
Less: Accumulated depreciation	(546,757)	(506,046)
	1,047,087	953,841
Construction in progress	313,802	372,829
	<u>1,360,889</u>	<u>1,326,670</u>
CAPITAL ASSETS, NET		
	1,360,889	1,326,670
RESTRICTED ASSETS		
Cash and cash equivalents	298,962	310,634
Investments	5,208	5,146
Accrued interest receivable	360	1,034
	<u>304,530</u>	<u>316,814</u>
TOTAL RESTRICTED ASSETS		
	304,530	316,814
UNAMORTIZED BOND ISSUANCE COSTS	6,081	7,097
CURRENT ASSETS		
Cash and cash equivalents	162,498	125,676
Restricted cash and cash equivalents	11,036	13,862
Investments	58,921	104,539
Receivables:		
Accounts receivable - net of allowance for doubtful accounts		
of \$14,241,000 in 2008 and \$13,303,000 in 2007	37,137	31,254
Unbilled revenue	29,280	28,435
Due from other City of Cleveland departments, divisions or funds	3,009	2,766
Accrued interest receivable	699	1,410
Materials and supplies - at average cost, net of allowance for		
obsolescence of \$600,000 in 2008 and \$600,000 2007	3,285	3,059
Prepaid expenses	2,185	2,084
	<u>308,050</u>	<u>313,085</u>
TOTAL CURRENT ASSETS		
	308,050	313,085
TOTAL ASSETS	<u>\$ 1,979,550</u>	<u>\$ 1,963,666</u>

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES

DIVISION OF WATER

BALANCE SHEETS

December 31, 2008 and 2007

(In thousands)

	2008	2007
NET ASSETS AND LIABILITIES		
NET ASSETS		
Invested in capital assets, net of related debt	\$ 649,739	\$ 613,294
Restricted for debt service	98,793	89,814
Unrestricted	<u>247,760</u>	<u>252,494</u>
TOTAL NET ASSETS	996,292	955,602
LIABILITIES		
LONG-TERM OBLIGATIONS-excluding amounts due within one year		
Revenue bonds	792,455	828,152
OWDA loans	103,014	100,840
Accrued wages and benefits	<u>2,049</u>	<u>2,070</u>
TOTAL LONG-TERM OBLIGATIONS	897,518	931,062
CURRENT LIABILITIES		
Current portion of long-term debt, due within one year	32,094	24,212
Accounts payable	3,653	3,264
Current payable from restricted assets	11,036	13,861
Due to other City of Cleveland departments, divisions or funds	2,574	3,203
Accrued interest	19,310	16,328
Current portion of accrued wages and benefits	11,790	11,160
Other accrued expenses	393	393
Customer deposits and other liabilities	<u>4,890</u>	<u>4,581</u>
TOTAL CURRENT LIABILITIES	85,740	77,002
TOTAL LIABILITIES	<u>983,258</u>	<u>1,008,064</u>
TOTAL NET ASSETS AND LIABILITIES	<u>\$ 1,979,550</u>	<u>\$ 1,963,666</u>

See notes to financial statements.

(Concluded)

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CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Years Ended December 31, 2008 and 2007

	<i>(In thousands)</i>	
	2008	2007
OPERATING REVENUES		
Charges for services	\$ 242,181	\$ 240,628
TOTAL OPERATING REVENUES	242,181	240,628
OPERATING EXPENSES		
Operations	92,866	90,221
Maintenance	50,967	49,989
Depreciation	41,857	38,993
TOTAL OPERATING EXPENSES	185,690	179,203
OPERATING INCOME	56,491	61,425
NON-OPERATING REVENUE (EXPENSE)		
Investment income	10,479	17,364
Interest expense	(27,633)	(25,541)
Amortization of bond issuance costs, premiums, and discounts	1,267	729
Workers' compensation refund	16	47
Gain (loss) on disposal of capital assets	(12)	—
TOTAL NON-OPERATING REVENUE (EXPENSE), NET	(15,883)	(7,401)
INCOME (LOSS) BEFORE OTHER CONTRIBUTIONS	40,608	54,024
CAPITAL AND OTHER CONTRIBUTIONS	82	799
INCREASE IN NET ASSETS	40,690	54,823
NET ASSETS, beginning of year	955,602	900,779
NET ASSETS, end of year	\$ 996,292	\$ 955,602

See notes to financial statements.

CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2008 and 2007

	<i>(In thousands)</i>	
	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 232,489	\$ 229,068
Cash payments to suppliers for goods or services	(62,328)	(58,170)
Cash payments to employees for services	<u>(78,520)</u>	<u>(76,998)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	91,641	93,900
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Capital and other contributions	82	1,879
Workers' compensation refund	<u>16</u>	<u>47</u>
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	98	1,926
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(61,932)	(97,950)
Proceeds of OWDA loan	7,500	10,625
Principal paid on long-term debt	(24,959)	(21,005)
Interest paid on long-term debt	(42,708)	(39,731)
Cash paid to escrow agent for refunding	(100,333)	(157,426)
Proceeds of bonds, premiums and discounts	<u>90,800</u>	<u>290,389</u>
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	(131,632)	(15,098)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities		(91,814)
Proceeds from sale and maturity of investment securities	45,864	111,666
Interest received on investments	<u>16,353</u>	<u>21,975</u>
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	<u>62,217</u>	<u>41,827</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	22,324	122,555
CASH AND CASH EQUIVALENTS, beginning of year	<u>450,172</u>	<u>327,617</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 472,496</u>	<u>\$ 450,172</u>

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES DIVISION OF WATER

STATEMENTS OF CASH FLOWS For the Years Ended December 31, 2008 and 2007

	<i>(In thousands)</i>	
	<u>2008</u>	<u>2007</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
OPERATING INCOME	\$ 56,491	\$ 61,425
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	41,857	38,993
Changes in assets and liabilities:		
Accounts receivable, net	(5,883)	(4,554)
Unbilled revenue	(845)	(4,282)
Due from other City of Cleveland departments, divisions or funds	(243)	797
Materials and supplies, net	(226)	(143)
Prepaid expenses	(101)	(401)
Accounts payable	389	647
Due to other City of Cleveland departments, divisions or funds	(629)	589
Accrued wages and benefits	609	859
Customer deposits and other liabilities	222	(30)
TOTAL ADJUSTMENTS	<u>35,150</u>	<u>32,475</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 91,641</u>	<u>\$ 93,900</u>

(Concluded)

See notes to financial statements.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2008 and 2007**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Division of Water (Division) is reported as an Enterprise Fund of the City of Cleveland's Department of Public Utilities and is a part of the City of Cleveland's (City) primary government. The Division was created for the purpose of supplying water services to customers within the metropolitan area. The following is a summary of the more significant accounting policies.

Reporting Model and Basis of Accounting: The accounting policies and financial reporting practices of the Division comply with accounting principles generally accepted in the United States of America applicable to governmental units. In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which is effective for the year ended December 31, 2007. The Division has determined that GASB Statement No. 45 has no impact on its financial statements as of December 31, 2007. Effective January 1, 2007, the City implemented GASB Statement No. 48, *Sales and Pledges of Receivables and Intra-Entity Transfers of Assets and Future Revenue*, which is effective for the year ended December 31, 2007. GASB Statement No. 48 established criteria to ascertain whether certain transactions should be regarded as sales or as collateralized borrowings, as well as disclosure requirements for future revenues that are pledged and sold. The implementation of GASB Statement No. 48 did not have an effect on the financial statements of the Division; however, additional disclosure related to revenues pledged for the repayment of revenue bonds has been provided in Note B – Long-Term Debt. In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which is effective for the year ended December 31, 2008. The Division has determined that GASB Statement No. 49 has no impact on its financial statements as of December 31, 2008. In May 2007, GASB issued Statement No. 50, *Pension Disclosure — an amendment of GASB Statements No. 25 and No. 27*, which is effective for the year ended December 31, 2008. The Division has determined that GASB Statement No. 50 has no impact on its financial statements as of December 31, 2008 and the proper disclosures have been made.

The Division's net assets are accounted for in the accompanying balance sheets and the net assets are divided into the following categories:

- Amount invested in capital assets, net of related debt
- Amount restricted for debt service
- Remaining unrestricted amount

In addition, certain additional financial information regarding the Division is included in these footnotes. The implementation of the new GASB statements did not result in a change in the Division's beginning net asset/equity balance as previously reported.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Accounting: The Division's financial statements are prepared under the accrual basis of accounting. Under this method, revenues are recognized when earned and measurable and expenses are recognized as incurred. Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Activities*, all proprietary funds will continue to follow Financial Accounting Standards Board (FASB) standards issued on or before November 30, 1989. However, from that date forward, proprietary funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements), or 2) continuing to follow new FASB pronouncements (unless they conflict with GASB pronouncements). The City has chosen not to apply future FASB standards.

Revenues: Revenues are derived primarily from sales of water to residential, commercial and industrial customers based upon actual water consumption. Water rates are authorized by City Council and billings are made on a cyclical basis. Estimates for services between the ends of the various cycles and the end of the year are recorded as unbilled revenue.

Statement of Cash Flows: The Division utilizes the direct method of reporting for the statement of cash flows as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. In a statement of cash flows, cash receipts and cash payments are classified according to operating, non-capital financing, capital and related financing, and investment activities.

Cash and Cash Equivalents: Cash and cash equivalents represent cash on hand and cash deposits maintained by the City Treasurer on behalf of the Division. Cash equivalents are defined as highly liquid investments with a maturity of three months or less when purchased and include certificates of deposit, U.S. Treasury bills, State Treasury Asset Reserve of Ohio (STAROhio) and repurchase agreements. The City's policy is to enter into repurchase agreements with local commercial banks and to obtain confirmation of securities pledged.

Investments: The Division follows the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, which requires governmental entities to report certain investments at fair value in the balance sheet and recognize the corresponding change in the fair value of investments in the year in which the change occurred. The fair value is based on quoted market prices.

The City has invested funds in STAROhio during 2008 and 2007. STAROhio is an investment pool managed by the State Treasurer's Office, which allows governments within the State to pool their funds for investment purposes. STAROhio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAROhio are valued at STAROhio's share price, which is the price the investment could be sold for on December 31, 2008 and 2007.

Restricted Assets: Proceeds from debt and amounts set aside in various fund accounts for payment of revenue bonds are classified as restricted assets since their use is limited by the bond indentures.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Capital Assets and Depreciation: Capital assets are stated on the basis of historical cost, or if contributed, at fair market value as of the date received. Depreciation is computed by allocating the cost of capital assets over the estimated useful lives of the assets using the straight-line method. A capital asset is defined as a tangible item with a useful life in excess of one year and an individual cost of more than \$5,000 for land, furniture, fixtures, equipment and vehicles and \$10,000 for all other assets. When capital assets are disposed, the cost and related accumulated depreciation are removed from the accounts with gains or losses on disposition being reflected in operations. The estimated useful lives are as follows:

Utility plant	10 to 100 years
Land improvements	38 to 100 years
Buildings, structures and improvements	20 to 60 years
Furniture, fixtures, equipment and vehicles	5 to 50 years

The Division's policy is to capitalize interest on construction projects up to the point in time that the project is substantially completed. Capitalized interest is included in the cost of the assets and is depreciated on the straight-line basis over the estimated useful lives of such assets. The Division applies Statement of Financial Accounting Board Standards No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants*, for its revenue bonds. This statement requires capitalization of interest cost of eligible borrowings, less interest earned on investment of the related bond proceeds from the date of borrowing until the assets constructed from the bond proceeds are ready for their intended use.

For 2008 and 2007, total interest costs incurred amounted to \$48,425,000 and \$41,435,000, respectively, of which \$15,995,000 and \$8,050,000, respectively, was capitalized, net of interest income of \$4,797,000 in 2008 and \$7,844,000 in 2007.

Bond Issuance Costs, Discounts and Unamortized Losses on Debt Refundings: Bond issuance costs are recorded as deferred expenses, and unamortized original issuance discounts are netted against long-term debt. Both are amortized over the lives of the related bonds. Unamortized losses on debt refundings are netted against long-term debt and are amortized over the shorter of the remaining life of the defeased bond or the newly issued bond.

Compensated Absences: The Division accrues for compensated absences such as vacation, sick leave and compensatory time using the termination payment method specified under GASB Statement No. 16, *Accounting for Compensated Absences*. These amounts are recorded as accrued wages and benefits in the accompanying balance sheets. The portion of the compensated absence liability that is not expected to be paid or utilized within one year is reported as a long-term liability.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Normally, all vacation time is to be taken in the year available. The Division allows employees to carryover up to 80 hours of vacation time from one year to the next with proper approval. Sick days not taken may be accumulated until retirement. An employee is paid one-third of accumulated sick leave upon retirement, calculated at the three year average base salary rate, with the balance being forfeited.

NOTE B – LONG-TERM DEBT

Long-term debt outstanding at December 31, 2008 and 2007 is as follows:

	<u>Interest Rate</u>	<u>Original Issuance</u>	<u>2008</u>	<u>2007</u>
(In thousands)				
Water Revenue Bonds:				
Series G, 1993, due through 2021	5.50%	\$ 228,170	\$ 107,760	\$ 107,760
Series H, 1996, due through 2026	5.30%-5.75%	204,885	7,990	14,280
Series I, 1998, due through 2009	5.00%-5.25%	305,650	3,530	16,655
Series J, 2001, due through 2016	4.00%-5.38%	92,595	53,385	56,240
Series K, 2002, due through 2021	3.50%-5.25%	138,050	61,605	65,740
Series L, 2002	Variable	90,000		90,000
Series M, 2004, due through 2033	3.53% Swap Rate	175,000	172,335	172,335
Series N, 2005, due through 2023	3.00%-5.00%	64,480	64,220	64,480
Series O, 2007, due through 2037	4.25%-5.00%	143,570	141,095	143,570
Series P, 2007, due through 2028	4.00%-5.00%	135,410	135,410	135,410
Series Q, 2008, due through 2033	Variable	90,800	90,800	
Ohio Water Development Authority Loans payable annually through 2029	3.20%-4.14%	126,880	107,823	105,392
		<u>\$ 1,795,490</u>	945,953	971,862
Adjustments:				
Unamortized discount and premium			15,284	17,320
Unamortized loss on debt refunding			(33,674)	(35,978)
Current portion			<u>(32,094)</u>	<u>(24,212)</u>
Total Long-Term Debt			<u>\$ 895,469</u>	<u>\$ 928,992</u>

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE B – LONG-TERM DEBT (Continued)

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

	Balance January 1, 2008	Increase	Decrease	Balance December 31, 2008	Due Within One Year
	(In thousands)				
Water Revenue Bonds:					
Series G, 1993, due through 2021	\$ 107,760	\$	\$	\$ 107,760	\$
Series H, 1996, due through 2026	14,280		(6,290)	7,990	5,895
Series I, 1998, due through 2009	16,655		(13,125)	3,530	3,530
Series J, 2001, due through 2016	56,240		(2,855)	53,385	335
Series K, 2002, due through 2021	65,740		(4,135)	61,605	4,300
Series L, 2002	90,000		(90,000)		
Series M, 2004, due through 2033	172,335			172,335	1,305
Series N, 2005, due through 2023	64,480		(260)	64,220	9,550
Series O, 2007, due through 2037	143,570		(2,475)	141,095	2,370
Series P, 2007, due through 2028	135,410			135,410	
Series Q, 2008, due through 2033		90,800		90,800	
Ohio Water Development Authority Loans payable annually through 2029	<u>105,392</u>	<u>7,567</u>	<u>(5,136)</u>	<u>107,823</u>	<u>4,809</u>
Total revenue bonds/loans	971,862	98,367	(124,276)	945,953	32,094
Accrued wages and benefits	<u>13,230</u>	<u>770</u>	<u>(161)</u>	<u>13,839</u>	<u>11,790</u>
Total	<u>\$ 985,092</u>	<u>\$ 99,137</u>	<u>\$ (124,437)</u>	<u>\$ 959,792</u>	<u>\$ 43,884</u>

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE B – LONG-TERM DEBT (Continued)

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

	Balance January 1, 2007	Increase	Decrease	Balance December 31, 2007	Due Within One Year
(In thousands)					
Water Revenue Bonds:					
Series G, 1993, due through 2021	\$ 121,275	\$	\$ (13,515)	\$ 107,760	\$
Series H, 1996, due through 2026	14,470		(190)	14,280	6,290
Series I, 1998, due through 2028	161,875		(145,220)	16,655	6,120
Series J, 2001, due through 2016	63,345		(7,105)	56,240	2,855
Series K, 2002, due through 2033	69,725		(3,985)	65,740	4,135
Series L, 2002, due through 2033	90,000			90,000	
Series M, 2004, due through 2033	172,335			172,335	
Series N, 2005, due through 2023	64,480			64,480	260
Series O, 2007, due through 2037		143,570		143,570	
Series P, 2007, due through 2028		135,410		135,410	
Ohio Water Development Authority Loans payable annually through 2024	98,320	10,923	(3,851)	105,392	4,552
Total revenue bonds/loans	855,825	289,903	(173,866)	971,862	24,212
Accrued wages and benefits	12,371	859		13,230	11,160
Total	<u>\$ 868,196</u>	<u>\$ 290,762</u>	<u>\$ (173,866)</u>	<u>\$ 985,092</u>	<u>\$ 35,372</u>

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE B – LONG-TERM DEBT (Continued)

Minimum principal and interest payments on long-term debt for the next five years and thereafter are as follows:

	Principal	Interest	Total
	(In thousands)		
2009	\$ 32,094	\$ 42,279	\$ 74,373
2010	37,119	40,568	77,687
2011	51,699	38,503	90,202
2012	54,130	36,043	90,173
2013	50,167	33,581	83,748
2014-2018	235,043	133,608	368,651
2019-2023	202,521	83,258	285,779
2024-2028	163,433	44,314	207,747
2029-2033	93,108	18,698	111,806
2034-2037	33,560	3,458	37,018
Total	\$ 952,874	\$ 474,310	\$ 1,427,184

The above schedule of minimum principal and interest payments on long-term debt includes the amortization on seven loans provided to the City of Cleveland by the Ohio Water Development Authority (OWDA).

OWDA provided the City with the amount expected to be financed, the interest rate, initial repayment date and other significant items(s) for each of the seven loans. From the information received, the City prepared a detailed amortization schedule for each loan based upon the amount expected to be financed. However, the amortization schedule is tentative and will be adjusted if, and when, OWDA revises the amount to be financed.

Further, OWDA requires the City to begin making semi-annual payments for each loan based on the agreed upon initial repayment date, regardless of whether the City has received all loan proceeds or has completed the project(s).

In 2006, the Division received an OWDA loan of \$11,612,382 out of an expected \$25,160,122 to fund the Morgan Water Treatment Plant Filter Rehabilitation. Another \$9,456,188 was received in 2007 and \$1,027,564 was added in 2008. This is a 20 year, 3.25% loan with payments beginning in 2008. In addition, the outstanding balance on the Division's OWDA loan for Morgan Reservoir increased by \$6,539,019 in 2008.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE B – LONG-TERM DEBT (Continued)

Therefore, at December 31, 2008, the amount financed on these seven loan projects, less principal payments made, totaled \$114,744,000 and was reflected in the debt service payment schedule. However, the total on the actual loan balances received by the City was \$107,823,000 as reflected on the schedules of long-term debt outstanding and changes in long-term debt obligations as of December 31, 2008. The difference of \$6,921,000 will be received or accrued in future year(s).

The Division has defeased certain Revenue Bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. In 2008, the Division deposited cash in the amount of \$9,959,000 in an escrow account for the payment of future debt service requirements. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Division's financial statements. The aggregate amount of defeased debt outstanding at December 31, 2008 and 2007 is as follows:

Bond Issue	2008	2007
	(In thousands)	
Series G, 1993	\$ 12,290	\$ 24,060
Series I, 1998	7,005	266,700
Series K, 2002	68,325	68,325
Series O, 2007	2,475	

In 1996, the City authorized the adoption of the eighth supplemental indenture to amend and restate the existing indenture, subject to the receipt of consent of the requisite number of bondholders. With the issuance of the Series J bonds, the City reached the 66²/₃% consent required to enact the Amended and Restated Indenture. Effective October 5, 2001, all outstanding bonds and any future bonds are secured by the Amended and Restated Indenture. Under the new indenture, the bonds are no longer secured by a mortgage lien. All bonds are secured by the Division's net revenues and by the pledged funds.

The Division's indentures have certain restrictive covenants and principally require that bond reserve funds be maintained and charges for fees to customers be in sufficient amounts, as defined, to satisfy the obligations under the indenture agreements. In addition, special provisions exist regarding covenant violations, redemption of principal and maintenance of properties in good condition.

The indenture requires that at all times the Division will charge rates and fees for the products and services of the waterworks system, so that revenues will be at least sufficient to provide funds for the payment in each year of the necessary operating and maintenance expenses of the waterworks system and the greater of (1) an amount equal to 1.25 times the payments of principal, premium, if any, and interest on the revenue bonds then outstanding due in that year or (2) an amount sufficient to maintain the required balances in all funds and accounts created under the indenture. As of December 31, 2008 and 2007, the Division was in compliance with the terms and requirements of the bond indenture.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE B – LONG-TERM DEBT (Continued)

The indenture establishes the following fund accounts for the application of revenues:

Revenue Fund: All revenues will be deposited into this fund and will be used for payment of current operating expenses and deposits into other funds. An amount equal to one-sixth of the operating expenses, before depreciation, for the preceding fiscal year must be maintained in this fund.

Debt Service Fund: Deposits will be made from the revenue fund to cover succeeding principal and interest payments as they become due on the revenue bonds.

Debt Service Reserve Fund: Deposits will be made to this fund if the amount in the debt service fund at any time is less than the debt service reserve requirement. Amounts in the fund were deposited from the proceeds of the revenue bonds and represent the maximum annual debt service requirement of these bonds.

Contingency Fund: The balance in this fund must be maintained at \$3,500,000.

Construction Fund: Proceeds from the revenue bonds were deposited into this fund to be used, along with earnings from investments of amounts held therein, for the payment of capital costs. Capital costs include all costs of additions, extensions, renewals, replacements, alterations, betterments and any other capital improvements to the waterworks system. Amounts held in this fund are subject to a lien in favor of bondholders and may be used to pay principal of outstanding revenue bonds to the extent that amounts in all other funds are insufficient. No payment need be made into a fund if the amounts in such fund are equal to the required fund balance, if any.

Amounts held in any fund may be invested by the City Treasurer or the trustee in permitted investments, however, the use of funds is limited by the bond indenture and, accordingly, are classified as restricted assets in the accompanying financial statements.

In December 2008, the Division utilized cash on hand to defease \$9,480,000 principal amount of outstanding Series I and Series O bonds. The Division placed \$9,959,000 in an irrevocable trust account which will be used to pay principal and interest on the defeased bonds. As a result the bonds are considered defeased and the liability for the bonds has been removed from long-term debt.

On November 6, 2008, the City issued \$90,800,000 Water Revenue Bonds, Series Q, 2008. These bonds were issued to currently refund all of the outstanding \$90,000,000 Water Revenue Bonds, Series L, 2002. Proceeds were used to fund an escrow deposit that refunded the Series L Bonds and to pay costs of issuance. Net proceeds of the Series Q Bonds in the amount of \$90,273,770, together with other available funds in the amount of \$100,000, were placed in an irrevocable escrow account and were used to pay the principal and interest on the refunded bonds on November 21, 2008. As a result, the refunded bonds were defeased and the liability for these bonds has been removed from long-term debt. The City completed the refunding in order to address the increased interest rates incurred on the Series L Bonds because of the downgrade of the bond insurer and the resulting termination of the liquidity facility. The Series Q Bonds were issued as weekly variable rate demand obligations with the payment of principal and interest secured by a letter of credit provided by Bank of America, N.A..

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE B – LONG-TERM DEBT (Continued)

In December 2007, the Division utilized cash on hand to defease outstanding Series G Bonds. The Division placed \$12,966,000 in an irrevocable account which will be used to pay principal and interest on defeased bonds. As a result, the bonds are considered defeased and the liability for those bonds has been removed from long term debt. The total principal amount of bonds defeased in this manner was \$12,290,000.

On November 28, 2007, the City issued \$135,410,000 Water Revenue Bonds, Series P, 2007. These bonds were issued to currently refund \$140,030,000 of outstanding Water Revenue Bonds, Series I. Proceeds were used to fund an escrow deposit that will refund the bonds and pay cost of issuance. Net proceeds of \$144,460,566 were placed in an irrevocable escrow account and were used to pay the principal, interest and premium on the refunded bonds on January 1, 2008. As a result, the refunded bonds are considered to be defeased and the liability for these bonds has been removed from long-term debt. The total aggregate amount of the bonds refunded by the Series P Bonds was \$140,030,000. The City completed the refunding to reduce its total debt service payments by \$6,376,000 and to obtain an economic gain (the difference between the present values of the old and new debt service payments) of approximately \$5,838,000 or 4.17%.

Effective June 28, 2007, the City issued \$143,570,000 Water Revenue Bonds, Series O, 2007. The proceeds of these bonds will be used to pay costs of improvements to the waterworks system through 2010, to fund a deposit to the Reserve Fund, to pay capitalized interest on the bonds and to pay costs of issuing the bonds. In conjunction with the issuance of these bonds, both Standard & Poor's and Moody's Investors Service upgraded their ratings of the City's Water Revenue Bonds to AA and Aa2, respectively.

The City has pledged future water system revenues, net of specified operating expenses, to repay \$838,130,000 in various Water Improvement Revenue Bonds issued in various years since 1993. Proceeds from the bonds provided financing for water system operations. The bonds are payable from water system net revenues and are payable through 2037. Annual principal and interest payments on the bonds are expected to require less than 61 percent of net revenues. The total principal and interest remaining to be paid on the various Water Improvement Revenue Bonds is \$1,273,446,000. Principal and interest paid for the current year and total net revenues were \$65,425,000 and \$108,827,000, respectively.

Interest Rate Swap Transactions:

Terms: Simultaneously with the issuance of the City's \$175,000,000 Water Revenue Bonds, Series M, 2004, on August 10, 2004, the City entered into floating to fixed rate swap agreements with notional amounts equal to the total declining balance of the Series M Bonds. Bear Stearns Financial Products Inc. (Bear Stearns), (which has been acquired by JPMorgan Chase Bank, N.A. (JPM)), is the counterparty on a two-thirds pro-rata share of the transaction and Morgan Stanley Capital Services Inc. (Morgan Stanley) is the counterparty on a one-third pro-rata share of the transaction.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE B – LONG-TERM DEBT (Continued)

Under the swap agreements for the Series M Bonds, the water system is the fixed rate payor, paying a fixed rate of 3.53%. Each counterparty is a floating rate payor, with each paying the water system 61.25% of one month LIBOR plus a spread of 28 basis points. Net payments are exchanged semiannually on January 1 and July 1. The obligation of the water system to make periodic payments (but not any termination payment) is secured by a pledge of and lien on the net revenues of the water system on a parity with the pledge and lien securing the payment of debt service on the bonds. Both the bond debt service payments on the Series M bonds and the periodic swap payments are insured by Financial Security Assurance (FSA).

Objective: The City entered into the swaps in order to maximize the savings associated with the refunding of the bonds. The actual savings to be realized by the Water System will depend upon the payments made on the variable rate bonds and the payments received under the swap agreement.

Basis Risk: By entering into swaps based upon the 30 day LIBOR rate of interest, the City has undertaken basis risk associated with a change in tax rates and structure. While the average relationship between Securities Industry Financial Markets Association (SIFMA) (tax-exempt) and LIBOR (taxable) interest rates has been 67%, this relationship may not always apply. If the payments received from the counterparties are less than the amount paid on the variable rate bonds, the water system must make up the difference in addition to paying the fixed rate resulting from the swap. As a result of the turmoil in the financial markets during 2008, the SIFMA/LIBOR ratio was significantly higher than 67% for portions of the year. In addition, a reduction in federal income tax rates would increase the percentage relationship between SIFMA and LIBOR and would potentially increase the cost of the financing.

Counterparty Risk: The City selected highly rated counterparties in order to minimize this risk. However, in the wake of the subprime mortgage crisis, Bear Stearns was acquired by JPM. The portion of the City's swap with Bears Stearns as the counterparty has been assumed by JPM. Over the long-term it is possible that the credit strength of JPM and/or Morgan Stanley could change and this event could trigger a termination payment on the part of the City.

Termination Risk: The swap agreement may be terminated prior to its stated termination date under certain circumstances. Upon termination, a payment may be owed by the City to JPM and Morgan Stanley, or by JPM and Morgan Stanley to the City, depending upon the prevailing economic circumstances at the time of the termination. The City obtained insurance to mitigate much of the risk associated with termination due to the event of a rating downgrade of the water system.

Fair Value: The fair value of the swaps at December 31, 2008 and December 31, 2007 as reported by JPM and Morgan Stanley totaled \$28,346,000 and \$6,220,000 respectively which would be payable by the City.

Ohio Water Development Authority (OWDA) Loans: These loans are payable from net revenues derived from the waterworks. These obligations do not have a lien on revenues of the Division. The Division received an increase in OWDA loans in the amount of \$7,567,000 and \$10,923,000 during 2008 and 2007, respectively. The current loans are being paid directly to the contractor by the State of Ohio, but accounted for as if the Division received and disbursed those monies.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE C – DEPOSITS AND INVESTMENTS

Deposits: The carrying amount of the Division's deposits at December 31, 2008 and 2007 totaled \$62,376,000 and \$63,003,000, respectively, and the Division's bank balances were \$62,232,000 and \$67,471,000, respectively. The differences represent normal reconciling items.

Based on the criteria described in GASB Statement No.3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, \$62,232,000 and \$67,471,000 of the bank balances at December 31, 2008 and 2007, respectively, were insured or collateralized with securities held by the City or by its agent in the City's name.

Investments: The City's investment policies are governed by state statutes and City ordinances which authorize the City to invest in obligations of the U.S. Treasury, agencies and instrumentalities; bonds and other State obligations; certificates of deposit; U.S. Government Money Market Mutual Funds; State Treasury Asset Reserve (STAROhio); guaranteed investment contracts and repurchase transactions. Such repurchase transactions must be purchased from financial institutions or registered broker/dealers and are not to exceed a period of one year and confirmation of securities pledged must be obtained.

Under City policy, investments are limited to repurchase agreements, U.S. Government securities, certificates of deposit, investments in certain money market mutual funds, and STAROhio. Generally, investments are recorded in segregated accounts by way of book entry through the bank's commercial or trust department and are kept at the Federal Reserve Bank in the depository institution's separate custodial account for the City, apart from the assets of the depository institution. Ohio statute prohibits the use of Reverse Repurchase Agreements.

Investment securities are exposed to various risks such as interest rate, market and credit. Market values of securities fluctuate based on the magnitude of changing market conditions; significant changes in market conditions could materially affect portfolio value.

Interest rate risk: As a means of limiting its exposure to fair value losses caused by rising interest rates, the Division invests primarily in short-term investments maturing within five years from the date of purchase. The intent is to avoid the need to sell securities prior to maturity. Investment maturities are disclosed in the table on the following page.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Division will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. The Division does not have an investment policy dealing with investment custodial credit risk beyond the requirement in the State statute.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

Credit Risk: The Division's investments as of December 31, 2008 and 2007 include U.S. Agencies, Allegiant Government Money Market Funds, STAROhio, mutual funds, repurchase agreements and guaranteed investment contracts. The Division maintains the highest ratings for their investments. Investments in FHLMC, FNMA, FFCB and FHLB agency securities are rated AAA by Standard & Poor's. Investments in the Allegiant Government Money Market Fund and STAROhio carry a rating of AAAM, which is the highest money market fund rating given by Standard & Poor's. Ohio law requires that STAROhio maintain the highest rating provided by at least one nationally recognized standard rating service. The Division has no investment policy that would further limit its investment choices.

Concentration of Credit Risk: The Division places a limitation on the amount it may invest in any one issuer to help minimize the concentration of credit risk. The Division had the following investments at December 31, 2008 and 2007, which include those classified as cash and cash equivalents in the balance sheet in accordance with the provisions of GASB Statement No. 9 since they have a maturity of three months or less:

<u>Type of Investment</u>	2008		2007		<u>Investment Maturities</u>		
	Fair Value	2008 Cost	Fair Value	2007 Cost	Less than One Year	1 - 5 Years	5 Years or More
	(In thousands)						
U.S. Agency Obligations	\$ 64,129	\$ 61,923	\$109,685	\$107,787	\$ 12,311	\$ 51,818	\$
STAROhio	57,606	57,606	23,383	23,383	57,606		
Investment in Mutual Funds	301,379	301,379	251,476	251,476	301,379		
Repurchase Agreement	14,285	14,285	8,220	8,220	14,285		
Guaranteed Investment Contracts	<u>36,850</u>	<u>36,850</u>	<u>104,090</u>	<u>104,090</u>		<u>20,000</u>	<u>16,850</u>
Total Investments	474,249	472,043	496,854	494,956	385,581	71,818	16,850
Total Deposits	<u>62,376</u>	<u>62,376</u>	<u>63,003</u>	<u>63,003</u>	<u>62,376</u>	-	-
Total Deposits and Investments	<u>\$536,625</u>	<u>\$534,419</u>	<u>\$559,857</u>	<u>\$557,959</u>	<u>\$ 447,957</u>	<u>\$ 71,818</u>	<u>\$ 16,850</u>

As of December 31, 2008, the investments in U.S. Agency Obligations, STAROhio, mutual funds, repurchase agreements and guaranteed investment contracts are approximately 13%, 12%, 64%, 3% and 8%, respectively, of the Division's total investments. As of December 31, 2007, the investments in U.S. Agency Obligations, mutual funds and guaranteed investment contracts are approximately 22%, 51%, and 21%, respectively, of the Division's total investments.

The City's current guaranteed investment contracts are not categorized as investments on the financial statements because they are reserved against future debt service requirements and may need to be liquidated prior to maturity.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE D – CAPITAL ASSETS

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

	Balance January 1, 2008	Additions	Deletions	Balance December 31, 2008
	(In thousands)			
Capital assets, not being depreciated:				
Land	\$ 5,463	\$	\$	\$ 5,463
Construction in progress	<u>372,829</u>	<u>74,559</u>	<u>(133,586)</u>	<u>313,802</u>
Total capital assets, not being depreciated	378,292	74,559	(133,586)	319,265
Capital assets, being depreciated:				
Land improvements	16,973			16,973
Utility plant	1,084,014	56,712	(1,843)	1,138,883
Buildings, structures and improvements	213,217	4,977		218,194
Furniture, fixtures, equipment and vehicles	<u>140,220</u>	<u>75,177</u>	<u>(1,066)</u>	<u>214,331</u>
Total capital assets, being depreciated	1,454,424	136,866	(2,909)	1,588,381
Less: Accumulated depreciation	<u>(506,046)</u>	<u>(41,857)</u>	<u>1,146</u>	<u>(546,757)</u>
Total capital assets being depreciated, net	<u>948,378</u>	<u>95,009</u>	<u>(1,763)</u>	<u>1,041,624</u>
Capital assets, net	<u>\$ 1,326,670</u>	<u>\$ 169,568</u>	<u>\$ (135,349)</u>	<u>\$ 1,360,889</u>

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE D – CAPITAL ASSETS (Continued)

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

	Balance January 1, 2007	Additions	Deletions	Balance December 31, 2007
(In thousands)				
Capital assets, not being depreciated:				
Land	\$ 5,463	\$	\$	\$ 5,463
Construction in progress	315,892	104,750	(47,813)	372,829
Total capital assets, not being depreciated	321,355	104,750	(47,813)	378,292
Capital assets, being depreciated:				
Land improvements	16,973			16,973
Utility plant	1,056,192	29,377	(1,555)	1,084,014
Buildings, structures and improvements	204,520	8,697		213,217
Furniture, fixtures, equipment and vehicles	131,280	10,432	(1,492)	140,220
Total capital assets, being depreciated	1,408,965	48,506	(3,047)	1,454,424
Less: Accumulated depreciation	(469,329)	(38,994)	2,277	(506,046)
Total capital assets being depreciated, net	939,636	9,512	(770)	948,378
Capital assets, net	\$ 1,260,991	\$ 114,262	\$ (48,583)	\$ 1,326,670

Commitments: The Division has outstanding commitments at December 31, 2008 and 2007 of approximately \$226,284,000 and \$262,864,000, respectively, for future capital expenditures, respectively. It is anticipated that these commitments will be financed from the Division's cash balances; however, at the discretion of the Division, additional long-term debt may be issued in the future to finance a portion of the costs.

NOTE E – DEFINED BENEFIT PENSION PLAN

Ohio Public Employees Retirement System: All full-time employees participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans as described below:

- 1) The Traditional Pension Plan – a cost-sharing, multiple-employer defined benefit pension plan.
- 2) The Member-Directed Plan – a defined contribution plan in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). Under the Member-Directed Plan, members accumulate retirement assets equal to the value of member and (vested) employer contributions plus any investment earnings.
- 3) The Combined Plan – a cost-sharing, multiple-employer defined benefit pension plan. Under the Combined Plan, OPERS invests employer contributions to provide a formula retirement benefit similar in nature to the Traditional Pension Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

OPERS provides retirement, disability, survivor and death benefits and annual cost-of-living adjustments to members of the Traditional Pension and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits. Authority to establish and amend benefits is provided in Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to OPERS, 277 East Town Street, Columbus, Ohio 43215-4642, or by calling (614) 222-5601 or (800) 222-7377.

The Ohio Revised Code provides statutory authority for member and employer contributions. For 2008, member and employer contribution rates were consistent across all three plans. Member contribution rates were 10.00% in 2008, 9.50% in 2007 and 9.00% in 2006, and employer contribution rates were 14.00% of covered payroll in 2008, 13.85% in 2007 and 13.70% in 2006. The Division's required employer contributions to OPERS for the pension portion of all the plans for the years ending December 31, 2008, 2007 and 2006 were approximately \$3,969,000, \$4,575,000 and \$4,929,000 each year, respectively. The required payments due in 2008, 2007 and 2006 have been made.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS

Ohio Public Employees Retirement System: All full-time employees participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans: The Traditional Pension Plan – a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan – a defined contribution plan; and the Combined Plan – a cost-sharing, multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS maintains a cost-sharing multiple employer defined benefit postemployment health care plan, which includes a medical plan, prescription drug program and Medicare Part B premium reimbursement, to qualifying members of both the Traditional Pension and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including postemployment health care coverage. In order to qualify for postemployment health care coverage, age-and-service retirees under the Traditional Pension and Combined Plans must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability benefit recipients and qualified survivor benefit recipients is available. The health care coverage provided by OPERS meets the definition of an Other Postemployment Benefit (OPEB) as described in GASB Statement 45. The Ohio Revised Code permits, but does not mandate, OPERS to provide OPEB benefits to its eligible members and beneficiaries. Authority to establish and amend benefits is provided in Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by writing OPERS, 277 East Town Street, Columbus, Ohio 43215-4642, or by calling (614) 222-5601 or (800) 222-7377.

The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement health care through their contributions to OPERS. A portion of each employer's contribution to OPERS is set aside for funding of post-retirement health care benefits. Employer contribution rates are expressed as a percentage of the covered payroll of active members. The employer contribution rates were 14.00% of covered payroll in 2008, 13.85% in 2007 and 13.70% in 2006. The Ohio Revised Code currently limits the employer contribution to a rate not to exceed 14.00% of covered payroll.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE F – OTHER POSTEMPLOYMENT BENEFITS (Continued)

Active members do not make contributions to the OPEB Plan. OPERS Postemployment Health Care plan was established under and is administrated in accordance with, Internal Revenue Code 401(h). Each year, the OPERS Retirement Board determines the portion of the employer contribution rate that will be set aside for funding of postemployment health care benefits. Employer contribution rates to fund postemployment health care benefits were 7.00% in 2008, 5.00% from January 1, 2007 to June 30, 2007 and 6.00% from July 1, 2007 to December 31, 2007 and 4.50% in 2006. The OPERS Retirement Board is also authorized to establish rules for the payment of a portion of the health care benefits provided, by the retiree or their surviving beneficiaries. Payment amounts vary depending on the number of covered dependents and the coverage selected. The Division's actual contributions for 2008 to OPERS to fund postemployment benefits were approximately \$3,969,000.

The Health Care Preservation Plan (HCPP) adopted by the OPERS Retirement Board on September 9, 2004, was effective January 1, 2007. Member and employer contribution rates increased as of January 1, 2006, January 1, 2007 and January 1, 2008, which allowed additional funds to be allocated to the health care plan.

NOTE G – CONTINGENT LIABILITIES AND RISK MANAGEMENT

Contingent Liabilities: Various claims are pending against the City involving the Division for personal injuries, property damage and other matters. The City is responsible for the suits. The City's management is of the opinion that ultimate settlement of such claims will not result in a material adverse effect on the Division's financial position, results of operations or cash flows.

Risk Management: The Division is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Division is generally self-insured. No material losses, including incurred but not reported losses, occurred in 2008 or 2007.

The City provides the choice of four separate health insurance plans for its employees. These plans are provided by two different insurers through commercial insurance. Operating funds are charged a monthly rate per employee, by type of coverage. The City participates in the State of Ohio workers' compensation retrospective rating program.

In accordance with GASB Statement No. 10, claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, and damage awards. Accordingly, claims are re-evaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors.

The estimate of the claims liability also includes amounts for incremental claim adjustment expenses related to specific claims and other claim adjustment expenses, regardless of whether allocated to specific claims. Estimated recoveries, for example from salvage or subrogation, are another component of the claims liability estimate. Claims liability for the Division is immaterial.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE H – RELATED PARTY TRANSACTIONS

Revenues and Accounts Receivable: The Division provides water services to the City of Cleveland, including its various departments and divisions. Standard consumption rates are charged, except for the Division of Fire, public buildings and certain other facilities owned by the City of Cleveland, which by ordinance are provided free water services.

The Division performs billing and collection services for the Division of Water Pollution Control for a fee. This fee is based on the number of billings made on behalf of that division during the year at the same rates as charged to other users of the billing system. Revenue realized from the Division of Water Pollution Control for such services was approximately \$2,141,000 and \$2,278,000 in 2008 and 2007, respectively. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately \$2,596,000 and \$2,614,000 in 2008 and 2007, respectively.

Operating Expenses: The Division is provided various intra-city services. Charges are based on actual use or on a reasonable pro-rata basis. The more significant costs for the years ended December 31 were as follows:

	<u>2008</u>		<u>2007</u>
	(In thousands)		
Electricity purchases	\$ 12,741	\$	12,632
City administration	2,856		2,856
Motor Vehicle Maintenance	2,982		2,726
Telephone exchange	695		1,782
Utilities Administration and Utilities Fiscal Control	3,635		3,284
Street construction	644		939

NOTE I – CUYAHOGA COUNTY REAL PROPERTY TAXES

The Division is required by ordinance to keep records of the estimated property taxes which would be payable to Cuyahoga County were it subject to such taxes. The estimated property taxes for the Division, based on book value of real estate at the current tax rates, would have been approximately \$5,097,000 and \$5,039,000 for the years ended December 31, 2008 and 2007, respectively.

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2008 and 2007**

NOTE J- SUBSEQUENT EVENTS

Effective February 12, 2009, the City issued \$54,735,000 Water Revenue Bonds, Series R, 2009 and \$26,295,000 Water Revenue Bonds, Series S, 2009. These bonds were issued to refund a portion of the outstanding Water Revenue Bonds, Series M, 2004. The Series M Bonds were refunded in order to address the increased interest rates incurred on the bonds as a result of the downgrade of the bond insurer and liquidity facility provider. The Series R and Series S Bonds were issued as weekly variable rate demand bonds. The Series R Bonds are secured by a direct pay letter of credit issued by BNP Paribas while the Series S Bonds are secured by the letter of credit provided by Allied Irish Banks, p.l.c.. In conjunction with the issuance of the Series R and S Bonds, the City issued \$84,625,000 Water Revenue Bonds, Series T, 2009 effective February 25, 2009. These bonds, which are fixed rate bonds, refunded the remaining portion of the outstanding Series M Bonds. At the time of the refundings, the interest rate swaps associated with the Series M Bonds were transferred to the Series R and Series S Bonds with the remaining portion being assigned to the Series Q Bonds issued in 2008.



Mary Taylor, CPA
Auditor of State

CITY OF CLEVELAND-DIVISION OF WATER

CUYAHOGA COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
SEPTEMBER 24, 2009**