



CITY OF MILWAUKEE – WATER WORKS

Basic Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

CITY OF MILWAUKEE – WATER WORKS

Table of Contents

| | Page |
|--|-------------|
| Independent Auditors' Report | 1 |
| Management's Discussion and Analysis | 3 |
| Basic Financial Statements: | |
| Statements of Net Position | 13 |
| Statements of Revenues, Expenses, and Changes in Fund Net Position | 14 |
| Statements of Cash Flows | 15 |
| Notes to Basic Financial Statements | 17 |



KPMG LLP
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Independent Auditors' Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the City of Milwaukee – Water Works as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the City of Milwaukee – Water Works as of December 31, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matter

As discussed in note 1, the financial statements present only the business-type activities of the City of Milwaukee – 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, 2012 and 2011, the changes in its financial position, or, where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management’s discussion and analysis on pages 3 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Milwaukee, Wisconsin
July 30, 2013

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

The management of the City of Milwaukee – Water Works (Water Works) offers readers of the organization’s basic financial statements this narrative overview and analysis of the Water Works’ basic financial statements for the fiscal years ended December 31, 2012 and 2011. 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, 2012

- Total revenues increased by 3.9% in 2012, from \$84.8 million in 2011 to \$88.1 million in 2012.
- Total expenses decreased by 3.8% in 2012, from \$69.2 million in 2011 to \$66.6 million in 2012.
- As of December 31, 2012, the Water Works’ outstanding debt consisted of \$6.5 million in revenue bonds through the State of Wisconsin Safe Drinking Water Loan Program, \$18.9 million in general obligation bonds, and \$4.0 million in extendable municipal commercial paper promissory notes for a total of \$29.4 million.
- The Water Works is an enterprise fund within the primary government of the City of Milwaukee and as such is not subject to property taxes. In place of property taxes, the Water Works contributes to the City’s tax levy by making a payment in lieu of taxes (PILOT). The PILOT was \$11.9 million in 2012 and \$11.2 million in 2011, and is reported in the accompanying statement of revenues, expenses, and changes in fund net position as transfers out.

Year ended December 31, 2011

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

The PILOT amounted to \$11.2 million in 2011 and \$10.1 million in 2010.

Overview of the Basic Financial Statements

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

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

Required Basic Financial Statements

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

The statement of net position presents information on all of the Water Works' assets and liabilities, with the difference between the two reported as net position. 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 position. This statement measures the results of operations over the past year and can be used to determine whether the Water Works has successfully recovered all of its costs through user fees and other charges.

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

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

Financial Analysis of the Water Works

Statement of Net Position

A summary of assets, liabilities, and net position as of December 31, 2012, 2011, and 2010, respectively, is as follows:

**Table A-1
Condensed Summary of Net Position**

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|----------------------------------|-----------------------|--------------------|--------------------|
| Assets: | | | |
| Current assets | \$ 49,913,573 | 42,489,598 | 37,099,120 |
| Net capital assets | <u>403,835,151</u> | <u>402,123,710</u> | <u>402,177,931</u> |
| Total assets | <u>453,748,724</u> | <u>444,613,308</u> | <u>439,277,051</u> |
| Liabilities: | | | |
| Current liabilities | 30,093,957 | 27,831,747 | 35,658,451 |
| Noncurrent liabilities | <u>25,672,583</u> | <u>29,217,425</u> | <u>21,296,580</u> |
| Total liabilities | <u>55,766,540</u> | <u>57,049,172</u> | <u>56,955,031</u> |
| Net position: | | | |
| Net investment in capital assets | 374,444,457 | 372,346,156 | 379,969,164 |
| Restricted for debt service | 705,525 | 692,467 | 679,746 |
| Unrestricted net position | <u>22,832,202</u> | <u>14,525,513</u> | <u>1,673,110</u> |
| Total net position | <u>\$ 397,982,184</u> | <u>387,564,136</u> | <u>382,322,020</u> |

Net position 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 \$398.0 million and \$387.6 million at December 31, 2012 and 2011, respectively.

In Table A-1, it can be seen that the largest portion of the Water Works’ net position (94.1% and 96.1% as of December 31, 2012 and 2011, respectively,) reflects the net investment in capital assets (e.g., water mains, buildings, machinery, and equipment). Also, as shown in Table A-3, the Water Works’ water main system makes up approximately 58% of the capital assets as of December 31, 2012 and 59% as of December 31, 2011. The Water Works uses these capital assets to provide safe, reliable, and aesthetically pleasing drinking water to its 861,000-customer base that lives in the City of Milwaukee and surrounding communities.

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

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

Most of the remaining net position (5.7% and 3.7% as of December 31, 2012 and 2011, respectively, are unrestricted and represent current assets (e.g., cash on hand for operation, cash held in the local government investment pool, accounts receivable, and inventory and materials).

As can be seen in Table A-1, net investment in capital assets increased by \$2.1 million and decreased by \$7.6 million during the years ended December 31, 2012 and 2011, respectively. The increase in the net investment in capital assets in 2012 is mainly due to a \$1.7 million increase in net capital assets with no significant change in total debt. The decrease in net investment in capital assets in 2011 was due to a new debt of \$11.6 million issued in 2011 for various capital improvements. The amounts of contributed capital were \$0.7 million both in 2012 and 2011. Due to completion of several major State of Wisconsin DOT, Milwaukee County, Metropolitan Milwaukee Sewerage District projects, in prior years, a continued decrease in contributions has been experienced by the Water Works starting in 2010 and thereafter.

Statement of Revenues, Expenses, and Changes in Net Position

While the summary of net position (Table A-1) shows the amount of net position, the summary of revenues, expenses, and changes in fund net position (Table A-2) exhibits the nature and source of the changes.

Table A-2

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

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|---|-----------------------|---------------------|---------------------|
| Operating revenues | \$ 88,122,036 | 84,393,483 | 73,473,353 |
| Nonoperating revenues | 13,692 | 448,060 | 59,833 |
| Total revenues | <u>88,135,728</u> | <u>84,841,543</u> | <u>73,533,186</u> |
| Depreciation expense | 14,110,051 | 14,066,822 | 13,433,958 |
| Other operating expenses | 50,655,891 | 54,062,167 | 53,611,194 |
| Nonoperating expenses | 1,805,276 | 1,066,588 | 921,318 |
| Total expenses | <u>66,571,218</u> | <u>69,195,577</u> | <u>67,966,470</u> |
| Income before capital contributions and transfers | 21,564,510 | 15,645,966 | 5,566,716 |
| Capital contributions | 744,749 | 747,013 | 910,324 |
| Transfers out | <u>(11,891,211)</u> | <u>(11,150,863)</u> | <u>(13,153,957)</u> |
| Changes in net position | 10,418,048 | 5,242,116 | (6,676,917) |
| Net position – beginning of year | <u>387,564,136</u> | <u>382,322,020</u> | <u>388,998,937</u> |
| Net position – end of year | <u>\$ 397,982,184</u> | <u>387,564,136</u> | <u>382,322,020</u> |

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

Year ended December 31, 2012

A review of Table A-2 shows that operating revenues increased by \$3.7 million, or 4.4% in 2012 and total expenses in 2012 decreased by \$3.3 million, or 4.7%. These results may be explained as follows:

Revenues

- Operating revenues increased by \$3.7 million in 2012. This increase in revenue reflects a full year impact of implementation of a conventional rate increase in February of 2011 coupled with a slight increase in water sales for some customer classes. Table A-4 shows the sale of water (in billion gallons) for the last five years. According to this table, the sale of water for most customer classes has consistently dropped from year to year since 2007. However, in 2012, the sale of water has gone up for residential, commercial and wholesale customer categories, resulting in a total increase of over 650 million gallons of water. The boost in sale of water is mainly due to the very hot and dry summer Milwaukee experienced in 2012.
- Nonoperating revenues mainly consist of rental income from antenna contracts, and also include miscellaneous fees for service and branch tapping, interest income and other revenues such as from sale of nonutility properties. Miscellaneous nonoperating revenues for 2012 decreased by \$1.065 million or 97.0%, from 2011. This decrease is a result of a rare sale of a nonutility property at a loss and the write-off of another nonutility asset (Kilbourn Reservoir). In 2012, the Water Works transferred the Lincoln Distribution Yard to the City of Milwaukee (Parking Fund) and sustained a loss as the facilities were not fully depreciated. Moreover, the sale of a nonutility property, in 2011 with a gain, contributed to the huge drop in nonoperating revenues 2012 by comparison. There has been no significant change in interest income.

Expenses

- Operating expenses, excluding depreciation, decreased by 6.3% to \$50.7 in 2012 from \$54.1 million in 2011. This is a combination of decreases in all expense categories except billing and collection expenses which remained about the same from 2011 to 2012 at \$2.7 million. A major reduction in expenses was reflected in fringe benefits for all categories due to the implementation of Act 10 in 2012 which required employees to contribute towards their health insurance premiums. Transmission and distribution expenses decreased by 4.5% or 978 thousand to \$20.7 million in 2012. This was due to a net effect of different expense categories. In 2012, there were less water main breaks, 467 in 2012, versus 547 in 2011, but there was an increase in cost of repairing pavement cuts. The Greenfield Tank was also painted in 2011 for \$1.1 million. There were 9.8% and 8.6% decrease in pumping expenses and treatment expenses, respectively, in 2012. The cost of decommissioning of the Menomonee Valley Booster Station which amounted to \$715,000 contributed to the increase in pumping expenses in 2011 and showed as a decrease in 2012 by comparison. Treatment expenses decreased in 2012, mainly due to a decrease in chemical expenses.
- Interest expense, which comprises the most significant portion of nonoperating expenses, increased by 9.0% from \$1.1 million in 2011 to \$1.2 million in 2012. This increase was mainly due to new debt issued in 2012.

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

Year ended December 31, 2011

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

Revenues

- Operating revenues increased by \$10.9 million in 2011. This increase in revenue, despite consistent decrease in water consumption, is due to a 20.8% conventional rate increase implemented in February of 2011. Table A-4 shows the sale of water (in billion gallons) for the last five years. According to this table, the sale of water for most customer classes has consistently dropped from year to year since 2007.
- Nonoperating revenues for 2011 increased by \$388 thousand, or 649%, from 2010. This increase is mainly a result of a rare sale of a nonutility property. In 2011, the Water Works sold the decommissioned Menomonee Valley Pumping Station to the State of Wisconsin. A continued decline in interest income was experienced in both 2011 and 2010. The average interest rates on investments in the Local Government Investment Pool (LGIP) with the State of Wisconsin, where most of the Water Works’ funds are invested, were only 0.14% and 0.20% for 2011 and 2010, respectively, resulting in a further decrease in interest income in 2011. In addition to the falling interest rates, there has been a decreasing trend in cash and cash equivalents. Cash and cash equivalents decreased slightly, from \$4.2 million at the end of 2010 to \$4.0 million at the end of 2011.

Expenses

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

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

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

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, 2012, the Water Works investment in capital assets, net of accumulated depreciation, increased by \$1.7 million or 0.43% to \$403.8 million. Transmission and distribution system assets and machinery and equipment increased by \$2.8 million and \$1.5 million, respectively, and construction in progress increased by \$6.6 million. The increase in construction in progress is due to the undertaking of major projects in 2012 such as the Florist Booster Station upgrade and backup power project. Nonutility property decreased by \$1.8 million mainly as a result of the transfer of the Lincoln Distribution Yard to the City of Milwaukee.

As of December 31, 2011, the Water Works investment in capital assets, net of accumulated depreciation, remained almost the same, at \$402.1 million, as that of 2010. Transmission and distribution system assets and machinery and equipment increased by \$1.1 million and \$6.9 million, respectively, and construction in progress decreased by \$9.9 million. The decrease in construction in progress is due to capitalization of capital projects that were completed as of December 31, 2011 and also reclassification of some charges to operating expenses. The increase in machinery and equipment represents the completion and capitalization of the backup power project at the Riverside Pumping Station for a total of over \$6.0 million. Nonutility property increased by \$0.7 million as a result of the final addition to the Kilbourn Reservoir Park development.

**Table A-3
Capital Assets**

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|--------------------------------------|-----------------------|----------------------|----------------------|
| Capital assets: | | | |
| Land | \$ 1,363,077 | 1,363,077 | 1,367,127 |
| Buildings | 27,267,641 | 27,258,906 | 25,406,006 |
| Transmission and distribution system | 359,862,298 | 357,017,568 | 355,873,188 |
| Machinery and equipment | 214,764,110 | 213,309,827 | 206,449,773 |
| Construction in progress | 9,415,583 | 2,829,311 | 12,716,715 |
| Nonutility property | <u>4,308,994</u> | <u>6,076,558</u> | <u>5,346,893</u> |
| Total capital assets | 616,981,703 | 607,855,247 | 607,159,702 |
| Less accumulated depreciation | <u>(213,146,552)</u> | <u>(205,731,537)</u> | <u>(204,981,771)</u> |
| Net capital assets | <u>\$ 403,835,151</u> | <u>402,123,710</u> | <u>402,177,931</u> |

Investment Administration

As an enterprise fund within the primary government of the City of Milwaukee, the Water Works does not have a direct investment plan. As such, cash not in use for day-to-day operation is invested through the City of Milwaukee, primarily in the State of Wisconsin’s LGIP and/or other types of investment instruments as determined by the City Treasurer. As of December 31, 2012 and 2011, the City Treasurer held cash and cash equivalents of \$5.8 million and \$4.1 million, respectively, on behalf of the Water Works that consisted of certificates of deposit, LGIP investments, and cash accounts.

CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

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, 2012 and 2011, the Water Works debt consisted of \$6.5 million and \$7.5 million, respectively, in revenue bonds through the State of Wisconsin Safe Drinking Water Loan program, \$18.9 million and \$22.3 million, respectively, in general obligation bonds, respectively, and \$4.0 million of extendable municipal commercial paper promissory notes as of December 31, 2012, for a total indebtedness of \$29.4 million and \$29.8 million as of December 31, 2012 and 2011, respectively.

Economic Factors

Volume of water sold increased by 653 million gallons in 2012 and dropped by 188 million gallons in 2011 from the previous year. 2012 was a very hot and dry year. As shown in Table A-4, there has been a steady decline in water volume sold in the four years preceding 2012. Over the last five years, the volume of water sold to industrial customers has dropped by 18.8% making it the customer category that lost the most. Volume of water sold to all customers dropped by 6.2% over the last five years. Table A-5 shows, graphically, the volume of water sold to different categories of customers over the last 20 years. As can be observed in the graph, there is a significant decline in the sale of water to all customer categories over the 20-year period.

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

In 2011, the PSC designed an Economic Development Rate (EDR), also known as the WAVE Rate (Water Attracting Valued Employers), to encourage business growth. The Water Works is authorized to offer discounted water rates to new and existing business customers for a period of five years in exchange for increased water usage and living wage job creation and retention. As of December 31, 2012, no customers had applied for the EDR, despite an aggressive marketing campaign. The Water Works has requested that the PSC discontinue the EDR.

CITY OF MILWAUKEE – WATER WORKS

Management’s Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

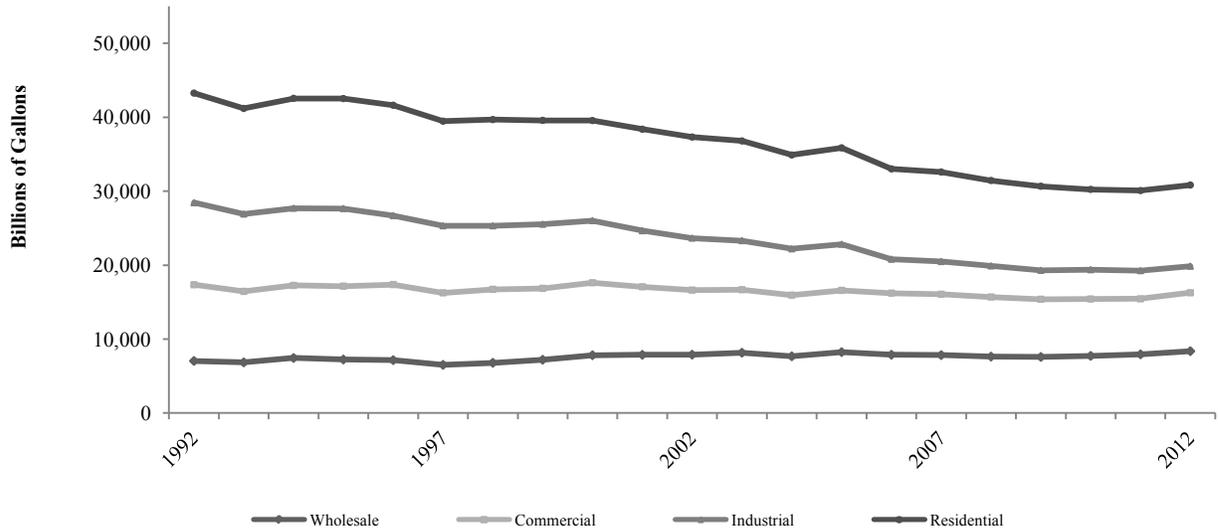
Table A-4

Sale of Water

| | <u>2012</u> | <u>2011</u> | <u>2010</u> | <u>2009</u> | <u>2008</u> |
|------------------|-------------------------|-------------|-------------|-------------|-------------|
| | (In billion of gallons) | | | | |
| Customer class: | | | | | |
| Residential | 11.0 | 10.8 | 10.8 | 11.4 | 11.5 |
| Commercial | 7.9 | 7.5 | 7.7 | 7.8 | 8.0 |
| Industrial | 3.6 | 3.8 | 4.0 | 3.9 | 4.2 |
| Public authority | 2.0 | 2.2 | 2.2 | 2.6 | 2.7 |
| Subtotal | 24.5 | 24.3 | 24.7 | 25.7 | 26.4 |
| Wholesale | 8.4 | 7.9 | 7.7 | 7.6 | 7.7 |
| Total | <u>32.9</u> | <u>32.2</u> | <u>32.4</u> | <u>33.3</u> | <u>34.1</u> |

Table A-5

Volume of Water Sold by Customer Type



CITY OF MILWAUKEE – WATER WORKS

Management's Discussion and Analysis

December 31, 2012 and 2011

(Unaudited)

Subsequent Events

In April 2013, the Milwaukee Water Works applied to the PSC for a Simplified Rate Increase which will enable the utility narrow the gap between its actual rate of return and the rate of return allowable by the PSC.

Contacting Water Works Financial Management

This financial report is designed to provide a general overview of the Water Works' finances to its customers, creditors, and anyone who has an interest in the Water Works' operations. If you have questions about this report or need additional information, contact the Water Works' Superintendent, Carrie Lewis, 841 N. Broadway, Room 409, Milwaukee, Wisconsin 53202.

CITY OF MILWAUKEE – WATER WORKS

Statements of Net Position

December 31, 2012 and 2011

| | 2012 | 2011 |
|--|----------------|-------------|
| Assets: | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 5,119,978 | 3,360,324 |
| Restricted cash and cash equivalents | 705,525 | 692,467 |
| Accounts receivable, net | 17,317,006 | 17,074,763 |
| Unbilled accounts receivable | 11,957,000 | 11,976,000 |
| Accrued interest | 1,434 | 1,139 |
| Due from other funds | 11,636,117 | 6,480,792 |
| Inventory of materials and supplies | 2,607,862 | 2,571,944 |
| Prepaid items | 555,545 | 121,948 |
| Other assets | 13,106 | 210,221 |
| Total current assets | 49,913,573 | 42,489,598 |
| Noncurrent assets: | | |
| Water plant in service, net | 390,471,751 | 393,983,168 |
| Construction work in process | 9,415,583 | 2,829,310 |
| Other property, net | 3,947,817 | 5,311,232 |
| Total noncurrent assets | 403,835,151 | 402,123,710 |
| Total assets | \$ 453,748,724 | 444,613,308 |
| Liabilities: | | |
| Current liabilities: | | |
| Accounts payable | \$ 4,646,487 | 4,303,713 |
| Interest payable | 218,256 | 246,771 |
| Accrued wages | 1,253,016 | 1,251,566 |
| Compensated absences | 1,134,831 | 1,079,086 |
| Due to other funds | 14,889,685 | 16,635,863 |
| Long-term debt due within one year | 7,951,682 | 4,314,748 |
| Total current liabilities | 30,093,957 | 27,831,747 |
| Noncurrent liabilities: | | |
| General obligation bonds payable | 15,945,847 | 18,954,309 |
| Revenue bonds payable | 5,493,165 | 6,508,497 |
| Net other postemployment benefits obligation | 4,233,571 | 3,754,619 |
| Total noncurrent liabilities | 25,672,583 | 29,217,425 |
| Total liabilities | \$ 55,766,540 | 57,049,172 |
| Net position: | | |
| Net investment in capital assets | \$ 374,444,457 | 372,346,156 |
| Restricted for debt service | 705,525 | 692,467 |
| Unrestricted | 22,832,202 | 14,525,513 |
| Total net position | \$ 397,982,184 | 387,564,136 |

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Revenues, Expenses, and Changes in Fund Net Position
Years ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|-----------------------|---------------------|
| Operating revenues: | | |
| Water sales | \$ 73,076,006 | 69,943,592 |
| Fire protection service | 7,159,090 | 6,920,730 |
| Charges for shared services | 5,196,083 | 5,084,729 |
| Other | <u>2,690,857</u> | <u>2,444,432</u> |
| Total operating revenues | <u>88,122,036</u> | <u>84,393,483</u> |
| Operating expenses: | | |
| Administrative and general | 6,087,111 | 6,474,096 |
| Billing and collection | 2,770,331 | 2,703,710 |
| Transmission and distribution | 20,709,462 | 21,687,762 |
| Water pumping | 7,888,874 | 8,748,474 |
| Water treatment | 13,200,113 | 14,448,125 |
| Depreciation | <u>14,110,051</u> | <u>14,066,822</u> |
| Total operating expenses | <u>64,765,942</u> | <u>68,128,989</u> |
| Operating income | <u>23,356,094</u> | <u>16,264,494</u> |
| Nonoperating revenues (expenses): | | |
| Interest income | 13,692 | 12,427 |
| Interest expense | (1,175,096) | (1,066,588) |
| Miscellaneous | <u>(630,180)</u> | <u>435,633</u> |
| Total nonoperating expenses, net | <u>(1,791,584)</u> | <u>(618,528)</u> |
| Income before capital contributions and transfers | 21,564,510 | 15,645,966 |
| Capital contributions | 744,749 | 747,013 |
| Transfers out | <u>(11,891,211)</u> | <u>(11,150,863)</u> |
| Increase in net position | 10,418,048 | 5,242,116 |
| Net position – beginning of year | <u>387,564,136</u> | <u>382,322,020</u> |
| Net position – end of year | <u>\$ 397,982,184</u> | <u>387,564,136</u> |

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Cash flows from operating activities: | | |
| Receipts from customers and users | \$ 83,090,939 | 75,008,235 |
| Receipts from interfund services provided | 5,196,083 | 5,084,728 |
| Payments to suppliers | (24,712,049) | (27,871,091) |
| Payments to employees | (21,448,022) | (24,132,829) |
| Payments to other funds | <u>(11,179,032)</u> | <u>(4,219,168)</u> |
| Net cash provided by operating activities | <u>30,947,919</u> | <u>23,869,875</u> |
| Cash flows from noncapital financing activities: | | |
| Miscellaneous nonoperating revenue (expense) | (630,180) | 435,633 |
| Interfund borrowings | <u>(11,891,211)</u> | <u>3,539,636</u> |
| Net cash (used in) provided by noncapital financing activities | <u>(12,521,391)</u> | <u>3,975,269</u> |
| Cash flows from capital and related financing activities: | | |
| Acquisition of property, plant, and equipment | (15,076,742) | (34,481,957) |
| Proceeds from bonds, notes, and revenue bonds | 4,000,000 | 11,625,000 |
| Retirement of bonds, notes, and revenue bonds | (4,314,748) | (3,989,190) |
| Interest paid | <u>(1,275,723)</u> | <u>(1,133,370)</u> |
| Net cash used in capital and related financing activities | <u>(16,667,213)</u> | <u>(27,979,517)</u> |
| Cash flows from investing activity: | | |
| Interest income | <u>13,397</u> | <u>13,002</u> |
| Net cash provided by investing activity | <u>13,397</u> | <u>13,002</u> |
| Net increase (decrease) in cash and cash equivalents | 1,772,712 | (121,371) |
| Cash and cash equivalents – beginning of year | <u>4,052,791</u> | <u>4,174,162</u> |
| Cash and cash equivalents – end of year | <u>\$ 5,825,503</u> | <u>4,052,791</u> |
| Cash and cash equivalents at year-end consist of: | | |
| Unrestricted cash and cash equivalents | \$ 5,119,978 | 3,360,324 |
| Restricted cash and cash equivalents | <u>705,525</u> | <u>692,467</u> |
| Total cash and cash equivalents | <u>\$ 5,825,503</u> | <u>4,052,791</u> |

CITY OF MILWAUKEE – WATER WORKS

Statements of Cash Flows

Years ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|-------------------|
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 23,356,094 | 16,264,494 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 14,110,051 | 14,066,822 |
| Changes in assets and liabilities: | | |
| Receivables | (223,243) | (4,751,850) |
| Due from/to other funds resulting from operations | (6,901,504) | (2,063,297) |
| Inventory of materials and supplies | (35,918) | 60,722 |
| Prepaid items | (433,597) | 468,055 |
| Other assets | 197,115 | 48,144 |
| Noncapital accounts payable | 342,774 | (789,295) |
| Accrued wages and compensated absences | 57,195 | (111,535) |
| Net other postemployment benefits obligation | 478,952 | 677,615 |
| Net cash provided by operating activities | <u>\$ 30,947,919</u> | <u>23,869,875</u> |
| Noncash activities: | | |
| During the year, water mains and related property installed by others were deeded to the Water Works in the amount of | \$ 744,749 | 747,013 |

See accompanying notes to basic financial statements.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

(1) Summary of Significant Accounting Policies

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

(a) Reporting Entity

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

- (1) Appointment of a voting majority of the component unit's board and either:
 - (a) the ability to impose will by the primary government; or
 - (b) the possibility that the component unit will provide a financial benefit to or impose a financial burden on the primary government; or
- (2) Fiscal dependency on the primary government.

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

(b) Basis of Accounting

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

Nonexchange transactions, in which the Water Works receives value without directly giving equal value in return, include contributions and grants. On an accrual basis, revenue from contributions and grants is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements and expenditure requirements. Timing requirements specify the year when the resources are required to be used or the fiscal year when use is first permitted. Expenditure requirements specify the year in which the resources are provided to the Water Works on a reimbursement basis.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

(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 \$837,645 and \$607,922 as of December 31, 2012 and 2011, respectively. The accounts receivable year-end balance includes actual unpaid charges. The unbilled accounts receivable balance consists of an estimate of the 2012 receivables that will be billed in the first quarter of 2013.

(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.
- 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

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

agency or if that security is senior to, or on a parity with, a security of the same issuer which has such a rating.

- Securities of open-end management investment companies or investment trusts (mutual funds) if the portfolio is limited to (a) bonds and securities issued by the federal government or a commission, board or other instrumentality of the federal government, (b) bonds that are guaranteed as to principal and interest by the federal government or a commission, board or other instrumentality of the federal government, and (c) repurchase agreements that are fully collateralized by these bonds or securities.

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

(g) Capital Assets

Capital assets are defined by the Water Works as assets with an initial, individual cost of more than \$2,000 and an estimated useful life in excess of a year. Capital assets are capitalized at cost when purchased or constructed. Donated capital assets are recorded at their estimated fair value at the date of donation. Intangible assets not specifically excluded by its scope provisions will be classified as capital assets. Costs of depreciable property retired are removed from utility plant accounts and are charged to accumulated depreciation. Maintenance and repair costs are charged to operations as incurred and renewals and improvements are added to the asset accounts. Depreciation is provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

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

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

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

(i) Net Position

Net position is displayed in three components as follows:

Net investment in capital assets – 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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

Restricted – This consists of amounts that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, it is the Water Works’ policy to use restricted resources first, and then unrestricted resources when they are needed. The Water Works has restricted net position of \$705,525 and \$692,467 at December 31, 2012 and 2011, respectively. The restriction of net position is related to the debt service reserve requirements of the revenue bonds.

Unrestricted – This consists of amounts that do not meet the definition of “restricted” or “net investment in capital assets.”

(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, 2012 and 2011, accumulated sick leave earned but not taken was approximately \$4,133,173 and \$4,149,329, respectively. Accumulated sick leave is determined on the basis of current salary rate. The amount of accumulated sick leave to be forfeited upon termination and retirement is not available and would reduce this amount.

(l) *Classification of Revenues and Expense*

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

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

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

(m) *Taxes*

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

(n) *Estimates*

The preparation of basic financial statements, in conformity with U.S. generally accepted accounting principles, requires management to make estimates and assumptions relating to the reporting of

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from this estimate.

(o) New Accounting Pronouncements

The Water Works implemented the provisions of GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements during the year ended December 31, 2012*. This Statement incorporated certain financial and reporting guidance from the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA) which did not conflict or contradict GASB statements into the GASB authoritative literature. There was no impact on the Water Works’ financial statements as a result of the implementation.

The Water Works implemented the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position during the year ended December 31, 2012*. This Statement introduced and defined deferred outflows and deferred inflows as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. This Statement also amended the net asset reporting requirements in GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The Water Works renamed its basic financial statements from the net asset measure to the net position measure, however there was no other impact as a result of the implementation.

(2) Deposits and Investments

As of December 31, 2012 and 2011, the Water Works’ deposits and investments were as follows:

| | 2012 | 2011 |
|----------------------------------|--------------|-------------|
| Local Government Investment Pool | \$ 3,883,336 | 828,028 |
| Deposits and cash on hand | 1,942,167 | 3,224,763 |
| Total | \$ 5,825,503 | 4,052,791 |

(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, 2012 and 2011, 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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

(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.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

(3) Capital Assets

Capital asset activity for the year ended December 31, 2012 was as follows:

| | <u>Balance December 31, 2011</u> | <u>Additions</u> | <u>Deletions</u> | <u>Balance December 31, 2012</u> |
|--|--|--------------------|---------------------|--|
| Capital assets not being depreciated: | | | | |
| Land and land improvements | \$ 1,363,077 | — | — | 1,363,077 |
| Nonutility property, land | 654,868 | — | — | 654,868 |
| Construction in progress | <u>2,829,311</u> | <u>17,275,209</u> | <u>(10,688,937)</u> | <u>9,415,583</u> |
| Total capital assets not being depreciated | <u>4,847,256</u> | <u>17,275,209</u> | <u>(10,688,937)</u> | <u>11,433,528</u> |
| Capital assets being depreciated: | | | | |
| Buildings | 27,258,906 | 223,346 | (214,611) | 27,267,641 |
| Transmission and distribution system | 357,017,568 | 3,094,120 | (249,390) | 359,862,298 |
| Machinery and equipment | 213,309,827 | 7,371,471 | (5,917,188) | 214,764,110 |
| Nonutility property | <u>5,421,690</u> | <u>—</u> | <u>(1,767,564)</u> | <u>3,654,126</u> |
| Total capital assets being depreciated | <u>603,007,991</u> | <u>10,688,937</u> | <u>(8,148,753)</u> | <u>605,548,175</u> |
| Less accumulated depreciation: | | | | |
| Buildings | 16,500,716 | 861,410 | (210,111) | 17,152,015 |
| Transmission and distribution system | 86,241,911 | 4,799,866 | (300,221) | 90,741,556 |
| Machinery and equipment | 102,223,584 | 8,448,774 | (5,780,554) | 104,891,804 |
| Nonutility property | <u>765,326</u> | <u>171,003</u> | <u>(575,152)</u> | <u>361,177</u> |
| Total accumulated depreciation | <u>205,731,537</u> | <u>14,281,053</u> | <u>(6,866,038)</u> | <u>213,146,552</u> |
| Total capital assets being depreciated, net | <u>397,276,454</u> | <u>(3,592,116)</u> | <u>(1,282,715)</u> | <u>392,401,623</u> |
| Total capital assets, net | <u>\$ 402,123,710</u> | <u>13,683,093</u> | <u>(11,971,652)</u> | <u>403,835,151</u> |

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

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

| | Balance December 31, 2010 | Additions | Deletions | Balance December 31, 2011 |
|--|--|-----------------------------|-----------------------------|--|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Capital assets not being depreciated: | | | | |
| Land and land improvements | \$ 1,367,127 | — | (4,050) | 1,363,077 |
| Nonutility property, land | 654,868 | — | — | 654,868 |
| Construction in progress | <u>12,716,715</u> | <u>34,364,638</u> | <u>(44,252,042)</u> | <u>2,829,311</u> |
| Total capital assets not being depreciated | <u>14,738,710</u> | <u>34,364,638</u> | <u>(44,256,092)</u> | <u>4,847,256</u> |
| Capital assets being depreciated: | | | | |
| Buildings | 25,406,006 | 2,055,580 | (202,680) | 27,258,906 |
| Transmission and distribution system | 355,873,188 | 24,644,844 | (23,500,464) | 357,017,568 |
| Machinery and equipment | 206,449,773 | 17,551,618 | (10,691,564) | 213,309,827 |
| Nonutility property | <u>4,692,025</u> | <u>729,665</u> | <u>—</u> | <u>5,421,690</u> |
| Total capital assets being depreciated | <u>592,420,992</u> | <u>44,981,707</u> | <u>(34,394,708)</u> | <u>603,007,991</u> |
| Less accumulated depreciation: | | | | |
| Buildings | 15,974,163 | 833,028 | (306,475) | 16,500,716 |
| Transmission and distribution system | 83,977,782 | 4,637,147 | (2,373,018) | 86,241,911 |
| Machinery and equipment | 104,453,820 | 8,596,648 | (10,826,884) | 102,223,584 |
| Nonutility property | <u>576,006</u> | <u>189,320</u> | <u>—</u> | <u>765,326</u> |
| Total accumulated depreciation | <u>204,981,771</u> | <u>14,256,143</u> | <u>(13,506,377)</u> | <u>205,731,537</u> |
| Total capital assets being depreciated, net | <u>387,439,221</u> | <u>30,725,564</u> | <u>(20,888,331)</u> | <u>397,276,454</u> |
| Total capital assets, net | \$ <u><u>402,177,931</u></u> | <u><u>65,090,202</u></u> | <u><u>(65,144,423)</u></u> | <u><u>402,123,710</u></u> |

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

(4) Long-Term Obligations

(a) Changes in Long-Term Obligations

Changes in long-term obligations for the year ended December 31, 2012 were as follows:

| | Balance December 31, 2011 | Additions | Deletions | Balance December 31, 2012 | Due within one year |
|--|--|------------------|--------------------|--|------------------------------------|
| General obligation bonds | \$ 22,052,884 | — | (3,325,532) | 18,727,352 | 2,936,350 |
| Extendable municipal commercial paper | — | 4,000,000 | — | 4,000,000 | 4,000,000 |
| Unamortized premiums | 268,796 | — | (103,480) | 165,316 | — |
| Deferred amount on refundings | (41,839) | — | 31,368 | (10,471) | — |
| Revenue bonds | 7,497,713 | — | (989,216) | 6,508,497 | 1,015,332 |
| Other postemployment benefits | 3,754,619 | 478,952 | — | 4,233,571 | — |
| Total | \$ <u>33,532,173</u> | <u>4,478,952</u> | <u>(4,386,860)</u> | <u>33,624,265</u> | <u>7,951,682</u> |

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

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

(b) General Obligation Bonds

The City issues general obligation bonds to provide funds for the acquisition and construction of the water plant and related equipment (water system). General obligation bonds are secured by the full faith and unlimited taxing power of the City. The bonds for the Water Works will be retired by revenues from water services or, if the revenues are not sufficient, by future tax levies. The original amount of general obligation bonds issued in years prior to 2010 was \$26,720,019. During the years ended December 31, 2011, the City issued \$11,625,000, of general obligation bonds which were used for capital improvement of the water system.

(c) Extendable Municipal Commercial Paper

During 2012, the City began issuing extendable municipal commercial paper promissory notes which are not general obligations of the City; the notes are limited obligations of the City of Milwaukee payable from proceeds of the sale of notes or refunding notes issued to refinance the notes. The notes

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

do not represent or constitute a debt of the City within the meaning of any constitutional or statutory limitations. During 2012, the City issued \$4,000,000 of extendable municipal commercial paper for the Water Works which was used to finance capital improvements of the water system, and which are included in the long-term obligations table in note 4(a) above.

General obligation bonds and extendable municipal commercial paper outstanding at December 31, 2012 and 2011 were as follows:

| Series | Maturity | Interest rates | Original | Principal | |
|------------------------------|--------------|----------------|---------------|------------------------|------------|
| | | | | Balance at December 31 | |
| | | | | 2012 | 2011 |
| Refunding E | 2012 to 2019 | 4.50% to 5.00% | \$ 3,125,658 | 997,665 | 1,023,477 |
| Refunding C, D, F, G, J, & K | 2012 to 2016 | 5.00% to 5.25% | 17,953,357 | 6,069,363 | 8,506,760 |
| Refunding 2006 N9, Refd C&D | 2012 to 2015 | 4.25% to 5.00% | 114,756 | 45,324 | 72,647 |
| 2009-N1 | 2012 to 2019 | 3.00% to 5.00% | 150,000 | 105,000 | 120,000 |
| 2009-B2 | 2020 to 2024 | 4.00% to 5.00% | 75,000 | 75,000 | 75,000 |
| 2010-N1 | 2012 to 2020 | 2.50% to 5.00% | 450,000 | 360,000 | 405,000 |
| 2010-B5 | 2021 to 2025 | 1.50% to 5.00% | 225,000 | 225,000 | 225,000 |
| 2011-N3 | 2012 to 2021 | 4.00% to 5.00% | 7,750,000 | 6,975,000 | 7,750,000 |
| 2011-B4 | 2021 to 2026 | 4.00% to 5.00% | 3,875,000 | 3,875,000 | 3,875,000 |
| 2012-C6-G | 2017 | .23% | 4,000,000 | 4,000,000 | — |
| Total | | | \$ 37,718,771 | 22,727,352 | 22,052,884 |

(d) 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, 2012 and 2011 were as follows:

| Series | Maturity | Interest rates | Original | Principal | |
|--------|--------------|----------------|---------------|------------------------|-----------|
| | | | | Balance at December 31 | |
| | | | | 2012 | 2011 |
| SDW-1 | 2012 to 2018 | 2.64% | \$ 4,873,153 | 1,806,266 | 2,080,797 |
| SDW-2 | 2012 to 2018 | 2.64 | 1,618,213 | 599,801 | 690,964 |
| SDW-3 | 2012 to 2018 | 2.64 | 5,001,067 | 1,853,678 | 2,135,415 |
| SDW-4 | 2012 to 2018 | 2.64 | 4,148,305 | 1,537,596 | 1,771,293 |
| SDW-5 | 2012 to 2018 | 2.64 | 1,918,640 | 711,156 | 819,244 |
| Total | | | \$ 17,559,378 | 6,508,497 | 7,497,713 |

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

(e) Debt Service Requirements

The maturities of the outstanding principal and related interest requirements as of December 31, 2012 are as follows:

| Year: | General obligation bonds | | Revenue bonds | |
|-------------|--------------------------|-----------|---------------|----------|
| | Principal | Interest | Principal | Interest |
| 2013 | \$ 2,936,350 | 927,266 | 1,015,332 | 158,422 |
| 2014 | 3,121,153 | 777,852 | 1,042,136 | 131,263 |
| 2015 | 2,511,389 | 626,147 | 1,069,649 | 103,388 |
| 2016 | 1,816,828 | 496,636 | 1,097,887 | 74,776 |
| 2017 | 4,856,010 | 398,860 | 1,126,872 | 45,410 |
| 2018 – 2022 | 4,220,620 | 1,339,686 | 1,156,621 | 15,267 |
| 2023 – 2026 | 3,265,002 | 321,625 | — | — |
| Total | \$ 22,727,352 | 4,888,072 | 6,508,497 | 528,526 |

(5) Revenue Bond Debt Covenants

| Fiscal year: | Gross revenues | Debt coverage expenses | Net revenue available for debt service | Debt service requirements | | | Coverage |
|--------------|----------------|------------------------|--|---------------------------|----------|-----------|----------|
| | | | | Principal | Interest | Total | |
| 2011 | \$ 84,405,910 | 65,213,030 | 19,192,880 | 989,216 | 184,882 | 1,174,098 | 16.35 |
| 2012 | 88,135,728 | 62,547,102 | 25,588,626 | 1,015,332 | 158,422 | 1,173,754 | 21.80 |

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, 2012 and 2011, there were no other debt obligations payable from the revenues of the water system.

(6) Retirement Plan and Other Postemployment Benefits

(a) Pension Benefits

Plan Description – The City makes contributions to the Employees’ Retirement System of the City of Milwaukee (the System), a cost-sharing multiple-employer defined-benefit pension plan, on behalf of all eligible City employees. The System provides retirement, disability, and death benefits to plan members and beneficiaries. The City Charter assigns the authority to establish and amend benefit provisions. The System issues a publicly available financial report that includes basic financial statements and required supplementary information for the System. That report may be

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

obtained by writing to the Employees' Retirement System of the City of Milwaukee, 789 North Water Street, Suite 300, Milwaukee, WI 53202.

Funding Policy – Plan members are required to contribute, or have contributed on their behalf, a percentage of their annual earnable compensation equal to 5.5%, 6.0%, 7.0%, and 7.0% for general City employees, police officers, firefighters, and elected officials, respectively. New hires who are not sworn police/fire must pay 1.6% of pensionable earnings for eight years to fund the cost of benefit escalators due to the Global Pension Settlement. The City is required to contribute the actuarially determined amount. The City Charter assigns the authority to establish and amend contribution requirements. The Water Works' contribution to the System for the years ended December 31, 2012, 2011, and 2010 was \$961,031, \$940,303 and \$1,049,289, respectively, and is equal to the required contributions on behalf of the plan members for the year.

(b) Other Postemployment Benefits

The City provides other postemployment benefits (OPEB) to its retirees for health and life insurance.

Plan Description – The City provides a single-employer defined-benefit healthcare plan and life insurance administered by both the City and Milwaukee's Employee Retirement System (MERS). The City provides medical insurance benefits for substantially all retirees in accordance with terms set forth in labor contracts or by Common Council resolution. Retirees are eligible to enroll in any of the group plans offered by the City. Aside from the basic plan, this includes a Health Maintenance Organization (HMO) plan currently offered to active employees. The City provides full health insurance coverage to general City employees who retire at age 55, but less than age 65, with 30 years of creditable service or age 60, but less than age 65, with 15 years of creditable service until the age of 65. Management employees retiring beginning in 2004 at age 55, but less than 65, pay a portion of health insurance the same as active management employees. In accordance with a "percentage formula" as provided in labor agreements, the City provides between 65% and 100% of the cost of the basic plan coverage for firefighters and police officers who retire with 25 years of creditable service and having attained at least the age of 52 but less than 60. Upon reaching the age of 60 but prior to the age of 65, the City provides full health insurance coverage for firefighters and police officers with single enrollment status. The City contribution for firefighters and police officers between the ages of 60 and 65 with family enrollment status is the greater of 100% of the cost of single enrollment in the basic plan or an amount determined using the "percentage formula." The "percentage formula" used to determine the City contribution in the labor agreements is based on the amount of unused sick leave at retirement.

After attaining the age of 65 and having completed a minimum of 15 years of creditable service, all retirees are eligible to enroll in a "subsidized plan" for medical insurance. Under this plan, the City contributes 25% of the base rate toward retirees enrolled in the basic plan, while the retiree pays 75% of the base rate and 100% of the major medical rate. For those retirees enrolled in an HMO, the City contributes a 25% subsidy of the applicable HMO premium.

In addition to medical insurance, the City allows its employees to continue life insurance coverage under the Group Life Insurance Plan offered to active employees in accordance with Section 350-25 of the Code of Ordinances. The base amount of coverage for general City employees is equal to the employee's annual basic salary to the next higher thousand dollars. The base amount of coverage for

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

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

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

Funding Policy – The contribution of plan members and the Water Works is established and may be amended by the City. The required contribution for medical and life insurance for retirees is based on a pay-as-you-go financing. Medical benefits provided through the basic healthcare plan are self-insured. For 2012, the Water Works paid approximately \$1,259,775 and \$36,000, respectively, toward medical and life insurance for retirees. For 2011, the Water Works paid approximately \$1,394,500 and \$36,000, respectively, toward medical and life insurance for retirees.

Annual OPEB Cost and Net OPEB Obligation – The Water Works’ annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the Water Works’ annual OPEB cost for the year, the amount actually contributed to the plan (pay-as-you-go basis), and the changes in the Water Works’ net OPEB obligation for the years ended December 31, 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|--|------------------------------|------------------------------|
| Annual required contribution (ARC) | \$ 1,750,202 | 2,085,548 |
| Interest on net OPEB obligation | 162,004 | 143,052 |
| Adjustment to ARC | <u>(137,479)</u> | <u>(120,464)</u> |
| Annual OPEB cost | 1,774,727 | 2,108,136 |
| Contributions made | <u>1,295,775</u> | <u>1,430,521</u> |
| Increase in net OPEB obligation | (478,952) | (677,615) |
| Net OPEB obligation at beginning of year | <u>(3,754,619)</u> | <u>(3,077,004)</u> |
| Net OPEB obligation at end of year | \$ <u><u>(4,233,571)</u></u> | \$ <u><u>(3,754,619)</u></u> |

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

The Water Works annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2012, 2011 and 2010 were as follows:

| | <u>Employer contribution</u> | | | <u>Net OPEB obligation</u> |
|-------------------------|------------------------------|-------------------------------|----|----------------------------|
| | <u>Annual OPEB cost</u> | <u>Percentage contributed</u> | | |
| Year ended December 31: | | | | |
| 2012 | \$ 1,774,727 | 73.0% | \$ | 4,233,571 |
| 2011 | 2,108,136 | 67.9 | | 3,754,619 |
| 2010 | 2,072,185 | 67.4 | | 3,077,004 |

Funded Status and Funding Progress – As of January 1, 2011, the most recent actuarial valuation date, the actuarial accrued liability for benefits related to all City employees was \$916,400,000 and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of \$916,400,000. Of this amount, it was estimated that 4% is attributable to Water Works. The covered payroll (annual payroll of all active City employees covered by the plan) was \$407,800,000 and the ratio of the UAAL to the covered payroll was 225%. The covered payroll for Water Works employees was \$16,300,000.

Actuarial valuations of an ongoing plan involve estimates of value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend amounts determined regarding the funded status of the plan, and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations, and new estimates are made about the future.

Actuarial Methods and Assumptions – The retiree healthcare valuation was based on the projected unit credit (PUC) cost method. The PUC method produces an explicit normal cost and actuarial accrued liability. The normal cost and actuarial accrued liability are directly proportional to the employee’s service. That is, the normal cost equals the present value of future benefits divided by projected service at retirement, and the actuarial accrued liability equals the present value of benefits multiplied by the ratio of service at valuation date to projected service at retirement. Depending on the demographic characteristics of the current group and new entrants in the future, this method could produce stable annual costs, in the aggregate, when expressed as a percentage of pay.

The OPEB valuation uses a discount rate assumption of 4.5% based on the City’s projected short-term investment rate of return. The healthcare cost trends rate is 9.0% initially, and reduced by decrements to the ultimate rate of 4.5% after 10 years. The actuarial assumption for wage inflation is 3.5%. The amortization of the unfunded actuarial accrued liability is based on a level percentage of pay over a 30-year open amortization period.

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

(7) Related-Party Transactions

A summary of significant revenue and expense transactions between the City and Water Works for 2012 and 2011 is shown below:

| | <u>2012</u> | <u>2011</u> |
|--|----------------------|-------------------|
| Revenues (receipts from the City) – water consumption | \$ 250,984 | 375,223 |
| Transfer from Parking Fund – Lincoln Yards Installment | 27,229 | — |
| Total revenues | <u>\$ 278,213</u> | <u>375,223</u> |
| Expenses (payments to the City): | | |
| Payment in lieu of taxes and other transfers | \$ 11,891,211 | 11,150,863 |
| Employee fringe benefits | 7,070,161 | 8,151,069 |
| Administrative services | 910,085 | 925,941 |
| Electrical equipment maintenance | 531,895 | 456,320 |
| Motor vehicle usage and maintenance | 940,063 | 886,952 |
| Street repairs | 4,028,796 | 3,221,553 |
| All other services | 5,866,437 | 5,910,135 |
| Total payments to the City | <u>\$ 31,238,648</u> | <u>30,702,833</u> |

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

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

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

(8) Regulatory Agency

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

CITY OF MILWAUKEE – WATER WORKS

Notes to Basic Financial Statements

December 31, 2012 and 2011

The effect of such differences on net income as shown on the PSC reports is as follows for the years ended December 31, 2012 and 2011:

| | <u>2012</u> | <u>2011</u> |
|--|------------------|--------------|
| | (In thousands) | |
| Increase in net position as shown in accompanying financial statements | \$ 10,418 | 5,242 |
| Amortization of deferred credits resulting from Contributions in Aid of Construction (CIAC) reclassification | 811 | 811 |
| Writeoff Nonutility Property | 564 | — |
| Sale of property | <u>357</u> | <u>(293)</u> |
| Net income as shown on PSC reports | <u>\$ 12,150</u> | <u>5,760</u> |

(9) Commitments and Contingencies

The Water Works is generally committed under the terms of various contracts for construction of improvements and additions to the Water Works' system. Contract terms provide for partial payments as construction progresses with specified retention to assure full contract compliance. Open commitments on such contracts as of December 31, 2012 totaled \$5,393,960.

(10) Transfers and Interfund Balances

At December 31, 2012 and 2011, the Water Works has recorded a due from other funds of \$11,636,117 and \$6,480,792, respectively, which in part represents cash held by the general obligation debt fund of the City on behalf of Water Works for the 2012 and 2011 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, 2012 and 2011, the Water Works has recorded a due to the City (General and Sewer Funds) of \$14,889,685 and \$16,635,863, respectively, for sewer maintenance and other municipal fees collected by the Water Works.

The Water Works transfers funds to the City (general fund) for PILOT. In 2012 and 2011, the PILOT transfers to the City were \$11,891,211 and \$11,150,863, respectively. In 2010, the Water Works transferred \$3,000,000 to the City's general fund as a nonexchange transaction.

(11) Subsequent Events

In April 2013, MWW applied to the Public Service Commission (PSC) for a Simplified Rate Increase. Under Docket 3720-WQ-103, on May 9, 2013 the PSC authorized a 3% rate increase with an effective date of June 1, 2013.