CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

REPORT ON AUDITS OF FINANCIAL STATEMENTS
For the years ended December 31, 2012 and 2011

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

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INDEPENDENT AUDITORS' REPORT

To the Honorable Frank G. Jackson, Mayor, Members of Council and the Audit Committee
Division of Water
Department of Public Utilities
City of Cleveland, Ohio:

Report on the Financial Statements

We have audited the accompanying financial statements of the Division of Water, Department of Public Utilities, City of Cleveland, Ohio (the Division) 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 accounting principles generally accepted in the United States of America; 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit 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.

one east fourth street, ste. 1200
cincinnati, oh 45202

www.cshco.com
p. 513.241.3111
f. 513.241.1212

Opinions

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the Division of Water, Department of Public Utilities, City of Cleveland, Ohio, (as of December 31, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Effect of Adopting New Accounting Standards

As discussed in Note A, the Division adopted the provisions of Governmental Accounting Standards Board Statement No. 60 *Accounting and Financial Reporting for Service Concession Arrangements*, Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provision*. Our opinion is not modified with respect to this matter.

Other Matters

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, 2012 and 2011, 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. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 15 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.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
June 25, 2013

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, 2012 and 2011. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 17.

The Division services not only the City, but also 69 surrounding communities, six master meter communities, and eight emergency standby communities. They provide water to approximately 417,069 city and suburban accounts in the Cleveland metropolitan area. They also sell water to master meter communities that operate their own distribution systems, and they provide billing and payment services for the Northeast Ohio Regional Sewer District and other communities.

During 2012, the Division provided services to approximately 124,520 accounts located within Cleveland and approximately 292,549 accounts located in direct service communities. Water provided to each master meter community is metered at each community's boundary. Consumers within the City of Cleveland accounted for 21% of the Division's metered sales revenue, while the direct service and master meter communities accounted for 70% and 9% of metered sales revenue, respectively.

The Division, along with Division of Utilities Fiscal Control (UFC), provides a complete array of processing services including billing, payment processing, mailing delinquency notices, terminating water service on delinquent accounts and distributing the money collected to the communities. UFC processes approximately 5,000 bills daily, which include bills for water only, sewer only, water and sewer, final notices and delinquent bills.

COMPARISON OF CURRENT YEAR'S AND PRIOR YEARS' DATA

FINANCIAL HIGHLIGHTS

- The Division restated its 2011 beginning capital assets due to the acquisition of $167,777,000, net of accumulated depreciation, of suburban distribution water mains by agreements signed with 21 suburbs from 2005 through 2010.

- The Division's net position was $1,259,472,000, $1,197,743,000 and $1,190,443,000 at December 31, 2012, 2011 and 2010, respectively. Of these amounts, $257,578,000, $204,911,000 and $207,491,000 are unrestricted net position at December 31, 2012, 2011 and 2010, respectively, and may be used to meet the Division's ongoing obligations to customers and creditors.

- In 2012, the operating revenues of the Division increased by $43,697,000 mainly due to a water rate increase. In 2011, the operating revenues of the Division decreased by $644,000.

- In 2012 the Division had a decrease in water pumpage of 0.16%. The major users of water consumption were ISG-Cleveland, Cuyahoga Metropolitan Housing Authority, Nestle Inc., Cleveland Clinic Foundation, Alcoa Inc., Northeast Ohio Regional Sewer District, Pepsi Inc. and Case Western Reserve University. In 2011 the Division had an increase in water pumpage of 0.2%. The major users of water consumption were ISG-Cleveland, Cuyahoga Metropolitan Housing Authority, Nestle Inc., Alcoa Inc., Cleveland Clinic Foundation, Pepsi Inc., Northeast Ohio Regional Sewer District and NASA Lewis Research Center.

FINANCIAL HIGHLIGHTS (Continued)

- The Division's overall net position increased by $61,729,000 and $7,300,000 in 2012 and 2011 respectively.

- The Division had increases in capital assets, net of accumulated depreciation, of $26,286,000 and $23,318,000 in 2012 and 2011, respectively. The major additions during these years were related to the continuing renovation projects for plant enhancements at the Morgan, Baldwin, Crown and Nottingham sites, suburban water main renewal and the meter reading program. The Division added the water mains for three suburbs in 2012 for $20,044,000. The major projects that were closed in construction in progress and moved to assets were Cleveland Security Contracts, Keller II Water Tower, Warehouse Improvements, Baldwin Residuals and Fairmount, Morgan Chemical Facility and the Plant Enhancements Program.

- The total long-term revenue bonds and loans payable of the Division increased $81,844,000 in 2012. This increase is primarily attributed to the issuance of $44,410,000 of Senior Lien, Series X Bonds and $76,710,000 Second Lien, Series A Bonds, which was offset by $40,239,000 of debt retired. The total long-term debt of the Division decreased $62,551,000 in 2011. This decrease is attributed to $43,407,000 of debt retired and $101,800,000 of debt defeased, which was offset by the issuance of $82,090,000 of revenue bonds and receipt of one Ohio Water Development Authority loan totaling $566,000.

- In July, 2012 the Division issued $50,000,000 of Water Revenue Subordinate Lien Notes Series 2012 in order to refund notes issued in 2011 to fund a portion of the Automated Meter Reading program. The 2012 Notes were redeemed in November 2012 with a portion of the proceeds from Second Lien Series A 2012 Bonds.

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 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 17 – 22 of this report.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

OVERVIEW OF THE FINANCIAL STATEMENTS (Continued)

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 23 - 45 of this report.

CONDENSED STATEMENT OF NET POSITION INFORMATION

Provided below is condensed statement of net position information for the Division as of December 31, 2012, 2011 and 2010:

	2012	Restated 2011	Restated 2010
		(In thousands)	
Assets:			
Capital assets, net	$ 1,686,939	$ 1,660,653	$ 1,637,335
Restricted assets	211,843	171,598	240,993
Unamortized bond issuance costs	5,151	4,517	4,911
Current assets	308,093	271,720	276,285
Total assets	2,212,026	2,108,488	2,159,524
Deferred outflows of resources:			
Derivative instruments-interest rate swaps	27,699	27,955	17,664
Total deferred outflows of resources	27,699	27,955	17,664
Total assets and deferred outflows	2,239,725	2,136,443	2,177,188
Net Position, Deferred Inflows and Liabilities:			
Net position:			
Net Investment in capital assets	914,193	899,231	881,062
Restricted for capital projects	99		
Restricted for debt service	87,602	93,601	101,890
Unrestricted	257,578	204,911	207,491
Total net positon	1,259,472	1,197,743	1,190,443
Deferred inflows of resources:			
Derivative instruments-interest rate swaps	27,699	27,955	17,664
Total deferred inflows of resources	27,699	27,955	17,664
Liabilities:			
Long-term obligations	869,040	765,540	819,238
Current liabilities	83,514	145,205	149,843
Total liabilities	952,554	910,745	969,081
Total net position, deferred inflows and liabilities	$ 2,239,725	$ 2,136,443	$ 2,177,188

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Total Assets and Deferred Outflows: The Division's investment in total assets and deferred outflows as of December 31, 2012 amounted to $2,239,725,000, which is an increase of $103,282,000 from 2011. The Division had an increase in restricted assets and current assets of $40,245,000 and $36,373,000 respectively, due primarily to the issuance of revenue bonds of $44,410,000 and second lien water bonds of $76,710,000, and an increase of $634,000 in unamortized bond issuance costs. The division had a decrease in deferred outflows of resources of $256,000. The Division's capital assets as of December 31, 2012 amounted to $1,686,939,000, which is an increase of $26,286,000.

The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had additions of $145,112,000, buildings, structures and improvements had additions $17,159,000 and furniture, fixtures, equipment and vehicles had additions of $21,158,000. Included in these additions is $20,044,000, net of accumulated depreciation, of distribution mains acquired from three suburbs.

Also, construction in progress had deletions of $146,245,000 due to the completion of several major projects: Kirtland Pump Station Rehab, Fairmount Pump Station Rehab, Morgan Pretreatment and Residuals, Warehouse Rehabilitation and Baldwin Residuals and Fairmount offset by several ongoing major projects: Automated Meter Reading program, Crown Water Plant Improvements, Suburban Water Main Renewal, Morgan Chemical Facility Improvements, plant enhancement program improvements and 800MHz radio system renewal.

The Division's investment in total assets and deferred outflows as of December 31, 2011 amounted to $2,136,443,000 which is a decrease of $40,745,000 from 2010. The Division had decreases in restricted assets of $69,395,000, current assets of $4,565,000 and unamortized bond issuance costs of $394,000. The Division had an increase in deferred outflows of resources of $10,291,000.

The Division's capital assets as of December 31, 2011 amounted to $1,660,653,000 which is an increase of $23,318,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had additions of $112,795,000, buildings, structures and improvements had additions $1,437,000 and furniture, fixtures, equipment and vehicles had additions of $5,709,000. Also, construction in progress decreased by $35,012,000 due to the completion of several major projects: Kirtland Pump Station Rehab, Fairmount Pump Station Rehab, Morgan Pretreatment and Residuals, Water Tank Rehabilitation and Water and Aurora Road Water Main Improvement, offset by several ongoing major projects: Automated Meter Reading program, Warehouse Improvements Phase 1 and 2, Crown Water Plant Improvements, Suburban Water Main Renewal, Morgan Chemical Facility Improvements and plant enhancement program improvements.

The increase in restricted assets of $40,245,000 as of December 31, 2012 is mainly attributed to increased cash balances in the debt service fund and restricted funds mainly due to the sale of the new Series X and the Second Lien Series A 2012 bonds.

The decrease in restricted assets of $69,395,000 as of December 31, 2011 is mainly attributed to decreased cash balances in the debt service fund and restricted funds for revenue bonds Series K, N, O and T.

The deferred outflow of resources related to the Division's interest rate swap agreements decreased from $27,955,000 in 2011 to $27,699,000 in 2012. The fair value of the swaps is determined by the taxable LIBOR rate as of December 31, 2012.

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

Capital Assets: The Division of Water restated their capital assets balances for 2011. The Division entered into amended Water Service Agreements with 21 member communities prior to 2011. These Agreements transferred ownership of the distribution mains from the member communities to the Division of Water. The Division's increase in their capital assets balance as a result of the restatement is $167,777,000 as of January 1, 2011. This is an increase of 11.4% compared to the reported capital assets balance prior to the restatement.

In 2012, the Division of Water entered into amended Water Service Agreements with three member communities. The amended Water Service Agreements transferred the ownership of the distribution mains to the Division. These new assets account for $20,044,000, net of accumulated depreciation, or 7.8% of the additions recorded in 2012.

The Division's investment in capital assets, as of December 31, 2012 amounted to $1,686,939,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was approximately 1.6%. The Division's investment in capital assets, as of December 31, 2011 amounted to $1,660,653,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for 2011 was approximately 1.4%. A summary of the activity in the Division's capital assets during the years ended December 31, 2012 and 2011 is as follows:

	Balance January 1, 2012	Additions	Reductions	Balance December 31, 2012
	(In thousands)			
Land	$ 5,463	$	$	$ 5,463
Land improvements	16,549			16,549
Utility plant	1,354,191	145,112	(1,425)	1,497,878
Buildings, structures and improvements	221,373	17,159		238,532
Furniture, fixtures, equipment and vehicles	566,679	21,158	(1,288)	586,549
Construction in progress	275,907	71,505	(146,245)	201,167
Total	2,440,162	254,934	(148,958)	2,546,138
Less: Accumulated depreciation	(779,509)	(82,370)	2,680	(859,199)
Capital assets, net	$ 1,660,653	$ 172,564	$ (146,278)	$ 1,686,939

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

	Restated Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011
		(In thousands)		
Land	$ 5,463	$	$	$ 5,463
Land improvements	16,549			16,549
Utility plant	1,241,644	112,795	(248)	1,354,191
Buildings, structures and improvements	219,953	1,437	(17)	221,373
Furniture, fixtures, equipment and vehicles	565,014	5,709	(4,044)	566,679
Construction in progress	310,919	84,929	(119,941)	275,907
Total	2,359,542	204,870	(124,250)	2,440,162
Less: Accumulated depreciation	(722,207)	(61,611)	4,309	(779,509)
Capital assets, net	$ 1,637,335	$ 143,259	$ (119,941)	$ 1,660,653

Major events during 2012 affecting the Division’s capital assets included the following:

- The construction, renovations and plant enhancements were completed on the Morgan, Baldwin and Nottingham facilities, the rehabilitation of the Fairmount and Kirtland pump stations and the rehabilitation of water mains and water tanks amounted to $148,401,000 in 2012. The major projects still under construction include: Security Enhancements Program, Plant Enhancement Program, Pump Station Enhancement Program, Water Tank Rehabilitation and Automated Meter Reading program.

- Three cities signed asset transfer agreements that turned over their distribution water mains in the amount of $20,044,000, net of accumulated depreciation.

Major events during 2011 affecting the Division’s capital assets included the following:

- The construction, renovations, and plant enhancements on the Morgan, Baldwin and Nottingham facilities, the rehabilitation of the Fairmount and Kirtland pump stations and the rehabilitation of water mains and water tanks amounted to $135,070,000. The major programs totaling $124,645,000 are: Security Enhancements Program, Plant Enhancement Program, Pump Station Enhancement Program, Water Tank Rehabilitation, Automated Meter Reading program and the purchase of office equipment and vehicles. Other smaller programs, such as the Electrical Power Reliability program comprise the remaining $10,425,000.

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

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

***Liabilities*:** In 2012, the factors for the Division's net increase in long-term obligations of $103,500,000 is primarily attributed the issuance of $122,283,000 of new bonds and loans and an increase in the unamortized discount and premium of $16,686,000, a decrease in unamortized loss on debt refunding of $2,788,000, offset by $40,239,000 of debt retirement. The increase in long-term obligations occurred due to the Division issuing bonds in order to refinance the $50,000,000 Series 2012 Notes with the balance of the proceeds used to fund the Automated Meter Reading program.

In 2011, the factors for the Division's net decrease in long-term obligations of $53,698,000 is attributed to additional Ohio Water Development Authority Loans of $566,000, the issuance of $132,090,000 of new bonds and notes and an increase in the unamortized discount and premium of $3,829,000. These amounts were offset by $93,407,000 of debt retirement, $101,800,000 of debt defeased, a decrease in unamortized loss on debt refunding of $1,857,000 and a decrease in accrued wages and benefits of $499,000.

Current Liabilities: In 2012, total current liabilities decreased by $61,691,000. The significant component of the change was a reduction to the current portion of long-term debt obligations and short-term notes of $52,281,000, which was primarily due to the retirement of the $50,000,000 Series 2011 short-term notes. Other decreases included customer deposits and other liabilities of $8,062,000, which was due to recognizing completed construction deposits and current payable from restricted assets of $2,087,000. These reductions were offset by a minor increase in accrued interest payable of $794,000.

In 2011, total current liabilities decreased by $4,638,000. The significant components of the change were increases to payable from accounts payable of $565,000, due to other City departments, divisions or funds of $547,000 and customer deposits and other liabilities of $1,669,000. These increases were offset by reductions to the current portion of long-term debt obligations and short-term notes of $3,322,000, current payable from restricted assets of $885,000, of accrued interest of $2,870,000 and current portion of accrued wages and benefits of $344,000.

Long-term Debt: At the end of 2012, the Division had total long-term debt outstanding of $892,939,000. All bonds 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 2011, the Division had total long-term debt outstanding of $811,095,000. All bonds 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.

Short-term Debt: The Division had no short-term debt outstanding at the end of 2012.

The City issued $50,000,000 Subordinate Lien Water Revenue Notes, Series 2012 in July 2012 to retire the Series 2011 Notes. The Series 2012 Notes were then redeemed on November 1, 2012 from the proceeds of the Second Lien Series A, 2012 Bonds.

At the end of 2011, the Division had $50,000,000 of Water Revenue Subordinate Revenue Notes outstanding. The Notes, which are subordinate to the Division's outstanding revenue bonds, were redeemed on July 26, 2012 with the proceeds of Series 2012 Notes and were backed by the revenues generated by the Division.

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2012 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	Balance January 1, 2012	Debt Issued	Debt Retired	Balance December 31, 2012
		(In thousands)		
Long-Term Debt				
Water Revenue Bonds:				
Series G, 1993	$ 81,225	$	$ (14,365)	$ 66,860
Series N, 2005	33,045		(5,030)	28,015
Series O, 2007	133,315		(2,705)	130,610
Series P, 2007	119,095		(5,815)	113,280
Series Q, 2008	90,800			90,800
Series T, 2009	77,415		(6,085)	71,330
Series U, 2010	54,935			54,935
Series V, 2010	26,495			26,495
Series W, 2011	82,090			82,090
Series X, 2012		44,410		44,410
Second Lien, Series A 2012		76,710		76,710
Ohio Water Development Authority Loans	112,680	963	(6,239)	107,404
Total	$ 811,095	$ 122,083	$ (40,239)	$ 892,939

	Balance January 1, 2012	Debt Issued	Debt Retired	Balance December 31, 2012
		(In thousands)		
Short-Term Debt				
Water Revenue Notes:				
Sub. Lien Revenue Notes, 2011	$ 50,000	$	$ (50,000)	$ -
Sub. Lien Revenue Notes, 2012		50,000	(50,000)	-
Total	$ 50,000	$ 50,000	$ (100,000)	$ -

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2011 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	Balance January 1, 2011	Debt Issued	Debt Defeased	Debt Retired	Balance December 31, 2011
			(In thousands)		
Long-Term Debt					
Water Revenue Bonds:					
Series G, 1993	$ 94,830	$	$	$ (13,605)	$ 81,225
Series H, 1996	2,020		(1,940)	(80)	-
Series J, 2001	43,230		(42,865)	(365)	-
Series K, 2002	52,810		(48,095)	(4,715)	-
Series N, 2005	33,045				33,045
Series O, 2007	138,725		(2,825)	(2,585)	133,315
Series P, 2007	135,410		(6,075)	(10,240)	119,095
Series Q, 2008	90,800				90,800
Series T, 2009	83,340			(5,925)	77,415
Series U, 2010	54,935				54,935
Series V, 2010	26,495				26,495
Series W, 2011		82,090			82,090
Ohio Water Development Authority Loans	118,006	566		(5,892)	112,680
Total	$ 873,646	$ 82,656	$ (101,800)	$ (43,407)	$ 811,095

	Balance January 1, 2011	Debt Issued	Debt Retired	Balance December 31, 2011
		(In thousands)		
Short-Term Debt				
Water Revenue Notes:				
Sub. Lien Revenue Notes, 2010	$ 50,000	$	$ (50,000)	$ -
Sub. Lien Revenue Notes, 2011		50,000		50,000
Total	$ 50,000	$ 50,000	$ (50,000)	$ 50,000

CONDENSED STATEMENT OF NET POSITION INFORMATION (Continued)

The bond ratings for the Division's outstanding revenue bonds as of December 31, 2012 are as follows:

	Moody's Investors Service	Standard & Poor's
Waterworks Revenue Bonds	Aa1	AA
Second Lien Water Revenue Bonds	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 2012, 2011 and 2010 was 231%, 144% and 132%, respectively.

Additional information on the Division's long-term debt can be found in Note B on pages 27 - 37.

Net Position: Net position serves as a useful indicator of a government's financial position. In the case of the Division, assets and deferred outflows exceed liabilities and deferred inflows by $1,259,472,000, $1,197,743,000 and $1,190,443,000 at December 31, 2012, 2011 and 2010, respectively.

Of the Division's net position, $914,193,000 or 72.6% and $899,231,000 or 75.1% at December 31, 2012 and 2011, respectively, reflects its investment in capital assets, 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 position, $87,701,000 or 7.0%, and $93,601,000 or 7.8%, at December 31, 2012 and 2011, respectively, represents resources that are subject to external restrictions. These funds are set aside for the payment of revenue bonds and capital projects. The remaining balance of unrestricted net position, $257,578,000 or 20.4% and $204,911,000 or 17.1%, at December 31, 2012 and 2011, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.

CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION INFORMATION

The Division's net position increased during 2012 and 2011 by $61,729,000 and $7,300,000, respectively. The following table identifies the key elements of the Division's results of operations as of and for the years ended December 31, 2012, 2011 and 2010:

	2012	Restated 2011	Restated 2010
		(In thousands)	
Operating revenues	$ 280,323	$ 236,626	$ 237,270
Operating expenses	216,624	207,844	208,016
Operating income (loss)	63,699	28,782	29,254
Non-operating revenue (expense):			
Investment income	1,965	2,349	4,007
Interest expense	(28,322)	(27,071)	(27,410)
Amortization of bond issuance costs, premiums and discounts	4,284	2,682	2,189
Gain (Loss) on disposal of capital assets	(15)		1
Total non-operating revenue (expense), net	(22,088)	(22,040)	(21,213)
Income (loss) before capital and other contributions	41,611	6,742	8,041
Capital and other contributions	20,118	558	5,001
Increase (decrease) in net position	61,729	7,300	13,042
Net position, beginning of year (as restated)	1,197,743	1,190,443	1,177,401
Net position, end of year	$ 1,259,472	$ 1,197,743	$ 1,190,443

Operating revenue: In 2012, total operating revenues increased by $43,697,000. The Division of Water had a minor decrease in pumpage of 0.16% and an increase in new rates and a full year of the fixed rate fee in 2012. The major users of water were as follows: ISG-Cleveland, Cuyahoga Metropolitan Housing Authority, Nestle Inc., Alcoa Inc., Cleveland Clinic Foundation, Pepsi Inc., Northeast Ohio Regional Sewer District and Case Western Reserve University.

In 2011, total operating revenues decreased by $644,000. The Division of Water had a minor increase in pumpage of 0.2%. The major users of water were as follows: ISG-Cleveland, Cuyahoga Metropolitan Housing Authority, Nestle Inc., Alcoa Inc., Cleveland Clinic Foundation, Pepsi Inc., Northeast Ohio Regional Sewer District and NASA Lewis Research Center.

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

Operating expenses: In 2012, the overall increase in operating expenses of $8,780,000 was primarily due to a $3,466,000 increase in operations expense and a $5,844,000 increase in depreciation expense. Operations expense increases were identified in the following areas: bad debt expense and professional services. Depreciation increased because several assets were brought into service during the year.

In 2011, the overall decrease in operating expenses of $172,000 was due to a $611,000 increase in operations expense and a $3,109,000 increase for depreciation expense. These increases were offset by a decrease of $3,892,000 in maintenance expenses. Operations expense increases were identified in the following areas: contractual services and electricity. The decrease in maintenance expenses were noted in the following areas: computer hardware maintenance and Ohio Public Employee Retirement System. Salary and benefit costs also decreased as a result of retirements, reductions in overtime costs, hospitalization and workers compensation costs.

Non-operating revenue (expense): The major changes in 2012 were an increase of $1,251,000 in interest expense and an increase of $1,602,000 in amortization of bond costs, premiums and discounts.

The major changes in 2011 were a decrease of $1,658,000 in investment income (attributed to declining interest rates), decrease of $339,000 in interest expense and an increase of $493,000 in amortization expense.

Capital and other contributions: In 2012, there was a $19,560,000 rise in capital and other contributions as compared to 2011. The increase is primarily attributed to the Division acquiring suburban distribution mains totaling $20,044,000 throughout the year.

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:

WATER RATES				
CLEVELAND - PER 1st .6 MCF (Thousand cubic feet)			CLEVELAND - PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2013	$15.51	$8.53	$29.48	$8.53
January 1, 2014	$17.34	$10.41	$31.22	$10.41
January 1, 2015	$19.26	$12.52	$32.74	$12.52

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

WATER RATES				
DIRECT SERVICE SUBURBS - PER 1st .6 MCF (Thousand cubic feet)			DIRECT SERVICE SUBURBS-PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2013	$22.11-$30.33	$12.16-$16.68	$42.01-$57.63	$12.16-$16.68
January 1, 2014	$23.63-$33.00	$14.18-$19.80	$42.53-$59.39	$14.18-$19.80
January 1, 2015	$25.04-$35.63	$16.27-$23.16	$42.56-$60.57	$16.27-$23.16

These increase in rates, fixed customer charges and recommended modifications to the Division's water rate structure were adopted by the Cleveland City Council on May 23, 2011. The fixed customer charges change became effective July 16, 2011 and was first billed on October 16, 2011. The new fixed customer charges are based on meter size. The first increase in a series of annual increases in water consumption charges became effective January 1, 2012. The annual rate increases for the years 2013 through 2015 are expected to increase operating revenues to adequately cover anticipated operating expenses. The increases in rates within the City of Cleveland average 12.7%, 11.8% and 11.1% for the first .6 MCF and 7.1%, 5.9% and 4.9% for each additional MCF for the years 2013, 2014 and 2015, respectively. The increases in rates within the suburbs average 8.0%, 6.9% and 6.0% for the first .6 MCF and 0.7%, 1.2% and 0.1% for each additional MCF for the years 2013, 2014 and 2015, respectively. The increases for fixed customer charges for Cleveland and suburbs average 16.7%, 14.3% and 12.5% for the years 2013, 2014 and 2015, respectively.

On July 24, 2012, the City issued $50,000,000 Subordinate Lien Water Revenue Notes, Series 2012. Proceeds of the notes were used to retire the $50,000,000 Subordinate Lien Water Revenue Notes issued in 2011. The Series 2012 Notes were redeemed on November 1, 2012 from the proceeds of the Second Lien Series A 2012 Bonds. The original notes, which were issued in 2010, provided a portion of the funds needed for a new Automated Meter Reading program for the Division.

Effective October 24, 2012, the Division issued $44,410,000 of Senior Lien Water Revenue Bonds Series X 2012 and $76,710,000 of Second Lien Water Revenue Bonds Series A 2012. Proceeds of the Series X Bonds will be used to pay costs of improvements to the Waterworks System and to pay costs of issuing the bonds. From the proceeds of the Series A 2012 Bonds, $42,000,000 will be used to fund the rest of the Automated Meter Reading program and the remainder was used to refund all of the outstanding $50,000,000 Water Revenue Subordinate Notes Series 2012 and to pay issuance costs.

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
STATEMENTS OF NET POSITION
December 31, 2012 and 2011

	(*In thousands*) 2012	Restated 2011
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES		
CAPITAL ASSETS		
Land	$ 5,463	$ 5,463
Land improvements	16,549	16,549
Utility plant	1,497,878	1,354,191
Buildings, structures and improvements	238,532	221,373
Furniture, fixtures, equipment and vehicles	586,549	566,679
	2,344,971	2,164,255
Less: Accumulated depreciation	(859,199)	(779,509)
	1,485,772	1,384,746
Construction in progress	201,167	275,907
CAPITAL ASSETS, NET	1,686,939	1,660,653
RESTRICTED ASSETS		
Cash and cash equivalents	211,759	171,498
Accrued interest receivable	84	100
TOTAL RESTRICTED ASSETS	211,843	171,598
UNAMORTIZED BOND ISSUANCE COSTS	5,151	4,517
CURRENT ASSETS		
Cash and cash equivalents	194,377	146,027
Restricted cash and cash equivalents	12,755	14,842
Investments		12,141
Receivables:		
Accounts receivable - net of allowance for doubtful accounts of $15,299,000 in 2012 and $23,401,000 in 2011	48,868	54,175
Unbilled revenue	31,540	27,225
Due from other City of Cleveland departments, divisions or funds	14,662	12,449
Accrued interest receivable		1
Materials and supplies - at average cost, net of allowance for obsolescence of $127,200 in 2012 and $126,500 in 2011	4,713	3,722
Prepaid expenses	1,178	1,138
TOTAL CURRENT ASSETS	308,093	271,720
DEFERRED OUTFLOWS OF RESOURCES		
Derivative instruments-interest rate swaps	27,699	27,955
TOTAL DEFERRED OUTFLOWS OF RESOURCES	27,699	27,955
TOTAL ASSETS AND DEFERRED OUTFLOWS	$ 2,239,725	$ 2,136,443

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF NET POSITION
December 31, 2012 and 2011

	(In thousands) 2012	Restated 2011
NET POSITION, LIABILITIES AND DEFERRED INFLOWS OF RESOURCES		
NET POSITION		
Net investment in capital assets	$ 914,193	$ 899,231
Restricted for capital projects	99	
Restricted for debt service	87,602	93,601
Unrestricted	257,578	204,911
TOTAL NET POSITION	1,259,472	1,197,743
LIABILITIES		
LONG-TERM OBLIGATIONS-excluding amounts due within one year		
Revenue bonds	766,975	657,481
OWDA loans	100,700	106,595
Accrued wages and benefits	1,365	1,464
TOTAL LONG-TERM OBLIGATIONS	869,040	765,540
CURRENT LIABILITIES		
Current portion of long-term debt, due within one year and short-term notes	37,804	90,085
Accounts payable	4,951	4,870
Current payable from restricted assets	12,755	14,842
Due to other City of Cleveland departments, divisions or funds	2,630	2,770
Accrued interest payable	13,521	12,727
Current portion of accrued wages and benefits	10,083	10,079
Other accrued expenses	395	395
Customer deposits and other liabilities	1,375	9,437
TOTAL CURRENT LIABILITIES	83,514	145,205
TOTAL LIABILITIES	952,554	910,745
DEFERRED INFLOW OF RESOURCES		
Derivative instruments-interest rate swaps	27,699	27,955
TOTAL DEFERRED INFLOWS OF RESOURCES	27,699	27,955
TOTAL NET POSITION, LIABILITIES AND DEFERRED INFLOWS	$ 2,239,725	$ 2,136,443

See notes to financial statements.

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CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
For the Years Ended December 31, 2012 and 2011

	(In thousands) 2012	Restated 2011
OPERATING REVENUES		
Charges for services	$ 280,323	$ 236,626
TOTAL OPERATING REVENUES	280,323	236,626
OPERATING EXPENSES		
Operations	103,687	100,221
Maintenance	45,482	46,012
Depreciation	67,455	61,611
TOTAL OPERATING EXPENSES	216,624	207,844
OPERATING INCOME (LOSS)	63,699	28,782
NON-OPERATING REVENUE (EXPENSE)		
Investment income	1,965	2,349
Interest expense	(28,322)	(27,071)
Amortization of bond issuance costs, premiums, and discounts	4,284	2,682
Gain (loss) on disposal of capital assets	(15)	
TOTAL NON-OPERATING REVENUE (EXPENSE), NET	(22,088)	(22,040)
INCOME (LOSS) BEFORE CAPITAL AND OTHER CONTRIBUTIONS	41,611	6,742
CAPITAL AND OTHER CONTRIBUTIONS	20,118	558
INCREASE (DECREASE) IN NET POSITION	61,729	7,300
NET POSITION, beginning of year (as restated)	1,197,743	1,190,443
NET POSITION, end of year	$ 1,259,472	$ 1,197,743

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, 2012 and 2011

	(In thousands) 2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$ 264,534	$ 229,625
Cash payments to suppliers for goods or services	(66,921)	(64,085)
Cash payments to employees for services	(76,526)	(75,905)
Other	140	(226)
NET CASH PROVIDED BY(USED FOR) OPERATING ACTIVITIES	121,227	89,409
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(67,355)	(89,005)
Capital grant proceeds		558
Proceeds of OWDA loan		1,362
Principal paid on long-term debt	(90,239)	(93,407)
Interest paid on long-term debt	(34,236)	(39,158)
Cash paid to escrow agent for refunding	(50,000)	(104,676)
Proceeds of bonds, premiums and discounts	142,924	104,626
Proceeds from sale of notes	50,000	50,000
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	(48,906)	(169,700)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(99,959)	(12,044)
Proceeds from sale and maturity of investment securities	112,004	6,998
Interest received on investments	2,158	2,588
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	14,203	(2,458)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	86,524	(82,749)
CASH AND CASH EQUIVALENTS, beginning of year	332,367	415,116
CASH AND CASH EQUIVALENTS, end of year	$ 418,891	$ 332,367

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2012 and 2011

	2012	Restated 2011
	(In thousands)	
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
OPERATING INCOME (LOSS)	$ 63,699	$ 28,782
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	67,455	61,611
Changes in assets and liabilities:		
Accounts receivable, net	5,307	(4,834)
Unbilled revenue	(4,315)	1,475
Due from other City of Cleveland departments, divisions or funds	(2,213)	(585)
Materials and supplies, net	(991)	218
Prepaid expenses	(40)	(65)
Accounts payable	81	565
Due to other City of Cleveland departments, divisions or funds	(140)	547
Accrued liabilities		2
Accrued wages and benefits	(95)	(499)
Customer deposits and other liabilities	(7,521)	2,192
TOTAL ADJUSTMENTS	57,528	60,627
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	$ 121,227	$ 89,409
SCHEDULE OF NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES		
Contribution of capital assets	$ 20,044	

See notes to financial statements. (Concluded)

NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2012 and 2011

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Division of Water (the 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 (the 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 November of 2010, Governmental Accounting Standards Board (GASB) Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements* was issued. This Statement is effective for fiscal periods beginning after December 15, 2011. The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. The Division has determined that GASB Statement No. 60 has no impact on its financial statements as of December 31, 2012.

In December of 2010, Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* was issued. This Statement is effective for fiscal periods beginning after December 15, 2011. The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements: (1) Financial Accounting Standards Board (FASB) Statements and Interpretations, (2) Accounting Principles Board Opinions and (3) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. As required, the Division has implemented GASB Statement No. 62 effective for the 2012 fiscal year.

In June of 2011, Governmental Accounting Standards Board (GASB) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* was issued. This Statement is effective for fiscal periods beginning after December 15, 2011. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. As required, the Division has implemented GASB Statement No. 63 effective for the 2012 fiscal year.

In June of 2011, Governmental Accounting Standards Board (GASB) Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provision* was issued. This Statement is effective for fiscal periods beginning after June 15, 2011. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. As required, the Division has implemented GASB Statement No. 64 effective for the 2012 fiscal year.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Division's net position is accounted for in the accompanying statement of net position and the net position is divided into the following categories:

- Net investment in capital assets
- Amount restricted for capital projects
- Amount restricted for debt service
- Remaining unrestricted amount

In addition, certain 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 position/equity balance as previously reported.

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.

Revenues: Revenues are derived primarily from sales of water to residential, commercial and industrial customers based upon actual water consumption and from a fixed charge based upon meter size. 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, noncapital 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.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The City has invested funds in STAROhio during 2012 and 2011. 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, 2012 and 2011.

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.

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 an 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	5 to 100 years
Land improvements	15 to 100 years
Buildings, structures and improvements	5 to 60 years
Furniture, fixtures, equipment and vehicles	3 to 60 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 General Accounting Standards Board guidance pertaining to capitalization of interest costs 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 2012 and 2011, total interest costs incurred amounted to $37,094,000 and $39,260,000, respectively, of which $8,581,000 and $11,998,000, respectively, was capitalized, net of interest income of $191,000 in 2012 and $191,000 in 2011.

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.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 statement of net position. 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.

Normally, all vacation time is to be taken in the year available. The Division allows employees to carryover vacation from one year to the next. 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 highest year average base salary rate, with the balance being forfeited.

Interfund Transactions: During the course of normal operations the Division has numerous transactions between other City divisions and departments. Unpaid amounts at year end are generally reflected as due to or due from in the accompanying financial statements.

Deferred Outflows/Inflows of Resources: In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to future period(s) and so will *not* be recognized as an outflow of resources (expense/expenditure) until then.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to future period(s) and so will *not* be recognized as an inflow of resources (revenues) until that time.

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2012 and 2011

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS

Debt outstanding at December 31, 2012 and 2011 is as follows:

	Interest Rate	Original Issuance	2012	2011
			(In thousands)	
Water Revenue Bonds:				
Series G, 1993, due through 2021	5.50%	$ 228,170	$ 66,860	$ 81,225
Series N, 2005, due through 2023	3.50%-5.00%	64,480	28,015	33,045
Series O, 2007, due through 2037	4.25%-5.00%	143,570	130,610	133,315
Series P, 2007, due through 2028	4.00%-5.00%	135,410	113,280	119,095
Series Q, 2008, due through 2033	Variable	90,800	90,800	90,800
Series T, 2009, due through 2021	2.00%-5.00%	84,625	71,330	77,415
Series U, 2010, due through 2033	Variable	54,935	54,935	54,935
Series V, 2010, due through 2033	Variable	26,495	26,495	26,495
Series W, 2011, due through 2026	2.00%-5.00%	82,090	82,090	82,090
Series X, 2012, due through 2042	3.63%-5.00%	44,410	44,410	
Second Lien Series A, 2012, due 2027	4.00%-5.00%	76,710	76,710	
Ohio Water Development Authority Loans payable annually through 2032	0.00%-4.14%	151,625	107,404	112,680
		$ 1,183,320	892,939	811,095
Adjustments:				
Unamortized discount and premium			38,244	21,558
Unamortized loss on debt refunding			(25,704)	(28,492)
Current portion			(37,804)	(40,085)
Total Long-Term Debt			$ 867,675	$ 764,076

	Interest Rate	Original Issuance	2012	2011
			(In thousands)	
Water Revenue Notes:				
Subordinate Lien Revenue Notes, due 2012	1.00%	$ 50,000	$	$ 50,000
Total Short-Term Debt		$ 50,000	$ -	$ 50,000

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Summary: Changes in long and short-term obligations for the year ended December 31, 2012 are as follows:

	Balance January 1, 2012	Increase	Decrease	Balance December 31, 2012	Due Within One Year
			(In thousands)		
Water Revenue Bonds:					
Series G, 1993, due through 2021	$ 81,225	$	$ (14,365)	$ 66,860	$ 310
Series N, 2005, due through 2023	33,045		(5,030)	28,015	5,280
Series O, 2007, due through 2037	133,315		(2,705)	130,610	
Series P, 2007, due through 2028	119,095		(5,815)	113,280	
Series Q, 2008, due through 2033	90,800			90,800	
Series T, 2009, due through 2021	77,415		(6,085)	71,330	6,180
Series U, 2010, due through 2033	54,935			54,935	
Series V, 2010, due through 2033	26,495			26,495	
Series W, 2011, due through 2026	82,090			82,090	19,330
Series X, 2012, due through 2042		44,410		44,410	
Second Lien Series A 2012, due through 2027		76,710		76,710	
Ohio Water Development Authority Loans payable annually through 2032	112,680	963	(6,239)	107,404	6,704
Total revenue bonds/loans	811,095	122,083	(40,239)	892,939	37,804
Accrued wages and benefits	11,543	9,984	(10,079)	11,448	10,083
Total	$ 822,638	$ 132,067	$ (50,318)	$ 904,387	$ 47,887

	Balance January 1, 2012	Increase	Decrease	Balance December 31, 2012	Due Within One Year
			(In thousands)		
Water Revenue Notes:					
Subordinate Lien Revenue Notes, due 2012	$ 50,000	$	$ (50,000)	$ -	$
Subordinate Lien Revenue Notes, due 2013		50,000	(50,000)	-	
Total revenue notes	$ 50,000	$ 50,000	$ (100,000)	$ -	$ -

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

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

	Balance January 1, 2011	Increase	Decrease	Balance December 31, 2011	Due Within One Year
			(In thousands)		
Water Revenue Bonds:					
Series G, 1993, due through 2021	$ 94,830	$	$ (13,605)	$ 81,225	$ 14,365
Series H, 1996, due through 2026	2,020		(2,020)	-	
Series J, 2001, due through 2016	43,230		(43,230)	-	
Series K, 2002, due through 2021	52,810		(52,810)	-	
Series N, 2005, due through 2023	33,045			33,045	5,030
Series O, 2007, due through 2037	138,725		(5,410)	133,315	2,705
Series P, 2007, due through 2028	135,410		(16,315)	119,095	5,815
Series Q, 2008, due through 2033	90,800			90,800	
Series T, 2009, due through 2021	83,340		(5,925)	77,415	6,085
Series U, 2010, due through 2033	54,935			54,935	
Series V, 2010, due through 2033	26,495			26,495	
Series W, 2011, due through 2026		82,090		82,090	
Ohio Water Development Authority Loans payable annually through 2031	118,006	566	(5,892)	112,680	6,085
Total revenue bonds/loans	873,646	82,656	(145,207)	811,095	40,085
Accrued wages and benefits	12,042	9,924	(10,423)	11,543	10,079
Total	$ 885,688	$ 92,580	$ (155,630)	$ 822,638	$ 50,164

	January 1, 2011	Increase	Decrease	December 31, 2011	Within One Year
			(In thousands)		
Water Revenue Notes:					
Subordinate Lien Revenue Notes, due 2011	$ 50,000	$	$ (50,000)	$ -	$
Subordinate Lien Revenue Notes, due 2012		50,000		50,000	50,000
Total revenue notes	$ 50,000	$ 50,000	$ (50,000)	$ 50,000	$ 50,000

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (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)	
2013	$ 37,804	$ 37,900	$ 75,704
2014	46,829	38,119	84,948
2015	48,341	36,082	84,423
2016	48,657	33,813	82,470
2017	51,400	31,405	82,805
2018-2022	245,174	121,885	367,059
2023-2027	232,413	67,856	300,269
2028-2032	113,780	30,193	143,973
2033-2037	64,785	10,298	75,083
2038-2042	14,565	1,893	16,458
Total	$ 903,748	$ 409,444	$ 1,313,192

The above schedule of minimum principal and interest payments on long-term debt includes the amortization on ten loans provided to the City 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 ten 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 2012, the Division expended another $817,000 for the Baldwin Residuals and Fairmount Reservoir. The OWDA loan associated with this project is a zero percent loan for the face value of $8,304,000 which matures January 1, 2031. The Division also expended $146,000 on the Crown Chemical project which is funded by a 2.0% OWDA loan maturing in July 2032.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

At December 31, 2012, the amount financed on these ten loan projects, less principal payments made, totaled $118,213,000 and is reflected in the debt service payment schedule. However, the total of the actual loan balances received by the City was $107,404,000 as reflected on the schedules of long-term debt outstanding and changes in long-term debt obligations as of December 31, 2012. The difference of $10,809,000 will be received or accrued in future years.

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 2011, the Division deposited cash in the amount of $9,327,000 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, 2012 and 2011 is as follows:

Bond Issue	**2012**	**2011**
	(In thousands)	
Series H, 1996	$	$ 1,940
Series J, 2001		52,335
Series K, 2002		116,420
Series O, 2007	2,825	2,825
Series P, 2007	6,075	6,075
Total	$ 8,900	$ 179,595

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 66.7% 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 are 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, 2012 and 2011, the Division was in compliance with the terms and requirements of the bond indenture.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (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 payments 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, the funds are classified as restricted assets in the accompanying financial statements.

Effective October 24, 2012, the City issued $44,410,000 of Senior Lien Water Revenue Bonds, Series X, 2012 and $76,710,000 of, Second Lien Water Revenue Bonds, Series A, 2012. Proceeds of the Series X Bonds will be used to pay costs of improvements to the Waterworks System and to pay costs of issuing the bonds. From the proceeds of the Series A 2012 Bonds, $42,000,000 will be used to fund the rest of the Automated Meter Reading program and the remainder was used to refund all of the outstanding $50,000,000 Water Revenue Subordinate Notes, Series 2012 and to pay issuance costs.

In conjunction with the issuance of the Second Lien Water Revenue Bonds, Series A, 2012 in October 2012, the Division established a Subordinate Bonds indenture. Bonds issued under this indenture are special obligations of the City payable solely from and secured solely by a pledge of and lien on the Subordinate Pledged Revenues and the Subordinate Pledged funds. The Subordinate Pledged Revenues generally consist of the net revenues of the Division which remain after the payment of all operating expenses and the deposit of all funds required to be made on the Senior Bonds. Bonds issued under this indenture are subordinate to those issued as senior lien bonds under the Amended and Restated Indenture.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

On July 24, 2012, the City issued $50,000,000 Subordinate Lien Water Revenue Notes, Series 2012. Proceeds of the notes were used to retire the $50,000,000 Subordinate Lien Water Revenue Notes issued in 2011. The Series 2012 Notes were subsequently redeemed on November 1, 2012 from the proceeds of the Second Lien Series A, 2012 Bonds. The original notes, which were issued in 2010, provided a portion of the funds needed for a new automated meter reading system for the Division. At the end of 2012, the Division no longer had any notes outstanding.

In December 2011, the Division utilized cash on hand to defease $2,825,000 principal amount of outstanding Series O bonds and $6,075,000 principal amount of outstanding Series P bonds. The Division placed $9,327,000 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.

Effective July 26, 2011, the Division issued $50,000,000 of Subordinate Lien Water Revenue Notes. The notes, which mature on July 26, 2012, refunded $50,000,000 Subordinate Lien Water Revenue Notes issued in 2010 to provide a portion of the funds needed for the acquisition and installation of a new automated meter reading system.

Effective October 6, 2011, the City issued $82,090,000 Water Revenue Bonds, Series W, 2011. Proceeds of these bonds were used to refund all of 1) the outstanding $1,940,000 Waterworks Improvement and Refunding First Mortgage Revenue Bonds, Series H, 1996, 2) the outstanding $42,865,000 Waterworks Refunding Revenue Bonds, Series J, 2001 and 3) the outstanding $48,095,000 Water Revenue Bonds, Series K, 2002 and to pay issuance costs. Net proceeds of the Series W Bonds, amounts then on deposit in the Series H, J and K bond funds and an amount released from the debt service reserve fund all totaling $95,349,171 were placed in an irrevocable escrow account to pay the principal and interest on the refunded bonds on January 1, 2012. 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 achieve debt service savings of approximately $9,527,000 or an economic gain (the difference between the present values of the old and new debt service payments) of approximately $8,955,000 or 9.6%.

The City has pledged future water system revenues, net of specified operating expenses, to repay $785,535,000 in various Senior Lien Water Revenue Bonds and Subordinate Lien Bonds issued in various years since 1993. Proceeds from the bonds provided financing for Water System improvements. The bonds are payable from water system net revenues and are payable through 2042. Annual principal and interest payments on the bonds are expected to require less than 46% of net revenues. The total principal and interest remaining to be paid on the various Water Revenue Bonds is $1,165,786,000. Principal and interest requirements for the current year and total net revenues were $60,856,000 and $133,119,000, respectively.

Interest Rate Swap Transactions:

Upon the refunding of the Series M Bonds in 2009, the Division's swap became associated with the Series Q, Series R and Series S Bonds. When the Series R and Series S Bonds were refunded in 2010, the swap associated with these bonds was transferred to a portion of the new Series U and Series V bonds.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Terms: Simultaneously with the issuance of the City's $175,000,000 Water Revenue Bonds, Series M, 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 since been acquired by JPMorgan Chase Bank, N.A. (JPM)), was 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.

Under the original swap agreements for the Series M Bonds, the Water System was the fixed rate payor, paying a fixed rate of 3.533%. Each counterparty was 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 were exchanged semiannually on January 1 and July 1. The obligation of the Water System to make periodic payments (but not any termination payment) was 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 were insured by Financial Security Assurance (FSA). As part of the refunding of the Series M Bonds, the City amended and restated the original swap agreements to (a) eliminate the swap insurance and related insurer rights, (b) modify the payment frequency, (c) transfer the original swap agreement from Bear Stearns to JPM and (d) split each original swap agreement into two separate interest rate swaps in order to hedge separate series of bonds. The original Bear Stearns swap, which has been assumed by JPM, hedged the entire principal amount of Series R and certain maturities of the Series Q Bonds. The original Morgan Stanley swap hedged the entire principal amount of Series S and a portion of the Series Q Bonds. The floating rate received by the City was not altered. However, the fixed rate paid by the City was adjusted to 3.553% for the JPM swap and 3.5975% for the Morgan Stanley swap. The termination date for the swaps associated with the Series Q Bonds is January 1, 2021 while the termination date for the Series R and Series S swaps is January 1, 2033. Net payments are now exchanged monthly. With the refunding of the Series R and Series S Bonds, the JPM swap now hedges all but $200,000 of the Series U Bonds and the Morgan Stanley Swap hedges all but $200,000 of the Series V Bonds.

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 since 2008, the SIFMA/LIBOR ratio has been significantly higher than 67% for large periods of time. In addition, a reduction in federal income tax rates might increase the percentage relationship between SIFMA and LIBOR and may potentially increase the cost of the financing.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

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.

Fair Value: The fair value of the swaps (including accrued amounts) at December 31, 2012 and December 31, 2011 as reported by JPM and Morgan Stanley totaled $27,699,000 and $27,955,000, respectively, which would be payable by the City.

Derivative Instruments: Derivative instruments are contracts, the value of which depends on, or derives from, the value of an underlying asset, index or rate. The most common types of derivatives used by governments are interest rate swaps and interest rate locks. The City has entered into various derivative or hedging agreements since 1999. A detailed description of each outstanding derivative, including its terms, objectives, risks and fair value, can be found in the section discussing the bonds to which the derivative relates.

	Changes in Fair Value		Fair Value at December 31, 2012		
	Classification	**Amount**	**Classification**	**Amount**	**Notional**
			(In thousands)		
Hedging Derivatives:					
Floating to fixed interest rate swaps					
2008 Q Water Swap	Deferred inflow	$ 592	Debt	$ (9,569)	$ 76,375
2010 U Water Swap	Deferred outflow	(192)	Debt	(12,096)	54,735
2010 V Water Swap	Deferred outflow	(144)	Debt	(6,034)	26,295

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

	Changes in Fair Value		Fair Value at December 31, 2011		
	Classification	Amount	Classification	Amount	Notional
			(In thousands)		
Hedging Derivatives:					
Floating to fixed interest rate swaps					
2008 Q Water Swap	Deferred outflow	$ (2,210)	Debt	$ (10,161)	$ 82,625
2010 U Water Swap	Deferred outflow	(5,467)	Debt	(11,904)	54,735
2010 V Water Swap	Deferred outflow	(2,614)	Debt	(5,890)	26,295

The following table presents the objective and significant terms of the City's derivative instruments at December 31, 2012, along with the credit rating of each swap counterparty.

Bonds	Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms	Counterparty Credit Rating
Water Series Q	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series Q Water System Bonds	$ 50,190,000	8/10/2004	1/1/2021	Pay 3.553%, receive 61.25% of LIBOR + 28 bps	Aa3/A+/A+
Water Series Q	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series Q Water System Bonds	$ 26,185,000	8/10/2004	1/1/2021	Pay 3.5975%, receive 61.25% of LIBOR + 28 bps	Baa1/A-/A
Water Series U	Pay Fixed Interest Rate Swap	Hedge in changes in cash flow on the Series U Water System Bonds	$ 54,735,000	2/12/2009	1/1/2033	Pay 3.553%, receive 61.25% of LIBOR + 28 bps	Aa3/A+/A+
Water Series V	Pay Fixed Interest Rate Swap	Hedge in changes in cash flow on the Series V Water System Bonds	$ 26,295,000	2/12/2009	1/1/2033	Pay 3.5975%, receive 61.25% of LIBOR + 28 bps	Baa1/A-/A

The following table presents the aggregate debt service requirements on the City's hedged debt and net receipts/payments on the associated hedging derivative instruments as of December 31, 2012. These amounts assume that the interest rates on variable rate bonds and the reference rates in existence as of December 31, 2012 remain the same for the life of the hedging agreement. However, these rates will vary over time and the actual interest payments on the variable rate bonds and the net receipts/payments on the hedging derivative instruments will deviate from the numbers presented below.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS (Continued)

Fiscal Year Ending December 31	Principal	Interest	Hedging Derivatives, Net	Total
		(In thousands)		
2013	$	$ 800	$ 4,786	$ 5,586
2014		800	4,522	5,322
2015		799	4,244	5,043
2016		801	4,186	4,987
2017		800	4,147	4,947
2018-2022	17,000	3,850	14,804	35,654
2023-2027	81,415	1,491	3,712	86,618
2028-2032	61,730	274	257	62,261
2033	12,085	2	1	12,088
Total	$ 172,230	$ 9,617	$ 40,659	$ 222,506

Ohio Water Development Authority (OWDA) Loans: These loans are payable from net revenues derived from the Waterworks System. These obligations do not have a lien on revenues of the Division. The Division received an increase in OWDA loans in the amount of $963,000 and $566,000 during 2012 and 2011, 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.

NOTE C – DEPOSITS AND INVESTMENTS

Deposits: The carrying amount of the Division's deposits at December 31, 2012 and 2011 totaled $133,643,000 and $126,903,000, respectively, and the Division's bank balances were $134,956,000 and $128,025,000, respectively. The differences represent positions in pooled bank accounts and 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* and GASB Statement No. 40, Deposit and Investment Risk Disclosures – an Amendment of GASB Statement No. 3, $134,956,000 and $128,025,000 of the bank balances at December 31, 2012 and 2011, respectively, were insured or collateralized with securities held by the City or by its agent in the City's name.

Custodial credit risk for deposits is the risk that in the event of bank failure, the Divisions will not be able to recover deposits or collateral for securities that are in possession of an outside party. At year end, the Division's deposits were fully insured or collateralized. All deposits are collateralized with eligible securities pledged and deposited either with the City or with a qualified trustee by the financial institution as security for repayment of all public monies deposited in the financial institution whose market value at all times is equal to at least 110% of the carrying value of the deposits being secured.

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

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; State Treasurer Asset Reserve Fund (STAROhio); commercial paper; US Government Money Market Mutual Funds; guaranteed investment contracts; manuscript debt; bonds and other State of Ohio obligations; certificates of deposit; 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, STAROhio, certificates of deposit, commercial paper and investments in certain money market mutual funds. 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 below.

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.

Credit Risk: The Division's investments as of December 31, 2012 and 2011 include U.S. Agencies, STAROhio, commercial paper, mutual funds, guaranteed investment contracts and other investments. The Division maintains the highest ratings for their investments. Investments in STAROhio and Allegiant Government Money Market Funds carry a rating of AAAm, which is the highest money market fund rating given by Standard & Poor's. The Division's investment in U.S. Bank N.A. Open Commercial Paper carries a Standard & Poor's rating of A-1+. Ohio law requires that STAROhio maintain the highest rating provided by at least one nationally recognized standard rating service.

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

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, 2012 and 2011, which include those classified as cash and cash equivalents in the statement of net position in accordance with the provisions of GASB Statement No. 9 since they have a maturity of three months or less:

Type of Investment	2012 Fair Value	2012 Cost	2011 Fair Value	2011 Cost	Investment Maturities Less than One Year	Investment Maturities 1 - 5 Years
	(In thousands)					
U.S. Agency Obligations	$	$	$ 12,141	$ 12,045	$	$
STAROhio	63,604	63,604	32,134	32,134	63,604	
Commercial Paper	89,164	89,164	135,521	135,521	89,164	
Investment in Mutual Funds	94,252	94,252	959	959	94,252	
Guaranteed Investment Contracts	36,850	36,850	36,850	36,850		36,850
Other Investments	1,378	1,378			1,378	
Total Investments	285,248	285,248	217,605	217,509	248,398	36,850
Total Deposits	133,643	133,643	126,903	126,903	133,643	
Total Deposits and Investments	$ 418,891	$ 418,891	$ 344,508	$ 344,412	$ 382,041	$ 36,850

These amounts are monies invested by the City Treasurer on behalf of the Division and are used in daily operations with excess monies invested daily in STAROhio and mutual funds. These investments are carried at cost which approximates market value.

As of December 31, 2012, the investments in STAROhio, commercial paper, mutual funds, guaranteed investment contracts and escrow are approximately 22%, 31%, 33%, 13% and 1%, respectively, of the Division's total investments. As of December 31, 2011, the investments in U.S. Agency Obligations, STAROhio, commercial paper, mutual funds, and guaranteed investment contracts are approximately 6%, 15%, 62%, <1% and 17%, 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, 2012 and 2011

NOTE D – CAPITAL ASSETS

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

	Balance January 1, 2012	Additions	Deletions	Balance December 31, 2012
		(In thousands)		
Capital assets, not being depreciated:				
Land	$ 5,463	$	$	$ 5,463
Construction in progress	275,907	71,505	(146,245)	201,167
Total capital assets, not being depreciated	281,370	71,505	(146,245)	206,630
Capital assets, being depreciated:				
Land improvements	16,549			16,549
Utility plant	1,354,191	145,112	(1,425)	1,497,878
Buildings, structures and improvements	221,373	17,159		238,532
Furniture, fixtures, equipment and vehicles	566,679	21,158	(1,288)	586,549
Total capital assets, being depreciated	2,158,792	183,429	(2,713)	2,339,508
Less: Accumulated depreciation	(779,509)	(82,370)	2,680	(859,199)
Total capital assets being depreciated, net	1,379,283	101,059	(33)	1,480,309
Capital assets, net	$ 1,660,653	$ 172,564	$ (146,278)	$ 1,686,939

NOTE D – CAPITAL ASSETS (Continued)

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

	Restated Balance January 1, 2011	Additions	Deletions	Balance December 31, 2011
	(In thousands)			
Capital assets, not being depreciated:				
Land	$ 5,463	$	$	$ 5,463
Construction in progress	310,919	84,929	(119,941)	275,907
Total capital assets, not being depreciated	316,382	84,929	(119,941)	281,370
Capital assets, being depreciated:				
Land improvements	16,549			16,549
Utility plant	1,241,644	112,795	(248)	1,354,191
Buildings, structures and improvements	219,953	1,437	(17)	221,373
Furniture, fixtures, equipment and vehicles	565,014	5,709	(4,044)	566,679
Total capital assets, being depreciated	2,043,160	119,941	(4,309)	2,158,792
Less: Accumulated depreciation	(722,207)	(61,611)	4,309	(779,509)
Total capital assets being depreciated, net	1,320,953	58,330	-	1,379,283
Capital assets, net	$ 1,637,335	$ 143,259	$ (119,941)	$ 1,660,653

Capital assets were restated for 2011 due to the Division entering into amended Water Service Agreements with 21 member communities prior to 2011. Additional information is provided in Note J on page 45.

Commitments: The Division has outstanding commitments at December 31, 2012 and 2011 of approximately $93,395,000 and $84,911,000, respectively, for future capital expenditures. 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, other than non-administrative full-time police officers and firefighters, 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.

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 visiting https://www.opers.org/investments/cafr.shtml, writing 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 2012, member and employer contribution rates were consistent across all three plans. Member contribution rates were 10.00% in 2012, 2011 and 2010. The employer contribution rates were 14.00% of covered payroll in 2012, 2011 and 2010.

The Division's required employer contributions to OPERS for the pension portion of all the plans for the years ending December 31, 2012, 2011 and 2010 were $5,452,000, $5,406,000 and $5,286,000 each year, respectively. The required payments due in 2012, 2011 and 2010 have been made.

In June 2012, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions.* This accounting standard replaces GASB Statement No. 27 and it is effective for employer fiscal years beginning after June 15, 2014.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS

***Ohio Public Employees Retirement System*:** All full-time employees, other than non-administrative full-time police officers and firefighters, 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 No. 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 visiting https://www.opers.org/investments/cafr.shtml, writing 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 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 2012, 2011 and 2010. The Ohio Revised Code currently limits the employer contribution to a rate not to exceed 14.00% of covered payroll. 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 used to fund postemployment benefits were 4.00% for members of the Traditional Plan in 2012 and 2011, 6.05% for members of the Combined Plan in 2012 and 2011 and 5.50% from January 1, 2010 through February 28, 2010 and 5.00% from March 1, 2010 through December 31, 2010 for both plans. Effective January 1, 2013, the portion of employer contributions allocated to health care was lowered to 1.00% for both plans, as recommended by the OPERS Actuary. 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 to OPERS to fund postemployment benefits were $2,180,000 in 2012, $2,162,000 in 2011 and $3,013,000 in 2010. The required payments due in 2012, 2011, and 2010 have been made.

Changes to the health care plan were adopted by the OPERS Board of Trustees on September 19, 2012, with a transition plan commencing January 1, 2014. With the recent passage of pension legislation under SB343 and the approved health care changes, OPERS expects to be able to consistently allocate 4.00% of the employer contributions toward the health care fund after the end of the transition period.

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 2012 or 2011.

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.

NOTE H – RELATED PARTY TRANSACTIONS

Revenues and Accounts Receivable: The Division provides water services to the City, 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, 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 $2,421,000 and $2,414,000 in 2012 and 2011, respectively. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately $3,586,000 and $3,716,000 in 2012 and 2011, respectively.

NOTE H – RELATED PARTY TRANSACTIONS (Continued)

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:

	2012	2011
	(In thousands)	
Electricity purchases	$ 12,988	$ 13,147
City administration	2,612	2,549
Motor Vehicle Maintenance	3,572	3,699
Telephone exchange	955	865
Utilities Administration and Utilities Fiscal Control	3,313	3,119
Street construction	451	578

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 $5,258,000 and $4,045,000 for the years ended December 31, 2012 and 2011, respectively.

NOTE J – RESTATEMENT

The Division of Water entered into amended Water Service Agreements with 21 member communities prior to 2011. As part of the Agreements, ownership of distribution mains was transferred to the Division of Water. The City also gained tax sharing agreements with each suburb related to commercial entities relocating in or out of the City. The financial impact of the addition of these assets was not included in the financial statements in the year the Agreements were finalized and ownership was officially transferred. As a result, the following restatements are necessary:

	January 1, 2011	Restatment	Restated January 1, 2011
		(In thousands)	
Capital assets	$ 2,120,467	$ 239,075	$ 2,359,542
Accumulated depreciation	(650,909)	(71,298)	(722,207)
Net Position	1,022,666	167,777	1,190,443

Depreciation expense was restated for the 2011 fiscal year from $58,796,000 to $61,611,000.