

CITY OF CLEVELAND, OHIO



DEPARTMENT OF PUBLIC UTILITIES DIVISION OF WATER

**REPORT ON AUDITS OF FINANCIAL STATEMENTS
For the years ended December 31, 2007 and 2006**

CITY OF CLEVELAND, OHIO

**DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

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Mary Taylor, CPA

Auditor of State

INDEPENDENT ACCOUNTANTS' REPORT

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

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

We have audited the accompanying basic financial statements of the Division of Water, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, (the Division) as of and for the years ended December 31, 2007 and December 31, 2006, as listed in the table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note A, the financial statements present only the Division and do not purport to, and do not, present fairly the financial position of the City of Cleveland as of December 31, 2007 and December 31, 2006, and the respective changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Division of Water, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, as of December 31, 2007 and December 31, 2006, and the respective changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Division of Water
Department of Public Utilities
City of Cleveland
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Independent Accountants' Report
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Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information the accounting principles generally accepted in the United States of America requires. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

Mary Taylor, CPA
Auditor of State

June 4, 2008

**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, 2007 and 2006. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 15.

The Division was created in 1853 and charged with the responsibility of collecting, treating, pumping and distributing potable water and providing related water service to customers within its service areas. The Division operates a major public water supply system, the eighth largest in the United States, that serves not only the City, but also 70 suburban municipalities in Cuyahoga, Medina, Summit and Geauga counties. The Division is an emergency standby provider for systems in three other counties. The present service area covers over 640 square miles and serves over 1.5 million people. In 2007, the aggregate metered consumption of water in the City constituted 33% of the total metered consumption in the service area, while consumption in the direct service communities and master meter communities constituted 56% and 11%, respectively.

COMPARISON OF CURRENT YEAR'S AND PRIOR YEARS' DATA

FINANCIAL HIGHLIGHTS

- The assets of the Division exceeded its liabilities (net assets) by \$955,602,000, \$900,779,000 and \$880,787,000 at December 31, 2007, 2006 and 2005, respectively. Of these amounts, \$252,494,000, \$243,388,000 and \$246,355,000 (unrestricted net assets) at December 31, 2007, 2006 and 2005, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.
- In 2007, the operating revenues of the Division increased by \$30,650,000 due to a combined rate increase of approximately 5.5%, a quarterly service charge of \$7 and an increase in billed consumption of 1.92%. Billed consumption increased in several major users, such as Mittal Steel, Ford Motor Company, North East Ohio Regional Sewer District and Stouffer Company, due to an increase of needed services. In 2006 the operating revenues of the Division decreased by \$12,657,000 due to a decrease in billed consumption of approximately 5.0%. In 2005, the operating revenues increased by \$13,042,000 due to a combined rate increase of approximately 3.5% and an increased in billed consumption of 2.11%. Several major users, such as ISG Steel, North East Ohio Regional Sewer District and the Cleveland Clinic, experienced an increase of needed services.
- The Division's overall net assets increased by \$54,823,000, \$19,992,000 and \$43,257,000 in 2007, 2006 and 2005, respectively.
- The Division had increases in capital assets, net of accumulated depreciation, of \$65,679,000, \$67,540,000 and \$81,596,000 in 2007, 2006 and 2005, respectively. The major additions during these years were related to the continuing renovation projects at the Morgan, Baldwin and Nottingham sites.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

FINANCIAL HIGHLIGHTS (Continued)

- The total long-term debt of the Division increased by \$116,037,000 in 2007. This increase is attributed to the issuance of \$143,570,000 Series O and \$135,410,000 Series P Water Revenue Bonds and the receipt of five Ohio Water Development Authority Loans totaling \$10,923,000, which was offset by \$21,546,000 of debt retired and \$152,320,000 debt defeased. In 2006, the total long-term debt decreased by \$1,937,000. This decrease is attributed to \$20,209,000 of debt retired and \$11,770,000 of debt defeased, which was offset by the receipt of four Ohio Water Development Authority Loans totaling \$30,042,000. In 2005, total long-term debt decreased by \$5,506,000. This decrease is attributed to \$21,516,000 of debt retired, \$10,000,000 debt defeased and \$65,510,000 of debt refunded which was offset by the receipt of three Ohio Water Development Authority Loan of \$27,040,000 and the issuance of \$64,480,000 of new 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 of Water Fund is considered an enterprise fund because the operations of the Division are similar to a private-sector business enterprise. Accordingly, in accounting for the activities of the Division, the economic resources measurement focus and the accrual basis of accounting is used. This is similar to businesses in the private sector.

The basic financial statements of the Division can be found on pages 15 - 20 of this report.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 21 - 37 of this report.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION

Provided below is condensed balance sheet information for the Division as of December 31, 2007, 2006 and 2005:

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(In thousands)		
Assets:			
Capital assets, net	\$ 1,326,670	\$ 1,260,991	\$ 1,193,451
Restricted assets	316,814	222,739	267,979
Unamortized bond issuance costs	7,097	5,704	6,337
Current assets	<u>313,085</u>	<u>292,640</u>	<u>294,997</u>
 Total assets	 <u>1,963,666</u>	 <u>1,782,074</u>	 <u>1,762,764</u>
 Net Assets and Liabilities:			
Net assets:			
Invested in capital assets, net of related debt	373,466	431,663	363,969
Restricted for capital projects	239,828	141,994	188,110
Restricted for debt service	89,814	83,734	82,353
Unrestricted	<u>252,494</u>	<u>243,388</u>	<u>246,355</u>
Total net assets	955,602	900,779	880,787
Liabilities:			
Long-term obligations	931,062	810,767	813,762
Current liabilities	<u>77,002</u>	<u>70,528</u>	<u>68,215</u>
Total liabilities	<u>1,008,064</u>	<u>881,295</u>	<u>881,977</u>
Total net assets and liabilities	<u>\$ 1,963,666</u>	<u>\$ 1,782,074</u>	<u>\$ 1,762,764</u>

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

The Division's investment in capital assets as of December 31, 2006 amounted to \$1,260,991,000 (net of accumulated depreciation) which is an increase of \$67,540,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had net additions of \$54,723,000, buildings, structures and improvements had net reductions of \$834,000 and furniture, fixtures, equipment and vehicles had net additions of \$12,495,000. Also, net construction in progress increased by \$33,420,000 due to continuing renovations to the Morgan, Baldwin and Nottingham plants.

The addition in restricted assets of \$94,075,000 is mainly attributed to debt issued for plant enhancement projects that significantly increase cash and investment balances.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

The increase in current assets of \$20,445,000 was primarily due to additions of \$31,152,000 in cash and cash equivalents, \$4,554,000 in accounts receivable and \$4,282,000 in unbilled revenue, offset by a decrease of \$20,515,000 in investments at fair value.

Capital Assets: The Division's investment in capital assets, as of December 31, 2007 amounted to \$1,326,670,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was approximately 5.2%. The Division's investment in capital assets, as of December 31, 2006 amounted to \$1,260,991,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was approximately 5.7%. A summary of the activity in the Division's capital assets during the years ended December 31, 2007 and 2006 is as follows:

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

	Balance January 1, 2006	Additions	Reductions	Balance December 31, 2006
(In thousands)				
Land	\$ 5,463	\$	\$	\$ 5,463
Land improvements	16,406	567		16,973
Utility plant	1,001,469	58,861	(4,138)	1,056,192
Buildings, structures and improvements	205,354	107	(941)	204,520
Furniture, fixtures, equipment and vehicles	118,785	13,267	(772)	131,280
Construction in progress	282,472	104,290	(70,870)	315,892
Total	1,629,949	177,092	(76,721)	1,730,320
Less: Accumulated depreciation	(436,498)	(37,581)	4,750	(469,329)
Capital assets, net	<u>\$ 1,193,451</u>	<u>\$ 139,511</u>	<u>\$ (71,971)</u>	<u>\$ 1,260,991</u>

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

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

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

Major events during 2006 affecting the Division's capital assets included the following:

- The construction, renovations, and plant enhancements on the Morgan, Baldwin and Nottingham facilities and the rehabilitation of water mains amounted to \$56,595,000. The major programs are: Security Enhancements Program, Plant Enhancement Program, Electrical Power Reliability Program and the coordinated Graphical Information System.
- The purchase of office equipment and vehicles for \$1,796,000 and water main rehabilitation for \$7,510,000.

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

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

In 2006, the factors for the Division's net decrease in long-term obligations of \$2,995,000 is attributed to the receipt of four Ohio Water Development Authority Loans totaling \$30,042,000, a decrease in the unamortized discount and premium of \$1,269,000 and a decrease in long-term accrued wages and benefits of \$342,000. These amounts were offset by \$20,209,000 of debt retirement, \$11,770,000 of debt defeased, and a decrease in unamortized loss on debt refunding of \$3,052,000. There was also an increase in the current portion of long-term obligations of \$2,499,000.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

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

In 2006, total current liabilities increased by \$2,313,000. The significant components of the change were increases to the current portion of long-term debt of \$2,499,000, and customer deposits and other liabilities of \$705,000. These increases were offset by reductions of \$986,000 in accrued interest payable.

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

At the end of 2006, the Division had total long-term debt outstanding of \$855,825,000. All bonds and notes are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2006 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	Balance January 1, 2006	Debt Issued	Debt Defeased	Debt Retired	Balance December 31, 2006
	(In thousands)				
Water Revenue Bonds:					
Series G, 1993	\$ 133,045	\$	\$ (11,770)	\$	\$ 121,275
Series H, 1996	18,190			(3,720)	14,470
Series I, 1998	165,115			(3,240)	161,875
Series J, 2001	70,110			(6,765)	63,345
Series K, 2002	69,725				69,725
Series L, 2002	90,000				90,000
Series M, 2004	174,095			(1,760)	172,335
Series N, 2005	64,480				64,480
Ohio Water Development Authority Loan	73,002	30,042		(4,724)	98,320
Total	<u>\$ 857,762</u>	<u>\$ 30,042</u>	<u>\$ (11,770)</u>	<u>\$ (20,209)</u>	<u>\$ 855,825</u>

In June 2007, Moody's Investors Service upgraded its rating on the Division's bonds from Aa3 to Aa2 and Standard and Poor's Rating Service raised its rating from AA- to AA. The bond ratings for the Division's outstanding revenue bonds are as follows:

Moody's		Standard & Poor's
<u>Investors Service</u>		<u>Standard & Poor's</u>
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 2007, 2006 and 2005 was 234%, 172%, and 204%, respectively.

Additional information on the Division's long-term debt can be found in Note B on pages 24 - 31.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

CONDENSED BALANCE SHEET INFORMATION (Continued)

Net Assets: Net assets serve as a useful indicator of a government's financial position. In the case of the Division, assets exceed liabilities by \$955,602,000, \$900,779,000 and \$880,787,000 at December 31, 2007, 2006 and 2005, respectively.

Of the Division's net assets, \$373,466,000, or 39% and \$431,663,000, or 48% at December 31, 2007 and 2006, respectively, reflects its investment in capital assets (e.g., land, buildings, utility plant, machinery and equipment), net of accumulated depreciation, less any related, still-outstanding debt used to acquire those assets. The Division uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Division's net assets, \$329,642,000, or 34% and \$225,728,000, or 25% at December 31, 2007 and 2006, respectively, represents resources that are subject to external restrictions. These funds are set aside for the payment of revenue bonds or represent unspent bond proceeds relating to capital projects. The remaining balance of unrestricted net assets, \$252,494,000, or 27% and \$243,388,000, or 27% at December 31, 2007 and 2006, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.

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

The Division's operations during 2007 and 2006 increased its net assets by \$54,823,000 and \$19,992,000, respectively. Provided below are the key elements of the Division's results of operations as of and for the years ended December 31, 2007, 2006 and 2005:

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

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

	<u>2007</u>	<u>2006</u>	<u>2005</u>
	(In thousands)		
Operating revenues	\$ 240,628	\$ 209,978	\$ 222,635
Operating expenses	<u>179,203</u>	<u>170,461</u>	<u>160,190</u>
Operating income	<u>61,425</u>	<u>39,517</u>	<u>62,445</u>
Non-operating revenue (expense):			
Investment income	17,364	13,925	7,719
Interest expense	(25,541)	(33,690)	(31,838)
Amortization of bond issuance costs premiums and discounts	729	637	269
Workers' compensation refund	47	11	2
Gain (Loss) on disposal of capital assets	<u> </u>	<u>(894)</u>	<u>(29)</u>
Total non-operating revenue (expense), net	<u>(7,401)</u>	<u>(20,011)</u>	<u>(23,877)</u>
Income (loss) before other contributions	54,024	19,506	38,568
Capital and other contributions	<u>799</u>	<u>486</u>	<u>4,689</u>
Increase in net assets	54,823	19,992	43,257
Net assets, beginning of year	<u>900,779</u>	<u>880,787</u>	<u>837,530</u>
Net assets, end of year	<u>\$ 955,602</u>	<u>\$ 900,779</u>	<u>\$ 880,787</u>

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

In 2006, total operating revenues decreased by \$12,657,000 due to a decrease in billed consumption of approximately 5.0%. However despite the billed consumption decrease, several major users, such as Mittal Steel, Ford Motor Company, North East Ohio Regional Sewer District, and Stouffer Company experienced an increase of needed services.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

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

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

In 2006, the overall increase in operating expenses of \$10,271,000 was due to a \$6,057,000 increase in operations expense, \$2,891,000 increase in maintenance expenses and \$1,323,000 increase for depreciation expense due to an increase in plant and equipment additions.

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

In 2006, total net non-operating revenue (expense) decreased by \$3,866,000 primarily due to a \$6,206,000 increase in interest income which was offset by an increase of \$1,852,000 in interest expense.

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

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

CLEVELAND - PER MCF (Thousand cubic feet)			CLEVELAND - PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2007	\$9.62	\$4.27	\$20.57	\$4.27
January 1, 2008	\$10.63	\$4.72	\$22.73	\$4.72
January 1, 2009	\$11.59	\$5.15	\$24.78	\$5.15

DIRECT SERVICE SUBURBS - PER MCF (Thousand cubic feet)			DIRECT SERVICE SUBURBS-PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2007	\$16.35-\$21.55	\$7.26-\$9.56	\$34.97-\$46.08	\$7.26-\$9.56
January 1, 2008	\$17.54-\$23.17	\$7.79-\$10.29	\$37.50-\$49.55	\$7.79-\$10.29
January 1, 2009	\$18.54-\$24.57	\$8.24-\$10.92	\$39.65-\$52.53	\$8.24-\$10.92

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

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

On February 5, 2007, legislation was passed by City Council authorizing the issuance of not to exceed \$185,000,000 of Water Revenue Bonds. Bonds were sold effective June 28, 2007. The City issued \$143,570,000 Water Revenue Bonds, Series O, 2007. The proceeds of these bonds will be used to pay costs of improvements to the Water system. In conjunction with the issuance, Moody's Investors Service and Standard & Poor's Ratings Services upgraded their ratings on all of the Division's bonds to Aa2 and AA respectively.

In November 2007, the City issued \$135,410,000 Water Revenue Bonds, Series P, 2007. The proceeds were used to refund \$140,030,000 of outstanding Water Revenue Bonds, Series I. As a result of this refunding, the Division will reduce its total debt service payments by \$6,376,000.

The Division of Water is installing a new Customer Information System and installing radio read meters in the City of Brunswick.

ADDITIONAL INFORMATION

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

BASIC FINANCIAL STATEMENTS

CITY OF CLEVELAND, OHIO

**DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER**

BALANCE SHEETS

December 31, 2007 and 2006

	<i>(In thousands)</i>	
	2007	2006
ASSETS		
CAPITAL ASSETS		
Land	\$ 5,463	\$ 5,463
Land improvements	16,973	16,973
Utility plant	1,084,014	1,056,192
Buildings, structures and improvements	213,217	204,520
Furniture, fixtures, equipment and vehicles	140,220	131,280
	<u>1,459,887</u>	<u>1,414,428</u>
Less: Accumulated depreciation	<u>(506,046)</u>	<u>(469,329)</u>
	953,841	945,099
Construction in progress	372,829	315,892
	<u>1,326,670</u>	<u>1,260,991</u>
	CAPITAL ASSETS, NET	1,260,991
RESTRICTED ASSETS		
Cash and cash equivalents	310,634	220,111
Investments	5,146	1,998
Accrued interest receivable	1,034	630
	<u>316,814</u>	<u>222,739</u>
	TOTAL RESTRICTED ASSETS	222,739
UNAMORTIZED BOND ISSUANCE COSTS	7,097	5,704
CURRENT ASSETS		
Cash and cash equivalents	125,676	94,524
Restricted cash and cash equivalents	13,862	12,982
Investments	104,539	125,054
Receivables:		
Accounts receivable - net of allowance for doubtful accounts		
of \$13,303,000 in 2007 and \$11,547,000 in 2006	31,254	26,700
Unbilled revenue	28,435	24,153
Due from other City of Cleveland departments, divisions or funds	2,766	3,563
Accrued interest receivable	1,410	1,065
Materials and supplies - at average cost, net of allowance for		
obsolescence of \$600,000 in 2007 and \$600,000 2006	3,059	2,916
Prepaid expenses	2,084	1,683
	<u>313,085</u>	<u>292,640</u>
	TOTAL CURRENT ASSETS	292,640
	TOTAL ASSETS	1,963,666
	<u>\$ 1,963,666</u>	<u>\$ 1,782,074</u>

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES

DIVISION OF WATER

BALANCE SHEETS

December 31, 2007 and 2006

	<i>(In thousands)</i>	
	2007	2006
NET ASSETS AND LIABILITIES		
NET ASSETS		
Invested in capital assets, net of related debt	\$ 373,466	\$ 431,663
Restricted for capital projects	239,828	141,994
Restricted for debt service	89,814	83,734
Unrestricted	252,494	243,388
TOTAL NET ASSETS	955,602	900,779
LIABILITIES		
LONG-TERM OBLIGATIONS-excluding amounts due within one year:		
Revenue bonds	828,152	713,313
OWDA loans	100,840	95,175
Accrued wages and benefits	2,070	2,279
TOTAL LONG-TERM OBLIGATIONS	931,062	810,767
CURRENT LIABILITIES		
Current portion of long-term debt, due within one year	24,212	20,840
Accounts payable	3,264	2,617
Current payable from restricted assets	13,861	12,982
Due to other City of Cleveland departments, divisions or funds	3,203	2,614
Accrued interest	16,328	16,379
Current portion of accrued wages and benefits	11,160	10,092
Other accrued expenses	393	393
Customer deposits and other liabilities	4,581	4,611
TOTAL CURRENT LIABILITIES	77,002	70,528
TOTAL LIABILITIES	1,008,064	881,295
TOTAL NET ASSETS AND LIABILITIES	\$ 1,963,666	\$ 1,782,074

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 ASSETS
For the Years Ended December 31, 2007 and 2006

	<i>(In thousands)</i>	
	2007	2006
OPERATING REVENUES		
Charges for services	\$ 240,628	\$ 209,978
TOTAL OPERATING REVENUES	240,628	209,978
OPERATING EXPENSES		
Operations	90,221	84,371
Maintenance	49,989	48,508
Depreciation	38,993	37,582
TOTAL OPERATING EXPENSES	179,203	170,461
OPERATING INCOME	61,425	39,517
NON-OPERATING REVENUE (EXPENSE)		
Investment income	17,364	13,925
Interest expense	(25,541)	(33,690)
Amortization of bond issuance costs, premiums, and discounts	729	637
Worker's compensation refund	47	11
Gain (loss) on disposal of capital assets		(894)
TOTAL NON-OPERATING REVENUE (EXPENSE), NET	(7,401)	(20,011)
Income (Loss) before other Contributions	54,024	19,506
CAPITAL AND OTHER CONTRIBUTIONS	799	486
INCREASE IN NET ASSETS	54,823	19,992
NET ASSETS, beginning of year	900,779	880,787
NET ASSETS, end of year	\$ 955,602	\$ 900,779

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, 2007 and 2006

	<i>(In thousands)</i>	
	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$ 229,068	\$ 208,456
Cash payments to suppliers for goods or services	(58,170)	(51,913)
Cash payments to employees for services	(76,998)	(74,504)
NET CASH PROVIDED BY OPERATING ACTIVITIES	93,900	82,039
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Capital and other contributions	1,879	1,908
Workers compensation refund	47	12
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	1,926	1,920
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(97,950)	(104,670)
Proceeds of OWDA loan	10,625	29,978
Principal paid on long-term debt	(21,005)	(18,321)
Interest paid on long-term debt	(39,731)	(41,011)
Cash paid to escrow agent for refunding	(157,426)	(12,417)
Proceeds of bonds, premiums and discounts	290,389	
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	(15,098)	(146,441)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(91,814)	(76,724)
Proceeds from sale and maturity of investment securities	111,666	122,282
Interest received on investments	21,975	19,742
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	41,827	65,300
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	122,555	2,818
CASH AND CASH EQUIVALENTS, beginning of year	327,617	324,799
CASH AND CASH EQUIVALENTS, end of year	\$ 450,172	\$ 327,617

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES DIVISION OF WATER

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2007 and 2006

	<i>(In thousands)</i>	
	<u>2007</u>	<u>2006</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
OPERATING INCOME	\$ 61,425	\$ 39,517
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	38,993	37,582
Changes in assets and liabilities:		
Accounts receivable, net	(4,554)	(635)
Unbilled revenue	(4,282)	1,181
Due from other City of Cleveland departments, divisions or funds	797	2,156
Materials and supplies, net	(143)	1,894
Prepaid expenses	(401)	16
Accounts payable	647	98
Due to other City of Cleveland departments, divisions or funds	589	148
Accrued wages and benefits	859	(623)
Customer deposits and other liabilities	<u>(30)</u>	<u>705</u>
TOTAL ADJUSTMENTS	<u>32,475</u>	<u>42,522</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 93,900</u>	<u>\$ 82,039</u>

(Concluded)

See notes to financial statements.

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

**NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2007 and 2006**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Reporting Model and Basis of Accounting: The accounting policies and financial reporting practices of the Division comply with accounting principles generally accepted in the United States of America applicable to governmental units. Beginning January 1, 2002, the Division changed its financial reporting to comply with GASB Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments*. In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section*, which is effective for the year ended December 31, 2006. The Division has determined that GASB Statement No. 44 has no impact on its financial statements as of December 31, 2006. In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*, which is effective for the year ended December 31, 2006. The Division has determined that GASB Statement No. 47 has no impact on its financial statements as of December 31, 2006. In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which is effective for the year ended December 31, 2007. The Division has determined that GASB Statement No. 45 has no impact on its financial statements as of December 31, 2007. Effective January 1, 2007, the City implemented GASB Statement No. 48 “*Sales and Pledges of Receivables and Intra-Entity Transfers of Assets and Future Revenues*”, which is effective for the year ended December 31, 2007. GASB Statement No. 48 established criteria to ascertain whether certain transactions should be regarded as sales or as collateralized borrowings, as well as disclosure requirements for future revenues that are pledged and sold. The implementation of GASB Statement No. 48 did not have an effect on the financial statements of the Division; however, additional disclosure related to revenues pledged for the repayment of revenue bonds has been provided in Note B.

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

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

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

Basis of Accounting: The Division’s financial statements are prepared under the accrual basis of accounting. Under this method, revenues are recognized when earned and measurable and expenses are recognized as incurred. Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Activities*, all Proprietary Funds will continue to follow Financial Accounting Standards Board (FASB) standards issued on

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

or before November 30, 1989. However, from that date forward, Proprietary Funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements), or 2) continuing to follow new FASB pronouncements (unless they conflict with GASB pronouncements). The City has chosen not to apply future FASB standards.

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

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

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

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

The City has invested funds in STAROhio during 2007 and 2006. 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, 2007 and 2006.

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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

For 2007 and 2006, total interest costs incurred amounted to \$41,435,000 and \$42,349,000, respectively, of which \$8,050,000 and \$3,086,000, respectively, was capitalized, net of interest income of \$7,844,000 in 2007 and \$5,573,000 in 2006.

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

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

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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT

Long-term debt outstanding at December 31, 2007 and 2006 is as follows:

	Interest Rate	Original Issuance	2007	2006
			(In thousands)	
Water Revenue Bonds:				
Series G, 1993, due through 2021	5.50%	\$ 228,170	\$ 107,760	\$ 121,275
Series H, 1996, due through 2026	5.20%-5.75%	204,885	14,280	14,470
Series I, 1998, due through 2010	5.00%-5.25%	305,650	16,655	161,875
Series J, 2001, due through 2016	4.00%-5.375%	92,595	56,240	63,345
Series K, 2002, due through 2021	3.50%-5.25%	138,050	65,740	69,725
Series L, 2002, due through 2033	Variable	90,000	90,000	90,000
Series M, 2004, due through 2033	3.533% Swap Rate	175,000	172,335	172,335
Series N, 2005, due through 2023	3.00%-5.00%	64,480	64,480	64,480
Series O, 2007, due through 2037	4.25%-5.00%	143,570	143,570	
Series P, 2007, due through 2028	4.00%-5.00%	135,410	135,410	
Ohio Water Development Authority Loans payable annually through 2029	3.20%-4.14%	<u>128,071</u>	<u>105,392</u>	<u>98,320</u>
		<u>\$ 1,705,881</u>	971,862	855,825
Adjustments:				
Unamortized discount and premium			17,320	7,311
Unamortized loss on debt refunding			(35,978)	(33,808)
Current portion			<u>(24,212)</u>	<u>(20,840)</u>
Total Long-Term Debt			<u>\$ 928,992</u>	<u>\$ 808,488</u>

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT (Continued)

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

	Balance January 1, 2007	Increase	Decrease	Balance December 31, 2007	Due Within One Year
(In thousands)					
Water Revenue Bonds:					
Series G, 1993, due through 2021	\$ 121,275	\$	\$ (13,515)	\$ 107,760	\$
Series H, 1996, due through 2026	14,470		(190)	14,280	6,290
Series I, 1998, due through 2028	161,875		(145,220)	16,655	6,120
Series J, 2001, due through 2016	63,345		(7,105)	56,240	2,855
Series K, 2002, due through 2021	69,725		(3,985)	65,740	4,135
Series L, 2002, due through 2033	90,000			90,000	
Series M, 2004, due through 2033	172,335			172,335	
Series N, 2005, due through 2023	64,480			64,480	260
Series O, 2007, due through 2037		143,570		143,570	
Series P, 2007, due through 2028		135,410		135,410	
Ohio Water Development Authority Loans payable annually through 2029	98,320	10,923	(3,851)	105,392	4,552
Total revenue bonds/loans	855,825	289,903	(173,866)	971,862	24,212
Accrued wages and benefits	12,371	859		13,230	11,160
Total	\$ 868,196	\$ 290,762	\$ (173,866)	\$ 985,092	\$ 35,372

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT (Continued)

Summary: Changes in long-term obligations for the year ended December 31, 2006 are as follows:

	Balance January 1, 2006	Increase	Decrease	Balance December 31, 2006	Due Within One Year
	(In thousands)				
Water Revenue Bonds:					
Series G, 1993, due through 2021	\$ 133,045	\$	\$ (11,770)	\$ 121,275	\$ 1,225
Series H, 1996, due through 2026	18,190		(3,720)	14,470	190
Series I, 1998, due through 2028	165,115		(3,240)	161,875	5,190
Series J, 2001, due through 2016	70,110		(6,765)	63,345	7,105
Series K, 2002, due through 2033	69,725			69,725	3,985
Series L, 2002, due through 2033	90,000			90,000	
Series M, 2004, due through 2033	174,095		(1,760)	172,335	
Series N, 2005, due through 2023	64,480			64,480	
Ohio Water Development Authority Loans payable annually through 2024	<u>73,002</u>	<u>30,042</u>	<u>(4,724)</u>	<u>98,320</u>	<u>3,145</u>
Total revenue bonds/loans	857,762	30,042	(31,979)	855,825	20,840
Accrued wages and benefits	<u>12,993</u>		<u>(622)</u>	<u>12,371</u>	<u>10,092</u>
Total	<u>\$ 870,755</u>	<u>\$ 30,042</u>	<u>\$ (32,601)</u>	<u>\$ 868,196</u>	<u>\$ 30,932</u>

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT (Continued)

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

	Principal	Interest	Total
	(In thousands)		
2008	\$ 24,212	\$ 41,345	\$ 65,557
2009	32,114	42,503	74,617
2010	46,618	40,790	87,408
2011	51,718	38,484	90,202
2012	54,150	36,024	90,174
2013-2017	244,968	144,913	389,881
2018-2022	207,000	91,990	298,990
2023-2027	172,413	51,423	223,836
2028-2032	98,671	23,338	122,009
2033-2037	54,360	5,589	59,949
Total	\$ 986,224	\$ 516,399	\$ 1,502,623

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

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

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

In 2006, the Division received an OWDA loan of \$11,612,382 out of an expected \$25,766,313 to fund the Morgan Water Treatment Plant Filter Rehabilitation. Another \$9,456,188 was received in 2007. This is a 20 year, 3.25% loan with payments beginning in 2008. In addition, the outstanding balance on the Division's OWDA loans for Baldwin Chemical Plant, the Nottingham Plant Improvements and the Baldwin Treatment Plant Improvements increased by \$592,618, \$462,099 and \$323,190 respectively.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT (Continued)

Therefore, at December 31, 2007, the amount financed on these seven loan projects, less principal payments made, totaled \$119,754,000 and was reflected in the debt service payment schedule. However, the total on the actual loan balances received by the City was \$105,392,000 as reflected on the schedules of long-term debt outstanding and changes in long-term debt obligations as of December 31, 2007. The difference of \$14,362,000 will be received or accrued in future years(s).

The Division has defeased certain Revenue Bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. In 2007, the Division deposited cash in the amount of \$12,966,000 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, 2007 and 2006 is as follows:

Bond Issue	<u>2007</u>	<u>2006</u>
	(In thousands)	
Series G, 1993	\$ 24,060	\$ 21,770
Series I, 1998	266,700	129,925
Series K, 2002	68,325	68,325

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

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

The indenture requires that at all times the Division will charge rates and fees for the products and services of the waterworks system, so that revenues will be at least sufficient to provide funds for the payment in each year of the necessary operating and maintenance expenses of the waterworks system and the greater of (1) an amount equal to 1.25 times the payments of principal, premium, if any, and interest on the revenue bonds then outstanding due in that year or (2) an amount sufficient to maintain the required balances in all funds and accounts created under the indenture. As of December 31, 2007 and 2006, the Division was in compliance with the terms and requirements of the bond indenture.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT (Continued)

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

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

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

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

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

Construction Fund: Proceeds from the revenue bonds were deposited into this fund to be used, along with earnings from investments of amounts held therein, for the payment of capital costs. As of December 31, 2007 and 2006, the Division had \$179,443,000 and \$137,122,000, respectively, of outstanding commitments for future construction costs which will be funded by available bond proceeds and operating revenues. Capital costs include all costs of additions, extensions, renewals, replacements, alterations, betterments and any other capital improvements to the waterworks system. Amounts held in this fund are subject to a lien in favor of bondholders and may be used to pay principal of outstanding revenue bonds to the extent that amounts in all other funds are insufficient. No payment need be made into a fund if the amounts in such fund are equal to the required fund balance, if any.

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

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

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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT (Continued)

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

In 2006, the Division utilized cash on hand to defease \$11,770,000 principal amount of outstanding Series G bonds. The Division placed \$12,417,000 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.

The City has pledged future Water System revenues, net of specified operating expenses, to repay \$866,470,000 in various Water Improvement Revenue Bonds issued in various years since 1993. Proceeds from the bonds provided financing for water system operations. The bonds are payable from Water System net revenues and are payable through 2037. Annual principal and interest payments on the bonds are expected to require less than 43 percent of net revenues. The total principal and interest remaining to be paid on the various Water Improvement Revenue Bonds is \$1,339,821,000. Principal and interest paid for the current year and total net revenues were \$50,320,206 and \$117,782,000, respectively.

Interest Rate Swap Transactions:

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. is the counterparty on a two-thirds pro rata share of the transaction and Morgan Stanley Capital Services Inc. is the counterparty on a one-third pro rata share of the transaction.

Under the swap agreements for the Series M Bonds, the Water System is the fixed rate payor, paying a fixed rate of 3.533%. Each counterparty is a floating rate payor, with each paying the Water System 61.25% of one month LIBOR plus a spread of 28 basis points. Net payments are exchanged semiannually on January 1 and July 1. The obligation of the Water System to make periodic payments (but not any termination payment) is secured by a pledge of and lien on the Net Revenues of the Water System on a parity with the pledge and lien securing the payment of debt service on the bonds.

Both the bond debt service payments on the Series M bonds and the periodic swap payments are insured by Financial Security Assurance (FSA).

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

Basis Risk: By entering into swaps based upon the 30 day LIBOR rate of interest, the City has undertaken basis risk associated with a change in tax rates and structure. While the average relationship between LIBOR (taxable) and Securities Industry Financial Markets Association (SIFMA) (tax-exempt) interest rates has been 67%, this relationship may not continue to apply. If the payments received from the counterparties are less

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
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**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE B – LONG-TERM DEBT (Continued)

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. In addition, a reduction in federal income tax rates would increase the percentage relationship between SIFMA and LIBOR and would potentially increase the cost of the financing.

Counterparty Risk: The City selected highly rated counterparties in order to minimize this risk. However, over the long term it is possible that the credit strength of Bear Stearns and 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 Bear Stearns and Morgan Stanley, or by Bear Stearns and Morgan Stanley to the City, depending upon the prevailing economic circumstances at the time of the termination. The City obtained insurance to mitigate much of the risk associated with termination due to the event of a rating downgrade of the Water System.

Fair Value: The fair value of the swaps at December 31, 2007 and December 31, 2006 as reported by Bear Stearns and Morgan Stanley totaled \$6,220,000 and \$1,823,000 respectively which would be payable by the City.

Ohio Water Development Authority (OWDA) Loans: These loans are payable from net revenues derived from the waterworks. These obligations do not have a lien on revenues of the Division. The Division received an increase in OWDA loans in the amount of \$10,923,000 and \$30,042,000 during 2007 and 2006, 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, 2007 and 2006 totaled \$63,003,000 and \$51,986,000, respectively, and the Division's bank balances were \$67,471,000 and \$49,031,000, respectively. The differences represent normal reconciling items.

Based on the criteria described in GASB Statement No.3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* and GASB Statement No. 40, *Deposit and Investments Risk Disclosures – an Amendment to GASB Statement No. 3*, \$67,471,000 and \$49,031,000 of the bank balances at December 31, 2007 and 2006, 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 Division 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.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

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; bonds and other State obligations; certificates of deposit; U.S. Government Money Market Mutual Funds; STAROhio; guaranteed investment contracts and repurchase transactions. Such repurchase transactions must be purchased from financial institutions or registered broker/dealers and are not to exceed a period of one year and confirmation of securities pledged must be obtained.

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

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

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

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

Credit Risk: The Division's investments as of December 31, 2007 and 2006 include U.S. Agencies, repurchase agreements, Allegiant Government Money Market Funds, STAROhio, mutual funds and guaranteed investment contracts. The Division maintains the highest ratings for their investments. Investments in FHLMC, FNMA, FFCB and FHLB agency securities are rated AAA by Standard & Poor's. Investments in the Allegiant Government Money Market Fund and STAROhio carry a rating of AAAM, which is the highest money market fund rating given by Standard & Poor's. Ohio law requires that STAROhio maintain the highest rating provided by at least one nationally recognized standard rating service. The Division has no investment policy that would further limit its investment choices.

Concentration of Credit Risk: The Division places a limitation on the amount it may invest in any one issuer to help minimize the concentration of credit risk. The Division had the following investments at December 31, 2007 and 2006, which include those classified as cash and cash equivalents in the balance sheet in accordance with the provisions of GASB Statement No. 9 since they have a maturity of three months or less:

**CITY OF CLEVELAND, OHIO
DEPARTMENT OF PUBLIC UTILITIES
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**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

<u>Type of Investment</u>	<u>2007 Fair Value</u>	<u>2007 Cost</u>	<u>2006 Fair Value</u>	<u>2006 Cost</u>	<u>Investment Maturities</u>		
					<u>Less than One Year</u>	<u>1 - 5 Years</u>	<u>5 Years or More</u>
(In thousands)							
U.S. Agency Obligations	\$109,685	\$107,787	\$127,052	\$127,640	\$	\$109,685	\$
STAROhio	23,383	23,383	11,115	11,115	23,383		
Investment in Mutual Funds	251,476	251,476	125,278	125,278	251,476		
Repurchase Agreement	8,220	8,220			8,220		
Guaranteed Investment Contracts	<u>104,090</u>	<u>104,090</u>	<u>139,238</u>	<u>139,238</u>		<u>67,240</u>	<u>36,850</u>
Total Investments	<u>496,854</u>	<u>494,956</u>	<u>402,683</u>	<u>403,271</u>	<u>283,079</u>	<u>176,925</u>	<u>36,850</u>
Total Deposits	<u>63,003</u>	<u>63,003</u>	<u>51,986</u>	<u>51,986</u>	<u>63,003</u>		
Total Deposits and Investments	<u>\$559,857</u>	<u>\$557,959</u>	<u>\$454,669</u>	<u>\$455,257</u>	<u>\$ 346,082</u>	<u>\$ 176,925</u>	<u>\$ 36,850</u>

As of December 31, 2007, the investments in U.S. Agency Obligations, mutual funds and guaranteed investment contracts are approximately 22%, 51% and 21%, respectively, of the Division's total investments. As of December 31, 2006, the investments in U.S. Agency Obligations, mutual funds and guaranteed investment contracts are approximately 32%, 31% and 35%, respectively, of the Division's total investments.

NOTE D – CAPITAL ASSETS

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

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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE D – CAPITAL ASSETS (Continued)

Capital Asset Activity: Capital asset activity for the year ended December 31, 2006 was as follows:

	<u>Balance January 1, 2006</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance December 31, 2006</u>
	(In thousands)			
Capital assets, not being depreciated:				
Land	\$ 5,463	\$	\$	\$ 5,463
Construction in progress	<u>282,472</u>	<u>104,290</u>	<u>(70,870)</u>	<u>315,892</u>
Total capital assets, not being depreciated	287,935	104,290	(70,870)	321,355
Capital assets, being depreciated:				
Land improvements	16,406	567		16,973
Utility plant	1,001,469	58,861	(4,138)	1,056,192
Buildings, structures and improvements	205,354	107	(941)	204,520
Furniture, fixtures, equipment and vehicles	<u>118,785</u>	<u>13,267</u>	<u>(772)</u>	<u>131,280</u>
Total capital assets, being depreciated	1,342,014	72,802	(5,851)	1,408,965
Less: Accumulated depreciation	<u>(436,498)</u>	<u>(37,581)</u>	<u>4,750</u>	<u>(469,329)</u>
Total capital assets being depreciated, net	<u>905,516</u>	<u>35,221</u>	<u>(1,101)</u>	<u>939,636</u>
Capital assets, net	<u>\$ 1,193,451</u>	<u>\$ 139,511</u>	<u>\$ (71,971)</u>	<u>\$ 1,260,991</u>

Commitments: The Division has outstanding commitments at December 31, 2007 and 2006 of approximately \$262,864,000 and \$249,489,000, respectively, for future capital expenditures, respectively. It is anticipated that these commitments will be financed from the Division's cash balances; however, at the discretion of the Division, additional long-term debt may be issued in the future to finance a portion of the costs.

NOTE E – DEFINED BENEFIT PENSION PLAN

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

- 1) The Traditional Pension Plan (TP) – a cost-sharing, multiple-employer defined benefit pension plan.
- 2) The Member-Directed Plan (MD) – 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 (CO) – a cost-sharing, multiple-employer defined benefit pension plan. Under the Combined Plan, employer contributions are invested by OPERS to provide a formula retirement benefit similar in nature to the Traditional Pension Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

**CITY OF CLEVELAND, OHIO
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**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE E – DEFINED BENEFIT PENSION PLAN (Continued)

OPERS provides retirement, disability, survivor and death benefits and annual cost-of-living adjustments to members of the Traditional Pension and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits. Authority to establish and amend benefits is provided by state statute per Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to OPERS, Attention: Finance Director, 277 East Town Street, Columbus, Ohio 43215-4642, or by calling (614) 222-5601 or 1-800-222-7377.

The Ohio Revised Code provides statutory authority for member and employer contributions. For 2007, member and employer contribution rates were consistent across all three plans (TP, MD and CO). Member contribution rates were 9.5% in 2007, 9.00% in 2006 and 8.50% in 2005, and employer contribution rates were 13.85% of covered payroll in 2007, 13.70% in 2006 and 13.55% in 2005. The Division's required employer contributions to OPERS for the pension portion of all the plans for the years ending December 31, 2007, 2006 and 2005 were approximately \$4,575,000, \$4,929,000 and \$5,095,000 each year, respectively. The required payments due in 2007, 2006 and 2005 have been made.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS

Ohio Public Employees Retirement System: Ohio Public Employees Retirement System (OPERS) administers three separate pension plans: The Traditional Pension Plan (TP) – a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – 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 post-employment healthcare plan, which includes a medical plan, prescription drug program and Medicare Part B premium reimbursement, to qualifying members of both the Traditional Pension and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employment health care coverage. In order to qualify for post-employment 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 Post-employment 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 making a written request to OPERS, Attention: Finance Director, 277 East Town Street, Columbus, Ohio 43215-4642, or by calling (614) 222-5601 or 1-800-222-7377.

The Ohio Revised Code provides 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 the funding of post retirement health care benefits. Employer contribution rates are expressed as a percentage of the covered payroll of active members, The Division's contribution rate was 13.85% of covered payroll in 2007, 13.70% of covered payroll in 2006 and 13.55% of covered payroll in 2005. 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' Post Employment 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 post employment health care benefits. For 2007, the employer contribution allocated to the health

**CITY OF CLEVELAND, OHIO
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**NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2007 and 2006**

NOTE F – OTHER POSTEMPLOYMENT BENEFITS (Continued)

care plan from January 1 through June 30, 2007 and July 1 through December 31, 2007 was 5% and 6% of covered payroll, respectively. In 2006, 4.50% of covered payroll was used to fund health care and 4.00% of covered payroll in 2005. 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 the surviving beneficiaries. Payment amounts vary depending on the number of covered dependents and the coverage selected. The Division's actual contributions for 2007 which were to fund post-employment benefits were approximately \$3,007,000.

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

NOTE G – CONTINGENT LIABILITIES AND RISK MANAGEMENT

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

Risk Management: The Division is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Division is generally self-insured. No material losses, including incurred but not reported losses, occurred in 2007 or 2006.

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

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

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

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

**NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2007 and 2006**

NOTE H – RELATED PARTY TRANSACTIONS

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

The Division performs billing and collection services for the Division of Water Pollution Control for a fee. This fee is based on the number of billings made on behalf of that division during the year at the same rates as charged to other users of the billing system. Revenue realized from the Division of Water Pollution Control for such services was approximately \$2,278,000 and \$2,257,000 in 2007 and 2006, respectively. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately \$2,614,000 and \$2,387,000 in 2007 and 2006, respectively.

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

	<u>2007</u>	<u>2006</u>
	(In thousands)	
Electricity purchases	\$ 12,632	\$ 11,835
City administration	2,856	4,032
Motor Vehicle Maintenance	2,726	2,279
Telephone exchange	1,782	928
Utilities Administration and Utilities Fiscal Control	3,284	2,980

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 \$5,039,000 and \$4,962,000 for the years ended December 31, 2007 and 2006, respectively.



Mary Taylor, CPA
Auditor of State

CITY OF CLEVELAND
DIVISION OF WATER

CUYAHOGA COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
JULY 15, 2008