CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

REPORT ON AUDITS OF FINANCIAL STATEMENTS
For the years ended December 31, 2003 and 2002

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

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Auditor of State
Betty Montgomery

INDEPENDENT ACCOUNTANTS' REPORT

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

To the Honorable Jane L. Campbell, Mayor, Members of Council, and the Audit Committee:

We have audited the Balance Sheets, the Statements of Revenues, Expenses and Changes in Net Assets, and the Statements of Cash Flows of the Division of Water, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, as of and for the years ended December 31, 2003 and December 31, 2002. These financial statements are the responsibility of the Division of Water'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 obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As described in Note A, the financial statements present only the Division of Water and do not purport to, and do not, present fairly the financial position of the City of Cleveland as of December 31, 2003 and December 31, 2002, and the 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 financial position of the Division of Water, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, as of December 31, 2003 and December 31, 2002, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information the Governmental Accounting Standards Board 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.

Betty Montgomery

Betty Montgomery
Auditor of State

June 18, 2004

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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 fiscal year ended December 31, 2003. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 11.

The Division of Water 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 of Cleveland, but also 70 suburban municipalities in Cuyahoga, Medina, Summit and Geauga counties. The Division is an emergency standby provider for systems in 3 other counties. The present service area covers over 640 square miles and serves over 1.5 million people. In 2003, the aggregate metered consumption of water in the City constituted 35% of the total metered consumption in the service area, while consumption in the direct service communities and master meter communities constituted 54% and 11%, respectively.

FINANCIAL HIGHLIGHTS

- The assets of the Division exceeded its liabilities at December 31, 2003 by $810,590,000 (net assets). Of this amount, $264,832,000 (unrestricted net assets) may be used to meet the Division's ongoing obligations to customers and creditors.

- Although a customer rate increase of approximately 3.4% occurred in 2003, overall consumption declined by 6.28% resulting in a decrease in operating revenues of $11,866,000. The decrease was primarily due to several major commercial customers' reduction of needed services.

- The Division's overall net assets increased by $36,724,000.

- During 2003, the Division had an increase in capital assets, net of accumulated depreciation, of $79,150,000. The major additions during the year were related to the continuing renovation projects at the Morgan, Baldwin and Nottingham sites.

- The Division's total long-term debt decreased by $7,423,000 or less than 1% in 2003. This decrease is attributed to scheduled debt service payments of $24,377,000 offset by an Ohio Water Development Authority Loan of $16,954,000.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Division's basic financial statements. The accompanying financial statements present financial information for the City of Cleveland'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.

OVERVIEW OF THE FINANCIAL STATEMENTS (Continued)

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 11 - 16 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 17 - 31 of this report.

CONDENSED BALANCE SHEET INFORMATION

Provided below is condensed balance sheet information for the Division as of December 31, 2003 and 2002:

	2003	2002	Increase/ (Decrease)
		(In thousands)	
Assets:			
Capital assets, net	$ 1,046,337	$ 967,187	$ 79,150
Restricted assets	371,118	404,240	(33,122)
Unamortized bond issuance costs	6,908	7,512	(604)
Current assets	300,814	312,230	(11,416)
Total assets	1,725,177	1,691,169	34,008
Net Assets and Liabilities:			
Net assets:			
Invested in capital assets, net of related debt	447,076	394,542	52,534
Restricted for debt service	98,682	101,428	(2,746)
Unrestricted	264,832	277,896	(13,064)
Total net assets	810,590	773,866	36,724
Liabilities:			
Long-term obligations	834,508	841,374	(6,866)
Payable from restricted assets	11,522	13,318	(1,796)
Current liabilities	68,557	62,611	5,946
Total liabilities	914,587	917,303	(2,716)
Total net assets and liabilities	$ 1,725,177	$ 1,691,169	$ 34,008

CONDENSED BALANCE SHEET INFORMATION (Continued)

Total Assets: The Division's investment in capital assets as of December 31, 2003 amounted to $1,046,337,000 (net of accumulated depreciation) which is an increase of $79,150,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant increased by $49,934,000 while Building, Structures and Improvements added an additional $14,973,000. Renovations to Baldwin, Morgan and Nottingham plants also contributed to these increases.

The reduction in restricted assets of $33,122,000 is mainly attributed to payments for plant enhancement projects that significantly reduced cash and investment balances and the elimination of the 2002 OWDA $3,906,000 loan receivable.

The decrease in current assets of $11,416,000 was primarily due to the reduction of cash and investments balances needed for increased operational and maintenance expenses in 2003. The Division also reduced its Due from Other City of Cleveland departments by $1,196,000. Customer accounts receivables decreased by $1,997,000 due to a more aggressive collection effort and an increase in allowance for doubtful accounts.

Capital assets: The Division's investment in capital assets, as of December 31, 2003, amounted to $1,046,337,000 (net of accumulated depreciation). The total increase in the Division's investment in capital assets for the current fiscal year was approximately 8%. A summary of the activity in the Division's capital assets during the year ended December 31, 2003 is as follows:

	Balance January 1, 2003	Additions	Reductions	Balance December 31, 2003
	(In thousands)			
Land	$ 5,262	$ 193		$ 5,455
Land improvements	14,116	895		15,011
Utility plant	851,096	52,522	(2,588)	901,030
Buildings, structures and improvements	178,192	14,973		193,165
Furniture, fixtures, equipment and vehicles	94,894	13,381	(448)	107,827
Construction in progress	165,774	104,110	(76,286)	193,598
Total	1,309,334	186,074	(79,322)	1,416,086
Less: Accumulated depreciation	(342,147)	(28,354)	752	(369,749)
Capital assets, net	$ 967,187	$ 157,720	$ (78,570)	$ 1,046,337

Major events during the current fiscal year affecting the Division's capital assets included the following:

- Construction, renovations, and plant enhancements on Morgan, Baldwin and Nottingham facilities amounted to $61,800,000.
- $5,600,000 for purchase of vehicles and equipment.
- Water main rehabilitation of $5,400,000, the tower painting program of $4,500,000 and the Warrensville supply main renovation of $7,200,000.

CONDENSED BALANCE SHEET INFORMATION (Continued)

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:

The main factors for the Division's net decrease in long-term obligations of $6,866,000 were debt service payments of $24,377,000 offset by an additional Ohio Water Development Authority loan of $16,954,000.

Payables from restricted assets: Payables from restricted assets decreased by $1,796,000 due mainly to the completion of the North Royalton pump and Nottingham plant renovation projects in which existing construction retainages were paid.

Current liabilities: Total current liabilities increased by $5,946,000. The significant components for the increase were the workers compensation payable increase of $1,460,000 based on the State of Ohio's rates, the current portion of long-term debt increase of $1,373,000 and the accrued interest payable increase by $2,088,000 related to the 2002 bond issuance.

Long-term debt: At the end of the current fiscal year, the Division had total long-term debt outstanding of $878,498,000. 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 Divisions.

The activity in the Division's debt obligations outstanding during the year ended December 31, 2003 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	Balance January 1, 2003	Debt Issued	Debt Refunded (In thousands)	Debt Retired	Balance December 31, 2003
			(In thousands)		
Water Revenue Bonds:					
Series G, 1993	181,110			(8,800)	172,310
Series H, 1996	72,075			(3,105)	68,970
Series I, 1998	301,865			(2,175)	299,690
Series J, 2001	92,595			(9,910)	82,685
Series K, 2002	138,050				138,050
Series L, 2002	90,000				90,000
Ohio Water Development Authority Loan	10,226	16,954		(387)	26,793
Total	$ 885,921	$ 16,954	$	$ (24,377)	$ 878,498

CONDENSED BALANCE SHEET INFORMATION (Continued)

The bond ratings for the Division's outstanding revenue bonds are as follows and remain unchanged since 2001.

Moody's Investors Service	Standard & Poor's
Aa3	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 2003, 2002, and 2001 was 149%, 186%, and 213%, respectively.

Additional information on the Division's long-term debt can be found in Note B on pages 20 - 25.

Net Assets: Net assets serves as a useful indicator of a government's financial position. In the case of the Division, assets exceed liabilities by $810,590,000 at December 31, 2003.

By far, the largest portion of the Division's net assets, $447,076,000 or 55% reflects its investment in capital assets (e.g., land, buildings, utility plant, machinery and equipment), net of accumulated depreciation, less any related, still-outstanding debt used to acquire those assets. The Division uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Division's net assets, $98,682,000, or 12%, represents resources classified as restricted assets since their use is limited by bond indentures. These funds are set aside for payment of revenue bonds. The remaining balance of unrestricted net assets, $264,832,000, or 33%, 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 2003 and 2002 increased its net assets by $36,724,000 and $57,088,000, respectively. Key elements of these are summarized on the following page:

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

	2003	2002	Increase/ (Decrease)
		(In thousands)	
Operating revenues	$ 203,822	$ 215,688	$ (11,866)
Operating expenses	154,956	149,275	5,681
Operating income	48,866	66,413	(17,547)
Non-operating revenue (expense):			
Investment income	6,530	10,706	(4,176)
Interest expense	(19,467)	(20,233)	766
Amortization of bond issuance costs and discount	631	163	468
Workers' compensation refund	19	39	(20)
(Loss) on disposal of capital assets	(21)		(21)
Total non-operating revenue (expense), net	(12,308)	(9,325)	(2,983)
Income (loss) before other contributions	36,558	57,088	(20,530)
Capital and other contributions	166		166
Increase in net assets	36,724	57,088	(20,364)
Net assets, beginning of year	773,866	716,778	57,088
Net assets, end of year	$ 810,590	$ 773,866	$ 36,724

Operating revenue:

Due to the adverse economic conditions and the drop in overall consumption of 6.28%, the Division's operating revenues decreased by $11,866,000 in 2003. Several major users, such as ISG Steel, Ford Motor Company, the Cleveland Metroparks and Alcoa Company, experienced a reduction of needed services, which reduced Divisional revenues in 2003.

Operating expenses:

The overall $5,681,000 increase in operating expenses were primarily due to a 13% increase for wages and benefits in 2003 due to the addition of over 70 new employees and the rise in the health care costs to the City of Cleveland. Also, depreciation expense increased by $1,777,000 due to the increase in plant and equipment additions.

Non-Operating revenue (expense):

Total net non-operating expenses in 2003 increased by $2,983,000 primarily due to an increase in the amount of capitalized interest which significantly reduced 2003 investment income as compared to 2002.

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

An annual rate increase of approximately 3.4% in 2004 and 2005 will potentially increase operational revenue to adequately cover anticipated operating expenditures.

The Division introduced legislation for the funding of an enhanced system-wide security system and the purchase and installation of back-up electrical generating facilities for treatment and distribution stations. These two major initiatives will each require capital expenditures of approximately $25 million, and they are a direct result of the events of September 11, 2001 and the major blackout experience of August 14, 2003, respectively.

City Council passed legislation on June 14, 2004 which would authorize the issuance and sale of Water Revenue Bonds in an amount not to exceed $175,000,000 for the purpose of refunding outstanding Water Revenue Bonds. The proposed legislation also authorizes the Division of Water to transfer up to $50,000,000 in funds on-hand to an escrow fund for the payment of principal and interest on designated bonds.

Legislation was passed in February 2004 that allows the Division of Water to enter into professional consultant contracts to provide a comprehensive financial plan for the years 2006 through 2010, including but not limited to a cost of service studies and rate and fee analysis.

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, 2003 and 2002

	(*In thousands*) 2003	2002
ASSETS		
CAPITAL ASSETS		
Land	$ 5,455	$ 5,262
Land improvements	15,011	14,116
Utility plant	901,030	851,096
Buildings, structures and improvements	193,165	178,192
Furniture, fixtures, equipment and vehicles	107,827	94,894
	1,222,488	1,143,560
Less: Accumulated depreciation	(369,749)	(342,147)
	852,739	801,413
Construction in progress	193,598	165,774
CAPITAL ASSETS, NET	1,046,337	967,187
RESTRICTED ASSETS		
Cash and cash equivalents	365,438	388,662
Investments	5,000	10,999
Accrued interest receivable	680	673
OWDA loans receivable		3,906
TOTAL RESTRICTED ASSETS	371,118	404,240
UNAMORTIZED BOND ISSUANCE COSTS	6,908	7,512
CURRENT ASSETS		
Cash and cash equivalents	74,456	91,806
Investments	170,883	160,256
Receivables:		
Accounts receivable - net of allowance for doubtful accounts of $7,732,000 in 2003 and $7,258,000 in 2002	21,605	23,602
Unbilled revenue	25,028	25,214
Due from other City of Cleveland departments, divisions or funds	3,536	4,732
Accrued interest receivable	1,171	1,249
Materials and supplies - at average cost, net of allowance for obsolescence of $600,000 in 2003 and 2002	3,942	4,880
Prepaid expenses	193	491
TOTAL CURRENT ASSETS	300,814	312,230
TOTAL ASSETS	$ 1,725,177	$ 1,691,169

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
BALANCE SHEETS
December 31, 2003 and 2002

	(In thousands) 2003	2002
NET ASSETS AND LIABILITIES		
NET ASSETS		
Invested in capital assets, net of related debt	$ 447,076	$ 394,542
Restricted for debt service	98,682	101,428
Unrestricted	264,832	277,896
TOTAL NET ASSETS	810,590	773,866
LIABILITIES		
LONG-TERM OBLIGATIONS-excluding amounts due within one year:		
Revenue bonds	805,701	829,312
OWDA loans	26,203	9,839
Accrued wages and benefits	2,604	2,223
TOTAL LONG-TERM OBLIGATIONS	834,508	841,374
PAYABLE FROM RESTRICTED ASSETS	11,522	13,318
CURRENT LIABILITIES		
Current portion of long-term debt, due within one year	25,750	24,377
Accounts payable	3,402	3,208
Due to other City of Cleveland departments, divisions or funds	4,909	5,001
Accrued interest	19,936	17,848
Current portion of accrued wages and benefits	10,972	8,619
Other accrued expenses	393	393
Customer deposits and other liabilities	3,195	3,165
TOTAL CURRENT LIABILITIES	68,557	62,611
TOTAL LIABILITIES	914,587	917,303
TOTAL NET ASSETS AND LIABILITIES	$ 1,725,177	$ 1,691,169

See notes to financial statements. (Concluded)

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CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Years Ended December 31, 2003 and 2002

	(*In thousands*) 2003	2002
OPERATING REVENUES		
Charges for services	$ 203,822	$ 215,688
TOTAL OPERATING REVENUES	203,822	215,688
OPERATING EXPENSES		
Operations	86,593	91,259
Maintenance	37,047	28,477
Depreciation	31,316	29,539
TOTAL OPERATING EXPENSES	154,956	149,275
OPERATING INCOME	48,866	66,413
NON-OPERATING REVENUE (EXPENSE)		
Investment income	6,530	10,706
Interest expense	(19,467)	(20,233)
Amortization of bond issuance costs, premiums, and discounts	631	163
Worker's compensation refund	19	39
Loss on disposal of capital assets	(21)	
TOTAL NON-OPERATING REVENUE (EXPENSE), NET	(12,308)	(9,325)
Income (Loss) before other Contributions	36,558	57,088
CAPITAL AND OTHER CONTRIBUTIONS	166	
INCREASE IN NET ASSETS	36,724	57,088
NET ASSETS, beginning of year	773,866	716,778
NET ASSETS, end of year	$ 810,590	$ 773,866

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, 2003 and 2002

	(In thousands) 2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$ 206,702	$ 212,910
Cash payments to suppliers for goods or services	(49,452)	(60,023)
Cash payments to employees for services	(69,587)	(63,559)
Receipt of customer deposits, net		534
NET CASH PROVIDED BY OPERATING ACTIVITIES	87,663	89,862
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Grants	166	473
Workers compensation refund	19	95
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	185	568
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(84,365)	(87,449)
Proceeds of OWDA loan	11,548	457
Principal paid on long-term debt	(24,377)	(30,491)
Interest paid on long-term debt	(38,926)	(34,885)
Cash paid to escrow agent for refunding		(17,307)
Proceeds of new and refunding bonds		234,717
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	(136,120)	65,042
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(227,731)	(206,780)
Proceeds from sale and maturity of investment securities	221,906	167,944
Interest received on investments	13,523	12,739
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	7,698	(26,097)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(40,574)	129,375
CASH AND CASH EQUIVALENTS, beginning of year	480,468	351,093
CASH AND CASH EQUIVALENTS, end of year	$ 439,894	$ 480,468

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2003 and 2002

	(In thousands) 2003	2002
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
OPERATING INCOME	$ 48,866	$ 66,413
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	31,316	29,539
Changes in assets and liabilities:		
Accounts receivable, net	1,997	(3,172)
Unbilled revenue	186	(2,464)
Due from other City of Cleveland departments, divisions or funds	1,196	381
Materials and supplies, net	938	463
Prepaid expenses	298	695
Accounts payable	194	(2,179)
Due to other City of Cleveland departments, divisions or funds	(92)	(533)
Accrued wages and benefits	2,734	222
Other accrued expenses		(37)
Customer deposits and other liabilities	30	534
TOTAL ADJUSTMENTS	38,797	23,449
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 87,663	$ 89,862

(Concluded)

NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2003 and 2002

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. Effective January 1, 2002, the Division changed its financial reporting by implementing the provisions of Statement No. 34 of the Governmental Accounting Standards Board (GASB), Ma*nagement's Discussion and Analysis – for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures.* These "Reporting Model" statements affected the way the Division prepares and presents financial information. As a result of the implementation of these new GASB statements, the amount previously reported as the Division's equity is now reported as the Division's net assets in the accompanying balance sheets, and the net assets are divided into three categories as follows:

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

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

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

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

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2003 and 2002

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 2003 and 2002. 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, 2003 and 2002.

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 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	6 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

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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 2003 and 2002, total interest costs incurred amounted to $43,302,000 and $38,007,000, respectively, of which $18,113,000 and $15,199,000, respectively, was capitalized, net of interest income of $5,722,000 in 2003 and $2,575,000 in 2002.

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. Amounts in excess of 80 hours are forfeited unless written approval for carryover of vacation time is obtained. 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.

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2003 and 2002

NOTE B - LONG-TERM DEBT

Long-term debt outstanding at December 31, 2003 and 2002 is as follows:

	Interest Rate	Original Issuance	2003	2002
			(In thousands)	
Water Revenue Bonds:				
Series G, 1993, due through 2021	5.12%-5.50%	$ 228,170	$ 172,310	$ 181,110
Series H, 1996, due through 2026	5.20%-6.00%	204,885	68,970	72,075
Series I, 1998, due through 2028	4.10%-5.25%	305,650	299,690	301,865
Series J, 2001, due through 2016	4.00%-5.375%	92,595	82,685	92,595
Series K, 2002, due through 2033	3.50%-5.250%	138,050	138,050	138,050
Series L, 2002, due through 2033	4.00%-Variable	90,000	90,000	90,000
Ohio Water Development Authority Loans payable annually through 2025	3.20%-4.14%	50,697	26,793	10,226
		$ 1,110,047	878,498	885,921
Adjustments:				
Unamortized discount and premium			8,313	9,085
Unamortized loss on debt refunding			(29,157)	(31,478)
Current portion			(25,750)	(24,377)
Total Long-Term Debt			$ 831,904	$ 839,151

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2003 and 2002

NOTE B - LONG-TERM DEBT (Continued)

Summary: Changes in long-term obligations for the year ended December 31, 2003 are as follows:

	Balance January 1, 2003	Increase	Decrease	Balance December 31, 2003	Due Within One Year
			(In thousands)		
Water Revenue Bonds:					
Series G, 1993, due through 2021	181,110		(8,800)	172,310	9,255
Series H, 1996, due through 2026	72,075		(3,105)	68,970	7,510
Series I, 1998, due through 2028	301,865		(2,175)	299,690	2,260
Series J, 2001, due through 2016	92,595		(9,910)	82,685	6,135
Series K, 2002, due through 2033	138,050			138,050	
Series L, 2002, due through 2033	90,000			90,000	
Ohio Water Development Authority Loans payable annually through 2024	10,226	16,954	(387)	26,793	590
Total revenue bonds/loans	885,921	16,954	(24,377)	878,498	25,750
Accrued wages and benefits	10,842	2,734		13,576	10,972
Total	$ 896,763	$ 19,688	$ (24,377)	$ 892,074	$ 36,722

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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)	
2004	$ 25,750	$ 43,136	$ 68,886
2005	27,350	41,953	$ 69,303
2006	30,676	41,551	$ 72,227
2007	36,527	39,835	$ 76,362
2008	38,237	37,967	$ 76,204
2009-2013	215,777	157,482	$ 373,259
2014-2018	193,987	102,964	$ 296,951
2019-2023	155,311	57,881	$ 213,192
2024-2028	115,981	24,365	$ 140,346
2029-2033	61,815	6,443	$ 68,258
Total	$ 901,411	$ 553,577	$ 1,454,988

The above schedule of minimum principal and interest payments on long-term debt includes the amortization on four 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 four 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).

Therefore, at December 31, 2003, the amount financed on these four loan projects, less the principal payments made to date, totaled $49,706,000 and was reflected in the debt service payment schedule. However, the total on the actual loan balances received by the City was $26,793,000 as reflected on the schedules of long-term debt outstanding and changes in long-term debt obligations as of December 31, 2003. The difference of $22,913,000 will be received or accrued in future years(s).

NOTE B - LONG-TERM DEBT (Continued)

In prior years, the Division defeased certain Mortgage 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. 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, 2003 and 2002 is as follows:

Bond Issue	2003	2002
	(In thousands)	
Series H, 1996	$102,340	$102,340
Series D, 1986		15,350

In 1996, the City authorized the adoption of the eighth supplemental indenture to amend and restate the existing indenture, subject to the receipt of the consent of the requisite number of bondholders. With the issuance of the Series J bonds, the City reached the 66 2/3% 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.

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. On the 25th day of each month, 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.

NOTE B - LONG-TERM DEBT (Continued)

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, 2003 and 2002, the Division had $198,532,000 and $172,731,000 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 October 4, 2001, the Division of Water issued $92,595,000 of Waterworks Refunding Revenue Bonds, Series J 2001. The proceeds were used to currently refund certain outstanding Series F, Series G and Series H Revenue Bonds and to pay costs of issuance. Proceeds of $96,566,000 were placed in an irrevocable escrow account, which will be used to pay the principal, interest, and premium on the refunded bonds. As a result, the refunded bonds in the aggregate principal amount of $91,965,000 are considered to be defeased and the liability for these bonds has been removed from long-term debt. The City completed the refunding to reduce its total debt service payments over the next fifteen years by $7,231,000 and to obtain an economic gain (difference between the present values of the old and new debt service payment) of $7,193,000.

On November 21, 2002, the Division of Water issued $138,050,000 of Water Revenue Bonds, Series K, 2002 and $90,000,000 Water Revenue Bonds, Series L, 2002. The proceeds of the Series K Bonds will be used to currently refund all of the $15,350,000 outstanding Waterworks Improvement First Mortgage Refunding Revenue Bonds, Series D, 1986, to pay costs of improvement to the Waterworks System and to pay costs of issuance of the Series K Bonds. Net proceeds of $15,733,750 were placed in an escrow account, which was used to pay principal and interest on the refunded bonds on January 1, 2003. As a result, the refunded bonds are considered to be defeased and the liability for these bonds have been removed from long-term debt. The City completed the refunding of the Series D Bonds to reduce its total debt service payments by $1.38 million over the next 14 years and to obtain an economic gain (difference between the present values of the old and new debt service payments) of approximately $881,000. The Series L Bonds were issued to pay costs of improvements to the Waterworks System and to pay costs of issuance of the Series L Bonds. Series L Bonds were issued as variable rate bonds in a weekly mode with a liquidity facility provided by WestLB, AG, acting through its New York branch.

NOTE B - LONG-TERM DEBT (Continued)

Ohio Water Development Authority (OWDA) Loans: These loans are payable from net revenues derived from the waterworks and water pollution control systems. These obligations do not have a lien on revenues of the Divisions. The Division received an increase in OWDA loans in the amount of $16,954,000 during 2003.

NOTE C - DEPOSITS AND INVESTMENTS

Deposits: The carrying amount of the Division's deposits at December 31, 2003 and 2002 totaled $70,509,000 and $76,059,000, respectively, and the Division's bank balances were $68,567,000 and $77,741,000, respectively.

Based on the criteria described in GASB Statement No.3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, $55,058,000 and $63,174,000 of the bank balances at December 31, 2003 and 2002, respectively, were insured or collateralized with securities held by the City or by its agent in the City's name, and $13,509,000 for both years, respectively, was invested in Bank Investment Contracts secured by repurchase agreements of government securities held as collateral by the City's trustee in the name of the trustee. The remaining balance of $1,058,000 for 2002 was uncollateralized as defined by the GASB because they were secured by a collateral pool held at the Federal Reserve Bank in the name of the respective depository bank, which pledges a pool of collateral against all public deposits it holds, as permitted under Ohio law.

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.

GASB Statement No. 3, *Deposits with Financial Institutions, Investments (Including Repurchase Agreements) and Reverse Repurchase Agreements*, requires the City to categorize its investments into one of three credit risk categories:

NOTE C - DEPOSITS AND INVESTMENTS (Continued)

Category 1: Includes insured or registered, or securities held by the City or its agent in the City's name.

Category 2: Includes uninsured and unregistered, with securities held by the counterparty's trust department or agent in the City's name.

Category 3: Includes uninsured and unregistered, with securities held by the counterparty, or it's trust department or agent but not in the City's name.

The categorized investments shown in the following table include those which are 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:

Type of Investment	Risk Category	2003 Fair Value	2003 Cost	2002 Fair Value	2002 Cost
		(In thousands)			
U.S. Agency Obligations	1	$ 175,883	$ 175,237	$ 171,256	$ 169,413
STAROhio	n/a	2,431	2,431	20,422	20,422
Investment in Mutual Funds	n/a	126,709	126,709	136,987	136,987
Guaranteed Investment Contract	n/a	240,245	240,245	246,999	246,999
Total Investments		545,268	544,622	575,664	573,821
Total Deposits		70,509	70,509	76,059	76,059
Total Deposits and Investments		$ 615,777	$ 615,131	$ 651,723	$ 649,880

STAROhio investments, guaranteed investment contracts, and investments in mutual funds are not classified by risk categories because they are not evidenced by securities that exist in physical or book entry form.

NOTE D - CAPITAL ASSETS

Capital Asset Activity: Capital asset activity for the year ended December 31, 2003 was as follows:

	Balance January 1, 2003	Additions	Deletions	Balance December 31, 2003
		(In thousands)		
Capital assets, not being depreciated:				
Land	$ 5,262	$ 193	$	$ 5,455
Construction in progress	165,774	104,110	(76,286)	193,598
Total capital assets, not being depreciated	171,036	104,303	(76,286)	199,053
Capital assets, being depreciated:				
Land improvements	14,116	895		15,011
Utility plant	851,096	52,522	(2,588)	901,030
Buildings, structures and improvements	178,192	14,973		193,165
Furniture, fixtures, equipment and vehicles	94,894	13,381	(448)	107,827
Total capital assets, being depreciated	1,138,298	81,771	(3,036)	1,217,033
Less: Accumulated depreciation	(342,147)	(28,354)	752	(369,749)
Total capital assets being depreciated, net	796,151	53,417	(2,284)	847,284
Capital assets, net	$ 967,187	$ 157,720	$ (78,570)	$ 1,046,337

Commitments: The Division has outstanding commitments at December 31, 2003 and 2002 of approximately $198,570,000 and $150,870,000 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 - EMPLOYEES RETIREMENT PLAN

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 thereon.
3). The Combined Plan (CO) – a cost-sharing multiple-employer defined benefit pension plan. Under the Combined Plan employer contributions are invested by the retirement system to provide a formula retirement benefit similar in nature to the Traditional 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.

NOTE E - EMPLOYEES RETIREMENT PLAN (Continued)

OPERS provides retirement, disability, survivor and death benefits and annual cost of living adjustments to members of the Traditional Plan 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. The Ohio Public Employees Retirement System issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 222-6705 or 1-800-222-7377.

The Ohio Revised Code provides statutory authority for member and employer contributions. Member and employer contribution rates were consistent across all three plans (TP, MD and CO). Member contribution rates were 8.5% and employer contribution rates were 13.55% of covered payroll. The Division required employer contributions to OPERS for all plans for the years ending December 31, 2003, 2002 and 2001 were approximately $7,020,000, $6,568,000, $6,071,000 each year, respectively. The required payments due in 2003, 2002 and 2001 have been made.

NOTE F - OTHER POST-EMPLOYMENT BENEFITS

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 provides retirement, disability, survivor and post-retirement health care benefits to qualifying members of both the Traditional and the Combined Plans; however, health care benefits are not statutorily guaranteed. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employment health care coverage. In order to qualify for post-retirement health care coverage, age and service retirees must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability recipients and primary survivor recipients is available. The health care coverage provided by the Retirement System is considered an Other Post-employment Benefit (OPEB) as described in GASB Statement No. 12.

A portion of each employer's contribution to OPERS is set aside for the funding of post-retirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The Division's contribution rate was 13.55% of covered payroll, and 5.00% was used to fund health care for the year. The Ohio Revised Code provides the statutory authority to require public employers to fund post retirement health care through their contributions to OPERS. The assumptions and calculations below were based on the System's latest Actuarial Review performed as of December 31, 2002. An entry-age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually. The investment assumption rate for 2002 was 8.00%. An annual increase of 4.00%, compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.00% base increase, were assumed to range from 0.50% to 6.30%.

NOTE F - OTHER POST-EMPLOYMENT BENEFITS (Continued)

Health care costs were assumed to increase 4.00% annually. OPEBs are advance-funded on an actuarially determined basis. At year-end 2003, the number of active contributing participants in the Traditional and Combined Plans totaled 364,881. The employer contribution rates are the actuarially determined contribution requirements for OPERS. The Division's actual contributions for 2003 which were to fund postemployment benefits were approximately $2,590,000. $10.0 billion represents the actuarial value of the Retirement System's net assets available for OPEB at December 31, 2002. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were $18.7 billion and $8.7 billion, respectively.

In December 2001, the Board adopted the Health Care "Choices" Plan in its continuing effort to respond to the rise in the cost of health care. The Choices Plan will be offered to all persons newly hired in an OPERS covered-position after January 1, 2003, with no prior service credit accumulated toward health care coverage. Choices, as the name suggests, will incorporate a cafeteria approach, offering a more broad range of health care options. The plan uses a graded scale from ten to thirty years to calculate a monthly health care benefit. This is in contrast to the ten-year "cliff" eligibility standard for the present plan. The benefit recipient will be free to select the option that best meets their needs. Recipients will fund health care costs in excess of their monthly health care benefit. The Plan will also offer a spending account feature, enabling the benefit recipient to apply his or her allowance toward specific medical expenses, much like a Medical Spending Account. In response to the adverse investment returns experienced by OPERS from 2000 through 2002 and the continued staggering rate of health care inflation, the OPERS Board, during 2003, considered extending "Choices" type cost cutting measures to all active members and benefit recipients. As of this date, the Board has not determined the exact changes that will be made to the health care plan. However, changes to the plan are expected to be approved by the summer of 2004

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 2003 or 2002.

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. In 2002, the City participated in the State of Ohio workers' compensation premium program to provide workers' compensation benefits to its employees. In 2003, the City exercised the option of retrospective rating mechanism for our workers' compensation program.

NOTE G - CONTINGENT LIABILITIES AND RISK MANAGEMENT (Continued)

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 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 $2,230,000 and $2,239,000 in 2003 and 2002, respectively. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately $3,128,000 and $1,026,000 in 2003 and 2002, 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:

	2003	2002
	(In thousands)	
Electricity purchases	$ 12,435	$ 13,200
City administration	1,674	1,100
Motor Vehicle Maintenance	1,955	1,926
Telephone exchange	732	677
Utilities administration and fiscal control	1,858	2,086

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 $4,137,000 and $3,582,000 for the years ended December 31, 2003 and 2002, respectively.

NOTE J - SUBSEQUENT EVENTS

Legislation was passed on June 14, 2004 which authorized the issuance and sale of Water Revenue Bonds in an amount not to exceed $175,000,000 for the purpose of refunding outstanding water revenue bonds. The proposed legislation also authorizes the Division of Water to transfer up to $50,000,000 in funds on hand to an escrow fund for the payment of principal and interest on designated bonds.

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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
AUGUST 17, 2004