CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

REPORT ON AUDITS OF FINANCIAL STATEMENTS
For the years ended December 31, 2011 and 2010

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying basic financial statements of the Division of Water, Department of Public Utilities, City of Cleveland, Ohio (the Division) as of and for the years ended December 31, 2011 and 2010, as listed in the table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 opinion.

As described in Note A, the financial statements present only the financial position and the changes in financial position and cash flows of the Division and do not purport to, and do not, present fairly the financial position of the City of Cleveland as of December 31, 2011 and 2010, 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 State of America

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the Division of Water, Department of Public Utilities, City of Cleveland, Ohio as of December 31, 2011 and 2010, 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.

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

www.cshco.com
p. 513.241.3111
f. 513.241.1212

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 15 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Clark, Schaefer, Hackett & Co.

Cincinnati, Ohio
June 25, 2012

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, 2011 and 2010. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 17.

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 ninth largest in the United States based on the number of accounts served within the City and 69 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 2011, the aggregate metered consumption of water in the City constituted 32% of the total metered consumption in the service area, while consumption in the direct service communities and master meter communities constituted 57% and 11%, respectively.

The Division services the City of Cleveland and 69 other surrounding suburbs including six master meter suburbs. In addition to selling water directly to customers the Division is also the emergency standby provider for systems in eight municipalities which span three counties. They provide water to 414,006 city and suburban accounts in the Cleveland metropolitan area. They also sell water for resale to master meter municipalities that operate their own distribution systems, and provide billing and payment services for the Northeast Ohio Regional Sewer District and other sewer municipalities. During 2011, the Division provided services to approximately 123,554 accounts located within Cleveland and approximately 290,452 accounts located in direct service municipalities. Water provided to each master meter municipality is metered at each municipality's boundary. Consumers within the City of Cleveland accounted for 21% of the Division's metered sales revenue, while the direct service and master meter municipalities accounted for 69% and 10% of metered sales revenue, respectively.

The Division, along with Division of Utilities Fiscal Control, provides a complete array of processing services including billing, processing payments, mailing delinquency notices, terminating water service on delinquent accounts and distributing the money collected to the municipalities. The Division processes approximately 5,000 payments daily, which include payments for water, water and sewer, waste collection fee, final notices and delinquent notices.

COMPARISON OF CURRENT YEAR'S AND PRIOR YEARS' DATA

FINANCIAL HIGHLIGHTS

- The assets of the Division exceeded its liabilities (net assets) by $1,032,782,000, $1,022,666,000 and $1,006,836,000 at December 31, 2011, 2010 and 2009, respectively. Of these amounts, $204,911,000, $207,491,000 and $225,340,000 (unrestricted net assets) at December 31, 2011, 2010 and 2009, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.

FINANCIAL HIGHLIGHTS (Continued)

- In 2011, the operating revenues of the Division decreased by $644,000. In 2010, the operating revenues of the Division increased by $9,035,000.

- In 2011 the Division had an increase in water pumpage of 0.2%. The major users of water consumption were ISG-Cleveland, Cuyahoga Metropolitan Housing Authority, Nestle Inc., Alcoa Inc., Cleveland Clinic Foundation, Pepsi Inc., North East Ohio Regional Sewer District and NASA Lewis Research Center. In 2010 the Division had an increase in water pumpage of 2.1%. The major users of water consumption were Forest City, ISG-Cleveland, Ford Motor Company, Aurora Commerce, Cuyahoga Metropolitan Housing Authority, Cleveland Clinic Foundation, NASA Lewis Research Center, Alcoa Inc. and North East Ohio Regional Sewer District.

- The Division's overall net assets increased by $10,116,000, $15,830,000 and $10,544,000 in 2011, 2010 and 2009, respectively.

- The Division had increases in capital assets, net of accumulated depreciation, of $26,134,000, $53,749,000 and $54,920,000 in 2011, 2010 and 2009, respectively. The major additions during these years were related to the continuing renovation projects at the Morgan, Baldwin and Nottingham sites.

- The total long-term debt of the Division decreased $62,551,000 in 2011. This decrease is attributed to $43,407,000 of debt retired and $101,800,000 of debt defeased, which was offset by the issuance of $82,090,000 of revenue bonds and receipt of one Ohio Water Development Authority loan totaling $566,000. The total long-term debt of the Division decreased $26,867,000 in 2010. This decrease is attributed to $36,528,000 of debt retired and $90,500,000 of debt defeased, which was offset by the issuance of $81,430,000 of revenue bonds and receipts on two Ohio Water Development Authority loans totaling $18,731,000.

- In July 2011 the Division issued $50,000,000 of Water Revenue Subordinated, Series 2011 Lien Notes in order to refund notes issued in 2010 to fund a portion of the automated meter reading program.

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.

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 17 - 22 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 23 - 44 of this report.

CONDENSED BALANCE SHEET INFORMATION

Provided below is condensed balance sheet information for the Division as of December 31, 2011, 2010 and 2009:

	2011	2010	2009
		(In thousands)	
Assets:			
Capital assets, net	$ 1,495,692	$ 1,469,558	$ 1,415,809
Restricted assets	171,598	240,993	238,324
Unamortized bond issuance costs	4,517	4,911	5,612
Deferred outflows of resources	27,955	17,664	13,077
Current assets	271,720	276,285	291,679
Total assets	1,971,482	2,009,411	1,964,501
Net Assets and Liabilities:			
Net Assets:			
Invested in capital assets, net of related debt	734,270	713,285	682,816
Restricted for debt service	93,601	101,890	98,680
Unrestricted	204,911	207,491	225,340
Total net assets	1,032,782	1,022,666	1,006,836
Liabilities:			
Long-term obligations	765,540	819,238	852,303
Derivative instruments - interest rate swaps	27,955	17,664	13,077
Current liabilities	145,205	149,843	92,285
Total liabilities	938,700	986,745	957,665
Total net assets and liabilities	$ 1,971,482	$ 2,009,411	$ 1,964,501

CONDENSED BALANCE SHEET INFORMATION (Continued)

Total Assets: The Division's investment in capital assets as of December 31, 2011 amounted to $1,495,692,000 (net of accumulated depreciation) which is an increase of $26,134,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had additions of $112,795,000, buildings, structures and improvements had additions $1,437,000 and furniture, fixtures, equipment and vehicles had additions of $5,709,000. Also, construction in progress decreased by $35,012,000 due to the completion of several major projects: Kirtland Pump Station Rehab, Fairmount Pump Station Rehab, Morgan Pretreatment and Residuals, Water Tank Rehabilitation and Water and Aurora Road Water Main Improvement, offset by several ongoing major projects: Meter Automation and Replacement Program Warehouse Improvements Phase 1 and 2, Crown Water Plant Improvements, Suburban Water Main Renewal, Morgan Chemical Facility Improvements, plant enhancement program improvements.

The Division's investment in capital assets as of December 31, 2010 amounted to $1,469,558,000 (net of accumulated depreciation) which is an increase of $53,749,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had additions of $121,556,000, buildings, structures and improvements had additions $1,018,000 and furniture, fixtures, equipment and vehicles had additions of $7,490,000. Also, construction in progress decreased by $20,600,000 due to the completion of several major projects: Baldwin Chemical Project, Voice and Data Project, Morgan East Reservoir Project and Water Main Rehab 2008, offset by several ongoing major projects: Morgan filter improvements, Fairmount pump improvements, Kirtland pump improvements, plant enhancement program improvements and Baldwin plant improvements.

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

The increase in restricted assets of $2,669,000 as of December 31, 2010 is mainly attributed to increased cash balances in the debt service fund.

The deferred outflow of resources related to the Division's interest rate swap agreements increased from $17,664,000 in 2010 to $27,955,000 million in 2011. The fair value of the swaps is determined by the taxable LIBOR rate as of December 31, 2011.

CONDENSED BALANCE SHEET INFORMATION (Continued)

Capital Assets: The Division's investment in capital assets, as of December 31, 2011 amounted to $1,495,692,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was approximately 1.8%. The Division's investment in capital assets, as of December 31, 2010 amounted to $1,469,558,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for 2010 was approximately 3.8%. A summary of the activity in the Division's capital assets during the years ended December 31, 2011 and 2010 is as follows:

	Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011
	(In thousands)			
Land	$ 5,463	$	$	$ 5,463
Land improvements	16,549			16,549
Utility plant	1,002,569	112,795	(247)	1,115,117
Buildings, structures and improvements	219,953	1,437	(17)	221,373
Furniture, fixtures, equipment and vehicles	565,014	5,709	(4,044)	566,679
Construction in progress	310,919	84,929	(119,941)	275,907
Total	2,120,467	204,870	(124,249)	2,201,088
Less: Accumulated depreciation	(650,909)	(58,795)	4,308	(705,396)
Capital assets, net	$ 1,469,558	$ 146,075	$ (119,941)	$ 1,495,692

	Balance January 1, 2010	Recategor-izations *	Additions	Reductions	Balance December 31, 2010
	(In thousands)				
Land	$ 5,463	$	$	$	$ 5,463
Land improvements	17,061	(512)			16,549
Utility plant	1,152,834	(271,821)	121,556		1,002,569
Buildings, structures and improvements	218,420	515	1,018		219,953
Furniture, fixtures, equipment and vehicles	285,706	271,818	7,490		565,014
Construction in progress	331,519		108,712	(129,312)	310,919
Total	2,011,003	-	238,776	(129,312)	2,120,467
Less: Accumulated depreciation	(595,194)		(55,715)		(650,909)
Capital assets, net	$ 1,415,809	$ -	$ 183,061	$ (129,312)	$ 1,469,558

* Some Capital Assets were moved to more exact categories when assets were entered into the City's new Advantage Accounting System as of January 1, 2010.

CONDENSED BALANCE SHEET INFORMATION (Continued)

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

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

Major events during 2010 affecting the Division's capital assets included the following:

- The construction, renovations, and plant enhancements on the Morgan, Baldwin and Nottingham facilities, the rehabilitation of the Fairmount and Kirtland pump stations and the rehabilitation of water mains amounted to $101,000,000. The major programs totaling $96,250,000 are: Security Enhancements Program, Plant Enhancement Program, Pump Station Enhancement Program, the Customer Information System, Meter Automation and Replacement and the purchase of office equipment and vehicles. The water main rehabilitation comprises the remaining $4,750,000.

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

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

In 2010, the factors for the Division's net decrease in long-term obligations of $33,065,000 is attributed to additional Ohio Water Development Authority Loans of $18,731,000, the issuance of $131,430,000 of new bonds and notes and a decrease in the unamortized discount and premium of $2,297,000. These amounts were offset by $36,528,000 of debt retirement, $90,500,000 of debt defeased, a decrease in unamortized loss on debt refunding of $2,648,000 and a decrease in accrued wages and benefits of $1,210,000.

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

In 2010, total current liabilities increased by $57,558,000. The significant components of the change were increases to the current portion of long-term debt obligations and short-term notes of $56,223,000, payable from restricted assets of $670,000, accounts payable of $802,000 and customer deposits and other liabilities of $1,703,000. These increases were offset by reductions of accrued interest of $658,000, current portion of accrued wages and benefits of $884,000 and $298,000 due to other City of Cleveland departments, divisions or funds.

CONDENSED BALANCE SHEET INFORMATION (Continued)

Long-term Debt: At the end of 2011, the Division had total long-term debt outstanding of $811,095,000. All bonds are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

At the end of 2010, the Division had total long-term debt outstanding of $873,646,000. All bonds are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

Short-term Debt: In 2010 the Division issued $50,000,000 Subordinated Lien Revenue Notes which were due on July 28, 2011. These notes were reissued in 2011.

At the end of 2011, the Division had $50,000,000 of Water Revenue Subordinated Revenue Notes outstanding. The notes, which are subordinate to the Division’s outstanding revenue bonds, are due on July 26, 2012 and are backed by the revenues generated by the Division.

CONDENSED BALANCE SHEET INFORMATION (Continued)

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

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

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

CONDENSED BALANCE SHEET INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2010 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	Balance January 1, 2010	Debt Issued	Debt Defeased (In thousands)	Debt Retired	Balance December 31, 2010
Water Revenue Bonds:					
Series G, 1993	$ 107,760	$	$	$ (12,930)	$ 94,830
Series H, 1996	2,095			(75)	2,020
Series J, 2001	53,050		(9,470)	(350)	43,230
Series K, 2002	57,305			(4,495)	52,810
Series N, 2005	45,855			(12,810)	33,045
Series O, 2007	138,725				138,725
Series P, 2007	135,410				135,410
Series Q, 2008	90,800				90,800
Series R, 2009	54,735		(54,735)		-
Series S, 2009	26,295		(26,295)		-
Series T, 2009	84,625			(1,285)	83,340
Series U, 2010		54,935			54,935
Series V, 2010		26,495			26,495
Ohio Water Development Authority Loans	103,858	18,731		(4,583)	118,006
Total	$ 900,513	$ 100,161	$ (90,500)	$ (36,528)	$ 873,646

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

CONDENSED BALANCE SHEET INFORMATION (Continued)

The bond ratings for the Division's outstanding revenue bonds as of December 31, 2011 are as follows:

Moody's Investors Service	Standard & Poor's
Aa1	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 2011, 2010 and 2009 was 144%, 132% and 130%, respectively.

Additional information on the Division's long-term debt can be found in Note B on pages 26 - 36.

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 $1,032,782,000, $1,022,666,000, and $1,006,836,000 at December 31, 2011, 2010 and 2009, respectively.

Of the Division's net assets, $734,270,000, or 71.1% and $713,285,000, or 69.7% at December 31, 2011 and 2010, 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, $93,601,000, or 9.1%, and $101,890,000, or 10.0%, at December 31, 2011 and 2010, respectively, represents resources that are subject to external restrictions. These funds are set aside for the payment of revenue bonds. The remaining balance of unrestricted net assets, $204,911,000, or 19.8%, and $207,491,000, or 20.3%, at December 31, 2011 and 2010, 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 net assets increased during 2011 and 2010 by $10,116,000 and $15,830,000, respectively. The following table identifies the key elements of the Division's results of operations as of and for the years ended December 31, 2011, 2010 and 2009:

	2011	2010	2009
		(In thousands)	
Operating revenues	$ 236,626	$ 237,270	$ 228,235
Operating expenses	205,028	205,228	197,498
Operating income (loss)	31,598	32,042	30,737
Non-operating revenue (expense):			
Investment income	2,349	4,007	4,122
Interest expense	(27,071)	(27,410)	(26,787)
Amortization of bond issuance costs, premiums and discounts	2,682	2,189	1,937
Workers' compensation refund			10
Gain (Loss) on disposal of capital assets		1	65
Total non-operating revenue (expense), net	(22,040)	(21,213)	(20,653)
Income (loss) before other contributions	9,558	10,829	10,084
Capital and other contributions	558	5,001	460
Increase (decrease) in net assets	10,116	15,830	10,544
Net assets, beginning of year	1,022,666	1,006,836	996,292
Net assets, end of year	$ 1,032,782	$ 1,022,666	$ 1,006,836

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

In 2010, total operating revenues increased by $9,035,000. The Division of Water had an increase in pumpage of 2.1%. The major users of water were as follows: Forest City, ISG-Cleveland, Ford Motor Company, Aurora Commerce, Cuyahoga Metropolitan Housing Authority, Cleveland Clinic Foundation, NASA Lewis Research Center, Alcoa Inc. and North East Ohio Regional Sewer District.

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

Operating expenses: In 2011, the overall decrease in operating expenses of $200,000 was due to a $611,000 increase in operations expense and a $3,081,000 increase for depreciation expense. These increases were offset by a decrease of $3,892,000 in maintenance expenses. Operations expense increases were identified in the following areas: contractual services and electricity. The decrease in maintenance expenses were noted in the following areas: computer hardware maintenance and PERS. Salary and benefit costs also decreased as a result of retirements, reductions in overtime costs, hospitalization and workers compensation costs.

In 2010, the overall increase in operating expenses of $7,730,000 was due to a $6,705,000 increase in operations expense and a $5,933,000 increase for depreciation expense. These increases were offset by a decrease of $4,908,000 in maintenance expenses. Operations expense increases were identified in the following areas: professional services, contractual services, credit card processing fees, bad debt expense and debt service costs. The decrease in maintenance expenses were noted in the following areas: computer hardware maintenance, maintenance of utility system and building, and street construction maintenance repair. Salary and benefit costs also decreased as a result of retirements, reductions in overtime costs, hospitalization and workers compensation costs.

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

The major changes in 2010 were a decrease of $115,000 in investment income (attributed to declining interest rates) and an increase of $623,000 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 1st 1/3 MCF (Thousand cubic feet)			CLEVELAND - PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	**REGULAR**	**HOMESTEAD**	**REGULAR**	**HOMESTEAD**
January 1, 2012	$13.76	$6.88	$27.52	$6.88
January 1, 2013	$15.51	$8.53	$29.48	$8.53
January 1, 2014	$17.34	$10.41	$31.22	$10.41
January 1, 2015	$19.26	$12.52	$32.74	$12.52

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

DIRECT SERVICE SUBURBS - PER 1st 1/3 MCF (Thousand cubic feet)			DIRECT SERVICE SUBURBS-PER ADDITIONAL MCF (Thousand cubic feet)	
EFFECTIVE	REGULAR	HOMESTEAD	REGULAR	HOMESTEAD
January 1, 2012	$20.47-$27.62	$10.23-$13.81	$41.70-$55.41	$10.23-$13.81
January 1, 2013	$22.11-$30.33	$12.16-$16.68	$42.01-$57.63	$12.16-$16.68
January 1, 2014	$23.63-$33.00	$14.18-$19.80	$42.53-$59.39	$14.18-$19.80
January 1, 2015	$25.04-$35.63	$16.27-$23.16	$42.56-$60.57	$16.27-$23.16

These increases in rates, fixed customer charges and recommended modifications to the Division's water rate structure were adopted by the Cleveland City Council on May 23, 2011. The fixed customer charges change became effective October 16, 2011. The new fixed customer charges are based on meter size. The first increase in a series of annual increases in water consumption charges became effective January 1, 2012. The annual rate increases are expected to increase operating revenues to adequately cover anticipated operating expenses.

As outlined in the Comprehensive Financial Plan for the years 2011 through 2015, which set rates that were subsequently approved by Cleveland City Council, the Division intends to go forward with additional revenue bond financing in the third quarter of 2012 in the approximate amount of $50,000,000, to continue its capital improvement program.

Also at that time the Division intends to replace the $50,000,000 AMR Subordinated Notes with water revenue subordinated bonds. An additional $40,000,000 will also be added to this subordinated bond issue to provide the balance of funds needed for the completion of the AMR project.

Effective July 26, 2011, the Division issued $50,000,000 of Water Revenue Subordinated Notes Series 2011. The notes, which mature on July 26, 2012, refunded the Series 2010 Subordinate Lien Water Revenue Notes which were issued to provide a portion of the funds needed for the acquisition and installation of a new Automated Meter Reading system.

On October 6, 2011, the Division issued $82,090,000 Water Revenue Bonds, Series W. Proceeds of these bonds were used to refund the outstanding Water Revenue Bonds, Series H, 1996, the outstanding Waterworks Refunding Revenue Bonds, Series J, 2001 and the outstanding Water Revenue Bonds, Series K, 2002.

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, 2011 and 2010

	(In thousands)			
	2011		**2010**	
ASSETS				
CAPITAL ASSETS				
Land	$	5,463	$	5,463
Land improvements		16,549		16,549
Utility plant		1,115,117		1,002,569
Buildings, structures and improvements		221,373		219,953
Furniture, fixtures, equipment and vehicles		566,679		565,014
		1,925,181		1,809,548
Less: Accumulated depreciation		(705,396)		(650,909)
		1,219,785		1,158,639
Construction in progress		275,907		310,919
CAPITAL ASSETS, NET		1,495,692		1,469,558
RESTRICTED ASSETS				
Cash and cash equivalents		171,498		240,916
Accrued interest receivable		100		77
TOTAL RESTRICTED ASSETS		171,598		240,993
UNAMORTIZED BOND ISSUANCE COSTS		4,517		4,911
DEFERRED OUTFLOWS OF RESOURCES		27,955		17,664
CURRENT ASSETS				
Cash and cash equivalents		146,027		158,473
Restricted cash and cash equivalents		14,842		15,727
Investments		12,141		7,102
Receivables:				
Accounts receivable - net of allowance for doubtful accounts of $23,401,000 in 2011 and $19,611,000 in 2010		54,175		49,341
Unbilled revenue		27,225		28,700
Due from other City of Cleveland departments, divisions or funds		12,449		11,864
Accrued interest receivable		1		65
Materials and supplies - at average cost, net of allowance for obsolescence of $126,500 in 2011 and $125,500 in 2010		3,722		3,940
Prepaid expenses		1,138		1,073
TOTAL CURRENT ASSETS		271,720		276,285
TOTAL ASSETS	$	1,971,482	$	2,009,411

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
BALANCE SHEETS
December 31, 2011 and 2010

	2011 (In thousands)	2010
NET ASSETS AND LIABILITIES		
NET ASSETS		
Invested in capital assets, net of related debt	$ 734,270	$ 713,285
Restricted for debt service	93,601	101,890
Unrestricted	204,911	207,491
TOTAL NET ASSETS	1,032,782	1,022,666
LIABILITIES		
LONG-TERM OBLIGATIONS-excluding amounts due within one year		
Revenue bonds	657,481	705,505
OWDA loans	106,595	112,114
Accrued wages and benefits	1,464	1,619
TOTAL LONG-TERM OBLIGATIONS	765,540	819,238
DERIVATIVE INSTRUMENTS - INTEREST RATE SWAPS	27,955	17,664
CURRENT LIABILITIES		
Current portion of long-term debt, due within one year and short-term notes	90,085	93,407
Accounts payable	4,870	4,305
Current payable from restricted assets	14,842	15,727
Due to other City of Cleveland departments, divisions or funds	2,770	2,223
Accrued interest	12,727	15,597
Current portion of accrued wages and benefits	10,079	10,423
Other accrued expenses	395	393
Customer deposits and other liabilities	9,437	7,768
TOTAL CURRENT LIABILITIES	145,205	149,843
TOTAL LIABILITIES	938,700	986,745
TOTAL NET ASSETS AND LIABILITIES	$ 1,971,482	$ 2,009,411

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, 2011 and 2010

	(In thousands) 2011	2010
OPERATING REVENUES		
Charges for services	$ 236,626	$ 237,270
TOTAL OPERATING REVENUES	236,626	237,270
OPERATING EXPENSES		
Operations	100,221	99,610
Maintenance	46,011	49,903
Depreciation	58,796	55,715
TOTAL OPERATING EXPENSES	205,028	205,228
OPERATING INCOME (LOSS)	31,598	32,042
NON-OPERATING REVENUE (EXPENSE)		
Investment income	2,349	4,007
Interest expense	(27,071)	(27,410)
Amortization of bond issuance costs, premiums, and discounts	2,682	2,189
Gain (loss) on disposal of capital assets		1
TOTAL NON-OPERATING REVENUE (EXPENSE), NET	(22,040)	(21,213)
INCOME (LOSS) BEFORE OTHER CONTRIBUTIONS	9,558	10,829
CAPITAL AND OTHER CONTRIBUTIONS	558	5,001
INCREASE (DECREASE) IN NET ASSETS	10,116	15,830
NET ASSETS, beginning of year	1,022,666	1,006,836
NET ASSETS, end of year	$ 1,032,782	$ 1,022,666

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, 2011 and 2010

	2011	2010
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$ 229,625	$ 226,973
Cash payments to suppliers for goods or services	(64,085)	(65,037)
Cash payments to employees for services	(75,905)	(75,207)
Other	(226)	
NET CASH PROVIDED BY(USED FOR) OPERATING ACTIVITIES	89,409	86,729
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(89,005)	(82,684)
Capital grant proceeds	558	5,001
Proceeds of OWDA loan	1,362	17,367
Principal paid on long-term debt	(93,407)	(36,191)
Interest paid on long-term debt	(39,158)	(40,324)
Cash paid to escrow agent for refunding	(104,676)	(91,009)
Proceeds of bonds, premiums and discounts	104,626	71,487
Proceeds from sale of notes	50,000	50,000
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	(169,700)	(106,353)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(12,044)	
Proceeds from sale and maturity of investment securities	6,998	21,000
Interest received on investments	2,588	5,070
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	(2,458)	26,070
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(82,749)	6,446
CASH AND CASH EQUIVALENTS, beginning of year	415,116	408,670
CASH AND CASH EQUIVALENTS, end of year	$ 332,367	$ 415,116

(Continued)

CITY OF CLEVELAND, OHIO

DEPARTMENT OF PUBLIC UTILITIES
DIVISION OF WATER
STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2011 and 2010

	(In thousands) 2011	2010
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
OPERATING INCOME (LOSS)	$ 31,598	$ 32,042
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	58,796	55,715
Changes in assets and liabilities:		
Accounts receivable, net	(4,834)	1,885
Unbilled revenue	1,475	(4,690)
Due from other City of Cleveland departments, divisions or funds	(585)	(1,052)
Materials and supplies, net	218	169
Prepaid expenses	(65)	828
Accounts payable	565	802
Due to other City of Cleveland departments, divisions or funds	547	(298)
Accrued Liabilities	2	
Accrued wages and benefits	(499)	(1,210)
Customer deposits and other liabilities	2,191	2,538
TOTAL ADJUSTMENTS	57,811	54,687
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES	$ 89,409	$ 86,729

(Concluded)

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS
For the Years Ended December 31, 2011 and 2010

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Reporting Model and Basis of Accounting: The accounting policies and financial reporting practices of the Division comply with accounting principles generally accepted in the United States of America applicable to governmental units. In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which is effective for the year ended December 31, 2010. The City has determined that GASB Statement No. 51 has no impact on its financial statements as of December 31, 2011. GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments,* was issued in June 2008. This statement requires governments to measure most derivative instruments at fair value in financial statements using the accrual basis of accounting. Specific criteria are used to determine whether a derivative instrument results in an effective hedge. Changes in fair value for effective hedges are to be recognized in the reporting period to which they relate and are reported as deferrals in the statement of net assets or the balance sheet. Derivative instruments that either do not meet the criteria for an effective hedge or are associated with investments that are already reported at fair value are to be classified as investment derivative instruments for financial reporting purposes with the change in fair value reported as part of investment revenue in the current period. As required, the City has implemented GASB Statement No. 53 effective for the 2010 fiscal year.

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

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

In addition, certain 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) guidance 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 guidance, or 2) continuing to follow new FASB guidance (unless they conflict with GASB pronouncements). The City has chosen not to apply future FASB guidance.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, noncapital financing, capital and related financing, and investment activities.

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

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

The City has invested funds in STAROhio during 2011 and 2010. 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, 2011 and 2010.

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.

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 an item with a useful life in excess of one year and an individual cost of more than $5,000 for land, furniture, fixtures, equipment and vehicles and $10,000 for all other assets. When capital assets are disposed, the cost and related accumulated depreciation are removed from the accounts with gains or losses on disposition being reflected in operations. The estimated useful lives are as follows:

Utility plant	5 to 100 years
Land improvements	15 to 100 years
Buildings, structures and improvements	5 to 60 years
Furniture, fixtures, equipment and vehicles	3 to 60 years

The Division's policy is to capitalize interest on construction projects up to the point in time that the project is substantially completed. Capitalized interest is included in the cost of the assets and is depreciated on the straight-line basis over the estimated useful lives of such assets. The Division applies FASB guidance pertaining to capitalization of interest costs for its revenue bonds. This statement requires capitalization of interest cost of eligible borrowings, less interest earned on investment of the related bond proceeds from the date of borrowing until the assets constructed from the bond proceeds are ready for their intended use.

For 2011 and 2010, total interest costs incurred amounted to $39,260,000 and $43,139,000, respectively, of which $11,998,000 and $15,699,000, respectively, was capitalized, net of interest income of $191,000 in 2011 and $30,000 in 2010.

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. Sick days not taken may be accumulated until retirement. An employee is paid one-third of accumulated sick leave upon retirement, calculated at the three highest year average base salary rate, with the balance being forfeited.

NOTE B – DEBT AND OTHER LONG-TERM OBLIGATIONS

Debt outstanding at December 31, 2011 and 2010 is as follows:

	Interest Rate	Issuance	2011	2010
			(In thousands)	
Water Revenue Bonds:				
Series G, 1993, due through 2021	5.50%	$ 228,170	$ 81,225	$ 94,830
Series H, 1996, due through 2026	5.50%-5.75%	204,885		2,020
Series J, 2001, due through 2016	4.25%-5.38%	92,595		43,230
Series K, 2002, due through 2021	4.00%-5.25%	138,050		52,810
Series N, 2005, due through 2023	3.50%-5.00%	64,480	33,045	33,045
Series O, 2007, due through 2037	4.25%-5.00%	143,570	133,315	138,725
Series P, 2007, due through 2028	4.00%-5.00%	135,410	119,095	135,410
Series Q, 2008, due through 2033	Variable	90,800	90,800	90,800
Series T, 2009, due through 2021	2.00%-5.00%	84,625	77,415	83,340
Series U, 2010, due through 2033	Variable	54,935	54,935	54,935
Series V, 2010, due through 2033	Variable	26,495	26,495	26,495
Series W, 2011, due through 2026	2.00%-5.00%	82,090	82,090	
Ohio Water Development Authority Loans payable annually through 2031	0.00%-4.14%	141,367	112,680	118,006
		$ 1,487,472	811,095	873,646
Adjustments:				
Unamortized discount and premium			21,558	17,729
Unamortized loss on debt refunding			(28,492)	(30,349)
Current portion			(40,085)	(43,407)
Total Long-Term Debt			$ 764,076	$ 817,619

	Interest Rate	Issuance	2011	2010
			(In thousands)	
Water Revenue Notes:				
Subordinate Lien Revenue Notes, due 2011	2.00%	$ 50,000	$	$ 50,000
Subordinate Lien Revenue Notes, due 2012	1.00%	50,000	50,000	
Total Short-Term Debt		$ 100,000	$ 50,000	$ 50,000

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

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

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

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

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

Summary: Changes in long-term obligations for the year ended December 31, 2010 are as follows:

	Balance January 1, 2010	Increase	Decrease (In thousands)	Balance December 31, 2010	Due Within One Year
Water Revenue Bonds:					
Series G, 1993, due through 2021	$ 107,760	$	$ (12,930)	$ 94,830	$ 13,605
Series H, 1996, due through 2026	2,095		(75)	2,020	80
Series J, 2001, due through 2016	53,050		(9,820)	43,230	365
Series K, 2002, due through 2021	57,305		(4,495)	52,810	4,715
Series N, 2005, due through 2023	45,855		(12,810)	33,045	
Series O, 2007, due through 2037	138,725			138,725	2,585
Series P, 2007, due through 2028	135,410			135,410	10,240
Series Q, 2008, due through 2033	90,800			90,800	
Series R, 2009, due through 2033	54,735		(54,735)		
Series S, 2009, due through 2033	26,295		(26,295)		
Series T, 2009, due through 2021	84,625		(1,285)	83,340	5,925
Series U, 2010, due through 2033		54,935		54,935	
Series V, 2010, due through 2033		26,495		26,495	
Ohio Water Development Authority Loans payable annually through 2031	103,858	18,731	(4,583)	118,006	5,892
Total revenue bonds/loans	900,513	100,161	(127,028)	873,646	43,407
Accrued wages and benefits	13,252	10,097	(11,307)	12,042	10,423
Total	$ 913,765	$ 110,258	$ (138,335)	$ 885,688	$ 53,830

	January 1, 2010	Increase	Decrease (In thousands)	December 31, 2010	Within One Year
Water Revenue Notes:					
Subordinate Lien Revenue Notes, due 2011	$	$ 50,000	$	$ 50,000	$ 50,000
Total revenue notes	$ -	$ 50,000	$ -	$ 50,000	$ 50,000

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

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

	Principal	Interest	Total
		(In thousands)	
2012	$ 40,085	$ 34,525	$ 74,610
2013	37,383	33,709	71,092
2014	46,400	32,118	78,518
2015	47,903	30,090	77,993
2016	48,209	27,831	76,040
2017-2021	223,437	106,328	329,765
2022-2026	187,747	60,534	248,281
2027-2031	109,330	27,558	136,888
2032-2036	63,100	8,287	71,387
2037	9,015	225	9,240
Total	$ 812,609	$ 361,205	$ 1,173,814

Note: The table above does not include principal or interest payments due on short term debt. The Division has $50,000,000 principal and $500,000 interest due in July 2012 on its Subordinated Lien Revenue Notes.

The above schedule of minimum principal and interest payments on long-term debt includes the amortization on nine 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 nine 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 2011, the Division expended another $566,000 for the Baldwin Residuals and Fairmount Reservoir. The OWDA loan associated with this project is a zero percent loan for the face value of $9,000,000 which matures January 2031.

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

Therefore, at December 31, 2011, the amount financed on these nine loan projects, less principal payments made, totaled $114,194,000 and is reflected in the debt service payment schedule. However, the total on the actual loan balances received by the City was $112,680,000 as reflected on the schedules of long-term debt outstanding and changes in long-term debt obligations as of December 31, 2011. The difference of $1,514,000 will be received or accrued in future year(s).

The Division has defeased certain Revenue Bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. In 2011, the Division deposited cash in the amount of $9,327,000 in an escrow account for the payment of future debt service requirements. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Division's financial statements. The aggregate amount of defeased debt outstanding at December 31, 2011 and 2010 is as follows:

Bond Issue	**2011**	**2010**
	(In thousands)	
Series H, 1996	$ 1,940	$
Series J, 2001	52,335	9,470
Series K, 2002	116,420	68,325
Series N, 2005		8,815
Series O, 2007	2,825	
Series P, 2007	6,075	
Total	$ 179,595	$ 86,610

In 1996, the City authorized the adoption of the eighth supplemental indenture to amend and restate the existing indenture, subject to the receipt of consent of the requisite number of bondholders. With the issuance of the Series J bonds, the City reached the 66.7% consent required to enact the Amended and Restated Indenture. Effective October 5, 2001, all outstanding bonds and any future bonds are secured by the Amended and Restated Indenture. Under the new indenture, the bonds are no longer secured by a mortgage lien. All bonds are secured by the Division's net revenues and by the pledged funds.

The Division's indentures have certain restrictive covenants and principally require that bond reserve funds be maintained and charges for fees to customers 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, 2011 and 2010, the Division was in compliance with the terms and requirements of the bond indenture.

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

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

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

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

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

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

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

In December 2011, the Division utilized cash on hand to defease $2,825,000 principal amount of outstanding Series O bonds and $6,075,000 principal amount of outstanding Series P bonds. The Division placed $9,327,000 in an irrevocable trust account which will be used to pay principal and interest on the defeased bonds. As a result the bonds are considered defeased and the liability for the bonds has been removed from long-term debt.

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

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

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

Effective December 30, 2010, the Division issued $54,935,000 Water Revenue Bonds, Series U, and $26,495,000 Water Revenue Bonds, Series V. Proceeds of these bonds were used to refund the outstanding Water Revenue Bonds, Series R, 2009 and Water Revenue Bonds, Series S, 2009. The Series U bonds were issued in order to eliminate high letter of credit fees and the Series V Bonds were issued to address higher than expected interest rates caused by the downgrade of the letter of credit bank. The City negotiated a direct purchase of all of the Series U Bonds by U.S. Bank at an index rate of 75% of LIBOR plus 63.75 basis points. The City negotiated a direct purchase of the Series V Bonds by PNC Bank at an index rate of 65% of LIBOR plus 81.25 basis points. Both rates will be reset monthly and the bonds can be tendered for purchase after three years. The City obtained an economic gain (the difference between the present values of the old and new debt service payments) of approximately $2.7 million or 3.329% as a result of the refundings.

The City has pledged future Water System revenues, net of specified operating expenses, to repay $748,415,000 in various Water Improvement Revenue Bonds and notes issued in various years since 1993. Proceeds from the bonds provided financing for Water System improvements. The bonds are payable from water system net revenues and are payable through 2037. Annual principal and interest payments on the bonds are expected to require less than 70% of net revenues. The total principal and interest remaining to be paid on the various Water Improvement Revenue Bonds Notes is $1,079,593,000. Principal and interest paid for the current year and total net revenues were $65,668,000 and $92,743,000, respectively.

Interest Rate Swap Transactions:

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

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

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

Under the original swap agreements for the Series M Bonds, the Water System was the fixed rate payor, paying a fixed rate of 3.533%. Each counterparty was a floating rate payor, with each paying the Water System 61.25% of one month LIBOR plus a spread of 28 basis points. Net payments were exchanged semiannually on January 1 and July 1. The obligation of the Water System to make periodic payments (but not any termination payment) was secured by a pledge of and lien on the net revenues of the Water System on a parity with the pledge and lien securing the payment of debt service on the bonds. Both the bond debt service payments on the Series M bonds and the periodic swap payments were insured by Financial Security Assurance (FSA). As part of the refunding of the Series M Bonds, the City amended and restated the original swap agreements to (a) eliminate the swap insurance and related insurer rights, (b) modify the payment frequency, (c) transfer the original swap agreement from Bear Stearns to JPM and (d) split each original swap agreement into two separate interest rate swaps in order to hedge separate series of bonds. The original Bear Stearns swap which has been assumed by JPM hedged the entire principal amount of Series R and certain maturities of the Series Q Bonds. The original Morgan Stanley swap hedged the entire principal amount of Series S and a portion of the Series Q Bonds. The floating rate received by the City was not altered. However, the fixed rate paid by the City was adjusted to 3.553% for the JPM swap and 3.5975% for the Morgan Stanley swap. The termination date for the swaps associated with the Series Q Bonds is January 1, 2021 while the termination date for the Series R and Series S swaps is January 1, 2033. Net payments are now exchanged monthly. With the refunding of the Series R and Series S Bonds, the JPM swap now hedges all but $200,000 of the Series U Bonds and the Morgan Stanley Swap hedges all but $200,000 of the Series V Bonds.

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

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

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

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

Termination Risk: The swap agreement may be terminated prior to its stated termination date under certain circumstances. Upon termination, a payment may be owed by the City to JPM and Morgan Stanley, or by JPM and Morgan Stanley to the City, depending upon the prevailing economic circumstances at the time of the termination. 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 (including accrued amounts) at December 31, 2011 and December 31, 2010 as reported by JPM and Morgan Stanley totaled $27,955,000 and $17,664,000, respectively, which would be payable by the City.

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

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

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

	Changes in Fair Value		Fair Value at December 31, 2010		
	Classification	Amount	Classification	Amount	Notional
			(In thousands)		
Cash flow hedges:					
Floating to fixed interest rate swaps					
2008 Q Water Swap	Deferred outflow	$ (1,510)	Debt	$ (7,951)	$ 88,640
2010 U Water Swap	Deferred outflow	(2,054)	Debt	(6,437)	54,735
2010 V Water Swap	Deferred outflow	(1,023)	Debt	(3,276)	26,295

The following table presents the objective and significant terms of the City's derivative instruments at December 31, 2011, along with the credit rating of each swap counterparty.

Bonds	Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms	Counterparty Credit Rating
Water Series Q	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series Q Water System Bonds	$ 54,355,000	8/10/2004	1/1/2021	Pay 3.553%, receive 61.25% of LIBOR + 28 bps	Aa1/A+/AA-
Water Series Q	Pay Fixed Interest Rate Swap	Hedge of changes in cash flow on the Series Q Water System Bonds	$ 28,270,000	8/10/2004	1/1/2021	Pay 3.5975%, receive 61.25% of LIBOR + 28 bps	A2/A/A
Water Series U	Pay Fixed Interest Rate Swap	Hedge in changes in cash flow on the Series U Water System Bonds	$ 54,735,000	2/12/2009	1/1/2033	Pay 3.553%, receive 61.25% of LIBOR + 28 bps	Aa1/A+/AA-
Water Series V	Pay Fixed Interest Rate Swap	Hedge in changes in cash flow on the Series V Water System Bonds	$ 26,295,000	2/12/2009	1/1/2033	Pay 3.5975%, receive 61.25% of LIBOR + 28 bps	A2/A/A

The following table presents the aggregate debt service requirements on the City's hedged debt and net receipts/payments on the associated hedging derivative instruments as of December 31, 2011. These amounts assume that the interest rates on variable rate bonds and the reference rates in existence as of December 31, 2011 remain the same for the life of the hedging agreement. However, these rates will vary over time and the actual interest payments on the variable rate bonds and the net receipts/payments on the hedging derivative instruments will deviate from the numbers presented below.

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

Fiscal Year Ending December 31	Principal	Interest	Hedging Derivatives, Net	Total
		(In thousands)		
2012	$	$ 860	$ 4,879	$ 5,739
2013		860	4,680	5,540
2014		860	4,422	5,282
2015		860	4,150	5,010
2016		860	4,093	4,953
2017-2021	2,170	4,282	16,515	22,967
2022-2026	82,300	2,253	5,458	90,011
2027-2031	63,685	483	422	64,590
2032-2033	24,075	26	18	24,119
Total	$ 172,230	$ 11,344	$ 44,637	$ 228,211

Ohio Water Development Authority (OWDA) Loans: These loans are payable from net revenues derived from the Waterworks System. These obligations do not have a lien on revenues of the Division. The Division received an increase in OWDA loans in the amount of $566,000 and $18,731,000 during 2011 and 2010, 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, 2011 and 2010 totaled $126,903,000 and $155,335,000, respectively, and the Division's bank balances were $128,025,000 and $154,818,000, respectively. The differences represent positions in pooled bank accounts and normal reconciling items.

Based on the criteria described in GASB Statement No.3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, $128,025,000 and $154,818,000 of the bank balances at December 31, 2011 and 2010, respectively, were insured or collateralized with securities held by the City or by its agent in the City's name.

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

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

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

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

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

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

Credit Risk: The Division's investments as of December 31, 2011 and 2010 include U.S. Agencies, STAROhio, commercial paper, mutual funds and guaranteed investment contracts. The U.S. Agencies are rated AA+ by Standard and Poor's (S&P). The investment in commercial paper is rated A-1 by S&P. Investments in both STAROhio and mutual funds carry a rating of AAAm, which is the highest money market fund rating given by S&P. 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.

NOTE C – DEPOSITS AND INVESTMENTS (Continued)

Concentration of Credit Risk: The Division places a limitation on the amount it may invest in any one issuer to help minimize the concentration of credit risk. The Division had the following investments at December 31, 2011 and 2010, 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:

Type of Investment	2011 Fair Value	2011 Cost	2010 Fair Value	2010 Cost	Investment Maturities: Less than One Year	Investment Maturities: 1 - 5 Years
	(In thousands)					
U.S. Agency Obligations	$ 12,141	$ 12,045	$ 7,102	$ 6,998	$ 12,141	$
STAROhio	32,134	32,134	23,926	23,926	32,134	
Commercial Paper	135,521	135,521			135,521	
Investment in Mutual Funds	959	959	199,005	199,005	959	
Guaranteed Investment Contracts	36,850	36,850	36,850	36,850		36,850
Total Investments	217,605	217,509	266,883	266,779	180,755	36,850
Total Deposits	126,903	126,903	155,335	155,335	126,903	
Total Deposits and Investments	$ 344,508	$344,412	$422,218	$422,114	$ 307,658	$ 36,850

As of December 31, 2011, the investments in U.S. Agency Obligations, STAROhio, commercial paper and mutual funds, and guaranteed investment contracts are approximately 6%, 15%, 62%, <1% and 17%, respectively, of the Division's total investments. As of December 31, 2010, the investments in U.S. Agency Obligations, STAROhio, mutual funds and guaranteed investment contracts are approximately 3%, 9%, 74%, and 14%, respectively, of the Division's total investments.

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

NOTES TO FINANCIAL STATEMENTS (Continued)
For the Years Ended December 31, 2011 and 2010

NOTE D – CAPITAL ASSETS

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

	Balance January 1, 2011	Additions	Deletions	Balance December 31, 2011
		(In thousands)		
Capital assets, not being depreciated:				
Land	$ 5,463	$	$	$ 5,463
Construction in progress	310,919	84,929	(119,941)	275,907
Total capital assets, not being depreciated	316,382	84,929	(119,941)	281,370
Capital assets, being depreciated:				
Land improvements	16,549			16,549
Utility plant	1,002,569	112,795	(247)	1,115,117
Buildings, structures and improvements	219,953	1,437	(17)	221,373
Furniture, fixtures, equipment and vehicles	565,014	5,709	(4,044)	566,679
Total capital assets, being depreciated	1,804,085	119,941	(4,308)	1,919,718
Less: Accumulated depreciation	(650,909)	(58,795)	4,308	(705,396)
Total capital assets being depreciated, net	1,153,176	61,146	-	1,214,322
Capital assets, net	$ 1,469,558	$ 146,075	$ (119,941)	$ 1,495,692

NOTE D – CAPITAL ASSETS (Continued)

Capital Asset Activity: Capital asset activity for the year ended December 31, 2010 was as follows:

	Balance January 1, 2010	Recategor-izations *	Additions	Deletions	Balance December 31, 2010
			(In thousands)		
Capital assets, not being depreciated:					
Land	$ 5,463	$	$	$	$ 5,463
Construction in progress	331,519		108,712	(129,312)	310,919
Total capital assets, not being depreciated	336,982	-	108,712	(129,312)	316,382
Capital assets, being depreciated:					
Land improvements	17,061	(512)			16,549
Utility plant	1,152,834	(271,821)	121,556		1,002,569
Buildings, structures and improvements	218,420	515	1,018		219,953
Furniture, fixtures, equipment and vehicles	285,706	271,818	7,490		565,014
Total capital assets, being depreciated	1,674,021	-	130,064	-	1,804,085
Less: Accumulated depreciation	(595,194)		(55,715)		(650,909)
Total capital assets being depreciated, net	1,078,827	-	74,349	-	1,153,176
Capital assets, net	$ 1,415,809	$ -	$ 183,061	$ (129,312)	$ 1,469,558

* Some Capital Assets were moved to more exact categories when assets were entered into the City's new Advantage Accounting System as of January 1, 2010.

Commitments: The Division has outstanding commitments at December 31, 2011 and 2010 of approximately $84,911,000 and $185,209,000, 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, other than non-administrative full-time police officers and firefighters, participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans as described below:

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

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

The Ohio Revised Code provides statutory authority for member and employer contributions. For 2011, member and employer contribution rates were consistent across all three plans. Member contribution rates were 10.00% in 2011, 2010 and 2009. The employer contribution rates were 14.00% of covered payroll in 2011, 2010 and 2009.

The Division's required employer contributions to OPERS for the pension portion of all the plans for the years ending December 31, 2011, 2010 and 2009 were $5,406,000, $5,286,000 and $4,975,000 each year, respectively. The required payments due in 2011, 2010 and 2009 have been made.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS

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

The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement health care through their contributions to OPERS. A portion of each employer's contribution to OPERS is set aside for funding of post-retirement health care benefits. Employer contribution rates are expressed as a percentage of the covered payroll of active members. The employer contribution rates were 14.00% of covered payroll in 2011, 2010 and 2009. The Ohio Revised Code currently limits the employer contribution to a rate not to exceed 14.00% of covered payroll. Active members do not make contributions to the OPEB Plan. OPERS Postemployment Health Care plan was established under and is administrated in accordance with, Internal Revenue Code 401(h). Each year, the OPERS Retirement Board determines the portion of the employer contribution rate that will be set aside for funding of postemployment health care benefits. Employer contribution rates used to fund postemployment benefits were 4.00% for members of the Traditional Plan in 2011, 6.05% for members of the Combined Plan in 2011, 5.50% from January 1, 2010 through February 28, 2010 and 5.00% from March 1, 2010 through December 31, 2010 and 7.00% from January 1, 2009 through March 31, 2009 and 5.50% from April 1, 2009 through December 31, 2009. The portion of employer contributions allocated to health care beginning January 1, 2012 remained the same, but they are subject to change based on Board action. Employers will be notified if the portion allocated to health care changes during 2012. The OPERS Retirement Board is also authorized to establish rules for the payment of a portion of the health care benefits provided, by the retiree or their surviving beneficiaries. Payment amounts vary depending on the number of covered dependents and the coverage selected. The Division's actual contributions to OPERS to fund postemployment benefits were $2,162,000 in 2011, $3,013,000 in 2010 and $3,597,000 in 2009.

NOTE F – OTHER POSTEMPLOYMENT BENEFITS (Continued)

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 2011or 2010.

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

In accordance with GASB Statement No. 10, claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported.

The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, and damage awards. Accordingly, claims are re-evaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors.

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

NOTE H – RELATED PARTY TRANSACTIONS

Revenues and Accounts Receivable: The Division provides water services to the City 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.

NOTE H – RELATED PARTY TRANSACTIONS (Continued)

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 $2,414,000 and $2,350,000 in 2011 and 2010, respectively. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately $3,716,000 and $2,191,000 in 2011 and 2010, 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:

	2011	2010
	(In thousands)	
Electricity purchases	$ 13,147	$ 12,697
City administration	2,549	2,739
Motor Vehicle Maintenance	3,699	2,353
Telephone exchange	865	861
Utilities Administration and Utilities Fiscal Control	3,119	2,727
Street construction	578	598

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 $4,045,000 and $4,141,000 for the years ended December 31, 2011 and 2010, respectively.