

# **CITY OF CLEVELAND, OHIO**



**DEPARTMENT OF PUBLIC UTILITIES  
DIVISION OF WATER**

**REPORT ON AUDITS OF FINANCIAL STATEMENTS  
For the years ended December 31, 2004 and 2003**



**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 accompanying basic financial statements of the Division of Water, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, (Division of Water) as of and for the years ended December 31, 2004 and December 31, 2003. 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 reasonably assure whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

As 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, 2004 and December 31, 2003, 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, 2004 and December 31, 2003, 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 accounting principles generally accepted in the United States of America requires. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Betty Montgomery".

**Betty Montgomery**  
Auditor of State

May 31, 2005

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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 year ended December 31, 2004 and 2003. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 17.

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, 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 2004, 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.

**COMPARISON OF 2004 DATA TO 2003 DATA**

**FINANCIAL HIGHLIGHTS**

- The assets of the Division exceeded its liabilities at December 31, 2004 by \$837,530,000 (net assets). Of this amount, \$248,497,000 (unrestricted net assets) may be used to meet the Division's ongoing obligations to customers and creditors.
- The Division's operating revenues increased by \$5,771,000 due to a combined rate increase of approximately 3.4% which was offset by a drop in billed consumption of 2.14%. However, despite the billed consumption decrease, several major users, such as ISG Steel, North East Ohio Regional Sewer District and the Cleveland Clinic, experienced an increase of needed services.
- The Division's overall net assets increased by \$26,940,000.
- During 2004, the Division had an increase in capital assets, net of accumulated depreciation, of \$65,518,000. 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 \$15,230,000 or 1.7% in 2004. This decrease is attributed to \$47,550,000 of debt retired and \$163,305,000 of debt refunded offset by the receipt of an Ohio Water Development Authority Loan of \$20,625,000 and the issuance of \$175,000,000 of new bonds.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the Division's basic financial statements. The accompanying financial statements present financial information for the City's Division of Water Fund, in which the City accounts for the operations of the Department of Public Utilities Division of Water.

**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**OVERVIEW OF THE FINANCIAL STATEMENTS (Continued)**

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Division of Water Fund is considered an enterprise fund because the operations of the Division are similar to a private-sector business enterprise. Accordingly, in accounting for the activities of the Division, the economic resources measurement focus and the accrual basis of accounting is used. This is similar to businesses in the private sector.

The basic financial statements of the Division can be found on pages 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 - 39 of this report.

**CONDENSED BALANCE SHEET INFORMATION**

Provided below is condensed balance sheet information for the Division as of December 31, 2004 and 2003:

	<b>2004</b>	<b>2003</b>	<b>Increase/ (Decrease)</b>
	<b>(In thousands)</b>		
Assets:			
Capital assets, net	\$ 1,111,855	\$ 1,046,337	\$ 65,518
Restricted assets	314,307	359,596	(45,289)
Unamortized bond issuance costs	6,694	6,908	(214)
Current assets	280,738	312,336	(31,598)
Total assets	1,713,594	1,725,177	(11,583)
Net Assets and Liabilities:			
Net assets:			
Invested in capital assets, net of related debt	277,756	186,079	91,677
Restricted for capital projects	229,791	260,997	(31,206)
Restricted for debt service	81,486	98,682	(17,196)
Unrestricted	248,497	264,832	(16,335)
Total net assets	837,530	810,590	26,940
Liabilities:			
Long-term obligations	812,542	834,508	(21,966)
Current liabilities	63,522	80,079	(16,557)
Total liabilities	876,064	914,587	(38,523)
Total net assets and liabilities	\$ 1,713,594	\$ 1,725,177	\$ (11,583)



**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**CONDENSED BALANCE SHEET INFORMATION (Continued)**

**Total Assets:** The Division's investment in capital assets as of December 31, 2004 amounted to \$1,111,855,000 (net of accumulated depreciation) which is an increase of \$65,518,000. The Division's plant enhancements continue to be the primary reason for the increase in capital assets. Utility plant had additions of \$78,649,000 and buildings, structures and improvements also had additions of \$12,142,000. Renovations to the Baldwin, Morgan and Nottingham plants contributed to these increases.

The reduction in restricted assets of \$45,289,000 is mainly attributed to payments for plant enhancement projects that significantly reduced cash and investment balances.

The decrease in current assets of \$31,598,000 was primarily due to a decrease of \$36,732,000 of cash and cash equivalents and investments balances related to the defeasing of bond principal and interest of \$29,223,000.

**Capital assets:** The Division's investment in capital assets, as of December 31, 2004, amounted to \$1,111,855,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was approximately 6.3%. A summary of the activity in the Division's capital assets during the year ended December 31, 2004 is as follows:

	<b>Balance January 1, 2004</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance December 31, 2004</b>
	<b>(In thousands)</b>			
Land	\$ 5,455	\$ 8	\$	\$ 5,463
Land improvements	15,011	1,395		16,406
Utility plant	901,030	78,649	(2,347)	977,332
Buildings, structures and improvements	193,165	12,142		205,307
Furniture, fixtures, equipment and vehicles	107,827	2,646	(647)	109,826
Construction in progress	193,598	97,512	(90,527)	200,583
Total	1,416,086	192,352	(93,521)	1,514,917
Less: Accumulated depreciation	(369,749)	(34,605)	1,292	(403,062)
Capital assets, net	<u>\$ 1,046,337</u>	<u>\$ 157,747</u>	<u>\$ (92,229)</u>	<u>\$ 1,111,855</u>

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

- Construction, renovations, and plant enhancements on the Morgan, Baldwin and Nottingham facilities, coordinated GIS system and Plant Enhancement Program amounted to \$66,052,000.
- \$2,633,000 for purchase of equipment and vehicles.
- Water main rehabilitation of \$6,182,000, the tower painting program of \$3,245,000 and the Plant Enhancement Program of \$5,175,000.

**CITY OF CLEVELAND, OHIO  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**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 \$21,966,000 is mainly attributed to \$47,550,000 of debt retirement and debt refunding of \$163,305,000 offset by the receipt of an Ohio Water Development Authority Loan of \$20,625,000 and the issuance of \$175,000,000 of new bonds.

**Current liabilities:** Total current liabilities decreased by \$16,557,000. The significant components for the decrease were the current portion of long-term debt decrease of \$4,193,000, the accrued interest payable decrease of \$9,911,000 both of which are related to the defeasance of bonds in 2004 and current payables from restricted assets decreased by \$2,944,000 due mainly to the completion of the North Royalton pump and Nottingham plant renovation projects in which existing construction retainages were paid.

**Long-term debt:** At the end of the current year, the Division had total long-term debt outstanding of \$863,268,000. All bonds and notes are backed by the revenues generated by the Division. The Ohio Water Development Authority (OWDA) loans do not have a lien on revenues of the Division.

The activity in the Division's debt obligations outstanding during the year ended December 31, 2004 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

	<b>Balance January 1, 2004</b>	<b>Debt Issued</b>	<b>Debt Refunded</b>	<b>Debt Retired</b>	<b>Balance December 31, 2004</b>
	(In thousands)				
Water Revenue Bonds:					
Series G, 1993	\$ 172,310	\$	\$	\$ (22,768)	\$ 149,542
Series H, 1996	68,970		(22,100)	(14,902)	31,968
Series I, 1998	299,690		(72,880)	(3,057)	223,753
Series J, 2001	82,685			(6,135)	76,550
Series K, 2002	138,050		(68,325)		69,725
Series L, 2002	90,000				90,000
Series M, 2004		175,000			175,000
Ohio Water Development Authority Loan	26,793	20,625		(688)	46,730
<b>Total</b>	<b>\$ 878,498</b>	<b>\$ 195,625</b>	<b>\$ (163,305)</b>	<b>\$ (47,550)</b>	<b>\$ 863,268</b>

**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**CONDENSED BALANCE SHEET INFORMATION (Continued)**

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

<b>Moody's</b>	
<b>Investors Service</b>	<b>Standard &amp; Poor's</b>
<u>Aa3</u>	<u>AA-</u>

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 2004, 2003, and 2002 was 173%, 149%, and 186%, respectively.

Additional information on the Division's long-term debt can be found in Note B on pages 26 - 32.

**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 \$837,530,000 at December 31, 2004.

Of the Division's net assets, \$277,756,000, or 33%, 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, \$311,277,000, or 37%, represents resources that are subject to external restrictions. These funds are set aside for the payment of revenue bonds or represent unspent bond proceeds relating to capital projects. The remaining balance of unrestricted net assets, \$248,497,000, or 30%, 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 2004 and 2003 increased its net assets by \$26,940,000 and \$36,724,000, respectively. Key elements of these are summarized below:

**CITY OF CLEVELAND, OHIO  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

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

	<u>2004</u>	<u>2003</u>	<u>Increase/ (Decrease)</u>
	(In thousands)		
Operating revenues	\$ 209,593	\$ 203,822	\$ 5,771
Operating expenses	<u>161,626</u>	<u>154,956</u>	6,670
Operating income	<u>47,967</u>	<u>48,866</u>	(899)
Non-operating revenue (expense):			
Investment income	5,420	6,530	(1,110)
Interest expense	(26,276)	(19,467)	6,809
Amortization of bond issuance costs premiums and discounts	(204)	631	(835)
Workers' compensation refund	5	19	(14)
Gain (Loss) on disposal of capital assets	<u>28</u>	<u>(21)</u>	49
Total non-operating revenue (expense), net	<u>(21,027)</u>	<u>(12,308)</u>	8,719
Income (loss) before other contributions	26,940	36,558	(9,618)
Capital and other contributions	<u>          </u>	<u>166</u>	(166)
Increase in net assets	26,940	36,724	(9,784)
Net assets, beginning of year	<u>810,590</u>	<u>773,866</u>	36,724
Net assets, end of year	<u>\$ 837,530</u>	<u>\$ 810,590</u>	\$ 26,940

Operating revenue:

The Division's operating revenues increased by \$5,771,000 due to a combined rate increase of approximately 3.4% which was offset by a drop in billed consumption of 2.14%. However, despite the billed consumption decrease, several major users, such as ISG Steel, North East Ohio Regional Sewer District and the Cleveland Clinic, experienced an increase of needed services.

Operating expenses:

The overall \$6,670,000 increase in operating expenses were primarily due to a \$3,745,000 increase for wages and benefits in 2004 due to the addition of over 30 new employees and the rise in the health care costs to the Division. Also, depreciation expense increased by \$3,289,000 due to the increase in plant and equipment additions.

**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

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

Non-operating revenue (expense):

Total net non-operating expenses increased by \$8,719,000 primarily due to a \$6,809,000 increase in interest expense and a reduction of \$1,110,000 in 2004 investment income.

**COMPARISON OF 2003 DATA TO 2002 DATA**

**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.

**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**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 2003 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 - 39 of this report.

**CONDENSED BALANCE SHEET INFORMATION**

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

	<b>2003</b>	<b>2002</b>	<b>Increase/ (Decrease)</b>
	<b>(In thousands)</b>		
Assets:			
Capital assets, net	\$ 1,046,337	\$ 967,187	\$ 79,150
Restricted assets	359,596	390,922	(31,326)
Unamortized bond issuance costs	6,908	7,512	(604)
Current assets	312,336	325,548	(13,212)
Total assets	1,725,177	1,691,169	34,008
Net Assets and Liabilities:			
Net assets:			
Invested in capital assets, net of related debt	186,079	101,647	84,432
Restricted for capital projects	260,997	292,895	(31,898)
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)
Current liabilities	80,079	75,929	4,150
Total liabilities	914,587	917,303	(2,716)
Total net assets and liabilities	\$ 1,725,177	\$ 1,691,169	\$ 34,008

**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**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 had a net increase of \$49,934,000 while building, structures and improvements added an additional \$14,973,000. Renovations to the Baldwin, Morgan and Nottingham plants also contributed to these increases.

The reduction in restricted assets of \$31,326,000 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 \$13,212,000 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:

	<b>Balance January 1, 2003</b>	<b>Additions</b>	<b>Reductions</b>	<b>Balance December 31, 2003</b>
	(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	<u>165,774</u>	<u>104,110</u>	<u>(76,286)</u>	<u>193,598</u>
Total	1,309,334	186,074	(79,322)	1,416,086
Less: Accumulated depreciation	<u>(342,147)</u>	<u>(28,354)</u>	<u>752</u>	<u>(369,749)</u>
Capital assets, net	<u>\$ 967,187</u>	<u>\$ 157,720</u>	<u>\$ (78,570)</u>	<u>\$ 1,046,337</u>

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.

**CITY OF CLEVELAND, OHIO  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**CONDENSED BALANCE SHEET INFORMATION (Continued)**

Additional information on the Division's 2003 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.

**Current liabilities:** Total current liabilities increased by \$4,150,000. 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 of \$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):

	<b>Balance January 1, 2003</b>	<b>Debt Issued</b>	<b>Debt Refunded</b>	<b>Debt Retired</b>	<b>Balance December 31, 2003</b>
	(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
<b>Total</b>	<b>\$ 885,921</b>	<b>\$ 16,954</b>	<b>\$</b>	<b>\$ (24,377)</b>	<b>\$ 878,498</b>



**CITY OF CLEVELAND, OHIO  
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

**CONDENSED BALANCE SHEET INFORMATION (Continued)**

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

<b>Moody's</b>	
<b>Investors Service</b>	<b>Standard &amp; Poor's</b>
<u>Aa3</u>	<u>AA-</u>

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 26 - 32.

**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.

Of the Division's net assets, \$186,079,000 or 23% 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, \$359,679,000, or 44%, represents resources that are subject to external restrictions. These funds are set aside for payment of revenue bonds or represent unspent bond proceeds relating to capital projects. 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:

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

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

	<u>2003</u>	<u>2002</u>	<u>Increase/ (Decrease)</u>
	(In thousands)		
Operating revenues	\$ 203,822	\$ 215,688	\$ (11,866)
Operating expenses	<u>154,956</u>	<u>149,275</u>	5,681
Operating income	<u>48,866</u>	<u>66,413</u>	(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	<u>(21)</u>	<u>          </u>	21
Total non-operating revenue (expense), net	<u>(12,308)</u>	<u>(9,325)</u>	2,983
Income (loss) before other contributions	36,558	57,088	(20,530)
Capital and other contributions	<u>166</u>	<u>          </u>	166
Increase in net assets	36,724	57,088	(20,364)
Net assets, beginning of year	<u>773,866</u>	<u>716,778</u>	57,088
Net assets, end of year	<u>\$ 810,590</u>	<u>\$ 773,866</u>	\$ 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.

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

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

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

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

Legislation was passed in February 2004 that allows the Division of Water to enter into a contract to provide a comprehensive financial plan for the years 2006 through 2010, including but not limited to a cost of service study 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, 2004 and 2003**

	<i>(In thousands)</i>	
	<b>2004</b>	<b>2003</b>
<b>ASSETS</b>		
<b>CAPITAL ASSETS</b>		
Land	\$ 5,463	\$ 5,455
Land improvements	16,406	15,011
Utility plant	977,332	901,030
Buildings, structures and improvements	205,307	193,165
Furniture, fixtures, equipment and vehicles	109,826	107,827
	1,314,334	1,222,488
Less: Accumulated depreciation	(403,062)	(369,749)
	911,272	852,739
Construction in progress	200,583	193,598
<b>CAPITAL ASSETS, NET</b>	1,111,855	1,046,337
<b>RESTRICTED ASSETS</b>		
Cash and cash equivalents	308,427	353,916
Investments	4,540	5,000
Accrued interest receivable	1,340	680
<b>TOTAL RESTRICTED ASSETS</b>	314,307	359,596
<b>UNAMORTIZED BOND ISSUANCE COSTS</b>	6,694	6,908
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	67,941	74,456
Restricted cash and cash equivalents	8,578	11,522
Investments	143,610	170,883
Receivables:		
Accounts receivable - net of allowance for doubtful accounts of \$8,247,000 in 2004 and \$7,732,000 in 2003	25,260	21,605
Unbilled revenue	24,672	25,028
Due from other City of Cleveland departments, divisions or funds	4,056	3,536
Accrued interest receivable	999	1,171
Materials and supplies - at average cost, net of allowance for obsolescence of \$600,000 in 2004 and \$600,000 2003	4,905	3,942
Prepaid expenses	717	193
<b>TOTAL CURRENT ASSETS</b>	280,738	312,336
<b>TOTAL ASSETS</b>	\$ 1,713,594	\$ 1,725,177

(Continued)

**CITY OF CLEVELAND, OHIO**

**DEPARTMENT OF PUBLIC UTILITIES**

**DIVISION OF WATER**

**BALANCE SHEETS**

**December 31, 2004 and 2003**

	<i>(In thousands)</i>	
	<b>2004</b>	<b>2003</b>
<b>NET ASSETS AND LIABILITIES</b>		
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	\$ 277,756	\$ 186,079
Restricted for capital projects	229,791	260,997
Restricted for debt service	81,486	98,682
Unrestricted	248,497	264,832
<b>TOTAL NET ASSETS</b>	<b>837,530</b>	<b>810,590</b>
<b>LIABILITIES</b>		
<b>LONG-TERM OBLIGATIONS-excluding amounts due within one year:</b>		
Revenue bonds	764,134	805,701
OWDA loans	45,921	26,203
Accrued wages and benefits	2,487	2,604
<b>TOTAL LONG-TERM OBLIGATIONS</b>	<b>812,542</b>	<b>834,508</b>
<b>CURRENT LIABILITIES</b>		
Current portion of long-term debt, due within one year	21,557	25,750
Accounts payable	1,941	3,402
Current payable from restricted assets	8,578	11,522
Due to other City of Cleveland departments, divisions or funds	6,965	4,909
Accrued interest	10,025	19,936
Current portion of accrued wages and benefits	9,846	10,972
Other accrued expenses	393	393
Customer deposits and other liabilities	4,217	3,195
<b>TOTAL CURRENT LIABILITIES</b>	<b>63,522</b>	<b>80,079</b>
<b>TOTAL LIABILITIES</b>	<b>876,064</b>	<b>914,587</b>
<b>TOTAL NET ASSETS AND LIABILITIES</b>	<b>\$ 1,713,594</b>	<b>\$ 1,725,177</b>

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, 2004 and 2003

		<i>(In thousands)</i>	
		<u>2004</u>	<u>2003</u>
<b>OPERATING REVENUES</b>			
Charges for services		\$ 209,593	\$ 203,822
	<b>TOTAL OPERATING REVENUES</b>	209,593	203,822
<b>OPERATING EXPENSES</b>			
Operations		78,650	86,593
Maintenance		48,371	37,047
Depreciation		34,605	31,316
	<b>TOTAL OPERATING EXPENSES</b>	<u>161,626</u>	<u>154,956</u>
	<b>OPERATING INCOME</b>	47,967	48,866
<b>NON-OPERATING REVENUE (EXPENSE)</b>			
Investment income		5,420	6,530
Interest expense		(26,276)	(19,467)
Amortization of bond issuance costs, premiums, and discounts		(204)	631
Worker's compensation refund		5	19
Gain (loss) on disposal of capital assets		28	(21)
	<b>TOTAL NON-OPERATING REVENUE (EXPENSE), NET</b>	<u>(21,027)</u>	<u>(12,308)</u>
	<b>Income (Loss) before other Contributions</b>	26,940	36,558
<b>CAPITAL AND OTHER CONTRIBUTIONS</b>			
	<b>INCREASE IN NET ASSETS</b>	<u>26,940</u>	<u>36,724</u>
<b>NET ASSETS, beginning of year</b>		<u>810,590</u>	<u>773,866</u>
<b>NET ASSETS, end of year</b>		<u>\$ 837,530</u>	<u>\$ 810,590</u>

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, 2004 and 2003**

	<i>(In thousands)</i>	
	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash received from customers	\$ 206,739	\$ 206,702
Cash payments to suppliers for goods or services	(55,473)	(49,452)
Cash payments to employees for services	(73,626)	(69,587)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>77,640</u>	<u>87,663</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Grants		166
Workers compensation refund	6	19
<b>NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES</b>	<u>6</u>	<u>185</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Acquisition and construction of capital assets	(103,111)	(84,365)
Proceeds of OWDA loan	26,797	11,548
Principal paid on long-term debt	(25,848)	(24,377)
Interest paid on long-term debt	(40,584)	(38,926)
Cash paid to escrow agent for refunding	(204,130)	
Proceeds of bonds	175,000	
<b>NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<u>(171,876)</u>	<u>(136,120)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investment securities	(84,176)	(227,731)
Proceeds from sale and maturity of investment securities	111,264	221,906
Interest received on investments	12,194	13,523
<b>NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES</b>	<u>39,282</u>	<u>7,698</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(54,948)	(40,574)
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	<u>439,894</u>	<u>480,468</u>
<b>CASH AND CASH EQUIVALENTS, end of year</b>	<u>\$ 384,946</u>	<u>\$ 439,894</u>

(Continued)

# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PUBLIC UTILITIES DIVISION OF WATER

### STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2004 and 2003

	<i>(In thousands)</i>	
	<u>2004</u>	<u>2003</u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
<b>OPERATING INCOME</b>	\$ 47,967	\$ 48,866
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	34,605	31,316
Changes in assets and liabilities:		
Accounts receivable, net	(3,655)	1,997
Unbilled revenue	356	186
Due from other City of Cleveland departments, divisions or funds	(520)	1,196
Materials and supplies, net	(963)	938
Prepaid expenses	(524)	298
Accounts payable	(1,461)	194
Due to other City of Cleveland departments, divisions or funds	2,056	(92)
Accrued wages and benefits	(1,243)	2,734
Customer deposits and other liabilities	<u>1,022</u>	<u>30</u>
<b>TOTAL ADJUSTMENTS</b>	<u>29,673</u>	<u>38,797</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>\$ 77,640</u>	<u>\$ 87,663</u>

(Concluded)

See notes to financial statements.

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

**NOTES TO FINANCIAL STATEMENTS  
For the Years Ended December 31, 2004 and 2003**

**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), *Management'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 capital projects.
- Amount restricted for debt service.
- Remaining unrestricted amount.

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

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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**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 2004 and 2003. 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, 2004 and 2003.

**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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**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 2004 and 2003, total interest costs incurred amounted to \$40,707,000 and \$43,302,000, respectively, of which \$7,815,000 and \$18,113,000, respectively, was capitalized, net of interest income of \$6,616,000 in 2004 and \$5,722,000 in 2003.

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

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

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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE B - LONG-TERM DEBT**

Long-term debt outstanding at December 31, 2004 and 2003 is as follows:

	<b>Interest Rate</b>	<b>Original Issuance</b>	<b>2004</b>	<b>2003</b>
			<b>(In thousands)</b>	
Water Revenue Bonds:				
Series G, 1993, due through 2021	5.25%-5.50%	\$ 228,170	\$ 149,542	\$ 172,310
Series H, 1996, due through 2026	5.20%-5.75%	204,885	31,968	68,970
Series I, 1998, due through 2028	4.20%-5.25%	305,650	223,753	299,690
Series J, 2001, due through 2016	4.00%-5.375%	92,595	76,550	82,685
Series K, 2002, due through 2021	3.50%-5.25%	138,050	69,725	138,050
Series L, 2002, due through 2033	Variable	90,000	90,000	90,000
Series M, 2004, due through 2033	3.533%	175,000	175,000	
Ohio Water Development Authority Loans payable annually through 2025	3.20%-4.14%	<u>76,467</u>	<u>46,730</u>	<u>26,793</u>
		<u>\$ 1,310,817</u>	863,268	878,498
Adjustments:				
Unamortized discount and premium			4,873	8,313
Unamortized loss on debt refunding			(36,529)	(29,157)
Current portion			<u>(21,557)</u>	<u>(25,750)</u>
Total Long-Term Debt			<u>\$ 810,055</u>	<u>\$ 831,904</u>

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE B - LONG-TERM DEBT (Continued)**

*Summary:* Changes in long-term obligations for the year ended December 31, 2004 are as follows:

	<b>Balance January 1, 2004</b>	<b>Increase</b>	<b>Decrease</b>	<b>Balance December 31, 2004</b>	<b>Due Within One Year</b>
	(In thousands)				
<b>Water Revenue Bonds:</b>					
Series G, 1993, due through 2021	\$ 172,310	\$	\$ (22,768)	\$ 149,542	\$ 6,497
Series H, 1996, due through 2026	68,970		(37,002)	31,968	5,313
Series I, 1998, due through 2028	299,690		(75,937)	223,753	1,593
Series J, 2001, due through 2016	82,685		(6,135)	76,550	6,440
Series K, 2002, due through 2021	138,050		(68,325)	69,725	
Series L, 2002, due through 2033	90,000			90,000	
Series M, 2004, due through 2033		175,000		175,000	905
Ohio Water Development Authority Loans payable annually through 2024	<u>26,793</u>	<u>20,625</u>	<u>(688)</u>	<u>46,730</u>	<u>809</u>
Total revenue bonds/loans	878,498	195,625	(210,855)	863,268	21,557
Accrued wages and benefits	<u>13,576</u>		<u>(1,243)</u>	<u>12,333</u>	<u>9,846</u>
Total	<u>\$ 892,074</u>	<u>\$ 195,625</u>	<u>\$ (212,098)</u>	<u>\$ 875,601</u>	<u>\$ 31,403</u>

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE B - LONG-TERM DEBT (Continued)**

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

	<b>Balance January 1, 2003</b>	<b>Increase</b>	<b>Decrease</b>	<b>Balance December 31, 2003</b>	<b>Due Within One Year</b>
	(In thousands)				
<b>Water Revenue Bonds:</b>					
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	<u>10,226</u>	<u>16,954</u>	<u>(387)</u>	<u>26,793</u>	<u>590</u>
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	<u>\$ 896,763</u>	<u>\$ 19,688</u>	<u>\$ (24,377)</u>	<u>\$ 892,074</u>	<u>\$ 36,722</u>



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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**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:

	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
	(In thousands)		
2005	\$ 21,557	\$ 31,556	\$ 53,113
2006	18,344	40,187	58,531
2007	32,587	38,533	71,120
2008	34,081	36,892	70,973
2009	42,378	34,978	77,356
2010-2014	228,495	140,734	369,229
2015-2019	199,620	87,735	287,355
2020-2024	161,076	46,715	207,791
2025-2029	102,804	18,701	121,505
2030-2033	50,480	4,120	54,600
Total	\$ 891,422	\$ 480,151	\$ 1,371,573

The above schedule of minimum principal and interest payments on long-term debt includes the amortization on five 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 five 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, 2004, the amount financed on these five loan projects, less the principal payments made to date, totaled \$74,884,000 and was reflected in the debt service payment schedule. However, the total on the actual loan balances received by the City was \$46,730,000 as reflected on the schedules of long-term debt outstanding and changes in long-term debt obligations as of December 31, 2004. The difference of \$28,154,000 will be received or accrued in future years(s).

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**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. In 2004, the Division deposited cash in the amount of \$29,222,759 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, 2004 and 2003 is as follows:

Bond Issue	2004	2003
	(In thousands)	
Series G, 1993	\$ 13,513	\$
Series H, 1996	131,832	102,340
Series I, 1998	73,677	
Series K, 2002	68,325	

In 1996, the City authorized the adoption of the eighth supplemental indenture to amend and restate the existing indenture, subject to the receipt of 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.

**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**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, 2004 and 2003, the Division had \$200,583,000 and \$198,532,000 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.

On August 10, 2004, the City issued \$175,000,000 of Water Revenue Bonds, Series M, 2004. The Bonds were issued to advance refund a portion of the outstanding Series H, Series I, and Series K Water Revenue Bonds. Proceeds were used to fund an escrow deposit that, together with other available funds of the Water System, will refund the bonds and to pay costs of issuance. Net proceeds of \$174,907,022 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 are considered to be defeased and the liability for these bonds has been removed from long term debt. The total aggregate amount of the bonds refunded by the Series 2004 Bonds was \$163,305,000. The City completed the refunding to reduce its total debt service payments by \$13,490,000 and to obtain an economic gain (the difference between the present values of the old and new debt service payments) of approximately \$11,300,000. The Series M Bonds were issued as variable rate demand bonds and were immediately swapped to a fixed rate.

In addition, the Division utilized cash on hand to defease \$21,701,666 principal amount of outstanding Series G, Series H and Series I bonds. The Division placed \$29,222,759 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.

**Interest Rate Swap Transaction:**

**Terms:** Simultaneously with the issuance of the City's \$175,000,000 Series M Water Revenue Bonds on August 10, 2004, the City entered into floating to fixed rate swap agreements with notional amounts equal to the total declining balance of the Series M Bonds. Bear Stearns Financial Products Inc. is the counterparty on a two-thirds pro rata share of the transaction and Morgan Stanley Capital Services Inc. is the counterparty on a one-third pro rata share of the transaction.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE B - LONG-TERM DEBT (Continued)**

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

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

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

Basis Risk: By entering into swaps based upon the 30 day LIBOR rate of interest, the City has undertaken basis risk associated with a change in tax rates and structure. While the average relationship between LIBOR (taxable) and BMA (tax-exempt) interest rates has been 67%, this relationship may not continue to 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. In addition, a reduction in federal income tax rates would increase the percentage relationship between BMA and LIBOR and would potentially increase the cost of the financing.

Counterparty Risk: The City selected highly rated counterparties in order to minimize this risk. However, over the long term it is possible that the credit strength of Bear Stearns and Morgan Stanley could change and this event could trigger a termination payment on the part of the City.

Termination Risk: The swap agreement may be terminated prior to its stated termination date under certain circumstances. Upon termination, a payment may be owed by the City to Bear Stearns and Morgan Stanley, or by Bear Stearns and Morgan Stanley to the City, depending upon the prevailing economic circumstances at the time of the termination. The City obtained insurance to mitigate much of the risk associated with termination due to event of a rating downgrade of the Water System.

Fair Value: The fair value of the swaps at December 31, 2004 as reported by Bear Stearns and Morgan Stanley totaled \$6,613,834 which would be payable by the City to Bear Stearns and Morgan Stanley.

***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 \$20,625,000 during 2004. 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.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE C - DEPOSITS AND INVESTMENTS**

**Deposits:** The carrying amount of the Division's deposits at December 31, 2004 and 2003 totaled \$44,914,000 and \$70,509,000, respectively, and the Division's bank balances were \$46,191,000 and \$68,567,000, respectively. The differences represent normal reconciling items.

Based on the criteria described in GASB Statement No.3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, \$35,233,000 and \$55,058,000 of the bank balances at December 31, 2004 and 2003, respectively, were insured or collateralized with securities held by the City or by its agent in the City's name. The remaining balances of \$10,958,000 and \$13,509,000 were invested in Bank Investment Contract(s) that were secured by repurchase agreements of government securities held as collateral by the City's trustee in the name of the trustee.

**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:

- 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 its trust department or agent but not in the City's name.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE C - DEPOSITS AND INVESTMENTS (Continued)**

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:

<u>Type of Investment</u>	<u>Risk Category</u>	<u>2004 Fair Value</u>	<u>2004 Cost</u>	<u>2003 Fair Value</u>	<u>2003 Cost</u>
(In thousands)					
U.S. Agency Obligations	1	\$ 145,599	\$ 147,228	\$ 175,883	\$ 175,237
STAROhio	n/a	14,005	14,005	2,431	2,431
Investment in Mutual Funds	n/a	72,969	72,969	126,709	126,709
Guaranteed Investment Contract	n/a	255,609	255,609	240,245	240,245
Total Investments		488,182	489,811	545,268	544,622
Total Deposits		44,914	44,914	70,509	70,509
Total Deposits and Investments		<u>\$ 533,096</u>	<u>\$ 534,725</u>	<u>\$ 615,777</u>	<u>\$ 615,131</u>

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.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE D - CAPITAL ASSETS**

*Capital Asset Activity:* Capital asset activity for the year ended December 31, 2004 was as follows:

	<b>Balance January 1, 2004</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance December 31, 2004</b>
	<b>(In thousands)</b>			
Capital assets, not being depreciated:				
Land	\$ 5,455	\$ 8	\$	\$ 5,463
Construction in progress	193,598	97,512	(90,527)	200,583
Total capital assets, not being depreciated	199,053	97,520	(90,527)	206,046
Capital assets, being depreciated:				
Land improvements	15,011	1,395		16,406
Utility plant	901,030	78,649	(2,347)	977,332
Buildings, structures and improvements	193,165	12,142		205,307
Furniture, fixtures, equipment and vehicles	107,827	2,646	(647)	109,826
Total capital assets, being depreciated	1,217,033	94,832	(2,994)	1,308,871
Less: Accumulated depreciation	(369,749)	(34,605)	1,292	(403,062)
Total capital assets being depreciated, net	847,284	60,227	(1,702)	905,809
Capital assets, net	\$ 1,046,337	\$ 157,747	\$ (92,229)	\$ 1,111,855

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

	<b>Balance January 1, 2003</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance December 31, 2003</b>
	<b>(In thousands)</b>			
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

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE D - CAPITAL ASSETS (Continued)**

*Commitments:* The Division has outstanding commitments at December 31, 2004 and 2003 of approximately \$200,583,000 and \$198,570,000 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.
- 3) The Combined Plan (CO) – a cost-sharing, multiple-employer defined benefit pension plan. Under the Combined Plan, employer contributions are invested by OPERS to provide a formula retirement benefit similar in nature to the Traditional Pension Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

OPERS provides retirement, disability, survivor and death benefits and annual cost-of-living adjustments to members of the Traditional Pension 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 OPERS, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 222-6701 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's required employer contributions to OPERS for all plans for the years ending December 31, 2004, 2003 and 2002 were approximately \$7,236,000, \$7,020,000 and \$6,568,000 each year, respectively. The required payments due in 2004, 2003 and 2002 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 and survivor benefits as well as postretirement health care coverage to qualifying members of both the Traditional Pension and the Combined Plans.



**CITY OF CLEVELAND, OHIO  
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**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**NOTE F - OTHER POST-EMPLOYMENT BENEFITS (Continued)**

Members of the Member-Directed Plan do not qualify for ancillary benefits, including postemployment health care coverage. In order to qualify for postretirement 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 recipients and qualified survivor benefit recipients is available. The health care coverage provided by OPERS is considered to be an Other Postemployment 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 postretirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The Division's contribution rate was 13.55% of covered payroll, and 4.00% was used to fund health care for the year. The Ohio Revised Code provides the statutory authority requiring public employers to fund postretirement health care through their contributions to OPERS. The assumptions and calculations below were based on OPERS' latest actuarial review performed as of December 31, 2003. 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 2003 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%.

Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 1% to 6% for the next 8 years. In subsequent years (and beyond) health care costs were assumed to increase at 4% (the projected inflation rate). OPEBs are advance-funded on an actuarially determined basis. At year-end 2004, the number of active contributing participants in the Traditional and Combined Plans totaled 369,885. The employer contribution rates are the actuarially determined contribution requirements for OPERS. The Division's actual contributions for 2004 which were to fund postemployment benefits were approximately \$2,136,000. \$10.5 billion represents the actuarial value of OPERS' net assets available for OPEB at December 31, 2003. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$26.9 billion and \$16.4 billion, respectively.

On September 9, 2004 the OPERS Retirement Board adopted a Health Care Preservation Plan (HCPP) with an effective date of January 1, 2007. The HCPP restructures OPERS' health care coverage to improve the financial solvency of the fund in response to skyrocketing health care costs.

Under the HCPP, retirees eligible for health care coverage will receive a graded monthly allocation based on their years of service at retirement. The Plan incorporates a cafeteria approach, offering a broad range of health care options that allow benefit recipients to use their monthly allocation to purchase health care coverage customized to meet their individual needs. If the monthly allocation exceeds the cost of the options selected, the excess is deposited into a Retiree Medical Account that can be used to fund future health care expenses.

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

**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**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 2004 or 2003.

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

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

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

**CITY OF CLEVELAND, OHIO  
DEPARTMENT OF PUBLIC UTILITIES  
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**NOTES TO FINANCIAL STATEMENTS (Continued)  
For the Years Ended December 31, 2004 and 2003**

**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 \$2,514,000 and \$2,230,000 in 2004 and 2003, respectively. The Division also provides miscellaneous services to other departments and divisions of the City. Revenue realized from such services was approximately \$2,813,000 and \$3,128,000 in 2004 and 2003, respectively.

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

	<u>2004</u>		<u>2003</u>
	(In thousands)		
Electricity purchases	\$ 12,946	\$	12,435
City administration	1,743		1,674
Motor Vehicle Maintenance	1,900		1,955
Telephone exchange	659		732
Utilities Administration and Utilities Fiscal Control	2,976		1,858

**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 \$4,438,000 and \$4,137,000 for the years ended December 31, 2004 and 2003, respectively.





**Auditor of State  
Betty Montgomery**

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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  
JULY 14, 2005**