

**City of Warren, Michigan
Water and Sewer System
(a fund of the City of Warren, Michigan)**

**Financial Report
with Supplemental Information
December 31, 2013**

City of Warren, Michigan Water and Sewer System

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Independent Auditor's Report

To the Honorable Mayor and Members of the City Council
City of Warren, Michigan Water and Sewer System

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Warren, Michigan Water and Sewer System (the "Water and Sewer Fund") as of and for the year ended December 31, 2013 and the related notes to the financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Honorable Mayor and Members of the City Council
City of Warren, Michigan Water and Sewer System

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Water and Sewer Fund of the City of Warren, Michigan as of December 31, 2013 and the changes in its financial position and cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As described in Note 12 to the financial statements, in 2013, the Water and Sewer Fund adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

We draw attention to Note 1, which explains that these financial statements present only the Water and Sewer Fund of the City of Warren, Michigan and do not purport to, and do not, present fairly the financial position of the City of Warren, Michigan as of June 30, 2014 or the changes in its financial position and the changes in its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, pension system schedules of funding progress and employer contributions, and other postemployment benefits schedules of funding progress and employer contributions, as identified in the table of contents, 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, which 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 supplemental 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.

Plante & Moran, PLLC

December 5, 2014

City of Warren, Michigan Water and Sewer System

Management's Discussion and Analysis

This narrative overview accompanies the City of Warren, Michigan Water and Sewer System's financial report as of and for the fiscal year ended December 31, 2013. This discussion and analysis is designed to assist the reader in focusing on financial performance during the fiscal year and significant changes and issues. Readers are encouraged to consider the information presented here in conjunction with the financial statements as a whole.

Financial Highlights

As discussed in further detail in this discussion and analysis, the following represents the most significant financial highlights for the year ended December 31, 2013:

- Total net position, the difference between total assets and total liabilities, increased from \$89,797,292 at December 31, 2012 to \$93,453,419 at December 31, 2013. The increase is primarily due to an increase in both the restricted and unrestricted net position. Unrestricted net position is the part of net position that can be used to finance day-to-day operations. Unrestricted net position increased as a result of an operating income of \$5,935,825.
- Net income, after depreciation and nonoperating expenses, was \$3,656,127. Compared to the 2012 net income of \$7,121,427, this was an unfavorable change of \$3,465,300. The decrease in net income was mainly attributable to a decrease in water sales and penalty charges. Actual operating expenses were \$4,024,582 less than budgeted, mainly attributable to major cuts and postponements in spending in the water and sewer maintenance and waste water treatment plant sectors.
- The 2013 budget was based on sales of 690 million cubic feet while actual sales were 657 million cubic feet, missing expectations by 4.8 percent. This decrease in sales was primarily due to a wetter than average summer. From 2004 through 2013, the average annual sales volume has been approximately 775 million cubic feet. The volume of water purchased by our customers has decreased over the last decade for many reasons, including vacant industrial/residential properties and aging meters not registering at the same level as when they were new.

Using this Financial Report

This discussion and analysis is intended to serve as an introduction to the Water and Sewer System's (the "System") financial statements, which is comprised of three basic financial statements and the notes to the financial statements. The Water and Sewer System is comprised of an operating and maintenance fund and five special purpose reserves. The special purpose reserves are established primarily for the purpose of segregating capital and debt service activities of the System. The activities of the operating fund and reserves are consolidated in the basic financial statements, with capital activities reflected as changes in capital assets and debt service activities disclosed in the nonoperating section of the statement of revenues, expenses, and changes in net position.

City of Warren, Michigan Water and Sewer System

Management's Discussion and Analysis (Continued)

The basic financial statements are designed to provide the readers with a broad overview of the System's finances, in a manner similar to a private sector business. The statement of net position presents information on all the System's assets and liabilities, with the difference reported as equity. Over time, increases or decreases in equity may serve as a useful indicator of whether the financial position of the System is improving or deteriorating. Net position increases when actual revenue exceeds actual expenses. Increases to assets without a corresponding increase in liabilities also increase net position.

The statement of revenues, expenses, and changes in net position presents information showing how the System's net position changed during the fiscal year. All changes in net position are recorded as the underlying event occurs, regardless of the time of related cash flows. Thus, revenue and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused compensatory time).

The notes to 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 10-23 of this report.

Financial Analysis

Net position may serve, over time, as a useful indicator of an entity's financial position. In the case of the Water and Sewer System, assets exceeded liabilities by \$93,453,419 at the close of the 2013 fiscal year. This represents an increase of \$3,656,127 (4.1 percent) from the previous year. The unrestricted net position was \$23,762,899. The System maintains restricted net position to allow for a debt service reserve to meet long-term obligations. Restricted net position at December 31, 2013 was \$11,418,448.

The largest portion of the System's net position (62.4 percent) reflects its investment in capital assets (e.g., water mains, sewer lines, buildings, water meters, repair equipment, etc.) less any related debt used to acquire those assets that is still outstanding, adjusted for unspent proceeds. The System uses these assets to provide services. Consequently, these assets are not available to liquidate liabilities or for other spending. Although the City of Warren, Michigan's (the "City") investment in its capital assets is reported net of related debt, it should be noted that resources needed to repay this debt must be provided from other sources as well.

City of Warren, Michigan Water and Sewer System

Management's Discussion and Analysis (Continued)

The following tables show, in a condensed format, the current year's net position and changes in net position compared to the prior year:

Note: GASB 65 was implemented in fiscal year 2014, but bond refunding loss being amortized was not reflected retroactively in the fiscal year 2013 column below.

	Business-type Activities			Percent Change
	2013	2014	Change	
Assets				
Current assets	\$ 33,613,827	\$ 35,755,169	\$ 2,141,342	6%
Other noncurrent assets	24,141,671	38,077,359	13,935,688	58%
Capital assets	<u>113,883,128</u>	<u>115,372,332</u>	<u>1,489,204</u>	1%
Total assets	171,638,626	189,204,860	17,566,234	10%
Deferred Outflows of Resources -				
Bond refunding charges being amortized	-	1,182,757	1,182,757	
Liabilities				
Current liabilities	10,350,153	10,784,892	434,739	4%
Long-term liabilities	<u>71,491,181</u>	<u>86,149,306</u>	<u>14,658,125</u>	21%
Total liabilities	<u>81,841,334</u>	<u>96,934,198</u>	<u>15,092,864</u>	18%
Net Position				
Net investment in capital assets	57,108,595	58,272,072	1,163,477	2%
Restricted	10,511,646	11,418,448	906,802	9%
Unrestricted	<u>22,177,051</u>	<u>23,762,899</u>	<u>1,585,848</u>	7%
Total net position	<u>\$ 89,797,292</u>	<u>\$ 93,453,419</u>	<u>\$ 3,656,127</u>	4%

	Business-type Activities			Percent Change
	2013	2014	Change	
Operating revenue	\$ 40,839,611	\$ 38,541,038	\$ (2,298,573)	-6%
Operating expenses, other than depreciation	27,761,309	28,121,634	360,325	1%
Depreciation	<u>4,040,451</u>	<u>4,483,579</u>	<u>443,128</u>	11%
Operating income	9,037,851	5,935,825	(3,102,026)	-34%
Investment income and other nonoperating general revenue	383,057	289,922	(93,135)	-24%
Interest expense	(2,389,481)	(2,569,620)	(180,139)	-8%
Capital contributions	<u>90,000</u>	<u>-</u>	<u>(90,000)</u>	-100%
Change in net position	<u>\$ 7,121,427</u>	<u>\$ 3,656,127</u>	<u>\$ (3,465,300)</u>	-49%

City of Warren, Michigan Water and Sewer System

Management's Discussion and Analysis (Continued)

Budgetary Highlights

As mentioned above, the water and sewer maintenance and waste water treatment plant sectors stayed below budget by \$1,440,552 and \$976,664, respectively. In both sectors, the most significant change was a decrease in estimated employee wage and fringe benefit costs as a result of additional reductions in overtime and the delay in filling vacant positions.

On another note, penalties charges were below budget by \$747,007. This was a result of an aggressive delinquent account collections effort. In 2013, the delinquent collection effort resulted in outstanding receivables from sales to customers decreasing by \$3,334,537.

Capital Assets and Debt Administration

Capital Assets - The System's investment in capital assets amounts to \$115,372,332, net of accumulated depreciation, as of December 31, 2013. Capital assets include water mains, sewer lines, water meters, buildings, vehicles, and operating equipment. Major capital acquisitions in the current year included:

Waste water treatment energy improvements	\$3,460,294
Water mains	1,610,996

Long-term Debt - The System has outstanding long-term debt of \$91,085,772 (net of unamortized bond discounts and premiums), an increase of \$14,551,435 (19.0 percent). The significant factor relating to this change is a new capital improvement bond in the amount of \$18,775,000 for sanitary relief sewers.

Economic Factors and Next Year's Budget and Rates

Water sales over the last few years have decreased due to vacant industrial, commercial, and residential accounts along with unpredictable weather conditions. This places great pressure on the Water and Sewer System to keep rates low without ignoring the needs of the System. The administration continues to look at the long-term capital needs and has addressed that in the budget. Managers continue to take an aggressive approach to control expenses by reducing costs where and when it is possible. As previously mentioned, employee costs fell below budget expectations.

Contacting the System's Management

This financial report is intended to provide citizens, customers, and investors with a general overview of the System's finances and to show the System's accountability for the money it receives. If you have any questions about this report or need additional information, please contact the City controller at One City Square, Warren, MI 48093.

City of Warren, Michigan Water and Sewer System

Statement of Net Position December 31, 2013

	Water and Sewer Fund
Assets	
Current assets:	
Cash and cash equivalents	\$ 23,945,178
Receivables:	
Receivables from sales to customers on account	11,101,082
Accrued interest receivable	78
Other receivables	152,786
Due from other funds (Note 4)	10,389
Inventory	491,370
Prepaid expenses and other assets	54,286
Total current assets	<u>35,755,169</u>
Noncurrent assets:	
Restricted unspent bond proceeds for capital projects (Note 1)	31,978,839
Assets with financing entity	823,916
Restricted assets (Notes 1 and 6)	5,274,604
Capital assets (Note 3):	
Assets not subject to depreciation	1,626,357
Assets subject to depreciation	113,745,975
Total noncurrent assets	<u>153,449,691</u>
Total assets	189,204,860
Deferred Outflows of Resources - Bond refunding charges being amortized	1,182,757
Liabilities	
Current liabilities:	
Accounts payable	2,265,860
Due to other funds (Note 4)	1,670,942
Accrued liabilities and other	808,024
Customer deposits	70,447
Compensated absences (Note 6)	548,529
Current portion of long-term debt (Note 6)	5,421,090
Total current liabilities	<u>10,784,892</u>
Noncurrent liabilities:	
Compensated absences - Due in more than one year (Note 6)	484,624
Long-term debt - Net of current portion (Note 6)	85,664,682
Total noncurrent liabilities	<u>86,149,306</u>
Total liabilities	<u>96,934,198</u>
Equity	
Net position:	
Net investment in capital assets	58,272,072
Restricted	11,418,448
Unrestricted	23,762,899
Total net position	<u>\$ 93,453,419</u>

The Notes to Financial Statements are
an Integral Part of this Statement.

City of Warren, Michigan Water and Sewer System

Statement of Revenues, Expenses, and Changes in Net Position Year Ended December 31, 2013

	<u>Water and Sewer Fund</u>
Operating Revenue	
Charges for sales and service:	
Sale of water	\$ 19,965,782
Sewage disposal charges	16,854,724
Other sales to customers	217,539
Interest and penalty charges	<u>1,502,993</u>
Total operating revenue	38,541,038
Operating Expenses	
Cost of water	9,423,500
Other operating and maintenance costs	3,900,836
Billing and administrative costs	1,966,936
Wages and fringe benefits	11,184,951
Supplies	765,488
Professional services	879,923
Depreciation	<u>4,483,579</u>
Total operating expenses	<u>32,605,213</u>
Operating Income	5,935,825
Nonoperating Revenue (Expenses)	
Capital grant	188,364
Interest expense	(2,569,620)
Investment income	64,219
Gain on sale of assets	<u>37,339</u>
Total nonoperating expenses	<u>(2,279,698)</u>
Increase in Net Position	3,656,127
Net Position - Beginning of year	<u>89,797,292</u>
Net Position - End of year	<u><u>\$ 93,453,419</u></u>

City of Warren, Michigan Water and Sewer System

Statement of Cash Flows Year Ended December 31, 2013

	Water and Sewer Fund
Cash Flows from Operating Activities	
Receipts from customers	\$ 41,856,285
Payments to suppliers	(17,096,989)
Payments to employees	(11,260,165)
Internal activity - Payments from other funds	214,873
Net cash provided by operating activities	<u>13,714,004</u>
Cash Flows from Capital and Related Financing Activities	
Issuance of bonds	21,057,103
Receipt of capital grants	233,285
Proceeds from sales of capital assets	81,988
Purchase of capital assets	(4,241,382)
Principal and interest paid on capital debt	(8,987,402)
Net cash provided by capital and related financing activities	<u>8,143,592</u>
Cash Flows from Investing Activities - Interest received on investments	<u>64,376</u>
Net Increase in Cash and Cash Equivalents	21,921,972
Cash and Cash Equivalents - Beginning of year	<u>39,276,649</u>
Cash and Cash Equivalents - End of year	<u>\$ 61,198,621</u>
Balance Sheet Classification of Cash and Cash Equivalents	
Cash and investments	\$ 23,945,178
Restricted cash	5,274,604
Restricted investments	31,978,839
Total cash and cash equivalents	<u>\$ 61,198,621</u>
Reconciliation of Operating Income to Net Cash from Operating Activities	
Operating income	\$ 5,935,825
Adjustments to reconcile operating income to net cash from operating activities:	
Depreciation and amortization	4,483,579
Changes in assets and liabilities:	
Receivables	3,315,247
Inventories	737,650
Prepaid and other assets	(33,432)
Accounts payable	(789,611)
Due to others	214,873
Accrued and other liabilities	(150,127)
Net cash provided by operating activities	<u>\$ 13,714,004</u>

Noncash Investing, Capital, and Financing Activities - During the year ended December 31, 2011, a capital lease transaction was entered into for \$8,021,303. In 2013, \$1,776,050 was used for capital improvements and there was \$823,916 of proceeds remaining that is held with a financing entity.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note I - Summary of Significant Accounting Policies

Reporting Entity

The City of Warren, Michigan Water and Sewer System (the "Water and Sewer Fund") provides water delivery and treatment services for residential, commercial, and industrial customers in the City of Warren and some parcels in adjacent communities. The water division and waste water treatment plant operate under the control of the mayor and City Council and are divisions under the Department of Public Service.

The Water and Sewer Fund will be included in the basic financial statements of the City of Warren, Michigan at June 30, 2014.

Accounting and Reporting Principles

The accounting policies of the City of Warren, Michigan Water and Sewer System (the "Water and Sewer Fund") conform to accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. The following is a summary of the significant accounting policies used by the City of Warren, Michigan Water and Sewer System:

Basis of Accounting

The financial statements are reported using the full accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Specific Balances and Transactions

Cash, Cash Equivalents, and Investments - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

Receivables and Payables - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that is representative of lending/borrowing arrangements outstanding at the end of the fiscal year is referred to as "advances to/from other funds."

All trade receivables are shown net of allowance for uncollectible amounts. The allowance for uncollectible amounts in the current year is \$653,961.

Inventories and Prepaid Items - Inventories consist primarily of water meters, valued at cost, on a first-in, first-out basis. The cost of supply inventory is recorded as an expense when consumed rather than when purchased. Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note I - Summary of Significant Accounting Policies (Continued)

Restricted Assets - The total restricted assets of \$31,978,839 were unspent bond proceeds to be spent on water main replacements, the meter replacement project, and the pressure-reducing station project. In addition, the Water and Sewer Fund's revenue bonds have a covenant that requires the fund to maintain certain reserve levels which amounted to \$5,274,604 at December 31, 2013.

Capital Assets - Capital assets are defined by the Water and Sewer Fund as assets with an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. No depreciation expense has been recorded for amounts reflected as construction in progress.

Interest incurred during the construction of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. During the current year, no interest expense was capitalized as part of the cost of assets under construction.

Infrastructure, intangibles, buildings, equipment, and vehicles are depreciated using the straight-line method over the following useful lives:

Capital Asset Class	Lives
Buildings and improvements	40 years
Water and sewer lines	50 years
Meters and remote registers	25 years
Pumping equipment	25 years
Machinery and equipment	10 years

Long-term Obligations - Long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts are deferred and amortized over the life of the bonds using the effective interest method; bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are expensed at the time they are incurred.

Restricted Net Position - Monies have been restricted to pay for future long-term debt costs pursuant to an ordinance adopted by the City Council and the revenue bond reserve requirements.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note I - Summary of Significant Accounting Policies (Continued)

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. The Water and Sewer Fund has one item that qualifies for reporting in this category: the deferred charge on refunding. A deferred charge on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element represents an acquisition of net position that applies to a future period and so will not be recognized as an inflow of resources (revenue) until that time. The Water and Sewer Fund has no items that qualify for reporting in this category.

Net Position Flow Assumption

Sometimes the Water and Sewer Fund will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted net position and unrestricted net position in the proprietary fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the Water and Sewer Fund's policy to consider restricted net position to have been depleted before unrestricted net position is applied.

Pension and Other Postemployment Benefit Costs - The Water and Sewer Fund offers both pension and retiree healthcare benefits to retirees. The Water and Sewer Fund receives an actuarial valuation to compute the annual required contribution (ARC) necessary to fund the obligation over the remaining amortization period. The Water and Sewer Fund reports the full accrual cost equal to the current year required contribution.

Compensated Absences (Vacation, Sick Leave, and Compensatory Time) - It is the Water and Sewer Fund's policy to permit employees to accumulate earned but unused sick and vacation pay benefits. Unused sick time vests up to certain limits and is accrued as it vests. All vacation pay is accrued as it is earned throughout the year and awarded to the employee the following year. Compensatory time is allowed in lieu of receiving overtime pay by employee request and is accrued as it is earned.

Significant Customers - The Water and Sewer Fund has two significant customers: General Motors Corporation and Chrysler Group, which comprise 6.2 percent and 4.4 percent of operating revenue, respectively.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 1 - Summary of Significant Accounting Policies (Continued)

Proprietary Funds Operating Classification - Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of this proprietary fund relates to charges to customers for sales and services. The portion intended to recover the cost of the infrastructure is recognized as nonoperating revenue. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Note 2 - Deposits and Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The law also allows investments outside the state of Michigan when fully insured. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Water and Sewer Fund has designated three banks for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in bonds and securities of the United States government and bank accounts and CDs, but not the remainder of state statutory authority as listed above. The Water and Sewer Fund's deposits and investment policies are in accordance with statutory authority.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 2 - Deposits and Investments (Continued)

The Water and Sewer Fund's cash and investments are subject to risk, which is examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Water and Sewer Fund's deposits may not be returned to it. The Water and Sewer Fund does not have a deposit policy for custodial credit risk. At year end, the Water and Sewer Fund had \$61,264,533 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The Water and Sewer Fund believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all deposits. As a result, the Water and Sewer Fund evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

Note 3 - Capital Assets

Capital asset activity of the Water and Sewer Fund was as follows:

Water and Sewer Fund	Balance January 1, 2013	Reclassifications	Additions	Disposals	Balance December 31, 2013
Capital assets not being depreciated:					
Land	\$ 605,219	\$ -	\$ -	\$ -	\$ 605,219
Construction in progress	1,924,253	(1,699,453)	796,338	-	1,021,138
Subtotal	2,529,472	(1,699,453)	796,338	-	1,626,357
Capital assets being depreciated:					
Water and sewer lines	111,635,382	35,353	1,575,643	(51,697)	113,194,681
Buildings and improvements	73,174,785	1,664,100	2,512,808	(145,200)	77,206,493
Machinery and equipment	11,433,769	-	199,090	(4,514)	11,628,345
Meters and remote registers	10,121,141	-	933,553	(242,680)	10,812,014
Pumping equipment	1,709,634	-	-	-	1,709,634
Subtotal	208,074,711	1,699,453	5,221,094	(444,091)	214,551,167
Accumulated depreciation:					
Water and sewer lines	54,793,366	-	1,736,128	(51,697)	56,477,797
Buildings and improvements	27,643,831	-	2,107,249	(100,551)	29,650,529
Machinery and equipment	10,310,431	-	189,488	(4,514)	10,495,405
Meters and remote registers	2,307,664	-	448,520	(242,680)	2,513,504
Pumping equipment	1,665,763	-	2,194	-	1,667,957
Subtotal	96,721,055	-	4,483,579	(399,442)	100,805,192
Net capital assets being depreciated	111,353,656	1,699,453	737,515	(44,649)	113,745,975
Net capital assets	\$ 113,883,128	\$ -	\$ 1,533,853	\$ (44,649)	\$ 115,372,332

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 3 - Capital Assets (Continued)

Construction Commitments - The Water and Sewer Fund has active construction projects at year end. The Water and Sewer Fund's significant active construction project related to sanitary relief sewer and water main replacement. This project is funded through the 2013 Water and Sewer Capital Improvement bond issue. At year end, the significant commitments with contractors are as follows:

	<u>Spent to Date</u>	<u>Remaining Commitment</u>
Sanitary relief sewer and water main replacement	\$ -	\$ 9,999,056

Note 4 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Due to/from Other Funds		
General Fund	Water and Sewer Fund	<u>\$ 1,670,942</u>
Water and Sewer Fund	General Fund	<u>\$ 10,389</u>

These balances result from the time lag between the dates that goods and services are provided or reimbursable expenditures occur, transactions are recorded in the accounting system, and payments between funds are made.

Note 5 - Leases

Capital Leases - In 2011, the Water and Sewer Fund entered into a lease agreement as lessee for financing the purchase of energy performance improvements for the waste water treatment plant. The total amount of financing is \$8,021,303. This lease agreement qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments as of the inception date. At December 31, 2013, the construction of the assets under capital lease was considered construction in progress totaling \$7,893. As of December 31, 2013, the project is ongoing; however, a portion of the project totaling \$3,460,294 was completed during the fiscal year and was placed into service, along with \$3,729,200 completed in 2012, where these amounts are considered a capital asset subject to depreciation. The remaining \$823,916 is considered as cash with the paying agent.

In 2010, the Water and Sewer Fund entered into a lease agreement as lessee for financing the purchase of a waste-to-heat energy project. The total amount of the financing is \$970,444.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 5 - Leases (Continued)

The future minimum lease obligations and the net present value are as follows:

Years Ending December 31	Amount
2014	\$ 738,121
2015	757,681
2016	573,664
2017	626,472
2018	649,255
2019-2023	3,629,729
2024-2026	<u>2,521,574</u>
Total minimum lease payments	9,496,496
Less amount representing interest	<u>(1,655,806)</u>
Present value	<u>\$ 7,840,690</u>

Note 6 - Long-term Debt

The Water and Sewer Fund issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the Water and Sewer Fund. Revenue bonds involve a pledge of specific income derived from the acquired or constructed assets to pay debt service. The revenue bonds have a covenant that requires the fund to maintain certain reserve levels at December 31, 2013 that amounted to \$5,274,604. Capital lease obligations for the waste water treatment plant energy performance improvements are recorded as amounts spent as long-term debt (see Note 5).

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 6 - Long-term Debt (Continued)

Long-term debt activity can be summarized as follows:

	Interest Rate Ranges	Principal Maturity Ranges	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Business-type Activities							
Revenue Bonds -							
Revenue Bonds, Series 2012	3.00%-4.00%	\$325,000 - \$2,010,000	\$ 17,780,000	\$ -	\$ (870,000)	\$ 16,910,000	\$ 900,000
Capital Improvement Bonds:							
Capital Improvement Bonds, Series 2003	3.30%-4.125%	\$60,000 - \$90,000	820,000	-	(60,000)	760,000	65,000
Capital Improvement Bonds, Series 2006	3.750%	\$87,306 - \$121,102	1,979,880	-	(1,979,880)	-	-
Capital Improvement Bonds, Series 2010	2.50%-3.00%	\$690,000 - \$1,165,000	3,945,000	-	(1,165,000)	2,780,000	1,065,000
Capital Improvement Bonds, Series 2010	2.55%-6.00%	\$375,000 - \$715,000	8,990,000	-	(300,000)	8,690,000	325,000
Capital Improvement Bonds, Series 2012	2.00%-4.10%	\$420,000 - \$980,000	15,680,000	-	(420,000)	15,260,000	430,000
Capital Improvement Bonds, Series 2013 Refunding	2.70%		-	1,909,472	-	1,909,472	150,674
Capital Improvements Bonds Series 2013	4.00% - 4.50%	\$700,000 - \$1,325,000	-	18,775,000	-	18,775,000	700,000
State Revolving Fund:							
State Revolving 5134-01	2.500%	\$225,000 - \$300,000	3,130,000	-	(225,000)	2,905,000	230,000
State Revolving 5134-02	2.125%	\$300,000 - \$390,000	4,805,000	-	(300,000)	4,505,000	305,000
State Revolving 5134-03	2.125%	\$55,000 - \$72,091	737,091	-	(55,000)	682,091	55,000
State Revolving 5134-04	1.625%	\$385,000 - \$475,000	6,010,000	-	(385,000)	5,625,000	390,000
State Revolving 5401-01	2.500%	\$125,000 - \$195,000	2,597,912	121,006	(125,000)	2,593,918	125,000
2010 capital lease (Note 5)		\$184,143 - \$199,321	575,046	-	(184,143)	390,903	191,582
2011 installment purchase (Note 5)		\$303,300 - \$847,679	7,753,087	-	(303,300)	7,449,787	330,438
Total bonds payable before deferred amounts			74,803,016	20,805,478	(6,372,323)	89,236,171	5,262,694
Less deferred amounts:							
Issuance discounts			(306,307)	-	28,553	(277,754)	(12,937)
Issuance premiums			2,037,628	251,625	(161,898)	2,127,355	171,333
Total bonds payable			76,534,337	21,057,103	(6,505,668)	91,085,772	5,421,090
Accumulated compensated absences			1,354,354	437,670	(758,871)	1,033,153	548,529
Total business-type activities			\$ 77,888,691	\$ 21,494,773	\$ (7,264,539)	\$ 92,118,925	\$ 5,969,619

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 6 - Long-term Debt (Continued)

Total interest expense for the year was \$2,569,620. Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

Years Ending December 31	Business-type Activities		
	Principal	Interest	Total
2014	\$ 5,262,693	\$ 2,890,779	\$ 8,153,472
2015	5,343,238	2,748,902	8,092,140
2016	5,723,230	2,610,630	8,333,860
2017	5,307,293	2,445,112	7,752,405
2018	5,431,655	2,278,334	7,709,989
2019-2023	27,114,022	8,719,741	35,833,763
2024-2028	19,185,122	4,787,790	23,972,912
2029-2033	12,203,918	2,077,836	14,281,754
2034-2037	3,665,000	308,610	3,973,610
Total	<u>\$ 89,236,171</u>	<u>\$ 28,867,734</u>	<u>\$ 118,103,905</u>

Current Refundings - In 2013, the City issued Water and Sewer Refunding Bonds, Series 2013, in the amount of \$1,909,472. The debt refunded amounted to \$1,892,574 of Water and Sewer Refunding Bonds, Series 2006, maturing in 2026. The refunding was undertaken to reduce the debt service payment over the next 13 years with net savings of \$144,153 and to obtain an economic (present value) gain for the City of Warren of \$115,601.

Note 7 - Defined Benefit Pension Plan

Plan Description - The City of Warren, Michigan is the plan administrator of a single-employer defined benefit pension plan (Employees' Retirement System Defined Benefit Plan) that is governed by a five-member board of trustees. This plan covers all full-time employees, except police and fire personnel, hired prior to the close of the plan. The system provides retirement, disability, and death benefits to plan members and their beneficiaries. The plan was closed to new members in February 2000 and current members were given the option of remaining in the plan or transferring to the defined contribution plan. The plan issues a publicly available financial report that includes financial statements and required supplemental information for the system. That report may be obtained by writing to the system at One City Square, Warren, Michigan 48093.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 7 - Defined Benefit Pension Plan (Continued)

Funding Policy - The obligation to contribute to and maintain the system for these employees was established by negotiation with the Water and Sewer Fund's competitive bargaining units. The funding policy provides for periodic employer contributions at actuarially determined rates. From January 1, 2013 to June 30, 2013, the rate was 73.29 percent of covered payroll in accordance with the actuarial valuation dated December 31, 2010, and \$1,486,248 for the period from July 1, 2013 through December 31, 2013 in accordance with the actuarial valuation dated December 31, 2011. Employees are not required to contribute to the system. Amounts shown as employee contributions represent purchase of prior service credit. Administrative costs are financed through investment earnings.

Annual Pension Cost - For the year ended December 31, 2013, the Water and Sewer Fund's annual pension cost of \$1,948,714 for the plan was equal to the Water and Sewer Fund's required and actual contribution. The pension cost for the three most recent years is as follows:

	Fiscal Year Ended December 31		
	2013	2012	2011
Annual pension cost (APC)	\$ 1,948,714	\$ 1,624,780	\$ 1,616,264
Percentage of APC contributed	100.0 %	100.0 %	100.0 %
Net pension obligation	-	-	-

Funded Status and Funding Progress - The funding status for the System for the three most recent years is as follows (the Water and Sewer Fund represents approximately 31 percent of total covered payroll in the plan):

	Actuarial Valuation Date Ended December 31		
	2012	2011	2010
Actuarial value of assets	\$ 115,209,000	\$ 113,878,000	\$ 121,368,000
Actuarial accrued liability (AAL) (entry age)	\$ 185,367,000	\$ 184,905,000	\$ 180,371,000
Unfunded AAL (UAAL)	\$ 70,158,000	\$ 71,027,000	\$ 59,003,000
Funded ratio	62.2 %	61.6 %	67.3 %
Covered payroll	\$ 8,332,000	\$ 10,328,000	\$ 10,860,000
UAAL as a percentage of covered payroll	842.0 %	687.7 %	543.3 %

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 7 - Defined Benefit Pension Plan (Continued)

Actuarial Methods and Assumptions - The annual required contribution was determined as part of actuarial valuations at December 31, 2010 and December 31, 2011, using the entry age actuarial cost method. Significant actuarial assumptions used include (a) a 7.5 percent investment rate of return and (b) projected salary increases of 4.0 percent to 7.8 percent per year based on age-related rates for merit and longevity. Both (a) and (b) include an inflation component of 4.0 percent. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility over a four-year period. The unfunded actuarial liability is being amortized as a level percentage of payroll on a closed basis. The remaining amortization period is the expected future working lifetime.

Note 8 - Defined Contribution Pension Plan

Plan Description - The Defined Contribution Plan and Trust was approved by the Warren City Council at its meeting on April 8, 1997. The plan is administered by the International City Management Association Retirement Corporation (ICMA). Participation in the plan is extended to all full-time employees, other than police and fire personnel. Employees were allowed to transfer the actuarially determined value of prior service credit from the City Employees' Retirement System to the Defined Contribution Plan and Trust upon adoption of the plan and settlement of respective collective bargaining agreements. Employees hired after ratification of the respective collective bargaining agreements are automatically enrolled in the Defined Contribution Plan and Trust. There were 252 active participants in the plan as of June 30, 2013. As of December 31, 2013, 54 water and sewer system employees participate in the Defined Contribution Plan and Trust.

Funding Policy - For employees transferring from the defined benefit pension plan to the defined contribution plan, the City contributes 15 percent of payroll and the employee contributes 3 percent. For employees hired after ratification of their respective union contracts, the City contributes 10 percent of payroll and the employee contributes 4 percent.

The Water and Sewer Fund's contribution for the year ended December 31, 2013 was \$449,108.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 9 - Other Postemployment Benefits

Plan Description - The Water and Sewer Fund provides retiree healthcare benefits to eligible employees and their spouses through the City of Warren, Michigan City Employees' Retirement Health, Life, and Disability Benefits Plan and Trust. This is a single-employer public employee Voluntary Employee Benefit Association (VEBA) Trust. The plan and trust is administered by the City Employees' Retirement System Board of Trustees. The benefits are provided under collective bargaining agreements. The plan issues a separate stand-alone financial statement which can be obtained by writing to One City Square, Warren, Michigan 48093.

Funding Policy - The collective bargaining agreements do not require a contribution from employees. The Water and Sewer Fund funding policy provides for periodic employer contributions at actuarially determined rates. From January 1, 2013 through December 31, 2013, the rate was 41.53 percent of covered payroll in accordance with the actuarial valuation at December 31, 2010.

Funding Progress - For the year ended December 31, 2013, the Water and Sewer Fund has estimated the cost of providing retiree healthcare benefits through an actuarial valuation as of December 31, 2010. The valuation computes an annual required contribution, which represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The funding is determined as 41.53 percent of covered payroll. The annual required contribution has been funded in its entirety in the current year and previous years.

The annual OPEB costs, the percentage contributed to the plan, and the net OPEB obligation for the current and two preceding years were as follows:

Fiscal Year Ended	Actuarial Valuation Date	Annual Required Contribution *	Percentage Contributed	Net OPEB Obligation
12/31/13	12/31/10	\$ 1,530,948	100.0	\$ -
12/31/12	12/31/10	1,656,947	100.0	-
12/31/11	12/31/08	1,637,316	100.0	-

* The required contribution is expressed to the City as a percentage of payroll.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 9 - Other Postemployment Benefits (Continued)

The funding progress of the plan is as follows (the Water and Sewer Fund represents about 25 percent of covered payroll in the plan):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/12	\$ 25,617,427	\$ 159,271,972	\$ 133,654,545	16.1	\$ 16,496,331	810.2
12/31/10	23,670,836	168,000,923	144,330,087	14.1	20,751,208	695.5
12/31/08	16,522,158	158,665,734	142,143,576	10.4	25,743,285	552.2

Actuarial Methods and Assumptions - Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented above, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2012 actuarial valuation, the entry age actuarial cost method was used. The actuarial assumptions included a 7.5 percent investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer's own investments calculated based on the funded level of the plan at the valuation date, and an annual healthcare cost trend rate of 8.0 percent initially, reduced by decrements to an ultimate rate of 5 percent after six years. Both rates included a 5.0 percent inflation assumption. The actuarial value of assets was determined using techniques that spread the effects of short-term volatility in the market value of investments over a five-year period. The UAAL is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2012 was 30 years.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2013

Note 10 - Defined Contribution Health Benefits

Recent collective bargaining agreements have included Retirement Health Savings account provisions for new hires. During employment, the City will contribute 1 percent of the employee's wages and the employee will contribute 1 percent to 5 percent of wages into the plan. At retirement, the employee will not be provided retiree health insurance under any of the City's existing plans. In 2013, the Water and Sewer Fund's contribution was \$17,132.

Note 11 - Risk Management

The Water and Sewer Fund is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation), as well as medical benefits provided to employees. The Water and Sewer Fund is self-insured through the City of Warren's self-insurance plan. The self-insurance costs are charged to the Water and Sewer Fund through the administration fee from the City of Warren.

Note 12 - Change in Accounting

During the current year, the Water and Sewer Fund adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The objective of this statement is to establish standards that reclassify certain items that were previously reported as assets and liabilities and instead to classify them as deferred inflows of resources, deferred outflows of resources, or outflows of resources.

As a result of implementing this statement, the following items have been reclassified, as indicated:

<u>Item</u>	<u>Amount</u>	<u>Prior Reporting Classification/Treatment</u>	<u>New Classification After Adoption of GASB 65</u>
Deferred amounts on debt refundings	\$ 1,182,757	Adjustment to the bonds payable liability	Deferred outflow of resources

Note 13 - Subsequent Events

On August 11, 2014, the City of Warren suffered a significant rainstorm. There was extensive damage to City-owned buildings and residential homes. On October 1, 2014, the Federal Emergency Management Agency (FEMA) declared southeastern Michigan eligible for disaster assistance. The City believes that between insurance coverage and assistance from FEMA, the City will not sustain any material loss from this event.

Required Supplemental Information

City of Warren, Michigan Water and Sewer System

Required Supplemental Information Pension System Schedule Year Ended December 31, 2013

The schedule of funding progress is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/06	\$132,076,000	\$176,356,000	\$44,280,000	74.9	\$14,879,000	297.6
12/31/07	136,044,000	180,381,000	44,337,000	75.4	14,734,000	300.9
12/31/08	129,942,000	180,298,000	50,356,000	72.1	14,577,000	345.4
12/31/09	126,091,000	181,207,000	55,116,000	69.6	13,046,000	422.5
12/31/10	121,368,000	180,371,000	59,003,000	67.3	10,860,000	543.3
12/31/11	113,878,000	184,905,000	71,027,000	61.6	10,328,000	687.7
12/31/12	115,209,000	185,367,000	70,158,000	62.2	8,332,000	842.0

The schedule of employer contributions is as follows:

Fiscal Year Ended	Actuarial Valuation Date	Annual Required Contribution *	Percentage Contributed
12/31/10	12/31/08	\$1,532,200	100.0
12/31/11	12/31/09	1,616,264	100.0
12/31/12	12/31/10	1,624,780	100.0
12/31/13	12/31/11	1,948,714	100.0

* Until the valuation dated December 31, 2012, the required contribution is expressed to the City as a percentage of payroll.

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2012, the latest actuarial valuation, follows:

Amortization method	Level percent
Amortization period (perpetual)	30 years
Asset valuation method	Fair market value
Actuarial assumptions:	
Investment rate of return	7.5%
Projected salary increases*	4.0 - 7.8%
*Includes inflation at	4.0%
Cost of living adjustments	None

City of Warren, Michigan Water and Sewer System

Required Supplemental Information OPEB System Schedule Year Ended December 31, 2013

The schedule of funding progress for the City Employees' Retirement Health, Life, and Disability Benefits Plan and Trust is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (Percent) (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll
12/31/06	\$ 16,229,489	\$161,270,365	\$145,040,876	10.1	\$ 27,490,701	527.6
12/31/08	16,522,158	158,665,734	142,143,576	10.4	25,743,285	552.2
12/31/10	23,670,836	168,000,923	144,330,087	14.1	20,751,208	695.5
12/31/12	25,617,427	159,271,972	133,654,545	16.1	16,496,331	810.2

The schedule of employer contributions is as follows:

Fiscal Year Ended	Actuarial Valuation Date	Annual Required Contribution *	Percentage Contributed
12/31/10	12/31/08	\$ 1,684,386	100.0
12/31/11	12/31/08	1,637,316	100.0
12/31/12	12/31/10	1,656,947	100.0
12/31/13	12/31/10	1,530,948	100.0

* The required contribution is expressed to the City as a percentage of payroll.

The information presented above was determined as part of the actuarial valuations at the dates indicated. Additional information as of December 31, 2012, the latest actuarial valuation, follows:

Amortization method	Level percent
Amortization period (perpetual)	30 years
Asset valuation method	Fair market value
Actuarial assumptions:	
Investment rate of return	7.5%
Projected healthcare cost rates*	5.0 - 8.0%
*Includes inflation at	5.0%
Cost of living adjustments	None