

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

**Financial Report
December 31, 2012**

City of Warren, Michigan Water and Sewer System

Contents

Report Letter	1-2
Management's Discussion and Analysis	3-6
Basic Financial Statements	
Statement of Net Position	7
Statement of Revenues, Expenses, and Changes in Net Position	8
Statement of Cash Flows	9
Notes to Financial Statements	10-22

Independent Auditor's Report

To the Board of Directors
City of Warren, Michigan
Water and Sewer System

Report on the Financial Statements

We have audited the accompanying financial statements of the Water and Sewer Fund of the City of Warren, Michigan (the "Water and Sewer Fund") as of and for the year ended December 31, 2012 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 Board of Directors
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, 2012 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

We draw attention to Note I, which explains that these financial statements present only the Water and Sewer Fund and do not purport to, and do not, present fairly the financial position of the City of Warren as of June 30, 2013 or the changes in its financial position and the changes in its cash flows, where applicable thereof, 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 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 13, 2013

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 financial report as of and for the fiscal year ended December 31, 2012. 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, 2012:

- Total net position, the difference between total assets and total liabilities, increased from \$82,675,865 at December 31, 2011 to \$89,797,292 at December 31, 2012. The increase is primarily due to an increase in unrestricted net position, 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 \$9,037,851 and the reclassification of amounts that were previously recorded as restricted.
- Net income, after depreciation and nonoperating expenses, was \$7,031,427. Compared to the 2011 net income of \$5,599,776, this was a favorable change of \$1,431,651. The increase in net income was mainly attributable to both an increase in rates to fund future debt obligations and a favorable budget to actual comparison as it relates to expenses. Actual operating expenses were \$3,595,177 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 2012 budget was based on sales of 705 million cubic feet while actual sales were 700 million cubic feet, slightly missing expectations by less than 1.0 percent. From 2003 through 2012, the average annual sales volume has been approximately 805 million cubic feet. The volume of water purchased by our customers has decreased over the last decade for many reasons, including economic factors 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 revenue, 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 revenue, 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 10-22 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 \$89,797,292 at the close of the 2012 fiscal year. This represents an increase of \$7,121,427 (8.6 percent) from the previous year. The unrestricted net position was \$22,177,051. The System maintains restricted net position to allow for a debt service reserve to meet long-term obligations. Restricted net position at December 31, 2012 was \$10,511,646.

The largest portion of the System's net position (63.6 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:

	Business-type Activities			Percent Change
	2011	2012	Change	
Assets				
Current assets	\$ 31,091,561	\$ 33,613,827	\$ 2,522,266	8%
Other noncurrent assets	11,755,306	24,141,671	12,386,365	105%
Capital assets	<u>108,532,490</u>	<u>113,883,128</u>	<u>5,350,638</u>	5%
Total assets	151,379,357	171,638,626	20,259,269	13%
Liabilities				
Current liabilities	7,756,181	10,350,153	2,593,972	33%
Long-term liabilities	<u>60,947,311</u>	<u>71,491,181</u>	<u>10,543,870</u>	17%
Total liabilities	<u>68,703,492</u>	<u>81,841,334</u>	<u>13,137,842</u>	19%
Net Position				
Net investment in capital assets	56,653,790	57,108,595	454,805	1%
Restricted	9,800,098	10,511,646	711,548	7%
Unrestricted	<u>16,221,977</u>	<u>22,177,051</u>	<u>5,955,074</u>	37%
Total net position	<u>\$ 82,675,865</u>	<u>\$ 89,797,292</u>	<u>\$ 7,121,427</u>	9%

	Business-type Activities			Percent Change
	2011	2012	Change	
Operating revenue	\$ 38,427,954	\$ 40,839,611	\$ 2,411,657	6%
Operating expenses, other than depreciation	26,144,687	27,761,309	1,616,622	6%
Depreciation and amortization	<u>4,203,371</u>	<u>4,040,451</u>	<u>(162,920)</u>	-4%
Operating income	8,079,896	9,037,851	957,955	12%
Investment income and other nonoperating general revenue	291,608	383,057	91,449	31%
Interest expense	(1,988,269)	(2,389,481)	(401,212)	20%
Other nonoperating expenses	(783,459)	-	783,459	100%
Capital contributions	<u>-</u>	<u>90,000</u>	<u>90,000</u>	100%
Change in net position	<u>\$ 5,599,776</u>	<u>\$ 7,121,427</u>	<u>\$ 1,521,651</u>	27%

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 \$1,471,727 and \$1,520,794, 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 above budget by \$586,146. This was a result of the current economic climate and the inability for many customers to make payments by the due date. When customers fail to bring their accounts current, the outstanding balance is transferred to the City's taxes with a 17 percent penalty. The total amount of delinquent charges has increased over the last few years, causing penalty charges to increase as well.

Capital Assets and Debt Administration

Capital Assets - The System's investment in capital assets amounts to \$113,883,128, net of accumulated depreciation, as of December 31, 2012. Capital assets include water mains, sewer lines, water meters, buildings, vehicles, and operating equipment. Major capital acquisitions in the current year included:

Meters and meter reading equipment	\$5,615,775
Waste water treatment energy improvements	2,466,809

Long-term Debt - The System has outstanding long-term debt of \$75,263,694 (net of unamortized bond discounts and premiums and deferred loss on refunding issues), an increase of \$11,629,688 (18.3 percent). The significant factor relating to this change is a new capital improvement bond in the amount of \$15,680,000 for various sewer and main work.

Economic Factors and Next Year's Budget and Rates

The economic climate is still depressed in Michigan resulting in tighter financial restraint for residential and commercial and industrial users. 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, 2012

	Water and Sewer Fund
Assets	
Current assets:	
Cash and cash equivalents	\$ 17,734,944
Receivables:	
Receivables from sales to customers on account	14,435,619
Accrued interest receivable	235
Other receivables	110,894
Due from other governmental units	67,523
Due from other funds	14,738
Inventory	1,229,020
Prepaid expenses and other assets	20,854
Total current assets	<u>33,613,827</u>
Noncurrent assets:	
Restricted unspent bond proceeds for capital projects (Note 1)	15,889,195
Assets with financing entity	2,599,966
Restricted assets (Note 6)	5,652,510
Capital assets (Note 3):	
Assets not subject to depreciation	2,529,472
Assets subject to depreciation	111,353,656
Total noncurrent assets	<u>138,024,799</u>
Total assets	<u>171,638,626</u>
Liabilities	
Current liabilities:	
Accounts payable	3,058,947
Due to other funds	1,460,418
Accrued liabilities and other	636,950
Customer deposits	66,971
Compensated absences (Note 6)	604,777
Current portion of long-term debt (Note 6)	4,522,090
Total current liabilities	<u>10,350,153</u>
Noncurrent liabilities:	
Compensated absences - Due in more than one year (Note 6)	749,577
Long-term debt - Net of current portion (Note 6)	70,741,604
Total noncurrent liabilities	<u>71,491,181</u>
Total liabilities	<u>81,841,334</u>
Equity - Net position	
Net investment in capital assets	57,108,595
Restricted	10,511,646
Unrestricted	22,177,051
Total net position	<u><u>\$ 89,797,292</u></u>

City of Warren, Michigan Water and Sewer System

Statement of Revenues, Expenses, and Changes in Net Position Year Ended December 31, 2012

	Water and Sewer Fund
Operating Revenue	
Charges for sales and service:	
Sale of water	\$ 20,955,632
Sewage disposal charges	17,650,089
Other sales to customers	147,744
Interest and penalty charges	2,086,146
Total operating revenue	<u>40,839,611</u>
Operating Expenses	
Cost of water	9,740,191
Other operating and maintenance costs	3,798,150
Billing and administrative costs	2,023,210
Wages and fringe benefits	10,714,005
Supplies	668,116
Professional services	817,637
Depreciation	4,040,451
Total operating expenses	<u>31,801,760</u>
Operating Income	9,037,851
Nonoperating Revenue (Expenses)	
Capital grant	199,164
Interest expense	(2,389,481)
Investment income	43,785
Gain on sale of assets	140,108
Total nonoperating expenses	<u>(2,006,424)</u>
Income - Before capital contributions	7,031,427
Capital Contributions	<u>90,000</u>
Increase in Net Position	7,121,427
Net Position - Beginning of year	<u>82,675,865</u>
Net Position - End of year	<u><u>\$ 89,797,292</u></u>

City of Warren, Michigan Water and Sewer System

Statement of Cash Flows Year Ended December 31, 2012

	Water and Sewer Fund
Cash Flows from Operating Activities	
Receipts from customers	\$ 40,918,548
Payments to suppliers	(16,073,071)
Payments to employees	(10,900,531)
Internal activity - Payments from other funds	1,315,372
Net cash provided by operating activities	<u>15,260,318</u>
Cash Flows from Capital and Related Financing Activities	
Issuance of bonds	35,170,088
Receipt of capital grants	180,765
Proceeds from sales of capital assets	140,108
Purchase of capital assets	(7,121,023)
Principal and interest paid on capital debt	(25,929,881)
Net cash provided by capital and related financing activities	<u>2,440,057</u>
Cash Flows from Investment Activities - Interest received on investments	<u>43,662</u>
Net Increase in Cash and Cash Equivalents	17,744,037
Cash and Cash Equivalents - Beginning of year	<u>21,532,612</u>
Cash and Cash Equivalents - End of year	<u>\$ 39,276,649</u>
Balance Sheet Classification of Cash and Cash Equivalents	
Cash and investments	\$ 17,734,944
Restricted cash	5,652,510
Restricted investments	15,889,195
Total cash and cash equivalents	<u>\$ 39,276,649</u>
Reconciliation of Operating Income to Net Cash from Operating Activities	
Operating income	\$ 9,037,851
Adjustments to reconcile operating income to net cash from operating activities:	
Depreciation and amortization	4,040,451
Changes in assets and liabilities:	
Receivables	78,937
Inventories	523,445
Prepaid and other assets	68,329
Accounts payable	398,737
Due to others	1,315,372
Accrued and other liabilities	(202,804)
Net cash provided by operating activities	<u>\$ 15,260,318</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 2012, \$2,180,066 was used for capital improvements and there was \$2,599,966 of proceeds remaining that is held with a financing entity.

Also in 2012, the Water and Sewer Fund received a \$90,000 noncash grant related contribution to improve the waste water treatment facility.

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

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note I - Nature of Business and Significant Accounting Policies

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:

Reporting Entity

The City of Warren, Michigan Water and Sewer System 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, 2013.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The financial statements are reported using the economic resources measurement focus and the 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.

When an expense is incurred for purposes for which both restricted and unrestricted net position or fund balance are available, the Water and Sewer Fund's policy is to first apply restricted resources.

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.

Assets, Liabilities, and Net Position or Equity

Bank Deposits 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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Receivables and Payables - In general, outstanding balances between funds are reported as "due to/from other funds." Activity between funds that are 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 as net of allowance for uncollectible amounts. The allowance for uncollectible amounts in the current year is \$672,242.

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.

Restricted Assets - The total restricted assets of \$15,889,195 were unspent bond proceeds to be spent on water main replacements, the meter replacement project, and the pressure reducing station project.

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

Building 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

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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Long-term Obligations - Long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount.

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.

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.

Significant Customers - The City has two significant customers: General Motors Corporation and Chrysler Group, which comprise 6.0 percent and 3.5 percent of operating revenue, respectively.

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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note 2 - Deposits and Investments (Continued)

The Water and Sewer Fund has designated three banks for the deposit of its funds. The investment policy adopted by the City Council 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.

The Water and Sewer Fund's cash and investments are subject to custodial credit 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. The Water and Sewer Fund and the City of Warren have deposits at the same banks. In the event of a bank failure, it is the City's policy that the insured deposits will be returned to the City of Warren. At year end, the Water and Sewer Fund had \$38,869,388 of bank deposits (certificates of deposit, checking, and savings accounts) that were uninsured and uncollateralized. The City of Warren pools the City's bank deposits, including the Water and Sewer Fund, to earn a greater interest rate return. The associated FDIC insurance is attributed to the City's General Fund deposits. 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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note 3 - Capital Assets

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

Water and Sewer Fund	Balance	Additions	Disposals	Balance
	January 1, 2012			December 31, 2012
Capital assets not being depreciated:				
Land	\$ 605,219	\$ -	\$ -	\$ 605,219
Construction in progress	3,186,644	2,466,809	(3,729,200)	1,924,253
Subtotal	3,791,863	2,466,809	(3,729,200)	2,529,472
Capital assets being depreciated:				
Water and sewer lines	110,621,864	1,047,121	(33,603)	111,635,382
Buildings and improvements	69,405,772	3,769,013	-	73,174,785
Machinery and equipment	11,320,626	221,571	(108,428)	11,433,769
Meters and remote registers	6,780,866	5,615,775	(2,275,500)	10,121,141
Pumping equipment	1,709,634	-	-	1,709,634
Subtotal	199,838,762	10,653,480	(2,417,531)	208,074,711
Accumulated depreciation:				
Water and sewer lines	53,126,727	1,700,242	(33,603)	54,793,366
Buildings and improvements	25,783,874	1,859,957	-	27,643,831
Machinery and equipment	10,225,590	193,269	(108,428)	10,310,431
Meters and remote registers	4,298,375	284,789	(2,275,500)	2,307,664
Pumping equipment	1,663,569	2,194	-	1,665,763
Subtotal	95,098,135	4,040,451	(2,417,531)	96,721,055
Net capital assets being depreciated	104,740,627	6,613,029	-	111,353,656
Net capital assets	<u>\$ 108,532,490</u>	<u>\$ 9,079,838</u>	<u>\$ (3,729,200)</u>	<u>\$ 113,883,128</u>

Note 4 - Interfund Receivables, Payables, and Transfers

The composition of interfund balances is as follows:

Receivable Fund	Payable Fund	Amount
Due to/from Other Funds		
General Fund	Water and Sewer Fund	\$ 1,460,418
Water and Sewer Fund	General Fund	10,389
	Fiduciary funds	4,349
	Total Water and Sewer Fund	14,738
	Total	<u>\$ 1,475,156</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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

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, with \$54,693 of issuance costs included in the total. 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, 2012, the construction of the assets under capital lease was considered construction in progress totaling \$1,692,137. The remaining \$2,599,966 is considered to be cash with paying agent. As of December 31, 2012, the project is ongoing; however, a portion of the project totaling \$3,729,200 was completed during the fiscal year and was placed into service where it is considered a capital asset and is subject to depreciation. The future minimum lease obligations and the net present value are as follows:

<u>Years Ending December 31</u>	<u>Amount</u>
2013	\$ 514,959
2014	533,817
2015	553,377
2016	573,664
2017	626,472
2018-2022	3,496,868
2023-2026	<u>3,303,661</u>
Total minimum lease payments	9,602,818
Less amount representing interest	<u>(1,849,731)</u>
Present value	<u>\$ 7,753,087</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, 2012 that amounted to \$5,652,510. 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, 2012

Note 6 - Long-term Debt (Continued)

Long-term debt activity can be summarized as follows:

	Interest Rate Ranges	Principal Maturity Ranges	Beginning Balance - As restated	Additions	Reductions	Ending Balance	Due Within One Year
Business-type Activities							
Revenue Bonds:							
Revenue Bonds, Series 2005	3.750% - 4.750%	\$870,000 - \$2,170,000	\$ 20,560,000	\$ -	\$ (20,560,000)	\$ -	\$ -
Revenue Bonds, Series 2012	2.50% - 4.00%	\$870,000 - \$2,010,000	-	17,780,000	-	17,780,000	870,000
Capital Improvement Bonds:							
Capital Improvement Bonds, Series 2003	2.750% - 4.125%	\$60,000 - \$90,000	880,000	-	(60,000)	820,000	60,000
Capital Improvement Bonds, Series 2006	3.750% - 4.000%	\$87,306 - \$121,102	2,022,125	-	(42,245)	1,979,880	87,306
Capital Improvement Bonds, Series 2010	2.000% - 3.000%	\$1,165,000	5,080,000	-	(1,135,000)	3,945,000	1,165,000
Capital Improvement Bonds, Series 2010	1.450% - 6.000%	\$300,000 - \$715,000	9,290,000	-	(300,000)	8,990,000	300,000
Capital Improvement Bonds, Series 2012	2.00% - 4.10%	\$420,000 - \$980,000	-	15,680,000	-	15,680,000	420,000
State Revolving Fund:							
State Revolving 5134-01	2.500%	\$225,000 - \$300,000	3,350,000	-	(220,000)	3,130,000	225,000
State Revolving 5134-02	2.125%	\$300,000 - \$390,000	5,095,000	-	(290,000)	4,805,000	300,000
State Revolving 5134-03	2.125%	\$55,000 - \$72,091	787,091	-	(50,000)	737,091	55,000
State Revolving 5134-04	1.625%	\$385,000 - \$475,000	6,390,000	-	(380,000)	6,010,000	385,000
State Revolving 5401-01	2.500%	\$125,000 - \$195,000	2,700,310	22,602	(125,000)	2,597,912	125,000
2010 capital lease		\$184,143 - \$199,321	752,039	-	(176,993)	575,046	184,143
2011 installment purchase (Note 5)		\$303,300 - \$847,679	8,021,303	-	(268,216)	7,753,087	303,300
Total bonds payable before deferred amounts			64,927,868	33,482,602	(23,607,454)	74,803,016	4,479,749
Less deferred amounts:							
Issuance discounts			(148,378)	(171,485)	13,556	(306,307)	(14,053)
Issuance premiums			65,390	2,011,272	(39,034)	2,037,628	158,752
Cost of issuance deferred charge			(1,210,874)	(152,301)	92,532	(1,270,643)	(102,358)
Total bonds payable			63,634,006	35,170,088	(23,540,400)	75,263,694	4,522,090
Accumulated compensated absences			1,611,006	444,100	(700,752)	1,354,354	604,777
Total business-type activities			\$ 65,245,012	\$ 35,614,188	\$ (24,241,152)	\$ 76,618,048	\$ 5,126,867

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note 6 - Long-term Debt (Continued)

Total interest expense for the year was \$2,389,481. 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
2013	\$ 4,479,749	\$ 2,283,065	\$ 6,762,814
2014	4,550,795	2,126,895	6,677,690
2015	4,634,156	2,016,366	6,650,522
2016	4,991,964	1,904,996	6,896,960
2017	4,552,436	1,767,230	6,319,666
2018-2022	23,301,839	6,646,251	29,948,090
2023-2027	16,957,077	3,336,696	20,293,773
2028-2032	6,855,000	1,475,719	8,330,719
2033-2037	4,480,000	474,320	4,954,320
Total	<u>\$ 74,803,016</u>	<u>\$ 22,031,538</u>	<u>\$ 96,834,554</u>

Current Refundings - In October 2012, the City issued Water and Sewer Refunding Bonds, Series 2012, in the amount of \$17,780,000. The debt refunded amounted to \$19,695,000 of Water and Sewer Refunding Bonds, Series 2005, maturing in the years 2013 through 2026. The refunding was undertaken to reduce the debt service payment over the next 14 years with net savings of \$3,130,967 and to obtain an economic (present value) gain for the City of Warren of \$2,711,995.

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, 2012

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, 2012 to June 30, 2012, the rate was 64.79 percent of covered payroll in accordance with the actuarial valuation dated December 31, 2009, and from July 1, 2012 to December 31, 2012, the rate was 73.29 percent of covered payroll in accordance with the actuarial valuation dated December 31, 2010.

Annual Pension Cost - For the year ended December 31, 2012, the Water and Sewer Fund's annual pension cost of \$1,624,780 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		
	2012	2011	2010
Annual pension cost (APC)	\$ 1,624,780	\$ 1,616,264	\$ 1,532,200
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 about 35 percent of total covered payroll in the plan):

	Actuarial Valuation Date Ended December 31		
	2011	2010	2009
Actuarial value of assets	\$ 113,878,210	\$ 121,367,563	\$ 126,090,951
Actuarial accrued liability (AAL)			
(entry age)	\$ 198,448,018	\$ 195,147,440	\$ 199,209,644
Unfunded AAL (UAAL)	\$ 84,569,808	\$ 73,779,877	\$ 73,118,693
Funded ratio	57.4 %	62.2 %	63.3 %
Covered payroll	\$ 10,328,458	\$ 10,860,218	\$ 13,045,664
UAAL as a percentage of covered payroll	818.8 %	679.4 %	560.5 %

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

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, 2009 and December 31, 2010, 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 10 years.

Note 8 - Defined Contribution Pension Plan

Plan Description - The Defined Contribution Plan and Trust was approved by the Warren City Council at their 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 193 active participants in the plan as of June 30, 2012. As of December 31, 2012, 43 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, 2012 was \$381,610.

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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note 9 - Other Postemployment Benefits (Continued)

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, 2012 through December 31, 2012, 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, 2012, 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
12/31/12	12/31/10	\$ 1,656,947	100.0	\$ -
12/31/11	12/31/08	1,637,316	100.0	-
12/31/10	12/31/08	1,684,386	100.0	-

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

The funding progress of the plan is as follows (the Water and Sewer Fund represents about 14 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
12/31/10	\$ 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
12/31/06	16,229,489	161,270,365	145,040,876	10.1	27,490,701	527.6

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

Note 9 - Other Postemployment Benefits (Continued)

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, 2010 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, 2010 was 30 years.

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 2012, the Water and Sewer Fund's contribution was \$11,063.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2012

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 - Subsequent Events

The City of Warren, Michigan Water and Sewer System sold two capital improvement bonds after year end during 2013. The first bond was a refinancing of the series 2006 bond which sold on August 1, 2013. The issue has a 2.7 percent interest rate with the principal payments starting September 1, 2014. The bonds will mature September 1, 2026.

The second bond issue is a new capital improvement bond sold in October 2013 in the amount of \$18,775,000. The initial rate on the variable rate bonds is 4.0 percent with principal payments starting October 1, 2014 for \$700,000. The bonds will mature October 1, 2033.