

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

**Financial Report
December 31, 2011**

City of Warren, Michigan Water and Sewer System

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Independent Auditor's Report

To the Mayor and Members of the City Council
City of Warren, Michigan

We have audited the accompanying financial statements of the Water and Sewer Fund of the City of Warren, Michigan (the "City") as of and for the year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the 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, Michigan as of December 31, 2011, the changes in its financial position or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to previously 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, 2011 and the changes in financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis 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 (GASB), 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 management's discussion and analysis 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.

To the Mayor and Members of City Council
City of Warren, Michigan

As described in Note 2, during the current year, the Water and Sewer Fund changed its accounting for federal loan forgiveness, depreciation expense, and the liability for employee vacation time.

Plante & Morse, PLLC

August 1, 2012

City of Warren, Michigan Water and Sewer System

Management's Discussion and Analysis

This narrative overview accompanies the City of Warren Water and Sewer System financial report as of and for the fiscal year ended December 31, 2011. 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, 2011:

- Total net assets, the difference between total assets and total liabilities, increased from \$77,076,089 at December 31, 2010 to \$82,675,865 at December 31, 2011. The increase is primarily due to an increase in unrestricted net assets, the part of net assets that can be used to finance day-to-day operations. Unrestricted net assets increased as a result of an operating income of \$7,459,918 and the reclassification of amounts that were previously recorded as restricted.
- Net income, after depreciation and nonoperating expenses, was \$5,599,776. Compared to the 2010 net income of \$4,539,001, this was a favorable change of \$1,060,775. 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 expenses were \$2,772,096 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 2011 budget was based on sales of 695 million cubic feet while actual sales were 693 million cubic feet, slightly missing expectations by less than 1.0 percent. From 2001 through 2010, the average annual sales volume has been approximately 865 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. A major meter replacement program was approved during fiscal year 2010. Installation of the new meters began in June 2011 and, at December 31, 2011, approximately 21 percent of the new meters were placed in service.

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 assets.

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 assets 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 assets increase when actual revenue exceeds actual expenses, and increases to assets without a corresponding increase in liabilities also increase net assets.

The statement of revenue, expenses, and changes in net assets presents information showing how the System's net assets changed during the fiscal year. All changes in net assets 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 11-22 of this report.

Financial Analysis

Net assets 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 \$82,675,865 at the close of the 2011 fiscal year. This represents an increase of \$5,599,776 (7.3 percent) from the previous year. The unrestricted net assets were \$16,221,977. The System maintains restricted net assets to allow for contractor commitments, insurance demands, and a debt service reserve to meet long-term obligations. Restricted net assets at December 31, 2011 were \$9,800,098.

The largest portion of the System's net assets (68.5 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 assets and changes in net assets, compared to the prior year:

	2010	2011	Change	Percent Change
Assets:				
Current assets	\$ 24,441,500	\$ 29,641,603	\$ 5,200,103	21%
Other noncurrent assets	10,307,531	13,187,375	2,879,844	28%
Capital assets	<u>105,726,733</u>	<u>108,532,490</u>	<u>2,805,757</u>	3%
Total assets	140,475,764	151,361,468	\$ 10,885,704	8%
Liabilities:				
Current liabilities	7,719,765	7,966,567	246,802	3%
Long-term liabilities	<u>55,679,910</u>	<u>60,719,036</u>	<u>5,039,126</u>	9%
Total liabilities	63,399,675	68,685,603	5,285,928	8%
Net assets:				
Invested in capital assets -				
Net of related debt	58,033,660	56,653,790	(1,379,870)	-2%
Restricted	7,656,513	9,800,098	2,143,585	28%
Unrestricted	<u>11,385,916</u>	<u>16,221,977</u>	<u>4,836,061</u>	42%
Total net assets	<u>\$ 77,076,089</u>	<u>\$ 82,675,865</u>	<u>\$ 5,599,776</u>	7%

City of Warren, Michigan Water and Sewer System

Management's Discussion and Analysis (Continued)

	2010	2011	Change	Percent Change
Operating revenue	\$ 37,288,058	\$ 38,427,954	\$ 1,139,896	3%
Operating expenses				
other than depreciation	(26,323,229)	(26,764,665)	(441,436)	2%
Depreciation	<u>(4,084,029)</u>	<u>(4,203,371)</u>	<u>(119,342)</u>	3%
Operating income	6,880,800	7,459,918	579,118	8%
Investment income and other nonoperating general revenue	26,051	291,608	265,557	1019%
Interest expense	(1,648,280)	(1,988,269)	(339,989)	21%
Other nonoperating expenses	<u>(719,570)</u>	<u>(163,481)</u>	<u>556,089</u>	-77%
Change in net assets	<u>\$ 4,539,001</u>	<u>\$ 5,599,776</u>	<u>\$ 1,060,775</u>	23%

Budgetary Highlights

As mentioned above, the water and sewer maintenance and waste water treatment plant sectors stayed below budget by \$1,211,094 and \$1,643,878, 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 \$1,144,063. 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.

City of Warren, Michigan Water and Sewer System

Management's Discussion and Analysis (Continued)

Capital Assets and Debt Administration

Capital Assets - The System's investment in capital assets amounts to \$108,532,490, net of accumulated depreciation, as of December 31, 2011. 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	\$3,186,644
Meters and meter reading equipment	2,319,168
Buildings and improvements	974,607

Long-term Debt - The System has outstanding long-term debt of \$63,634,006 (net of unamortized bond discounts and premiums and deferred loss on refunding issues), an increase of \$3,573,401 (5.9 percent). Significant factors relating to this change include an installment purchase agreement in the amount of \$8,021,303 entered into by the waste water treatment plant for energy improvements, reductions for current principal payments in the amount of \$3,221,792, and the recognition of the \$2,060,000 loan forgiveness on State Revolving issue 5401-01.

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. 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.

Water purchases from the City of Detroit for this year were 25.8 percent of overall expenses. The cost of water has risen significantly as a result of a fixed charge implemented in recent years by the City of Detroit. We anticipate the cost of water will continue to rise, which will cause future water rate increases for customers. Current ordinances allow the rates to increase mid-year to absorb any additional costs for water purchases. This ordinance also allows for mid-year rate increases to provide funding for water main and sewer line improvements and replacements.

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 Assets December 31, 2011

	<u>Water and Sewer Fund</u>
Assets	
Current assets:	
Cash and investments (Note 3)	\$ 14,557,338
Receivables:	
Receivables from sales to customers on account	14,406,635
Accrued interest receivable	112
Other receivables	90,353
Due from other governmental units	177,586
Inventory	320,396
Prepaid expenses and other assets	<u>89,183</u>
Total current assets	29,641,603
Noncurrent assets:	
Restricted unspent bond proceeds for capital projects (Note 1)	6,975,274
Assets with financing entity	4,780,032
Uninstalled meters	1,432,069
Capital assets (Note 4):	
Assets not subject to depreciation	3,791,863
Assets subject to depreciation	<u>104,740,627</u>
Total noncurrent assets	<u>121,719,865</u>
Total assets	151,361,468
Liabilities	
Current liabilities:	
Accounts payable	2,667,798
Due to other funds	130,308
Accrued liabilities and other	583,102
Customer deposits	59,383
Compensated absences (Note 7)	697,905
Current portion of long-term debt (Note 7)	<u>3,828,071</u>
Total current liabilities	7,966,567
Noncurrent liabilities:	
Compensated absences (Note 7)	913,101
Long-term debt - Net of current portion (Note 7)	<u>59,805,935</u>
Total noncurrent liabilities	<u>60,719,036</u>
Total liabilities	<u>68,685,603</u>
Equity - Net assets	
Invested in capital assets - Net of related debt	56,653,790
Restricted:	
Debt service	9,221,695
Capital projects	78,403
Other	500,000
Unrestricted	<u>16,221,977</u>
Total net assets	<u><u>\$ 82,675,865</u></u>

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

City of Warren, Michigan Water and Sewer System

Statement of Revenue, Expenses, and Changes in Net Assets Year Ended December 31, 2011

	Water and Sewer Fund
Operating Revenue	
Charges for sales and service:	
Sale of water	\$ 19,175,736
Sewage disposal charges	16,798,058
Other sales to customers	210,097
Interest and penalty charges	2,244,063
Total operating revenue	<u>38,427,954</u>
Operating Expenses	
Cost of water	8,538,853
Other operating and maintenance costs	3,937,408
Billing and administrative costs	2,213,539
Wages and fringe benefits	10,639,725
Payroll taxes and fringes	52,993
Supplies	644,857
Professional services	737,290
Depreciation	4,203,371
Total operating expenses	<u>30,968,036</u>
Operating Income	7,459,918
Nonoperating Revenue (Expenses)	
Federal revenue	178,457
Interest expense	(1,988,269)
Other nonoperating expenses	(163,481)
Investment income	22,247
Gain on sale of assets	90,904
Total nonoperating expenses	<u>(1,860,142)</u>
Increase in Net Assets	5,599,776
Net Assets - Beginning of year - As restated (Note 2)	<u>77,076,089</u>
Net Assets - End of year	<u><u>\$ 82,675,865</u></u>

City of Warren, Michigan Water and Sewer System

Statement of Cash Flows Year Ended December 31, 2011

	Water and Sewer Fund
Cash Flows from Operating Activities	
Receipts from customers	\$ 37,924,707
Payments to suppliers	(15,738,367)
Payments to employees	(10,506,129)
Internal activity - Payments to other funds	(912,304)
Net cash provided by operating activities	10,767,907
Cash Flows from Capital and Related Financing Activities	
Proceeds from issuance of bonds	3,623,204
Receipt of capital grants	151,935
Benefit fees	(1,432,069)
Proceeds from sales of capital assets	90,904
Purchase of capital assets	(3,822,484)
Principal and interest paid on capital debt	(5,166,211)
Net cash used in capital and related financing activities	(6,554,721)
Cash Flows from Investing Activities	22,157
Net Increase in Cash and Cash Equivalents	4,235,343
Cash and Cash Equivalents - Beginning of year	17,297,269
Cash and Cash Equivalents - End of year	\$ 21,532,612
Balance Sheet Classification of Cash and Cash Equivalents	
Cash and investments	\$ 14,557,338
Restricted unspent bond proceeds for capital projects	6,975,274
Total cash and cash equivalents	\$ 21,532,612
Reconciliation of Operating Income to Net Cash from Operating Activities	
Operating income	\$ 7,459,918
Depreciation and amortization	4,203,371
Changes in assets and liabilities:	
Receivables	(503,247)
Inventories	7,490
Prepaid and other assets	(4,506)
Accounts payable	330,596
Due to others	(912,304)
Accrued and other liabilities	186,589
Net cash provided by operating activities	\$ 10,767,907

Noncash Investing, Capital, and Financing Activities - During the year ended December 31, 2011, a capital lease transaction was entered into for \$8,021,303. Of the proceeds, \$54,693 was used for bond issuance costs and the balance was used for construction in progress of \$3,186,644. The remaining assets held with the financing entity amounts to \$4,780,032.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 1 - 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 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 at June 30, 2012.

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.

Private sector standards of accounting issued prior to December 1, 1989 are generally followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with the standards of the Governmental Accounting Standards Board. The Water and Sewer Fund has elected to also follow private sector standards issued after November 30, 1989 for its business-type activities.

When an expense is incurred for the purpose for which both restricted and unrestricted net assets 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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

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

Assets, Liabilities, and Net Assets 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.

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 \$595,628.

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 \$6,975,274 were unspent bond proceeds to be spent on 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

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

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

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.

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 Assets - 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 6.5 percent and 3.4 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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 2 - Prior Period Adjustment

The financial statements for the year ended December 31, 2010 have been restated in order to reflect the following three corrections: (1) federal revenue was not previously recorded related to principal forgiveness in accordance with the ARRA program for the State Revolving Fund 5401-01 debt issuance of 2010, (2) the depreciation expense methodology used in prior years resulted in an overstatement in accumulated depreciation and depreciation expense in prior years, and (3) the vacation time liability was not previously recorded. The effects of these corrections are described in the following table:

	Water and Sewer Fund
Net assets - December 31, 2010 - As previously reported	\$ 74,235,331
To properly reflect revenue previously recorded as debt for the State Revolving Fund 5401-01 debt	2,060,000
To properly adjust accumulated depreciation in prior years	1,197,395
To properly record the vacation time liability not previously recorded	<u>(416,637)</u>
Net assets - December 31, 2010 - As restated	<u>\$ 77,076,089</u>

Note 3 - 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 mature 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 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.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 3 - Deposits and Investments (Continued)

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 \$21,140,092 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.

Note 4 - Capital Assets

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

	Balance - As restated			Balance December 31,
	January 1, 2011	Additions	Disposals	2011
Water and Sewer Fund				
Capital assets not being depreciated:				
Land	\$ 605,219	\$ -	\$ -	\$ 605,219
Construction in progress	-	3,186,644	-	3,186,644
Subtotal	605,219	3,186,644	-	3,791,863
Capital assets being depreciated:				
Water and sewer lines	110,341,245	289,926	(9,307)	110,621,864
Buildings and improvements	68,431,165	974,607	-	69,405,772
Machinery and equipment	11,081,843	238,783	-	11,320,626
Meters and remote registers	6,177,217	2,319,168	(1,715,519)	6,780,866
Pumping equipment	1,709,634	-	-	1,709,634
Subtotal	197,741,104	3,822,484	(1,724,826)	199,838,762
Accumulated depreciation:				
Water and sewer lines	50,920,089	2,215,945	(9,307)	53,126,727
Buildings and improvements	24,073,094	1,710,780	-	25,783,874
Machinery and equipment	10,086,989	138,601	-	10,225,590
Meters and remote registers	5,878,043	135,851	(1,715,519)	4,298,375
Pumping equipment	1,661,375	2,194	-	1,663,569
Subtotal	92,619,590	4,203,371	(1,724,826)	95,098,135
Net capital assets being depreciated	105,121,514	(380,887)	-	104,740,627
Net capital assets	\$ 105,726,733	\$ 2,805,757	\$ -	\$ 108,532,490

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 5 - 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	\$ 130,308

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 6 - Leases

Capital Leases - The Water and Sewer Fund has 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, 2011, the construction of the assets under capital lease was considered construction in progress totaling \$3,186,644. The remaining \$4,780,032 is considered as cash with paying agent. The project will be completed as of December 31, 2012 and will be considered a capital asset subject to depreciation. The future minimum lease obligations and the net present value are as follows:

Years Ending December 31	Amount
2012	\$ 487,198
2013	514,959
2014	533,817
2015	553,377
2016	573,664
2017-2021	3,368,774
2022-2026	4,058,257
Total minimum lease payments	10,090,046
Less amount representing interest	<u>(2,068,743)</u>
Present value	<u>\$ 8,021,303</u>

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 7 - 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, 2011 that amounted to \$6,222,756. Capital lease obligations for the waste water treatment plant energy performance improvements are recorded as amounts spent as long-term debt (see Note 6).

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 1999	4.500%	\$ -	\$ 50,000	\$ -	\$ (50,000)	\$ -	\$ -
Revenue Bonds, Series 2000	5.125%	-	625,000	-	(625,000)	-	-
Revenue Bonds, Series 2005	3.750% - 4.750%	\$865,000 - \$2,170,000	20,695,000	-	(135,000)	20,560,000	865,000
Capital Improvement Bonds:							
Capital Improvement Bonds, Series 2003	2.750% - 4.125%	\$60,000 - \$90,000	935,000	-	(55,000)	880,000	60,000
Capital Improvement Bonds, Series 2006	3.750% - 4.000%	\$42,245 - \$121,102	2,064,370	-	(42,245)	2,022,125	42,245
Capital Improvement Bonds, Series 2010	2.000% - 3.000%	\$690,000 - \$1,165,000	6,230,000	-	(1,150,000)	5,080,000	1,135,000
Capital Improvement Bonds, Series 2010	1.450% - 6.000%	\$300,000 - \$715,000	9,290,000	-	-	9,290,000	300,000
State Revolving Fund:							
State Revolving 5134-01	2.500%	\$220,000 - \$300,000	3,565,000	-	(215,000)	3,350,000	220,000
State Revolving 5134-02	2.125%	\$290,000 - \$390,000	5,380,000	-	(285,000)	5,095,000	290,000
State Revolving 5134-03	2.125%	\$50,000 - \$72,091	837,091	-	(50,000)	787,091	50,000
State Revolving 5134-04	1.625%	\$380,000 - \$475,000	6,765,000	-	(375,000)	6,390,000	380,000
State Revolving 5401-01	2.500%	\$125,000 - \$195,000	2,091,478	728,832	(120,000)	2,700,310	125,000
2011 capital lease			871,586	-	(119,547)	752,039	176,993
2011 installment purchase (Note 6)			-	8,021,303	-	8,021,303	268,216
Total bonds payable before deferred amounts			59,399,525	8,750,135	(3,221,792)	64,927,868	3,912,454
Less deferred amounts:							
Issuance discounts			(177,959)	-	29,581	(148,378)	(8,907)
Issuance premiums			80,479	-	(15,089)	65,390	15,090
Cost of issuance deferred charge			(1,301,440)	-	90,566	(1,210,874)	(90,566)
Total bonds payable			58,000,605	8,750,135	(3,116,734)	63,634,006	3,828,071
Accumulated compensated absences							
			1,411,685	615,958	(416,637)	1,611,006	697,905
Total business-type activities			\$ 59,412,290	\$ 9,366,093	\$ (3,533,371)	\$ 65,245,012	\$ 4,525,976

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 7 - Long-term Debt (Continued)

Total interest expense for the year was \$1,988,269. Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

Year Ending December 31	Business-type Activities		
	Principal	Interest	Total
2012	\$ 3,912,454	\$ 2,119,511	\$ 6,031,965
2013	4,074,749	2,026,141	6,100,890
2014	4,150,795	1,927,796	6,078,591
2015	4,229,157	1,819,923	6,049,080
2016	4,676,964	1,707,438	6,384,402
2017-2021	22,395,548	6,370,764	28,766,312
2022-2026	17,473,201	2,734,647	20,207,848
2027-2031	4,015,000	557,325	4,572,325
Total	<u>\$ 64,927,868</u>	<u>\$ 19,263,545</u>	<u>\$ 84,191,413</u>

Note 8 - 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.

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, 2011 to June 30, 2011, the rate was 55.99 percent of covered payroll in accordance with the actuarial valuation dated December 31, 2008 and from July 1, 2011 to December 31, 2011, the rate was 64.79 percent of covered payroll in accordance with the actuarial valuation dated December 31, 2009.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 8 - Defined Benefit Pension Plan (Continued)

Annual Pension Cost - For the year ended December 31, 2011, the Water and Sewer Fund's annual pension cost of \$1,616,264 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		
	2011	2010	2009
Annual pension cost (APC)	\$ 1,616,264	\$ 1,532,200	\$ 1,943,932
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 25 percent of total covered payroll in the plan):

	Actuarial Valuation Date Ended December 31		
	2010	2009	2008
Actuarial value of assets	\$ 121,367,563	\$ 126,090,951	\$ 129,941,657
Actuarial accrued liability (AAL) (entry age)	195,147,440	199,209,644	198,549,341
Unfunded AAL (UAAL)	73,779,877	73,118,693	68,607,684
Funded ratio	62.2 %	63.3 %	65.4 %
Covered payroll	10,860,218	13,045,664	14,036,856
UAAL as a percentage of covered payroll	679.4 %	560.5 %	488.8 %

Actuarial Methods and Assumptions - The annual required contribution was determined as part of actuarial valuations at December 31, 2008 and December 31, 2009, 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 5.0 percent to 8.8 percent per year based on age-related rates for merit and longevity. Both (a) and (b) include an inflation component of 5.0 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 11 years.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 9 - 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 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. There were 228 active participants in the plan as of June 30, 2011. As of December 31, 2011, 39 water and sewer system employees participate in the Defined Contribution Plan.

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, 2011 was \$349,518.

Note 10 - 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 of employees. The Water and Sewer Fund funding policy provides for periodic employer contributions at actuarially determined rates. From January 1, 2011 through December 31, 2011, the rate was 36.11 percent of covered payroll in accordance with actuarial valuation of December 31, 2008.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 10 - Other Postemployment Benefits (Continued)

Funding Progress - For the year ended December 31, 2011, the Water and Sewer Fund has estimated the cost of providing retiree healthcare benefits through an actuarial valuation as of December 31, 2008. 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 36.11 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
12/31/11	12/31/08	\$ 1,637,316	100.0	\$ -
12/31/10	12/31/08	1,684,386	100.0	-
12/31/09	12/31/06	2,029,118	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 22 percent of covered payroll in the plan):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial 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

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 multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

City of Warren, Michigan Water and Sewer System

Notes to Financial Statements December 31, 2011

Note 10 - Other Postemployment Benefits (Continued)

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, 2008 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, 2008 was 30 years.

Note 11 - 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 2011, the Water and Sewer Fund's contribution was \$9,018.

Note 12 - 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. A total of \$500,000 is restricted for future claims.

Note 13 - Subsequent Events

The City of Warren Water and Sewer System sold capital improvement bonds in June 2012 in the amount of \$15,680,000. The initial interest rate on the variable rate bonds is 2.0 percent with principal payments starting June 1, 2013 for \$420,000. The bonds will mature June 1, 2030.