

**DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF  
NASHVILLE AND DAVIDSON COUNTY**

**AUDITED FINANCIAL STATEMENTS  
AND OTHER FINANCIAL INFORMATION**

**JUNE 30, 2012**

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

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## Independent Auditors' Report

The Honorable Mayor and Members of Council  
The Metropolitan Government of Nashville and  
Davidson County, Tennessee

We have audited the accompanying statement of net assets of the Department of Water and Sewerage Services (the "Department"), an enterprise fund of The Metropolitan Government of Nashville and Davidson, County, Tennessee (the "Metropolitan Government"), as of June 30, 2012, and the related statements of revenue, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Department'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 A, the financial statements present only the Department of Water and Sewerage Services Enterprise Fund and do not purport to, and do not, present fairly the financial position of The Metropolitan Government of Nashville and Davidson County, Tennessee, as of June 30, 2012, and 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 above present fairly, in all material respects, the financial position of the Department (an enterprise fund of the Government) as of June 30, 2012, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.



In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2012, on our consideration of the Department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The supplementary information on pages 33 - 35 is presented for purposes of additional analysis and is not a required part of the financial statements. This supplementary information is marked "unaudited" and has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

*Crosslin + Associates, P.C.*

Nashville, Tennessee  
October 31, 2012

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

JUNE 30, 2012

**MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management of the Metropolitan Government of Nashville and Davidson County (the "Government"), Department of Water and Sewerage Services (the "Department") - (an enterprise fund of the Government), offers readers of the Department's financial statements this overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2012. This information should be read in conjunction with the financial statements.

**FINANCIAL HIGHLIGHTS**

The Department provides water and sewerage service to most of Davidson County, Tennessee, and small portions of the surrounding counties. It serves approximately 184,400 water accounts and 195,400 sewer accounts. Its activities are funded entirely from revenues generated from its operations, with no tax revenues from the Government. A covenant with the bondholders provides assurance that there will be adequate funds for necessary major repairs and replacement of facilities, by requiring revenues to equal at least 110% of the sum of the year's operating budget (exclusive of depreciation and certain other expenses) and the debt service on its outstanding revenue bonds. These monies, not required for normal operations, flow into the Extension and Replacement Fund to be used to finance the ongoing capital requirements of the Department, as supplemented with state loans and revenue bonds. Water rates were increased on May 1 of 2009, 2010, and 2011 by five percent each year. Sewerage rates were increased by nine percent on May 1, 2009, by eight percent on May 1, 2010, and by seven percent on May 1, 2011.

On February 2, 2012, \$129,625,000 of revenue bonds were issued through the Water and Sewer Revenue Refunding Bonds, Series 2012. The purpose of this bond issue was to retire the outstanding loan debt and exit the loan program financed by the Tennessee State Revolving Fund. These bonds received ratings from Moody's Investment Services, Inc. and Standard and Poor's Ratings Services of A1 and A+ respectively.

At June 30, 2012, the assets of the Department exceeded its liabilities by over \$1.3 billion (total net assets). This was an increase of approximately \$36.8 million as compared to 2011, resulting from net income and capital grants and contributions as reflected on the Statements of Revenue, Expenses, and Changes in Net Assets. In 2012, operating revenues increased, due to increases in consumption and the rate increase effective May 1, 2011. Operating expenses increases were due to contractual services and cost of repair materials. Investment income decreased by 80% as compared to 2011. Capital grants and contributions decreased by approximately \$16.2 million as compared to 2011. The Department ended 2012 \$68,300 under its operating budget.

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In 2012, cash and cash equivalents and investments increased by approximately \$5.5 million as compared to 2011, while restricted cash and equivalents and investments decreased by approximately \$22.1 million. The decrease in restricted cash and equivalents and investments resulted from construction project payments using the proceeds from the Series 2010 Bond Issue. Capital assets increased by approximately \$140.1 million, before depreciation of \$60.1 million, for a net increase of \$80 million for 2012. These assets were acquired using revenues of the Department, revenue bonds, grants, contributions and loans from the State of Tennessee. The Department had construction funds available at June 30, 2012, of approximately \$211.3 million and liabilities of approximately \$16.4 million for a net of \$194.9 million available for capital additions, less outstanding commitments.

The water and sewerage services have gradually been expanded and include: improvements financed by revenues; improvements resulting from capital contributions in aid of construction by private developers; all improvements, additions and extensions financed with the proceeds of outstanding bonds and governmental grants; and facilities acquired from the Nashville Suburban Utility District, the First Suburban Water Utility District of Davidson County, Tennessee, the Parkwood Service Company, the Joelton Water Utility District, the City of Lakewood sewerage system, Rayon City Water Company, the Cumberland Utility District, and the sewerage service of the Nolensville/College Grove Utility District in Williamson County.

Under the Charter and Tennessee Code Annotated §7-3-302, the Metropolitan Government can assume and take over any water and/or sewer utility district located within its boundaries through ordinances adopted by the Metropolitan Council. Several such systems currently operate inside Davidson County and if a decision is made to consolidate these operations into the Department, the Government will take subject to or retire all debts and liabilities of the systems. The economic impact of such an assumption or takeover would be evaluated prior to the submission of any legislation to the Metropolitan Council. By contract dated February 1996, the Government has agreed not to take over the Harpeth Valley Utility District before February 2026.

Historically, the Department managed and partially funded the stormwater operations of the Government. In 2009, the Government established a Stormwater Division of the Department as a stand-alone enterprise fund with its own set of service fees, which are now an itemized part of the water bill. Further funding of stormwater operations will not be required of the Department.

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In December 2005, the Department received an inquiry from United States Environmental Protection Agency (“EPA”), pertaining to the Department’s Operations, Capital Plan, and Stormwater Management. The Department’s response was submitted in January 2006. The Department, TDEC and EPA agreed on a recommended consent decree on March 12, 2009 (the “Consent Decree”) to address and correct deficiencies within the Department’s sewer system that have caused violations of the Clean Water Act (“CWA”). The original Consent Decree required that the Department fully develop, in two years, a Corrective Action Plan/Engineering Report (“CAP/ER”) for its separate sewer system and a Long Term Control Plan (“LTCP”) for its combined sewer system to achieve the goals of the CWA. Upon submittal and approval of the plans, the Department would have an additional nine years to complete the work as developed by the plans.

On May 14, 2010, Metro petitioned EPA and TDEC for a time extension for the delivery of both plans and the final compliance with the Consent Decree based on the flood of May 2010. EPA and TDEC granted the requested time extensions to the Department of Water and Sewerage Services. The Department met the current deadline for submittal of the CAP/ER and LTCP of September 11, 2011 and the deadline for final compliance with the Consent Decree is eleven years after the final approval of the plans by EPA and TDEC. As of June 30, 2012, the EPA and TDEC were still reviewing the CAP/ER and LTCP.

Failure to comply with the Consent Decree and meet future established deadlines could result in penalties up to \$3,000 per occurrence, and up to \$5,000 per day for failure to timely implement work. The Department has thus far been successful in meeting all the deadlines established by the Consent Decree, and is currently in compliance with the Consent Decree in all respects.

Over the weekend of May 1 and 2, 2010, the Middle Tennessee region received over 15 inches of rainfall resulting in a flood disaster event that severely impacted several of the Department’s facilities. Two wastewater treatment facilities and one water treatment facility received significant damage and over 25 sewer lift stations were flooded and damaged. The cost of repairing and refurbishing the damaged facilities is expected to be approximately \$70 million when complete by the end of 2012. The region was declared a federal disaster area and approved for assistance from the Federal Emergency Management Agency (“FEMA”). Federal and state assistance was approved for approximately 30 percent of the damage total and the Department has appealed the eligibility of another 30 percent of the cost to date.

## **OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements. The Department's basic financial statements consist of the Statements of Net Assets, the Statements of Revenue, Expenses, and Changes in Net Assets and the Statements of Cash Flows. Data on these statements represent an enterprise fund of the Government as established by the master bond resolution and the Charter of the Government. These funds consist of the Revenue Fund, the Operating Fund, the Operating Reserve Fund, the Debt Service Fund, the Debt Service Reserve Fund, the Revolving Fund, and the Extension and Replacement Fund. All revenues of the Department are required to be used for the benefit of the ratepayers.

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JUNE 30, 2012

<b>Statements of Net Assets</b>	Condensed Financial Information as of June 30,	
	2012	2011
<u>ASSETS</u>		
Total current assets	\$ 111,949,305	\$ 98,899,296
Total capital and other noncurrent assets	<u>1,998,896,275</u>	<u>1,946,741,041</u>
Total assets	2,110,845,580	2,045,640,337
<u>LIABILITIES and NET ASSETS</u>		
Total current liabilities	158,463,796	89,220,866
Total noncurrent liabilities	<u>647,366,682</u>	<u>688,233,028</u>
Total net assets	<u>\$ 1,305,015,102</u>	<u>\$ 1,268,186,443</u>
 <b>Statement of Revenue, Expenses, and Changes in Net Assets</b>		
Operating revenues	\$ 200,762,485	\$ 195,544,617
Depreciation (expense)	(60,102,853)	(60,144,713)
Other operating (expenses)	<u>(103,421,549)</u>	<u>(95,411,856)</u>
Operating income	37,238,083	39,988,048
Nonoperating revenues (expenses):		
Investment income	35,758	176,347
Interest expense	(18,776,274)	(28,706,224)
Other	464,759	546,851
Capital grants and contributions	25,306,607	39,467,594
Transfers to other funds of the Metropolitan Government, net	<u>(7,440,274)</u>	<u>(6,367,638)</u>
Change in net assets	36,828,659	45,104,978
Net assets, beginning of year	1,268,186,443	1,223,081,465
Net assets, end of year	<u>\$ 1,305,015,102</u>	<u>\$ 1,268,186,443</u>

Current assets in 2012 exceed 2011 by approximately \$13.0 million, due to increased cash and cash equivalents. Current liabilities increased by \$69.2 million due to additional borrowing under the existing commercial paper program, yielding a current ratio of 0.71. Capital assets, net of depreciation increased by \$80 million in 2012 from 2011. These increases are from a combination of infrastructure being deeded to the Department by developers, recovery efforts from the 2010 flood event, and the Department's efforts to maintain and improve the system.

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The Department has an ongoing program to improve both the water and sewer infrastructure by cleaning and/or relining existing pipes, as well as replacing and extending facilities.

**CAPITAL ASSETS AND BONDS AND NOTES PAYABLE**

Capital Assets – The Department’s investment in capital assets as of June 30, 2012 is \$1.7 billion, which is an increase of 5.0 percent from the year ending June 30, 2011. Depreciation expense for FY 2012 totaled \$60.1 million.

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Utility plant in service	\$ 2,401,490,915	\$ 2,285,736,748
Land	10,010,297	10,010,297
Buildings and improvements	40,293,786	38,586,346
Improvements other than buildings	41,000,878	40,983,879
Furniture, machinery and equipment	35,729,034	34,229,225
Construction work in progress	99,330,085	78,282,422
Less accumulated depreciation	<u>(930,391,214)</u>	<u>(870,354,455)</u>
	<u>\$ 1,697,463,781</u>	<u>\$ 1,617,474,462</u>

Utility plant in service increased \$115.8 million and construction work in progress increased \$21.0 million during the year ending June 30, 2012. The primary reasons for the increases were due to flood recovery activities at treatment plants, pumping stations, reservoirs, and water distribution or sewer collection lines.

Additional information on the Department’s capital assets can be found in Note C beginning on page 21 of this report.

Bonds and Notes Payable – At June 30, 2012, the Department had total outstanding bond debt, including deferred charges/premiums, net, of \$689.6 million. The revenues of the Department collateralized all bond debt. The Department had one outstanding state economic and development loan totaling \$196,884.

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Revenue bonds payable	\$ 659,360,000	\$ 567,565,000
Deferred charges / premiums, net	30,266,859	8,142,912
State construction loans	-	159,438,661
State economic and development loan	<u>196,884</u>	<u>242,574</u>
Total	<u>\$ 689,823,743</u>	<u>\$ 735,389,147</u>

Additional information on the Department’s bonds and note payable can be found in Note D beginning on page 22 of this report.

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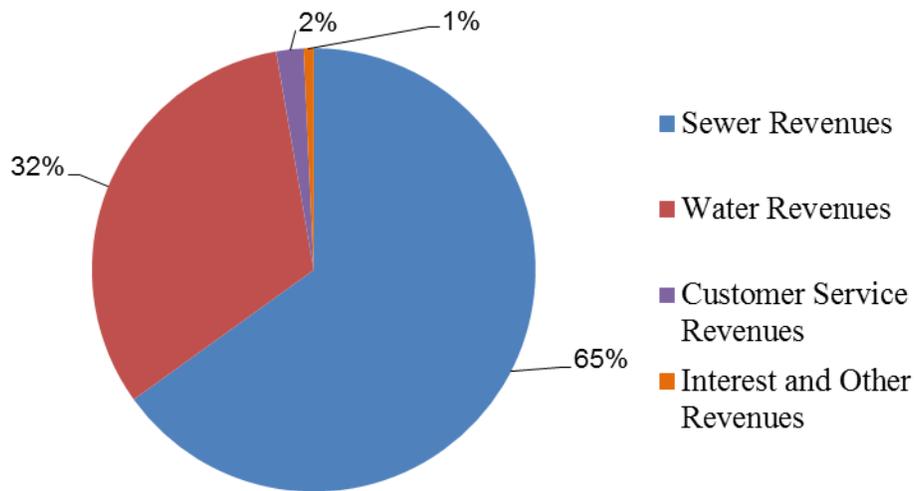
JUNE 30, 2012

Commercial Paper – In November 2009, the Metropolitan Government instituted a Water and Sewer revenue bond commercial paper program to provide interim and short-term financing for various authorized capital projects of the Department. There was \$60,352,500 outstanding commercial paper under the Water and Sewer program at June 30, 2012.

**OTHER INFORMATION**

Sources of Revenues

The Department collects its primary revenues from charges for water and sewerage services provided to customers. In addition, these revenues are invested to earn interest. Customers are charged fees (Customer Service Revenue) to establish service, for late payment and for insufficient funds checks. The Department also charges a fee to tap onto the water system, a similar fee to connect to the sewerage system and a sewer capacity fee. These are illustrated on the chart below as a percentage of total revenues:

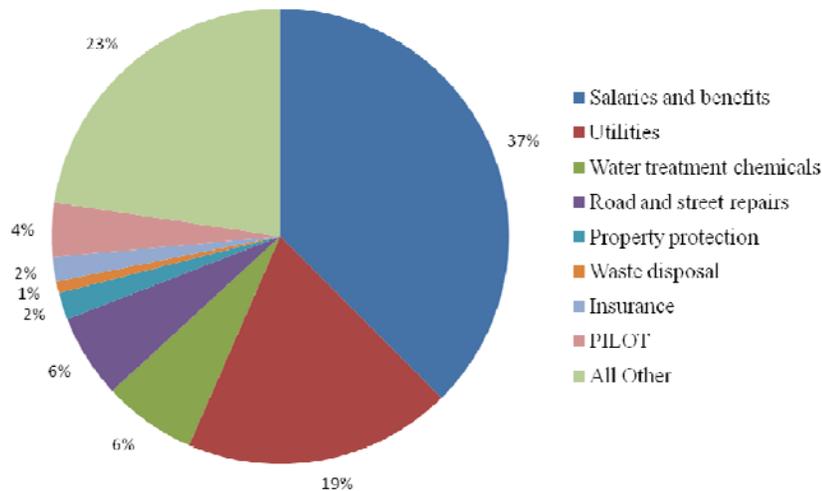


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Major Expenses

In addition to the salaries and benefits of its employees, the major expenses incurred by the Department include electricity, payment in lieu of taxes to the Government (“PILOT”), water treatment chemicals, biosolids disposal, insurance, and property protection. Other expenses include the materials, supplies, and outside labor to maintain the system. These expense categories are charted below as a percentage of total operating expenses, excluding Depreciation, and Amortization:



**REQUESTS FOR INFORMATION**

This financial report is designed to provide a general overview of the Department's finances for citizens, taxpayers, customers, investors, creditors and all others with an interest in the Department's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to The Metropolitan Government of Nashville and Davidson County, Department of Finance, Division of Accounts, <mailto:cafr@nashville.gov>.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
STATEMENT OF NET ASSETS  
JUNE 30, 2012

ASSETS

Current assets:	
Cash and cash equivalents	\$ 37,511,772
Accounts receivable	22,744,662
Allowance for doubtful accounts	( 3,166,134)
Accrued interest receivable	5,483
Due from other funds of the Government	316,939
Inventories of supplies	2,287,258
Other current assets	1,000
Restricted Assets:	
Debt service and reserve funds:	
Accrued interest receivable	990
Other current assets	112,435
Construction funds:	
Cash and cash equivalents	881,486
Accounts receivable	42,881
Accrued interest receivable	1,242
Due from other funds of the Government	<u>51,209,291</u>
Total current assets	<u>111,949,305</u>
Capital and other noncurrent assets:	
Capital assets:	
Utility plant in service	2,401,490,915
Land	10,010,297
Buildings and improvements	40,293,786
Improvements other than buildings	41,000,878
Furniture, machinery and equipment	35,729,034
Construction in progress	99,330,085
Less accumulated depreciation	<u>( 930,391,214)</u>
Capital assets, net	1,697,463,781
Restricted assets:	
Debt service and reserve funds:	
Cash and cash equivalents	63,076,341
Construction funds:	
Cash and cash equivalents	159,166,292
Other noncurrent assets	<u>79,189,861</u>
Total capital and other noncurrent assets	<u>1,998,896,275</u>
Total assets	<u>2,110,845,580</u>

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
STATEMENT OF NET ASSETS - Continued  
JUNE 30, 2012

LIABILITIES AND NET ASSETS

Current liabilities:	
Accounts payable	\$ 7,585,139
Accrued payroll	628,757
Due to other funds of the Government	7,189,656
Customer deposits	3,168,278
Other current liabilities	3,671,952
Liabilities payable from restricted assets:	
Debt service and reserve funds:	
Accrued interest payable - revenue bonds	17,104,192
Current portion of revenue bonds, net	42,410,000
Construction funds:	
Accounts payable	9,058,977
Accrued payroll	122,666
Current portion of state loans	47,061
Commercial paper payable	60,352,500
Due to other funds of the Government	<u>7,124,618</u>
Total current liabilities	<u>158,463,796</u>
Noncurrent liabilities:	
Revenue bonds, net	647,216,859
State loans	<u>149,823</u>
Total noncurrent liabilities	<u>647,366,682</u>
Total liabilities	<u>805,830,478</u>
Net assets:	
Invested in capital assets, net of related debt	1,216,115,852
Restricted for debt retirement	46,085,574
Unrestricted	<u>42,813,676</u>
Total net assets	<u>\$1,305,015,102</u>

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS  
YEAR ENDED JUNE 30, 2012

Operating revenues:	
Charges for services	\$ 200,412,355
Other	<u>350,130</u>
Total operating revenues	<u>200,762,485</u>
Operating expenses:	
Personal services	41,249,138
Contractual services	42,565,249
Supplies and materials	13,252,364
Depreciation	60,102,853
Amortization	936,324
Other	<u>5,418,474</u>
Total operating expenses	<u>163,524,402</u>
Operating income	<u>37,238,083</u>
Nonoperating revenue (expense):	
Investment income	35,758
Interest expense	( 18,776,274)
Gain on sale of capital assets	167,304
Other	<u>297,455</u>
Nonoperating expense, net	<u>( 18,275,757)</u>
Income before capital grants and contributions and transfers	<u>18,962,326</u>
Capital grants and contributions	25,306,607
Transfers from other funds of the Government	200,000
Transfers to other funds of the Government	<u>( 7,640,274)</u>
Increase in net assets	36,828,659
Net assets, beginning of year	<u>1,268,186,443</u>
Net assets, end of year	<u>\$ 1,305,015,102</u>

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
STATEMENT OF CASH FLOWS  
YEAR ENDED JUNE 30, 2012

Cash flows from operating activities:	
Receipts from customers and users	\$ 205,328,622
Payments to suppliers	( 54,936,017)
Payments to employees	( 42,823,231)
Other receipts	<u>10,302,622</u>
Net cash provided by operating activities	<u>117,871,996</u>
Cash flows from noncapital financing activities:	
Transfers from other funds of the Government	200,000
Transfers to other funds of the Government	<u>( 7,640,274)</u>
Net cash used in noncapital financing activities	<u>( 7,440,274)</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(103,934,230)
Proceeds from the sale of capital assets	167,304
Proceeds from borrowings	60,396,634
Principal payments on borrowings	( 43,300,783)
Interest subsidy	5,336,423
Interest paid	( 35,397,457)
Capital contributions received	3,383,485
Advances to other funds of the Government	<u>( 13,713,014)</u>
Net cash used in capital and related financing activities	<u>(127,061,638)</u>
Cash flows from investing activities:	
Interest received	<u>56,060</u>
Net cash provided by investing activities	<u>56,060</u>
Net decrease in cash and cash equivalents	( 16,573,856)
Cash and cash equivalents at beginning of year	<u>277,209,747</u>
Cash and cash equivalents at end of year	<u>\$ 260,635,891</u>
Cash and cash equivalents are classified as:	
Current assets	\$ 37,511,772
Current restricted assets construction funds	881,486
Noncurrent restricted assets debt service and reserve funds	63,076,341
Noncurrent restricted assets construction funds	<u>159,166,292</u>
	<u>\$260,635,891</u>

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
STATEMENT OF CASH FLOWS - Continued  
YEAR ENDED JUNE 30, 2012

Reconciliation of operating income to net cash  
provided by operating activities:

Operating income	<u>\$ 37,238,083</u>
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	61,039,177
Bad debt expense	( 240,000)
Other receipts	297,455
Changes in assets and liabilities:	
Accounts receivable	4,931,545
Due from other funds of the Government	1,252,098
Inventories of supplies	( 217,836)
Other current assets	45,271
Due from other governmental agencies	366,178
Accounts payable	1,377,357
Accrued payroll	( 1,574,093)
Due to other funds of the Government	12,745,839
Customer deposits	224,722
Other current liabilities	<u>386,200</u>
Total adjustments	<u>80,633,913</u>
Net cash provided by operating activities	<u>\$ 117,871,996</u>
Supplemental disclosure of non-cash items:	
Contributions of the capital assets	<u>\$ 22,322,289</u>

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements encompass the financial activities of the Department of Water and Sewerage Services (the “Department”). The Department is an enterprise fund of The Metropolitan Government of Nashville and Davidson County, Tennessee (the “Metropolitan Government”) and, accordingly, is included in the basic financial statements of the Metropolitan Government. The accompanying financial statements do not purport to present fairly the financial position of The Metropolitan Government of Nashville and Davidson County, Tennessee and changes in its financial position and its cash flows. The Department provides water and sewerage services to customers in the Metropolitan Nashville area on a self-support basis utilizing a rate structure designed to produce revenues sufficient to fund debt service requirements and operating expenses and maintain adequate working capital.

Basis of Accounting

The financial statements are presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. The Department applies all relevant Government Accounting Standards Board (“GASB”) pronouncements. In addition, the Department has elected to apply all Financial Accounting Standards Board (“FASB”) pronouncements issued after November 30, 1989, except for those that may conflict with or contradict GASB pronouncements. Effective July 1, 2009, FASB pronouncements have been codified in a single source, *FASB Accounting Standard Codification* (“ASC”).

Estimates

Estimates used in the preparation of financial statements require management to make assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include amounts in demand deposits and highly liquid short-term investments with maturity dates within three months of the date of acquisition. The Department participates in the centrally managed cash and investment pool of the Metropolitan Government, under which the Metropolitan Government remits payments on behalf of the Department. In fiscal 2012, the amount for “due to other funds of the Metropolitan Government” included in liabilities payable from restricted assets represents an unliquidated obligation as a result of an investment purchase that is held by the construction funds. Such obligation was settled subsequent to year-end. Investment income earned on funds invested in pooled accounts is allocated to the Department by the Metropolitan Government on the basis of relative balances.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

Inventories

Inventories, principally materials, supplies and replacement parts, are valued at the lower of cost (average cost method) or market. Inventory items are recorded as expenditures when used under the consumption method.

Capital Assets

Utility plant acquired prior to July 31, 1952, is stated at the estimated cost at that date, as determined by independent engineers, with subsequent additions recorded at cost. Net interest expense incurred during the construction of plant and equipment is capitalized as part of the cost of the related asset. Capitalized interest for the year ended June 30, 2012 was \$13,835,653. Capital assets are generally defined as assets with an individual cost in excess of \$5,000 and a useful life in excess of one year. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets. The estimated useful lives are as follows:

Utility plant in service	7 - 100 years
Building and improvements	3 - 50 years
Improvements other than buildings	20 - 100 years
Machinery and equipment	3 - 50 years

The Department closes completed construction projects to capital assets upon beneficial use.

Bond Premiums Discounts and Issuance Costs

Bond premiums, discounts and issuance costs are deferred and amortized on a straight-line basis over the term of the related bond issue.

Compensated Absences

General policy of the Metropolitan Civil Service Commission permits the accumulation, within certain limitations, of unused vacation days and sick leave. Vacation days may accumulate to an amount equal to three times the current vacation accrual rate. Accumulated unpaid vacation pay is recorded as a liability by the Department. Although sick pay may accumulate, no amounts are vested in the event of employee termination; therefore, no liability for sick pay has been accrued.

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A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

Restricted Assets

Restricted assets represent amounts which are required to be maintained pursuant to Department bond resolutions relating to bonded indebtedness (construction and sinking funds) and funds received for specific purposes pursuant to U.S. Government grants (related primarily to construction projects).

Operating and Nonoperating Revenues and Expenses

Operating revenues and expenses generally result from providing services and providing and delivering goods and services in connection with the Department's principal ongoing operations and consist primarily of charges to customers or departments, cost of sales and services, administrative expense, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. When both restricted and unrestricted resources are available for use, it is the Department's policy to use restricted resources first and then unrestricted resources, as they are needed.

Capital Grants and Contributions

Capital grants and contributions include funds received from federal and state agencies for certain sewer projects by the Department, contributions from local governments and other sources, tap and capacity fees, and deeds of conveyance. Utility plant contributed is recorded/presented in accordance with the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* and GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis' for State and Local Governments*. These statements require that capital contributions be reported in the statement of revenue, expenses and changes in net assets as a separate line item after non-operating revenues and expenses, rather than as direct additions to contributed capital, as under previous standards.

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A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

Impairment of Long-Lived Assets

The carrying value of long-lived assets held and used are reviewed whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. For purpose of evaluating the recoverability of long-lived assets, the recoverability test is performed using undiscounted net cash flows before consideration of interest expense. Should the sum of the expected future net cash flows be less than the carrying value of the asset being evaluated, an impairment loss would be recognized. The evaluation of asset impairment requires the Department to make assumptions about future cash flows over the life of the asset being evaluated. Assets to be disposed of are reported at the lower of their carrying amount or fair value less costs to sell, and are no longer depreciated. No impairment loss was considered necessary during fiscal year 2012.

Revenue Recognition

Revenues from services provided by the Department are recognized from meters read on a monthly cycle basis. At the end of each month, services rendered from the latest date of each meter-reading cycle to month end is accrued and included as accounts receivable, net of an estimated allowance for uncollectible accounts.

Fair Value Measurements

Assets and liabilities recorded at fair value in the statement of net assets are categorized based on the level of judgment associated with the inputs used to measure their fair value. Level inputs, as defined by ASC 820, *Fair Value Measurements*, are as follows:

- Level 1 - Values are unadjusted quoted prices for identical assets and liabilities in active markets accessible at the measurement date.
- Level 2 - Inputs include quoted prices for similar assets and liabilities in active markets, quoted prices from those willing to trade in markets that are not active, or other inputs that are observable or can be corroborated by market data for the term of the instrument. Such inputs include market interest rates and volatilities, spreads and yield curves.
- Level 3 - Certain inputs are unobservable (supported by little or no market activity) and significant to the fair value measurement. Unobservable inputs reflect the best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

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A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

The Department's financial instruments consist of cash equivalents, accounts receivable, accounts payable and bonds and notes payable. The carrying value of cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term maturity of these instruments. The aggregate fair value of the bonds and notes payable exceeded their recorded values by approximately \$47,000,000 at June 30, 2012. The fair value was estimated using discounted cash flow analyses based on the Department's current incremental borrowing rates for similar types of borrowing arrangements.

Accounting Pronouncements

The Department plans to adopt GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, required for fiscal periods beginning after June 15, 2012, in fiscal 2013. This Statement is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statements No. 14 and 34, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued.

The Department plans to adopt GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, required for fiscal periods beginning after December 15, 2011, in fiscal 2013. This Statement is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board ("FASB") and American Institute of Certified Public Accountants ("AICPA") pronouncements.

The Department plans to adopt GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, required for fiscal periods beginning after December 15, 2011, in fiscal 2013. This Statement is intended to improve financial reporting by providing citizens and other users of state and local government reports with information about how past transactions will continue to impact a government's financial statements in the future.

The Department adopted GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, required for fiscal periods beginning after June 15, 2011, in fiscal 2012. This Statement will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The adoption of this Statement had no impact on the Government's financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
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A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

The Department plans to adopt GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, required for fiscal periods beginning after December 15, 2012, in fiscal 2014. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

The Department plans to adopt GASB Statement No. 66, *Technical Corrections - 2012- an amendment of GASB Statements No. 10 and No. 62*, required for fiscal periods beginning after December 15, 2012, in fiscal 2014. This Statement improves accounting and financial reporting by resolving conflicting guidance that resulted from the issuance of Statements No. 54 and No. 62.

The Department plans to adopt GASB Statement No. 67, *Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25*, required for fiscal periods beginning after June 15, 2013, in fiscal 2014. This Statement improves financial reporting by state and local government pension plans.

The Department plans to adopt GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, required for fiscal periods beginning after June 15, 2014, in fiscal 2015. This Statement improves accounting and financial reporting by state and local governments for pensions.

Unless otherwise noted, management is in the process of determining the effects that the adoption of these Statements will have on the Department's financial statements.

B. CASH AND CASH EQUIVALENTS

Deposit Policy

The Department is authorized by policy to invest funds that are not immediately needed in: United States Treasury Bills, Bonds and Notes; the State of Tennessee Local Government Investment Pool; bonds issued by the Government; bonds of commercial entities; and other investments such as repurchase agreements and commercial paper. The Department is authorized to invest in these instruments either directly or through the Metro Investment Pool.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
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B. CASH AND CASH EQUIVALENTS - Continued

Deposits in financial institutions are required by State statute to be secured and collateralized by the institutions. The collateral must meet certain requirements and must have a total minimum market value of 105% of the value of the deposits placed in the institutions, less the amount protected by federal depository insurance. Collateral requirements are not applicable for financial institutions that participate in the State of Tennessee's collateral pool. As of June 30, 2012, most of the Department's deposits were held by financial institutions, which participate in the bank collateral pool administered by the Treasurer of the State of Tennessee or in the State of Tennessee Local Government Investment Pool. Participating banks determine the aggregated balance of their public fund accounts for the Department. The amount of collateral required to secure these public deposits must be at least 105% of the average daily balance of public deposits held. Collateral securities required to be pledged by the participating banks to protect their public fund accounts are pledged to the State Treasurer on behalf of the bank collateral pool. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. Accounts covered by the State collateral pool are classified as category A in accordance with GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*.

The Department's deposits are categorized below to give an indication of the level of risk assumed by the Department at fiscal year-end. Category A includes deposits that are insured or collateralized with securities held by the Department or by its agent in the Department's name. Category B includes deposits that are uninsured and uncollateralized. The carrying amount of the cash and cash equivalents totaled \$260,635,891, and the corresponding bank balance was \$260,750,708. The difference between the carrying amounts of cash and cash equivalents and the corresponding bank balances is due primarily to outstanding checks and deposits in transit. The entire balance of cash and cash equivalents was covered by the State collateral pool, federal depository insurance or collateralized with securities held by the government's agent in the government's name (Category A).

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C. CAPITAL ASSETS

The following summarizes the changes in capital assets during the year ended June 30, 2012.

	<u>Balance</u> <u>July 1, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2012</u>
Depreciable assets:				
Utility plant in service	\$2,285,736,748	\$115,754,167	\$ -	\$2,401,490,915
Buildings and improvements	38,586,346	1,707,440	-	40,293,786
Improvements other than buildings	40,983,879	16,999	-	41,000,878
Furniture, machinery and equipment	<u>34,229,225</u>	<u>1,585,077</u>	<u>85,268</u>	<u>35,729,034</u>
Total depreciable assets	<u>2,399,536,198</u>	<u>119,063,683</u>	<u>85,268</u>	<u>2,518,514,613</u>
Nondepreciable assets:				
Land	10,010,297	-	-	10,010,297
Construction in progress	<u>78,282,422</u>	<u>152,639,028</u>	<u>131,591,365</u>	<u>99,330,085</u>
Total nondepreciable assets	<u>88,292,719</u>	<u>152,639,028</u>	<u>131,591,365</u>	<u>109,340,382</u>
Total at historical cost	<u>2,487,828,917</u>	<u>271,702,711</u>	<u>131,676,633</u>	<u>2,627,854,995</u>
Less accumulated depreciation for:				
Utility plant in service	780,956,388	57,105,151	-	838,061,539
Buildings and improvements	25,675,478	1,051,677	-	26,727,155
Improvements other than buildings	32,951,570	689,322	-	33,640,892
Furniture, machinery and equipment	<u>30,771,019</u>	<u>1,256,702</u>	<u>66,093</u>	<u>31,961,628</u>
Total accumulated depreciation	<u>870,354,455</u>	<u>60,102,852</u>	<u>66,093</u>	<u>930,391,214</u>
Capital assets, net	<u>\$1,617,474,462</u>	<u>\$211,599,859</u>	<u>\$131,610,540</u>	<u>\$1,697,463,781</u>

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
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D. BONDS AND NOTES PAYABLE

Transaction Summary

Bonds and notes payable activity for the year ended June 30, 2012 was as follows:

	<u>Balance</u> <u>July 1, 2011</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2012</u>	<u>Due Within</u> <u>One Year</u>
Revenue bonds payable	\$567,565,000	\$129,625,000	\$( 37,830,000)	\$659,360,000	\$42,410,000
Deferred charges/ premiums, net	8,142,912	22,123,947	-	30,266,859	-
State construction loans	159,438,661	-	(159,438,661)	-	-
State economic and development loan	<u>242,574</u>	<u>-</u>	<u>( 45,690)</u>	<u>196,884</u>	<u>47,061</u>
Total	<u>\$735,389,147</u>	<u>\$151,748,947</u>	<u>\$(197,314,351)</u>	<u>\$689,823,743</u>	<u>\$42,457,061</u>

Description of Amount Payable

Amounts payable at June 30, 2012 are as follows:

	<u>Interest Rate</u>	<u>Amount</u>
Revenue bonds payable:		
Department of Water and Sewerage Revenue Bonds, Series 1993, due in varying amounts to January 1, 2013	5.20 - 6.50%	\$ 15,385,000
Department of Water and Sewerage Revenue Bonds Series 1998B, due in varying amounts to January 1, 2014	4.55 - 5.25%	17,685,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2007, due in varying amounts to January 1, 2016	4.25 - 5.00%	35,340,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2008A, due in varying amounts to January 1, 2022	3.25 - 5.25%	112,120,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2008B, due in varying amounts to January 1, 2016	3.45 - 4.84%	27,545,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2010A, due in varying amounts to July 1, 2027	3.00 - 5.00%	104,050,000

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D. BONDS AND NOTES PAYABLE - Continued

Description of Amount Payable - Continued

	<u>Interest Rate</u>	<u>Amount</u>
Department of Water and Sewerage Revenue Bonds, Federally Taxable (BAB's), Series 2010B, due in varying amounts to July 1, 2037	6.393 - 6.568%	\$135,000,000
Department of Water and Sewerage Revenue Bonds, Federally Taxable, Series 2010C, due in varying amounts to July 1, 2041	6.693%	75,000,000
Department of Water and Sewerage Revenue Refunding Bonds, Federally Taxable, Series 2010D, due in varying amounts to July 1, 2018	4.255 - 4.791%	7,610,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2012, due in varying amounts to July 1, 2023	1.00 - 5.00%	129,625,000
Deferred charge/premium, net		<u>30,266,859</u>
Total revenue bonds payable		689,626,859
State economic and development loan	3.00%	<u>196,884</u>
Total		<u>\$689,823,743</u>

The bonds and notes payable are classified in the Statement of Net Assets as follows:

Current liabilities:

Liabilities payable from restricted assets:

Current portion of revenue bonds, net and  
state construction loans

\$ 42,457,061

Noncurrent liabilities:

Revenue bonds, net and state loans

647,366,682

Total

\$689,823,743

Collateral

All bonds are collateralized by the revenues of the Department.

Bond Covenants

The various revenue bond indentures contain significant limitations and restrictions on annual debt service requirements, maintenance of a flow of monies through various restricted accounts, minimum amounts to be maintained in various sinking funds, and minimum revenue bond coverages. As of June 30, 2012, the Department believes it is in compliance with all financial limitations and restrictions.

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D. BONDS AND NOTES PAYABLE - Continued

Annual Debt Service Requirements

The annual requirements to amortize all revenue bonds outstanding as of June 30, 2012 are as follows:

<u>Year Ending June 30,</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2013	\$ 42,410,000	\$ 29,385,694
2014	30,885,000	27,854,157
2015	53,350,000	26,149,914
2016	25,735,000	23,922,449
2017	28,795,000	22,511,535
2018 - 2022	195,985,000	85,923,340
2023 - 2027	69,825,000	49,592,754
2028 - 2032	56,890,000	37,159,180
2033 - 2037	69,970,000	23,766,491
2038 - 2042	<u>85,515,000</u>	<u>8,132,852</u>
	659,360,000	334,398,366
Deferred charge/premium	<u>30,266,859</u>	<u>-</u>
Total	<u>\$689,626,859</u>	<u>\$334,398,366</u>

Commercial Paper

In November 2009, the Department instituted a revenue commercial paper (bond anticipation note) program. Commercial paper notes are issued to provide interim or short-term financing of various water and sewer capital projects. The notes may be refunded with new notes (rollover notes) until the Department is prepared to issue long-term bonds and thereby provide permanent financing for the capital projects financed under the commercial paper program. The Department entered into Standby Note Purchase Agreements with two banks to provide liquidity for the commercial paper program. If the commercial paper dealer was ever unable to market notes in the amount needed to pay the maturing notes, the liquidity providers would issue bank notes, the proceeds of which are applied to pay the principal of and interest on commercial paper notes on the respective maturity dates.

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D. BONDS AND NOTES PAYABLE - Continued

Commercial Paper - Continued

Revenue commercial paper is issued as federally tax-exempt notes. The commercial paper is sold at par as interest-bearing obligations in minimum denominations of \$100,000 with interest payable at maturity. The commercial paper has varying maturities not to exceed 270 days, and all rollover commercial paper will not have a final maturity more than two years from the initial dates of issuance. The State has waived the two-year final maturity limitation and approved a final maturity not to exceed six years. Interest rates vary depending on the market. At June 30, 2012, the amount of principal outstanding could not exceed \$183.4 million. The balance on the commercial payer obligations on June 30, 2012 was \$60,352,500.

Commercial paper activity for the year ended June 30, 2012 was as follows:

	<u>Balance</u> <u>July 1, 2011</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2012</u>
Commercial paper payable	\$ <u>          -</u>	<u>\$150,000,000</u>	<u>\$(89,647,500)</u>	<u>\$60,352,500</u>

Issuance of Bonds

On February 2, 2012, the Government issued \$129,625,000 Water and Sewer Revenue Refunding Bonds, Series 2012, maturing on July 1, 2023, with interest rates ranging from 1.00% to 5.00%. The series 2012 Bonds refunded the outstanding balances of the Department of Water and Sewerage Services State Construction Loans with the Tennessee Department of Conservation and the Tennessee Local Development Authority under the State of Tennessee's Revolving Fund Loan Program. By issuing the Series 2012 Bonds, the Government obtained an estimated economic gain (difference between the present values of the debt service payments on the defeased and new debt) of \$8,802,543. The refunding will reduce the Government's debt service payments over the next twenty-one years by an estimated \$13,408,528.

Defeased Bonds

In the current and prior years, the Department has defeased certain other obligation bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service requirements on the retired bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Department's financial statements. As of June 30, 2012, \$23,695,000 of revenue bonds are considered defeased.

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D. BONDS AND NOTES PAYABLE - Continued

Redemption Options

Certain bonds are subject to redemption prior to maturity at the option of the Department. The stated payments of principal and interest on the Department of Water and Sewerage Services Series 1992 and Series 2010A, B, C and D are insured by municipal bond insurance policies which cannot be canceled.

State Economic and Development Loan

In January 2009, the Department entered a loan agreement with the Tennessee Department of Economic Development for \$330,000. The proceeds of the loan will be used to fund the installation of variable frequency drives on the raw water pumps at the K.R. Harrington water treatment plant. The energy savings resulting from the ability to gradually increase or decrease pump speeds rather than adding or dropping pumps at full capacity will be used to repay the loan. The loan is for seven years, and interest is calculated on the loan at 3%.

State economic and development loan principal maturities as of June 30, 2012 are summarized below:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>
2013	\$ 47,061	\$ 5,907
2014	48,472	4,495
2015	49,927	3,041
2016	<u>51,424</u>	<u>1,543</u>
Total state economic and development loan	<u>\$196,884</u>	<u>\$14,986</u>

E. EMPLOYEE BENEFIT PLANS

Pension Plans

The Government sponsors or guarantees several single-employer pension plans, including (a) the closed City Plan ("City Plan"), (b) the Davidson County Employees' Retirement Fund (County Plan), both of which were closed to new members on April 1, 1963, and (c) The Metropolitan Employees' Benefit Trust Fund Division A or B ("Metro Plan"). Division A of the Metro Plan was established at the inception of The Government on April 1, 1963, and was closed to new members on July 1, 1995. Division B of the Metro Plan was established as of July 1, 1995.

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E. EMPLOYEE BENEFIT PLANS - Continued

All plans of the Government were established by or continue under the authority of the Metropolitan Charter, Article XIII, effective April 1, 1963. Approval of the Metropolitan Council is required to establish and amend benefit provisions. Article XIII also requires that all pension plans be actuarially sound. Administrative costs of the plans are financed by plan assets. The plans are administered by the Metropolitan Employee Benefit Board, an independent board created by the Metropolitan Charter. The financial position and results of operations of the pension plans are reported as fiduciary funds of the Government and, accordingly, are not included in the financial statements of the Department.

Substantially all employees of the Department are members of the Metropolitan Plan. Periodic contributions by the Department to the Metropolitan Plan are at actuarially determined rates that are designed to accumulate sufficient assets to pay benefits when due. Contributions to closed plans are made on a pay-as-you-go basis whereby contributions are made in amounts sufficient to cover benefits paid during the year. Actuarially required employer contributions are not computed because the plans are closed and there are few active employees. Employees do not contribute to any of the pension plans.

Normal retirement for employees occurs at age 65 – Division A, or 60 – Division B, and entitles employees to a lifetime monthly benefit as determined under the Plan. Benefits fully vest upon completing five years of service.

Amounts of actuarially determined net pension obligation are reported in the government-wide financial statement of the Metropolitan Government. Accordingly, no additional liability has been accrued in the financial statements of the Department.

Contributions to the various pension plans totaled \$4,876,805 for the year ended June 30, 2012.

Other Post-Employment Benefit (OPEB) Plans

Retirees in the Metropolitan, City or County Plans may elect to participate in the Metropolitan Employees' Medical Benefit Plan, a single-employer defined benefit healthcare plan. The Metropolitan Plan is administered by the Employee Benefit Board and provides medical, dental and life insurance. The other post-employment benefits for Government employees were authorized by the Government's charter and code. The Metropolitan Plan does not issue a stand-alone financial report.

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E. EMPLOYEE BENEFIT PLANS - Continued

The post-employment benefits for the Metropolitan plans were authorized by the Government's Charter. As the Government has assumed the responsibility for funding these benefits, the Department has accrued no liability as of June 30, 2012.

The contribution requirements of Metropolitan Employees' Medical Benefit Plan members and the Government are established and may be amended by the Employee Benefit Board. The required contribution is based on projected pay-as-you-go financing requirements under which contributions are made in amounts sufficient to cover benefits paid, administrative costs and anticipated inflationary increases. For health insurance, the Government contributes 75% of all premium payments, and the retirees contribute 25%. The Government also provides a 50% matching contribution on dental insurance for any retiree who elects to participate. Finally, the Government provides life insurance at no charge to the retirees.

Deferred Compensation Plan

The Government offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits deferral of a portion of salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. Because the assets are not held in a trustee capacity by the Government, they are not included in the Government's financial statements. No contributions are made to this plan by the Government.

F. COMMITMENTS AND CONTINGENCIES

Litigation

The Department is a party to various litigation filed in the normal course of business. It is believed that the outcome of these cases will not have a material effect on the financial position of the Department.

Insurance and Benefits

The Department is subject to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; illnesses or injuries to employees; and natural disasters. The Department is a member of the Metropolitan Government's self-insurance program with respect to the first \$3,000,000 of liability claims and casualty losses in any one year. Liabilities for accidents are generally limited under the Governmental Tort Liability Act of the Tennessee Code as follows; bodily injury - \$300,000 per person, \$700,000 per accident; and property damage - \$100,000 per accident. Claims on real and personal property in losses to a \$10,000 deductible.

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F. COMMITMENTS AND CONTINGENCIES - Continued

The Department is also a member of the Government's self-insurance program with respect to medical benefits and employee blanket bond coverage. Premiums paid by the Department to the program were \$5,841,975 for the year ended June 30, 2012.

Federal and State Financial Assistance

The Department has received federal and state financial assistance for specific purposes that is subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the programs, the Department believes that any required reimbursements would not be material to the Department's financial statements. Accordingly, no provision has been made for any potential reimbursements to the grantor agencies.

Prior to the issuance of the Water and Sewer Revenue Refunding Bonds, Series 2010A, on December 16, 2010, the full faith and credit of the Metropolitan Government was pledged for possible deficiencies in the collection of required state sewer user fees established in connection with certain grants received from the State Funding Board (TCA 68-221-202 through 68-221-214). The Department acted as a conduit with respect to sewer user fees imposed by the state. These user fees were set at an amount sufficient to recover the project costs, including related interest expense. A portion of the proceeds from the Series 2010A Bonds was used to fully prepay the Tennessee Local Development Authority ("TLDA") loans. The amount of prepayment is \$73,833,383 at June 30, 2012 and is reported as other noncurrent assets. Subsequent to the issuance of the Bonds, the user fees are considered a general sewer charge and reflected as revenue. The amounts received were recorded as capital grants and contributions by the Department.

At June 30, 2012, the Department had commitments of \$87,075,791 for construction contracts.

The Department, the Metropolitan Council, the State of Tennessee Department of Environment and Conservation ("TDEC"), and the United States Environmental Protection Agency ("EPA"), have agreed on a consent decree to address and correct deficiencies within the Department's sewer system that have caused violations of the Clean Water Act ("CWA"). The consent decree was approved by the Federal Court in March 2009. Per the original decree, the Department was required to fully develop, in two years, a Corrective Action Plan/Engineering Report ("CAP/ER") for its sanitary sewer system and a Long-term Control Plan ("LTCP") for its combined sewer system to achieve the goals of the CWA and meet water quality requirements in the Cumberland River. Upon submittal and approval of the Plans, the Department will have an additional nine years to complete the work as developed by the Plans.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

F. COMMITMENTS AND CONTINGENCIES - Continued

Due to the historic floods that occurred in Nashville in May 2010, the Department petitioned EPA and TDEC for a six-month extension for developing the CAP/ER and LTCP and a two year extension for completing the work (final compliance) under the force majeure clause of the consent decree. Approval has been granted for both extensions. The due date for the CAP/ER and LTCP was September 11, 2011, and the due date for all work coming out of those two plans (final compliance) is eleven years after approval of the plans by EPA and TDEC. The Department submitted both plans on Friday, September 9, 2011, and is waiting for feedback from EPA and TDEC. The Department has hired an internal program director as well as an external program management team composed of engineering consultants to manage planning, design and oversight of the program. The Department has also contracted for a construction management team to protect the investment in construction projects. A group of project set designers has been selected to assist with the design of individual projects. A total of seventeen different design firms were selected for large projects and six additional small business design firms for smaller projects.

The future related capital expenditures are expected to be between \$1 billion and \$1.5 billion. Continuing to have sewer overflows along with failure to comply with the mandate and meet future established deadlines could result in stipulated penalties of up to \$3,000 per occurrence for sanitary sewer overflows, and up to \$5,000 per day for failure to implement the improvements on a timely basis. EPA sent a demand letter for \$147,000 in stipulated penalties for sanitary overflow on September 9, 2011. This was for a negotiated 147 violations for 2010 and the first quarter of 2011. No penalties have been demanded for any delays in submitting reports and deliverables nor from the failure to timely implement work. Proposed plans to fund capital expenditures for the next few years include internally generated cash and borrowings

G. RELATED PARTY TRANSACTIONS

The Department supplies water and sewerage services to the other departments of the Government, for which standard rates are charged.

The Government performs certain administrative functions for the Department. The cost of such services included in operating expenses is \$8,381,604 for the year ended June 30, 2012.

In addition, in February 1996, the Metropolitan Government adopted a resolution which requires the Department to make an annual payment to the Government of \$4,000,000, representing a payment in lieu of ad valorem taxes. This payment is included in operating expenses for the year ended June 30, 2012.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2012

H. SUBSEQUENT EVENTS

On August 17, 2012, the Department purchased a tract of 125 acres of land adjacent to the Omohundro Water Treatment Plant for \$12,465,447 for business purposes including future water plant expansion to meet capacity and water quality regulations, location and proximity to large water and sewer existing infrastructure, and May 2010 flood mitigation.

The Department has evaluated subsequent events through October 31, 2012, the date the financial statements were available for issuance, and has determined that there are no other items requiring disclosure.

## **SUPPLEMENTARY INFORMATION**

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
 THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
 SCHEDULE OF UTILITY RATES (UNAUDITED)  
 JUNE 30, 2012

The rate structure is composed of a meter charge and a volume charge.

The Department had the following rate structure in effect at June 30, 2012:

Meter Size	Water				Sewer			
	Residential	Small Commercial	Intermediate Commercial	Large Commercial	Residential	Small Commercial	Intermediate Commercial	Large Commercial
5/8"	\$3.13	\$3.98	\$13.85	\$597.23	\$7.62	\$8.51	\$27.89	\$1,076.37
3/4"	10.62	11.32	19.64	603.69	21.63	24.22	39.55	1,088.01
1"	12.77	13.63	21.51	605.80	26.05	29.17	43.33	1,091.79
1 1/2"	18.77	20.03	26.71	611.60	38.29	42.89	53.81	1,102.25
2"	25.29	26.97	32.63	618.22	51.57	57.75	65.73	1,114.18
3"	33.38	35.61	40.84	624.04	68.04	76.21	82.26	1,124.65
4"	54.41	58.03	64.65	650.65	110.88	124.18	130.22	1,172.65
6"	85.42	91.12	99.81	689.96	174.12	195.01	201.05	1,243.48
8"	133.59	142.50	155.38	755.41	272.29	304.96	312.96	1,361.43
10"	133.59	142.50	155.38	755.41	272.29	304.96	312.96	1,361.43

VOLUME:

Water usage charges per 100 cubic feet  
 (For usage over 200 cubic feet)

\$2.33    \$2.48    \$2.14    \$1.81

Sewer usage charges per 100 cubic feet  
 (For usage over 200 cubic feet)

\$4.74    \$5.30    \$4.32    \$3.26

See accompanying accountants' report.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
SCHEDULE OF NUMBER OF CUSTOMERS (UNAUDITED)  
JUNE 30, 2012

	<u>Residential</u>	<u>Commercial</u>	<u>Total</u>
Water Customers	165,064	19,357	184,421
Sewer Customers	<u>179,201</u>	<u>16,179</u>	<u>195,380</u>
Total Customers	<u>344,265</u>	<u>35,536</u>	<u>379,801</u>

See accompanying accountants' report.

DEPARTMENT OF WATER AND SEWERAGE SERVICES  
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY  
SCHEDULE OF UNACCOUNTED FOR WATER (UNAUDITED)  
JUNE 30, 2012

(All amounts in gallons)

Water Treated and Purchased:		
Water Pumped (potable)	31,945,340,000	
Water Purchased	<u>155,354,000</u>	
 Total Water Treated and Purchased		 32,100,694,000
 Accounted for Water:		
Water Sold	22,471,428,000	
Metered for Consumption (in house usage)	53,800,000	
Fire Departments Usage	68,927,000	
Flushing	123,563,000	
Tank Cleaning/Filling	3,300,000	
Street/Sewer Cleaning	3,530,000	
Bulk Sales	-	
Water Bill Adjustments	<u>-</u>	
 Total Accounted for Water		 <u>22,724,548,000</u>
 Unaccounted for Water		 <u>9,376,146,000</u>
 Percent Unaccounted for Water		 29.21%

See accompanying accountants' report.



Independent Auditors' Report on Internal Control over  
Financial Reporting and on Compliance and Other Matters Based on an  
Audit of Financial Statements Performed in Accordance  
With *Government Auditing Standards*

The Honorable Mayor and Members of Council  
The Metropolitan Government of Nashville and  
Davidson County, Tennessee

We have audited the financial statements of the Department of Water & Sewerage Services (the "Department"), an enterprise fund of the Metropolitan Government of Nashville and Davidson County, Tennessee (the "Metropolitan Government"), as of and for the year ended June 30, 2012, and have issued our report thereon dated October 31, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Department is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.



The Honorable Mayor and Members of Council  
The Metropolitan Government of Nashville and  
Davidson County, Tennessee

### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Department, The Metropolitan Government of Nashville and Davidson County, Tennessee, the State of Tennessee, management, and federal and state agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Crosslin + Associates, P.C.*

Nashville, Tennessee

October 31, 2012