MaherDuessel
Certified Public Accountants

Pittsburgh Water And Sewer Authority

Financial Statements and Required Supplementary and Additional Information

Years Ended December 31, 2009 and 2008
with Independent Auditor's Report

PITTSBURGH WATER AND SEWER AUTHORITY

YEARS ENDED DECEMBER 31, 2009 AND 2008

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Independent Auditor's Report

Board of Directors
Pittsburgh Water and Sewer Authority

We have audited the accompanying financial statements of the Pittsburgh Water and Sewer Authority (Authority), a component unit of the City of Pittsburgh (City), Pennsylvania, as of and for the years ended December 31, 2009 and 2008 as listed in the accompanying table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2009 and 2008, and the respective changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis Section on pages i through vi is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's basic financial statements. The additional information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The additional information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Maher Duessel

Pittsburgh, Pennsylvania
April 27, 2010

THE PITTSBURGH WATER AND SEWER AUTHORITY

2009 Financial Statements
Management Discussion and Analysis

The Pittsburgh Water and Sewer Authority (the "Authority") comparative 2009 and 2008 fiscal year financial statements enclosed have been conformed to meet the requirements of Governmental Accounting Standards Board ("GASB") Statement No. 34, *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments"*. The financial statements incorporate three basic statements: the Statements of Net Assets, the Statements of Revenues, Expenses and Changes in Net Assets, and Statements of Cash Flows.

This Management's Discussion and Analysis (MD&A) is based upon facts, decisions, and conditions known as of the date of the audit report. Please note that the historical information provided in the financial statements and MD&A reflect the results of past operations and is not necessarily indicative of results of future operations. Future operations will be affected by various factors, including, but not limited to, regulatory mandates, rate changes, weather, labor contracts, population changes, business environment and other matters, the nature and effect of which cannot now be determined.

Using This Financial Report – Overview of Reporting Changes

The Statements of Net Assets present information about the resources which are available to the Authority and claims against these resources. Both assets and liabilities are classified in a format which segregates current from long-term. In addition assets available for special purposes – labeled "restricted assets" are segregated from those assets available for operations. The Authority's restricted assets represent money on deposit with the bond trustee to meet indenture, debt service, and construction program requirements. Liabilities have a similar classification segregating claims on restricted assets from claims on assets available for operations. The net asset section of the balance sheet classifies the total net asset deficit, as invested in capital assets, restricted for capital activity and unrestricted.

The Statements of Revenues, Expenses, and Changes in Net Assets summarize operating and non-operating activity for the fiscal year and the resulting impact on the Authority's net assets.

The Statements of Revenues, Expenses, and Changes in Net Assets include Wastewater Treatment Revenues and Expenses for services provided by the Allegheny County Sanitary Authority (ALCOSAN). There are no outstanding bond issues associated directly or indirectly with wastewater revenue streams.

The Statements of Cash Flows have been prepared using the direct method. The statements provide an analysis of the Authority's cash by operating, investing and capital and related financing activities over the respective fiscal year.

Effective January 1, 2009, the Authority began depreciating certain qualifying utility assets capitalized in 2009 over 50 and 70 year lives. The change was made prospectively, for qualifying assets acquired prior to January 1, 2009. The purpose of the change was to bring the Authority's depreciable lives of specific infrastructure categories such as plant, water and sewer lines in sync with industry standard practices.

During 2009, the Authority completed a review of over 400 utility assets having a total acquisition value exceeding $410.0 million and having a net book value of $289.0 million. Only assets having an acquisition value of $50,000 or greater were included in the analysis. Prior to the change, the average number of years remaining on the qualified assets was 31 years. Post-implementation extended, on average, the qualifying asset lives by an additional 27 years. The result is an annual reduction in depreciation expense of $4.66 million beginning in 2009.

Financial Highlights

In 2009, operating income increased by 18.5% or $4.5 million resulting in net income of $4.6 million, up from a $.4 million net loss in 2008. Below are the 2009 financial highlights:

Total operating revenues in 2009 were up $4.4 million or 3.4% to $134.2 million when compared to 2008. This was driven primarily by a 13.6% increase in wastewater treatment revenues due to a 16% rate increase by ALCOSAN effective January 1, 2009. Water and sewer conveyance revenues remained unchanged from 2008.

Total non-operating revenues increased by $9.5 million, mostly driven by the $14.8 million rise in development/donated revenues. Some the largest development projects include the Port Authority's $8.0 million North Shore Connector project, Army Corps of Engineer's $2.2 million Sheraden Park, Pittsburgh's $1.85 million Casino project, Carson Street's $1.7 million and the Pittsburgh Technology Center's project for $.735 million. Non-operating revenues for grants declined 74.8% or $.738 million to $.248 million and interest revenue decreased by $4.3 million to $.690 million due to lower market rates.

Total operating expenses remained unchanged in 2009 at $105.6 million compared to $105.6 million in 2008. Significant operating expenses included the following factors:

- Salary and employee benefit expenses were up $1.1 million or 7.5%. The increase is attributed to an average salary increase of 3% and staff increases in operations.

  The majority of Authority employees are represented by one of three labor unions. The Pittsburgh Joint Collective Bargaining Committee (PJCBC) represents blue-collar employees. The American Federation of State, County and Municipal Employees (AFSCME) represent Local 2719 [white-collar] employees and Local 2037 [foremen]. A new five-year agreement with AFSCME became effective January 1, 2009 and will expire December 31, 2013. A five-year agreement with the PJCBC became effective January 1, 2008, and expires December 31, 2012.

- Overall direct operating expenses, including salaries and benefits, increased by $6 million to $58.6 million in 2009 or, 11.4% from $52.6 million in 2008. Wastewater treatment expense increased by $4.7 million or 11.7% to $44.8 million over $40.1 million in 2008. Chemicals expense increased by $.4 million. Equipment increased by $.2 million for new vehicles. Sewer repairs decreased by $.216 million or 17.0% to $1.05 million in 2009, from $1.27 million in 2008. Vactor Debris removal expense increased by $.1 million. Emergency water line repairs decreased by $.826 million to $.842 million or 49.5% from $1.67 million in 2008. Curb box repairs increased by $.23 million. Catch basin repairs increased by $.518 million to $1.3 million or 68.2% from $.759 million in 2008. Repairs and maintenance expense for IT infrastructure and building repairs increased by $.656 million due primarily to annual software support costs in 2009, up $.538 million.

- Overall G&A expenses decreased by $2.2 million to $10.3 million, or 18% in 2009 compared to $12.5 million in 2008. This was achieved primarily due to a high rate of collections on delinquent accounts resulting from a new relationship with a third-party collection agency and a $1.4 million settlement associated with the Authority's purchase of the Borough of Millvale's (formerly a wholesale customer) water infrastructure systems. Additional information on the purchase is provided below.

- Overall other expenses increased 6.7% or $3.9 million to $61.8 million in 2009 from $57.9 million in 2008. Non-city water subsidy to Pennsylvania American Water Company (PAWC) increased 50% or $.5 million to $1.6 million in 2009 compared to $1.07 million in 2008. Interest expense on bond debt increased 29.5% or $9.0 million to $39.7 million in 2009 compared to $30.7 million in 2008. The increase in interest expense was driven by the recognition of 12 months of expense in 2009 compared to 6 months of expense in 2008. The new 2008 Construction Fund of $98 million was established in June 2008. Interest expense was also up due to an increase in liquidity and remarketing fees and lower receipts from the SWAP Partners. Expenses related to the cooperate agreement with the City of Pittsburgh decreased by $1.02 in 2009 and finally, as mentioned above, depreciation and amortization expense decreased by $4.66 million due to the change in utility asset lives for specific and qualifying infrastructure.

- In 2009, collections increased by $8.5 million or 7.0%. ALCOSAN's 16% rate increase for wastewater treatment provided $6.9 million of the increase, while the remaining $2.9 million was derived by improved collection agency results and a $1.4 settlement of one delinquent wholesale customer. These significant improvements in collections resulted in a drop in bad debt expense of $1.9 million from 2008.

Other 2009 highlights include:

- For the first time in its history, the Authority agreed to purchase and fully manage a water system outside the City of Pittsburgh. In an effort to seek efficiencies and reduce increasing infrastructure costs, the Borough of Millvale, an adjacent municipality, agreed to sell its water system to the Authority for $1.555 million in cash and settlement of all outstanding AR balances of $1.4 million. The agreement brings 1,800 customers, servicing some 4,000 residents, to the Authority system increasing revenues by an estimated $.7 million per year.

- In March, the Authority appointed Jordan Tax Service, Inc. as its Collector and the law firm of Goehring, Rutter & Boehm, P.C. as Special Legal Counsel for the collection of delinquent water, sewer and sewage treatment charges. The agreement calls for a collection commission, plus other administrative and legal proceeding costs to be added to all Authority delinquent claims not paid within 90 days of the initial billing date. If fully collected, the Authority stands to collect 100% of delinquent balances without incurring a collection agency fee. The agency collected over $2.6 million, of which the Authority received $2.3 million during 2009.

- In 2009, the Authority restructured its Series B of 2008 Water and Sewer System First Lien Revenue Refunding Bonds from variable rate obligations enhanced with FSA bond insurance and a Dexia standby agreement to variable rate obligations enhanced by direct pay letters of credit (LOCs). The Series 2008B Bonds were restructured into two subseries. The 2008 B-1 with a par value of $72.75 million with a Bank of America LOC and the 2008 B-2 with a par value of $72.745 million with a PNC Bank, NA LOC. The Authority maintained the FSA insurance on the swap agreements associated with the Series B Bonds. The LOCs will expire on October 22, 2011. Merrill Lynch serves as remarketing agent on the Series B1 and J.P. Morgan Securities Inc. as remarketing agent on the Series B2. Each series is rated Aaa/VMIG 1 by Moody's and AAA/A-1 by Standard & Poor's. Due to the expiration of the Dexia standby agreement on October 8, 2009, the 2008 B Bonds went into bank bond mode for 14 days, accruing interest of $.440 million. Annual fees increased from 25 bps to 175 bps.

- Also in 2009, the Authority restructured its Series C of 2008 Water and Sewer System Subordinate Revenue Refunding Bonds from weekly variable rate bonds to term mode bonds. The Series C Bonds were converted into four subseries 2008C-1A, 2008C-1B, 2008C-1C and 2008C-1D's, each maintaining the FSA bond insurance. However, the 2008C-1A, 2008C-1B and 2008C-1C's utilized LOCs provided by Northwest Savings Bank, ESB Bank, and Washington Federal Savings Bank, respectively, with confirming letter of credits (CLOCs) provided by the Federal Home Loan Bank of Pittsburgh. The initial term mode for these bonds is September 1, 2010. At the end of this period, there will be a mandatory tender. The bonds could then be converted to another term mode, fixed or a weekly mode. During the final months of the restructuring, portions of the Series 2008 C Bonds structured with a federal home loan bank LOC moved into bank bond status for 33 days accruing interest of $.408 million. The remaining Series C-1D Bonds were structured as term mode with FSA bond insurance without a standby agreement. The initial term mode for the Series C-1D Bonds is September 1, 2012. At the end of this period, there will be a mandatory tender. The bonds could then be converted to another term mode, fixed or a weekly mode. Prior to the restructuring of the 2008 Series C-1 Bonds the liquidity expired on October 8, 2009 and a portion of the bonds were held in bank bond mode for 23 days accruing interest of $.170 million. The CLOC provides coverage for payments of regularly scheduled principal and interest, as well as unremarketed tendered bonds for an amount equal to 195 days at the 12% maximum rate. The anticipated expiration of the CLOC is November 9, 2011 unless terminated earlier or extended for an additional year. Annual fees increased from 25 bps to 125 bps with FHLB member banks.

- The Authority, in an exchange with JP Morgan Chase, for extending liquidity on the 2008 Series D2 Bonds and 2008 Series C2 Bonds which expired on June 11, 2009, agreed to revise the liquidity expiration date on the 2007 Series B1 and B2 to 1 year from an initial five-year period. The liquidity for the 2007 Series B1 and B2 now expire on June 11, 2010. Annual liquidity fees on the 2007 Series B1 and B2 Bonds increased by 10 bps. Annual fees on the 2008 Series D2 Bonds increased by 110 bps and the fees for the 2008 Series C2 Bonds increased by 105 bps.

- Debt service coverage in 2009 and 2008 was 1.87 and 2.1, respectively. These coverage factors exceed the 1.2 coverage factor required under the bond covenant.

- In late December, the Authority went live with an Electronic Billing and Presentment (EBPP) system. Customers now have the ability to enroll for this free service, receive their Authority bills via e-mail and to pay them on-line. The process is provided by BillTrust and linked to the Authority's web site. Internally, the Authority now processes in-house checks using a scanning machine provided by ProfitStars. This process scans customer and miscellaneous revenue checks, creates two electronic files, one for the bank for deposit and another for automatically uploading into the financial reporting systems. This eliminates the need to physically take in-house checks to a bank and improves the accuracy of bank reconciliations.

- The Authority applied for and closed on five (5) low-interest loans with the Pennsylvania Infrastructure Investment Authority (Pennvest) totaling $36.8 million including three sewer projects and two water projects. The three sewer projects will cover $19.8 million cost of rehabilitation on 10 miles of 8"-30" diameter sewer pipe, 8,215 linear feet of large diameter public sewers, and 7,867 linear feet of 18"-24" reinforced concrete sewer lines. The work is required under the Consent Order and Agreement. The two water projects include $8.6 million for rehabilitation of the Clarifiers No. 1, 2 & 3, replacement of 10,000 linear feet of pipe main that is over 150 years old, and $8.4 million in construction of a new backwash water holding tank and tank rehabilitation on Herron Hill. This project qualified for funding under the American Recovery & Reinvestment Act (ARRA).

- As part of its health and wellness program, the Authority installed exercise equipment in a designated area and provided mandatory instructional training sessions to allow employees at specific times of the day to use the systems to improve their health and lifestyle. The employee responses have been encouraging.

- Partnership with Port Authority - In 2009, the Authority recognized $8.0 million in donated property revenues related to construction and relocation of several large water and sewer lines to accommodate the North Shore Connector. This project is ongoing and, upon completion, will improve the quality of life for city residents.

- The City of Pittsburgh is the largest of the 83 municipalities that convey raw sewage to ALCOSAN for treatment. In January 2004, the Authority and the City of Pittsburgh executed a Consent Order and Agreement (the Order) regarding sanitary and combined sewer overflows within the City of Pittsburgh. The other signatories to the Order are the Pennsylvania Department of Environmental Protection and Allegheny County Health Department which executed the Order on April 21, 2004. The intent of the Order is to develop a regional Long-Term Control Plan to address combined and sanitary sewer overflows and ultimately improve water quality.

  The Order does not contain fines or penalties for past non-compliance, but does propose binding obligations for work on a going forward basis. The Authority continues to meet the requirements of the Order. See note 12 - Commitments and Contingencies for additional details.

- The City of Pittsburgh remained under financial stress in 2009. The Authority has three agreements with the City of Pittsburgh. The Authority leases the water and sewer system under the Capital Lease, which was fully funded in 1998. The Authority makes payment to the City of Pittsburgh for direct and indirect services under the Cooperation Agreement. Under this Agreement the Authority also funds, on behalf of the City of Pittsburgh, a rate equalization subsidy to other City water companies. Under a separate agreement the Authority also, on behalf of the City of Pittsburgh, is required to purchase delinquent wastewater treatment receivables. The Authority is financially self-sufficient and should not be adversely affected by any bankruptcy filing by the City of Pittsburgh. Any other actions by the City of Pittsburgh to increase Authority funding would require Board approval.

CONDENSED STATEMENT OF NET ASSETS

(Dollars expressed in thousands)

	December 31,		Variance	
	2009	2008	Dollars	%
Capital assets:			Increase (Decrease)	
Producing assets	$ **444,804**	$ **416,413**	$ 28,391	6.8%
Construction in progress	**25,548**	**27,307**	(1,759)	-6.4%
Restricted assets	**107,188**	**135,943**	(28,755)	-21.2%
Current assets and bond costs	**92,474**	**90,899**	1,575	1.7%
Total Assets	$ **670,014**	$ **670,562**	$ (548)	-0.1%
Liabilities:				
Current liabilities	$ **50,333**	$ **43,695**	$ 6,638	15.2%
Long-term liabilities	**650,119**	**661,864**	(11,745)	-1.8%
Total Liabilities	**700,452**	**705,559**	(5,107)	-0.7%
Net Assets (Deficit):				
Invested in capital assets, net of related liabilities	**(57,456)**	**(71,634)**	14,178	-19.8%
Restricted for capital activity and debt service	**13,954**	**15,988**	(2,034)	-12.7%
Unrestricted	**13,064**	**20,649**	(7,585)	-36.7%
Total Net Assets (Deficits)	**(30,438)**	**(34,997)**	4,559	-13.0%
Total Liabilities and Net Assets (Deficits)	$ **670,014**	$ **670,562**	$ (548)	-0.1%

CONDENSED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

(Dollars expressed in thousands)

	Year Ended December 31, 2009	Year Ended December 31, 2008	Variance Dollars Increase (Decrease)	Variance % Increase (Decrease)
Operating Revenues	$ **134,175**	$ **129,734**	$ 4,441	3.4%
Operating Expenses:				
Direct operating	**38,770**	**38,346**	424	1.1%
Wastewater treatment	**44,795**	**40,096**	4,699	11.7%
Cooperation Agreement	**8,631**	**9,650**	(1,019)	-10.6%
Subsidy of non-customer City residents	**1,603**	**1,070**	533	49.8%
Depreciation and amortization	**11,808**	**16,471**	(4,663)	-28.3%
Total Operating Expenses	**105,607**	**105,633**	(26)	0.0%
Operating Income	**28,568**	**24,101**	4,467	18.5%
Non-operating revenues (expenses):				
Federal grants	**248**	**986**	(738)	-74.8%
Donated property	**14,819**	**204**	14,615	7164.2%
Interest revenue	**690**	**5,032**	(4,342)	-86.3%
Interest expense and other	**(39,766)**	**(30,717)**	(9,049)	29.5%
Total Non-operating Revenues (Expenses)	**(24,009)**	**(24,495)**	486	-2.0%
Net Gain/(Loss)	$ **4,559**	$ **(394)**	$ 4,953	-1257.1%

Financial Condition

The Authority's financial condition in 2009 remained stable for a seventh year in a row despite the downturn in the national economy and major disruptions in the financial markets. Water utility revenues remained steady and unrestricted cash reserves from operations increased by 2.5% or $1.0 million.

The Authority's strategic plan continues to focus on improving its financial condition, customer service, improving internal efficiencies, maintaining regulatory compliance and security, while providing an environment that encourages employee development.

Requests for Information

This financial report is designed to provide a general overview of the Authority's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Executive Director, Penn Liberty Plaza I, 1200 Penn Ave., Pittsburgh, PA 15222.

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

DECEMBER 31, 2009 AND 2008

Assets	2009	2008
Current assets:		
Cash and cash equivalents	$ 42,937	$ 41,914
Accounts receivable, net:		
Water:		
Billed	8,357	10,159
Unbilled	4,457	4,245
Total water	12,814	14,404
Wastewater treatment:		
Billed	4,739	4,894
Unbilled	3,362	3,235
Total wastewater treatment	8,101	8,129
Other receivables	1,077	2,137
Total accounts receivable, net	21,992	24,670
Prepaid expenses	296	190
Inventory	1,623	1,564
Total current assets	66,848	68,338
Noncurrent assets:		
Restricted assets:		
Accrued interest receivable	78	484
Cash and cash equivalents	10,648	22,366
Investments	96,462	113,093
Total restricted assets	107,188	135,943
Capital assets, not being depreciated	25,548	27,307
Capital assets, net of accumulated depreciation	444,804	416,413
Bond issue costs, net of accumulated amortization	25,626	22,561
Total noncurrent assets	603,166	602,224
Total Assets	$ 670,014	$ 670,562

(Continued)

The notes to financial statements are an integral part of this statement.

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

DECEMBER 31, 2009 AND 2008

(Continued)

Liabilities and Net Assets	2009	2008
Liabilities:		
Current liabilities:		
Bonds and loans payable, current portion	$ 16,435	$ 14,625
Accrued payroll and related obligations	683	673
Accounts payable wastewater treatment	15,703	13,757
Accounts payable and other accrued expenses	4,101	3,326
Accounts payable from restricted assets	3,359	1,610
Accrued interest payable from restricted assets	10,052	9,704
Total current liabilities	50,333	43,695
Noncurrent liabilities:		
Deferred revenue	335	356
Accrued payroll and related obligations	1,149	1,150
Bonds and loans payable, net of current portion	648,635	660,358
Total noncurrent liabilities	650,119	661,864
Total Liabilities	700,452	705,559
Net Assets:		
Invested in capital assets, net of related debt	(57,456)	(71,634)
Restricted for capital activity and debt service	13,954	15,988
Unrestricted	13,064	20,649
Total Net Assets	(30,438)	(34,997)
Total Liabilities and Net Assets	$ 670,014	$ 670,562

(Concluded)

The notes to financial statements are an integral part of this statement.

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

(Dollars expressed in thousands)

YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
Operating Revenues:		
Residential, commercial, and industrial water sales	$ 86,271	$ 86,627
Wastewater treatment	45,514	39,439
Other	2,390	3,668
Total operating revenues	134,175	129,734
Operating Expenses:		
Direct operating expenses	38,770	38,346
Wastewater treatment	44,795	40,096
Cooperation agreement operating expenses:		
Indirect cost allocation - sewer conveyance	4,500	4,415
Indirect cost allocation - water	4,131	5,235
Expense of water provided by other entities:		
Subsidy of customers located in the City	1,603	1,070
Depreciation	10,317	13,914
Amortization of capitalized lease assets	1,491	2,557
Total operating expenses	105,607	105,633
Operating Income	28,568	24,101
Non-operating Revenues (Expenses):		
Federal grants	248	986
Donated property	14,819	204
Interest revenue	690	5,032
Interest expense - bonds	(37,984)	(29,362)
Interest expense - other	(149)	(153)
Amortization of bond issue costs	(1,633)	(1,202)
Total non-operating revenues (expenses)	(24,009)	(24,495)
Net Income (Loss)	4,559	(394)
Net Assets:		
Beginning of year	(34,997)	(34,603)
End of year	$ (30,438)	$ (34,997)

The notes to financial statements are an integral part of this statement.

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF CASH FLOWS

(Dollars expressed in thousands)

YEARS ENDED DECEMBER 31, 2009 AND 2008

	2009	2008
Cash Flows From Operating Activities:		
Cash received from customers	$ 136,853	$ 130,718
Cash paid to suppliers and employees and customer refunds	(37,964)	(39,555)
Cash paid to City of Pittsburgh under the Cooperation Agreement	(8,631)	(9,650)
Cash paid to other water companies for subsidy of customers located in the City of Pittsburgh	(1,603)	(1,070)
Cash paid to ALCOSAN for wastewater treatment	(42,849)	(38,507)
Net cash provided by (used in) operating activities	45,806	41,936
Cash Flows From Investing Activities:		
Purchase of investment securities	(325,996)	(706,271)
Proceeds from sale and maturities of investment securities	347,937	619,409
Interest income	1,096	4,886
Net cash provided by (used in) investing activities	23,037	(81,976)
Cash Flows From Capital and Related Financing Activities:		
Purchase/construction of property, plant, and equipment	(23,621)	(16,738)
Proceeds from federal grants	248	408
Proceeds from issuance of long-term debt	-	419,276
Payment to refunding bond escrow agent	-	(300,489)
Payment made for bond reoffering costs	(4,719)	-
Principal payments on debt	(14,625)	(15,531)
SWAP receipts	1,926	5,850
SWAP payments	(18,007)	(10,620)
Liquidity and remarketing fees	(4,707)	(824)
Interest paid on borrowings	(16,033)	(18,629)
Net cash provided by (used in) capital and related financing activities	(79,538)	62,703
Increase (Decrease) in Cash and Cash Equivalents	(10,695)	22,663
Cash and Cash Equivalents:		
Beginning of year	64,280	41,617
End of year	$ 53,585	$ 64,280
Consists of:		
Restricted cash and cash equivalents	$ 10,648	$ 22,366
Unrestricted cash and cash equivalents	42,937	41,914
	$ 53,585	$ 64,280
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities:		
Operating income	$ 28,568	$ 24,305
Adjustments:		
Depreciation and amortization	11,808	16,471
Reserve for uncollectible amounts	(2,997)	1,788
Change in:		
Accounts receivable	4,615	(788)
Other accounts receivable	1,060	(220)
Wastewater accounts payable	1,946	1,589
Accounts payable and other accrued expenses	774	(997)
Other	32	(212)
Net cash provided by (used in) operating activities	$ 45,806	$ 41,936

The notes to financial statement are an integral part of this statement.

1. ORGANIZATION

The Pittsburgh Water and Sewer Authority (Authority) provides water to approximately 80,000 residential, commercial, and industrial customers located in the City of Pittsburgh (City), Pennsylvania, and collects wastewater throughout the City.

A Board of Directors (Board) appointed by the Mayor of the City governs the Authority.

The Authority is a body politic and corporate, organized and existing under the Pennsylvania Municipalities Authorities Act. The Authority was established by the City in 1984 to assume responsibility from the City for management, operation, maintenance, and improvement of virtually the entire City water supply, distribution, and wastewater collection systems (the "Water and Wastewater System" or "System"). The Authority's term of existence is through 2045. At inception, the City contributed $5.3 million to the Authority in the form of customer accounts receivable.

The Authority has the right to establish user fees and charges without being subject to the approval of any department, board, or agency of Pennsylvania or the City. The Authority is also authorized to issues bonds and notes payable solely from the Authority's revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

These financial statements present the financial position, income, changes in net assets, and cash flows of the Authority. The Authority is a component unit of the City as defined in Governmental Accounting Standards Board (GASB) Statement No. 14, *"Financial Reporting Entity."* The Authority's financial statements are not intended to present the financial position or results of operations of the City taken as a whole.

Basis of Accounting and Measurement Focus

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by GASB. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. The Authority applies only the Financial Accounting Standards Board pronouncements issued before November 30, 1989.

The Authority functions as a Business-Type Activity, as defined by GASB.

Classification of Net Assets

In accordance with the provision of GASB Statement No. 34, *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,"* net assets are classified into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets net of bond issue costs, premiums and discounts and remaining deferred refunding losses.

- Restricted – This component of net assets consists of constraints placed on net asset use through external restrictions.

- Unrestricted – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." The net investment in joint ventures is also reflected here.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the Authority's policy is to first apply the expense towards restricted resources and then towards unrestricted resources.

Deferred Interest

Interest expense, net of related earnings on funds restricted for the purpose of capital improvements, is deferred and allocated to the cost of capital assets. Accordingly, during 2009, the Authority's interest expense of $784, net of deferred interest earnings of $76, resulted in net capitalized interest expense of $708. During 2008, the Authority's interest expense of $797, net of deferred interest earnings of $56, resulted in net capitalized interest expense of $741.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments, both restricted and unrestricted, with maturity of three months or less at date of purchase.

Bond Issue and Reoffering Costs, Premiums, and Discounts

Bond issue and reoffering costs are deferred and amortized over the life of the related bonds using the effective interest method. The unamortized balance is an asset on the statements of net assets.

Original issue bond premiums and discounts are amortized over the life of the related bonds using the effective interest method of amortization. The unamortized balance of premiums and discounts is presented net on the statements of net assets as a decrease to bonds payable.

Deferred Refunding Loss

In accordance with GASB Statement No. 23, *"Accounting and Reporting for Refunding of Debt by Proprietary Activities,"* the excess of the reacquisition price over the net carrying amount of debt refunded with proceeds from the Series 1993, 1998, 2003, 2007, and 2008 Bonds were recorded as deferred refunding losses. The deferred refunding losses are being amortized using the effective interest method over the originally scheduled life of the defeased issues which extend to 2037. The unamortized balances are reflected as a reduction of bonds payable.

Interest Rate Swap Termination Costs

Termination costs associated with the defeasance of hedged debt are included in the net carrying amount of the old refunded debt when calculating the deferred refunding loss. During 2008, the Authority paid approximately $6 million in swap termination costs associated with the partial refunding of the Series 2007 Bonds.

Remarketing, Liquidity and Letter of Credit Fees

Associated with the Authority's variable rate bonds, the Authority pays various fees to periodically remarket the bonds and to a third party to provide liquidity in the event that the Authority is unable to remarket the variable rate bonds and needs to repurchase the bonds on a temporary basis until they can be later remarketed. These fees are generally paid quarterly and are calculated as a percentage of the outstanding par amount of the variable rate bonds.

Capital Assets

Capital assets owned by the Authority are recorded at cost including that portion of deferred interest that is ultimately capitalized. Depreciation of fixed assets owned by the Authority is provided on the straight-line method based on the estimated useful lives of the various classes of assets. Utility assets have estimated useful lives ranging from 30 to 70 years. Non-utility assets have estimated useful lives ranging from 5 to 10 years.

The water and sewer system represents assets leased from the City. Amortization of capital lease assets is provided on the straight-line basis applying an estimated average remaining useful life from the inception of the lease.

Maintenance and repairs are charged to expense as incurred.

Change in Accounting Estimate

As of December 31, 2008, the Authority depreciated its Utility assets using the straight-line method with assigned useful lives of between 30 and 40 years. Private and public industry practice can include asset lives for specific categories (i.e., plant, water and sewer lines) for up to 70 or more years.

During 2009, the Authority took on the task of reviewing approximately 400 utility assets, having a total acquisition value just over $410 million with a net book value of $289 million. As a result of this analysis the Authority changed the useful lives on certain utility assets of the authority. The Authority determined the actual useful lives on these assets should be 50-70 years. The change was made prospectively. The new depreciation expense on assets already in service was calculated by using the difference in prior useful life and the new useful life as the new useful life. The net book value at December 31, 2008 is now being depreciated over the new calculated useful life. This change in accounting estimate resulted in a decrease in depreciation expense of approximately $4.66 million for the year ended December 31, 2009.

Clarification of Revenues

The Authority has classified its revenues as either operating or non-operating revenues according to the following criteria:

- Operating revenues – Operating revenues include activities that have the characteristics of exchange transactions, such as residential, commercial, industrial water sales and wastewater treatment.

- Non-operating revenues – Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as interest income and other revenue sources that are defined as non-operating revenues by GASB Statement No. 9, *"Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting"* and GASB Statement No. 34.

Compensated Absences

A liability for vacation, personal, and sick days is accrued when related benefits are attributable to services rendered and to the extent it is probable that the Authority will ultimately compensate employees.

Inventory

Inventory is stated at cost, on a moving average price basis.

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 continent 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.

Reclassifications

Certain amounts from the prior year financial statements were reclassified to conform to the current year presentation.

Pending Pronouncements

In June 2008, GASB issued Statement No. 53, *"Accounting and Financial Reporting for Derivative Instruments."* This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. This Statement is intended to improve how state and local governments report information about derivative instruments - financial arrangements used by governments to manage specific risks or make investments - in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and will be effective for the Authority's financial statements for the year ended December 31, 2010. The Authority is currently evaluating the impact that this new pronouncement will have on the financial statements.

3. Transactions with the City of Pittsburgh

In 1984, pursuant to a Lease and Management Agreement, the Authority leased the System from the City and assumed responsibility for establishing and collecting user fees and charges and for maintaining and improving the System. The Lease and Management Agreement provided for the City to operate and maintain the System for the Authority subject to the general supervision of the Authority.

The City and the Authority agreed to terminate the Lease and Management Agreement in July 1995 and concurrently entered into a Capital Lease Agreement and a Cooperation Agreement (collectively referred to as the "Agreements").

Cooperation Agreement

Under the terms of the Cooperation Agreement, City water department employees became employees of the Authority. As a result, the Authority assumed various personnel-related obligations from the City's water department. Other direct costs of the System's water operations are now generally paid directly by the Authority under the Cooperation Agreement, rather than paid by the City and reimbursed by the Authority. The City provides the Authority with various services in accordance with the Cooperation Agreement and the Authority reimburses the City for direct and indirect costs attributed by the City to the operation and maintenance of the System.

Under the Agreements, the Authority provides up to 600 million gallons of water annually for the City's use without charge. Also, the Authority assumes the City's obligation for the cost of subsidizing water service to residents of the City situated beyond the Authority's service area so that those water users pay charges that mirror the rates of the Authority.

System Leases

The Capital Lease Agreement stipulates minimum lease payments of approximately $101 million, all of which were satisfied during the initial three years of the capital lease.

The Capital Lease Agreement has a term of thirty years and provides the Authority with the option to purchase the System for one dollar in 2025.

Pension

Employees of the Authority participate in the City's Municipal Pension Fund Plan (Plan). Employees who became members of the Plan prior to January 1, 1988 are required to contribute 5% of pre-tax pay. Those joining thereafter are required to contribute 4%. Substantially, all the Authority's 2009 payroll of $11,879 was covered by the Plan. Employee contributions for the year amounted to approximately $459.

The City's obligations relative to the Plan are determined in accordance with various Pennsylvania statutes. The extent of the Authority's participation in such obligations with respect to those former City employees whose membership continued upon becoming employees of the Authority is determined by the shared interpretation of the City and Authority of the intent of the Cooperation Agreement.

The 2009 Minimum Municipal Obligation calculated for the City's Plan indicated a 2009 normal cost of $561 associated with those former City employees whose participation continued upon becoming employees of the Authority as provided by the Cooperation Agreement. The Authority estimates that the normal cost for 2009, together with other elements of expense for employee service during 2009 would not exceed the sum of the 2009 contributions made by the Authority and employees.

Uncertainty exists about the future obligation of the Authority and its employees to make contributions to the Plan. Such contributions are contingent upon the continuing eligibility of the Authority's employees to participate in the City's Plan. Eligibility for ongoing employee participation in the City's Plan could end if the Authority were to introduce another pension plan. At this time, the Authority and City have no definite plans to establish another pension plan for the Authority, other than an agreement in principle that the Authority should have its own plan in the future. Future obligations of the Authority to make contributions to the Plan may also be subject to other amendments of the existing arrangement agreed-upon by the Authority and the City.

Normal retirement benefits are available upon attainment of age sixty and completion of twenty service years. Early retirement benefits are available upon attainment of age fifty and completion of eight service years. Early retirement benefits may be deferred until age sixty or may be obtained upon retirement at a reduced level. A member who terminates employment after attaining age forty and completing eight service years can sustain eligibility for benefits by continuing contributions through age fifty. A member who terminates employment after attaining fifteen service years, but has been a member since before January 1, 1975, can be vested by continuing contributions through age fifty.

Retirement benefits for employees who were members of the Plan are based upon a percentage of either three-year or four-year average pay, depending on date of hire, subject to certain specified minimum monthly benefit amounts. Special membership and benefit rules apply to those experiencing disability.

The "pension benefit obligation," which is an actuarial present value of credited projected benefits, is a standardized measure for financial statement disclosure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future by the Plan as a result of members' service to date. The measure is intended to help users assess the Plan's funding status on a going concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among public employee retirement systems. The Plan has not reported or attributed measurements of assets or the pension benefit obligation on the basis of the group of members who are Authority employees.

Additional information about the Plan and ten-year historical trend information showing the Plan's progress in accumulating sufficient assets to pay benefits when due is presented in the City's Comprehensive Annual Financial Report.

4. Revenue and Accounts Receivable

Water

Water sales revenue is recognized as earned during the period when water is supplied to customers. Customers are billed on a monthly billing cycle by the Authority based on actual or estimated meter readings. The Authority recognizes unbilled accounts receivable for water service provided prior to year-end that is billed during the following year.

Water accounts receivable are presented net of a reserve for uncollectible amounts. This reserve, based upon historical experience, is recognized coincident with recognition of revenue. At December 31, 2009 and 2008, the reserve for uncollectible water accounts was approximately $15.4 million and $17.1 million, respectively. The Authority has rights to utilize collection agencies, service terminations, liens, and real property sales to protect its interests, limit further losses, and motivate payments from delinquent customers.

Wastewater Treatment

Although the Authority does not provide wastewater treatment, it assumed responsibility for certain wastewater treatment revenue and expenses beginning in 1996. Pursuant to a 1955 agreement, the City was responsible for paying the Allegheny County Sanitary Authority (ALCOSAN) face amounts for delinquent wastewater treatment receivables. Until 1996, the City undertook to bill and collect these delinquent accounts directly. In 1996, the City and the Authority entered into a memorandum of understanding (MOU) whereby the Authority received assets including rights to wastewater treatment receivables assigned by the City and assumed the City's obligation to pay ALCOSAN for delinquencies. During 2004, the Authority and ALCOSAN executed a first amendment to the 1955 agreement whereby the Authority elected to change the billing structure. Effective May 2004, the Authority began direct billing City residents for current and delinquent wastewater treatment charges and remitting to ALCOSAN the aggregate amount of service charges billed. Wastewater treatment activity and the related assets and liabilities appear on the statements of revenue, expenses and changes in net assets and the statements of net assets, respectively. At December 31, 2009 and 2008, the reserve for uncollectible wastewater accounts was approximately $7.44 million and $8.66 million, respectively.

5. Capital Assets

Capital assets consisted of the following at December 31, 2009 and 2008:

(Dollars expressed in thousands unless otherwise indicated)

	Balance at December 31, 2008	Additions	Transfers	Balance at December 31, 2009
Capital assets not being depreciated:				
Construction in progress	$ 27,307	$ 27,875	$ (29,634)	$ 25,548
Capital assets being depreciated:				
Water and sewer system	102,167	-	-	102,167
Utility assets	480,912	41,766	(1,867)	520,811
Non-utility assets	16,228	300	-	16,528
Total capital assets being depreciated	599,307	42,066	(1,867)	639,506
Total capital assets	626,614	69,941	(31,501)	665,054
Accumulated depreciation	(182,894)	(11,808)	-	(194,702)
Capital assets, net	$ 443,720	$ 58,133	$ (31,501)	$ 470,352

	Balance at December 31, 2007	Additions	Transfers	Balance at December 31, 2008
Capital assets not being depreciated:				
Construction in progress	$ 22,901	$ 13,549	$ (9,143)	$ 27,307
Capital assets being depreciated:				
Water and sewer system	102,167	-	-	102,167
Utility assets	468,557	13,321	(966)	480,912
Non-utility assets	15,842	392	(6)	16,228
Total capital assets being depreciated	586,566	13,713	(972)	599,307
Total capital assets	609,467	27,262	(10,115)	626,614
Accumulated depreciation	(166,446)	(16,448)	-	(182,894)
Capital assets, net	$ 443,021	$ 10,814	$ (10,115)	$ 443,720

During 2009 the Authority received donated utility assets of $14,819 related to various development projects.

(Dollars expressed in thousands unless otherwise indicated)

6. Payroll and Related Obligations

Payroll and related obligations presented on the statements of net assets are comprised of:

	Balance at December 31, 2008	Change	Balance at December 31, 2009	Current Portion
Compensated absences	$ 795	$ 101	$ 896	$ 112
Workers' compensation	637	(151)	486	122
Early retirement incentive	-		-	-
Payroll, withholdings, and taxes	390	60	450	449
	$ 1,822	$ 10	$ 1,832	$ 683

	Balance at December 31, 2007	Change	Balance at December 31, 2008	Current Portion
Compensated absences	$ 778	$ 17	$ 795	$ 16
Workers' compensation	644	(7)	637	266
Early retirement incentive	7	(7)	-	-
Payroll, withholdings, and taxes	694	(303)	391	391
	$ 2,123	$ (300)	$ 1,823	$ 673

7. Bonds and Loans Payable

To finance its initial capital improvement program, the Authority issued Daily Adjustable Demand Water and Wastewater System Revenue Bonds of $93,600 in 1984 ("1984 Bonds"). In 1985, the Authority issued Water and Wastewater System Adjustable Rate Tender Revenue Bonds ("1985 Bonds") that accomplished an advance refunding which defeased the 1984 Bonds. In 1986, the Authority issued $134,700 Water and Wastewater System Adjustable Rate Tender Revenue Bonds ("1986 Bonds") to finance the next phase of its capital improvement program. In July 1991, the Authority issued $248,329 Water and Wastewater System Revenue Refunding Bonds, Series A of 1991 ("1991 Bonds") which refunded the outstanding 1985 and 1986 Bonds. The principal of defeased 1986 Bonds still outstanding at December 31, 2009 and 2008 is $122,790 and $136,490, respectively.

Series 1993

In November 1993, the Authority issued $278,970, Series A Refunding Bonds, ("Series A-1993 Bonds") and $10,785 Series B Revenue Bonds, ("Series B-1993 Bonds") to finance additional capital improvements. Series A-1993 Bond proceeds of $276,613 (net of $3,402 in underwriting fees, FGIC insurance, and other issuance costs) defeased the 1991 Bonds through an advance refunding.

During 2009, the bond insurance company for the Series 1993 Bonds had their rating withdrawn by Standard & Poor's and are currently unrated. In October of 2008, the bond insurance company and a financial institution entered into a reinsurance agreement whereby the financial institution reinsured certain bond insurance risks of the bond insurance company.

The Series A-1993 Bonds bear interest at a fixed rate of 6.5%, payable semi-annually at March 1 and September 1. The outstanding 1993 Bonds are not subject to optional or mandatory redemption.

Fair value of the 1993 Bonds at December 31, 2009 and 2008, with carrying amounts of $27 million and $27 million, respectively, based on quoted market prices, is approximately $31 million and $30 million, respectively.

Series 1998

In March 1998, the Authority issued $93,355, Series A First Lien Revenue Bonds ("1998 Series A Bonds"), the proceeds of which were used to defease through an advance refunding the entire balance of 1995 Series A Bonds outstanding ($89,850), $36,440 Series B First Lien Revenue Bonds ("1998 Series B Bonds"), the proceeds of which are dedicated to a capital improvements program, and $101,970 Series C Subordinate Revenue Bonds ("1998 Series C Bonds"), the proceeds of which were used to defease through an advance refunding the entire balance of the 1995 Series B Bonds outstanding ($98,410). At December 31, 2009 and 2008, the remaining unamortized deferred refunding loss of $533 and $569, respectively, on the transaction is shown as a reduction of the long-term debt and will be amortized through 2037.

Fair value of the 1998 Bonds at December 31, 2009 and 2008, with carrying amounts of $59 million and $56 million, respectively, based on quoted market prices, is approximately $59 million and $56 million, respectively.

The 1998 Series B Bonds are capital appreciation bonds with an original issuance amount of $36,440. The 1998 Series B Bonds have maturity values of $2.3 million to $31.8 million from 2017 to 2030. The bonds were issued to yield rates from 5.18% to 5.3%. The 1998 Series B Bonds accrue and compound interest on a semi-annual basis and are carried at cost plus accrued interest. Total maturity value of the 1998 Series B Bonds is $146.8 million.

A portion of the 1998 Bonds are subject to optional redemption in various face amounts beginning March 1, 2008.

Series 2003

On September 23, 2003, the Authority issued $167,390 of Water and Sewer System Revenue Refunding Bonds ("2003 Bonds"). The proceeds of the 2003 Bonds were used to provide funds for the current refunding of a portion of the 1993 Bond Series. In connection with the 2003 debt refundings, the Authority recorded a deferred refunding loss of $3,162 which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. The unamortized balance of the deferred refunding adjustment is $1,376 and $1,468 at December 31, 2009 and 2008, respectively.

The 2003 Bonds were issued at a bond discount of $830, which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method.

The 2003 Bonds bear interest at rates ranging from 1.45% to 4.75%. Interest is payable in semi-annual installments on March 1 and September 1 until maturity. Stated maturities for the 2003 Bonds are at various face amounts on September 1 of each year beginning September 1, 2004 through 2023. The 2003 Bonds which mature after September 1, 2014, are subject to redemption prior to maturity at the option of the Authority.

The fair market value of the 2003 Bonds at December 31, 2009 and 2008, with carrying amounts of $57 million and $67 million, respectively, based on quoted market prices, is approximately $60 million and $69 million, respectively.

Series 2007

During March 2007, the Authority issued $158,895 Series 2007 First Lien Water and Sewer Revenue Bonds ("2007 Bonds"): $43,720 Series A of 2007 (fixed rate), $57,585 Series B-1 of 2007 (variable rate demand), and $57,590 Series B-2 of 2007 (variable rate demand). The purpose of this bond issue was to refund the Series 2002 and Series 2005 Bonds (the refunded bonds). Proceeds of the 2007 Bonds were invested in an escrow account to pay principal and interest on the refunded bonds from the time of refunding through the bonds' earliest optional call dates. In connection with the debt refundings, the Authority recorded a deferred refunding loss of $6,032, which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. At December 31, 2009 and 2008, the remaining unamortized deferred refunding loss of $5,402 and $5,759, respectively. At December 31, 2009, the principal of the defeased Series 2002 Bonds outstanding was $94,810, and the defeased 2005 Bonds outstanding was $46,515.

The 2007 Bonds were issued at a bond premium of $2,660, which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. Bond issuance costs of $598 are also being amortized over the life of the 2007 Bonds using the effective interest method.

The 2007 Series A Bonds bear interest at rates ranging from 4.00% to 5.00%. Interest is payable in semi-annual installments on March 1 and September 1 until maturity. The 2007 Series A Bonds are subject to extraordinary redemption prior to maturity at the option of the Authority in the event of a condemnation, damage or destruction of the water and sewer system.

The 2007 Series B Bonds bear interest at a variable rate with interest payments due on the first business day of each month. The 2007 Series B Bonds that mature on September 1 of 2018-2033 are subject to mandatory sinking fund redemption.

The fair market value of the 2007 Bonds at December 31, 2009 and 2008, with carrying amounts of $120 million and $124 million, respectively, based on quoted market prices, is approximately $123 million and $127 million, respectively.

In conjunction with the issuance of the 2007 Variable Rate Bonds, the Authority entered into various pay fixed/receive variable interest rate swaps to effectively change the Bonds' variable interest rates to synthetic fixed rates. These swap transactions are discussed in Note 8: Interest Rate Swaps.

Series 2008

During May 2008, the Authority issued $93,635 Series 2008 Water and Sewer System First Lien Revenue Bonds ("2008 Fixed Rate Bonds"): $68,970 Series A of 2008 (fixed rate, taxable) and $24,665 Series D-1 of 2008 (fixed rate). The purpose of this bond issue was to advance refund portions of certain maturities of the Series 1993A and Series 2003 Bonds, to fund the costs of certain capital additions, to fund the premium for the Bond Insurance Policy securing payments on 2008 Fixed Rate Bonds, and to fund termination payments on certain interest rate swaps.

During June 2008, the Authority issued $320,515 Series 2008 Water and Sewer System First Lien Revenue Bonds ("2008 Variable Rate Demand Bonds"): $145,495 Series B of 2008 (variable rate demand), $51,910 Series C-1 of 2008 (variable rate demand), $51,885 Series C-2 of 2008 (variable rate demand), and $71,225 Series D-2 of 2008 (variable rate demand). The purpose of this bond issue was to currently refund the Series 1998A and Series 1998C, to currently refund certain maturities of the Series 2007 B-1 and Series 2007 B-2 Bonds, to advance refund certain maturities of the Series 1998B Bonds, to fund approximately $98 million of certain capital additions, to fund the premium for the Bond Insurance Policy securing payments on 2008 Variable Rate Demand Bonds, and to fund termination payments on certain interest rate swaps.

In connection with these advance refundings, portions of the proceeds of the 2008 Bonds were deposited into irrevocable trusts with an escrow agent to provide for certain debt service payments on the refunded bonds. The advance refunding resulted in a deferred refunding loss of $18,119 which is amortized as an adjustment to interest expense over the life of the 2008 Bonds using the effective interest method. At December 31, 2009, the remaining unamortized deferred refunding loss of $16,357 on the transaction is shown as a reduction of long-term debt and will be amortized through 2037.

At December 31, 2009, the principal of the defeased Series 1993A Bonds outstanding was $21,875 and the defeased 2003 Bonds outstanding was $29,730. The maturity value of defeased 1998B compound interest bonds outstanding at December 31, 2009 was $19,300.

The Taxable 2008 Series A Bonds bear interest at rates ranging from 6.36% to 6.61%. Interest is payable in semi-annual installments on March 1 and September 1 until maturity. The Taxable 2008 Series A Bonds are subject to optional redemption, in whole or in part, on any date, at the option of the Authority. The Taxable 2008 Series A Bonds that mature in 2018 and 2024 are subject to mandatory sinking fund payments beginning in 2017 and continuing through 2024.

The 2008 Series D-1 Bonds (together with the Taxable 2008 Series A Bonds are the 2008 Fixed Rate Bonds) bear interest at rates ranging from 4.50% to 5.00%. Interest is payable in semi-annual installments on March 1 and September 1 until maturity. The 2008 Series D-1 Bonds which mature on or after September 1, 2019 are subject to optional redemption, in whole or in part, on any date, at the option of the Authority at any time on or after September 1, 2018, at 100% of the principal amount plus accrued interest.

The 2008 Series B, C, and D-2 Bonds (2008 Variable Rate Bonds) as originally offered bear interest at a variable rate with interest payments due on the first business day of each month. Interest rates are reset weekly; the fluctuating rate per annum to be determined by the respective remarketing agents. The weekly rate is subject to a cap of 12% per annum.

During the second part of 2009, the Authority reoffered the 2008 Series B Bonds and the 2008 Series C-1 variable rate bonds. The 2008 Series B Bonds had an outstanding principal amount of $145,495,000 and the 2008 C-1 bonds had an outstanding principal balance of $51,910,000 at the time of reoffering.

The Series B Bonds were reoffered on October 16, 2009. The reason for this reoffering was the replacement of expiring standby bond purchase agreements on these variable rate bonds with letters of credit. Bank of America is the letter of credit provider on the Series B-1 Bonds ($72,750,000) and PNC is the letter of credit provider on the Series B-2 Bonds ($72,745,000). The reoffering did not change the interest rate mode on these variable rate bonds.

The 2008 Series C-1 bonds were reoffered in two separate reofferings. On November 10, 2009, $25,000,000 was reoffered in a term interest rate mode. The interest rate on these bonds is fixed at 2% for two years. After the two-year period, the interest rate will reset. The new reoffered bonds are as follows: Series C1-A $10,000,000; Series C1-B $10,000,000, and Series C1-C $5,000,000.

During November the remaining C-1 Bonds were reoffered as the C1-D Series of $26,910,000. These bonds were also issued in a term interest rate mode, fixing the interest rate at 2.625%. It is the Authority's understanding that this rate is only fixed for one year before it will reset.

Credit facilities for the 2008 Series C1-A, C1-B and C1-C bonds are provided by the Northwest Savings Bank, ESB Bank and Washington Federal Savings bank, respectively. Liquidity facilities continue to be provided by JP Morgan Chase on the 2007-B1, 2007-B2, 2008-C2 and 2008-D2 Series bonds and are set to expire on June 11, 2010.

Variable Rate Bonds are subject to optional redemption, in whole or in part, on any date, at the option of the Authority. The 2008 Series B Bonds that mature on September 1 of 2039 are subject to mandatory sinking fund redemption. The 2008 Series C Bonds that mature on September 1 of 2035 are subject to mandatory sinking fund redemption. The 2008 Series D-2 Bonds that mature on September 1 of 2040 are subject to mandatory sinking fund redemption.

The 2008 Series Bonds are subject to extraordinary redemption prior to maturity at the option of the Authority in the event of a condemnation, damage or destruction of the water and sewer system.

The 2008 Fixed Rate Bonds were issued at a bond premium of $824, which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. Bond issuance costs of $7,459, including $5,036 of swap termination fees, are also being amortized over the life of the Bonds using the effective interest method.

The 2008 Variable Rate Bonds issuance costs of $9,337, including $594 of swap termination fees, are being amortized over the life of the Bonds using the effective interest method.

The fair market value of the 2008 Bonds at December 31, 2009 and 2008, with carrying amounts of $414 and $414 million, respectively, based on quoted market prices, is approximately $415 and $413 million, respectively.

Variable rate bonds require a liquidity facility and/or a letter of credit. The Authority is subject to the risk that the bank does not renew the credit facility and/or that the pricing changes throughout the life of the bonds. Additionally, the Authority purchased insurance as a credit enhancement on the variable rate bonds. Trading spreads on the bonds and the preservation of the liquidity facility may be largely linked to the credit quality of the insurance provider. Therefore, if there is an event that would adversely affect the investor's perception of the credit quality of the insurer, the Authority could be subject to paying higher credit spreads on the bonds and risk losing the liquidity facility.

During 2008, the Authority experienced delays in remarketing certain 2008 Variable Rate Demand Bonds (bonds). These bonds were not able to be remarketed on a timely basis due to a downgrade in the bond insurer's credit rating and other market concerns. The bonds were temporarily considered to be Bank Bonds, as they were purchased by banks as governed by the respective series' Standby Bond Purchase Agreement. The yield on bank bonds was 7% per annum. As a result of market deterioration during 2008 and into 2009, the liquidity and remarketing fees paid in 2009 on the variable rate bonds were higher then anticipated.

(Dollars expressed in thousands unless otherwise indicated)

In conjunction with the issuance of the 2008 Variable Rate Bonds, the Authority entered into various pay fixed/receive variable interest rate swaps to effectively change the Bonds' variable interest rates to synthetic fixed rates. These swap transactions are discussed in Note 8: Interest Rate Swaps.

Bonds and state loans payable (PENNVEST) consisted of the following at December 31, 2009 and 2008:

	Balance at December 31, 2008	Additions	Reductions	Balance at December 31, 2009
Bonds and loans payable:				
Revenue bonds	$ 688,165	$ 3,038	$ (13,820)	$ 677,383
State loans (PENNVEST)	13,365	-	(805)	12,560
	701,530	3,038	(14,625)	689,943
Less: deferred refunding loss	(28,934)	-	1,828	(27,106)
Unamortized bond (discount)/premium	2,387	-	(154)	2,233
Total bonds and loans	$ 674,983	$ 3,038	$ (12,951)	$ 665,070

	Balance at December 31, 2007	Additions	Reductions	Balance at December 31, 2008
Bonds and loans payable:				
Revenue bonds	$ 574,121	$ 417,041	$ (302,997)	$ 688,165
State loans (PENNVEST)	14,165	-	(800)	13,365
	588,286	417,041	(303,797)	701,530
Less: deferred refunding loss	(20,543)	(18,119)	9,728	(28,934)
Unamortized bond (discount)/premium	85	2,384	(82)	2,387
Total bonds and loans	$ 567,828	$ 401,306	$ (294,151)	$ 674,983

Debt service payments of the State Loans at December 31, 2009 are as follows:

(Dollars expressed in thousands unless otherwise indicated)

	State Loans		
	Principal	Interest	Total
2010	$ 815	$ 163	$ 978
2011	826	152	978
2012	837	141	978
2013	849	129	978
2014	861	117	978
2015-2019	4,486	403	4,889
2020-2024	3,842	99	3,941
2025	44	-	44
	$ 12,560	$ 1,204	$ 13,764

Debt service payments on the 1993, 1998, 2003, 2007, and 2008 Bonds at December 31, 2009 are as follows:

	Revenue Bonds		
	Principal	Interest	Total
2010	$ 15,620	28,899	$ 44,519
2011	14,885	27,078	41,963
2012	12,465	26,226	38,691
2013	14,155	35,722	49,877
2014	15,250	24,699	39,949
2015-2019	82,235	116,994	199,229
2020-2024	99,458	98,659	198,117
2025-2029	46,314	171,523	217,837
2030-2034	131,879	69,691	201,570
2035-2039	177,920	28,619	206,539
2040	40,440	1,106	41,546
	650,620	$ 629,216	$ 1,279,836
Accretion	26,763		
Total	$ 677,383		

(Dollars expressed in thousands unless otherwise indicated)

Interest payments were calculated for the Variable Rate Bonds using the synthetic fixed rate interest rates as described in Footnote 8.

Interest incurred for the years ended December 31, 2009 and 2008 on bonds payable, exclusive of capitalized interest and amortization of refunding losses, was approximately $28 and $22 million, respectively. Interest costs for 2009 and 2008 included $1.8 million and $2.0 million, respectively, of amortization of the deferred refunding losses.

In accordance with the provisions of the trust indentures for the 1993, 1998, 2003, 2007, and 2008 Bonds, the Authority has created a number of funds that are restricted for specific purposes. The complement of these restricted funds, collectively referred to on the statements of net assets as "Restricted Assets" at December 31, 2009 and 2008, was:

	2009	2008
Capital project funds	$ 83,226	$ 110,112
Debt service and reserve funds	10,083	10,314
Operating reserve account	8,521	8,476
Capitalized interest fund	4,783	6,466
Other funds	575	575
	$ 107,188	$ 135,943

Among the Authority's debt covenants is one which requires that rates charged by the Authority will be sufficient to satisfy a formula which is intended to ensure that the Authority will be able to satisfy debt service requirements. The trust indenture also requires that revenue collections be deposited into a Revenue Fund and disbursed therefrom as provided for in the trust indenture. This Revenue Fund constitutes the vast majority of unrestricted funds cash and cash equivalents. At December 31, 2009, the Authority was in compliance with this covenant.

8. Interest Rate Swaps

Description of 2008 Swaps

During fiscal year 2008, the Authority entered into five pay-fixed, receive-variable interest rate swap contracts. The interest rate swaps were effective June 12, 2008. Beginning September 1, 2008, the Authority began to make semi-annual interest payments on the 1st of each March and September through September 1, 2035 (two swaps); September 1, 2039 (two swaps); and, September 1, 2040 (for one swap), respectively. The Counterparties make monthly interest payments on the 1st of each calendar month, which began July 1, 2008 through September 1, 2035 for two of the swaps; September 1, 2039 for two of the swaps; and, September 1, 2040 for one swap.

The intention of the 2008 swaps is to effectively change the Authority's variable interest rate on the $145,495 Water and Sewer System (Variable Rate Demand) First Lien Revenue Refunding Bonds Series B of 2008, on the $71,225 Water and Sewer System (Variable Rate Demand) First Lien Revenue Bonds Series D-2 of 2008, and on the $103,795 Water and Sewer System (Variable Rate Demand) Subordinate Revenue Refunding Bonds Series C of 2008 (the bonds) to synthetic fixed rates of 4.038%, 4.103%, and 3.998%, respectively.

The bonds will accrue interest at a weekly rate that is determined by a remarketing agent on each effective rate date. The interest rate on the bonds may not exceed 12%. Per the interest rate swap agreements, the Authority will receive SIFMA Municipal Swap Index while paying a fixed rates of 4.038%, 4.103%, and 3.998%, respectively.

The interest payments on the interest rate swaps are calculated based on notional amounts, all of which reduce, beginning on September 1, 2035, so that the notional amounts approximate the principal outstanding on the respective bonds. The interest rate swaps expire consistent with the final maturity of the respective bonds.

As of December 31, 2009, the 2008 swaps had the following notional amounts and market values: $72,747 notional amount and ($6,456) market value; $41,518 notional amount and ($3,460) market value; $72,747 notional amount and ($6,429) market value; $62,277 notional amount and ($5,100) market value; and, $71,225 notional amount and ($6,912) market value. The market value is an estimated net present value of the expected cash flows calculated using relevant mid-market data inputs and based on the assumption of no unusual market conditions or forced liquidation.

Description of 2007 Swaps

During fiscal year 2007, the Authority entered into two pay-fixed, receive-variable interest rate swap contracts. The interest rate swaps were effective March 9, 2007. Beginning September 1, 2007, the Authority began to make semi-annual interest payments on the 1st of each March and September through September 1, 2033. The Counterparties makes monthly interest payments on the 1st of each calendar month, beginning April 1, 2007 through September 1, 2033. During 2008, a portion of the 2007 interest rate swaps were terminated as the underlying bonds were refunded. The Authority paid $594 in termination costs related to the termination of these 2007 interest rate swaps.

The intention of the 2007 swaps is to effectively change the Authority's variable interest rate on the $41,320,000 Water and Sewer System (Variable Rate Demand) First Lien Revenue Refunding Bonds Series B-1 of 2007 and on the $41,325,000 Water and Sewer System (Variable Rate Demand) First Lien Revenue Refunding Bonds Series B-2 of 2007 (the bonds) to synthetic fixed rates of 3.932%, respectively.

The bonds will accrue interest at a weekly rate that is determined by a remarketing agent on each effective rate date. The interest rate on the bonds may not exceed 12%. Per the interest rate swap agreements, the Authority will receive SIFMA Municipal Swap Index while paying a fixed rate of 3.932%.

The interest payments on the interest rate swaps are calculated based on notional amounts, both of which reduce, beginning on September 1, 2018, so that the notional amounts approximate the principal outstanding on the respective bonds. The interest rate swaps expire on September 1, 2033 consistent with the final maturity of the bonds.

As of December 31, 2009, the 2007 swaps had the following notional amounts and market values: $41,325 notional amount and ($3,383) market value; and, $41,320 notional amount and ($3,318) market value. The market value is an estimated net present value of the expected cash flows calculated using relevant mid-market data inputs and based on the assumption of no unusual market conditions or forced liquidation.

Additionally, during 2007 in anticipation of the issuance of additional bonds, the Authority entered into four forward starting pay-fixed, receive-variable interest rate swaps. These swaps were terminated and cash settled by the Authority during 2008. Termination costs of approximately $5,063 were paid by the Authority from proceeds of the 2008 bond issues. As the 2007 forward starting swaps were entered into to lock interest rates in anticipation of issuing the 2008 bonds the cost of terminating the swaps were considered to be bond issue costs of the 2008 bonds. Bond issue costs are deferred and amortized into expense over the life of the related bonds.

Accounting and Risk Disclosures

During the years ended December 31, 2009 and 2008, the Authority paid $16,197 and $7,614, respectively, fixed and received $1,695 and $4,964, respectively, variable related to their outstanding swap agreements.

The Authority has the ability to early terminate the interest rate swaps and to cash settle the transaction on any business day by providing at least two business days written notice to the counterparty. Evidence that the Authority has sufficient funds available to pay any amount payable to the counterparty must be provided at the time notice is given. At early termination, the Authority will be required to pay or receive a settlement amount which is comprised of the market value of the terminated transaction(s) based on market quotations and any amounts accrued under the contract(s).

Through the use of derivative instruments such as this interest rate swap, the Authority is exposed to a variety of risks, including credit risk, interest rate risk, termination risk, basis risk, and rollover risk.

- Credit risk is the risk that a counterparty will not fulfill its obligations. On December 31, 2009, the interest rate swap counterparties were rated Aa3 and A2 by Moody's Investors Service, Inc., a nationally recognized statistical rating organization. If a counterparty failed to perform according to the terms of the interest rate swap agreement, there is some risk of loss to the Authority, up to the fair market value of the swaps.

  It is the Authority's policy to require counterparty collateral posting provisions in its non-exchange traded derivative instruments. There terms require collateral to be posted if the respective counterparty's credit rating falls below BBB+ by Standard & Poor's and the swap insurer becomes bankrupt. The amount of collateral to be posted is calculated based on derivatives in asset positions to the Authority. As of year-end, the counterparties had not and were not required to post collateral for these transactions.

- Termination risk is the risk that a derivative's unscheduled end will affect the Authority's asset/liability strategy or will present the Authority with potentially significant unscheduled termination payments to the counterparty. The counterparties to the interest rate swaps do not have the ability to voluntarily terminate the interest rate swap; however, the Authority is exposed to termination risk in the event that the one or more of the counterparties default.

- Basis risk is the risk that arises when variable interest rates on a derivative and an associated bond or other interest-paying financial instrument are based on different indexes. The Authority is subject to basis risk as the interest index on the variable rate arm of the swaps is based on the SIFMA Municipal Swap Index and the variable interest rate on the bonds is based on a different index, a weekly rate that is determined by a remarketing agent. Although expected to correlate, the relationships between different indexes vary and that variance could adversely affect the Authority's calculated payments, and as a result cost savings or synthetic interest rates may not be realized. During 2009, the weekly rate paid by the Authority on the underlying bonds was approximately $4,010 and exceeded the amount received on the various interest rate swaps of approximately $1,695.

- The Authority is further subject to basis risk in the event that the underlying bonds become fixed rate Bank Bonds or that the maturity of the underlying bonds is accelerated as discussed in Note 7: Bonds and Loans Payable.

- Rollover risk is the risk that a derivative associated with the Authority's debt does not extend to the maturity of that debt. When the derivative terminates, the associated debt will no longer have the benefit of the derivative. The Authority is not exposed to rollover risk as the swap agreements terminate on the same day the last payment is due on the respective bonds.

Contingencies

All of the Authority's derivative instruments, include provisions that require the Authority to post collateral in the event that the credit ratings of its credit support provider's senior long term, unsecured debt credit rating falls below BBB+ by Standard & Poor's and FSA, the swap insurer, becomes bankrupt. The amount of collateral to be posted is calculated based on derivatives in negative market value positions to the Authority. The collateral is to be posted in the form of cash, U.S. Treasuries or other approved securities. As of year-end, the Authority had not and was not required to post collateral for these transactions.

9. Investments and Deposits with Financial Institutions

The Authority is authorized to invest in: obligations of the U.S. Government and government-sponsored agencies and instrumentalities; fully insured or collateralized certificates of deposits; commercial paper of the highest rating; repurchase agreements collateralized by government obligations or securities; highly rated bank promissory notes or investment funds or trusts; and, as to trusteed assets, as otherwise permitted by the trust indenture as supplemented and amended in 1998. Throughout the years ended December 31, 2009 and 2008, the Authority invested its funds in such authorized investments. The Authority does not have a formal investment policy which addresses custodial credit risk, interest rate risk, credit risk, or concentration of credit risk.

(Dollars expressed in thousands unless otherwise indicated)

GASB Statement No. 40, *"Deposit and Investment Risk Disclosures,"* requires disclosures related to the following deposit and investment risks: credit risk (including custodial credit risk and concentration of credit risk), interest rate risk, and foreign currency risk. The following is a description of the Authority's deposit and investment risks.

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. As of December 31, 2009 and 2008, \$40,673 and \$42,153, respectively, of the Authority's bank balance of \$41,923 and \$42,653, respectively, was exposed to custodial credit risk. These amounts are collateralized in accordance with Act 72 of the Pennsylvania state legislature which requires the institution to pool collateral for all governmental deposits and have the collateral held by an approved custodian in the institution's name. These deposits have carrying amounts of \$42,937 and \$41,914 as of December 31, 2009 and 2008, respectively, all of which is reported as current assets in the statements of net assets.

In addition to the deposits noted above, included in cash and cash equivalents as non-current restricted assets on the statements of net assets are the following short-term investments at December 31, 2009 and 2008: money market funds of \$10,073 and \$22,366, respectively, and repurchase agreements of \$575 and \$575, respectively. Of the Authority's \$575 and \$575 investment in repurchase agreements, at December 31, 2009 and 2008, respectively, all of the underlying securities are held by the investment's counterparty, not in the name of the Authority.

At December 31, 2009, the Authority held the following investment balances:

	Carrying value	Maturity in years Less than 1 year
Commonwealth of PA Revenue Bonds (Guaranteed Investment Contracts)	$ 8,516	$ 8,516
Money market	10,073	10,073
Repurchase agreements	575	575
Commercial paper	87,946	87,946
Total Investments	$ 107,110	$ 107,110

(Dollars expressed in thousands unless otherwise indicated)

At December 31, 2008, the Authority held the following investment balances:

	Carrying value	Maturity in years: Less than 1 year
Commonwealth of PA Revenue Bonds (Guaranteed Investment Contracts)	$ 8,464	$ 8,464
Money market	22,366	22,366
Repurchase agreements	575	575
Commercial paper	102,450	102,450
U.S. Treasury	1,604	1,604
Total	$ 135,459	$ 135,459

With the exception of the guaranteed investment contracts, the carrying value of the Authority's investments is the same as their fair market value amount. The Guaranteed investment contracts are carried at amortized cost. Investments of $96,462 and $113,093 are included as noncurrent restricted investments on the statements of net assets at December 31, 2009 and 2008, respectively. Investments of $10,648, consisting of money market funds of $10,648 are included as noncurrent restricted cash and cash equivalents on the statements of net assets at December 31, 2009. Investments of $22,366, consisting of money market funds of $22,366 are included as noncurrent restricted cash and cash equivalents on the statements of net assets at December 31, 2008.

Interest Rate Risk – Interest rate risk, the risk that changes in the interest rates will adversely affect the fair market value of the Authority's investments. The Authority is not subject to interest rate risk as all of its investments at December 31, 2009 and 2008 had maturities of less than one year.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. As of December 31, 2009, the Authority's investments in the guaranteed investment contracts were rated AAA by Standard & Poor's. The counterparty to the Authority's guaranteed investment contracts is the Commonwealth of Pennsylvania Revenue Bonds. The Authority's investments in money markets were rated AAA by Standard & Poor's. The Authority's investments in commercial paper at December 31, 2009 were rated A-1 and AAA by Standard & Poor's. Additionally, at December 31, 2009, the Authority had various repurchase agreements. The underlying securities of these repurchase agreements consist primarily of U.S. Treasuries, and are therefore not subject to credit risk.

Concentration of Credit Risk – Concentrations of credit risk is the risk of loss attributed to the magnitude of a government's investments in a single issuer. The Authority places no limit on the amount it may invest in any one issuer. More than five percent of the Authority's investments are in Federated Government Obligation Fund, Dreyfus Cash Management, and Commonwealth of Pennsylvania. These investments are 73.8%, 9.4%, and 8%, respectively, of the Authority's total investments at December 31, 2009.

10. Net Assets

Net assets represent the difference between assets and liabilities. An analysis of net asset amounts is as follows:

(Dollars expressed in thousands unless otherwise indicated)

	December 31, 2009	December 31, 2008
Invested in capital assets, net of related liabilities:		
Net property, plant, and equipment in service	$ 470,352	$ 443,720
Debt subject to capital improvements	(617,683)	(633,699)
Accounts payable for capital items	(3,359)	(1,610)
Funded debt from restricted assets:		
Unspent debt proceeds:		
Capital projects	83,217	109,680
Debt service and reserve funds	10,017	10,275
	(57,456)	(71,634)
Restricted for capital activity and debt service:		
Restricted cash and cash equivalents	10,648	22,366
Restricted investments	96,462	113,093
Restricted receivables	78	484
Liabilities payable from restricted assets:		
Unspent debt proceeds:		
Capital projects	(83,217)	(109,680)
Debt service and reserve funds	(10,017)	(10,275)
	13,954	15,988
Unrestricted	13,064	20,649
Total Net Assets	$ (30,438)	$ (34,997)

11. Operating Lease

During 2007, the Authority entered into a new lease for office space. The term of the lease is for twenty years commencing on August 1, 2007 and ending on July 31, 2027. The lease is subject to an automatic roll-over for five years, if the Authority does not communicate in writing one year prior to expiration that is desires not to extend the lease. The general terms of the lease requires the lessor to provide for utilities, building repairs, maintenance, and real estate taxes.

The total minimum future commitments under the lease for year ending December 31, 2009 are as follows:

(Dollars expressed in thousands unless otherwise indicated)

2010	$	593
2011		593
2012		599
2013		616
2014		616
2015-2019		3,182
2020-2024		3,358
2025-2027		1,882
	$	11,439

The total annual rental for office space was approximately $593 for 2009 and 2008.

12. Commitments and Contingencies

The Authority is proceeding with a capital improvement program which the Authority's independent engineer has estimated will entail expenditure of the existing construction funds and potential future bond issues. As of December 31, 2009, $146 million of the program is complete and $78 million is under active contract.

In addition to the matters discussed in Note 13, Consent Agreement, various other claims and lawsuits are pending against the Authority. The ultimate outcome of these claims and lawsuits cannot presently be determined and, accordingly, no provision for amounts arising from settlements has been made in these financial statements. In the opinion of management, the effect on the financial statements of potential losses associated with any such claim and/or lawsuit should not be material.

The Authority was insured for general liability coverage through 2001; however, effective January 1, 2002, it became self-insured. In previous years, the Authority established a fund to pay for deductibles, small claims, and other litigation costs. At year-end, the balance in this fund was approximately $575. This fund is grouped with "Restricted Assets" on the statements of net assets. During 2009 and 2008, the Authority paid $0 from this fund for claims, and there is $0 and $0 accrued as of December 31, 2009 and 2008, respectively.

13. Purchase of Water System

In December 2009, the Authority entered into an agreement for the purchase of the water system of the Borough of Millvale (Borough) for approximately $3 million. $1.55 million was paid to the Borough and the Authority agreed to relieve the Borough of receivables totaling approximately $1.4 million. The Authority included the total purchase price of approximately $3 million as a utility asset addition for 2009. The Authority will also provide sanitary sewer and garbage billing to the Borough at no additional charge.

14. Consent Agreement

The Authority is subject to federal regulation under the Clean Water Act (1977) and regulations adopted under that Act. Among the specific requirements applicable to the Authority's system are those imposed by the United States Environmental Protection Agency's Combined Sewer Overflow (CSO) Policy (1994). On January 29, 2004, the Authority and the City of Pittsburgh executed a Consent Order and Agreement (Order) regarding wet weather sewer overflows within the City. The other signatories to the Order are the Pennsylvania Department of Environmental Protection (DEP) and the Allegheny County Health Department (ACHD).

Generally, the Order requires the Authority and the City to assess the City sewers in order to develop a plan with ALCOSAN to address wet weather sewer overflows within the City. The Order is part of a sewer assessment program for all municipalities served by ALCOSAN. Most assessment activities for critical sewers and separate sanitary sewers are to be completed by 2010. As of December 31, 2009, ninety percent of the critical sewers and separate sanitary sewer work had been completed. Assessment activities for non-critical sewers are to be completed on a longer schedule with some tasks to be completed by 2012. In addition to the assessment, the Order requires the Authority and the City to implement the Nine Minimum Controls to reduce combined sewer overflows, and to perform repairs and maintenance of deficiencies revealed by the assessment. Deficiency corrections identified during assessment in critical sewers and separate sanitary sewers are to be completed by 2010, and in non-critical sewers are to be completed by 2012.

Given the scope of the Order, the size of the City sewer system, and the various conditions and/or deficiencies that may be discovered by the assessment, it is difficult to predict the total cost of compliance with the Order. Moreover, it is difficult to predict what, if any, large-scale and/or regional capital improvements may be required after the completion of the assessment to address wet weather sewer overflows in the City and in the ALCOSAN service area. Large-scale and/or regional capital improvements are not covered by the Order. The Authority has hired two engineering firms to assess and model the sewer system, and it is moving forward with its plans to comply with the Order. Costs associated with Order compliance will be reflected in the capital improvement program and funded by proceeds of potential future bond issuances.

MaherDuessel
Certified Public Accountants

Additional Information

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS COMPOSITION - SCHEDULE I

(Dollars expressed in thousands)

DECEMBER 31, 2009

				Cash Equivalents		Investments					
	Total	Unrealized Gain/(Loss)	Accrued Interest Receivable	*(1) Dreyfus U.S. Gov't Securities	Tri-Party-Repo Investments	*(2) Federated Gov't Obligation Fnd #5 US Gov't Securities	Commonwealth of PA Revenue Bonds	*(3) Basin Elec PWR COOP DISC COML	*(4) Korea Dvlpmnt BK	*(5)White PT FDG INC DISC C/P 4/2	*(6) Silver Tower Fndng LLC C/P 4/2
Capital project and construction funds:											
2005 Capital Project Fund	$ 4,132	$ -	$ -	$ 4,132	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2008 Construction Fund	79,094	-	9	-	-	79,085	-	-	-	-	-
	83,226	-	9	4,132	-	79,085	-	-	-	-	-
Debt service funds:											
1993 Debt Service Fund	602	8	4	2	-	-	-	147	294	147	-
2003 Debt Service Fund	4,812	147	35	4	-	-	-	186	2,314	186	1,940
2007 A Debt Service Fund	1,987	54	15	5	-	-	-	148	956	148	661
2007 B-1 Var Debt Service Fund	12	-	-	12	-	-	-	-	-	-	-
2007 B-2 Var Debt Service Fund	11	-	-	11	-	-	-	-	-	-	-
2008A Debt Service Fund	1,538	17	12	1	-	-	-	377	754	377	-
2008B1 Debt Service Fund	18	-	-	18	-	-	-	-	-	-	-
2008B2 Debt Service Fund	17	-	-	17	-	-	-	-	-	-	-
2008C2 Debt Service Fund	13	-	-	13	-	-	-	-	-	-	-
2008D1 Debt Service Fund	989	-	-	989	-	-	-	-	-	-	-
2008D2 Debt Service Fund	84	-	-	84	-	-	-	-	-	-	-
	10,083	226	66	1,156	-	-	-	858	4,318	858	2,601
1993 Operating Reserve Fund	8,521	-	3	2	-	-	8,516	-	-	-	-
2008 Capitalized Interest Fund	4,783	-	-	4,783	-	-	-	-	-	-	-
Self-Insured Escrow Fund	575	-	-	-	575	-	-	-	-	-	-
	$ 107,188	$ 226	$ 78	$ 10,073	$ 575	$ 79,085	$ 8,516	$ 858	$ 4,318	$ 858	$ 2,601

(1) Dreyfus Gov't Cash Mgmt Agency with the Bank of New York Mellon, yielding 0.00%.

(2) Federated Government Obligation FD 5, yielding 0.09%

(3) Basin Elec Pwr COOP Disc Coml yielding 4.92% with a maturity date of 2/25/2010

(4) Korea Development Bk yielding 4.62% with a maturity date of 2/26/2010

(5) White Pt Fdg Inc Disc C/P 4/2 yielding 4.51% with a maturity date of 03/01/2010

(6) Silver Tower Fdg LLC 4/2 CPDS yielding 4.62% with a maturity date of 08/19/2010

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2009

	Series 1993 Bonds		Series 2003 Bonds	Series 2005 Bonds	Series 2007 Bonds				
	Debt Service Fund	Operating Reserve Account	Debt Service Fund	Capital Project Fund	2007 CPF/Project Fund	2007A Debt Service Fund	2007 B1 Debt Service Fund	2007 B2 Debt Service Fund	Subtotal
Increases:									
Interest	$ 21	$ 47	$ 257	$ 14	$ 27	$ 117	$ -	$ -	$ 483
Total increases	21	47	257	14	27	117	-	-	483
Bond Restructuring of the 2008B's and 2008C1's	-	-	-	-	(583)	-	-	-	(583)
Decreases:									
Capital projects	-	-	-	3,372	5,191	-	-	-	8,563
Interest	1,770	-	2,542	-	-	1,937	1,954	1,878	10,081
Bond principal/refunding escrow	-	-	10,005	-	-	3,815	-	-	13,820
Other	-	-	-	4	1	-	-	-	5
Total decreases	1,770	-	12,547	3,376	5,192	5,752	1,954	1,878	32,469
Interfund Transfers:									
Nontrusteed accounts	1,750	-	12,775	-	583	5,660	1,876	1,796	24,440
2008B Debt Svc Fund	-	-	-	-	-	-	-	-	-
2008C1 Debt Svc Fund	-	-	-	-	-	-	-	-	-
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-	-
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-	-
2008 Capital Projects Fund	-	-	-	-	-	-	-	-	-
Total interfund transfers	1,750	-	12,775	-	583	5,660	1,876	1,796	24,440
Net activity	1	47	485	(3,362)	(5,165)	25	(78)	(82)	(8,129)
Balance:									
Beginning of year	601	8,474	4,327	7,494	5,165	1,962	90	93	28,206
End of year	$ 602	$ 8,521	$ 4,812	$ 4,132	$ -	$ 1,987	$ 12	$ 11	$ 20,077

(Continued)

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2009
(Continued)

		Series 2008 Bonds										
	Self-Insured Escrow Account	2008 Cap. Int. Fund	2008A Debt Svc Fund	2008B Debt Svc Fund	2008B1 Debt Svc Fund	2008B2 Debt Svc Fund	2008C1 Debt Svc Fund	2008C2 Debt Svc Fund	2008D1 Debt Svc Fund	2008D2 Debt Svc Fund	2008 Cap. Proj. Fund	Total
Increases:												
Interest	$ -	$ 11	$ 42	$ -	$ -	$ -	$ -	$ -	$ 1	$ -	$ 106	$ 643
Total increases	-	11	42	-	-	-	-	-	1	-	106	643
Bond Restructuring of the 2008B's and 2008C1's	-	(169)	-	-	-	-	(353)	-	-	-	(2,417)	(3,522)
Decreases:												
Capital projects	-	-	-	-	-	-	-	-	-	-	12,295	20,858
Interest	-	-	4,531	7,438	20	17	2,725	2,355	1,222	3,476	-	31,865
Bond principal/refunding escrow	-	-	-	-	-	-	-	-	-	-	-	13,820
Other	-	3	-	-	-	-	-	-	-	-	48	56
Total decreases	-	3	4,531	7,438	20	17	2,725	2,355	1,222	3,476	12,343	66,599
Interfund Transfers:												
Nontrusteed accounts	-	-	4,492	6,776	38	34	2,524	2,199	-	235	-	40,738
2008 Capitalized Interest Fund	-	(1,523)	-	-	-	-	-	-	-	-	-	(1,523)
2008B Debt Svc Fund	-	-	-	291	-	-	-	-	-	-	-	291
2008C1 Debt Svc Fund	-	-	-	-	-	-	353	-	-	-	-	353
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-	1,395	-	-	1,395
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	3,175	-	3,175
2008 Capital Projects Fund	-	-	-	-	-	-	-	-	-	-	(3,706)	(3,706)
Total interfund transfers	-	(1,523)	4,492	7,067	38	34	2,877	2,199	1,395	3,410	(3,706)	40,723
Net activity	-	(1,684)	3	(371)	18	17	(201)	(156)	174	(66)	(18,360)	(28,755)
Balance:												
Beginning of year	575	6,467	1,535	371	-	-	201	169	815	150	97,454	135,943
End of year	$ 575	$ 4,783	$ 1,538	$ -	$ 18	$ 17	$ -	$ 13	$ 989	$ 84	$ 79,094	$ 107,188

(Concluded)