PITTSBURGH WATER AND SEWER AUTHORITY

SINGLE AUDIT

2008

MaherDuessel

Certified Public Accountants || *Pursuing the Profession While Promoting the Public Good®*

PITTSBURGH WATER AND SEWER AUTHORITY

YEARS ENDED DECEMBER 31, 2008 AND 2007

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YEARS ENDED DECEMBER 31, 2008 AND 2007

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MaherDuessel

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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, 2008 and 2007 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the 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, 2008 and 2007, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 29, 2009 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

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 accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the basic financial statements of the Authority. The additional information and the schedule of expenditures of federal awards, have 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 29, 2009

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THE PITTSBURGH WATER AND SEWER AUTHORITY

2008 Financial Statements
Management Discussion and Analysis

The Pittsburgh Water and Sewer Authority (the "Authority") comparative 2008 and 2007 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 Statement 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.

Effective with the 2008 Statements of Revenues, Expenses, and Changes in Net Assets, the Authority began reporting Wastewater Treatment Revenues and Expenses for services provided by the Allegheny County Sanitary Authority (ALCOSAN). The Statements of Net Assets are not impacted by this change and there are no outstanding bond issues associated directly or indirectly with wastewater revenue streams.

The purpose of this change is threefold; 1) To more accurately depict the economic size of the Authority's operations in the Western Pennsylvania region in terms of aggregate revenues and expenses. 2) To recognize the Authority's obligation to keep ALCOSAN whole for all wastewater treatment services billed to residents of the city. 3) To acknowledge that were it not for the existence of ALCOSAN, the Authority would remain contractually obligated to continue to provide wastewater treatment services to its customers in some other capacity.

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.

Financial Highlights

In 2008, operating income decreased by 18.7% or $5.6 million resulting in a net loss of $.4 million, down from a $3.3 million net income in 2007. Below are the 2008 financial highlights:

Total operating revenues in 2008 were unchanged at $129.9 million compared to 2007. However, a net $2.1 million increase in wastewater treatment revenues due to a 9% rate increase by ALCOSAN and an increase of $1.1 million in other revenues was offset by a $3.1 million or 3.5% decline in Water Sales revenues in 2008. The decline in water utility revenues was a result of an overall drop in consumption in 2008 compared to 2007.

Total operating expenses increased by $5.6 million or 5.6% to $105.6 million from $100 million in 2007. Significant operating expenses included the following factors:

- Salary and employee benefit expense were up $.867 million or 6.0%. The increase is attributed to an average salary increase of 2.5% and staff increases in operational and Customer Service areas.

  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) Local 2719 represents white-collar employees and Local 2037 represents foremen. The three-year AFSCME agreement expired in December 2008 and is currently in negotiations. A new five-year agreement with the PJCBC became effective January 1, 2008 and expires December 31, 2012. Negotiations are ongoing with the Local 2037 union.

- Overall direct operating expenses increased by $.9 million to $52.6 million in 2008 or, 2% from $51.7 million in 2007. Wastewater treatment expense increased by $2.0 million or, 5.2% to $40.1 million over $38.1 million in 2007. Sewer repairs increased by $.5 million or 77% to $1.3 million in 2008, from $.7 million in 2007. Emergency water line repairs increased by $.3 million to $1.7 million or 23% from $1.4 million in 2007. Catch basin repairs increased by $.3 million to $.7 million or 50% from $.5 million in 2007. Operating contracts-other increased by $.2 million. Repairs and maintenance expense for IT infrastructure and building repairs dropped by $2.6 million due to lower level of capital asset investment activity in 2008. IT infrastructure investment declined by $1.7 million and building & repairs fell by $.6 million compared to 2007.

- Overall G&A expenses increased by $3.3 million to $12.5 million, or 35% in 2008 compared to $9.2 million in 2007. The majority or, $2.3 million of this increase is directly associated with the decline in capital investment activity during 2008 (see above). Claims and deductible expense increased by $.6 million due to a $.5 million write-down of the Gateway reserve in 2007. Office rents increased 41% or, $.2 million due to the first full year of rents under the new 20 year lease agreement signed in 2007.

- Electricity expenses were up 7% or $.3 million to $4.7 million, from $4.4 million in 2007. Natural gas utilities increased $.3 million or 67% to $.8 million from $.5 million in 2007.

- Overall other expenses increased 3.9% or $2.2 million to $57.9 million in 2008 from $55.7 million in 2007. Non-city water subsidy increased 56% or $.4 million to $1.1 million in 2008 compared to $.7 million in 2007. Interest expense on bond debt increased 3.4% or $1 million to $29.4 million in 2008 compared to $28.4 million. Amortization of bond issue costs increased 93.3% or $.6 million to $1.2 million in 2008 compared to $.6 million in 2007.

- In 2008, collections decreased by $1.9 million or 1.5% while the accounts receivable aggregate reserve adjustment for bad debt expense decreased by 8% or, $.2M.

Other 2008 highlights include:

- In April, Michael P. Kenney was appointed by the Board of Directors to the position of Executive Director. Mr. Kenney arrived with twenty-five years of experience with the Municipal Authority of Westmoreland County (MAWC) where serving as Assistant Manager he was responsible for overseeing a system with over 125,000 connections for a population of over 400,000 spanning 5 counties. The MAWC had a work force of 270 employees including 55 management positions and 215 bargaining unit employees.

- In May of 2008, the Authority contacted Moody's and S&P for an independent rating for the first time in its history. Moody's rated the Authority Baa1 and S&P rated the Authority an A rating.

- In June 2008, the Authority issued its 2008 Bond Refunding and new Construction Fund series. To complete the restructuring, the Authority terminated its forward-start swaps established in 2007 for refunding 1998A and C Bond series, and a portion of the 2007 swaps. In addition, the Authority extended the final maturity of its debt to afford approximately $98 million in new construction monies without a rate impact. This necessitated amending the Articles of Incorporation to extend the statutory life of the Authority to May 2045.

- Currently, $403 million or, approximately 50% of the Authority's total debt portfolio consists of variable debt bonds. The variable rate debt is hedged or "synthetically fixed" at rates between 3.932% and 4.103%. Variable rate interest payments are partially offset by swap payments received from two counterparties. The degree of offset is a direct function of the weekly rate resets compared to the SIFMA Index or "trading spread."

- The 2007 VRDN bond series total approximately $82.7 million while the 2008 VRDN bond series total $320.5 million. The bonds and swaps are insured by FSA. Liquidity established under Stand By Purchase Agreements (SBPA's) is provided by JP Morgan Chase and Dexia. Liquidity on the 2007 bond series expires September 1, 2015. Liquidity on the 2008 bond series expire June 11, 2009. JP Morgan provides liquidity on approximately $123.1 million (bond series 2008C2 and 2008D2) while Dexia provides liquidity on approximately $197.4 million (bond series 2008B and 2008C1). The 2008C2's and 2008D2's have an acceleration clause requiring principal be repaid in semiannual installments over five years if liquidity is not renewed by the expiration date. The 2008B's and 2008C1's do not have an acceleration clause. The remarketing agents are JP Morgan Securities Inc. and Merrill Lynch.

- As a result of the financial market dislocation during the latter part of 2008, liquidity tightened dramatically causing the VRDN market to lose buyers while the weekly rates and trading spreads increased significantly. In addition, FSA was downgraded from Aaa to Aa3 by Moody's and put on negative credit watch by S&P while still maintaining its AAA rating. As a result of this market instability, a portion of the 2008B and C bond series experienced a lack of remarketing causing some bonds to be driven into bank bond status during October and November. In each instance, however, these bonds were successfully remarketed shortly afterwards. Since that time, all bonds have continued to be remarketed and none have returned to a bank bond status. Overall, the Authority paid approximately $2.3 million in additional debt service through year-end due to the global economic crisis. Nevertheless, availability and the cost of any renewed or replacement credit could facilitate a higher overall funding cost for PWSA.

- The Authority is currently negotiating with several financial institutions to either extend the SBPA's beyond June 11, 2009 or replace the facilities. The Authority is evaluating several offers and keeping open options that include Letters-of-Credit, Fixed Rate bonds, Cash Defeasance, Put Bonds, and other conversion instruments. While these matters are sensitive, it is estimated, based on current market conditions, liquidity costs could increase. The financial markets have continued to improve since late 2008 and a pending sale of FSA to Assured Guaranty could further stabilize the marketability of the VRDN bonds.

- Debt service coverage in 2008 and 2007 was 1.9 and 1.8, respectively. These coverage factors exceed the 1.2 coverage factor required under the bond covenant.

- The Authority contracted with a third party to provide its customers with the option to pay their monthly bill with a credit card via phone.

- Valve Replacement Program- In 2008, PWSA upgraded their water infrastructure through the valve replacement program. This program allowed for the installation of several large valves improving water service by increasing efficiency and allowing isolation for routine maintenance and outages. Most notable projects are the installation of a 36-inch valve on the Boulevard of the Allies and the installation of a 24-inch valve in Station Square.

- Permit Counter - In 2008, the PWSA Permit Counter collected approximately $2.5 million. Generating revenue from building permits helps the Authority to meet and exceed standards while keeping costs down. This revenue is not only a reflection of the Authority's commitment to excellence but also of the development occurring every day throughout the city.

- Tough Books/GIS Mapping - The MIS, GIS, Distribution, and Facilities departments formed a joint initiative to replace paper maps with electronic maps. Field crews can now access infrastructure maps in the field saving time and streamlining our operation. This conversion allows field crews to input real-time data, and helps customer service to better assist our customers. GIS mapping is critical to our operation providing immediate access to information for emergency response.

- Partnership with Port Authority - In 2008, PWSA partnered with Port Authority and the City of Pittsburgh to construct and relocate several large water and sewer lines to accommodate the North Shore Connector. PWSA Operations and Engineering departments put forth great effort in coordinating the relocation of the water and sewer lines while providing temporary service to customers. 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 the 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 2008. 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 for direct and indirect services under the Cooperation Agreement. Under this Agreement, the Authority also funds on behalf of the City a rate equalization subsidy to other City water companies. Under separate agreement, the Authority, also on behalf of the City, 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. Any other actions by the City of Pittsburgh to increase Authority funding would require Board approval.

CONDENSED FINANCIAL STATEMENTS

CONDENSED STATEMENT OF NET ASSETS

(Dollars expressed in thousands)

	December 31, 2008	December 31, 2007	Variance Dollars	Variance %
			Increase (Decrease)	
Capital assets:				
Producing assets	$ 416,413	$ 420,120	$ (3,707)	-0.9%
Construction in progress	27,307	22,901	4,406	19.2%
Restricted assets	135,943	51,547	84,396	163.7%
Current assets and bond costs	90,899	68,975	21,924	31.8%
Total Assets	$ 670,562	$ 563,543	$ 107,019	19.0%
Liabilities:				
Current liabilities	$ 43,695	$ 46,693	$ (2,998)	-6.4%
Long-term liabilities	661,864	551,453	110,411	20.0%
Total Liabilities	705,559	598,146	107,413	18.0%
Net Assets (Deficit):				
Invested in capital assets, net of related liabilities	(81,338)	(64,959)	(16,379)	25.2%
Restricted for capital activity and debt service	15,988	8,837	7,151	80.9%
Unrestricted	30,353	21,519	8,834	41.1%
Total Net Assets (Deficit)	(34,997)	(34,603)	(394)	1.1%
Total Liabilities and Net Assets (Deficits)	$ 670,562	$ 563,543	$ 107,019	19.0%

CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

(Dollars expressed in thousands)

	Year Ended December 31, 2008	Year Ended December 31, 2007	Variance Dollars	Variance %
			Increase (Decrease)	
Operating Revenues	$ 129,938	$ 129,907	$ 31	0.0%
Operating Expenses:				
Direct operating	38,346	35,328	3,018	8.5%
Wastewater treatment	40,096	38,094	2,002	5.3%
Cooperation Agreement	9,650	9,650	-	0.0%
Subsidy of non-customer City residents	1,070	684	386	56.4%
Depreciation and amortization	16,471	16,249	222	1.4%
Total Operating Expenses	105,633	100,005	5,628	5.6%
Operating Income	24,305	29,902	(5,597)	-18.7%
Non-operating revenue (expense):				
Federal grants	986	0	986	986.0%
Interest revenue	5,032	2,598	2,434	93.7%
Interest expense and other	(30,717)	(29,171)	(1,546)	5.3%
Total Non-operating Revenue (Expenses)	(24,699)	(26,573)	1,874	-7.1%
Net Gain/(Loss)	$ (394)	$ 3,329	$ (3,723)	-111.8%

Financial Condition

The Authority's financial condition in 2008 remained stable for a sixth year in a row despite the net book loss of $.394 million loss. While water utility revenues declined by 3.5%, unrestricted cash reserves from operations increased by 19.7% or $6.8 million due to debt restructuring and more focused efforts to improve collections and reporting capabilities.

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 a culture 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, 2008 AND 2007

Assets	2008	2007
Current assets:		
Cash and cash equivalents	$ 41,914	$ 35,024
Accounts receivable, net:		
Water:		
Billed	10,159	11,012
Unbilled	4,245	4,037
Total water	14,404	15,049
Wastewater treatment:		
Billed	4,894	5,527
Unbilled	3,235	2,957
Total wastewater treatment	8,129	8,484
Other receivables	2,137	1,339
Total accounts receivable, net	24,670	24,872
Prepaid expenses	190	434
Inventory	1,564	1,572
Total current assets	68,338	61,902
Noncurrent assets:		
Restricted assets:		
Accrued interest receivable	484	338
Cash and cash equivalents	22,366	6,593
Investments	113,093	44,616
Total restricted assets	135,943	51,547
Capital assets, not being depreciated	27,307	22,901
Capital assets, net of accumulated depreciation	416,413	420,120
Bond issue costs, net of accumulated amortization	22,561	7,073
Total noncurrent assets	602,224	501,641
Total Assets	$ 670,562	$ 563,543

(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, 2008 AND 2007

(Continued)

Liabilities and Net Assets	2008	2007
Liabilities:		
Current liabilities:		
Bonds and loans payable, current portion	$ 14,625	$ 17,936
Accrued payroll and related obligations	673	940
Accounts payable wastewater treatment	13,757	12,168
Accounts payable and other accrued expenses	3,326	4,323
Accounts payable from restricted assets	1,610	3,319
Accrued interest payable from restricted assets	9,704	8,007
Total current liabilities	43,695	46,693
Noncurrent liabilities:		
Deferred revenue	356	378
Accrued payroll and related obligations	1,150	1,183
Bonds and loans payable, net of current portion	660,358	549,892
Total noncurrent liabilities	661,864	551,453
Total Liabilities	705,559	598,146
Net Assets:		
Invested in capital assets, net of related debt	(81,338)	(62,961)
Restricted for capital activity and debt service	15,988	8,837
Unrestricted	30,353	19,521
Total Net Assets	(34,997)	(34,603)
Total Liabilities and Net Assets	$ 670,562	$ 563,543

(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, 2008 AND 2007

	2008	2007
Operating Revenues:		
Residential, commercial, and industrial water sales	$ 86,627	$ 89,766
Wastewater treatment	39,439	37,381
Other	3,872	2,760
Total operating revenues	129,938	129,907
Operating Expenses:		
Direct operating expenses	38,346	35,328
Wastewater treatment	40,096	38,094
Cooperation agreement operating expenses:		
Indirect cost allocation - sewer conveyance	4,415	4,415
Indirect cost allocation - water	5,235	5,235
Expense of water provided by other entities:		
Subsidy of customers located in the City	1,070	684
Depreciation	13,914	13,692
Amortization of capitalized lease assets	2,557	2,557
Total operating expenses	105,633	100,005
Operating Income	24,305	29,902
Non-operating Revenues (Expenses):		
Federal grants	986	-
Interest revenue	5,032	2,598
Interest expense - bonds	(29,362)	(28,394)
Interest expense - other	(153)	(155)
Amortization of bond issue costs	(1,202)	(622)
Total non-operating revenues (expenses)	(24,699)	(26,573)
Net Income (Loss)	(394)	3,329
Net Assets:		
Beginning of year	(34,603)	(37,932)
End of year	$ (34,997)	$ (34,603)

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, 2008 AND 2007

	2008	2007
Cash Flows From Operating Activities:		
Cash received from customers	$ 130,718	$ 128,470
Cash paid to suppliers and employees and customer refunds	(39,567)	(36,228)
Cash paid to City of Pittsburgh under the Cooperation Agreement	(9,650)	(9,650)
Cash paid to other water companies for subsidy of customers located in the City of Pittsburgh	(1,070)	(684)
Cash paid to ALCOSAN for wastewater treatment	(38,507)	(35,802)
Net cash provided by (used in) operating activities	41,924	46,106
Cash Flows From Investing Activities:		
Purchase of investment securities	(706,271)	(243,000)
Proceeds from sale and maturities of investment securities	619,421	257,372
Interest income	4,886	2,732
Net cash provided by (used in) investing activities	(81,964)	17,104
Cash Flows From Capital and Related Financing Activities:		
Purchase/construction of property, plant, and equipment	(16,738)	(23,153)
Proceeds from federal grants	408	-
Proceeds from issuance of long-term debt	419,276	159,165
Payment to refunding bond escrow agent	(300,489)	(159,188)
Principal payments on debt	(15,531)	(17,299)
Interest paid on borrowings	(24,223)	(22,345)
Net cash provided by (used in) capital and related financing activities	62,703	(62,820)
Increase (Decrease) in Cash and Cash Equivalents	22,663	390
Cash and Cash Equivalents:		
Beginning of year	41,617	41,227
End of year	$ 64,280	$ 41,617
Consists of:		
Restricted cash and cash equivalents	$ 22,366	$ 6,593
Unrestricted cash and cash equivalents	41,914	35,024
	$ 64,280	$ 41,617
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities:		
Operating income	$ 24,305	$ 29,902
Adjustments:		
Depreciation and amortization	16,471	16,249
Reserve for uncollectible amounts	1,788	2,364
Change in assets and liabilities:		
Change in:		
Accounts receivable	(788)	(3,931)
Other accounts receivable	(220)	131
Wastewater accounts payable	1,589	1,578
Accounts payable and other accrued expenses	(997)	(2,025)
Accrued interest on restricted assets	(1,709)	801
Accounts payable restricted assets	1,697	1,433
Other	(212)	(396)
Net cash provided by (used in) operating activities	$ 41,924	$ 46,106

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 83,000 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"). At inception, the City contributed $5.3 million to the Authority in the form of customer accounts receivable.

On March 14, 2008, the Authority agreed to amend its term of existence to 2045.

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. The significant GASB standards followed by the Authority are described as follows:

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 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 Costs, Premiums, and Discounts

Bond issue 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.

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 40 years. Non-utility assets have estimated useful lives ranging from 5 to 10 years.

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

Maintenance and repairs are charged to expense as incurred.

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, and industrial water sales.

- 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.

Change in Accounting Principle

In prior periods, the Authority has accounted for revenue for wastewater treatment net of related expenses. During 2008, the Authority elected to change their method of accounting for wastewater treatment. The Authority currently reports wastewater treatment revenue and wastewater treatment expenses gross on the Statement of Revenues, Expenses, and Changes in Net Assets. This method of accounting is preferable as it presents the wastewater treatment activity consistent with the Authority's responsibility for this activity. The current presentation allows for the reporting of operational income and losses related to wastewater treatment which is consistent with other Authorities with similar activities. Financial statements of prior years have been restated to apply the new method retroactively. The effect of the accounting change has been to gross up prior year income and expense for wastewater treatment. There is no effect on net income as previously reported for 2007 or any prior year.

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 considering 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 which 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 2008 payroll of $11,255 was covered by the Plan. Employee contributions for the year amounted to approximately $482.

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 2008 Minimum Municipal Obligation calculated for the City's Plan indicated a 2008 normal cost of $555 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 2008, together with other elements of expense for employee service during 2008 would not exceed the sum of the 2008 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, 2008 and 2007, the reserve for uncollectible water accounts was approximately $17.1 million and $15.6 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, 2008 and 2007, the reserve for uncollectible wastewater accounts was approximately $8.66 million and $8.4 million, respectively.

5. Capital Assets

Capital assets consisted of the following at December 31, 2008 and 2007:

(Dollars expressed in thousands unless otherwise indicated)

	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

	Balance at December 31, 2006	Additions	Transfers	Balance at December 31, 2007
Capital assets not being depreciated:				
Construction in progress	$ 16,658	$ 10,256	$ (4,013)	$ 22,901
Capital assets being depreciated:				
Water and sewer system	102,167	-	-	102,167
Utility assets	454,715	13,891	(49)	468,557
Non-utility assets	12,774	3,089	(21)	15,842
Total capital assets being depreciated	569,656	16,980	(70)	586,566
Total capital assets	586,314	27,236	(4,083)	609,467
Accumulated depreciation	(150,197)	(16,249)	-	(166,446)
Capital assets, net	$ 436,117	$ 10,987	$ (4,083)	$ 443,021

6. PAYROLL AND RELATED OBLIGATIONS

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

(Dollars expressed in thousands unless otherwise indicated)

	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	(304)	390	391
	$ 2,123	$ (301)	$ 1,822	$ 673

	Balance at December 31, 2006	Change	Balance at December 31, 2007	Current Portion
Compensated absences	$ 766	$ 12	$ 778	$ 33
Workers' compensation	590	54	644	206
Early retirement incentive	7	-	7	7
Payroll, withholdings,			-	
and taxes	625	69	694	694
	$ 1,988	$ 135	$ 2,123	$ 940

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, 2008 and 2007 is $136,490 and $148,995, 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. The principal of defeased 1991 Bonds still outstanding at December 31, 2008 and 2007 was $0 and $12,940, respectively.

During 2008, the bond insurance company for the Series 1993 Bonds was downgraded to a credit rating of CAA1 by Standard & Poor's.

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, 2008 and 2007, with carrying amounts of $27 million and $49 million, respectively, based on quoted market prices, is approximately $30 million and $56 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, 2008 and 2007, the remaining unamortized deferred refunding loss of $569 and $2,920, respectively, on the transaction is shown as a reduction of the long-term debt and will be amortized through 2028.

Fair value of the 1998 Bonds at December 31, 2008 and 2007, with carrying amounts of $56 million and $253 million, respectively, based on quoted market prices, is approximately $56 million and $261 million, respectively.

The 1998 Series A Bonds and 1998 Series C Bonds bear interest at fixed rates ranging from 5.0% to 5.25%, payable semi-annually at March 1 and September 1. 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 $167,390,000 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 $1,468 and $2,251 at December 31, 2008 and 2007, 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, 2008 and 2007, with carrying amounts of $67 million and $116 million, respectively, based on quoted market prices, is approximately $69 million and $118 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 which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. At December 31, 2008 and 2007, the remaining unamortized deferred refunding loss of $5,759 and $8,099, respectively. At December 31, 2008, the principal of the defeased Series 2002 Bonds outstanding was $97,145, and the defeased 2005 Bonds outstanding was $47,545.

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, 2008 and 2007, with carrying amounts of $124 million and $156 million, respectively, based on quoted market prices, is approximately $127 million and $161 million, respectively.

<u>Series 2008</u>

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 that will be amortized as an adjustment to interest expense over the life of the 2008 Bonds using the effective interest method. At December 31, 2008, the principal of the defeased Series 1993A Bonds outstanding was $21,875 and the defeased 2003 Bonds outstanding was $34,530. The maturity value of defeased 1998B compound interest bonds outstanding at December 31, 2008 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) 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. 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, 2008, with carrying amounts of $414 million, based on quoted market prices, is approximately $413 million.

The 2008 bond transactions were entered into to obtain approximately $98 million of new funds while maintaining a specified level of current debt service by extending the maturity of previously held debt. As a result, debt service for the refunded bonds is approximately $185 million higher over the life of the 2008 Bonds.

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 remarking certain 2008 Variable Rate Demand Bonds (bonds). These bonds were not able to be remarketed on a timely basis due to downgrades 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 of December 31, 2008, all of the 2008 Variable Rate Bonds had been remarketed and were no longer considered to be bank bonds.

Currently, Dexia and JP Morgan provide liquidity for the Authority's 2007 and 2008 variable rate demand bonds through Standby Bond Purchase Agreements. The JP Morgan and Dexia agreements related to the 2008 variable rate demand bonds are scheduled to expire on June 11, 2009. If the Authority is unable to extend or replace JP Morgan as the liquidity provider for approximately $123 million of outstanding bonds, the maturity of these bonds will be accelerated and will become due with scheduled maturities over a five year period. Dexia has provided notification to the Authority that they will not be extending the liquidity on approximately $197 million of bonds. The Authority is currently researching other means to provide liquidity or credit support for these bonds. In the event that liquidity or credit support is not provided, these bonds are not subject to an accelerated maturity but will be purchased by the current liquidity provider Dexia and held as Bank Bonds.

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 Footnote 8: Interest Rate Swaps.

Bonds and state loans payable (PENNVEST), consisted of the following at December 31, 2008 and 2007:

(Dollars expressed in thousands unless otherwise indicated)

	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

	Balance at December 31, 2006	Additions	Reductions	Balance at December 31, 2007
Bonds and loans payable:				
Revenue bonds	$ 579,685	$ 161,981	$ (167,545)	$ 574,121
State loans (PENNVEST)	14,689	270	(794)	14,165
	594,374	162,251	(168,339)	588,286
Less: deferred refunding loss	(14,784)	(7,593)	1,834	(20,543)
Unamortized bond (discount)/premium	(884)	2,493	(1,524)	85
Total bonds and loans	$ 578,706	$ 157,151	$ (168,029)	$ 567,828

Debt service payments of the State Loans at December 31, 2008 are as follows:

(Dollars expressed in thousands unless otherwise indicated)

	State Loans		
	Principal	Interest	Total
2009	$ 811	$ 156	$ 967
2010	820	146	966
2011	830	136	966
2012	841	126	967
2013	851	116	967
2014-2018	4,415	419	4,834
2019-2023	4,246	142	4,388
2024-2025	551	4	555
	$ 13,365	$ 1,245	$ 14,610

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

	Revenue Bonds		
	Principal	Interest	Total
2009	$ 13,820	$ 38,047	$ 51,867
2010	15,620	36,394	52,014
2011	14,885	32,251	47,136
2012	12,465	31,399	43,864
2013	14,155	40,893	55,048
2014-2018	80,195	171,270	251,465
2019-2023	95,612	128,366	223,978
2024-2028	61,951	177,231	239,182
2029-2033	106,257	123,866	230,123
2034-2038	170,365	47,845	218,210
2039-2040	79,115	6,213	85,328
	664,440	$ 833,775	$ 1,498,215
Accretion	23,725		
Total	$ 688,165		

(Dollars expressed in thousands unless otherwise indicated)

Interest payments were calculated for the Variable Rate Bonds using the effective interest rates as of December 31, 2008 and ranged between the lowest rate 4.632% and the highest rate of 5.848%.

Interest incurred for the years ended December 31, 2008 and 2007 on bonds payable, exclusive of capitalized interest and amortization of refunding losses was approximately $29 million. Interest costs for 2008 and 2007 included $2.0 million and $2.4 million, respectively, of amortization of the deferred refunding losses.

In accordance with the provisions of the trust indentures for the 1993, 1998, 2002, 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, 2008 and 2007, was:

	2008	2007
Capital project funds	$ 110,112	$ 27,511
Debt service and reserve funds	10,314	15,199
Operating reserve account	8,476	8,269
Capitalized interest fund	6,466	-
Other funds	575	568
	$ 135,943	$ 51,547

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.

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, 2008, the 2008 swaps had the following notional amounts and market values: $72,747 notional amount and ($16,508) market value; $41,518 notional amount and ($8,383) market value; $72,747 notional amount and ($16,183) market value; $62,277 notional amount and ($12,287) market value; and, $71,225 notional amount and ($17,238) 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.

As of April 16, 2009, the market value of the 2008 interest rate swaps was ($11,744); ($6,234); ($11,894); ($9,444); and, ($12,520), respectively.

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, 2008, the 2007 swaps had the following notional amounts and market values: $41,325 notional amount and ($6,495) market value; and, $41,320 notional amount and ($6,288) 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.

As of April 16, 2009, the market value of the 2007 interest rate swaps was ($5,193); and, ($5,206), respectively.

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, 2008 and 2007, the Authority paid $7,614 and $2,164, respectively, fixed and received $4,964 and $3,426, 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, 2008, the interest rate swap counterparties were both rated A1 by Moody's Investors Services, 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 and 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 2008, the weekly rate paid by the Authority on the underlying bonds exceeded the amount received on the various interest rate swaps.

  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 Footnote 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 and 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, US 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, 2008 and 2007, 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.

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, 2008 and 2007, $42,153 and $34,828, respectively, of the Authority's bank balance of $42,653 and $35,128, 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 $41,914 and $35,024 as of December 31, 2008 and 2007, 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, 2008 and 2007: money market funds of $22,366 and $6,027, respectively, and repurchase agreements of $0 and $566, respectively. Of the Authority's $0 and $566 investment in repurchase agreements, at December 31, 2008 and 2007, respectively, all of the underlying securities are held by the investment's counterparty, not in the name of the Authority.

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

(Dollars expressed in thousands unless otherwise indicated)

			Maturity in years
		Carrying value		Less than 1 year
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

At December 31, 2007, the Authority held the following investment balances:

				Maturity in years
		Carrying value		Less than 1 year
Guaranteed Investment Contracts	$	25,221	$	25,221
Money market		6,027		6,027
Repurchase agreements		566		566
Commercial paper		11,149		11,149
INVEST		8,246		8,246
Total	$	51,209	$	51,209

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 $113,093 and $44,616 are included as noncurrent restricted investments on the statements of net assets at December 31, 2008 and 2007, respectively. 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. Investments of $6,593, consisting of money market funds of $6,027 and repurchase agreements of $566, are included as noncurrent restricted cash and cash equivalents on the statements of net assets at December 31, 2007. The fair value of the Authority's investments in the external investment pool (INVEST) is the same as the value of the pool shares.

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, 2008 and 2007 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, 2008, 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. The Authority's investments in commercial paper at December 31, 2008 was rated AAA by Standard & Poor's. Additionally, at December 31, 2008, 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 Federal National Mortgage Association, Federal Home Loan Bank, and Commonwealth of Pennsylvania. These investments are 12.7%, 62.1%, and 6.2%, respectively, of the Authority's total investments at December 31, 2008.

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)

Invested in capital assets, net of related liabilities:		
Net property, plant, and equipment in service	$ 443,720	$ 443,021
Debt subject to capital improvements	(633,699)	(537,365)
Accrued interest payable	(9,704)	(8,007)
Accounts payable for capital items	(1,610)	(3,320)
Funded debt from restricted assets:		
Unspent debt proceeds:		
Capital projects	109,680	27,511
Debt service and reserve funds	10,275	15,199
	(81,338)	(62,961)
Restricted for capital activity and debt service:		
Restricted cash and cash equivalents	22,366	6,593
Restricted investments	113,093	44,616
Restricted receivables	484	338
Liabilities payable from restricted assets:		
Unspent debt proceeds:		
Capital projects	(109,680)	(27,511)
Debt service and reserve funds	(10,275)	(15,199)
	15,988	8,837
Unrestricted	30,353	19,521
Total Net Assets	$ (34,997)	$ (34,603)

11. OPERATING LEASE

During 2007, the Authority entered into a new lease for office space from an unrelated party. 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, 2008 are as follows:

(Dollars expressed in thousands unless otherwise indicated)

2009	$	593
2010		593
2011		593
2012		599
2013		616
2014-2018		3,136
2019-2023		3,336
2024-2027		2,566
	$	12,032

The total annual rental for office space was approximately $593 for 2008 and $421 for 2007. The 2007 rent included eight months under the old lease and four months under the new lease.

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, 2008, $80 million of the program is complete and $52 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 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 $565. This fund is grouped with "Restricted Assets" on the statements of net assets. During 2008 and 2007, the Authority paid $0 from this fund for claims, and there is $0 and $500 accrued as of December 31, 2008 and 2007, respectively.

13. 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. 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.

ADDITIONAL INFORMATION

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS COMPOSITION - SCHEDULE I

(Dollars expressed in thousands)

DECEMBER 31, 2008

				Cash Equivalents	Investments			
	Total	Unrealized Gain/(Loss)	Accrued Interest Receivable	*(1) Dreyfus U.S. Gov't Securities	Commonwealth of PA Revenue Bonds	*(2) State & Local Gov't Securities (DDDSLGS)	*(3) Federal Home Loan MTG Corp	Tri-Party-Repo Investments
Capital project and construction funds:								
2005 Capital Project Fund	$ 7,494	$ -	$ 5	$ 7,489	$ -	$ -	$ -	$ -
2007 Depository Agr-Project Fund	5,165	-	2	4,463	-	700	-	-
2008 Construction Fund	97,454	1,242	425	2,047	-	-	93,740	-
	110,113	1,242	432	13,999	-	700	93,740	-
Debt service funds:								
1993 Debt Service Fund	601	7	3	3	-	-	588	-
2003 Debt Service Fund	4,327	124	19	6	-	-	4,178	-
2007 A Debt Service Fund	1,962	35	9	5	-	-	1,913	-
2007 B-1 Var Debt Service Fund	90	-	-	90	-	-	-	-
2007 B-2 Var Debt Service Fund	93	-	-	93	-	-	-	-
2008A Debt Service Fund	1,536	18	7	2	-	-	1,509	-
2008B Debt Service Fund	371	-	-	371	-	-	-	-
2008C1 Debt Service Fund	201	-	-	201	-	-	-	-
2008C2 Debt Service Fund	169	-	-	169	-	-	-	-
2008D1 Debt Service Fund	815	-	-	815	-	-	-	-
2008D2 Debt Service Fund	149	-	-	149	-	-	-	-
	10,314	184	38	1,904	-	-	8,188	-
1993 Operating Reserve Fund	8,474	-	10	-	8,464	-	-	-
2008 Capitalized Interest Fund	6,467	-	4	6,463	-	-	-	-
Self-Insured Escrow Fund	575	-	-	-	-	-	-	575
	$ 135,943	$ 1,426	$ 484	$ 22,366	$ 8,464	$ 700	$ 101,928	$ 575

(1) Dreyfus Gov't Cash Mgmt Agency with the Bank of New York Mellon, yielding .81%.

(2) As per Depository Agreement with the Bank of New York Trust Co., investment in Daily Demand Deposit State & Local Gov't Series Securities.

(3) As per Investment Agreement with Cantor Fitzgerald dtd 9/17/08, yielding between 1.85%-2.28%, maturing through 10/20/09.

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2008

	Series 1993 Bonds		Series 1998 Bonds		Series 2002 Bonds			Series 2003 Bonds	Series 2005 Bonds		
	Debt Service Fund	Operating Reserve Account	Series A Debt Service Fund	Series C Debt Service Fund	Capital Projects Fund	Debt Service Fund	Debt Service Reserve Fund	Debt Service Fund	Capital Project Fund	Debt Service Fund	Subtotal
Increases:											
Interest	$ 35	$ 205	$ 55	$ 57	$ 11	$ 30	$ -	$ 450	$ 590	$ 12	$ 1,445
Total increases	35	205	55	57	11	30	-	450	590	12	1,445
New Refunding Bond issue	-	-	-	-	-	-	-	-	-	-	-
Decreases:											
Capital projects	-	-	-	-	522	-	-	-	12,162	-	12,684
Interest	2,481	-	2,352	2,515	-	-	-	3,578	-	-	10,926
Bond principal/refunding escrow	-	-	-	-	-	-	-	14,425	-	-	14,425
Other	-	-	2	-	-	1	-	-	-	-	3
Total decreases	2,481	-	2,354	2,515	522	1	-	18,003	12,162	-	38,038
Interfund Transfers:											
Nontrusteed accounts	1,976	-	1,936	2,070	-	-	-	15,602	-	-	21,584
1998A Debt Svc Fund	-	-	(1,217)	-	-	-	-	-	-	-	(1,217)
1998C Debt Svc Fund	-	-	-	(1,301)	-	-	-	-	-	-	(1,301)
2002 Capital Interest Fund	-	-	-	-	(761)	-	-	-	-	-	(761)
2002 Debt Service Fund	-	-	-	-	-	(2,551)	-	-	-	-	(2,551)
2005 Capital Project Fund	-	-	-	-	-	-	-	-	-	(1,004)	(1,004)
2007A Debt Service Fund	-	-	-	-	-	-	-	-	-	-	-
2007B1 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-
2007B2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-
2008 Capitalized Interest Fund	-	-	-	-	-	-	-	-	-	-	-
2008B Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-
2008C2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-
Total interfund transfers	1,976	-	719	769	(761)	(2,551)	-	15,602	-	(1,004)	14,750
Net activity	(470)	205	(1,580)	(1,689)	(1,272)	(2,522)	-	(1,951)	(11,572)	(992)	(21,843)
Balance:											
Beginning of year	1,071	8,269	1,580	1,689	1,272	2,522	-	6,278	19,066	992	42,739
End of year	$ 601	$ 8,474	$ -	$ -	$ -	$ -	$ -	$ 4,327	$ 7,494	$ -	$ 20,896

(Continued)

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2008
(Continued)

		Series 2007 Bonds					Series 2008 Bonds								
	Clearing Fund	2007 CPF/Project Fund	2007A Debt Service Fund	2007 B1 Debt Service Fund	2007 B2 Debt Service Fund	Self-Insured Escrow Account	2008 Cap. Int. Fund	2008A Debt Svc Fund	2008B 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	$ -	$ 304	$ 70	$ 4	$ 5	$ 7	$ 61	$ 27	$ 1	$ 1	$ 3	$ 3	$ 2	$ 2,398	$ 4,331
Total increases	-	304	70	4	5	7	61	27	1	1	3	3	2	2,398	4,331
New Refunding Bond issue	-	-	-	-	-	-	-	-	-	-	-	-	-	97,346	97,346
Decreases:															
Capital projects	-	2,312	-	-	-	-	-	-	-	-	-	-	-	2,274	17,270
Interest	-	-	1,949	3,053	3,096	-	-	994	3,442	1,345	1,248	268	1,463	-	27,784
Bond principal/refunding escrow	-	-	305	-	-	-	-	-	-	-	-	-	-	-	14,730
Other	-	-	-	-	-	-	2	-	-	-	-	-	-	16	21
Total decreases	-	2,312	2,254	3,053	3,096	-	2	994	3,442	1,345	1,248	268	1,463	2,290	59,805
Interfund Transfers:															
Nontrusteed accounts	-	-	3,391	2,941	2,986	-	-	2,502	2,595	1,545	113	-	1,004	-	38,661
1998A Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,217)
1998C Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,301)
2002 Capital Interest Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(761)
2002 Debt Service Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(2,551)
2005 Capital Project Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(1,004)
2007A Debt Service Fund	-	-	(2)	-	-	-	-	-	-	-	-	-	-	-	(2)
2007B1 Debt Svc Fund	-	-	-	43	-	-	-	-	-	-	-	-	-	-	43
2007B2 Debt Svc Fund	-	-	-	-	43	-	-	-	-	-	-	-	-	-	43
2008 Capitalized Interest Fund	-	-	-	-	-	-	6,408	-	-	-	-	-	-	-	6,408
2008B Debt Svc Fund	-	-	-	-	-	-	-	-	1,217	-	-	-	-	-	1,217
2008C2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	1,301	-	-	-	1,301
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	1,080	-	-	1,080
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	-	607	-	607
Total interfund transfers	-	-	3,389	2,984	3,029	-	6,408	2,502	3,812	1,545	1,414	1,080	1,611	-	42,524
Net activity	-	(2,008)	1,205	(65)	(62)	7	6,467	1,535	371	201	169	815	150	97,454	84,396
Balance:															
Beginning of year	-	7,173	757	155	155	568	-	-	-	-	-	-	-	-	51,547
End of year	$ -	$ 5,165	$ 1,962	$ 90	$ 93	$ 575	$ 6,467	$ 1,535	$ 371	$ 201	$ 169	$ 815	$ 150	$ 97,454	$ 135,943

(Concluded)

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2008

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Expenditures
U.S. Environmental Protection Agency:		
Passed through 3 Rivers Wet Weather, Inc.:		
Surveys, Studies, Investigations and Special Purpose Grants	66.606	$ 1,184,444
Passed through Pennsylvania Infrastructure Investment Authority:		
Capitalization Grants for Clean Water State Revolving Funds	66.458	3,215
Total Federal Expenditures		$ 1,187,659

See accompanying notes to schedule of expenditures of federal awards.

PITTSBURGH WATER AND SEWER AUTHORITY

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2008

1. BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards of the Pittsburgh Water and Sewer Authority (Authority) is presented in accordance with the requirements of *OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts may differ from amounts presented in, or used in the preparation of the basic financial statements.

2. BASIS OF ACCOUNTING

The information in this schedule is presented using the accrual method of accounting.

3. SUBRECIPIENTS

Of the federal expenditures presented in this schedule, The Pittsburgh Water and Sewer Authority provided federal awards to the subrecipient, Township of Ross, Pennsylvania, as follows:

Program Name	Federal CFDA	Amount
U.S. Environmental Protection Agency:		
Passed through program from 3 Rivers Wet Weather, Inc.:		
Surveys, Studies, Investigations and Special Purpose Grants	66.606	$ 88,721

PITTSBURGH WATER AND SEWER AUTHORITY

INDEPENDENT AUDITOR'S REPORTS IN ACCORDANCE WITH OMB CIRCULAR A-133

YEAR ENDED DECEMBER 31, 2008

MaherDuessel

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

Board of Directors
Pittsburgh Water and Sewer Authority

We have audited the financial statements of the Pittsburgh Water and Sewer Authority (Authority) as of and for the year ended December 31, 2008, and have issued our report thereon dated April 29, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America, such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Authority in a separate letter dated April 29, 2009.

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This report is intended solely for the information and use of the Board of Directors, management, and others within the Authority, and applicable federal and state agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Maher Duessel

Pittsburgh, Pennsylvania
April 29, 2009

MaherDuessel

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Independent Auditor's Report on Compliance with Requirements Applicable to its Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133

Board of Directors
Pittsburgh Water and Sewer Authority

Compliance

We have audited the compliance of the Pittsburgh Water and Sewer Authority (Authority) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2008. The Authority's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2008.

Internal Control over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on its major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

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

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This report is intended solely for the information and use of the Board of Directors, management, others within the Authority, and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Maher Duessel

Pittsburgh, Pennsylvania
April 29, 2009

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED DECEMBER 31, 2008

1. Summary of Auditor's Results:

   i. The auditor's report on the financial statements was an unqualified opinion.

   ii. There were no significant deficiencies or material weaknesses in internal control that were disclosed by the audit of the financial statements.

   iii. There were no instances of noncompliance material to the financial statements, which would be required to be reported in accordance with *Government Auditing Standards*, disclosed during the audit.

   iv. There were no significant deficiencies or material weaknesses in internal control over its major federal program that was disclosed during the audit.

   v. The auditor's report on compliance for its major federal program was an unqualified opinion.

   vi. The audit did not disclose an audit finding, which the auditor is required to report in accordance with Section 510(a) of OMB Circular A-133.

   vii. The major federal program was:

      a. CFDA #66.606 - Surveys, Studies, Investigations and Special Purpose Grants

   viii. The dollar threshold used to distinguish between type A and type B programs was $300,000.

   ix. Pittsburgh Water and Sewer Authority (Authority) was evaluated as a low risk auditee.

2. Findings related to financial statements, which are required to be reported in accordance with GAGAS.

No matters were reported.

3. Findings and questioned costs for federal awards.

No matters were reported.

PITTSBURGH WATER AND SEWER AUTHORITY

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

YEAR ENDED DECEMBER 31, 2008

None