Pittsburgh Water and Sewer Authority

Single Audit

2010

MaherDuessel
Certified Public Accountants

Pittsburgh | Harrisburg | Butler

Pursuing the profession while promoting the public good®
www.md-cpas.com

PITTSBURGH WATER AND SEWER AUTHORITY

YEARS ENDED DECEMBER 31, 2010 AND 2009

TABLE OF CONTENTS

Independent Auditor's Report

Management's Discussion and Analysis i

Financial Statements:

Statements of Net Assets 1

Statements of Revenues, Expenses, and Changes in Net Assets 3

Statements of Cash Flows 4

Notes to Financial Statements 5

Supplementary Information:

Schedule of Restricted Assets Composition – Schedule I 37

Schedule of Restricted Assets Activity – Schedule II 39

Schedule of Expenditures of Federal Awards 41

Notes to Schedule of Expenditures of Federal Awards 42

Independent Auditor's Reports in Accordance with OMB Circular A-133:

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* 43

Independent Auditor's Report on Compliance with Requirements that Could Have a Direct and Material Effect on its Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133 45

PITTSBURGH WATER AND SEWER AUTHORITY

YEARS ENDED DECEMBER 31, 2010 AND 2009

TABLE OF CONTENTS
(Continued)

Schedule of Findings and Questioned Costs	47
Summary Schedule of Prior Audit Findings	48

MaherDuessel
Certified Public Accountants

Pittsburgh
Three Gateway Center
Six West
Pittsburgh, PA 15222
Main 412.471.5500
Fax 412.471.5508

Harrisburg
3003 North Front Street
Suite 101
Harrisburg, PA 17110
Main 717.232.1230
Fax 717.232.8230

Butler
112 Hollywood Drive
Suite 204
Butler, PA 16001
Main 724.285.6800
Fax 724.285.6875

Independent Auditor's Report

Board of Directors
Pittsburgh Water and Sewer Authority

We have audited the 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, 2010 and 2009 which collectively comprise the Authority's basic financial statements as listed in the 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 opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Authority as of December 31, 2010 and 2009, and the respective changes in financial position, and cash flows, where applicable, thereof 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 26, 2011 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 should be considered in assessing the results of our audit.

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

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's financial statements as a whole. The supplementary 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 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 financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Maher Duessel

Pittsburgh, Pennsylvania
April 26, 2011

PITTSBURGH WATER AND SEWER AUTHORITY

2010 Financial Statements
Management's Discussion and Analysis

The Pittsburgh Water and Sewer Authority (the "Authority") comparative 2010 and 2009 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 Statement of Net Assets classifies the total net assets, as invested in capital assets, restricted for capital activity and debt service, and unrestricted.

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

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

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

Financial Highlights

In 2010, operating income increased by 9.1% or $2.61 million resulting in net income of $5.37 million, down from an $11.75 million net gain in 2009. Below are the 2010 financial highlights:

Total operating revenues in 2010 were up $5.58 million or 4.2% to $139.75 million when compared to 2009. This was driven primarily by a 7.5% increase in wastewater treatment revenues due to a 7% rate increase by ALCOSAN effective January 1, 2010. Water and sewer conveyance revenues increased $2.56 million from 2009, due to establishment of the Distribution Infrastructure System Charge (DISC) of 5% on total water and sewer conveyance bills.

Total non-operating revenues decreased by $8.98 million, mostly driven by a $.309 million reduction in the fair market value of the 2008-C2 swap contract as contrasted to a $7.19 million increase in 2009. Donated property revenue reached $15.10 million, an increase of $.281 million over 2009. This consisted of $7.326 million for projects completed in 2010 and recognition of $7.75 million in assets finished in prior years as adjusted for inflation and accumulated depreciation. Non-operating revenues for grants declined 79% or $.196 million to $.052 million and interest revenue decreased by $.140 million to $.550 million due to lower market rates.

Total operating expenses increased in 2010 to $108.58 million compared to $105.61 million in 2009. Significant operating expenses included the following factors:

- Salary and employee benefit expenses were up $.883 million or 5.5%. The increase is attributed to an average overall salary increase of 4.4%, a one time non-union bonus of $2,000 to non-union staff, and an 8.1% increase in benefit costs.

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

- Overall direct operating expenses, including salaries and benefits, increased by $1.3 million to $59.9 million in 2010 or, 2.2% from $58.6 million in 2009. Wastewater treatment expense increased by $3.99 million or 8.9% to $48.79 million over $44.79 million in 2009 due to the ALCOSAN rate hike. Chemicals expense decreased by $.711 million. Equipment decreased by $.227 million. Sewer repairs decreased by $.503 million or 47.8% to $.55 million in 2010, from $1.05 million in 2009. Vactor Debris removal expense stayed materially the same at .25 million. Emergency water line repairs decreased by $.293 million to $.549 million or 34.8% from $.841 million in 2009. Curb box repairs decreased by $.215 million. Catch basin repairs decreased by $1.17 million to $.103 million or 91.9% from $1.28 million in 2009. Repairs and maintenance expense for IT infrastructure and building repairs increased by $.450 million due primarily to higher annual software support costs and new computer hardware acquired in anticipation of the new ERP system in 2011, up $.654 million.

- Overall General and Administration expenses stayed materially the same, declining $.101 million to $10.2 million from $10.3 million in 2009. Significant expense reductions were a $.124 million drop in postage costs due to EBPP implementation and reduced dunning costs, $.143 million reduction in consultants, $.114 million in electric current, and a $.131 million reduction in non-capital miscellaneous services. Significant expense increases were $.111 in collection agency fees, $.152 in worker's compensation insurance, and $.388 in legal.

- Overall other expenses increased 4.5% or $2.79 million to $64.59 million in 2010 from $61.81 million in 2009. Non-city water subsidy to Pennsylvania American Water Company (PAWC) increased 45.1% or $.723 million to $2.33 million in 2010 compared to $1.60 million in 2009 due to the 2010 PAWC rate increase. Interest expense on bond debt increased 3.6% or $1.43 million to $41.2 million in 2010 compared to $39.77 million in 2009. The main reason for the increase in bond interest is a $4.19 million increase in SWAP fees that was only partially offset by a $2.78 million reduction in long-term debt expense. Expenses related to the cooperation agreement with the City of Pittsburgh increased by $.019 in 2010.

- In 2010, collections increased by $3.09 million or 2.3%. ALCOSAN's 7% rate increase for wastewater treatment provided part of the increase, while the remainder was derived by improved collection agency results. This was the second year in a row that the Authority collected more than 100% of its billings. These significant improvements in collections resulted in a drop in bad debt expense of $1.0 million from 2009.

Other 2010 highlights include:

- After an extensive review process lasting over a year, the Authority committed to the purchase of a new Enterprise Resource Program (ERP) to serve its business computing needs. From a list of three strong final candidates, it was decided in June to award the contract to Cogsdale Corporation, a Microsoft Dynamics Gold partner. The

implementation is estimated to take roughly 18 months, with the Finance Department to go online in January 2012 and other departments to phase in shortly after. The Authority is projected to save significant programming costs and achieve numerous operating efficiencies with this new system.

- The Authority continued its relationship with Jordan Tax Service, Inc. (JTS) as its Collector and the law firm of Goehring, Rutter & Boehm, P.C. as Special Legal Counsel for the collection of delinquent water, sewer, and sewage treatment charges. The agreement calls for a collection commission, plus other administrative and legal proceeding costs to be added to all Authority delinquent claims not paid within 90 days of the initial billing date. If fully collected, the Authority stands to collect 100% of delinquent balances without incurring a collection agency fee. The Authority is reimbursing JTS for commissions lost and expenses for certain accounts that have been recalled from collections. Said reimbursements totaled $.111 million in 2010, but the Authority and JTS are in negotiation on this sum. JTS collected over $3.28 million, of which the Authority received $2.86 million during 2010.

- In January of 2010, the Authority began assessing a 5% Distribution Infrastructure System Charge (DISC) on all bills. This charge is applied to the water and sewer conveyance components of the invoice and is dedicated to system improvements and capital needs. The DISC collection total in 2010 was $4.16 million, with no expenses. It was decided to allow funds to accumulate the first year, and then budget expenses for 2011 from the funds received in 2010. The 2011 budget for DISC expenses is $6.38 million, to draw from the 2010 collections and a 2% increase (to 7%) in the charge that was made effective for January 2011. These projected expenses include water and sewer relay costs and new vehicles. This budgeted amount may be reduced by performing some larger infrastructure replacements with capital monies.

- Also in 2010, the Authority implemented a change in its water and sewer line warranty program, engaging a new provider, Utility Line Security, LLC, (ULS) and changing from an opt-in to an opt-out program. Customers were given until June 30, 2010 to opt-out of the program, with a full refund of fees paid during that time period. Due to the wider participation generated by the opt-out program, the Authority was able to negotiate a better rate and greater coverage than with the previous vendor. In 2010, the Authority remitted $5.15 million to ULS, who spent $4.79 million addressing 1110 customer repairs and separating 152 combined sewers. In March of 2011, it was determined in the Court of Common Pleas of Allegheny County that this program unfairly competed with those offered by private line warranty vendors and the program was ordered to be shut down.

- The Authority in June of 2010 entered into an agreement with Iron City Brewing to settle the outstanding account receivable balance from operations at its former Lawrenceville plant. The Authority received $.45 million in January of 2011 pursuant to said agreement and holds a security interest in property owned by Iron City Brewing pending payment of a remaining $.20 million balance in 2011.

- In July of 2010, the Authority approved development of a 40-year Capital master plan and Water and Sewer master plan. The plan will be developed in order to assist the Authority in assessing its long range infrastructure and financing needs. Such planning should enable the Authority over time to reduce the volume of water lost to undetected leaks and cut into costs related to emergency leak repair.

- The Authority, in an attempt to reduce material costs related to its operating and DISC repairs contracts decided in 2010 to directly purchase pipe, valves, and fittings to be used in said contracts. It is felt that the discounts achieved through bulk purchase of these items and the elimination of contractor markup from these items if purchased by the contracting firms could generate substantial savings. This process is due to start in early 2011, with materials contracts awarded in November of 2010.

- In July of 2010, the Authority contracted with Wachs Valve & Hydrant, LLC to test and map all valves 12" and above for defects and to make needed repairs. The contract is expected to take roughly one year. This project ties directly into the Authority's commitment to reduce losses of unaccounted for water and proactively maintain vital fixed assets.

- As mentioned above, the Authority recognized $7.75 million in donated property revenue in 2010 for assets finished in prior years as adjusted for inflation and accumulated depreciation. This was due to a special project begun in response to single audit requirements. In 2008, the Authority began quarterly meetings to determine and report on the need or lack thereof for a single audit, a filing required if over $.500 million in federal monies are expended. It was discovered in analyzing development projects unfunded by the Authority as to whether federal dollars were involved that the scope of infrastructure replacement and new construction was unexpectedly large in 2009, leading to recognition of $14.819 million. Suspecting that projects like these may have gone unreported in previous years, the Authority's Engineering and Finance Departments, in cooperation with Chester Engineers, went through the files of developer documents from 1997 to 2008 looking for unrecognized items. In all, 57 items were discovered, totaling $9.63 million in inflation adjusted value. These items were then depreciated for the useful life already expended to reach the $7.75 million recognized in 2010. Procedures are now in place to find and recognize these items going forward.

- In February of 2010, a 25 year snow event struck the City of Pittsburgh, delivering 24 inches of snow on February 5th and generating the snowiest February ever recorded. The Authority found it necessary to mobilize significant resources in manpower and equipment to protect its assets. This event was declared a snow emergency by the state and federal governments, allowing for disaster cost reimbursement from FEMA. The Authority submitted $.070 million in reimbursable costs for this event and received $.052 million from FEMA.

- Debt service coverage in 2010 and 2009 was 1.99 and 1.87, respectively. These coverage factors exceed the 1.2 coverage factor required under the bond covenant.

- The Authority expended $41.77 million on capital projects in 2010, an increase of $21.77 million over the $20 million expended in 2009. In December of 2010, the 2005 Construction Fund was closed and $64 million remained in the 2008 Construction Fund. Of $36.80 million budgeted in PennVest loans, $16.20 million was spent in 2010, with $20.60 million remaining.

- After a tumultuous 2009, there was little bond related activity for the Authority in 2010. The only occurrences of note were the renewal of three standby purchase agreements and the replacement of another standby purchase provider with a different party. These agreement renewals were on bond series totaling $205 million. The Authority renewed the standby purchase agreements on the Series 2007 B-1 (face $41.32 million) and 2007 B-2 (face $41.33 million) bonds for two years, expiring June of 2012, and Series 2008 C-2 (face $51.89 million) for one year, expiring June 2011, with JP Morgan Chase. For the Series 2008 D2 (face $71.23 million) issue, the Authority replaced JP Morgan Chase with PNC Bank as standby provider for a term of one year, expiring August of 2011. This return to relative stability in bond financing markets reflects the ongoing recovery in the national economy and bond markets as a whole.

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

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

- The City of Pittsburgh remained under financial stress in 2010. The Authority has three agreements with the City of Pittsburgh. The Authority leases the water and sewer system under the Capital Lease, which was fully funded in 1998. The Authority makes payment to the City of Pittsburgh for direct and indirect services under the Cooperation Agreement. Under this Cooperation Agreement, the Authority also funds, on behalf of the City of Pittsburgh, a rate equalization subsidy to other City of Pittsburgh water companies. Under a separate agreement the Authority also, on behalf of the City of Pittsburgh, is required to purchase delinquent wastewater treatment receivables. The Authority is financially self-sufficient and should not be adversely affected by any bankruptcy filing by the City of Pittsburgh. Any other actions by the City of Pittsburgh to increase Authority funding would require Board approval.

CONDENSED FINANCIAL STATEMENTS

CONDENSED STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

	December 31,		Variance	
	2010	2009	Dollars	%
Capital assets:			Increase (Decrease)	
Producing assets	$ 475,701	$ 444,804	$ 30,897	6.9%
Construction in progress	41,328	25,548	15,780	61.8%
Restricted assets	78,070	107,188	(29,118)	-27.2%
Current assets and bond costs	123,613	122,431	1,182	1.0%
Total Assets	$ 718,712	$ 699,971	$ 18,741	2.7%
Liabilities:				
Current liabilities	$ 63,585	$ 50,333	$ 13,252	26.3%
Long-term liabilities	685,294	685,176	118	0.0%
Total Liabilities	748,879	735,509	13,370	1.8%
Net Assets (Deficit):				
Invested in capital assets, net of related liabilities	(40,489)	(62,556)	22,067	-35.3%
Restricted for capital activity and debt service	11,053	13,954	(2,901)	-20.8%
Unrestricted	(731)	13,064	(13,795)	-105.6%
Total Net Assets (Deficit)	(30,167)	(35,538)	5,371	-15.1%
Total Liabilities and Net Assets (Deficit)	$ 718,712	$ 699,971	$ 18,741	2.7%

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

(Dollars expressed in thousands)

	Year Ended December 31,		Variance	
	2010	2009	Dollars	%
			Increase (Decrease)	
Operating Revenues	$ 139,753	$ 134,175	$ 5,578	4.2%
Operating Expenses:				
Direct operating	36,393	38,770	(2,377)	-6.1%
Wastewater treatment	48,788	44,795	3,993	8.9%
Cooperation Agreement	8,650	8,631	19	0.2%
Subsidy of non-customer City residents	2,326	1,603	723	45.1%
Depreciation and amortization	12,420	11,808	612	5.2%
Total Operating Expenses	108,577	105,607	2,970	2.8%
Operating Income	31,176	28,568	2,608	9.1%
Non-operating revenues (expenses):				
Federal grants	52	248	(196)	-79.0%
Donated property	15,100	14,819	281	1.9%
Interest revenue	241	7,877	(7,636)	-96.9%
Interest expense and other	(41,198)	(39,766)	(1,432)	3.6%
Total Non-operating Revenues (Expenses)	(25,805)	(16,822)	(8,983)	53.4%
Net Gain/(Loss)	$ 5,371	$ 11,746	$ (6,375)	-54.3%

Financial Condition

The Authority's financial condition in 2010 remained stable for an eighth consecutive year despite the downturn in the national economy and major disruptions in the financial markets. Water utility revenues increased slightly to $88.83 million from $86.27 million. However, unrestricted cash reserves from operations decreased by 14% or $5.81 million due primarily to a reduction in interest revenue and increased bond related costs. The 7.7% rate increase passed for 2011 and continuing improvement in the financial markets should remedy this cash drain.

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

Requests for Information

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

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

DECEMBER 31, 2010 AND 2009

Assets	2010	2009
Current assets:		
Cash and cash equivalents	$ 37,129	$ 42,937
Accounts receivable, net:		
Water:		
Billed	9,581	8,357
Unbilled	4,115	4,457
Total water	13,696	12,814
Wastewater treatment:		
Billed	4,194	4,739
Unbilled	2,201	3,362
Total wastewater treatment	6,395	8,101
Other receivables	7,853	1,077
Total accounts receivable, net	27,944	21,992
Prepaid expenses	433	296
Inventory	1,649	1,623
Total current assets	67,155	66,848
Noncurrent assets:		
Restricted assets:		
Accrued interest receivable	78	78
Cash and cash equivalents	3,812	10,648
Investments	74,180	96,462
Total restricted assets	78,070	107,188
Capital assets, not being depreciated	41,328	25,548
Capital assets, net of accumulated depreciation	475,701	444,804
Deferred outflow	31,447	29,957
Bond issue costs, net of accumulated amortization	25,011	25,626
Total noncurrent assets	651,557	633,123
Total Assets	$ 718,712	$ 699,971

(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, 2010 AND 2009

(Continued)

	2010	2009
Liabilities and Net Assets (Net Deficits)		
Liabilities:		
Current liabilities:		
Bonds and loans payable, current portion	$ 15,711	$ 16,435
Accrued payroll and related obligations	672	683
Accounts payable wastewater treatment	17,631	15,703
Accounts payable and other accrued expenses	11,700	4,101
Accounts payable from restricted assets	6,308	3,359
Accrued interest payable from restricted assets	11,563	10,052
Total current liabilities	63,585	50,333
Noncurrent liabilities:		
Deferred revenue	314	335
Accrued payroll and related obligations	1,045	1,149
Swap liability	36,856	35,057
Bonds and loans payable, net of current portion	647,079	648,635
Total noncurrent liabilities	685,294	685,176
Total Liabilities	748,879	735,509
Net Assets (Deficits):		
Invested in capital assets, net of related debt	(40,489)	(62,556)
Restricted for capital activity and debt service	11,053	13,954
Unrestricted	(731)	13,064
Total Net Assets (Deficits)	(30,167)	(35,538)
Total Liabilities and Net Assets (Deficits)	$ 718,712	$ 699,971

(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, 2010 AND 2009

	2010	2009
Operating Revenues:		
Residential, commercial, and industrial water sales	$ 88,829	$ 86,271
Wastewater treatment	49,223	45,514
Other	1,701	2,390
Total operating revenues	139,753	134,175
Operating Expenses:		
Direct operating expenses	36,393	38,770
Wastewater treatment	48,788	44,795
Cooperation agreement operating expenses:		
Indirect cost allocation - sewer conveyance	4,500	4,500
Indirect cost allocation - water	4,150	4,131
Expense of water provided by other entities:		
Subsidy of customers located in the City	2,326	1,603
Depreciation	10,929	10,317
Amortization of capitalized lease assets	1,491	1,491
Total operating expenses	108,577	105,607
Operating Income	31,176	28,568
Non-operating Revenues (Expenses):		
Federal grants	52	248
Donated property	15,100	14,819
Interest revenue	550	690
Investment income - change in fair market value of swap	(309)	7,187
Interest expense - bonds	(39,202)	(37,984)
Interest expense - other	(185)	(149)
Amortization of bond issue costs	(1,811)	(1,633)
Total non-operating revenues (expenses)	(25,805)	(16,822)
Net Income	5,371	11,746
Net Assets:		
Beginning of year, restated	(35,538)	(47,284)
End of year	$ (30,167)	$ (35,538)

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, 2010 AND 2009

	2010	2009
Cash Flows From Operating Activities:		
Cash received from customers	$ 140,650	$ 136,853
Cash paid to suppliers and employees and customer refunds	(35,529)	(37,964)
Cash paid to City of Pittsburgh under the Cooperation Agreement	(8,650)	(8,631)
Cash paid to other water companies for subsidy of customers located in the City of Pittsburgh	(2,326)	(1,603)
Cash paid to ALCOSAN for wastewater treatment	(46,860)	(42,849)
Net cash provided by (used in) operating activities	47,285	45,806
Cash Flows From Investing Activities:		
Purchase of investment securities	(329,022)	(325,996)
Proceeds from sale and maturities of investment securities	355,090	347,937
Interest income	550	1,096
Net cash provided by (used in) investing activities	26,618	23,037
Cash Flows From Capital and Related Financing Activities:		
Purchase/construction of property, plant, and equipment	(43,997)	(23,621)
Proceeds from federal grants	52	248
Proceeds from Pennvest Loans	9,359	-
Payment made for bond reoffering costs	(1,062)	(4,719)
Principal payments on debt	(16,435)	(14,625)
SWAP receipts	1,057	1,926
SWAP payments	(18,680)	(18,007)
Liquidity and remarketing fees	(4,381)	(4,707)
Interest paid on borrowings	(12,460)	(16,033)
Net cash provided by (used in) capital and related financing activities	(86,547)	(79,538)
Increase (Decrease) in Cash and Cash Equivalents	(12,644)	(10,695)
Cash and Cash Equivalents:		
Beginning of year	53,585	64,280
End of year	$ 40,941	$ 53,585
Consists of:		
Restricted cash and cash equivalents	$ 3,812	$ 10,648
Unrestricted cash and cash equivalents	37,129	42,937
	$ 40,941	$ 53,585
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities:		
Operating income	$ 31,176	$ 28,568
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Depreciation and amortization	12,420	11,808
Reserve for uncollectible amounts	(1,746)	(2,997)
Change in:		
Accounts receivable - water and wastewater	2,570	4,615
Other accounts receivable	(6,776)	1,060
Wastewater accounts payable	1,928	1,946
Accounts payable and other accrued expenses	7,599	774
Other	114	32
Net cash provided by (used in) operating activities	$ 47,285	$ 45,806

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

1. ORGANIZATION

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

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

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

Basis of Accounting and Measurement Focus

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

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

Classification of Net Assets

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

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets net of bond issue costs, premiums and discounts and remaining deferred refunding losses.
- Restricted – This component of net assets consists of constraints placed on net asset use through external restrictions.
- Unrestricted – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

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 2010, the Authority's interest expense of $1,140, net of deferred interest earnings of $24, resulted in net capitalized interest expense of $1,116. During 2009, the Authority's interest expense of $784, net of deferred interest earnings of $76, resulted in net capitalized interest expense of $708.

Cash and Cash Equivalents

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

Bond Issue and Reoffering Costs, Premiums, and Discounts

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

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

Deferred Refunding Loss

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

Remarketing, Liquidity, and Letter of Credit Fees

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

Capital Assets

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

The Authority also receives donated property relating mostly to dedicated water and sewer lines. These assets are capitalized at their estimated fair market value and depreciated in accordance with the estimated useful lives noted above.

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

Maintenance and repairs are charged to expense as incurred.

Clarification of Revenues

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

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

- Non-operating revenues – Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as interest income and other revenue sources.

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.

Adoption of Pronouncements

Effective January 1, 2010, the Authority adopted, GASB 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. 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 Statement requires that accounting changes to conform with the provisions of this Statement should be applied retroactively by restating financial statements for all prior periods presented. As such, net assets as of December 31, 2008 and 2009 were restated to comply with the provision of this statement as follows:

Net assets, December 31, 2008	$	(34,997)
Establish deferred outflow		71,098
Establish swap liability		(83,385)
Net assets, December 31, 2008, as restated		(47,284)
Change in deferred outflow		(41,141)
Change in swap liability		48,328
Change in net assets - 2009 financial statements		4,559
Net assets, December 31, 2009, as restated	$	(35,538)

3. TRANSACTIONS WITH THE CITY OF PITTSBURGH

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

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

Cooperation Agreement

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

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

System Leases

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

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

Pension

Employees of the Authority participate in the City's Municipal Pension Fund Plan (Plan). Employees who became members of the Plan prior to January 1, 1988 are required to contribute 5% of pre-tax pay. Those joining thereafter are required to contribute 4%. Substantially, all the Authority's 2010 payroll of $12,435 was covered by the Plan. Employee contributions for the year amounted to approximately $494.

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 2010 Minimum Municipal Obligation calculated for the City's Plan indicated a 2010 normal cost of $597 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 2010, together with other elements of expense for employee service during 2010 would not exceed the sum of the 2010 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, 2010 and 2009, the reserve for uncollectible water accounts was approximately $14.2 million and $15.4 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, 2010 and 2009, the reserve for uncollectible wastewater accounts was approximately $6.84 million and $7.44 million, respectively.

5. CAPITAL ASSETS

Capital assets consisted of the following at December 31, 2010 and 2009:

	Balance at January 1, 2010	Additions	Transfers	Balance at December 31, 2010
Capital assets not being depreciated:				
Construction in progress	$ 25,548	$ 48,700	$ (32,920)	$ 41,328
Capital assets being depreciated:				
Water and sewer system	102,167	-	-	102,167
Utility assets	520,811	43,132	(393)	563,550
Non-utility assets	16,528	578	-	17,106
Total capital assets being depreciated	639,506	43,710	(393)	682,823
Total capital assets	665,054	92,410	(33,313)	724,151
Accumulated depreciation	(194,702)	(12,420)	-	(207,122)
Capital assets, net	$ 470,352	$ 79,990	$ (33,313)	$ 517,029

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

During 2010 and 2009, the Authority received donated utility assets of $15,100 and $14,819, respectively, related to various development projects.

6. PAYROLL AND RELATED OBLIGATIONS

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

	Balance at December 31, 2009	Change	Balance at December 31, 2010	Current Portion
Compensated absences	$ 896	$ (129)	$ 767	$ 2
Workers' compensation	486	(84)	402	122
Payroll, withholdings, and taxes	450	98	548	548
	$ 1,832	$ (115)	$ 1,717	$ 672

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

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, 2010 and 2009 is $108,860 and $122,790, respectively.

Series 1993

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

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

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

Fair value of the 1993 Bonds at December 31, 2010 and 2009, with carrying amounts of $27 million and $27 million, respectively, based on quoted market prices, is approximately $30 million and $31 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, 2010 and 2009, the remaining unamortized deferred refunding loss of $498 and $533, respectively, on the transaction is shown as a reduction of the long-term debt and will be amortized through 2037.

Fair value of the 1998 Bonds at December 31, 2010 and 2009, with carrying amounts of $62 million and $59 million, respectively, based on quoted market prices, is approximately $62 million and $59 million, respectively.

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

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

Series 2003

On September 23, 2003, the Authority issued $167,390 of Water and Sewer System Revenue Refunding Bonds ("2003 Bonds"). The proceeds of the 2003 Bonds were used to provide funds for the current refunding of a portion of the 1993 Bond Series. In connection with the 2003 debt refundings, the Authority recorded a deferred refunding loss of $3,162 which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. The unamortized balance of the deferred refunding adjustment is $1,287 and $1,376 at December 31, 2010 and 2009, 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, 2010 and 2009, with carrying amounts of $45 million and $57 million, respectively, based on quoted market prices, is approximately $47 million and $60 million, respectively.

Series 2007

During March 2007, the Authority issued $158,895 Series 2007 First Lien Water and Sewer Revenue Bonds ("2007 Bonds"): $43,720 Series A of 2007 (fixed rate), $57,585 Series B-1 of 2007 (variable rate demand), and $57,590 Series B-2 of 2007 (variable rate demand). The purpose of this bond issue was to refund the Series 2002 and Series 2005 Bonds (the refunded bonds). Proceeds of the 2007 Bonds were invested in an escrow account to pay

principal and interest on the refunded bonds from the time of refunding through the bonds' earliest optional call dates. In connection with the debt refundings, the Authority recorded a deferred refunding loss of $6,032, which is being amortized as an adjustment to interest expense over the life of the bonds using the effective interest method. At December 31, 2010 and 2009, the remaining unamortized deferred refunding loss of $5,060 and $5,402, respectively. At December 31, 2010, the principal of the defeased Series 2002 Bonds outstanding was $92,370, and the defeased 2005 Bonds outstanding was $45,450.

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, 2010 and 2009, with carrying amounts of $116 million and $120 million, respectively, based on quoted market prices, is approximately $118 million and $123 million, respectively.

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

Series 2008

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

securing payments on 2008 Fixed Rate Bonds, and to fund termination payments on certain interest rate swaps.

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

In connection with these advance refundings, portions of the proceeds of the 2008 Bonds were deposited into irrevocable trusts with an escrow agent to provide for certain debt service payments on the refunded bonds. The advance refunding resulted in a deferred refunding loss of $18,119 which is amortized as an adjustment to interest expense over the life of the 2008 Bonds using the effective interest method. At December 31, 2010 and 2009, the remaining unamortized deferred refunding loss was $15,307 and $16,357, respectively and the transaction is shown as a reduction of long-term debt and will be amortized through 2037.

At December 31, 2010, the principal of the defeased Series 1993A Bonds outstanding was $21,875 and the defeased 2003 Bonds outstanding was $26,130. The maturity value of defeased 1998B compound interest bonds outstanding at December 31, 2010 was $19,300.

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

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

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

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

The Series B Bonds were reoffered on October 16, 2009. The reason for this reoffering was the replacement of expiring standby bond purchase agreements on these variable rate bonds with letters of credit. Bank of America is the letter of credit provider on the Series B-1 Bonds ($72,750,000) and PNC is the letter of credit provider on the Series B-2 Bonds ($72,745,000). The reoffering did not change the interest rate mode on these variable rate bonds. Both the Bank of America and the PNC letters of credit are set to expire on October 22, 2011.

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

During November 2009, the remaining C-1 Bonds were reoffered as the C1-D Series of $26,910,000. These bonds were also issued in a term interest rate mode, fixing the interest rate at 2.625% through September of 2012.

Credit facilities for the 2008 Series C1-A, C1-B, and C1-C bonds are provided by the Northwest Savings Bank, ESB Bank, and Washington Federal Savings bank, respectively. Liquidity facilities continue to be provided by JP Morgan Chase on the 2007 B-1, 2007 B-2, 2008 C-2, and 2008 D-2 Series bonds and are set to expire on June 11, 2010. The Authority renewed the standby purchase agreements on the Series 2007 B-1 (face $41.32 million)and 2007 B-2 (face $41.33 million) bonds for two years, expiring June of 2012, and Series 2008 C-2 (face $51.89 million) for one year, expiring June 2011, with JP Morgan Chase. For the Series 2008 D-2 (face $71.23 million) issue, the Authority replaced JP Morgan Chase with PNC Bank as standby provider for a term of one year, expiring August of 2011.

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, 2010 and 2009, with carrying amounts of $414 million and $414 million, respectively, based on quoted market prices, is approximately $419 million and $415 million, respectively.

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

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

anticipated. As the markets have stabilized, the Authority experienced no instances of bonds going into Bank Bond status in either 2009 or 2010 and does not foresee such occurring in the immediate future.

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

Bonds and state loans payable (PENNVEST) consisted of the following at December 31, 2010 and 2009:

	Balance at December 31, 2009	Additions	Reductions	Balance at December 31, 2010
Bonds and loans payable:				
Revenue bonds	$ 677,383	$ 3,200	$ (15,620)	$ 664,963
State loans (PENNVEST)	12,560	9,359	(815)	21,104
	689,943	12,559	(16,435)	686,067
Less: deferred refunding loss	(27,106)	-	1,743	(25,363)
Unamortized bond (discount)/premium	2,233	-	(147)	2,086
Total bonds and loans	$ 665,070	$ 12,559	$ (14,839)	$ 662,790

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

Debt service payments of the State Loans at December 31, 2010 are as follows:

	State Loans		
	Principal	Interest	Total
2011	$ 1,184	$ 304	$ 1,488
2012	1,274	316	1,590
2013	1,293	296	1,589
2014	1,313	276	1,589
2015	1,333	256	1,589
2016-2020	11,757	340	12,097
2021-2025	2,950	57	3,007
	$ 21,104	$ 1,845	$ 22,949

Debt service payments on the 1993, 1998, 2003, 2007, and 2008 Bonds at December 31, 2010 are as follows:

	Revenue Bonds		
	Principal	Interest	Total
2011	$ 14,885	$ 27,078	$ 41,963
2012	12,465	26,226	38,691
2013	14,155	25,537	39,692
2014	15,250	24,699	39,949
2015	15,995	24,018	40,013
2016-2020	84,331	114,514	198,845
2021-2025	103,928	94,553	198,481
2026-2030	38,752	179,365	218,117
2031-2035	149,500	52,910	202,410
2036-2040	185,739	21,232	206,971
	635,000	$ 590,132	$ 1,225,132
Accretion	29,963		
Total	$ 664,963		

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

Interest incurred for the years ended December 31, 2010 and 2009 on bonds payable, exclusive of capitalized interest and amortization of refunding losses, was approximately $30 million and $28 million, respectively. Interest costs for 2010 and 2009 included $1.8 million of amortization of the deferred refunding losses.

In accordance with the provisions of the trust indentures for the 1993, 1998, 2003, 2007, and 2008 Bonds, the Authority has created a number of funds that are restricted for specific purposes. The complement of these restricted funds, collectively referred to on the statements of net assets as "Restricted Assets" at December 31, 2010 and 2009, was:

	2010	2009
Capital project funds	$ 57,097	$ 83,226
Debt service and reserve funds	9,920	10,083
Operating reserve account	8,532	8,521
Capitalized interest fund	1,946	4,783
Other funds	575	575
	$ 78,070	$ 107,188

Among the Authority's debt covenants is one which requires that rates charged by the Authority will be sufficient to satisfy a formula which is intended to ensure that the Authority will be able to satisfy debt service requirements. The trust indenture also requires that revenue collections be deposited into a Revenue Fund and disbursed therefrom as provided for in the trust indenture. This Revenue Fund constitutes the vast majority of unrestricted funds cash and cash equivalents. At December 31, 2010, the Authority was in compliance with this covenant.

8. INTEREST RATE SWAPS

The Authority had the following interest rate swaps as of December 31, 2010 and 2009:

Notional Amount	Effective Date	Maturity Date	Interest Rate Paid	Interest Rate Received	Counterparty Credit Rating	Underlying Bonds
Hedging derivatives, Cash flow hedges, Receive variable - pay fixed, Interest rate swaps:						
$ 41,325,000	3/9/2007	9/1/2033	3.932%	SIFMA	AA3	Series 2007 B-2
41,320,000	3/9/2007	9/1/2033	3.932%	SIFMA	Aa1	Series 2007 B-1
72,747,500	6/12/2008	9/1/2039	4.038%	SIFMA	AA3	Series 2008 B-1
41,518,000	6/12/2008	9/1/2035	3.998%	SIFMA	AA3	Series 2008 C
72,747,500	6/12/2008	9/1/2039	4.038%	SIFMA	Aa1	Series 2008 B-2
71,225,000	6/12/2008	9/4/2040	4.103%	SIFMA	Aa1	Series 2008 D-2
Investment derivatives, Receive variable - pay fixed, Interest rate swaps:						
62,277,000	6/12/2008	9/4/2035	3.998%	SIFMA	Aa1	Series 2008 C

Notional Amount	12/31/2008 Market Value *	Change in Market Value	12/31/2009 Market Value *	Change in Market Value	12/31/2010 Market Value *
Hedging derivatives, Cash flow hedges, Receive variable - pay fixed, Interest rate swaps:					
$ 41,325,000	$ (6,495,475)	$ 3,112,089	$ (3,383,386)	$ (642,154)	$ (4,025,540)
41,320,000	(6,288,228)	2,970,510	(3,317,718)	(671,709)	(3,989,427)
72,747,500	(16,508,480)	10,052,902	(6,455,578)	(37,809)	(6,493,396)
41,518,000	(8,383,478)	4,923,483	(3,459,995)	(188,978)	(3,648,973)
72,747,500	(16,183,214)	9,754,258	(6,428,956)	13,524	(6,415,332)
71,225,000	(17,238,296)	10,326,725	(6,911,571)	37,173	(6,874,398)
	(71,097,171)	41,139,967	(29,957,204)	(1,489,953)	(31,447,066)
Investment derivatives, Receive variable - pay fixed, Interest rate swaps:					
62,277,000	(12,287,377)	7,187,452	(5,099,925)	(309,377)	(5,409,302)
Total	$ (83,384,548)	$ 48,327,419	$ (35,057,129)	$ (1,799,330)	$ (36,856,368)

* The market value is an estimated net present value of the expected cash flows calculated using relevant mid-market data inputs and based on the assumption of no unusual market conditions or forced liquidation.

Description of 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 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.

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.

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.

Accounting and Risk Disclosures

During the years ended December 31, 2010 and 2009, the Authority paid $16,042 and $16,197, respectively, fixed and received $942 and $1,695, respectively, variable related to their outstanding swap agreements.

As noted in the tables above, current period changes in market value for the interest rate swaps that are accounted for as hedges are recorded on the statements of net assets as deferred outflows. Additionally current period changes in market value for the interest rate swap accounted for as an investment is recorded on the statements of revenues, expenses and changes in net assets as a component of investment income.

The cumulative fair market value of the outstanding interest rate swaps of December 31, 2010 and 2009 are reported on the statements of net assets as a swap liability.

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 interest rate swaps, 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. The credit ratings by Moody's Investors Service, Inc., a nationally recognized statistical rating organization for the respective counterparties are listed in the table above. 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.

  The Authority currently does not enter into master netting arrangements with its counterparties as such each derivative instrument should be evaluated on an individual basis for credit risk.

  Concentration of credit risk: The Authority currently has two counterparties, with four and three outstanding interest rate swaps respectively. The Authority's outstanding market value as of December 31, 2010 and 2009, respectively, is $(22,688,459) and $(21,758,170) with one counterparty and $(14,167,909) and $(13,298,959) with the second counterparty. Both counterparties operate in the same markets and could be similarly impacted by changes in economic or other conditions.

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

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

- Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of a government's financial instruments or cash flows. The interest rate swap

that is accounted for as an investment exposes the Authority to interest rate risk. The interest rate swap is highly sensitive to changes in interest rates; changes in the variable rate will have a material effect on the swap's fair market value. The interest rate swap will terminate on September 4, 2035.

- 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.

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

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

Contingencies

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

9. INVESTMENTS AND DEPOSITS WITH FINANCIAL INSTITUTIONS

The Authority is authorized to invest in: obligations of the U.S. Government and government-sponsored agencies and instrumentalities; fully insured or collateralized certificates of deposits; commercial paper of the highest rating; repurchase agreements collateralized by government obligations or securities; highly rated bank promissory notes or investment funds or trusts; and, as to trusteed assets, as otherwise permitted by the trust indenture as supplemented and amended in 1998. Throughout the years ended December 31, 2010 and 2009, 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, 2010 and 2009, $32,289 and $40,673, respectively, of the Authority's bank balance of $33,539 and $41,923, 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 $37,129 and $42,937 as of December 31, 2010 and 2009, 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, 2010 and 2009: money market funds of $3,812 and $10,073, respectively, and repurchase agreements of $0 and $575, respectively. Of the Authority's $0 and $575 investment in repurchase agreements, at December 31, 2010 and 2009, respectively, all of the underlying securities are held by the investment's counterparty, not in the name of the Authority.

At December 31, 2010, the Authority held the following investment balances:

	Carrying value	Maturity in years: Less than 1 year
Commonwealth of PA Revenue Bonds (Guaranteed Investment Contracts)	$ 8,531	$ 8,531
Money market	3,812	3,812
Commercial paper	65,649	65,649
Total Investments	$ 77,992	$ 77,992

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

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

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 $74,180 and $96,462 are included as noncurrent restricted investments on the statements of net assets at December 31, 2010 and 2009, respectively. Investments of $3,812, consisting of money market funds of $3,812 are included as noncurrent restricted cash and cash equivalents on the statements of net assets at December 31, 2010. Investments of $10,648, consisting of money market funds of $10,648 are included as noncurrent restricted cash and cash equivalents on the statements of net assets at December 31, 2009.

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, 2010 and 2009 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, 2010, the Authority's investments in the guaranteed investment contracts were rated AA by Standard & Poor's. The counterparty to the Authority's guaranteed investment contracts is the Commonwealth of Pennsylvania. The Authority's investments in money markets were rated AA by Standard & Poor's. The Authority's investments in commercial paper at December 31, 2010 were rated A-1 by Standard & Poor's. Not all of the investments in commercial paper were rated. Additionally, at December 31, 2010, 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 Abbey National, Wells Fargo/BLB Investment Agent, and Commonwealth of Pennsylvania. These investments are 6.0%, 72.6%, and 10.9%, respectively, of the Authority's total investments at December 31, 2010.

As further described in Note 8, the Authority has a derivative instrument that is accounted for as an investment. Credit and interest rate risks related to this investment are described in Note 8.

10. NET ASSETS

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

	December 31,	
	2010	2009
Invested in capital assets, net of related liabilities:		
Net property, plant, and equipment in service	$ 517,029	$ 470,352
Debt subject to capital improvements	(612,818)	(617,683)
Swap liabilty net of deferred outflow	(5,409)	(5,100)
Accounts payable for capital items	(6,308)	(3,359)
Funded debt from restricted assets:		
Unspent debt proceeds:		
Capital projects	57,097	83,217
Debt service and reserve funds	9,920	10,017
	(40,489)	(62,556)
Restricted for capital activity and debt service:		
Restricted cash and cash equivalents	3,812	10,648
Restricted investments	74,180	96,462
Restricted receivables	78	78
Liabilities payable from restricted assets:		
Unspent debt proceeds:		
Capital projects	(57,097)	(83,217)
Debt service and reserve funds	(9,920)	(10,017)
	11,053	13,954
Unrestricted, as restated	(731)	13,064
Total net assets	$ (30,167)	$ (35,538)

11. OPERATING LEASE

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

The total minimum future commitments under the lease for year ending December 31, 2010 are as follows:

2011	$	593
2012		599
2013		616
2014		616
2015		616
2016-2020		3,227
2021-2025		3,381
2026-2027		1,198
	$	10,846

The total annual rental for office space was approximately $593 for 2010 and 2009.

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, 2010, $41 million of the program is complete and $87 million is under active contract.

In addition to the matters discussed in Note 14, Consent Agreement, various other claims and lawsuits are pending against the Authority. The ultimate outcome of these claims and lawsuits cannot presently be determined and, accordingly, no provision for amounts arising from settlements has been made in these financial statements. In the opinion of management, the effect on the financial statements of potential losses associated with any such claim and/or lawsuit should not be material.

The Authority was insured for general liability coverage through 2001; however, effective January 1, 2002, it became self-insured. In previous years, the Authority established a fund to pay for deductibles, small claims, and other litigation costs. At year-end, the balance in this fund was approximately $575. This fund is grouped with "Restricted Assets" on the statements of net assets. During 2010 and 2009, the Authority paid $0 from this fund for claims, and there is $0 and $0 accrued as of December 31, 2010 and 2009, respectively.

Line Warranty Program

The Authority instituted an opt-out warranty line insurance program. Utility Line Security, LLC ("ULS") operated the program providing for the repair of water and sewer lines for

ratepayers. Dominion Products and Services, Inc., Dominion Retail, Inc., The Manchester Group, LLC and Pamela Post (collectively, "Dominion") filed a lawsuit in the Common Pleas Court of Allegheny County (the Court). Dominion sought no monetary damages, but rather an injunction and declaratory judgment. The injunction was denied in June 2010. However, on March 14, 2011, the Court found that while the program was a good program, it violated the Municipal Authority Act. As a result, PWSA ended the program as of March 18, 2011. ULS has filed for bankruptcy claiming that PWSA prematurely ended the warranty line program. ULS has listed a potential claim against PWSA for breach of contract in the amount of $3 million. However, ULS has not assumed the contract, and even if assumed, there remains a question as to what remains of the contract after the Court's ruling. On April 6, 2011, an appealable order was entered in the Dominion case. ULS appealed said Order on April 7, 2011, and Dominion filed a cross-appeal on April 14, 2011.

On February 9, 2011, two class action lawsuits were filed by in the Court. These actions were seeking a determination that the opt-out program was not permitted. The above Opinion affects these cases as well. The cases will not move forward both because of the issuance of an automatic stay in the Bankruptcy Court action involving ULS and the appeal of the Court's Opinion. The class action Suites are seeking monetary damages in an undetermined amount. The plaintiffs will likely file a claim in Bankruptcy Court as a creditor.

The effect on the financial statements and potential losses associated with these claims and/or lawsuits cannot be projected at this time. The Authority continues to vigorously defend its actions.

13. PURCHASE OF WATER SYSTEM

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

14. CONSENT AGREEMENT

The Authority is subject to federal regulation under the Clean Water Act (1977) and regulations adopted under that Act. Among the specific requirements applicable to the

Authority's system are those imposed by the United States Environmental Protection Agency's Combined Sewer Overflow (CSO) Policy (1994). On January 29, 2004, the Authority and the City of Pittsburgh executed a Consent Order and Agreement (Order) regarding wet weather sewer overflows within the City. The other signatories to the Order are the Pennsylvania Department of Environmental Protection (DEP) and the Allegheny County Health Department (ACHD).

Generally, the Order requires the Authority and the City to assess the City sewers in order to develop a plan with ALCOSAN to address wet weather sewer overflows within the City. The Order is part of a sewer assessment program for all municipalities served by ALCOSAN. To date, assessment activities have been completed for all accessible critical sewers and separate sanitary sewers with the exception of any additional sewers discovered through continued research and investigation. Ongoing pipe and manhole repairs are being completed in order to provide CCTV access to remaining inaccessible critical/sanitary sewer pipes. Assessment activities for non-critical sewers are to be completed on a longer schedule, including completing CCTV at an annual average rate that was utilized to complete the critical/sanitary televising. The majority of accessible non-critical manholes have been inspected with ongoing efforts to complete any remaining or newly identified. 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. The Authority maintains an expedited response to significant structural failures of the sewer system where imminent structural failures are determined by a professional engineer and prioritized for repair. Ongoing sewer line replacement, point repair, lining, point lining, and Gunite projects have been implemented to address structural deficiencies.

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.

Supplementary Information

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS COMPOSITION - SCHEDULE I

(Dollars expressed in thousands)

DECEMBER 31, 2010

	Total	Unrealized Gain/(Loss)	Accrued Interest Receivable	Cash Equivalents *(1) Fidelity Inst M Mkt Prime #690 Class 1	Investments Commonwealth of PA Revenue Bonds	Investments *(2) Abbey Nat'l N A LLC CPDS	Investments *(3)Abbey Nat'l N A LLC DISC C/P	Investments *(4) Abbey Nat'l N A LLC DISC C/P
Capital project and construction funds:								
2005 Capital Project Fund	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2008 Construction Fund	57,034	-	9	367	-	-	-	-
	57,034	-	9	367	-	-	-	-
Debt service funds:								
1993 Debt Service Fund	4,172	128	4	4	-	862	147	862
2003 Debt Service Fund	804	13	35	5	-	33	155	34
2007 A Debt Service Fund	1,988	55	15	4	-	344	135	343
2007 B-1 Var Debt Service Fund	13	-	-	13	-	-	-	-
2007 B-2 Var Debt Service Fund	13	-	-	13	-	-	-	-
2008A Debt Service Fund	1,539	17	12	1	-	-	377	-
2008B1 Debt Service Fund	22	-	-	22	-	-	-	-
2008B2 Debt Service Fund	19	-	-	19	-	-	-	-
2008C1A Debt Service Fund	15	-	-	15	-	-	-	-
2008C1D Debt Service Fund	15	-	-	15	-	-	-	-
2008C1C Debt Service Fund	8	-	-	8	-	-	-	-
2008C1D Debt Service Fund	235	-	-	235	-	-	-	-
2008C2 Debt Service Fund	16	-	-	16	-	-	-	-
2008D1 Debt Service Fund	998	-	-	998	-	-	-	-
2008D2 Debt Service Fund	128	-	-	128	-	-	-	-
	9,985	213	66	1,496	-	1,239	814	1,239
1993 Operating Reserve Fund	8,529	-	3	2	8,524	-	-	-
2008 Capitalized Interest Fund	1,947	-	-	1,947	-	-	-	-
Self-Insured Escrow Fund	575	-	-	-	-	-	-	-
	$ 78,070	$ 213	$ 78	$ 3,812	$ 8,524	$ 1,239	$ 814	$ 1,239

(Continued)

(1) Fidelity Institutional M Market Prime #690 Class 1, yielding 0.16%.

(2) Abbey National N A LLC CPDS, yielding 4.53% with a maturity date of 08/24/2011

(3) Abbey National N A LLC DISC C/P, yielding 4.58% with a maturity date of 02/28/2011

(4) Abbey National N A LLC DISC C/P, yielding 5.51% with a maturity date of 06/24/2011

(5) Abbey National N A LLC DISC C/P, yielding 5.10% with a maturity date of 07/22/2011

(6) Federal Home Loan MTG Corp DISC NTS, yielding 4.53% with a maturity date of 08/26/2011

(7) Federal Home Loan Bank Discount, yielding 4.94% with a maturity date of 02/25/2011

(8) White Pt Fdg Inc Disc C/P 4/2 yielding 4.56% with a maturity date of 02/28/2011

(9) General Electric Cap Corp DISC, yielding 4.52% with a maturity date of 2/28/2011

(10) Wells Fargo/BLB Investment Agreement, yielding 0.00% with a maturity date of 2/28/2011

(11) Ally Bank Midvale Utah CTF DEP DTD 11/26/10 ACT/365, yielding 0.50% with a maturity date of 01/25/2011

(12) Bank Baroda New York NY CTF DEP DTD 11/30/10 ACT/365, yielding 0.60% with a maturity date of 10/26/2011

(13) Beal BK Nev Las Vegas CTF DEP DTD 11/24/10 ACT/365, yielding 0.60% with a maturity date of 10/26/2011

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS COMPOSITION - SCHEDULE I

(Dollars expressed in thousands)

DECEMBER 31, 2010

(Continued)

	Investments								
*(5)Abbey Nat'l N A LLC DISC C/P	*(6) FHL Mtg Corp DISC NTS	*(7) FHL Bank DISC	*(8)White PT FDG INC CPDS	*(9) General Elec Cap Corp DISC	*(10) Wells Fargo/BLB Investment Agreement	*(11) Ally Bank Midvale Utah CTF DEP	*(12) Bank Bandora NY CTF Dep	*(13) Beal Bank Nev Las Vegas CTF DEP
$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
-	-	-	-	-	56,658	-	-	-
-	-	-	-	-	56,658	-	-	-
862	862	147	147	147	-	-	-	-
34	33	154	154	154	-	-	-	-
344	343	135	135	135	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	377	377	378	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
1,240	1,238	813	813	814	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	-	-	-
-	-	-	-	-	-	250	75	250
$ 1,240	$ 1,238	$ 813	$ 813	$ 814	$ 56,658	$ 250	$ 75	$ 250

(Concluded)

(1) Fidelity Institutional M Market Prime #690 Class 1, yielding 0.16%.

(2) Abbey National N A LLC CPDS, yielding 4.53% with a maturity date of 08/24/2011

(3) Abbey National N A LLC DISC C/P, yielding 4.58% with a maturity date of 02/28/2011

(4) Abbey National N A LLC DISC C/P, yielding 5.51% with a maturity date of 06/24/2011

(5) Abbey National N A LLC DISC C/P, yielding 5.10% with a maturity date of 07/22/2011

(6) Federal Home Loan MTG Corp DISC NTS, yielding 4.53% with a maturity date of 08/26/2011

(7) Federal Home Loan Bank Discount, yielding 4.94% with a maturity date of 02/25/2011

(8) White Pt Fdg Inc Disc C/P 4/2 yielding 4.56% with a maturity date of 02/28/2011

(9) General Electric Cap Corp DISC, yielding 4.52% with a maturity date of 2/28/2011

(10) Wells Fargo/BLB Investment Agreement, yielding 0.00% with a maturity date of 2/28/2011

(11) Ally Bank Midvale Utah CTF DEP DTD 11/26/10 ACT/365, yielding 0.50% with a maturity date of 01/25/2011

(12) Bank Baroda New York NY CTF DEP DTD 11/30/10 ACT/365, yielding 0.60% with a maturity date of 10/26/2011

(13) Beal BK Nev Las Vegas CTF DEP DTD 11/24/10 ACT/365, yielding 0.60% with a maturity date of 10/26/2011

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2010

	Series 1993 Bonds		Series 2003 Bonds	Series 2005 Bonds	Series 2007 Bonds			
	Debt Service Fund	Operating Reserve Account	Debt Service Fund	Capital Project Fund	2007A Debt Service Fund	2007 B1 Debt Service Fund	2007 B2 Debt Service Fund	Subtotal
Increases:								
Interest	$ 137	$ 7	$ 137	$ 3	$ 102	$ -	$ -	$ 386
Total increases	137	7	137	3	102	-	-	386
Decreases:								
Capital projects	-	-	-	4,135	-	-	-	4,135
Interest	1,770	-	2,242	-	1,784	1,627	1,623	9,046
Bond principal/refunding escrow	-	-	11,650	-	3,970	-	-	15,620
Other	-	-	-	-	-	-	-	-
Total decreases	1,770	-	13,892	4,135	5,754	1,627	1,623	28,801
Interfund Transfers:								
Nontrusteed accounts	5,203	-	9,747	-	5,653	1,628	1,625	23,856
2008B Debt Svc Fund	-	-	-	-	-	-	-	-
2008C1 Debt Svc Fund	-	-	-	-	-	-	-	-
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-
2008 Capital Projects Fund	-	-	-	-	-	-	-	-
Total interfund transfers	5,203	-	9,747	-	5,653	1,628	1,625	23,856
Net activity	3,570	7	(4,008)	(4,132)	1	1	2	(4,559)
Balance:								
Beginning of year	602	8,521	4,812	4,132	1,987	12	11	20,077
End of year	$ 4,172	$ 8,528	$ 804	$ -	$ 1,988	$ 13	$ 13	$ 15,518

(Continued)

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2010

(Continued)

		Series 2008 Bonds												
	Self-Insured Escrow Account	2008 Cap. Int. Fund	2008A Debt Svc Fund	2008B1 Debt Svc Fund	2008B2 Debt Svc Fund	2008C1A Debt Svc Fund	2008C1B Debt Svc Fund	2008C1C Debt Svc Fund	2008C1D Debt Svc Fund	2008C2 Debt Svc Fund	2008D1 Debt Svc Fund	2008D2 Debt Svc Fund	2008 Cap. Proj. Fund	Total
Increases:														
Interest	$ -	$ 6	$ 39	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 2	$ -	$ 92	$ 525
Total increases	-	6	39	-	-	-	-	-	-	-	2	-	92	525
Decreases:														
Capital projects	-	-	-	-	-	-	-	-	-	-	-	-	19,802	23,937
Interest	-	-	4,531	2,926	2,915	536	536	267	1,546	2,072	1,222	2,920	-	28,517
Bond principal/refunding escrow	-	-	-	-	-	-	-	-	-	-	-	-	-	15,620
Other	-	1	-	-	-	-	-	-	-	-	-	-	5	6
Total decreases	-	1	4,531	2,926	2,915	536	536	267	1,546	2,072	1,222	2,920	19,807	68,080
Interfund Transfers:														
Nontrusteed accounts	-	-	4,493	2,929	2,917	551	551	275	1,782	2,075	-	(157)	-	39,272
2008 Capitalized Interest Fund	-	(2,841)	-	-	-	-	-	-	-	-	-	-	-	(2,841)
2008B Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2008C1 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	1,228	-	-	1,228
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	3,121	-	3,121
2008 Capital Projects Fund	-	-	-	-	-	-	-	-	-	-	-	-	(2,343)	(2,343)
Total interfund transfers	-	(2,841)	4,493	2,929	2,917	551	551	275	1,782	2,075	1,228	2,964	(2,343)	38,437
Net activity	-	(2,836)	1	3	2	15	15	8	236	3	8	44	(22,058)	(29,118)
Balance:														
Beginning of year	575	4,783	1,538	18	17	-	-	-	-	13	989	84	79,094	106,198
End of year	$ 575	$ 1,947	$ 1,539	$ 21	$ 19	$ 15	$ 15	$ 8	$ 236	$ 16	$ 997	$ 128	$ 57,036	$ 78,070

(Concluded)

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2010

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Expenditures
United States Department of Environmental Protection:		
Passed through the Pennsylvania Department of Environmental Protection:		
ARRA - Capitalization Grants for Drinking Water State Revolving Funds	66.468	$ 2,793,233
United States Department of Homeland Security:		
Passed through Pennsylvania Emergency Management Agency:		
Disaster Grants - Public Assistance	97.036	51,999
Total Federal Expenditures		$ 2,845,232

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, 2010

1. BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards of the Pittsburgh Water and Sewer 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. DETERMINATION OF FEDERAL EXPENDITURES

The amount of federal expenditures for the United States Department of Environmental Protection loan represents the expenditures incurred under the loan as of December 31, 2010, which represents the loan balance.

Pittsburgh Water and Sewer Authority

Independent Auditor's Reports in Accordance with OMB Circular A-133

Year Ended December 31, 2010

MaherDuessel
Certified Public Accountants

Pittsburgh
Three Gateway Center
Six West
Pittsburgh, PA 15222
Main 412.471.5500
Fax 412.471.5508

Harrisburg
3003 North Front Street
Suite 101
Harrisburg, PA 17110
Main 717.232.1230
Fax 717.232.8230

Butler
112 Hollywood Drive
Suite 204
Butler, PA 16001
Main 724.285.6800
Fax 724.285.6875

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, 2010, and have issued our report thereon dated April 26, 2011. 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 deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented, or detected and corrected on a timely basis.

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

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 26, 2011.

* * * * * * * * * *

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 26, 2011

MaherDuessel
Certified Public Accountants

Pittsburgh
Three Gateway Center
Six West
Pittsburgh, PA 15222
Main 412.471.5500
Fax 412.471.5508

Harrisburg
3003 North Front Street
Suite 101
Harrisburg, PA 17110
Main 717.232.1230
Fax 717.232.8230

Butler
112 Hollywood Drive
Suite 204
Butler, PA 16001
Main 724.285.6800
Fax 724.285.6875

Independent Auditor's Report on Compliance with Requirements that Could Have a Direct and Material Effect on 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 Pittsburgh Water and Sewer Authority's (Authority) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on its major federal program for the year ended December 31, 2010. 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 compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2010.

Internal Control over Compliance

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 a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a

federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, 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.

* * * * * * * * * *

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 26, 2011

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED DECEMBER 31, 2010

I. Summary of Audit Results

1. Type of auditor's report issued: Unqualified

2. Internal control over financial reporting:

   Material weakness(es) identified? ☐ yes ☒ no
   Significant deficiencies identified that are not considered to be material weakness(es)?
   ☐ yes ☒ none reported

3. Noncompliance material to financial statements noted? ☐ yes ☒ no

4. Internal control over major programs:

   Material weakness(es) identified? ☐ yes ☒ no
   Significant deficiencies identified that are not considered to be material weakness(es)?
   ☐ yes ☒ none reported

5. Type of auditor's report issued on compliance for major programs: Unqualified

6. Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of Circular A-133? ☐ yes ☒ no

7. Major Programs:

CFDA Number(s)	Name of Federal Program or Cluster
66.468	Capitalization Grants for Drinking Water State Revolving Funds

8. Dollar threshold used to distinguish between type A and type B programs: $300,000

9. Auditee qualified as low-risk auditee? ☐ yes ☒ no

II. Findings related to the financial statements which are required to be reported in accordance with GAGAS.

No matters were reported.

III. 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, 2010

No Single Audit in Prior Year