Pittsburgh Water and Sewer Authority

Single Audit

2011

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, 2011 AND 2010

TABLE OF CONTENTS

PITTSBURGH WATER AND SEWER AUTHORITY

YEARS ENDED DECEMBER 31, 2011 AND 2010

TABLE OF CONTENTS
(Continued)

MaherDuessel
Certified Public Accountants

Pittsburgh
503 Martindale Street
Suite 600
Pittsburgh, PA 15212
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, 2011 and 2010, 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 financial position of the Authority as of December 31, 2011 and 2010, and the 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 24, 2012 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 24, 2012

THE PITTSBURGH WATER AND SEWER AUTHORITY

2011 Financial Statements
Management's Discussion and Analysis

The Pittsburgh Water and Sewer Authority (Authority) comparative 2011 and 2010 fiscal year financial statements enclosed have been conformed to meet the requirements of Governmental Accounting Standards Board (GASB) Statement No. 34, *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments."* The financial statements incorporate three basic statements: the Statements of Net Assets, the Statements of Revenues, Expenses, and Changes in Net Assets, and Statements of Cash Flows.

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

Using This Financial Report – Overview of Reporting Changes

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

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

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

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

Financial Highlights

In 2011, operating income increased by 12.3% or $3.85 million and non-operating income decreased by $22.56 million resulting in a net loss of $13.34 million, down from a $5.31 million net gain in 2010. Below are the 2011 financial highlights:

Total operating revenues in 2011 were up $.799 million or .6% to $140.55 million when compared to 2010. For 2011, the Board of ALCOSAN did not change its rate structure and wastewater treatment revenues dropped $5.68 million due to a significant credit adjustment to a major industrial user and reduced consumption. Water and sewer conveyance revenues increased $6.46 million from 2010, due to a rate increase of 7.7% and an increase to 7% from 5% in the Distribution Infrastructure System Charge (DISC) on total water and sewer conveyance bills.

Total non-operating revenues (expenses) decreased by $22.56 million, mostly driven by a $12.38 million reduction in the fair market value of the 2008C2 swap contract as contrasted to a $.309 million decrease in 2010. Donated property revenue was $2.277 million, a decrease of $12.823 million when compared to 2010, a year in which $7.75 million in assets finished in prior years were recognized. Non-operating revenues for grants declined to zero and interest revenue increased by $.159 million to $.709 million due to higher market rates.

Total operating expenses decreased in 2011 to $105.53 million compared to $108.58 million in 2010. Significant operating expenses included the following factors:

- Salary and employee benefit expenses were up $.431 million or 2.6%. The increase is attributed to an average overall salary increase of 2.9% and a 1.7% 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, excluding salaries and benefits, decreased by $3.75 million to $56.15 million in 2011 or 6.3% from $59.90 million in 2010. Wastewater treatment expense decreased by $5.32 million or 11% to $43.47 million when compared to $48.79 million in 2010 due to adjustments and reduced consumption. Chemicals expense increased by $.125 million. Equipment increased by $.905 million. Sewer repairs increased to $.586 million in 2011, from $.55 million in 2010. Vactor debris removal expense increased slightly to $.314 million. Emergency water line repairs decreased by $.224 million to $.325 million or 41% from $.548 million in 2010. Catch basin cleaning increased by $.91 million to $.203 million or 81.6% from 2010. Building repairs increased by $.139 million due primarily to work done at the main warehouse and several pumping stations. Annual software support decreased $.355 million as support needs for SAP declined in preparation for a new ERP implementation of Microsoft's Dynamics GP Systems developed by Cogsdale.

- Overall G&A expenses increased 13.2%, to $9.58 million from $8.46 million in 2010. Significant expense reductions were a $.286 million drop in legal expenses and $.170 million reduction in consultants. Significant expense increases were $.114 million in postage, $.100 million in Miscellaneous Services, and $1.33 million in claims and deductibles.

- Overall other expenses decreased 2.4% or $1.54 million to $63.05 million in 2011 from $64.59 million in 2010. Non-city water subsidy to Pennsylvania American Water Company (PAWC) decreased 29.7% or $.693 million to $1.63 million in 2011 compared to $2.33 million in 2010 due to the 2011 PWSA rate increase. Interest expense on bond debt decreased 5.4% or $2.23 million to $38.99 million in 2011 compared to $41.2 million in 2010. Expenses related to the cooperation agreement with the City of Pittsburgh increased by $.500 million in 2011.

- In 2011, cash collections increased by $2.39 million or 1.7%. Increases in the Authority's DISC charge by 2% and a 7.7% on water and sewer conveyance provided most of the increase, while a decrease in water usage, as is occurring at water systems nationwide, precluded a larger net increase. This was the third year in a row that the Authority collected more than 100% of its billings. These continuing improvements in collections resulted in a drop in bad debt reserve of $.493 million from 2010.

Other 2011 highlights include:

- After an extensive review process lasting over a year, the Authority committed in 2010 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 to award the contract to Cogsdale Corporation, a Microsoft Dynamics Gold partner. The implementation proceeded in 2011, with finance scheduled to go live 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 $.035 million in 2011, but the Authority and JTS are in negotiation on this sum. The JTS collected $2.789 million, of which the Authority received $2.425 million during 2011.

- In January of 2010, the Authority began assessing a 5% Distribution Infrastructure System Charge (DISC) on all bills, which increased to 7% in 2011. 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 expenditures. It was decided to allow funds to accumulate the first year, and then budget expenditures for 2011 from the funds received in 2010. The 2011 budget for DISC expenditures was $6.38 million, of which $5.114 million was spent. This leaves a reserve of $5.104 million in DISC fund revenues at year-end. The expenditures for 2011 included water and sewer relays, new vehicles, flocculation equipment, and computer switching.

- Also in 2010, the Authority implemented a change in its water and sewer line warranty program, engaging a new provider, Utility Line Security, LLC, and changing from an opt-in to an opt-out program. 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. In final settlement with ULS, which declared bankruptcy in 2011, $.350 million was paid to ULS by PWSA in January of 2012 in settlement of outstanding issues.

- 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 received the payment of a remaining $.20 million balance in January 2012, settling the account in full.

- In July of 2010, the Authority approved development of a 40-year Capital Plan and Water & Sewer Master Plan (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 mitigate CSO issues, rehabilitate its aging infrastructure and clearwell, reduce non-revenue water, and comply with new THM regulations. Plan development continued in 2011 with a final version to be issued in 2012.

- The Authority, in an attempt to reduce water system 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 started in early 2011.

- 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 was completed in September of 2011. This project generated direct savings of roughly $.250 million in repair of valves that had been targeted for replacement and generated vital valve location and condition data for future capital planning.

- Debt service coverage in 2011 and 2010 was 1.87 for both years. These coverage factors exceed the 1.2 coverage factor required under the bond covenant.

- The Authority expended $35.56 million on capital projects in 2011, a decrease of $6.21 million over the $41.77 million expended in 2010. In December of 2011, $36.34 million remained in the 2008 construction fund. Of $36.80 million budgeted in PennVest loans, $12.87 million was spent in 2011, with $7.73 million remaining. It should be noted that the DISC program is now funding some larger projects that would have historically been paid for with capital dollars. These projects totaled $1.461 million in 2011.

- There was a limited amount of bond related activity for the Authority in 2011. The only occurrences of note were the renewal of two standby purchase agreements and the renewal of three securitizing letters of credit. These agreement renewals were on bond series totaling $293.61 million. The Authority renewed the standby purchase agreements on the Series 2008 C2 (face $51.89 million) and 2008 D2 (face $71.23 million) bonds for two years, expiring August of 2014 with JP Morgan Chase and PNC Bank, respectively. The Authority renewed lines of credit on the Series 2008 B1 (face $72.75 million) with Bank of America, Series 2008 B2 (face $72.75 million) with PNC Bank, and Series 2008 C1 (A, B, & C) bonds with FHLB. It should be noted that these credit facilities were all renewed at better rates than in recent years, reflecting a return to relative stability in the bond financing markets

- 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 (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 2011. 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 1995. The Authority makes payment to the City of Pittsburgh for direct and indirect services under the Cooperation

Agreement. Under this Agreement, the Authority also funds, on behalf of the City of Pittsburgh, a rate equalization subsidy to other City 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	
	2011	2010	Dollars	%
Capital assets:			Increase (Decrease)	
Producing assets	$ **481,142**	$ **475,701**	$ 5,441	1.1%
Construction in progress	**62,461**	**41,328**	21,133	51.1%
Restricted assets	**50,208**	**78,070**	(27,862)	-35.7%
Current assets and bond costs	**192,071**	**123,613**	68,458	55.4%
Total Assets	$ **785,882**	$ **718,712**	$ 67,170	9.3%
Liabilities:				
Current liabilities	$ **58,654**	$ **63,585**	$ (4,931)	-7.8%
Long-term liabilities	**770,733**	**685,294**	85,439	12.5%
Total Liabilities	**829,387**	**748,879**	80,508	10.8%
Net Assets (Deficit):				
Invested in capital assets, net of related liabilities	**(52,350)**	**(35,080)**	(17,270)	49.2%
Restricted for capital activity and debt service	**9,112**	**11,053**	(1,941)	-17.6%
Unrestricted	**(267)**	**(6,140)**	5,873	-95.7%
Total Net Assets (Deficit)	**(43,505)**	**(30,167)**	(13,338)	44.2%
Total Liabilities and Net Assets (Deficit)	$ **785,882**	$ **718,712**	$ 67,170	9.3%

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

(Dollars expressed in thousands)

	Year Ended December 31,		Variance	
	2011	2010	Dollars	%
			Increase (Decrease)	
Operating Revenues	$ **140,552**	$ **139,753**	$ 799	0.6%
Operating Expenses:				
Direct operating	**37,976**	**36,393**	1,583	4.3%
Wastewater treatment	**43,468**	**48,788**	(5,320)	-10.9%
Cooperation Agreement	**9,150**	**8,650**	500	5.8%
Subsidy of non-customer City residents	**1,633**	**2,326**	(693)	-29.8%
Depreciation and amortization	**13,300**	**12,420**	880	7.1%
Total Operating Expenses	**105,527**	**108,577**	(3,050)	-2.8%
Operating Income	**35,025**	**31,176**	3,849	12.3%
Non-operating revenues (expenses):				
Federal grants	**-**	**52**	(52)	-100.0%
Donated property	**2,277**	**15,100**	(12,823)	-84.9%
Interest revenue	**(11,671)**	**241**	(11,912)	-4942.7%
Interest expense and other	**(38,969)**	**(41,198)**	2,229	-5.4%
Total Non-operating Revenues (Expenses)	**(48,363)**	**(25,805)**	(22,558)	87.4%
Net Gain/(Loss)	$ **(13,338)**	$ **5,371**	$ (18,709)	-348.3%

Financial Condition

The Authority's financial condition in 2011 remained stable for an eighth consecutive year despite the continuing issues in the national economy. Water utility revenues increased significantly to $95.29 million from $88.83 million. The 7.7% rate increase passed for 2011, receipt of cash payments for funds advanced related to PennVest projects, and continuing improvement in the financial markets remedied the 2010 cash reduction, resulting in an increase in cash reserves of $4.214 million to $45.155 million.

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

Requests for Information

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

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET ASSETS

(Dollars expressed in thousands)

DECEMBER 31, 2011 AND 2010

Assets	2011	2010
Current assets:		
Cash and cash equivalents	$ 41,676	$ 37,129
Accounts receivable, net:		
Water:		
Billed	8,557	9,581
Unbilled	5,414	4,115
Total water	13,971	13,696
Wastewater treatment:		
Billed	2,679	4,194
Unbilled	2,800	2,201
Total wastewater treatment	5,479	6,395
Other receivables	4,722	7,853
Total accounts receivable, net	24,172	27,944
Prepaid expenses	211	433
Inventory	1,718	1,649
Total current assets	67,777	67,155
Noncurrent assets:		
Restricted assets:		
Accrued interest receivable	-	78
Cash and cash equivalents	3,479	3,812
Investments	46,729	74,180
Total restricted assets	50,208	78,070
Capital assets, not being depreciated	62,461	41,328
Capital assets, net of accumulated depreciation	481,142	475,701
Deferred outflow	100,118	31,447
Bond issue costs, net of accumulated amortization	24,176	25,011
Total noncurrent assets	718,105	651,557
Total Assets	$ 785,882	$ 718,712

(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, 2011 AND 2010
(Continued)

Liabilities and Net Assets (Net Deficits)	2011	2010
Liabilities:		
Current liabilities:		
Bonds and loans payable, current portion	$ 14,888	$ 15,711
Accrued payroll and related obligations	662	672
Accounts payable wastewater treatment	16,305	17,631
Accounts payable and other accrued expenses	10,195	11,700
Accounts payable from restricted assets	5,325	6,308
Accrued interest payable from restricted assets	11,279	11,563
Total current liabilities	58,654	63,585
Noncurrent liabilities:		
Deferred revenue	292	314
Accrued payroll and related obligations	972	1,045
Swap liability	117,907	36,856
Bonds and loans payable, net of current portion	651,562	647,079
Total noncurrent liabilities	770,733	685,294
Total Liabilities	829,387	748,879
Net Assets (Deficit):		
Invested in capital assets, net of related debt	(52,350)	(40,489)
Restricted for capital activity and debt service	9,112	11,053
Unrestricted	(267)	(731)
Total Net Assets (Deficit)	(43,505)	(30,167)
Total Liabilities and Net Assets (Deficit)	$ 785,882	$ 718,712

(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, 2011 AND 2010

	2011	2010
Operating Revenues:		
Residential, commercial, and industrial water sales	$ 95,290	$ 88,829
Wastewater treatment	43,548	49,223
Other	1,714	1,701
Total operating revenues	140,552	139,753
Operating Expenses:		
Direct operating expenses	37,976	36,393
Wastewater treatment	43,468	48,788
Cooperation agreement operating expenses:		
Indirect cost allocation - sewer conveyance	4,400	4,500
Indirect cost allocation - water	4,750	4,150
Expense of water provided by other entities:		
Subsidy of customers located in the City	1,633	2,326
Depreciation	11,810	10,929
Amortization of capitalized lease assets	1,490	1,491
Total operating expenses	105,527	108,577
Operating Income	35,025	31,176
Non-operating Revenues (Expenses):		
Federal grants	-	52
Donated property	2,277	15,100
Interest revenue	709	550
Investment income - change in fair market value of swap	(12,380)	(309)
Interest expense - bonds	(36,747)	(39,202)
Interest expense - other	(422)	(185)
Amortization of bond issue costs	(1,800)	(1,811)
Total non-operating revenues (expenses)	(48,363)	(25,805)
Net Income (Loss)	(13,338)	5,371
Net Assets (Deficit):		
Beginning of year	(30,167)	(35,538)
End of year	$ (43,505)	$ (30,167)

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, 2011 AND 2010

	2011	2010
Cash Flows From Operating Activities:		
Cash received from customers	$ 148,136	$ 140,650
Cash paid to suppliers and employees and customer refunds	(43,208)	(35,529)
Cash paid to City of Pittsburgh under the Cooperation Agreement	(9,150)	(8,650)
Cash paid to other water companies for subsidy of customers located in the City of Pittsburgh	(1,633)	(2,326)
Cash paid to ALCOSAN for wastewater treatment	(44,794)	(46,860)
Net cash provided by (used in) operating activities	49,351	47,285
Cash Flows From Investing Activities:		
Purchase of investment securities	(116,844)	(329,022)
Proceeds from sale and maturities of investment securities	122,846	355,090
Interest income	787	550
Net cash provided by (used in) investing activities	6,789	26,618
Cash Flows From Capital and Related Financing Activities:		
Purchase/construction of property, plant, and equipment	(16,766)	(43,997)
Proceeds from federal grants	-	52
Proceeds from Pennvest Loans	15,506	9,359
Payment made for bond reoffering costs	(965)	(1,062)
Principal payments on debt	(16,748)	(16,435)
SWAP receipts	801	1,057
SWAP payments	(17,016)	(18,680)
Liquidity and remarketing fees	(5,232)	(4,381)
Interest paid on borrowings	(11,506)	(12,460)
Net cash provided by (used in) capital and related financing activities	(51,926)	(86,547)
Increase (Decrease) in Cash and Cash Equivalents	4,214	(12,644)
Cash and Cash Equivalents:		
Beginning of year	40,941	53,585
End of year	$ 45,155	$ 40,941
Consists of:		
Restricted cash and cash equivalents	$ 3,479	$ 3,812
Unrestricted cash and cash equivalents	41,676	37,129
	$ 45,155	$ 40,941
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities:		
Operating income	$ 35,025	$ 31,176
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Depreciation and amortization	13,300	12,420
Reserve for uncollectible amounts	(393)	(1,746)
Change in:		
Accounts receivable - water and wastewater	1,034	2,570
Other accounts receivable	3,131	(6,776)
Wastewater accounts payable	(1,326)	1,928
Accounts payable and other accrued expenses	(1,505)	7,599
Other	85	114
Net cash provided by (used in) operating activities	$ 49,351	$ 47,285

The notes to financial statements 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.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the GASB. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

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 2011, the Authority's interest expense of $1,185, net of deferred interest earnings of $0, resulted in net capitalized interest expense of $1,185. 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.

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 parties 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 contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Pending Pronouncements

GASB has issued Statement No. 61, *"The Financial Reporting Entity: Omnibus,"* effective for periods beginning after June 15, 2012. The objective of this statement is to improve financial reporting for a governmental financial reporting entity by modifying existing requirements for the assessment of potential component units. The effect of implementation of this statement has not yet been determined.

GASB has issued Statement No. 62, *"Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements,"* effective for periods beginning after December 15, 2011. This statement establishes accounting and financial reporting standards for the financial reporting statements of state and local governments by bringing together reporting literature in one place with the guidance modified as necessary. The effect of implementation of this statement has not yet been determined.

GASB has issued Statement No. 63, *"Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,"* effective for the year ending December 31, 2012. This statement establishes guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position. The effect of implementation of this statement has not yet been determined.

GASB has issued Statement No. 64, *"Derivative Instruments: Application of Hedge Accounting Termination Provisions,"* effective for periods beginning after June 15, 2011. The objective of this statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This statement is an amendment of GASB Statement No. 53 and sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The effect of implementation of this statement has not yet been determined.

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 2011 payroll of $12,796 was covered by the Plan. Employee contributions for the year amounted to approximately $497.

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 2011 Minimum Municipal Obligation calculated for the City's Plan indicated a 2011 normal cost of $733 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 2011, together with other elements of expense for employee service during 2011 would not exceed the sum of the 2011 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, 2011 and 2010, the reserve for uncollectible water accounts was approximately $13.95 million and $14.2 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, 2011 and 2010, the reserve for uncollectible wastewater accounts was approximately $6.71 million and $6.84 million, respectively.

5. Capital Assets

Capital assets consisted of the following at December 31, 2011 and 2010:

(Dollars expressed in thousands unless otherwise indicated)

	Balance at January 1, 2011	Additions	Transfers	Balance at December 31, 2011
Capital assets not being depreciated:				
Construction in progress	$ 41,328	$ 36,913	$ (15,780)	$ 62,461
Capital assets being depreciated:				
Water and sewer system	102,167	-	-	102,167
Utility assets	563,550	17,804	-	581,354
Non-utility assets	17,106	937	-	18,043
Total capital assets being depreciated	682,823	18,741	-	701,564
Total capital assets	724,151	55,654	(15,780)	764,025
Accumulated depreciation	(207,122)	(13,300)	-	(220,422)
Capital assets, net	$ 517,029	$ 42,354	$ (15,780)	$ 543,603

	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

During 2011 and 2010, the Authority received donated utility assets of $2,277 and $15,100, respectively, related to various development projects.

(Dollars expressed in thousands unless otherwise indicated)

6. Payroll and Related Obligations

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

	Balance at December 31, 2010	Change	Balance at December 31, 2011	Current Portion
Compensated absences	$ 767	$ (10)	$ 757	$ 4
Workers' compensation	402	(61)	341	122
Payroll, withholdings, and taxes	548	(12)	536	536
	$ 1,717	$ (83)	$ 1,634	$ 662

	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

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, 2011 and 2010 is $93,565 and $108,860, 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 is 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, 2011 and 2010, with carrying amounts of $17 million and $27 million, respectively, based on quoted market prices, is approximately $18 million and $30 million, respectively.

Series 1998

In March 1998, the Authority issued $93,355, Series A First Lien Revenue Bonds ("1998 Series A Bonds"), the proceeds of which were used to defease through an advance refunding the entire balance of 1995 Series A Bonds outstanding ($89,850); $36,440 Series B First Lien Revenue Bonds ("1998 Series B Bonds"), the proceeds of which are dedicated to a capital improvements program; and $101,970 Series C Subordinate Revenue Bonds ("1998 Series C Bonds"), the proceeds of which were used to defease through an advance refunding the entire balance of the 1995 Series B Bonds outstanding ($98,410). At December 31, 2011 and 2010, the remaining unamortized deferred refunding loss of $466 and $498, 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, 2011 and 2010, with carrying amounts of $62 million and $62 million, respectively, based on quoted market prices, is approximately $62 million and $62 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 is 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 $1,203 and $1,287 at December 31, 2011 and 2010, 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, 2011 and 2010, with carrying amounts of $45 million and $45 million, respectively, based on quoted market prices, is approximately $47 million and $47 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, 2011 and 2010, the remaining unamortized deferred refunding loss of $4,734 and $5,060, respectively. At December 31, 2011, the principal of the defeased Series 2002 Bonds outstanding was $89,830, and the defeased 2005 Bonds outstanding was $44,355.

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, 2011 and 2010, with carrying amounts of $112 million and $116 million, respectively, based on quoted market prices, is approximately $115 million and $118 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.

<u>Series 2008</u>

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

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

In connection with these advance refundings, portions of the proceeds of the 2008 Bonds were deposited into irrevocable trusts with an escrow agent to provide for certain debt service payments on the refunded bonds. The advance refunding resulted in a deferred refunding loss of $18,119 which is amortized as an adjustment to interest expense over the life of the 2008 Bonds using the effective interest method. At December 31, 2011 and 2010, the remaining unamortized deferred refunding loss was $14,305 and $15,307, respectively, and the transaction is shown as a reduction of long-term debt and will be amortized through 2037.

At December 31, 2011, the principal of the defeased Series 1993A Bonds outstanding was $16,875 and the defeased 2003 Bonds outstanding was $26,130. The maturity value of defeased 1998B compound interest bonds outstanding at December 31, 2011 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 have been renewed and are set to expire on October 22, 2013.

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. During August 2011, the 2008 Series C-1-A, B and C bonds were again reoffered. The bonds were reoffered at a term rate of .45% through September 2012. 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 Federal Home Loan Bank. Liquidity facilities provided by JP Morgan Chase on the 2007 B-1, 2007 B-2 and 2008 C-2 Series bonds have been renewed and are set to expire on June 10, 2014 for the 2007 B-1 and B-2 Series and June 9, 2014 for the 2008 C-2 Series. 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. During 2011, the Authority renewed the Series 2008 C-2 (face $51.89 million) and Series 2008 D-2 (face $71.23 million) for two years, expiring June 2014, with JP Morgan Chase and PNC Bank, respectively.

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, 2011 and 2010, with carrying amounts of $414 million and $414 million, respectively, based on quoted market prices, is approximately $431 million and $419 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.

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, 2011 and 2010:

(Dollars expressed in thousands unless otherwise indicated)

	Balance at December 31, 2010	Additions	Reductions	Balance at December 31, 2011
Bonds and loans payable:				
Revenue bonds	$ 664,963	$ 3,377	$ (14,885)	$ 653,455
State loans (PENNVEST)	21,104	15,506	(1,863)	34,747
	686,067	18,883	(16,748)	688,202
Less: deferred refunding loss	(25,363)	-	1,663	(23,700)
Unamortized bond (discount) premium	2,086	-	(138)	1,948
Total bonds and loans	$ 662,790	$ 18,883	$ (15,223)	$ 666,450

	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

Debt service payments of the State Loans at December 31, 2011 are as follows:

	State Loans		
	Principal	Interest	Total
2012	$ 2,422	$ 714	$ 3,136
2013	2,459	677	3,136
2014	2,497	639	3,136
2015	2,535	600	3,135
2016	2,513	704	3,217
2017-2021	13,112	3,297	16,409
2022-2026	8,741	1,903	10,644
Thereafter	468	56	524
	$ 34,747	$ 8,590	$ 43,337

(Dollars expressed in thousands unless otherwise indicated)

Debt service payments on the 1993, 1998, 2003, 2007, and 2008 Bonds at December 31, 2011 are as follows:

	Revenue Bonds		
	Principal	Interest	Total
2012	$ 12,466	$ 26,226	$ 38,692
2013	14,155	25,538	39,693
2014	15,250	24,699	39,949
2015	15,995	24,018	40,013
2016	16,755	23,304	40,059
2017-2021	86,585	111,787	198,372
2022-2026	91,341	111,924	203,265
2027-2031	59,720	154,094	213,814
2032-2036	156,130	47,433	203,563
2037-2040	151,718	14,031	165,749
	620,115	$ 563,054	$ 1,183,169
Accretion	33,340		
Total	$ 653,455		

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, 2011 and 2010 on bonds payable, exclusive of capitalized interest and amortization of refunding losses, was approximately $33 million and $30 million, respectively. Interest costs for 2011 and 2010 included $1.7 and $1.8 million, respectively, of amortization of the deferred refunding losses.

In accordance with the provisions of the trust indentures for the 1993, 1998, 2003, 2007, and 2008 Bonds, the Authority has created a number of funds that are restricted for specific purposes. The complement of these restricted funds, collectively referred to on the statements of net assets as “Restricted Assets” at December 31, 2011 and 2010, was:

	2011	2010
Capital project funds	$ 33,106	$ 57,097
Debt service and reserve funds	7,990	9,920
Operating reserve account	8,537	8,532
Capitalized interest fund	-	1,946
Other funds	575	575
	$ 50,208	$ 78,070

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, 2011, the Authority was in compliance with this covenant.

8. Interest Rate Swaps

Interest rate swaps disclosures (not in thousands) as of December 31, 2011 and 2010 are presented below:

(Dollars expressed in thousands unless otherwise indicated)

Interest rate swaps at December 31, 2011 and 2010:

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	Aaa	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	Aaa	Series 2008 B-1
41,518,000	6/12/2008	9/1/2035	3.998%	SIFMA	Aaa	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	9/1/2040	4.103%	SIFMA	Aa1	Series 2008 D-2
Investment derivatives, Receive variable - pay fixed, Interest rate swaps:						
62,277,000	6/12/2008	9/1/2035	3.998%	SIFMA	Aa1	Series 2008 C

Interest Rate Swap – Market Value Information:

Notional Amount	12/31/2009 Market Value *	Change in Market Value	12/31/2010 Market Value *	Change in Market Value	12/31/2011 Market Value *
Hedging derivatives, Cash flow hedges, Receive variable - pay fixed, Interest rate sw aps:					
$ 41,325,000	$ (3,383,386)	$ (642,154)	$ (4,025,540)	$ (5,341,685)	$ (9,367,225)
41,320,000	(3,317,718)	(671,709)	(3,989,427)	(5,383,814)	(9,373,241)
72,747,500	(6,455,578)	(37,818)	(6,493,396)	(16,260,801)	(22,754,197)
41,518,000	(3,459,995)	(188,978)	(3,648,973)	(8,210,370)	(11,859,343)
72,747,500	(6,428,956)	13,624	(6,415,332)	(16,338,865)	(22,754,197)
71,225,000	(6,911,571)	37,173	(6,874,398)	(17,135,256)	(24,009,654)
	(29,957,204)	(1,489,862)	(31,447,066)	(68,670,791)	(100,117,857)
Investment derivatives, Receive variable - pay fixed, Interest rate swaps:					
62,277,000	(5,099,925)	(309,377)	(5,409,302)	(12,379,713)	(17,789,015)
Total	$ (35,057,129)	$ (1,799,239)	$ (36,856,368)	$ (81,050,504)	$ (117,906,872)

* 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, 2012 for the 2008 C Bonds, September 1, 2032 for the 2008 D2 Bonds and September 1, 2035 for the 2008 B Bonds, 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, 2011 and 2010, the Authority paid $17,016 and $18,680, respectively, fixed and received $801 and $1,057, 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 an adjustment to 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, 2011 and 2010 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. As the Authority's derivative instruments currently have a negative fair market value position to the Authority at year-end, the Authority is not exposed to credit risk at December 31, 2011.

  <u>Concentration of credit risk:</u> 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, 2011 and 2010, respectively, is \$(73,926,107) and \$(22,688,459) with one counterparty and \$(43,980,765) and \$(14,167,909) 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 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, 2011 and 2010, 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, 2011 and 2010, $32,889 and $32,289, respectively, of the Authority's bank balance of $39,115 and $33,539, respectively, was exposed to custodial credit risk. These amounts are collateralized in accordance with Act 72 of the Pennsylvania state legislature, which requires the institution to pool collateral for all governmental deposits and have the collateral held by an approved custodian in the institution's name. These deposits have carrying amounts of $41,676 and $37,129 as of December 31, 2011 and 2010, 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, 2011 and 2010: money market funds of $2,901 and $3,812, respectively, and repurchase agreements of $578 and $0, respectively. Of the Authority's $578 and $0 investment in repurchase agreements, at December 31, 2011 and 2010, respectively, all of the underlying securities are held by the investment's counterparty, not in the name of the Authority.

At December 31, 2011, the Authority held the following investment balances:

(Dollars expressed in thousands unless otherwise indicated)

	Carrying value	Maturity in years Less than 1 year
Commonwealth of PA Revenue Bonds (Guaranteed Investment Contracts)	$ 8,536	$ 8,536
Money market	2,901	2,901
Repurchase agreements	578	578
Commercial paper	38,193	38,193
Total Investments	$ 50,208	$ 50,208

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

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 $46,729 and $74,180 are included as noncurrent restricted investments on the statements of net assets at December 31, 2011 and 2010, respectively. Investments of $3,479 consisting of money market funds of $2,901 and repurchase agreements of $578 are included as noncurrent restricted cash and cash equivalents on the statements of net assets at December 31, 2011. 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.

Interest Rate Risk – Interest rate risk is 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, 2011 and 2010 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, 2011, 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, 2011 were rated A-1 by Standard & Poor's. Not all of the investments in commercial paper were rated. Additionally, at December 31, 2011, 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 – Concentration 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 Fidelity Institutional Money Market, Wells Fargo/BLB Investment Agent, and Commonwealth of Pennsylvania. These investments are 5.8%, 65.2%, and 17.0%, respectively, of the Authority's total investments at December 31, 2011.

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:

(Dollars expressed in thousands unless otherwise indicated)

	December 31, 2011	December 31, 2010
Invested in capital assets, net of related liabilities:		
Net property, plant, and equipment in service	$ 543,603	$ 517,029
Debt subject to capital improvements	(613,935)	(612,818)
Swap liability net of deferred outflow	(17,789)	(5,409)
Accounts payable for capital items	(5,325)	(6,308)
Funded debt from restricted assets:		
Unspent debt proceeds:		
Capital projects	33,106	57,097
Debt service and reserve funds	7,990	9,920
	(52,350)	(40,489)
Restricted for capital activity and debt service:		
Restricted cash and cash equivalents	3,479	3,812
Restricted investments	46,729	74,180
Restricted receivables	-	78
Liabilities payable from restricted assets:		
Unspent debt proceeds:		
Capital projects	(33,106)	(57,097)
Debt service and reserve funds	(7,990)	(9,920)
	9,112	11,053
Unrestricted	(267)	(731)
Total net assets	$ (43,505)	$ (30,167)

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, 2011 are as follows:

(Dollars expressed in thousands unless otherwise indicated)

2012	$	599
2013		616
2014		616
2015		616
2016		616
2017-2021		3,273
2022-2026		3,404
2027-2028		513
	$	10,253

The total annual rental for office space was approximately $599 and $598 for 2011 and 2010 respectively.

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, 2011, $70 million of the program is complete and $69 million is under active contract.

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

The Authority was insured for general liability coverage through 2001; however, effective January 1, 2002, it became self-insured. In previous years, the Authority established a fund to pay for deductibles, small claims, and other litigation costs. At year-end, the balance in this fund was approximately $578. This fund is grouped with "Restricted Assets" on the statements of net assets. During 2011 and 2010, the Authority paid $0 from this fund for claims, and there is $0 and $0 accrued as of December 31, 2011 and 2010, 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. On March 18, 2011, ULS filed for bankruptcy protection in the United States Bankruptcy Court for the Western District of Pennsylvania (the "Bankruptcy Court") at Case No. 11-21630-JKF (the "Bankruptcy Case"). 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 April 15, 2011, ULS filed its Schedules of Assets and Liabilities in the Bankruptcy Court at Docket No. 69 and listed a potential claim against the Authority for breach of contract in the amount of $3 million. On December 2, 2011, ULS filed its Plan of Liquidation (the "Plan") in the Bankruptcy Case at Docket 206. Pursuant to Section 7.2 of the Plan, ULS agreed to fully and finally release the Authority of any and all claims and to withdraw the aforementioned appeal upon confirmation of the Plan by the Bankruptcy Court and the Authority's payment of $350,000. Pursuant to Section 13.04 of the Plan, any mechanic's liens that arose in connection with the ULS program are deemed released upon confirmation of the Plan by the Bankruptcy Court. On March 5, 2012, the Pennsylvania Supreme Court dismissed the appeal.

On February 9, 2011, two class action lawsuits were filed in the Court. These actions were seeking undetermined monetary damages and a determination that the opt-out program was not permitted. Counsel for the class and the Authority have reached a settlement in principal and have submitted a motion stipulation and a proposed notice to the class. The Authority will pay counsel fees in the amount of $125,000 for the allegations related to the legality of the opt-out program. Additionally, the Authority will credit members of the class in the amount of approximately $300,000 for DISC fees that were prematurely collected from the ratepayers. Counsel for the class will receive $25,000 in attorneys' fees for this portion of the settlement. At a hearing on April 3, 2012, the court declined to approve the notices for the class. Counsel for the parties is discussing revisions to the settlement proposal to make it acceptable to the Court.

Subsequent to year-end, the Authority was assessed a penalty of $110,000 by the Pennsylvania Department of Environmental Protection (DEP) under a consent order related to modifications to wastewater discharges at its water treatment plant. The non-compliance resulted from a failure by an engineering contractor to properly design required modifications, resulting in a delay in construction. Action is in process to correct the non-compliance; however, the potential exists for further penalties to be assessed by DEP. The

Authority is exploring a claim against the engineering contractor that is responsible for the delay.

13. CONSENT AGREEMENT

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

Generally, the Order requires the Authority and the City to assess the City sewers in order to develop a plan with ALCOSAN to address wet weather sewer overflows within the City. The Order is part of a sewer assessment program for all municipalities served by ALCOSAN. 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, 2011

				Cash Equivalents		Investments		
	Total	Unrealized Gain/(Loss)	Accrued Interest Receivable	*(1) Fidelity Inst M Mkt Prime #690 Class 1	*(7) Overnight Tri-Party Repo GNMA	Commonwealth of PA Revenue Bonds	*(2) BTM CAP CORP DISC CP	*(3)GE CAP CORP CPDS
Capital project and construction funds:								
2005 Capital Project Fund	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2008 Construction Fund	33,102	411	-	377	-	-	-	-
	33,102	411	-	377	-	-	-	-
Debt service funds:								
1993 Debt Service Fund	3,004	76	-	735	-	-	731	91
2003 Debt Service Fund	765	11	-	191	-	-	187	154
2007 A Debt Service Fund	1,961	45	-	482	-	-	478	121
2007 B-1 Var Debt Service Fund	7	-	-	7	-	-	-	-
2007 B-2 Var Debt Service Fund	10	-	-	10	-	-	-	-
2008A Debt Service Fund	1,525	15	-	379	-	-	377	376
2008B1 Debt Service Fund	9	-	-	9	-	-	-	-
2008B2 Debt Service Fund	8	-	-	8	-	-	-	-
2008C1A Debt Service Fund	15	-	-	15	-	-	-	-
2008C1D Debt Service Fund	15	-	-	15	-	-	-	-
2008C1C Debt Service Fund	9	-	-	9	-	-	-	-
2008C1D Debt Service Fund	235	-	-	235	-	-	-	-
2008C2 Debt Service Fund	12	-	-	12	-	-	-	-
2008D1 Debt Service Fund	407	-	-	407	-	-	-	-
2008D2 Debt Service Fund	10	-	-	10	-	-	-	-
	7,992	147	-	2,524	-	-	1,773	742
1993 Operating Reserve Fund	9,114	12	-	-	578	8,524	-	-
2008 Capitalized Interest Fund	-	-	-	-	-	-	-	-
Self-Insured Escrow Fund	-	-	-	-		-	-	-
	$ 50,208	$ 570	$ -	$ 2,901	$ 578	$ 8,524	$ 1,773	$ 742

(Continued)

(1) Fidelity Institutional M Market Prime #690 Class 1, yielding 0.10%.

(2) BTM Cap Corp Disc Commercial Paper, yielding 0.00% with a maturity date of 02/21/2012

(3) General Electric Cap Corp CPDs, yielding 0.00% with a maturity date of 02/29/2012

(4) Private Expt FDG Corp DISC C/P, yielding 0.0% with a maturity date of 02/29/2012

(5) Westpac BKG Corp CPDS, yielding 0.0% with a maturity date of 05/03/2012

(6) Wells Fargo/BLB Investment Agreement, yielding 0.00% with a maturity date of 6/30/2012

(7) Overnight Tri-Party Repo GNMA, yielding 0.0%

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS COMPOSITION - SCHEDULE I

(Dollars expressed in thousands)

DECEMBER 31, 2011
(Continued)

	Investments		
	*(4) PRVT EXCPT FDG CORP DISC CP	*(5)WESTPAC BKG CORP CPDS DISC C/P	*(6) Wells Fargo/BLB Investment Agreement
Capital project and construction funds:			
2005 Capital Project Fund	$ -	$ -	$ -
2008 Construction Fund	-	-	32,314
	-	-	32,314
Debt service funds:			
1993 Debt Service Fund	731	640	-
2003 Debt Service Fund	188	34	-
2007 A Debt Service Fund	478	357	-
2007 B-1 Var Debt Service Fund	-	-	-
2007 B-2 Var Debt Service Fund	-	-	-
2008A Debt Service Fund	378	-	-
2008B1 Debt Service Fund	-	-	-
2008B2 Debt Service Fund	-	-	-
2008C1A Debt Service Fund	-	-	-
2008C1D Debt Service Fund	-	-	-
2008C1C Debt Service Fund	-	-	-
2008C1D Debt Service Fund	-	-	-
2008C2 Debt Service Fund	-	-	-
2008D1 Debt Service Fund	-	-	-
2008D2 Debt Service Fund	-	-	-
	1,775	1,031	-
1993 Operating Reserve Fund	-	-	-
2008 Capitalized Interest Fund	-	-	-
Self-Insured Escrow Fund	-	-	-
	$ 1,775	$ 1,031	$ 32,314

(Concluded)

(1) Fidelity Institutional M Market Prime #690 Class 1, yielding 0.10%.

(2) BTM Cap Corp Disc Commercial Paper, yielding 0.00% with a maturity date of 02/21/2012

(3) General Electric Cap Corp CPDs, yielding 0.00% with a maturity date of 02/29/2012

(4) Private Expt FDG Corp DISC C/P, yielding 0.0% with a maturity date of 02/29/2012

(5) Westpac BKG Corp CPDS, yielding 0.0% with a maturity date of 05/03/2012

(6) Wells Fargo/BLB Investment Agreement, yielding 0.00% with a maturity date of 6/30/2012

(7) Overnight Tri-Party Repo GNMA, yielding 0.0%

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2011

	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	$ 181	$ 8	$ (11)	$ 3	$ 79	$ -	$ -	$ 260
Total increases	181	8	(11)	3	79	-	-	260
Decreases:								
Capital projects	-	-	-	4,135	-	-	-	4,135
Interest	1,769	-	1,858	-	1,625	1,640	1,643	8,535
Bond principal/refunding escrow	10,350	-	405	-	4,130	-	-	14,885
Other	-	-	-	-	-	-	-	-
Total decreases	12,119	-	2,263	4,135	5,755	1,640	1,643	27,555
Interfund Transfers:								
Nontrusteed accounts	10,770	-	2,236	-	5,649	1,634	1,640	21,929
2008B Debt Svc Fund	-	-	-	-	-	-	-	-
2008C1 Debt Svc Fund	-	-	-	-	-	-	-	-
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-
2008 Capital Projects Fund	-	-	-	-	-	-	-	-
Total interfund transfers	10,770	-	2,236	-	5,649	1,634	1,640	21,929
Net activity	(1,168)	8	(38)	(4,132)	(27)	(6)	(3)	(5,366)
Balance:								
Beginning of year	4,172	8,528	803	4,132	1,988	13	13	19,649
End of year	$ 3,004	$ 8,536	$ 765	$ -	$ 1,961	$ 7	$ 10	$ 14,283

(Continued)

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF RESTRICTED ASSETS ACTIVITY - SCHEDULE II

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2011
(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	$ 3	$ 1	$ 24	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 398	$ 686
Total increases	3	1	24	-	-	-	-	-	-	-	-	-	398	686
Decreases:														
Capital projects	-	-	-	-	-	-	-	-	-	-	-	-	22,934	27,069
Interest	-	-	4,531	2,946	2,920	426	426	212	1,728	2,098	1,222	2,946	-	27,990
Bond principal/refunding escrow	-	-	-	-	-	-	-	-	-	-	-	-	-	14,885
Other	-	1	-	-	-	-	-	-	-	-	-	-	966	967
Total decreases	-	1	4,531	2,946	2,920	426	426	212	1,728	2,098	1,222	2,946	23,900	70,911
Interfund Transfers:														
Nontrusteed accounts	-	-	4,494	2,933	2,909	426	426	213	1,728	2,094	18	1,061	-	38,231
2008 Capitalized Interest Fund	-	(1,947)	-	-	-	-	-		-	-	-	-	-	(1,947)
2008B Debt Svc Fund	-	-	-	-	-	-	-		-	-	-	-	-	-
2008C1 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	-	-	-
2008D1 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	612	-	-	612
2008D2 Debt Svc Fund	-	-	-	-	-	-	-	-	-	-	-	1,767	-	1,767
2008 Capital Projects Fund	-	-	-	-	-	-	-	-	-	-	-	-	(432)	(432)
Total interfund transfers	-	(1,947)	4,494	2,933	2,909	426	426	213	1,728	2,094	630	2,828	(432)	38,231
Net activity	3	(1,947)	(13)	(13)	(11)	-	-	1	-	(4)	(592)	(118)	(23,934)	(31,994)
Balance:														
Beginning of year	575	1,947	1,538	22	19	15	15	8	235	16	999	128	57,036	82,202
End of year	$ 578	$ -	$ 1,525	$ 9	$ 8	$ 15	$ 15	$ 9	$ 235	$ 12	$ 407	$ 10	$ 33,102	$ 50,208

(Concluded)

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2011

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	$ 4,283,028
Total Federal Expenditures		$ 4,283,028

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, 2011

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 during the year ended December 31, 2011.

Pittsburgh Water and Sewer Authority

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

Year Ended December 31, 2011

MaherDuessel
Certified Public Accountants

Pittsburgh
503 Martindale Street
Suite 600
Pittsburgh, PA 15212
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, 2011, and have issued our report thereon dated April 24, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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 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 24, 2012.

* * * * * * * * * *

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 24, 2012

MaherDuessel
Certified Public Accountants

Pittsburgh
503 Martindale Street
Suite 600
Pittsburgh, PA 15212
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 the 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, 2011. 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, 2011.

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, 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 24, 2012

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED DECEMBER 31, 2011

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	ARRA - 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, 2011

No Findings in Prior Year