Pittsburgh Water and Sewer Authority

Single Audit

2014

MaherDuessel
Certified Public Accountants

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PITTSBURGH WATER AND SEWER AUTHORITY

YEARS ENDED DECEMBER 31, 2014 AND 2013

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YEARS ENDED DECEMBER 31, 2014 AND 2013

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Independent Auditor's Report

Board of Directors
Pittsburgh Water and Sewer Authority

Report on the Financial Statements

We have audited the accompanying financial statements of the Pittsburgh Water and Sewer Authority (Authority), a component unit of the City of Pittsburgh (City), Pennsylvania, as of and for the years ended December 31, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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, 2014 and 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Supplementary Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The combining statements of net position and revenue, expenses, and changes in net position (combining statements) are presented for purposes of additional analysis and are not a required part of the basic financial statements. The 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 basic financial statements.

The combining statements and the schedule of expenditures of federal awards are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining statements and the schedule of expenditures of federal awards are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 16, 2015 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Maher Duessel

Pittsburgh, Pennsylvania
April 16, 2015

THE PITTSBURGH WATER AND SEWER AUTHORITY

2014 Financial Statements
Management Discussion and Analysis

The Pittsburgh Water and Sewer Authority (Authority) comparative 2014 and 2013 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 Position, the Statements of Revenues, Expenses and Changes in Net Position, and the 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 reflects 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 Position 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 position section of the Statements of Net Position classifies the total net position as net investment in capital assets, restricted for capital activity and debt service, and unrestricted.

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

The Statements of Revenues, Expenses, and Changes in Net Position 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 2014, operating income increased by 15% or $5.09 million to $38.49 million. However, the Authority experienced an overall net loss of $4.0 million due to swap valuation and debt reissuance items, down from a $10.62 million net gain in 2013. Below are the 2014 financial highlights:

Total operating revenues in 2014 were up $21.60 million or 13% to $164.26 million when compared to 2013. Wastewater treatment revenues increased $7.39 million. Water and sewer conveyance revenues increased $12.20 million from 2014. Both of these increases are attributable to rate increases by both PWSA and ALCOSAN. Other operating income increased by $2.01 million from 2013, as overall development in the City resulted in additional tap fees and other permitting related items.

Total non-operating expenses increased by $19.84 million, mostly driven by a turnaround in the fair market value of the 2008C2 investment swap from an $11.564 gain in 2013 to a $10.43 million loss in 2014 and a one-time recognized $9.47 million charge due to restructuring the 2008C swaps in November 2014. Both of these debt items were non-cash. Donated property revenue of $14.71 million, an increase of over $14 million when compared to 2013, was again driven by increased development. Interest revenue decreased by $.06 million to $.213 million due to continuing low market rates, and debt costs increased by $4.1 million due to additional debt service requirements tied to the 2013 bond issue and new Pennvest loans.

Total operating expenses increased in 2014 to $125.77 million compared to $109.25 million in 2013. Significant operating expenses included the following factors:

- Salary and employee benefit expenses were up $1.2 million or 7%. The increase is attributed to an average salary rate increase of 3% and a 9% 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) represents Local 2719 [white-collar] employees and Local 2037 [foremen]. A new three-year agreement with AFSCME became effective January 1, 2014 and will expire December 31, 2016. A four-year agreement with the PJCBC became effective January 1, 2013, and expires December 31, 2016.

- Overall direct operating expenses, excluding salaries and benefits, increased by $10.26 million to $64.87 million in 2014 or 19% from $54.61 million in 2013. Wastewater treatment expense increased by $6.81 million or 15% to $52.78 million when compared to $45.97 million in 2013, due to ALCOSAN's rate increase. Chemicals expense increased by $.323 million over 2013. Equipment expenses decreased by $.200 million. Repairs & maintenance increased by $2.6 million from 2013, primarily due to a $2.4 million increase in surface restoration caused by harsh winter weather. Field inspection expenses increased by $.387 million due to increased Authority and developer projects in 2014.

- Overall G&A expenses increased 23.6%, to $17.47 million from $14.14 million in 2013. Significant expense reductions were a $.126 million drop in contingencies, $.136 in computer software, and a $.249 million reduction in legal. Significant expense increases were $1.48 million in consultants, $.201 million in electric, $.114 million in claims, and a $.264 million increase in bad debt.

- Overall other expenses increased 7.1% or $4.12 million to $61.98 million in 2014 from $57.86 million in 2013. Non-city water subsidy to Pennsylvania American Water Company (PAWC) increased 41% or $.838 million to $2.88 million in 2014 compared to $2.04 million in 2013. Expense on long-term debt increased 21.7% or $6.14 million to $34.46 million in 2014 compared to $28.32 million in 2013. Debt credit facility and liquidity fees decreased $1.63 million to $2.16 million in 2014, down from $3.79 million in the prior year.

- In 2014, cash collections increased by $16.1 million, with $156.7 million collected from billings compared to $140.6 million in 2013. A decrease in average water usage due to conservation by customers and a mild summer resulted in reduced overall water sales. The Authority collection percentage also dropped slightly from previous year due to startup issues with the new CSM collections module. The Authority looks to return to historic collections levels in 2015.

Other 2014 highlights include:

- In early 2012, the Authority decided to engage an outside management company to direct its operations. After an extensive search, the Authority selected and engaged Veolia Water North America (Veolia), a subsidiary of Veolia Environnement S.A., the world's largest supplier of water services. Veolia was engaged for a one-year period beginning in July 2012, with an optional six-month renewal available at the Authority's discretion. Said extension was granted in mid-2013. The agreement was extended further through December of 2014 and again through 2015 with two optional six-month renewals for 2016.

- As part of the engagement of Veolia to manage the Authority, diagnostic studies were performed by Veolia of operations and expenditures. As a result of these evaluations, a number of operational improvement initiatives (known as Key Performance Indicators) and monetary efficiency initiatives (known as Opex Initiatives) were developed and presented to the Authority. It was felt that with implementation of these initiatives, as approved by the Authority, significant operational efficiencies and cost savings would be reached. In 2014, Veolia received approximately $3.1 million in shared savings and operational improvement performance payments from these initiatives. The Authority did generate millions in expense savings and additional revenues per the terms of these initiatives.

- In 2010, it was decided to award a new Enterprise Resource Program (ERP) contract to Cogsdale Corporation, a Microsoft Dynamics Gold partner. The implementation proceeded in 2011, with the Finance module going live in January 2012. Work was ongoing in 2012 and 2013 for implementing Cogsdale's Customer Service Module (CSM), which went live in late 2013. Additional CSM module implementation continued through 2014, with substantial completion by year-end.

- 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. JTS collected for the Authority $1.51 million during 2014.

- In January of 2010, the Authority began assessing a 5% Distribution Infrastructure System Charge (DISC) on all bills, increasing 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 make expenditures from monies so received. 2014 revenues for DISC charges were $6.62 million. The expenditures for 2014 included water and sewer relays, catch basin replacement, and manhole, catch basin, and sewer line point repair.

- The Authority has become increasingly focused on the environmental impact that excess storm water and sewage from combined sewer overflows during heavy rainfall events has on Pittsburgh's rivers and streams. PWSA believes the most cost effective and beneficial tactic for addressing this issue is a holistic "green first" option involving green infrastructure (GI) and integrated watershed planning within an adaptive management process. The City of Pittsburgh and PWSA are working together in the spirit of intergovernmental cooperation to achieve full compliance with the requirements of the Federal Clean Water Act and the Pennsylvania Clean Streams Act by incorporating GI into water quality solutions where feasible while striving to engage the community, encourage economic development, and provide environmental leadership. The Authority in 2014 created new positions in its engineering department to address the full range of technical, institutional, and public outreach issues associated with this process.

- The PWSA's Green Infrastructure department and select GI projects in 2014 have been funded in part from a variety of federal, state, and local grants. The additional staff dedicated to the GI program is supported with a total of $.238 million in funds awarded by the R. K. Mellon Foundation, the Pittsburgh Foundation, Colcom, and Heinz Endowments. GI storm water management projects in Squirrel Hill and Schenley Park have been made possible with over $.45 million in grants from the EPA and matching support from ALCOSAN. Other support for GI projects has been garnered from partnerships with agencies such as the Pittsburgh Parks Conservancy, Penn State Center, US Army Corps of Engineers, and a variety of local community development organizations.

- In order to reduce costs and add operational efficiencies to its construction management and payment processes for capital and operations projects, the Authority decided to purchase and implement the use of e-Builder, a leading web-based construction management software platform. The project was begun in early fall 2014 and the first phase went live at the start of 2015. In addition to management and payment benefits, it is felt that this software will also assist in limiting potential future change orders on Authority projects.

- The Authority in 2014 recognized that its existing Advanced Meter Infrastructure (AMI) was over 15 years old and was in need of upgrade and/or replacement. It was decided in spring of 2014 to replace the existing technology with a new system provided by Sensus USA, Inc. The cost of $7.5 million for the new system will be paid over a 15-year period from operations. As of the end of 2014, roughly 72,000 Meter Interface Units (MIUs) had been replaced, with full system functionality projected by midsummer 2015.

- Debt service coverage in 2014 was 1.83 in 2014 and 1.99 in 2013. These coverage factors exceed the 1.2 coverage factor required under the bond covenant.

- The Authority expended $24.58 million on Bond and Pennvest capital projects in 2014, an increase of $11.70 million over the $12.88 million expended in 2013. Of $42.29 million budgeted in Pennvest loans, $22.03 million was spent in prior years, $6.1 million was spent in 2014, and $14.16 million of approved funding remained available. The Authority increased its capital project proceeds with the issuance of the $75 million 2013 bond issue, spending $18.48 million, with $38.16 million in addition encumbered at year-end. The above 2013 bond expenditures include $4.58 million in reimbursement to the DISC program for funding of projects that would have historically been paid for with capital dollars.

- There was a significant event regarding bond-related activity for the Authority in 2014. During November 2014, the Authority terminated the original 2008 Series 2008 C-1A, C-1B, C-1C, and C-2 swaps and reissued and restructured to bear interest based upon 70% of one month LIBOR. Those derivative instruments had an aggregate fair value of ($9,471,392), which is considered a swap borrowing from the counterparty. This fair value reduction was recognized as a one-time non-operating expense in 2014 and will be amortized over the remaining life of the bonds as a reduction in interest expense. Further activity included renewal of Liquidity facilities on the 2008 D-2 Series bonds for three years.

- 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 Long-Term Control Plan to address combined and sanitary sewer overflows required under the order was submitted on schedule on July 31, 2013 and the Authority had not received a response through year-end 2014.

  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 2014. 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 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 the financial status of the City of Pittsburgh. Any other actions by the City of Pittsburgh to increase Authority funding would require Board approval.

CONDENSED FINANCIAL STATEMENTS

CONDENSED STATEMENT OF NET POSITION

(Dollars expressed in thousands)

	December 31,		Variance	
	2014	2013	Dollars	%
Capital assets:			Increase (Decrease)	
Producing assets	**$ 563,949**	**$ 547,726**	$ 16,223	2.96%
Construction in progress	**31,233**	**24,105**	7,128	29.57%
Restricted assets	**85,868**	**97,557**	(11,689)	-11.98%
Current assets	**58,930**	**57,705**	1,225	2.12%
Total Assets	**739,980**	**727,093**	12,887	1.77%
Total Deferred Outflows of Resources	**100,681**	**59,146**	41,535	70.22%
Liabilities:				
Current liabilities	**60,488**	**52,994**	7,494	14.14%
Long-term liabilities	**839,303**	**788,379**	50,924	6.46%
Total Liabilities	**899,791**	**841,373**	54,818	6.94%
Net Position:				
Net investment in capital assets	**(51,220)**	**(55,316)**	4,096	7.40%
Restricted for capital activity and debt service	**9,130**	**9,125**	5	0.05%
Unrestricted	**(17,040)**	**(8,943)**	(8,097)	-90.54%
Total Net Position	**$ (59,130)**	**$ (55,134)**	$ (3,996)	-7.25%

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

(Dollars expressed in thousands)

	Year Ended December 31,		Variance	
	2014	2013	Dollars	%
			Increase (Decrease)	
Operating Revenues	**$ 164,255**	**$ 142,657**	$ 21,598	15.14%
Operating Expenses:				
Direct operating	**48,647**	**40,667**	7,980	19.62%
Wastewater treatment	**52,782**	**45,969**	6,813	14.82%
Cooperation Agreement	**7,150**	**7,150**	-	0.0%
Subsidy of non-customer City residents	**2,875**	**2,037**	838	41.14%
Depreciation	**14,312**	**13,431**	881	6.56%
Total Operating Expenses	**125,766**	**109,254**	16,512	15.11%
Operating Income	**38,489**	**33,403**	5,086	15.23%
Non-operating revenues (expenses):				
Donated property	**14,708**	**616**	14,092	2,287.66%
Interest revenue	**213**	**278**	(65)	-23.38%
Interest expense and other	**(57,406)**	**(23,673)**	(33,733)	142.50%
Total Non-operating Revenues (Expenses)	**(42,485)**	**(22,779)**	-19,706	86.51%
Net Gain/(Loss)	**$ (3,996)**	**$ 10,624**	$ -14,620	-137.61%

Financial Condition

The Authority's financial condition in 2014 remained stable for a twelfth consecutive year. Water utility revenues increased to $105.25 million from $93.05 million. The rate increase effective January 2015 as implemented in 2013 should have a positive impact on utility revenue and unrestricted cash. Total cash and cash equivalents stood at $105.03 million at year-end 2014. Investment interest rates remain historically low, impacting return on reserves invested.

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 its finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Executive Director, Penn Liberty Plaza I, 1200 Penn Ave., Pittsburgh, PA 15222.

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET POSITION

(Dollars expressed in thousands)

DECEMBER 31, 2014 AND 2013

Assets	2014	2013
Current assets:		
Cash and cash equivalents	$ 31,219	$ 33,756
Accounts receivable, net:		
Water:		
Billed	8,353	7,578
Unbilled	5,292	5,001
Total water	13,645	12,579
Wastewater treatment:		
Billed	5,919	4,994
Unbilled	3,700	2,924
Total wastewater treatment	9,619	7,918
Other receivables	739	789
Total accounts receivable, net	24,003	21,286
Prepaid expenses	496	433
Inventory	3,212	2,230
Total current assets	58,930	57,705
Noncurrent assets:		
Restricted assets:		
Cash and cash equivalents	73,814	85,913
Investments	12,054	11,644
Total restricted assets	85,868	97,557
Capital assets, not being depreciated	31,233	24,105
Capital assets, net of accumulated depreciation	563,949	547,726
Total noncurrent assets	681,050	669,388
Total Assets	739,980	727,093
Deferred Outflows of Resources		
Deferred charge on refunding	30,501	33,329
Accumulated decrease in fair value of hedging derivatives	70,180	25,817
Total Deferred Outflows of Resources	100,681	59,146

(Continued)

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

PITTSBURGH WATER AND SEWER AUTHORITY

STATEMENTS OF NET POSITION

(Dollars expressed in thousands)

DECEMBER 31, 2014 AND 2013

(Continued)

	2014	2013
Liabilities		
Current liabilities:		
Bonds and loans payable, current	20,993	19,264
Accrued payroll and related obligations	656	747
Accounts payable wastewater treatment	18,148	16,068
Accounts payable and other accrued expenses	6,595	5,900
Accounts payable from restricted assets	4,457	3,579
Accrued interest payable from restricted assets	9,639	7,436
Total current liabilities	60,488	52,994
Noncurrent liabilities:		
Unearned revenue	228	249
Accrued payroll and related obligations	1,129	614
Swap liability	87,197	32,404
Bonds and loans payable, net of current portion	750,749	755,112
Total noncurrent liabilities	839,303	788,379
Total Liabilities	899,791	841,373
Net Position		
Net investment in capital assets	(51,220)	(55,316)
Restricted for capital activity and debt service	9,130	9,125
Unrestricted	(17,040)	(8,943)
Total Net Position	$ (59,130)	$ (55,134)

(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 POSITION

(Dollars expressed in thousands)

YEARS ENDED DECEMBER 31, 2014 AND 2013

	2014	2013
Operating Revenues:		
Residential, commercial, and industrial water sales	$ 105,252	$ 93,052
Wastewater treatment	54,357	46,969
Other	4,646	2,636
Total operating revenues	164,255	142,657
Operating Expenses:		
Direct operating expenses	48,647	40,667
Wastewater treatment	52,782	45,969
Cooperation agreement operating expenses:		
Indirect cost allocation - sewer conveyance	3,000	3,000
Indirect cost allocation - water	4,150	4,150
Expense of water provided by other entities:		
Subsidy of customers located in the City	2,875	2,037
Depreciation	14,312	13,431
Total operating expenses	125,766	109,254
Operating Income	38,489	33,403
Non-operating Revenues (Expenses):		
Donated property	14,708	616
Interest revenue	213	278
Investment income - change in fair market value of swap	(10,294)	11,564
Swap termination	(9,471)	-
Interest and amortization - bonds	(37,146)	(33,053)
Interest expense - other	(495)	(510)
Bond issuance costs	-	(1,674)
Total non-operating revenues (expenses)	(42,485)	(22,779)
Net Income (Loss)	(3,996)	10,624
Net Position:		
Beginning of year	(55,134)	(65,758)
End of year	$ (59,130)	$ (55,134)

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, 2014 AND 2013

	2014	2013
Cash Flows From Operating Activities:		
Cash received from customers	$ 161,538	$ 142,419
Cash paid to suppliers and employees and customer refunds	(47,716)	(40,878)
Cash paid to City of Pittsburgh under the Cooperation Agreement	(7,150)	(7,150)
Cash paid to other water companies for subsidy of customers located in the City of Pittsburgh	(2,875)	(2,037)
Cash paid to ALCOSAN for wastewater treatment	(50,702)	(47,142)
Net cash provided by (used in) operating activities	53,095	45,212
Cash Flows From Investing Activities:		
Purchase of investment securities	(59,410)	(126,025)
Proceeds from sale and maturities of investment securities	59,607	137,838
Interest income	213	278
Net cash provided by (used in) investing activities	410	12,091
Cash Flows From Capital and Related Financing Activities:		
Purchase/construction of property, plant, and equipment	(22,955)	(21,439)
Proceeds from issuance of revenue bonds	-	216,910
Proceeds from Pennvest Loans	4,963	2,537
Payment made for bond issuance and reoffering costs	-	(1,674)
Principal payments on debt	(19,249)	(144,184)
SWAP receipts	171	396
SWAP payments	(13,418)	(16,669)
Liquidity and remarketing fees	(2,630)	(4,643)
Interest paid on borrowings	(15,023)	(11,393)
Net cash provided by (used in) capital and related financing activities	(68,141)	19,841
Increase (Decrease) in Cash and Cash Equivalents	(14,636)	77,144
Cash and Cash Equivalents:		
Beginning of year	119,669	42,525
End of year	$ 105,033	$ 119,669
Consists of:		
Restricted cash and cash equivalents	$ 73,814	$ 85,913
Unrestricted cash and cash equivalents	31,219	33,756
	$ 105,033	$ 119,669
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities:		
Operating income	$ 38,489	$ 33,403
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Depreciation	14,312	13,431
Reserve for uncollectible amounts	264	(1,012)
Change in:		
Accounts receivable - water and wastewater	(3,031)	796
Other accounts receivable	50	(22)
Prepaid expenses	(63)	(161)
Inventory	(982)	(478)
Accounts payable wastewater treatment	2,080	(1,173)
Accounts payable and other accrued expenses	1,573	552
Accrued payroll and related obligations	424	(102)
Unearned revenue	(21)	(22)
Net cash provided by (used in) operating activities	$ 53,095	$ 45,212
Schedule of non-cash capital and related financing activities		
Donated property	$ 14,708	$ 616

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, changes in net position, and cash flows of the Authority. The Authority is a component unit of the City in accordance with applicable guidance. 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 the Governmental Accounting Standards Board (GASB). Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

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

Classification of Net Position

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 position is classified into three components – net investment in capital assets; restricted; and unrestricted. These classifications are defined as follows:

- Net investment in capital assets – This component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt are also included in this component of net position. If there are significant unspent related debt proceeds or deferred inflows of resources at the end of the reporting period, the portion of the debt or deferred inflows of resources attributable to the unspent amount is not included in the calculation of net investment in capital assets. Instead, that portion of the debt or deferred inflow of resources is included in the same net position component (restricted or unrestricted) as the unspent amount.
- Restricted – This component of net position consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.
- Unrestricted – This component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted components of net position.

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.

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.

Premiums and Discounts

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 position as a decrease to bonds payable.

Deferred Refunding Loss

In accordance with applicable guidance, the excess of the reacquisition price over the net carrying amount of refunded debt is recorded as a deferred outflow of resources on the statements of net position and amortized as a component of interest expense over the shorter of the term of the refunding issue or refunded bonds.

Remarketing, Liquidity, and Letter of Credit Fees

Associated with the Authority's variable rate bonds, the Authority pays various fees to periodically remarket the bonds and to 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 capital 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 value based on what it would have cost the Authority to construct the asset, 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.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position reports a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense) until then.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflow of resources*, represents an acquisition of net position that applies to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time. The Authority's financial statements currently do not include that element.

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.

Reclassification

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

Pending Pronouncements

GASB has issued Statement No. 68, *"Accounting and Financial Reporting for Pensions,"* effective for fiscal years beginning after June 15, 2014. This statement revises existing guidance for the financial reports of most pension plans, and establish new financial reporting requirements for most governments that provide their employees with pension benefits.

GASB has issued Statement No. 71, *"Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68,"* effective for financial statements for periods beginning after June 15, 2014. This statement addresses an issue regarding Statement No. 68 relating to amounts associated with contributions, if any, made by a state or local government employer or nonemployers contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability.

GASB has issued Statement No. 72, *"Fair Value Measurement and Application,"* effective for financial statements for periods beginning after June 15, 2015. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

The impact of the effect of the implementation of these statements on the Authority's financial statements has not yet been determined. Please refer to Note 3 below for further discussion about pension benefits for Authority employees.

3. TRANSACTIONS WITH THE CITY OF PITTSBURGH

During July 1995 the City and the Authority 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 2014 and 2013 payroll of $13,992 and $13,213, respectively, was covered by the Plan. Employee contributions for the years 2014 and 2013 amounted to $515 and $514, respectively.

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 2014 Minimum Municipal Obligation calculated for the City’s Plan indicated a 2014 normal cost of $700 associated with Authority employees that participate in the City’s Plan. The Authority estimates that the normal cost for 2014, together with other elements of expense for employee service during 2014 would not exceed the sum of the 2014 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 on an analytical review of projected monthly active accounts receivables balances, is recognized coincident with recognition of revenue. At December 31, 2014 and 2013, the reserve for uncollectible water accounts was approximately $13.22 million and $13.07 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. 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 position and the statements of net position, respectively. At December 31, 2014 and 2013, the reserve for uncollectible wastewater accounts was approximately $5.76 million and $5.65 million, respectively.

(Dollars expressed in thousands unless otherwise indicated)

5. Capital Assets

Capital assets consisted of the following at December 31, 2014 and 2013:

	Balance at January 1, 2014	Additions	Reclassifications/ Transfers	Balance at December 31, 2014
Capital assets not being depreciated:				
Construction in progress	$ 24,105	$ 22,276	$ (15,148)	$ 31,233
Capital assets being depreciated:				
Utility assets	772,596	30,365	-	802,961
Non-utility assets	21,950	170	-	22,120
Total capital assets being depreciated	794,546	30,535	-	825,081
Total capital assets	818,651	52,811	(15,148)	856,314
Accumulated depreciation	(246,820)	(14,312)	-	(261,132)
Capital assets, net	$ 571,831	$ 38,499	$ (15,148)	$ 595,182

	Balance at January 1, 2013	Additions	Reclassifications/ Transfers	Balance at December 31, 2013
Capital assets not being depreciated:				
Construction in progress	$ 48,681	$ 21,733	$ (46,309)	$ 24,105
Capital assets being depreciated:				
Utility assets	728,275	44,321	-	772,596
Non-utility assets	20,038	1,912	-	21,950
Total capital assets being depreciated	748,313	46,233	-	794,546
Total capital assets	796,994	67,966	(46,309)	818,651
Accumulated depreciation	(233,389)	(13,431)	-	(246,820)
Capital assets, net	$ 563,605	$ 54,535	$ (46,309)	$ 571,831

(Dollars expressed in thousands unless otherwise indicated)

During 2014 and 2013, the Authority received donated utility assets of $14,708 and $616, respectively, related to various development projects.

6. Payroll and Related Obligations

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

	Balance at December 31, 2013	Change	Balance at December 31, 2014	Current Portion
Compensated absences	$ 645	$ (6)	$ 639	$ 14
Workers' compensation	91	413	504	-
Payroll, withholdings, and taxes	625	88	642	642
	$ 1,361	$ 495	$ 1,785	$ 656

	Balance at December 31, 2012	Change	Balance at December 31, 2013	Current Portion
Compensated absences	$ 661	$ (16)	$ 645	$ 31
Workers' compensation	265	(174)	91	91
Payroll, withholdings, and taxes	537	88	625	625
	$ 1,463	$ (102)	$ 1,361	$ 747

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, 2014 and 2013 is $41,245 and $59,915, 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, 2014 and 2013, the remaining unamortized deferred refunding loss of $377 and $405, respectively, on the transaction is shown as a deferred outflow of resources and will be amortized through 2037.

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 ranging from $2.3 million to $26.9 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.

The 1998B Bonds at December 31, 2014 and 2013, have carrying amounts of approximately $77 million and $73 million, respectively.

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

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, 2014 and 2013, the remaining unamortized deferred refunding loss is $1,296 and $1,396, respectively. The remaining unamortized deferred refunding loss at December 31, 2014 and 2013 represents only the portion related to the Series 2007 A bonds, as the Series 2007 B-1 and B-2 were currently refunded during 2013. At December 31, 2014 and 2013, the principal of the defeased 2005 Bonds outstanding was $40,845 and $42,055, respectively.

The 2007 A 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.

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 A Bonds at December 31, 2014 and 2013, have carrying amounts of approximately $16 million and $20 million, respectively.

<u>Series 2008</u>

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

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

In connection with these advance refundings, portions of the proceeds of the 2008 Bonds were deposited into irrevocable trusts with an escrow agent to provide for certain debt service payments on the refunded bonds. The advance refunding resulted in a deferred refunding loss of $18,119, which is amortized as an adjustment to interest expense over the life of the 2008 Bonds using the effective interest method. At December 31, 2014 and 2013, the remaining unamortized deferred refunding loss was $12,566 and $12,436, respectively, and the transaction is shown as a deferred outflow of resources and will be amortized through 2037.

At December 31, 2014 and 2013, the principal of the defeased 2003 Bonds outstanding was $17,700 and $26,130, respectively. The maturity value of defeased 1998B compound interest bonds outstanding at December 31, 2014 and 2013 was $19,800.

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.

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. The reoffering did not change the interest rate mode on these variable rate bonds. During 2013, the Series B-1 letter of credit ($72,750,000) was renewed for five years with Bank of America and will expire on October 21, 2018. During 2013, the Series B-2 letter of Credit ($72,745,000) was renewed with Royal Bank of Canada for three years and will expire on October 21, 2016.

During August 2011, the 2008 Series C-1-A, B and C bonds were reoffered. The bonds were reoffered at a term rate of .45% through September 2012. During August 2012, the 2008 Series C-1-A, B and C bonds were again reoffered. The bonds were reoffered at a term rate of .40% through September 2013.

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. During August 2012, the C1-D Series were again reoffered. The bonds were reoffered at a term rate of 1.40% through August 2015.

During September 2013, the 2008 Series C-1A, B and C bonds were converted and reoffered. The bonds were converted to index interest rate mode. The 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 2014, the 2008 Series C-1A, B, C, and C-2 were reissued and restructured to bear interest based upon 70% of one-month LIBOR. The fixed rate was amended from 3.998% to 3.50%. Liquidity facilities provided by Bank of America Merrill Lynch (C-1A, 1B, 1C) and JP Morgan Chase (C-2) were also renewed as of November 3, 2014.

Liquidity facilities provided by PNC on the 2008 D-2 Series bonds were renewed as of July 9, 2014.

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.

The 2008 Bonds at both December 31, 2014 and 2013 have carrying amounts of approximately $414 million.

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.

Series 2013

During December 2013, the Authority issued $130,215 Series A First Lien Revenue Refunding Bonds ("2013 Series A Bonds"), the proceeds of which were used to defease through current refunding the entire balance of the Series 2003, Series 2007 B-1, and Series 2007 B-2 and pay certain amounts in respect of termination of certain interest rate swap agreement related to the Series 2007 B-1 and B-2 bonds; $86,695 Series B First Lien Revenue Bonds ("2013 Series B Bonds"), the proceeds of which are to fund certain water and sewer system capital improvement projects and reimburse the Authority for certain capital expenditures paid for by the Authority. In connection with the debt refundings and swap termination, the Authority recorded a deferred refunding loss of $16,389, which is being amortized as an adjustment to interest expense over the life of the bonds. At December 31, 2014 and 2013, the remaining unamortized deferred refunding loss was $14,750 and $16,389, respectively, and the transaction is shown as a deferred outflow of resources and will be amortized through 2023. The refunding was completed to reduce the Authority's debt service payments over the next 20 years by approximately $813 and to obtain an economic gain (difference between present values of old and new debt service payments) of $844.

The 2013 Bonds were issued at a bond premium of $14,828, which is being amortized as an adjustment to interest expense over the life of the bonds.

The 2013 Bonds at December 31, 2014 and 2013 have carrying amounts of approximately $205 million and $217 million, respectively.

(Dollars expressed in thousands unless otherwise indicated)

Swap Borrowing

During November 2014, the Authority terminated the original 2008 Series 2008 C-1A, C-1B, C-1C and C-2 swaps and reissued and restructured to bear interest based upon 70% of one month LIBOR. Those derivative instruments had an aggregate fair value of ($9,471,392), which is considered a swap borrowing from the counterparty.

Bonds, state loans payable (PENNVEST) and swap borrowing consisted of the following at December 31, 2014 and 2013:

	Balance at December 31, 2013	Additions	Reductions	Balance at December 31, 2014
Bonds and loans payable:				
Revenue bonds	$ 724,296	$ 3,941	$ (16,615)	$ 711,622
State loans (PENNVEST)	33,316	4,963	(2,634)	35,645
Swap borrowing	-	9,471	(136)	9,335
	757,612	18,375	(19,385)	756,602
Unamortized bond (discount) premium	16,764	25	(1,649)	15,140
Total bonds and loans	$ 774,376	$ 18,400	$ (21,034)	$ 771,742

	Balance at December 31, 2012	Additions	Reductions	Balance at December 31, 2013
Bonds and loans payable:				
Revenue bonds	$ 644,545	$220,651	$ (140,900)	$ 724,296
State loans (PENNVEST)	34,063	2,537	(3,284)	33,316
	678,608	223,188	(144,184)	757,612
Unamortized bond (discount) premium	1,813	15,150	(199)	16,764
Total bonds and loans	$ 680,421	$238,338	$ (144,383)	$ 774,376

(Dollars expressed in thousands unless otherwise indicated)

Debt service payments of the State Loans at December 31, 2014 are as follows:

	State Loans		
	Principal	Interest	Total
2015	$ 2,848	$ 480	$ 3,328
2016	2,949	546	3,495
2017	2,993	559	3,552
2018	3,056	497	3,553
2019	3,120	432	3,552
2020-2024	13,799	1,218	15,017
2025-2029	5,495	280	5,775
2030-2034	1,315	37	1,352
2035	70	1	71
	$ 35,645	$ 4,050	$ 39,695

Debt service payments on the 1998, 2007A, 2008, and 2013 Bonds at December 31, 2014 are as follows:

	Revenue Bonds		
	Principal	Interest	Total
2015	$ 18,145	$ 29,643	$ 47,788
2016	18,700	28,944	47,644
2017	17,714	29,710	47,424
2018	18,572	28,756	47,328
2019	19,454	27,765	47,219
2020-2024	112,088	123,555	235,643
2025-2029	62,044	193,180	255,224
2030-2034	143,209	84,662	227,871
2035-2039	195,325	33,882	229,207
2040	61,794	1,308	63,102
	667,045	$ 581,405	$ 1,248,450
Accretion	44,577		
Total	$ 711,622		

(Dollars expressed in thousands unless otherwise indicated)

Amortization on the swap borrowing is as follows.

Year Ending December 31,	Principal	Interest
2015	$ 423	$ 199
2016	432	190
2017	441	181
2018	451	171
2019	461	161
2020-2024	2,458	652
2025-2029	2,736	374
2030-2034	1,916	89
2035	17	1
	$ 9,335	$ 2,018

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, 2014 and 2013 on bonds and loans payable, exclusive of capitalized interest and amortization of refunding losses, was approximately $32 million and $30 million, respectively. Interest costs for 2014 and 2013 included $2.8 million and $1.2 million, respectively, of amortization of the deferred refunding losses.

In accordance with the provisions of the trust indentures for the 1998, 2007A, 2008, and 2013 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 position as “Restricted Assets,” at December 31, 2014 and 2013 was:

	2014	2013
Capital project funds	$ 61,317	$ 75,057
Debt service and reserve funds	15,421	13,375
Operating reserve account	8,550	8,545
Other funds	580	580
	$ 85,868	$ 97,557

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, 2014, the Authority was in compliance with this covenant.

8. Interest Rate Swaps

Interest rate swaps disclosures (not in thousands) as of December 31, 2014 and 2013 are presented below.

Interest rate swaps at December 31, 2014 and 2013:

(Dollars expressed in thousands unless otherwise indicated)

Current 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:							
$ 72,747,500	6/12/2008	9/1/2039	4.038%	SIFMA	A-	Series 2008 B-1	
41,464,000	6/12/2008	9/1/2035	3.998%	SIFMA	A-	Series 2008 C	*
41,464,000	11/3/2014	9/1/2035	2.000%	70% 1moLIBOR	A-	Series 2008 C	**
72,747,500	6/12/2008	9/1/2039	4.038%	SIFMA	A+	Series 2008 B-2	
71,225,000	6/12/2008	9/1/2040	4.103%	SIFMA	A+	Series 2008 D-2	
Investment derivatives, Receive variable - pay fixed, Interest rate swap:							
62,196,000	6/12/2008	9/1/2035	3.998%	SIFMA	A+	Series 2008 C	*
62,196,000	11/3/2014	9/1/2035	3.500%	70% 1moLIBOR	A+	Series 2008 C	**

* - This swap was restructured and reissued during November 2014.

** - This swap is the on-market component of the 2008 C hybrid investment and reflects the on-market rate as of November 3, 2014, the date of reissuance/restructuring of the underlying bonds.

Interest Rate Swap – Market Value Information:

Notional Amount	12/31/2012 Market Value *	Change in Market Value	12/31/2013 Market Value *	Change in Market Value	Swap Termination Loss	12/31/2014 Market Value *
Hedging derivatives, Cash flow hedges, Receive variable - pay fixed, Interest rate swaps:						
$ 72,747,500	$ (22,531,047)	$ 15,433,746	$ (7,097,301)	$ (15,226,080)	$ -	$ (22,323,381)
41,464,000	(12,100,478)	7,709,524	(4,390,954)	(5,080,438)	(9,471,392)	-
41,464,000	-	-	-	(1,873,220)	-	(1,873,220)
72,747,500	(22,531,047)	15,433,746	(7,097,301)	(15,226,080)	-	(22,323,381)
71,225,000	(23,405,311)	16,173,505	(7,231,806)	(16,427,968)	-	(23,659,774)
	(80,567,883)	54,750,521	(25,817,362)	(53,833,786)	(9,471,392)	(70,179,756)
Investment derivatives, Receive variable - pay fixed, Interest rate swap:						
62,196,000	(18,150,717)	11,564,286	(6,586,431)	(10,430,488)	-	(17,016,919)
Total	$ (98,718,600)	$ 66,314,807	$ (32,403,793)	$ (64,264,274)	$ (9,471,392)	$ (87,196,675)

* 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.

During November 2014, the 2008 Series C Bonds were reissued and restructured to bear interest based upon 70% of one-month LIBOR. In conjunction with this reissuance/restructuring, the floating rate on the Series 2008 C swaps was converted from SIFMA to 70% of one-month LIBOR and the fixed rate was amended from 3.998% to 3.50%. With respect to the Series 2008 C swap treated as an effective hedge, this "off-market" swap is considered to be a hybrid instrument consisting of an on-market swap and a borrowing. The on-market swap rate is calculated as of the date of reissuance. The borrowing will be amortized over the remaining life of the swap and is included in bonds and loans payable on the statement of net position. See Note 7: Bonds and Loans Payable for detail on the borrowing.

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 as noted in the chart above.

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 was 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 accrued 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 received SIFMA Municipal Swap Index while paying a fixed rate of 3.932%.

The interest payments on the interest rate swaps were 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.

On December 11, 2013, PWSA terminated the two 2007 interest rate swaps as part of refunding the underlying bonds. PWSA made termination payments of $6,180,000 for the 2007 B-1 swap and $6,195,000 for the 2007 B-2 swap. The termination payments were accounted for as part of the deferred refunding loss on the refunding transaction.

Accounting and Risk Disclosures

During the years ended December 31, 2014 and 2013, the Authority paid $13,418 and $16,699, respectively, fixed and received $171 and $396, 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 position 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 position as a component of investment income.

The cumulative fair market value of the outstanding interest rate swaps of December 31, 2014 and 2013 are reported on the statements of net position 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, 2014.

  <u>Concentration of credit risk:</u> The Authority currently has two counterparties, with three and two outstanding interest rate swaps, respectively. The Authority's outstanding market value as of December 31, 2014 and 2013, respectively, is $(63,000,074) and $(20,915,538) with one counterparty and $(24,196,601) and $(11,488,255) 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. As noted above, the Authority terminated two interest rate swaps on December 11, 2013 as part of refunding the underlying variable rate bonds. During 2014, 2008 C swaps were terminated and reissued.

- 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, 2014 and 2013, 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, 2014 and 2013, \$31,030 and \$33,097, respectively, of the Authority's bank balance of \$32,030 and \$34,097, respectively, was exposed to custodial credit risk. \$12,580 and \$15,193 of these amounts exposed to custodial credit risk 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 $31,219 and $33,756 as of December 31, 2014 and 2013, respectively, all of which is reported as current assets in the statements of net position.

(Dollars expressed in thousands unless otherwise indicated)

In addition to the deposits noted above, included in cash and cash equivalents as non-current restricted assets on the statements of net position are money market funds of $73,814 and $85,913 at December 31, 2014 and 2013, respectively.

At December 31, 2014, the Authority held the following investment balances:

		Maturity in years
	Carrying value	Less than 1 year
Commonwealth of PA Revenue Bonds (Guaranteed Investment Contracts)	$ 8,549	$ 8,549
Money market	73,814	73,814
Fixed income	881	881
Commercial paper	2,624	2,624
Total Investments	$ 85,868	$ 85,868

At December 31, 2013, 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)	$ 8,544	$ 8,544
Money market	85,913	85,913
Fixed income	474	474
Commercial paper	2,626	2,626
Total Investments	$ 97,557	$ 97,557

The carrying value of the Authority's investments is the same as their fair market value amount. Investments of $12,054 and $11,644 are included as noncurrent restricted investments on the statements of net position at December 31, 2014 and 2013, respectively. Investments of $73,814 and $85,913 consisting of money market funds are included as noncurrent restricted cash and cash equivalents on the statement of net position at December 31, 2014 and 2013, respectively.

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, 2014 and 2013 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, 2014, the Authority's investments in the guaranteed investment contracts were rated AAA by Standard & Poor's. The counterparty to the Authority's guaranteed investment contracts is the Commonwealth of Pennsylvania. The Authority's investments in money markets were rated AAA by Standard & Poor's. The Authority's investments in both fixed income and commercial paper at December 31, 2014 were rated A-1+ by Standard & Poor's.

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. The Authority has no investments of greater than 5% with one issuer.

(Dollars expressed in thousands unless otherwise indicated)

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 Position

Net position represents the difference between assets, deferred outflows of resources, and liabilities. An analysis of net position amounts is as follows:

	December 31, 2014	December 31, 2013
Net investment in capital assets:		
Net property, plant, and equipment	$ 595,182	$ 571,831
Debt subject to capital improvements	(722,832)	(738,742)
Swap liability net of deferred outflow	(17,017)	(6,587)
Swap borrowing	(9,335)	-
Deferred charge on refunding	30,501	33,329
Accounts payable for capital items	(4,457)	(3,579)
Restricted assets:		
Unspent debt proceeds:		
Capital projects	61,317	75,057
Debt service and reserve funds	15,421	13,375
	(51,220)	(55,316)
Restricted for capital activity and debt service:		
Restricted cash and cash equivalents	73,814	85,913
Restricted investments	12,054	11,644
Liabilities related to restricted assets:		
Unspent debt proceeds:		
Capital projects	(61,317)	(75,057)
Debt service and reserve funds	(15,421)	(13,375)
	9,130	9,125
Unrestricted	(17,040)	(8,943)
Total net position	$ (59,130)	$ (55,134)

(Dollars expressed in thousands unless otherwise indicated)

11. Operating Lease

The Authority leases 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 ended December 31, 2014 are as follows:

2015	$ 616
2016	616
2017	627
2018	661
2019	661
2020-2024	3,359
2025-2027	1,882
	$ 8,422

The total annual rental for office space was approximately $645 and $644 for 2014 and 2013, 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, 2014, budgeting $75 million from the Series 2013 bond issue is committed for the 2014-2016 capital improvement program.

During July 2012, the Authority contracted with Veolia Water North America (Veolia), an outside management company to direct is operations. The term of the contract was for one year with an optional 6 month extension. Veolia was paid $150,572 per month. During July 2013, the Authority extended Veolia for an additional 18 months through December 2014 at a cost of $135,000 per month. In addition, there are various Key Performance Indicators (KPIs) and OPEX initiatives which Veolia will be paid for if or when the requirements are met. During 2014 and 2013, payments to Veolia for KPIs and OPEX totaled approximately $3.1 million and $1.1 million, respectively. During November 2014, the Authority contracted with Veolia for the term January 1, 2015 through December 31, 2015 (unless earlier terminated) with two optional 6 month extensions. Veolia will be paid between $100,000 and $120,000 per month for the calendar year 2015, $75,000 per month for the first optional 6 month extension, and $50,000 per month for the second optional 6 month extension.

In addition to the matters discussed below and 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 $580. This fund is grouped with "Restricted Assets" on the statements of net position. During 2014 and 2013, the Authority paid $0 from this fund for claims, and there is $0 accrued as of December 31, 2014 and 2013.

During 2013, a complaint was filed against the Authority arising out of a flooding incident that occurred in August 2011 on Washington Boulevard, at the intersection of Negley Run Road and Allegheny River Boulevard in the City of Pittsburgh. The plaintiffs have asserted the Authority was negligent in the maintenance and operations of the sewer lines beneath Washington Boulevard. The Authority has recorded a provision for their liability limitation on the statement of net position.

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. 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. The Authority hired two engineering firms to assess and model the sewer system, and submitted its plans to comply with the Order to DEP in July of 2013 as required. The Authority, along with the other impacted local municipalities, is awaiting a response from DEP on its proposed plan. 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

COMBINING STATEMENT OF NET POSITION

(Dollars expressed in thousands)

DECEMBER 31, 2014

	Water	Sewer	Sewer Treatment	Admin	Elimination	Total
Assets						
Current assets	$ 8,641	$ 6,598	$ 9,619	$ 700,228	$ (666,156)	$ 58,930
Noncurrent assets	339,054	300,294	-	41,702	-	681,050
Total Assets	347,695	306,892	9,619	741,930	(666,156)	739,980
Deferred Outflows of Resources						
Deferred charge on refunding	-	-	-	30,501	-	30,501
Accumulated decrease in fair value of hedging derivatives	-	-	-	70,180	-	70,180
Total Deferred Outflows of Resources	-	-	-	100,681	-	100,681
Liabilities						
Current liabilities	347,695	306,892	9,619	62,438	(666,156)	60,488
Noncurrent liabilities	-	-	-	839,303	-	839,303
Total Liabilities	347,695	306,892	9,619	901,741	(666,156)	899,791
Net Position						
Net investment in capital assets	-	-	-	(51,220)	-	(51,220)
Restricted for capital activity and debt service	-	-	-	9,130	-	9,130
Unrestricted	-	-	-	(17,040)	-	(17,040)
Total Net Position	$ -	$ -	$ -	$ (59,130)	$ -	$ (59,130)

Note - The elimination column is used to remove the gross up of the related current assets and liabilities used to balance the Water, Sewer and Sewer Treatment Funds. The Authority records deferred outflows, payables and debt service in the admin fund rather than allocate to the individual funds. Therefore, the Water, Sewer and Sewer treatment funds were netted to a $0 balance net position

PITTSBURGH WATER AND SEWER AUTHORITY

COMBINING STATEMENT OF NET POSITION

(Dollars expressed in thousands)

DECEMBER 31, 2013

	Water	Sewer	Sewer Treatment	Admin	Elimination	Total
Assets						
Current assets	$ 8,479	$ 5,027	$ 7,917	$ 658,532	$ (622,250)	$ 57,705
Noncurrent assets	324,385	273,716	-	71,287	-	669,388
Total Assets	332,864	278,743	7,917	729,819	(622,250)	727,093
Deferred Outflows of Resources						
Deferred charge on refunding	-	-	-	33,329	-	33,329
Accumulated decrease in fair value of hedging derivatives	-	-	-	25,817	-	25,817
Total Deferred Outflows of Resources	-	-	-	59,146	-	59,146
Liabilities						
Current liabilities	332,864	278,743	7,917	55,720	(622,250)	52,994
Noncurrent liabilities	-	-	-	788,379	-	788,379
Total Liabilities	332,864	278,743	7,917	844,099	(622,250)	841,373
Net Position						
Net investment in capital assets	-	-	-	(55,316)	-	(55,316)
Restricted for capital activity and debt service	-	-	-	9,125	-	9,125
Unrestricted	-	-	-	(8,943)	-	(8,943)
Total Net Position	$ -	$ -	$ -	$ (55,134)	$ -	$ (55,134)

Note - The elimination column is used to remove the gross up of the related current assets and liabilities used to balance the Water, Sewer and Sewer Treatment Funds. The Authority records deferred outflows, payables and debt service in the admin fund rather than allocate to the individual funds. Therefore, the Water, Sewer and Sewer treatment funds were netted to a $0 balance net position

PITTSBURGH WATER AND SEWER AUTHORITY

COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2014

	Water	Sewer	Sewer Treatment	Admin	Total
Operating Revenues	$ 74,214	$ 36,270	$ 53,629	$ 142	$ 164,255
Operating Expenses	29,431	11,775	52,782	31,778	125,766
Operating Income	44,783	24,495	847	(31,636)	38,489
Non-operating Revenues (Expenses)	-	-	-	(42,485)	(42,485)
Net Income (Loss) before operating transfers	44,783	24,495	847	(74,121)	(3,996)
Operating Transfers	(44,783)	(24,495)	(847)	70,125	-
Net Income (Loss)	-	-	-	(3,996)	(3,996)
Net Position:					
Beginning of year	-	-	-	(55,134)	(55,134)
End of year	$ -	$ -	$ -	$ (59,130)	$ (59,130)

Note - Operating transfers are used to balance the funds due to the treatment of assets and liabilties as noted on the combining statement of net position.

PITTSBURGH WATER AND SEWER AUTHORITY

COMBINING STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET POSITION

(Dollars expressed in thousands)

YEAR ENDED DECEMBER 31, 2013

	Water	Sewer	Sewer Treatment	Admin	Total
Operating Revenues	$ 69,817	$ 25,477	$ 47,011	$ 352	$ 142,657
Operating Expenses	26,121	10,384	45,969	26,780	109,254
Operating Income	43,696	15,093	1,042	(26,428)	33,403
Non-operating Revenues (Expenses)	-	-	-	(22,779)	(22,779)
Net Income (Loss) before operating transfers	43,696	15,093	1,042	(49,207)	10,624
Operating Transfers	(43,696)	(15,093)	(1,042)	59,831	-
Net Income (Loss)	-	-	-	10,624	10,624
Net Position:					
Beginning of year	-	-	-	(65,758)	(65,758)
End of year	$ -	$ -	$ -	$ (55,134)	$ (55,134)

Note - Operating transfers are used to balance the funds due to the treatment of assets and liabilties as noted on the combining statement of net position.

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

YEAR ENDED DECEMBER 31, 2014

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:		
Capitalization Grants for Drinking Water State Revolving Funds	66.468	$ 3,183,146
Capitalization Grants for Clean Water State Revolving Funds	66.458	3,185,865
Total Expenditures of Federal Awards		$ 6,369,011

See accompanying notes to schedule of expenditures of federal awards.

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 the U.S. Office of Management and Budget (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, 2014.

Pittsburgh Water and Sewer Authority

Independent Auditor's Reports
Required by OMB Circular A-133

Year Ended December 31, 2014

MaherDuessel
Certified Public Accountants
1990 | 2015 25 YEARS OF PROMOTING THE PUBLIC GOOD

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

Board of Directors
Pittsburgh Water and Sewer Authority

We have audited, in accordance with the 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, the financial statements of the Pittsburgh Water and Sewer Authority (Authority) as of and for the year ended December 31, 2014, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated April 16, 2015.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from 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.*

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Maher Duessel

Pittsburgh, Pennsylvania
April 16, 2015

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Independent Auditor's Report on Compliance for the Major Program and on Internal Control over Compliance Required by OMB Circular A-133

Board of Directors
Pittsburgh Water and Sewer Authority

Report on Compliance for the Major Federal Program

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 the Authority's major federal program for the year ended December 31, 2014. 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.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Authority's major federal program based on our audit of the types of compliance requirements referred to above. 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 the 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 on compliance for the major federal program. However, our audit does not provide a legal determination of the Authority's compliance.

Opinion on the Major Federal Program

In our opinion, the Authority complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2014.

Report on Internal Control over Compliance

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the Authority's internal control over compliance with the types of requirements that could have a direct and material effect on the major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major federal program 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. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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 over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Maher Duessel

Pittsburgh, Pennsylvania
April 16, 2015

PITTSBURGH WATER AND SEWER AUTHORITY

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED DECEMBER 31, 2014

I. Summary of Audit Results

1. Type of auditor's report issued: Unmodified

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: Unmodified

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
66.458	Capitalization Grants for Clean 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, 2014

No Findings in Prior Year