

Basic Financial Statements and Independent Auditor's Report

**City of Dallas, Texas**

**Dallas Water Utilities**

**(An Enterprise Fund of the City of Dallas)**

September 30, 2010

**City of Dallas, Texas  
Dallas Water Utilities  
(An Enterprise Fund of the City of Dallas)**

**FINANCIAL STATEMENTS**

**For Fiscal Year Ended September 30, 2010**

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The Honorable Mayor and Members of the City Council  
City of Dallas, Texas

We have audited the accompanying statement of net assets of Dallas Water Utilities Fund (the Fund), an Enterprise Fund of the City of Dallas, Texas as of September 30, 2010, and the related statements of revenues, expenses and changes in fund net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Dallas Water Utilities Fund and do not purport to, and do not, present fairly the financial position of the City of Dallas, Texas, as of September 30, 2010, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Dallas Water Utilities Fund of the City of Dallas, Texas, as of September 30, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 7 is not a required part of the Fund's financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

GRANT THORNTON LLP

Dallas, Texas  
June 10, 2011

**City of Dallas, Texas  
Dallas Water Utilities  
(An Enterprise Fund of the City of Dallas)**

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)  
September 30, 2010

As management of the Dallas Water Utilities ("DWU"), an enterprise fund of the City of Dallas, Texas ("the City"), we offer readers of the financial statements this narrative overview and analysis of the financial activities of the Dallas Water Utilities for the fiscal year ended September 30, 2010. The Dallas Water Utilities' management's discussion and analysis is designed to (1) assist the reader in focusing on significant issues, (2) provide an overview of the Dallas Water Utilities' financial activity, (3) identify changes in the Dallas Water Utilities' financial position (its ability to address the next and subsequent year challenges), and (4) identify issues or concerns. We encourage readers to consider the information presented here in conjunction with the accompanying basic financial statements. All dollar amounts, unless otherwise indicated, are expressed in thousands.

**FINANCIAL HIGHLIGHTS**

- The assets of the Dallas Water Utilities exceeded its liabilities at the close of the 2010 fiscal year by \$2.1 billion and in the 2009 fiscal year by \$2.1 billion (net assets). Of this amount, \$64.5 million in fiscal year 2010 and \$60.0 million in fiscal year 2009 (unrestricted net assets) may be used to meet the Dallas Water Utilities' on-going obligations to citizens and creditors in accordance with the City's fund designation and fiscal policies.
- The Dallas Water Utilities total net assets increased by \$42.7 million in fiscal year 2010 and \$68.5 million in fiscal year 2009. The net asset increase was due to a rate increase for retail water of 4.2% and wholesale water of 3.9% effective October 1, 2009.
- The Dallas Water Utilities' revenue bonds increased from the prior year's balance of \$1.7 billion to \$1.9 billion (net of premiums, discounts, and refunding deferral.) Dallas Water Utilities issued \$295.9 million of revenue bonds during the current fiscal year and \$118.1 million in revenue bonds in the previous fiscal year.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

The Dallas Water Utilities basic financial statements are comprised of three components: 1) Management's Discussion and Analysis, 2) Financial Statements, and 3) Notes to the Financial Statements.

Financial Statements

The financial statements are designed to provide readers with a broad overview of the Dallas Water Utilities finances, in a manner similar to a private-sector business and are made up of the Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Fund Net Assets and Statement of Cash Flows. These statements are prepared using the economic resources measurement focus and the accrual basis of accounting.

**City of Dallas, Texas  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED  
September 30, 2010

**OVERVIEW OF THE FINANCIAL STATEMENTS - Continued**

The Statement of Net Assets presents information on all of the Dallas Water Utilities assets and liabilities, with the difference between the two reported as net assets. The Dallas Water Utilities follows the utility method for reporting Statement of Net Assets information. Under this method, capital assets appear first, followed by current assets and other noncurrent assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Dallas Water Utilities is improving or deteriorating. Other non-financial factors should also be taken into consideration, such as changes in the Dallas Water Utilities customer base and the condition of the Dallas Water Utilities infrastructure (i.e., water and wastewater lines, mains, etc.), to assess the overall health or financial condition of the Dallas Water Utilities.

The statement of revenues, expenses and changes in fund net assets presents information showing how the Dallas Water Utilities net assets changed during the fiscal year. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., revenues earned but unbilled and earned but unused compensated absences).

The statement of cash flows reflects changes to the beginning cash and cash equivalent balance. Cash flows are categorized into operating, non-capital financing, capital and related financing, and investing activities.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes can be found immediately following the financial statements.

**FINANCIAL ANALYSIS**

Current assets decreased by \$7.0 million from \$312.2 million to \$305.2 million, primarily from an increased use of cash for capital projects. Current liabilities decreased 33.1% percent from the previous fiscal year, primarily from the decrease in commercial paper outstanding. In July 2010, DWU issued Revenue Refunding Bonds Series 2010 for the purpose of refunding certain outstanding obligations and \$235.5 million of the outstanding commercial paper. The refunding also resulted in a lower liability for the current portion of the revenue bonds at September 30, 2010.

Unrestricted net assets are a measure of a fund's liquidity. As of September 30, 2010, unrestricted net assets were \$64.5 million. This represents 24.9% of the total operating expenses, excluding depreciation and amortization expense.

**City of Dallas, Texas  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED  
September 30, 2010

**FINANCIAL ANALYSIS - Continued**

**Table 1  
Condensed Statement of Net Assets  
(In thousands)**

	2010	2009
Current and other assets	\$ 631,196	\$ 700,057
Capital assets, net	3,659,821	3,513,231
Total assets	4,291,017	4,213,288
Current liabilities	258,206	386,093
Long-term debt	1,897,700	1,738,242
Other long-term liabilities	28,346	24,856
Total liabilities	2,184,252	2,149,191
Net assets:		
Invested in capital assets, net of related debt	1,880,460	1,827,258
Restricted	161,855	176,860
Unrestricted	64,450	59,979
Net assets	\$ 2,106,765	\$ 2,064,097

The largest portion of the Dallas Water Utilities net assets reflects its investments in capital assets (e.g., land, building, equipment, improvements, construction in progress and infrastructure), less any debt used to acquire those assets that is still outstanding. Dallas Water Utilities uses these capital assets to provide service to customers; consequently, these assets are not available for future spending. Although Dallas Water Utilities investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources since the capital assets themselves cannot be used to liquidate these liabilities.

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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED  
September 30, 2010

**FINANCIAL ANALYSIS - Continued**

An additional portion of Dallas Water Utilities net assets 7.7% represents resources that are subject to external restrictions such as sinking fund balances which include accrued amounts of principal and interest for debt service purposes and the reserve fund to be used for any future debt service payments in case the sinking fund is not appropriately funded. The balance of unrestricted net assets (\$64.5 million) may be used to meet ongoing obligations to customers and creditors. Retail Water and Wastewater rates increased 4.2% and wholesale rates increased 3.9% in fiscal year 2010.

Analysis of Dallas Water Utilities Operations

Net assets increased \$42.7 million, primarily from the sale of wholesale and retail water and treatment of wastewater in fiscal year 2010. Revenues from sale of water accounted for \$278.4 million and revenues from the treatment of wastewater accounted for \$189.1 million.

**Table 2  
Changes in Net Assets  
(In thousands)**

	2010	2009
Revenues:		
Operating revenues	\$ 467,527	\$ 467,929
Investment income	2,677	15,426
Total revenues	470,204	483,355
Expenses:		
Personnel services	84,184	76,938
Supplies and materials	75,896	82,695
Other operation and maintenance	98,426	105,275
Depreciation and amortization	99,283	92,106
Interest expense	67,961	68,151
(Gain) loss on property disposal	93	(93)
Total expenses	425,843	425,072
Increase in net assets before capital contributions	44,361	58,283
Capital contributions	10,345	14,825
Transfers in from other city funds	1,270	1,411
Transfers out to other city funds	(13,308)	(6,000)
Change in net assets	42,668	68,519
Beginning net assets	2,064,097	1,995,578
Ending net assets	\$ 2,106,765	\$ 2,064,097

**City of Dallas, Texas  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED  
September 30, 2010

**FINANCIAL ANALYSIS - Continued**

The change in net assets decreased \$25.8 million compared to fiscal year 2009 from \$68.5 million to \$42.7 million from a decrease in investment income, decrease in capital contributions and an increase in transfers to other departments. Investment income decreased due to lower interest income from funds held for construction. Increases occurred in personnel services from an increase in water and sewer maintenance crews, workers compensation, and pension contributions. Transfers-out increased for payment in lieu of taxes to support economic initiatives of the City.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

Capital Assets

During the current fiscal year, Dallas Water Utilities had \$3.7 billion invested in a broad range of capital assets, including water and sewer lines, mains, pump stations, buildings and vehicles. This amount represents a net increase (including additions, deductions and depreciation) of \$147 million, or 4.2%, increase over the prior fiscal year. The current fiscal year included project awards related to water and wastewater treatment plant expansion and improvement. Future capital expenditures will be used to support the partnership between the City of Dallas and Tarrant Regional Water District to transport water from Lake Palestine to the Dallas water system.

Some of the major projects attributable to this increase include the design of recommended Water Quality Improvements at all three water treatment plants, completion of the White Rock Lake Spillway construction, construction of the \$45.1 million East Side Water Treatment Plant 540 MGD (million gallons per day) Expansion Headworks and Chemical Improvements project, construction of Bachman Water Treatment Plant Control Center / Maintenance Building Renovation, the installation of approximately 123 miles of water and wastewater mains and completed construction of the Southside Wastewater Treatment Plant Sidestream Facility.

Water supply is now available to the City from six surface water impoundments, and from water in the Elm Fork of the Trinity River. The City has obtained most of its water supply through contractual agreements with surface reservoir operating entities, also a small portion of the City's wastewater is treated by the Trinity River Authority. Water supply from the six reservoirs presently connected to the System is adequate for current needs. Dallas Water Utilities provides treated water to its customers within the City on a "retail" basis. Treated and untreated water is provided on a "wholesale" basis to other cities and governmental entities outside of Dallas.

Debt

At year-end, Dallas Water Utilities had \$1.9 billion in revenue bonds (including premiums and deferred loss on refunding) outstanding, compared to \$1.7 billion at the end of the prior fiscal year, an increase of 11.7 percent.

The Dallas Water Utilities' share of pension obligation bonds was \$86.4 million (including premium of \$25.3 million) plus \$17.2 million of accreted interest.

**City of Dallas, Texas  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED) - CONTINUED  
September 30, 2010

**CAPITAL ASSETS AND DEBT ADMINISTRATION - Continued**

In June 2010, Dallas Water Utilities issued Waterworks and Sewer System Revenue Bonds Series 2010 of \$298.85 million with an interest rate range of 3.0 to 5.0 percent and a final maturity of October 1, 2039. The bonds were issued to refund previously issued waterworks and sewer bonds and to refund outstanding commercial paper used by Dallas Water Utilities to fund capital construction projects. Proceeds of \$81.7 million were deposited with an escrow agent to be used to pay the outstanding amount of the bonds. As a result, \$80.2 million of these bonds are considered defeased and the liability for the refunded portion of these bonds has been removed from the financial statements. The refunding resulted in a difference of \$1.5 million between the net carrying amount of the old debt and the acquisition price.

This difference, reported in the accompanying financial statements as a decrease to bonds payable, is being amortized to interest expense over the life of the bonds. Total debt service payments decreased by \$7.4 million as a result of the refunding. The City also incurred an economic gain (difference between the present value of the old debt and new debt service payments) of \$7.3 million.

Commercial Paper outstanding at the end of the fiscal year 2010 amounted to \$58 million which included \$10 million in Series B notes and \$48 million in Series D notes.

The Dallas Water Utilities Revenue Bonds underlying ratings are Aa1 by Moody's Investors Service and AAA by Standard & Poor's. See Note 5 for additional information.

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

Retail Water and Wastewater rates were increased 3.1% in the fiscal year 2011 budget. The rate increase was necessitated by an increase in payment in lieu of taxes, additional personnel, additional conservation programs and various enhancements to the current level of service including capital expenditures.

**CONTACTING THE DALLAS WATER UTILITIES' FINANCIAL MANAGEMENT**

The financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the Dallas Water Utilities finances and to demonstrate accountability for the money it receives. If you have questions about this report or need any additional financial information, contact the City Controller's Office, at City of Dallas, 1500 Marilla, Room 4BN, Dallas, Texas 75201.

**City of Dallas, Texas**  
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STATEMENT OF NET ASSETS  
September 30, 2010  
(In thousands)

**ASSETS**

**CAPITAL ASSETS**

Completed utility plant	\$ 4,803,906
Less accumulated depreciation and amortization	<u>(1,493,288)</u>
	3,310,618
Construction in progress	<u>349,203</u>
Total capital assets	3,659,821

**CURRENT ASSETS**

Cash and cash equivalents	118,942
Accounts receivable, less allowance for uncollectible accounts (\$18,996)	48,913
Interest receivable	2,224
Inventories, at cost	10,161
Advances due from other city funds	352
Restricted assets	
Customer assessment receivable	624
Cash and cash equivalents	
Held for construction purposes	130,875
Debt service	
Cash and cash equivalents	114,783
Customer deposits	
Cash and cash equivalents	<u>9,160</u>
Total current assets	436,034

**OTHER NONCURRENT ASSETS**

Advances due from other city funds	4,385
Deferred costs, less accumulated amortization	9,847
Net pension asset	79,486
Restricted assets	
Cash and cash equivalents held by escrow agent	15,455
Future debt service	
Cash and cash equivalents	2,303
Investments for future debt service	<u>83,686</u>
Total noncurrent assets	<u>195,162</u>
Total assets	<u>\$ 4,291,017</u>

See accompanying notes to basic financial statements.

**City of Dallas, Texas**  
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STATEMENT OF NET ASSETS - CONTINUED  
September 30, 2010  
(In thousands)

**LIABILITIES**

Long-term debt, less current maturities:	
Revenue bonds payable	\$ 1,796,194
Pension obligation bonds	84,297
Accreted interest pension obligation bonds	<u>17,209</u>
Total long-term debt	<u>1,897,700</u>
Current liabilities payable from restricted assets	
Construction accounts payable	60,639
Commercial paper notes payable	58,000
Current maturities of revenue bonds payable	73,445
Accrued interest	<u>38,917</u>
Total current liabilities (payable from restricted assets)	<u>231,001</u>
Current liabilities payable from current assets	
Accrued payroll	2,425
Accounts payable	17,727
Compensated absences	4,695
Current maturity of pension obligation bonds	2,085
Accrued interest pension obligation bonds	<u>273</u>
Total current liabilities (payable from current assets)	<u>27,205</u>
Other long-term liabilities	
Customer deposits, payable from restricted assets	9,238
Compensated absences	6,321
Other postemployment benefits	10,857
Customer and developer construction advances	<u>1,930</u>
Total other long-term liabilities	<u>28,346</u>
Total liabilities	<u>2,184,252</u>
Net assets:	
Invested in capital assets, net of related debt	\$ 1,880,460
Restricted:	
Revenue bond requirements	161,855
Unrestricted	<u>64,450</u>
Total net assets	<u>\$ 2,106,765</u>

See accompanying notes to basic financial statements.

**City of Dallas, Texas**  
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STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS  
For the Year ended September 30, 2010  
(In thousands)

Operating revenues:	
Water	\$ 278,419
Wastewater	<u>189,108</u>
Total operating revenues	467,527
Operating expenses:	
Personnel services	84,184
Supplies and materials	75,896
Other operation and maintenance	98,426
Depreciation and amortization	<u>99,283</u>
Total operating expenses	<u>357,789</u>
Operating income	109,738
Non-operating income (expense)	
Investment income	2,677
Bonds and commercial paper notes interest expense	(67,961)
Loss from property disposal	<u>(93)</u>
Total nonoperating income (expenses)	<u>(65,377)</u>
Income before contributions and transfers	44,361
Capital contributions	10,345
Transfers in from other city funds	1,270
Transfers out to other city funds	<u>(13,308)</u>
Change in net assets	42,668
Net assets, beginning of year	<u>2,064,097</u>
Net assets, end of year	<u>\$2,106,765</u>

See accompanying notes to basic financial statements.

**City of Dallas, Texas**  
**Dallas Water Utilities**  
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STATEMENT OF CASH FLOWS  
For the Year ended September 30, 2010  
(In thousands)

Cash flows from operating activities:	
Cash received from customers	\$ 474,241
Cash payments to suppliers for goods and services	(78,121)
Cash payments to employees for services	(77,542)
Cash payments for contractual services	(103,274)
Other operating cash payments	<u>(1,701)</u>
Net cash provided by operating activities	213,603
Cash flows from non-capital financing activities:	
Transfers from other funds	1,270
Transfers to other city funds	<u>(13,308)</u>
Net cash used in non-capital financing activities	(12,038)
Cash flows from capital and related financing activities:	
Increase in arbitrage rebate liability	(146)
Acquisition and construction of capital assets	(214,400)
Proceeds from sale of revenue refunding bonds	317,166
Principal paid on revenue and general obligation bonds maturities	(95,330)
Principal paid on refunding bonds	(80,200)
Interest paid on bonds	(81,716)
Proceeds from sale of commercial paper notes	123,503
Retirement of commercial paper notes	(235,486)
Interest paid on commercial paper	<u>(2,249)</u>
Net cash used in capital and related financing activities	(268,858)
Cash flows from investing activities:	
Purchase of investments	(59,397)
Maturity of investments	25,780
Investment income	<u>4,271</u>
Net cash used in investing activities	<u>(29,346)</u>
Net decrease in cash and cash equivalents	(96,639)
Cash and cash equivalents, beginning of year	<u>488,157</u>
Cash and cash equivalents, end of year	<u>\$ 391,518</u>

See accompanying notes to basic financial statements.

**City of Dallas, Texas**  
**Dallas Water Utilities**  
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STATEMENT OF CASH FLOWS - CONTINUED  
For the Year ended September 30, 2010  
(In thousands)

Reconciliation of operating income to net cash provided by operating activities:	
Operating income	<u>\$ 109,738</u>
Adjustments not affecting cash:	
Depreciation and amortization	99,283
Change in assets and liabilities	
(Increase) Decrease in accounts and other receivables	5,805
(Increase) Decrease in advances due from other city funds	175
(Increase) Decrease in inventories	(2,225)
(Increase) Decrease in other assets	29
Increase (Decrease) in due to other city funds	(445)
Increase (Decrease) in accounts and contracts payable	(4,656)
Increase (Decrease) in accrued payroll	617
Increase (Decrease) in accrued vacation and sick leave	1,776
Increase (Decrease) in allowance for doubtful accounts	462
Increase (Decrease) in customer deposits	272
Increase (Decrease) in other postemployment benefits	2,964
Increase (Decrease) in customer and developer construction advances	<u>(192)</u>
Total Adjustments	<u>103,865</u>
Net cash provided by operating activities	<u>\$ 213,603</u>
Current Assets:	
Pooled cash and cash equivalents	118,942
Pooled cash and cash equivalents for current debt service	114,783
Pooled cash and cash equivalents for customer deposits	9,160
Held for construction purposes:	
Cash and cash equivalents held by escrow agent	15,455
Cash and cash equivalents	130,875
Pooled cash and cash equivalents for future debt service	<u>2,303</u>
Total cash and cash equivalents end of year	<u>\$ 391,518</u>
Noncash investing, capital, and financing activities:	
Capital contributions	10,345
Change in fair value of non-pooled investments	(784)
Change in fair value of pooled investments	(3,431)
Premium/discount amortization	7,832
Bond issuance cost amortization	572
Accretion on capital appreciation bonds	3,789
Amortization of deferred gain/loss on refunding	2,012

See accompanying notes to basic financial statements.

**City of Dallas, Texas**  
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**(An Enterprise Fund of the City of Dallas)**

NOTES TO THE BASIC FINANCIAL STATEMENTS

For the Year Ended September 30, 2010

(In thousands except where indicated)

**NOTE 1 - FINANCIAL STATEMENT PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

The accompanying financial statements include only Dallas Water Utilities, an enterprise fund of the City of Dallas, Texas (the City). The Dallas Water Utilities financial statements are not intended to present the financial position or results of operations of the City. The City also administers other departments, whose operations are reflected in the Comprehensive Annual Financial Report of the City.

Dallas Water Utilities provides water and wastewater services to customers within the City and to other nearby cities and governmental entities. Chapter XI, Section 14 of the Dallas City Charter requires all costs of service to be paid from revenues arising from customer service rates. This City Charter section also establishes that all customer receipts and revenues shall be used only to provide water and wastewater services, and to provide for any charges made by the City in lieu of ad valorem taxes or that would be due the City if the Water Utilities Department were not a city-owned public utility.

The accounting policies of Dallas Water Utilities, as reflected in the accompanying accrual-basis financial statements, conform to accounting principles generally accepted in the United States of America (GAAP) for local government enterprises as prescribed by the Governmental Accounting Standards Board (GASB). The Dallas Water Utilities is accounted for using the economic resources measurement focus. Revenues are recognized when earned and expenses are recognized when a liability is incurred, regardless of the timing of related cash flow. Dallas Water Utilities has not elected to apply the option allowed in GASB Statement No. 20 "Accounting and Financial Reporting for Proprietary Entities" regarding application of statements and interpretations of the Financial Accounting Standards Board subsequent to November 30, 1989.

Cash and Cash Equivalents

Cash includes amounts in demand deposits as well as short-term investments with original maturities of 90 days or less. DWU's portion of the City's investment pool is displayed on the Statement of Net Assets as "Cash and cash equivalents." DWU treats pooled investments and short-term non-pooled investments as cash equivalents. Long-term pooled investments are reported as investments on the Statement of Net Assets. Investments in U.S. government obligations and other investments are recorded at fair value based on quoted market prices. (Note 2).

Capital Assets

Capital assets are stated at historical cost (estimated fair value for assets contributed by developers at the date of the contribution). Assets are capitalized when they generally have a value of at least five thousand dollars and a useful life of one year or more. Depreciation and amortization are provided using the straight-line method over estimated useful lives as shown below, stated in the number of years by property.

Rights to water supply and wastewater treatment	50 to 100
Buildings	10 to 50
Improvements other than buildings	10 to 100
Equipment	3 to 25
Other utility property	33 to 75

**City of Dallas, Texas**  
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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

(In thousands except where indicated)

**NOTE 1 - FINANCIAL STATEMENT PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES - Continued**

For appropriate constructed property, capitalized costs include amounts applicable to construction for payroll, payroll-related costs, and general and administrative overhead.

Maintenance and repairs are charged to operations as incurred. Improvements which extend the useful lives of capital assets are capitalized. Interest cost during construction is capitalized. The accompanying financial statements reflect capitalization of interest costs of \$10.3 million.

Transactions with Other City Departments

Operating revenues include billings and charges to other City departments for water and wastewater services, for which other departments made payments of \$5.5 million in 2010. Operating expenses include payments to other City departments of \$81 million in 2010 including health benefit payments for employees, office supplies, vehicle fuel and maintenance, communications and data services, programming and batch processing, street rental and other miscellaneous city services. Dallas Water Utilities also reimburses other City departments for other construction-related costs paid by those departments for Dallas Water Utilities. "Current assets" and "other non-current assets" at September 30, 2010 included advances of \$4.7 million due from other City funds bearing original interest at rates of 1.5%-3.0%, subject to change based on interest received on City investments. All other nonreciprocal transactions between funds which are not reimbursements and where the funds do not receive equivalent goods and services for the transactions are classified as transfers.

Compensated Absences

The City's employees earn vacation up to maximum periods based on length of service. Employees may either take vacation leave or receive cash payment upon retirement or termination. Sick leave accrues to employees based on hours worked, up to an unused maximum accrual, but is subject to specified reduction if paid in cash upon retirement or termination. The City accrues vacation and sick leave attributable to employee services already rendered, in amounts of estimated payments. A liability is recorded for accumulated sick leave that which is likely to vest, to the extent of probable payment upon termination for employees with 20 or more years of continuous service. At September 30, 2010 liabilities for accrued vacation and sick leave included the following amounts:

	<u>2010</u>
Current liabilities	\$4,695
Noncurrent liabilities	<u>6,321</u>
	<u>\$11,016</u>

Accounts Receivable

Accounts receivable includes unbilled customer receivables at September 30, 2010. Unbilled receivables include estimated revenues for water and wastewater services provided but not yet billed at September 30.

**City of Dallas, Texas**  
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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

(In thousands except where indicated)

**NOTE 1 - FINANCIAL STATEMENT PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES - Continued**

Inventory

Inventory consists of construction and operating materials, which are valued at average cost.

Operating Revenues and Expenses

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of Dallas Water Utilities are derived from treatment and supply of water, and collection of wastewater. Operating expenses for proprietary funds include the cost of services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Restricted vs. Unrestricted

Restricted assets include debt service, investments for future debt service and cash held for construction purposes. Unrestricted assets can be used for any operating expenses. When both restricted and unrestricted resources are available for use, it is the City's policy to use the restricted resources first and then unrestricted resources as they are needed.

Changes in Accounting Principles and New Accounting Pronouncements

During fiscal year 2010, Dallas Water Utilities (DWU) adopted the following Governmental Accounting Standards Board (GASB) Statements:

GASB Statement Number 51, "Accounting and Financial Reporting for Intangible Assets" requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. The statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. The implementation of this statement did not result in any change to the financial statements.

GASB Statement Number 53, "Accounting and Financial Reporting for Derivative Instruments" is intended to improve how state and local governments report information about derivative instruments – financial arrangements used by governments to manage specific risks or make investments – in their financial statements. It requires endowments to report their land and other real estate investments at fair value. The implementation of this statement did not result in any change to the financial statements.

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

(In thousands except where indicated)

**NOTE 1 - FINANCIAL STATEMENT PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES - Continued**

GASB Statement Number 58, "Accounting and Financial Reporting for Chapter 9 Bankruptcies" provides accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. The implementation of this statement did not result in any change to the financial statements.

The GASB has issued the following statements which will be effective in futures years as described below:

GASB Statement Number 54, "Fund Balance Reporting and Governmental Fund Type Definitions" will be implemented by Dallas Water Utilities as required by the GASB during the fiscal year ending September 30, 2011. This statement establishes accounting and financial reporting standards for all governments that report governmental funds. This statement establishes the criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. Since Dallas Water Utilities is an enterprise fund, the implementation of this statement will not result in any change to the financial statements.

GASB Statement Number 57, "OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans" will be implemented by Dallas Water Utilities as required by the GASB during the fiscal year ending September 30, 2012. This statement addresses issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans. The implementation of this statement will not result in any change to the financial statements.

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 2 - CASH, DEPOSITS, AND INVESTMENTS**

At September 30, 2010, the investments held for the Dallas Water Utilities General and Investment Pool Programs are as follows:

TYPES OF INVESTMENTS	<u>Total</u>
<u>Categorized Investments</u>	
United States Treasury Notes	\$ 17,655
Federal Farm Credit Bank Notes	50,078
Federal Home Loan Bank Notes	120,983
Federal Home Loan Mortgage Corp. Notes	81,030
Federal Home Loan Mortgage Corp. Notes Callable	7,747
Federal National Mortgage Association Notes	71,894
Federal National Mortgage Association Notes Callable	<u>2,542</u>
 Total Categorized Investments	 <u>\$351,929</u>
 <u>Investments Not Categorized</u>	
Blackrock Munifund	\$ 37,832
Federated Tax- Free Fund	7,917
AIM STIT Government and Agency Institution	9,522
Reserve Primary Fund	5
TexStar – Money Market Mutual Funds	20,208
TexPool - Money Market Mutual Funds	<u>23,164</u>
 Total Investments Not Categorized	 <u>98,648</u>
 Total General and Investment programs in City Treasury	 <u>\$450,577</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 2 - CASH, DEPOSITS, AND INVESTMENTS - Continued**

Deposit and Investment Risk Disclosures of Funds with the City Treasurer

GASB Statement No. 40, "Deposit and Investment Risk Disclosures", requires disclosure information related to common risks inherent in deposit and investment transactions. Investments are subject to certain types of risks, including custodial credit risk, concentration of credit risk, credit risk and interest rate risk and foreign currency risk. Exposure of deposited funds and investment risk are disclosed in the following sections of this note.

Custodial Credit Risk

Custodial credit is the risk that, in event of the failure of the counterparty, the City will not be able to recover the value of its deposit or collateral securities that are in the possession of an outside party. As of September 30, 2010, \$24,627 was fully collateralized and insured by U.S. Federal Agency securities and the Federal Deposit Insurance Corporation. The collateral pledged to the City is held in the City's name at the Federal Reserve Bank.

Fully Collateralized and Insured Deposits held by custodian banks	
Demand deposits	\$24,627

Texas statutes and City policy authorize operating, capital projects, bond reserve and trust monies to be deposited in demand deposits, time deposits, or certificates of deposits. Texas statutes and City policy require all uninsured collected deposits to be fully collateralized.

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 2 - CASH, DEPOSITS, AND INVESTMENTS - Continued**

Concentration of Credit Risk

Investments that individually represent 5% or more of net portfolio assets are stated below. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds and external investment pools are excluded.

Agency and Securities by Issuer	<u>Fair value</u>	<u>% of Total Portfolio</u>
Federal National Mortgage Assoc. (FNMA)	\$ 74,436	16.52%
Federal Home Loan Mortgage Corp. (FHLMC)	88,777	19.70%
Federal Home Loan Bank (FHLB)	120,983	26.85%
Federal Farm Credit Bank (FFCB)	<u>50,078</u>	<u>11.11%</u>
Total agency securities	<u>\$334,274</u>	<u>74.19%</u>

Credit Risk

The Public Funds Investment Act requires that investments shall be made in accordance with written policies at least annually by the governing body; investment policies must address safety of principal, liquidity, yield, diversification and maturity, with primary emphasis on safety of principal. In accordance with this policy, the City may invest in direct or guaranteed obligations of the U.S. Treasury, certain U.S. agencies and instrumentalities, and the state of Texas or its agencies and instrumentalities with a credit rating no less than A; fully collateralized certificates of deposits and repurchase agreements; no-load money market mutual funds and local government investment pools with credit ratings no less than AAA.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Money Market Mutual Funds and Local Government Investment pools in the City's portfolio are rated AAAM by Standard and Poor's and/or Aaa by Moody's. Long-term bond ratings are used for the U.S. Government Agencies. Ratings for the City's portfolio are listed on the following table.

<u>Security Type</u>	<u>Fair value</u>	<u>% of Total portfolio</u>	<u>S&amp;P/Moody's ratings</u>
Money market mutual funds and pools	\$ 98,648	21.89%	AAAM/Aaa
U.S. Treasury securities	17,655	3.92%	N/R
U.S. Agency securities	<u>334,274</u>	<u>74.19%</u>	AAA/Aaa
Total portfolio	<u>\$450,577</u>	<u>100.00%</u>	

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

(In thousands except where indicated)

**NOTE 2 - CASH, DEPOSITS, AND INVESTMENTS - Continued**

Interest Rate Risk

In order to ensure the ability of the City to meet obligations and to minimize potential liquidation losses, the dollar-weighted average stated maturity of the Investment Pool shall not exceed 1.5 years. The City's policy further limits the maximum stated maturity of U.S. treasuries, agencies, and municipal notes and bonds to 5 years; repurchase agreements to 30 days; and certificates of deposit to 1 year. The weighted average maturity of the securities held in the City's portfolio is as follows:

<u>Security type</u>	<u>Fair value</u>	<u>Weighted average maturity (days)</u>
Money market mutual funds and pools	\$ 98,648	1
U.S. Treasury securities	17,655	353
U.S. agency securities	<u>334,274</u>	248
Total portfolio	<u>\$450,577</u>	<u>211</u>

**NOTE 3 - ASSETS RESTRICTED FOR DEBT SERVICE**

Bond documents authorizing issuance of water and wastewater system revenue bonds and the related offering documents prescribe the timing and determination of amounts to be accumulated and maintained for debt service. These ordinances require that amounts to be set aside in advance to provide for the next scheduled principal and interest payments. Such amounts are reflected in the accompanying Statement of Net Assets as current maturities of revenue funds and accrued revenue bond interest. The ordinances also require that a "revenue bond reserve fund" be accumulated and maintained. If the reserve fund contains less than the future average annual principal and interest requirements of all outstanding revenue bonds, determined after each bond issue, the ordinances require equal monthly additions to the reserve fund in amounts which, after 60 months, will result in a reserve fund balance which is equal to the future average annual principal and interest requirements. At September 30, 2010, the reserve fund equaled or exceeded ordinance requirements.

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 4 - CAPITAL ASSETS**

Capital asset activity for the year ended September 30, 2010 is as follows:

	Balance, beginning of year	Additions	Transfers and Retirements	Balance, end of year
Capital assets, not being depreciated:				
Land	\$ 77,742	\$ 23	\$ -	\$ 77,765
Construction in progress	436,602	211,163	(298,562)	349,203
Total capital assets, not being depreciated	<u>514,344</u>	<u>211,186</u>	<u>(298,562)</u>	<u>426,968</u>
Capital assets, being depreciated:				
Water rights	353,910	-	-	353,910
Buildings	390,088	994	-	391,082
Improvements other than buildings	53,783	1,499	-	55,282
Infrastructure	422,989	5,890	-	428,879
Equipment	450,392	3,665	(1,068)	452,989
Utility property	2,722,591	321,408	-	3,043,999
Total capital assets, being depreciated	<u>4,393,753</u>	<u>333,456</u>	<u>(1,068)</u>	<u>4,726,141</u>
Less accumulated depreciation for:				
Water rights	(91,335)	(3,539)	-	(94,874)
Buildings	(152,494)	(7,871)	-	(160,365)
Improvements other than buildings	(5,030)	(1,646)	-	(6,676)
Infrastructure	(182,250)	(8,192)	-	(190,442)
Equipment	(274,755)	(20,074)	861	(293,968)
Utility property	(689,002)	(57,961)	-	(746,963)
Total accumulated depreciation	<u>(1,394,866)</u>	<u>(99,283)</u>	<u>861</u>	<u>(1,493,288)</u>
Total capital assets being depreciated, net	<u>2,998,887</u>	<u>234,173</u>	<u>(207)</u>	<u>3,232,853</u>
Total capital assets, net	<u>\$ 3,513,231</u>	<u>\$ 445,359</u>	<u>\$ (298,769)</u>	<u>\$ 3,659,821</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

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**NOTE 5 - BONDS PAYABLE**

Water and wastewater system revenue bonds constitute obligations of the DWU, secured solely by a pledge of all revenues of the City's water and wastewater system (operated as "Dallas Water Utilities"), after deduction of reasonable operation and maintenance expenses. All of Dallas Water Utilities' revenue bonds may be redeemed at the City's option, at par value, on or after the tenth annual serial maturity date.

Dallas Water Utilities is also obligated to pay a proportionate share of the Pension Obligation Bonds issued by the City of Dallas. The payments include both City contributions and employee contributions.

Revenue bonds payable at September 30, 2010 include the following issues. Future long term liabilities and interest rates shown on the following page are for bonds outstanding on September 30, 2010.

**City of Dallas Waterworks and Sewer System Revenue Bonds:**

\$74,000 <b>Series 2000</b> Refunding & Improvement, due in annual maturities of \$1,835 - \$5,840 through October 1, 2020, with interest of 5.25% to 5.75% including unamortized premium of \$414.	3,485
\$124,000 <b>Series 2001</b> Refunding & Improvement, due in annual maturities of \$3,955 - \$9,330 through October 1, 2021, with interest of 5% to 5.25%	5,570
\$43,455 <b>Series 2002</b> Revenue Refunding, due in annual maturities of \$1,790 - \$5,620 through October 1, 2013, with interest of 3% to 5.5%	4,090
\$179,350 <b>Series 2002A</b> Revenue Refunding, due in annual maturities of \$17,000 - \$30,000 through October 1, 2010, with interest of 3% to 5% (refunding deferral of \$15).	17,000
\$307,410 <b>Series 2003</b> Refunding & Improvement, due in annual maturities of \$9,060 - \$22,988 through October 1, 2022, with interest of 3% to 5.375% including unamortized premium of \$3,856.	100,110
\$164,000 <b>Series 2003A</b> Refunding & Improvement, due in annual maturities of \$5,985 - \$12,386 through October 1, 2023, with interest of 3.5% to 5% including unamortized premium of \$608.	126,490
\$235,805 <b>Series 2005</b> Refunding & Improvement, due in annual maturities of \$2,315-\$18,858 through October 1, 2024 with interest of 5% including unamortized premium of \$5,980.	101,065
\$255,375 <b>Series 2006</b> Refunding & Improvement, due in annual maturities of \$5,625-\$17,840 through October 1, 2035 with interest of 4.25% to 5.50% including unamortized premium of \$6,288.	231,460
\$678,480 <b>Series 2007</b> Refunding & Improvement, due in annual maturities of \$2,750-\$70795 through October 1, 2037 with interest of 4.00% to 5.00% including unamortized premium of \$14,337.	669,065

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 5 - BONDS PAYABLE - Continued**

\$158,655 <b>Series 2008</b> Refunding & Improvement, due in annual maturities of \$2,505-\$10,076 through October 1, 2038 with interest of 4.00% to 5.00% including unamortized premium of \$5,431.	152,455
\$15,100 <b>Series 2009A</b> Texas Water Development Board Revenue Bonds, due in annual maturities of \$650-\$958 through October 1, 2028 with interest of 0.423% to 2.877%.	14,450
\$8,280 <b>Series 2009B</b> Texas Water Development Board Revenue Bonds, due in annual maturities of \$96-\$633 through October 1, 2028 with interest of 1.303% to 2.877%.	8,280
\$94,723 <b>Series 2009C</b> Texas Water Development Board Revenue Bonds, due in annual maturities of \$1,610-\$6,716 through October 1, 2028 with interest of 0.148% to 3.018%.	94,723
\$295,850 <b>Series 2010</b> Waterworks and Sewer System Revenue Bonds, due in annual maturities of \$6,944-\$25897 through October 1, 2039 with interest of 3.00% to 5.00% including unamortized premium of \$21,951.	295,850
Total outstanding revenue bonds issued by the City of Dallas	1,824,093
Less current maturities	(73,445)
Total long term revenue bonds payable	<u>\$ 1,750,648</u>
Changes in bonds outstanding were as follows:	
Outstanding revenue bonds at beginning of year	\$ 1,733,390
Issues (net of premium and deferred loss on refunding)	317,219
Redemptions and refunding	(175,530)
Amortization net premium	(7,452)
Amortization refunding deferral	2,012
Outstanding revenue bonds at end of year	<u>1,869,639</u>
Outstanding pension obligation bonds at the beginning of year	90,307
Redemptions	(3,545)
Amortization net premium/discount	(380)
Pension obligation bonds at end of year	<u>86,382</u>
Accretion on capital appreciation bonds	<u>17,209</u>
Total outstanding at end of year	<u>\$ 103,591</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 5 - BONDS PAYABLE - Continued**

In June 2010, Dallas Water Utilities issued Waterworks and Sewer System Revenue Bonds Series 2010 of \$295.85 million with an interest rate range of 3.0 to 5.0 percent and a final maturity of October 1, 2039.

The bonds were issued to refund previously issued waterworks and sewer system bonds and to refund outstanding commercial paper used by Dallas Water Utilities to fund capital construction projects. Proceeds of \$81.7 million were deposited with an escrow agent to be used to pay the outstanding amount of the bonds. As a result, \$80.2 million of these bonds are considered defeased and the liability for the refunded portion of these bonds has been removed from the financial statements. The refunding resulted in a difference of \$1.5 million between the net carrying amount of the old debt and the acquisition price. This difference, reported in the accompanying financial statements as a decrease to bonds payable, is being amortized to interest expense over the life of the bonds. Total debt service payments decreased by \$7.4 million as a result of the refunding. The City also incurred an economic gain (difference between the present value of the old debt and new debt service payments) of \$7.3 million.

At September 30, 2010 and during the year then ended, management of the City believes it was in compliance with the financial covenants of all authorizing ordinances for outstanding water and wastewater system revenue debt.

The future principal and interest requirements of revenue bonds and pension obligation bonds attributed to Dallas Water Utilities is shown on the table below:

Fiscal Year	Dallas Water Utilities					
	Revenue Bonds			Pension Obligation Bonds		
	Principal	Interest	Total	Principal	Interest	Total
2011	\$ 73,445	\$ 78,890	\$ 152,335	\$ 2,085	\$ 1,969	\$ 4,054
2012	82,330	78,005	160,335	1,957	3,627	5,584
2013	96,115	73,987	170,102	1,823	3,921	5,744
2014	93,190	69,803	162,993	2,373	4,169	6,542
2015	89,270	65,759	155,029	1,622	4,668	6,290
2016-2020	427,295	270,556	697,851	7,906	26,333	34,239
2021-2025	381,650	176,981	558,631	26,929	12,985	39,914
2026-2030	252,953	109,367	362,320	7,549	38,607	46,156
2031-2035	199,085	56,721	255,806	8,843	44,782	53,625
2036-2040	128,760	11,782	140,542	-	-	-
	\$ 1,824,093	\$ 991,851	\$ 2,815,944	\$ 61,087	\$ 141,061	\$ 202,148

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 6 - OTHER LONG TERM OBLIGATIONS**

Other long-term obligations are as follows as of September 30, 2010:

	Balance, beginning of year	Additions	Deletions	Balance, end of year	Due within one year
Due to other city funds	\$ 445	\$ -	\$ 445	\$ -	
Compensated absences	9,240	7,922	6,146	11,016	4,695
Customer deposits, payable from restricted assets	8,966	1,055	783	9,238	-
Customer and developer construction advances	2,122	-	192	1,930	-
Arbitrage rebate payable	146	-	146	-	-
Other postemployment benefits	7,893	5,103	2,139	10,857	-
Total other long-term obligations	<u>\$ 28,812</u>	<u>\$ 14,080</u>	<u>\$ 9,851</u>	<u>\$ 33,041</u>	<u>\$ 4,695</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

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**NOTE 7 - COMMERCIAL PAPER NOTES PAYABLE**

On September 24, 1997, the Dallas City Council authorized a ten-year tax exempt commercial paper program, Series B, for improvements to the City's water and wastewater system. Series B was limited to \$120 million aggregate principal and maturity terms of not more than 270 days for interim financing of capital improvements. On December 12, 2001, the Dallas City Council approved increasing Series B to an aggregate principal amount of \$150 million. On September 30, 2002, the City Council authorized an additional commercial paper program, Series C, limited to \$50 million in aggregate principal. On August 25, 2004, the City Council authorized an increase of \$50 million to the Series B program aggregate principal amount making the program \$200 million and an increase of \$50 million to the Series C program aggregate principal amount making that program \$100 million. In September 2004, the City Council extended Series B and Series C for an additional 10 years with the new expiration date of September 30, 2014. On March 17, 2009, Dallas Water Utilities authorized a new ten-year tax exempt commercial paper program, Series D, with the aggregate principal amount of \$300 million. Series D is the third commercial paper program Dallas Water Utilities uses for improvements to the water and wastewater system.

The commercial paper programs are supported by three credit agreements through two banks and two pension funds. The credit agreement supporting Series B is through Bank of America, which extends to September 28, 2011 and has an aggregate amount not exceeding \$214.8 million which includes outstanding principal and interest. The credit agreement supporting the Series C program is through Bank of America, which extends to September 28, 2011 and has aggregate amount not exceeding \$102.5 million. The credit agreement supporting the Series D notes is through U.S. Bank National Association, California Public Employees' Retirement System and California State Teachers' Retirement System extends to March 17, 2012 and has an aggregate amount not exceeding \$326.6 million. All three commercial paper programs constitute an obligation subordinate to the City's water and wastewater system revenue bonds. Any advances for payments of commercial paper under the line of credit are secured by a subordinate lien on water and wastewater revenues. During fiscal year 2010, \$123.5 million was advanced and \$235.5 was retired. Changes in short-term obligations during fiscal year 2010 were as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
Commercial Paper	\$ 169,983	\$ 123,503	\$ 235,486	\$ 58,000

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**NOTE 8 - COMMITMENTS**

At September 30, 2010, commitments under construction contracts in progress and operating encumbrances were outstanding in the following amounts:

	<u>2010</u>
Construction Encumbrances	\$ 326,029
Operating Encumbrances	<u>2,152</u>
	<u>\$ 328,181</u>

For purposes of its water supply system, the City is contractually committed to pay a portion of the net operating and maintenance expenses of several reservoirs operated by other governmental agencies or authorities. The City is also contractually committed to pay a portion of the net operating and maintenance expenses of the Trinity River Authority's Regional Wastewater System (the "Authority"). The contract with the Authority provides in effect that amounts of capital obligation, interest, and operation and maintenance expenses vary with Dallas' proportionate share of total wastewater treated by the Authority's Central Regional Wastewater System.

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

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**NOTE 9 - CONTINGENCIES**

In accordance with GAAP, those judgments which are considered probable and estimable are accrued, while those claims and judgments which are considered reasonably possible are disclosed but not accrued. In the opinion of the City Attorney, the potential loss resulting from all significant claims which are considered possible, excluding condemnation proceedings, is approximately \$128 thousand as of September 30, 2010. In the opinion of the City Attorney, \$143 thousand represents a probable loss to the City; therefore, has been recorded in the Risk Fund of the City's financial statements.

**NOTE 10 - LEASES**

As Lessee

As lessee, Dallas Water Utilities is committed under various leases for building and office space, data processing and communications equipment. These leases are considered for accounting purposes to be operating leases.

<u>Year ending September 30</u>	<u>Rental Payments</u>
2011	\$1,087
2012	1,021
2013	574
2014	<u>272</u>
Minimum future rentals	<u>\$2,954</u>

As Lessor

As lessor Dallas Water Utilities is also under several lease agreements whereby it receives revenues from leasing land, building and water front facilities. These revenue leases are considered for accounting purposes as operating leases.

<u>Year ending September 30</u>	<u>Rental Receipts</u>
2011	\$ 46
2012	46
2013	46
2014	46
2015	47
2016-2020	233
2021-2025	213
Thereafter	<u>125</u>
Minimum future rentals	<u>\$802</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

For the Year Ended September 30, 2010

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**NOTE 11 - PENSION PLAN**

All full-time Dallas Water Utilities employees participate in the contributory City Employees' Retirement Fund, a defined benefit, single employer pension plan ("the Plan"). The Plan is administered by the City of Dallas (the "City"). Membership is a condition of employment for all full-time, permanent employees. Chapter 40A of the Dallas City Code provides legal authority for the Plan, which is for the benefit of all eligible employees of the City, excluding firefighters and police officers. Members have vested rights to retirement benefits after five years of service. Benefits are based on credited service and the average monthly earnings for the three highest calendar years. Members of the Plan are entitled to normal retirement pension at age 60; early retirement pension at age 55 if employed prior to May 9, 1972 or age 50 and if age and years of service total 78; service retirement pension at any age after thirty years of credited service and disability retirement pension as determined by the Board of Trustees. The new rates which became effective October 1, 2009 are 9.16% of pay for employees and a combined rate of 15.6% of pay for the City. The City's 15.6% is divided into 7.64% cash to the Plan and 7.96% for debt service payments on the pension obligation bonds. The maximum increase or decrease from one year to the next is 10%. The Board of Trustees of each plan establishes and may amend the contribution requirements of plan members and the City. The actuarial cost method is entry age; the amortization method is level percent open; and the remaining amortization period is 30 years.

<u>2008 Net Pension Asset</u>	<u>Annual Required Contribution (ARC)</u>	<u>Net Pension Obligation Interest</u>	<u>ARC Adjustment</u>	<u>City Contribution</u>	<u>Change in Net Pension Obligation</u>	<u>2009 Net Pension Asset</u>
\$ (424,944)	\$ 39,386	\$ (35,058)	\$ 27,665	\$ (25,232)	\$ 6,761	\$ (418,183)

  

<u>2007 Net Pension Asset</u>	<u>Annual Required Contribution (ARC)</u>	<u>Net Pension Obligation Interest</u>	<u>ARC Adjustment</u>	<u>City Contribution</u>	<u>Change in Net Pension Obligation</u>	<u>2008 Net Pension Asset</u>
\$ (405,960)	\$ 10,798	\$ (33,492)	\$ 26,430	\$ (22,720)	\$ (18,984)	\$ (424,944)

The net pension asset as of September 30, 2010 has been allocated between governmental activities and business type activities based on percentage of contribution by each. Dallas Water Utilities' share of the net pension asset is \$79,486. The percent contributed may vary from the legally required rate as the annual required contributions are based upon covered payroll as of the actuarial valuation date, January 1, whereas contributions are calculated and paid based upon actual payrolls throughout the year.

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 11 - PENSION PLAN - Continued**

At December 31, 2009, the Plan membership, including all participating City departments, was as follows:

	<u>2009 Membership Consisted of</u>
Retirees, beneficiaries currently receiving benefits and inactive members entitled to benefits but not yet receiving them	6,925
Current members:	
Vested	4,763
Nonvested	<u>2,891</u>
Total current members	<u>7,654</u>
Total membership	<u>14,579</u>

Employer contribution information for all Plan members is presented in the schedule below:

	2009	2008	2007
Actuarial valuation date	12/31/2009	12/31/2008	12/31/2007
Annual required employer contribution	\$39,386	\$10,798	\$9,387

Schedule of Employer Contributions

	Employees' Retirement Fund		Employees' Retirement Fund	
	Annual Required Contribution	Percentage Contribution	Annual Required Cost	Percentage Contributed
12/31/2009	\$ 39,386	64.06%	\$ 31,993	78.87%
12/31/2008	\$ 10,798	210.41%	\$ 3,736	608.14%
12/31/2007	\$ 9,387	250.27%	\$ 2,687	874.32%

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED

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**NOTE 12 - RISK MANAGEMENT**

The City is self-insured for all third-party general liability claims. Claims adjusting services are provided by an administrative services contractor. Interfund premiums are based primarily upon the insured fund's claims experience and exposure and are reported as cost reimbursement inter-fund transactions. The amount paid by Dallas Water Utilities was \$1.1 million in fiscal year 2010. The liability for unpaid claims includes the effects of specific incremental claims, adjustment expenses and if probable and material, salvage and subrogation.

All known City property, primarily buildings and contents, is insured through commercial insurance policies, subject to a \$1 million deductible per loss occurrence. The amount of settlements has not exceeded insurance coverage for the past three fiscal years.

The City is insured for workers' compensation losses in excess of \$750 per occurrence. Claims adjusting services are provided by an independent administrative services only contractor for claims within the retention. Workers compensation premiums are billed periodically to the different funds based on the loss experience and full time equivalents (FTEs) in the respective departments. The amount paid by Dallas Water Utilities was \$1.2 million in fiscal year 2010. When losses exceed premiums, the deficiencies are prorated and supplemented by the various applicable funds. Accrued worker's compensation liability consists of incurred but not reported as well as unpaid reported claims of which approximately \$61.4 million in fiscal year 2010 is recorded in the Risk Funds of the City.

All workers' compensation losses are accumulated in a clearing fund which is being reimbursed by the premiums collected. When losses exceed premiums, the deficiencies are prorated and supplemented by the various applicable funds. Accrued workers' compensation liability consists of incurred but not reported as well as unpaid reported claims of which \$61.4 million at September 30, 2010, is recorded in the Risk Funds. Of this amount, \$14.5 million is estimated to be payable in the next fiscal year.

The City maintains a group health insurance plan for employees and dependents which is self insured by the City. The City also offers enrollment in one health maintenance organization as an alternative. Premiums are determined based on the annual budget. Dallas Water Utilities had expensed \$6.6 million in fiscal year 2010.

The City also maintains a group life insurance plan, which offers term life and accidental death and dismemberment benefits for employees and dependents. The City is fully insured for employee term life. Health claims and claims incurred but not reported that are probable and reasonably estimated are accrued in the accompanying basic financial statements at September 30, 2010, in the amount of \$7.9 million in the Risk Funds.

At September 30, 2010, the City estimates its general liability at \$17 million, which includes \$11.6 million for automobile and general liability and \$5.4 million for probable claims and lawsuits. Of this amount, \$7.8 million is estimated to be payable in the next fiscal year.

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 13 - POST-EMPLOYMENT BENEFITS**

In addition to pension benefits, various Council resolutions require the City to provide certain healthcare and life insurance benefits for retired employees. Employees who are permanent, full-time employees are eligible to participate in the benefits at retirement. The City is self insured for these programs.

For retired employees over 65, the City pays on average \$450 (not in thousands) per month for Medicare "A" if the retirees are not eligible for Social Security coverage. The retirees are responsible for Medicare "B".

For retirees who qualify and choose the City health plan, the City pays approximately 50 percent of the retiree premium and the retiree pays the other 50 percent. Spouses of retirees, like active employees, pay 100% of premiums. There were 4,910 retiree participants in the health plan at October 1, 2010.

The City's annual other postemployment benefit (OPEB) expense is calculated based on the annual required contribution (ARC), an amount actuarially determined in accordance with GASB Statement No. 45. The actuarial cost method used in this valuation to determine the actuarial accrued liability and the annual required contribution (ARC) is the projected until credit method with service prorated. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed 30 years. The City has elected to amortize the unfunded actuarial liability over 30 years as a level percentage of payroll on an open basis. The discount rate used for the determination of the expense for fiscal year 2010 is 4.50%. Total claim payments for fiscal year 2010 were approximately \$19 million net of participants' and pension plans' contributions.

The following table shows the components of the City's annual OPEB cost for fiscal year 2010, 2009 and 2008, the amount actually contributed to the plan, and changes in the City's net OPEB obligation (in thousands):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Annual OPEB Cost	\$ 42,043	\$ 48,330	\$ 52,168
Contributions Made	<u>(18,965)</u>	<u>(11,950)</u>	<u>(15,364)</u>
Increase in net OPEB	23,078	36,380	36,804
Net OPEB Obligation, beginning of year	<u>73,184</u>	<u>36,804</u>	<u>-</u>
Net OPEB Obligation, end of year	<u>\$ 96,262</u>	<u>\$ 73,184</u>	<u>\$ 36,804</u>

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NOTES TO THE BASIC FINANCIAL STATEMENTS - CONTINUED  
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**NOTE 13 - POST-EMPLOYMENT BENEFITS - Continued**

Dallas Water Utilities' share of the OPEB Obligation is \$10,857.

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for fiscal year 2010, 2009 and 2008 are as follows (in thousands):

Fiscal Year Ended	Net OPEB Obligation Beginnig of Year	Annual OPEB Cost	Employer Contributions	Net OPEB Obligation End of Year	Annual OPEB Cost Contributed
2010	\$ 73,184	\$ 42,043	\$ 18,965	\$ 96,262	45.1%
2009	\$ 36,804	\$ 48,330	\$ 11,950	\$ 73,184	24.7%
2008	\$ -	\$ 52,168	\$ 15,364	\$ 36,804	29.5%

The funded status of the plan for fiscal year 2010, 2009 and 2008 are as follows:

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll
10/1/2009	\$ -	\$ 516,184	\$ 516,184	0.00%	N/A
10/1/2008	\$ -	\$ 590,856	\$ 590,856	0.00%	N/A
10/1/2007	\$ -	\$ 688,083	\$ 688,083	0.00%	N/A

This table presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

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**NOTE 13 - POST-EMPLOYMENT BENEFITS - Continued**

Actuarial Valuations

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the City are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the City and plan members) and include the types of benefits provided at the time of each valuation. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

	<u>Uniformed</u>	<u>Non-Uniformed</u>	<u>Total</u>
At October 1, 2009, membership was as follows (not in thousands):			
Active participants not eligible to retire	3,017	6,120	9,137
Active participants eligible to retire	2,081	957	3,038
Total active participants	<u>5,098</u>	<u>7,077</u>	<u>12,175</u>

**NOTE 14 – DEFERRED COMPENSATION PLANS**

There are three deferred compensation plans. Two of these plans are voluntary for city employees who participate in the City's pension plans. The third plan is mandatory for all employees and council members who are not covered by the City's pension plans. These plans comply with sections 401(k) and 457(b) of the Internal Revenue Code. Participants in the City's voluntary 457 and 401(k) plans have full discretion to choose investments from a list of standard plan options, a linked brokerage account, and a commingled pool managed by Fidelity Management Trust Company. The list of standard plan options includes mutual funds with varying styles and levels of investment risk. All the account balances in the mandatory 457 plan are invested in the same commingled pool. All contributions to these plans are deferred by plan participants from their compensation and all the earnings are allocated to each participant's account. Distributions from all the deferred compensation plans are available after termination of employment. Additionally, participants in the City's voluntary plans may also take out loans and may receive hardship withdrawals in accordance with federal regulations. The assets held in these plans are not included in the City's or DWU's financial statements and cannot be used for purposes other than the exclusive benefit of the participants or their beneficiaries or to pay the reasonable expenses of plan administration.

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**NOTE 15 - INTERFUND TRANSFERS**

During the year, transfers out to other city funds were made in the amount of \$13.3 million. These transfers were made for payments in lieu of taxes. During the year, transfers in from other city funds were made in the amount of \$1.3 million for debt service reimbursements related to software acquisition.