DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF
NASHVILLE AND DAVIDSON COUNTY

AUDITED FINANCIAL STATEMENTS
AND OTHER FINANCIAL INFORMATION

JUNE 30, 2013

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

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CROSSLIN
&ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditor's Report

The Honorable Mayor and Members of Council
The Metropolitan Government of Nashville and
Davidson County, Tennessee

Report on Financial Statements

We have audited the accompanying financial statements of the Department of Water and Sewerage Services (the "Department"), an enterprise fund of The Metropolitan Government of Nashville and Davidson County, Tennessee (the "Metropolitan Government"), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Department'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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 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 entity'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 Department of Water and Sewerage Services, an enterprise fund of the Metropolitan Government of Nashville and Davidson County, Tennessee, as of June 30, 2013, and the changes in its financial position and its cash flows for the year 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 management's discussion and analysis, as listed in the table of contents, 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 express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the basic financial statements that collectively comprise the Department's basic financial statements. The Schedule of Utility Rates, Schedule of Number of Customers, Schedule of Unaccounted for Water, Schedule of Pledged Revenue Coverage and Schedule of Noncurrent Restricted Cash and Cash Equivalents are presented for purposes of additional analysis and is not a required part of the financial statements.

The Schedule of Noncurrent Restricted Cash and Cash Equivalents is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. 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 information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The Schedule of Utility Rates, Schedule of Number of Customers, Schedule of Unaccounted for Water, and Schedule of Pledged Revenue Coverage have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 2013, on our consideration of the Department's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Department's internal control over financial reporting and compliance.

Crosslin + Associates, P.C.

Nashville, Tennessee
October 31, 2013

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Metropolitan Government of Nashville and Davidson County (the "Government"), Department of Water and Sewerage Services (the "Department") - (an enterprise fund of the Government), offer readers of the Department's financial statements this overview and analysis of the financial activities of the Department for the fiscal year ended June 30, 2013. This information should be read in conjunction with the financial statements.

FINANCIAL HIGHLIGHTS

The Department provides water and sewerage service to most of Davidson County, Tennessee, and small portions of the surrounding counties. It serves approximately 187,300 water accounts and 198,500 sewer accounts. Its activities are funded entirely from revenues generated from its operations, with no tax revenues from the Government. A covenant with the bondholders provides assurance that there will be adequate funds for necessary major repairs and replacement of facilities, by requiring revenues to equal at least 110% of the sum of the year's operating budget (exclusive of depreciation and certain other expenses) and the debt service on its outstanding revenue bonds. These monies, not required for normal operations, flow into the Extension and Replacement Fund to be used to finance the ongoing capital requirements of the Department, as supplemented with state loans and revenue bonds. Water rates were increased on May 1 of 2009, 2010, and 2011 by five percent each year. Sewerage rates were increased by nine percent on May 1, 2009, by eight percent on May 1, 2010, and by seven percent on May 1, 2011.

On April 25, 2013, $237,930,000 of revenue bonds were issued through the Water and Sewer Revenue Bonds, Series 2013. The purpose of this bond issue was to retire the outstanding commercial paper debt and to provide additional funding for the Department's capital program. These bonds received ratings from Moody's Investment Services, Inc. and Standard and Poor's Ratings Services of Aa3 and AA- respectively.

At June 30, 2013, the assets and deferred outflows of the Department exceeded its liabilities by over $1.3 billion (total net position). This was a decrease of approximately $17.1 million as compared to 2012, resulting from transfers to other funds of the Government as reflected on the Statements of Revenue, Expenses, and Changes in Net Position. In 2013, operating revenues increased, due to increases in consumption. Operating expenses increases were due to personal services and depreciation expense. Investment income increased by 368% as compared to 2012. Capital grants and contributions decreased by approximately $13.4 million as compared to 2012. The Department ended 2013 $4,543,000 under its operating budget.

In 2013, cash and cash equivalents decreased by approximately $14.1 million as compared to 2012, while restricted cash and cash equivalents increased by approximately $108.9 million. The increase in restricted cash and cash equivalents resulted from receiving the proceeds from the Series 2013 Bond Issue. Capital assets increased by approximately $116.5 million, before depreciation of $69.9 million, for a net increase of $46.5 million for 2013. These assets were acquired using revenues of the Department, revenue bonds, grants, contributions and loans from the State of Tennessee. The Department had construction funds available at June 30, 2013, of approximately $15.3 million and liabilities of approximately $12.9 million for a net of $2.4 million available for capital additions, less outstanding commitments, exclusive of the restricted cash and equivalents mentioned earlier in this paragraph.

The Water System and the Sewer System have gradually been expanded and include: improvements financed by revenues; improvements resulting from capital contributions in aid of construction by private developers; all improvements, additions and extensions financed with the proceeds of outstanding bonds and governmental grants; and facilities acquired from the Nashville Suburban Utility District, the First Suburban Water Utility District of Davidson County, Tennessee, the Parkwood Service Company, the Joelton Water Utility District, the City of Lakewood sewerage system, Rayon City Water Company, the Cumberland Utility District, and the sewerage service of the Nolensville/College Grove Utility District in Williamson County.

Under the Charter and Tennessee Code Annotated §7-3-302, the Government can assume and take over any water and/or sewer utility district located within its boundaries through ordinances adopted by the Metropolitan Council. Several such systems currently operate inside Davidson County and if a decision is made to consolidate these operations into the Department, the Government will take subject to or retire all debts and liabilities of the systems. The economic impact of such an assumption or takeover would be evaluated prior to the submission of any legislation to the Metropolitan Council. By contract dated February 1996, the Government has agreed not to take over the Harpeth Valley Utility District before February 2026. As of July 1, 2013, the Department will absorb the water and wastewater operations of the Old Hickory Utility District.

Historically, the Department managed and partially funded the stormwater operations of the Government. In 2009, the Government established a Stormwater Division of the Department as a stand-alone enterprise fund with its own set of service fees, which are now an itemized part of the water bill. Further funding of stormwater operations will not be required of the Department.

In December 2005, the Department received an inquiry from United States Environmental Protection Agency (“EPA”), pertaining to the Department’s Operations, Capital Plan, and Stormwater Management. The Department’s response was submitted in January 2006. The Department, TDEC and EPA agreed on a recommended consent decree on March 12, 2009 (the “Consent Decree”) to address and correct deficiencies within the Department’s sewer system that have caused violations of the Clean Water Act (“CWA”). The original Consent Decree required that the Department fully develop, in two years, a Corrective Action Plan/Engineering Report (“CAP/ER”) for its separate sewer system and a Long Term Control Plan (“LTCP”) for its combined sewer system to achieve the goals of the CWA. Upon submittal and approval of the plans, the Department would have an additional nine years to complete the work as developed by the plans.

On May 14, 2010, the Department petitioned EPA and TDEC for a time extension for the delivery of both plans and the final compliance with the Consent Decree based on the flood of May 2010. EPA and TDEC granted the requested time extensions to the Department. The Department met the current deadline for submittal of the CAP/ER and LTCP of September 11, 2011 and the deadline for final compliance with the Consent Decree is eleven years after the final approval of the plans by EPA and TDEC. As of June 30, 2013, the EPA and TDEC were still reviewing the CAP/ER and LTCP.

Failure to comply with the Consent Decree and meet future established deadlines could result in penalties up to $3,000 per occurrence, and up to $5,000 per day for failure to timely implement work. The Department has thus far been successful in meeting all the deadlines established by the Consent Decree, and is currently in compliance with the Consent Decree in all respects.

Over the weekend of May 1 and 2, 2010, the Middle Tennessee region received over 15 inches of rainfall resulting in a flood disaster event that severely impacted several of the Department’s facilities. Two wastewater treatment facilities and one water treatment facility received significant damage and over 25 sewer lift stations were flooded and damaged. The cost of repairing and refurbishing the damaged facilities was approximately $70 million when completed near the end of calendar year 2013. The region was declared a federal disaster area and approved for assistance from the Federal Emergency Management Agency (FEMA). Federal and state assistance was approved for approximately 30 percent of the damage total and the Department has appealed the eligibility of another 30 percent of the cost to date.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Department's basic financial statements. The Department's basic financial statements consist of the Statements of Net Position, the Statements of Revenue, Expenses, and Changes in Net Position and the Statements of Cash Flows. Data on these statements represent an enterprise fund of the Government as established by the master bond resolution and the Charter of the Government. These funds consist of the Revenue Fund, the Operating Fund, the Operating Reserve Fund, the Debt Service Fund, the Debt Service Reserve Fund, the Revolving Fund, and the Extension and Replacement Fund. All revenues of the Department are required to be used for the benefit of the ratepayers.

	Condensed Financial Information as of June 30, 2013	Condensed Financial Information as of June 30, 2012
Statements of Net Position		
Total current assets	$ 63,177,885	$ 111,949,305
Total capital and other noncurrent assets	2,143,429,733	1,993,539,798
Total assets	2,206,607,618	2,105,489,103
Deferred outflows of resources	4,831,280	3,085,631
Total current liabilities	74,716,123	158,463,796
Total noncurrent liabilities	854,210,011	650,452,313
Total liabilities	928,926,134	808,916,109
Total net position	$1,282,512,764	$1,299,658,625
Statements of Revenue, Expenses, and Changes in Net Position		
Operating revenues	$ 208,495,674	$ 200,762,485
Depreciation (expense)	(69,992,615)	(60,102,853)
Other operating (expenses)	(103,422,925)	(103,421,549)
Operating income	35,080,134	37,238,083
Nonoperating revenues (expenses):		
Investment income	167,230	35,758
Interest expense	(28,512,930)	(18,776,274)
Other	446,651	432,594
Capital grants and contributions	11,890,269	25,306,607
Transfers to other funds of the Metropolitan Government, net	(36,217,215)	(7,440,274)
Changes in net position	(17,145,861)	36,796,494
Net position, beginning of year, as restated	1,299,658,625	1,262,862,131
Net position, end of year	$ 1,282,512,764	$ 1,299,658,625

Current assets in 2013 were reduced from 2012 by approximately $48.8 million, due primarily to decreased cash and cash equivalents. Current liabilities decreased by $83.7 million due primarily to extinguishing of the existing commercial paper program by the 2013 Bond Issue, yielding a current ratio of 0.85. Capital assets, net of depreciation increased by $46.6 million in 2013 from 2012. These increases are from a combination of infrastructure being deeded to the Department by developers, recovery efforts from the 2010 flood event, and the Department's efforts to maintain and improve the system. The Department has an ongoing program to improve both the water and sewer infrastructure by cleaning and/or relining existing pipes, as well as replacing and extending facilities.

CAPITAL ASSETS AND BONDS AND NOTES PAYABLE

Capital Assets – The Department’s investment in capital assets as of June 30, 2013 is $1.74 billion, which is an increase of 2.7 percent from the year ending June 30, 2012. Depreciation expense for FY 2013 totaled $70.0 million.

	June 30, 2013	June 30, 2012
Utility plant in service	$ 2,457,337,569	$ 2,401,490,915
Land	22,475,744	10,010,297
Buildings and improvements	40,445,936	40,293,786
Improvements other than buildings	42,494,905	41,000,878
Furniture, machinery and equipment	36,460,555	35,729,034
Construction work in progress	145,160,683	99,330,085
Less accumulated depreciation	(1,000,353,246)	(930,391,214)
	$ 1,744,022,146	$ 1,697,463,781

Utility plant in service increased $55.8 million and construction work in progress increased $45.8 million during the year ending June 30, 2013. The primary reasons for the increases were due to construction activities related to the 2012 Bond Issue.

Additional information on the Department’s capital assets can be found in Note D beginning on page 24 of this report.

Bonds and Notes Payable – At June 30, 2013, the Department had total outstanding bond debt, including deferred charges/premiums, net, of $884.9 million. The revenues of the Department collateralized all bond debt. The Department had one outstanding state economic and development loan totaling $149,823.

	June 30, 2013	June 30, 2012
Revenue bonds payable	$ 827,450,000	$659,360,000
Deferred charges / premiums, net	57,423,660	33,352,490
State economic and development loan	149,823	196,884
Total	$885,023,483	$692,909,374

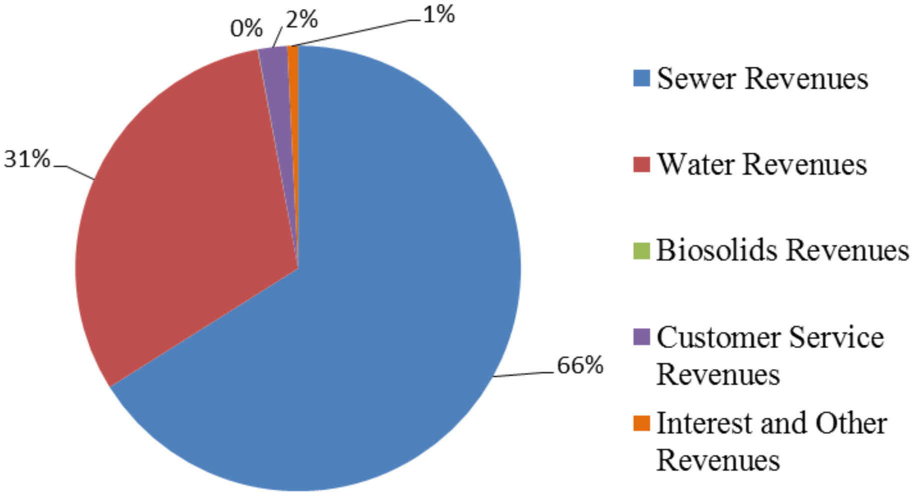
Additional information on the Department's bonds and note payable can be found in Note E beginning on page 25 of this report.

Commercial Paper - In November 2009, the Government instituted a Water and Sewer revenue bond commercial paper program to provide interim and short-term financing for various authorized capital projects of the Department. There was $0 outstanding commercial paper under the Water and Sewer program at June 30, 2013 due to the Series 2013 Bond Issue.

OTHER INFORMATION

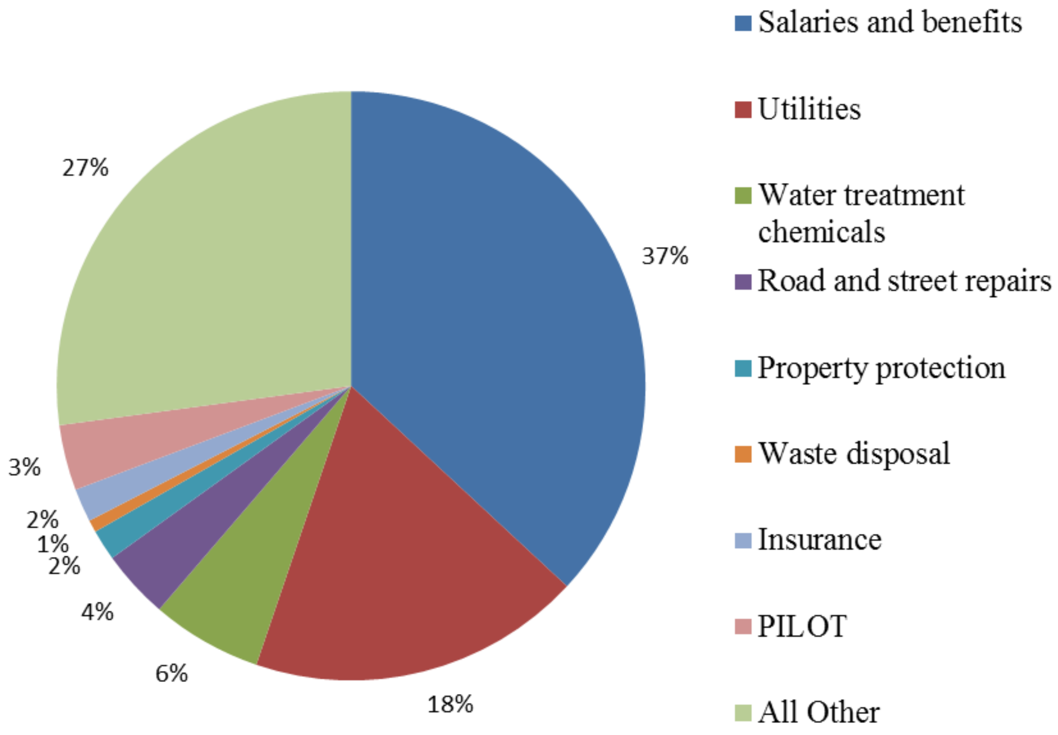
Sources of Revenues

The Department collects its primary revenues from charges for water and sewerage services provided to customers. In addition, these revenues are invested to earn interest. Customers are charged fees (Customer Service Revenue) to establish service, for late payment and for insufficient funds checks. The Department also charges a fee to tap onto the water system, a similar fee to connect to the sewerage system and a sewer capacity fee. These are illustrated on the chart below as a percentage of total revenues:



Major Expenses

In addition to the salaries and benefits of its employees, the major expenses incurred by the Department include electricity, payment in lieu of taxes to the Government (PILOT), water treatment chemicals, biosolids disposal, insurance, and property protection. Other expenses include the materials, supplies, and outside labor to maintain the system. These expense categories are charted below as a percentage of total operating expenses, excluding Depreciation, and Amortization:



REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Department's finances for citizens, taxpayers, customers, investors, creditors and all others with an interest in the Department's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Metropolitan Government of Nashville and Davidson County, Department of Finance, Division of Accounts, mailto:cafr@nashville.gov.

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
STATEMENT OF NET POSITION
JUNE 30, 2013

ASSETS:	
Current assets:	
Cash and cash equivalents	$ 23,420,504
Accounts receivable	23,250,628
Allowance for doubtful accounts	(2,926,134)
Accrued interest receivable	4,628
Due from other funds of the Government	705,871
Due from component units	6,123
Inventories of supplies	2,256,129
Other current assets	923
Restricted Assets:	
Cash and cash equivalents	949,643
Accounts receivable	89,216
Accrued interest receivable	7,309
Due from other funds of the Government	15,339,676
Other current assets	73,369
Total current assets	63,177,885
Capital and other noncurrent assets:	
Capital assets:	
Utility plant in service	2,457,337,569
Land	22,475,744
Buildings and improvements	40,445,936
Improvements other than buildings	42,494,905
Furniture, machinery and equipment	36,460,555
Construction in progress	145,160,683
Less accumulated depreciation	(1,000,353,246)
Capital assets, net	1,744,022,146
Restricted assets:	
Cash and cash equivalents	331,055,618
Other noncurrent assets	68,351,969
Total noncurrent assets	2,143,429,733
Total assets	2,206,607,618
DEFERRED OUTFLOWS OF RESOURCES:	
Deferred charge on refunding	4,831,280
Total deferred outflows of resources	4,831,280

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
STATEMENT OF NET POSITION - Continued
JUNE 30, 2013

LIABILITIES:	
Current liabilities:	
Accounts payable	$ 5,067,666
Accrued payroll	753,438
Due to other funds of the Government	492,523
Customer deposits	3,353,297
Other current liabilities	3,325,818
Liabilities payable from restricted assets:	
Accounts payable	12,690,936
Accrued payroll	133,523
Accrued interest	18,029,283
Current portion of long-term debt	30,765,000
Current portion of state loans	48,472
Due to other funds of the Government	56,167
Total current liabilities	74,716,123
Noncurrent liabilities:	
Revenue bonds, net	854,108,660
State loans	101,351
Total noncurrent liabilities	854,210,011
Total liabilities	928,926,134
NET POSITION:	
Net investment in capital assets	1,193,077,323
Restricted for debt retirement	55,709,511
Unrestricted	33,725,930
Total net position	$1,282,512,764

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET POSITION
YEAR ENDED JUNE 30, 2013

Operating revenues:	
Charges for services	$ 207,876,068
Other	619,606
Total operating revenues	208,495,674
Operating expenses:	
Personal services	42,233,525
Contractual services	42,352,850
Supplies and materials	12,235,967
Depreciation	69,992,615
Other	6,600,583
Total operating expenses	173,415,540
Operating income	35,080,134
Nonoperating revenue (expense):	
Investment income	167,230
Interest expense	(28,512,930)
Gain on sale of capital assets	111,821
Other	334,830
Nonoperating expense, net	(27,899,049)
Income before capital grants and contributions and transfers	7,181,085
Capital grants and contributions	11,890,269
Transfers to other funds of the Government	(36,217,215)
Change in net position	(17,145,861)
Net position, beginning of year, as restated	1,299,658,625
Net position, end of year	$ 1,282,512,764

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2013

Cash flows from operating activities:	
Receipts from customers and users	$ 207,268,787
Payments to suppliers	(53,443,203)
Payments to employees	(42,097,987)
Other payments	(19,606,663)
Net cash provided by operating activities	92,120,934
Cash flows from noncapital financing activities:	
Transfers to other funds of the Government	(36,217,215)
Net cash used in noncapital financing activities	(36,217,215)
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(106,105,832)
Proceeds from the sale of capital assets	111,821
Proceeds from borrowings	177,438,266
Principal payments on borrowings	(42,457,061)
Interest subsidy	5,104,289
Interest paid	(34,890,274)
Capital contributions received	4,159,437
Payments from other funds of the Government	35,362,501
Net cash provided by capital and related financing activities	38,723,147
Cash flows from investing activities:	
Interest received	163,008
Net cash provided by investing activities	163,008
Net increase in cash and cash equivalents	94,789,874
Cash and cash equivalents at beginning of year	260,635,891
Cash and cash equivalents at end of year	$ 355,425,765

Cash and cash equivalents are classified as:	
Current assets	$ 23,420,504
Current restricted assets	949,643
Noncurrent restricted assets	331,055,618
	$355,425,765

See accompanying notes to financial statements.

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
STATEMENT OF CASH FLOWS - Continued
YEAR ENDED JUNE 30, 2013

Reconciliation of operating income to net cash provided by operating activities:

Operating income	$ 35,080,134
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	69,992,615
Bad debt expense	(240,000)
Other receipts	334,830
Changes in assets and liabilities:	
Accounts receivable	(552,301)
Due from other funds of the Government	118,183
Due from component units	(6,123)
Inventories of supplies	31,128
Other current assets	39,143
Accounts payable	1,114,486
Accrued payroll	135,538
Due to other funds of the Government	(13,765,585)
Customer deposits	185,020
Other current liabilities	(346,134)
Total adjustments	57,040,800
Net cash provided by operating activities	$ 92,120,934

Supplemental disclosure of non-cash items:	
Contributions of the capital assets	$ 8,107,958

See accompanying notes to financial statements.

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements encompass the financial activities of the Department of Water and Sewerage Services (the “Department”). The Department is an enterprise fund of The Metropolitan Government of Nashville and Davidson County, Tennessee (the “Metropolitan Government”) and, accordingly, is included in the basic financial statements of the Metropolitan Government. The accompanying financial statements do not purport to present fairly the financial position of The Metropolitan Government of Nashville and Davidson County, Tennessee and changes in its financial position and its cash flows. The Department provides water and sewerage services to customers in the Metropolitan Nashville area on a self-support basis utilizing a rate structure designed to produce revenues sufficient to fund debt service requirements and operating expenses and maintain adequate working capital.

Basis of Accounting

The financial statements are presented using the economic resources measurement focus and the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. The Department applies all relevant Government Accounting Standards Board (“GASB”) pronouncements.

Estimates

Estimates used in the preparation of financial statements require management to make assumptions that affect the reported amounts of assets and liabilities, 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.

Cash and Cash Equivalents

Cash and cash equivalents include amounts in demand deposits and highly liquid short-term investments with maturity dates within three months of the date of acquisition. The Department participates in the centrally managed cash and investment pool of the Metropolitan Government, under which the Metropolitan Government remits payments on behalf of the Department. Investment income earned on funds invested in pooled accounts is allocated to the Department by the Metropolitan Government on the basis of relative balances.

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

Inventories

Inventories, principally materials, supplies and replacement parts, are valued at the lower of cost (average cost method) or market. Inventory items are recorded as expenditures when used under the consumption method.

Capital Assets

Utility plant acquired prior to July 31, 1952, is stated at the estimated cost at that date, as determined by independent engineers, with subsequent additions recorded at cost. Net interest expense incurred during the construction of plant and equipment is capitalized as part of the cost of the related asset. Capitalized interest for the year ended June 30, 2013 was $2,337,190. Capital assets are generally defined as assets with an individual cost in excess of $5,000 and a useful life in excess of one year. Depreciation is provided on the straight-line method over the estimated useful lives of the respective assets. The estimated useful lives are as follows:

Utility plant in service	7 - 100 years
Building and improvements	3 - 50 years
Improvements other than buildings	20 - 100 years
Machinery and equipment	3 - 50 years

The Department closes completed construction projects to capital assets upon beneficial use.

Bond Premiums and Discounts

Bond premiums and discounts are deferred and amortized on a straight-line basis over the term of the related bond issue.

Compensated Absences

General policy of the Metropolitan Civil Service Commission permits the accumulation, within certain limitations, of unused vacation days and sick leave. Vacation days may accumulate to an amount equal to three times the current vacation accrual rate. Accumulated unpaid vacation pay is recorded as a liability by the Department. Although sick pay may accumulate, no amounts are vested in the event of employee termination; therefore, no liability for sick pay has been accrued.

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

Restricted Assets

Restricted assets represent amounts which are required to be maintained pursuant to Department bond resolutions relating to bonded indebtedness (construction and sinking funds) and funds received for specific purposes pursuant to U.S. Government grants (related primarily to construction projects).

Deferred outflows of resources

In addition to assets, the Statement of Net Position will sometimes report a separate section for deferred outflows of resources. *Deferred outflows of resources* represent a consumption of net position that applies to a future period and so will not be recognized as an outflow of resource (expense) until then. The Department has one item that qualifies for reporting in this category. The *deferred charge on refunding* results from the difference in the carrying value of refunded debt and its reacquisition price. The amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

Operating and Nonoperating Revenues and Expenses

Operating revenues and expenses generally result from providing services and providing and delivering goods and services in connection with the Department's principal ongoing operations and consist primarily of charges to customers or departments, cost of sales and services, administrative expense, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. When both restricted and unrestricted resources are available for use, it is the Department's policy to use restricted resources first and then unrestricted resources, as they are needed.

Capital Grants and Contributions

Capital grants and contributions include funds received from federal and state agencies for certain sewer projects by the Department, contributions from local governments and other sources, tap and capacity fees, and deeds of conveyance. Utility plant contributed is recorded/presented in accordance with the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Non-exchange Transactions* and GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis' for State and Local Governments*. These statements require that capital contributions be reported in the statement of revenue, expenses and changes in net assets as a separate line item after non-operating revenues and expenses, rather than as direct additions to contributed capital, as under previous standards.

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

Impairment of Long-Lived Assets

The carrying value of long-lived assets held and used are reviewed whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. For purpose of evaluating the recoverability of long-lived assets, the recoverability test is performed using undiscounted net cash flows before consideration of interest expense. Should the sum of the expected future net cash flows be less than the carrying value of the asset being evaluated, an impairment loss would be recognized. The evaluation of asset impairment requires the Department to make assumptions about future cash flows over the life of the asset being evaluated. Assets to be disposed of are reported at the lower of their carrying amount or fair value less costs to sell, and are no longer depreciated. No impairment loss was considered necessary during fiscal year 2013.

Revenue Recognition

Revenues from services provided by the Department are recognized from meters read on a monthly cycle basis. At the end of each month, services rendered from the latest date of each meter-reading cycle to month end is accrued and included as accounts receivable, net of an estimated allowance for uncollectible accounts.

Net Position

The Department’s net position classifications are as follows:

- Net investment in capital assets - This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any debt and deferred inflows of resources attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of net investment in capital assets. Rather, that portion of the debt is included in the same net positions component as the unspent proceeds.

- Restricted - This component consists of net position restricted by grantors, contributors, or laws and regulations of other governments and restrictions imposed by law or through constitutional provisions or enabling legislation, reduced by liabilities and deferred inflows of resources related to those assets.

- Unrestricted - This component consists of net position that do not meet the definition of "restricted" or “net investment in capital assets."

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

Accounting Pronouncements

The Department adopted GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, required for fiscal periods beginning after June 15, 2012, in fiscal 2013. This Statement is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statements No. 14 and 34, to better meet user needs and address reporting entity issues that have come to light since those Statements were issued.

The Department adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, required for fiscal periods beginning after December 15, 2011, in fiscal 2013. This Statement is intended to enhance the usefulness of its Codification by incorporating guidance that previously could only be found in certain Financial Accounting Standards Board ("FASB") and American Institute of Certified Public Accountants ("AICPA") pronouncements.

The Department adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, required for fiscal periods beginning after December 15, 2011, in fiscal 2013. This Statement is intended to improve financial reporting by providing citizens and other users of state and local government reports with information about how past transactions will continue to impact a government's financial statements in the future.

The Department adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, required for fiscal periods beginning after December 15, 2012, in fiscal 2013. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. See Note B - Restatement of Net Position.

The Department plans to adopt GASB Statement No. 66, *Technical Corrections - 2012-- an amendment of GASB Statements No. 10 and No. 62*, required for fiscal periods beginning after December 15, 2012, in fiscal 2014. This Statement improves accounting and financial reporting by resolving conflicting guidance that resulted from the issuance of Statements No. 54 and No. 62.

A. SUMMARY SIGNIFICANT ACCOUNTING POLICIES - Continued

The Department plans to adopt GASB Statement No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25*, required for fiscal periods beginning after June 15, 2013, in fiscal 2014. This Statement improves financial reporting by state and local government pension plans.

The Department plans to adopt GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, required for fiscal periods beginning after June 15, 2014, in fiscal 2015. This Statement improves accounting and financial reporting by state and local governments for pensions.

The Department plans to adopt GASB Statement No. 69, *Government Operations and Disposals of Government Operations*, required for fiscal periods beginning after December 15, 2013, in fiscal 2015. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations.

The Department plans to adopt GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, required for fiscal periods beginning after June 15, 2013, in fiscal 2014. This Statement improves accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees.

Unless otherwise noted, management is in the process of determining the effects that the adoption of these Statements will have on the Department's financial statements.

B. RESTATEMENT OF NET POSITION

The Department adopted GASB Statement No. 65, Items Previously Reported as Assets and Liabilities, for the year ended June 30, 2013. The Statement established accounting and financial reporting standards that, among other things, recognized as outflows or inflows of resources, certain items that were previously reported as assets and liabilities. As a result, costs related to the issuance of debt previously deferred were reclassified as if they had been reported as an outflow of resources when incurred. The impact on the financial statements was a decrease in beginning net position as follows:

Net position - beginning of year, as previously reported	$ 1,305,015,102
Reclassification of deferred charge for debt issuance costs	(5,356,477)
Net position - beginning of year, as restated	$ 1,299,658,625

C. CASH AND CASH EQUIVALENTS

Deposit Policy

The Department is authorized by policy to invest funds that are not immediately needed in: United States Treasury Bills, Bonds and Notes; the State of Tennessee Local Government Investment Pool; bonds issued by the Government; bonds of commercial entities; and other investments such as repurchase agreements and commercial paper. The Department is authorized to invest in these instruments either directly or through the Metro Investment Pool.

Deposits in financial institutions are required by State statute to be secured and collateralized by the institutions. The collateral must meet certain requirements and must have a total minimum market value of 105% of the value of the deposits placed in the institutions, less the amount protected by federal depository insurance. Collateral requirements are not applicable for financial institutions that participate in the State of Tennessee's collateral pool. As of June 30, 2013, most of the Department's deposits were held by financial institutions, which participate in the bank collateral pool administered by the Treasurer of the State of Tennessee or in the State of Tennessee Local Government Investment Pool. Participating banks determine the aggregated balance of their public fund accounts for the Department. The amount of collateral required to secure these public deposits must be at least 105% of the average daily balance of public deposits held. Collateral securities required to be pledged by the participating banks to protect their public fund accounts are pledged to the State Treasurer on behalf of the bank collateral pool. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

The carrying amount of the cash and cash equivalents totaled $355,425,765, and the corresponding bank balance was $367,886,896. The difference between the carrying amounts of cash and cash equivalents and the corresponding bank balances is due primarily to outstanding checks and deposits in transit. The entire balance of cash and cash equivalents was covered by the State collateral pool, federal depository insurance or collateralized with securities held by the government's agent in the government's name.

D. CAPITAL ASSETS

The following summarizes the changes in capital assets during the year ended June 30, 2013.

	Balance July 1, 2012	Increases	Decreases	Balance June 30, 2013
Depreciable assets:				
Utility plant in service	$2,401,490,915	$ 55,846,654	$ -	$2,457,337,569
Buildings and improvements	40,293,786	152,150	-	40,445,936
Improvements other than buildings	41,000,878	1,494,027	-	42,494,905
Furniture, machinery and equipment	35,729,034	763,967	32,446	36,460,555
Total depreciable assets	2,518,514,613	58,256,798	32,446	2,576,738,965
Nondepreciable assets:				
Land	10,010,297	12,465,447	-	22,475,744
Construction in progress	99,330,085	100,244,452	54,413,854	145,160,683
Total nondepreciable assets	109,340,382	112,709,899	54,413,854	167,636,427
Total at historical cost	2,627,854,995	170,966,697	54,446,300	2,744,375,392
Less accumulated depreciation for:				
Utility plant in service	838,061,539	66,809,565	-	904,871,104
Buildings and improvements	26,727,155	1,230,449	-	27,957,604
Improvements other than buildings	33,640,892	749,971	-	34,390,863
Furniture, machinery and equipment	31,961,628	1,202,631	30,584	33,133,675
Total accumulated depreciation	930,391,214	69,992,616	30,584	1,000,353,246
Capital assets, net	$1,697,463,781	$100,974,081	$54,415,716	$1,744,022,146

E. BONDS AND NOTES PAYABLE

Transaction Summary

Bonds and notes payable activity for the year ended June 30, 2013 was as follows:

	Balance July 1, 2012	Additions	Reductions	Balance June 30, 2013	Due Within One Year
Revenue bonds payable	$659,360,000	$237,930,000	$(69,840,000)	$827,450,000	$30,765,000
Deferred charges/ premiums, net (1)	33,352,490	30,039,289	(5,968,119)	57,423,660	-
State economic and development loan	196,884	-	(47,061)	149,823	48,472
Total	$692,909,374	$267,969,289	$(75,855,180)	$885,023,483	$30,813,472

(1) The July 1, 2012 balance of the deferred premium was restated to reflect the reclassification of deferred charges on refunding from noncurrent assets to deferred outflows on the Statement of Net Position.

Description of Amounts Payable

Amounts payable at June 30, 2013 are as follows:

	Interest Rate	Amount
Revenue bonds payable:		
Department of Water and Sewerage Revenue Bonds Series 1998B, due in varying amounts to January 1, 2014	4.55 - 5.25%	$ 9,065,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2007, due in varying amounts to January 1, 2016	4.25 - 5.00%	24,380,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2008A, due in varying amounts to January 1, 2022	3.25 - 5.25%	107,005,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2010A, due in varying amounts to July 1, 2027	3.00 - 5.00%	104,050,000

E. BONDS AND NOTES PAYABLE - Continued

Description of Amount Payable - Continued

	Interest Rate	Amount
Department of Water and Sewerage Revenue Bonds, Federally Taxable (BAB's), Series 2010B, due in varying amounts to July 1, 2037	6.393 - 6.568%	$135,000,000
Department of Water and Sewerage Revenue Bonds, Federally Taxable, Series 2010C, due in varying amounts to July 1, 2041	6.693%	75,000,000
Department of Water and Sewerage Revenue Refunding Bonds, Federally Taxable, Series 2010D, due in varying amounts to July 1, 2018	4.255 - 4.791%	7,610,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2012, due in varying amounts to July 1, 2023	1.00 - 5.00%	127,410,000
Department of Water and Sewerage Revenue Refunding Bonds, Series 2013, due in varying amounts to July 1, 2033	3.00 - 5.00%	237,930,000
Deferred charge/premium, net		57,423,660
Total revenue bonds payable		884,873,660
State economic and development loan	3.00%	149,823
Total		$885,023,483

The bonds and notes payable are classified in the Statement of Net Position as follows:

Current liabilities:	
Liabilities payable from restricted assets:	
Current portion of revenue bonds, net and state construction loans	$ 30,813,472
Noncurrent liabilities:	
Revenue bonds, net and state loans	854,210,011
Total	$885,023,483

Collateral

All bonds are collateralized by the revenues of the Department.

E. BONDS AND NOTES PAYABLE - Continued

Bond Covenants

The various revenue bond indentures contain significant limitations and restrictions on annual debt service requirements, maintenance of a flow of monies through various restricted accounts, minimum amounts to be maintained in various sinking funds, and minimum revenue bond coverages. As of June 30, 2013, the Department believes it is in compliance with all financial limitations and restrictions.

Annual Debt Service Requirements

The annual requirements to amortize all revenue bonds outstanding as of June 30, 2013 are as follows:

	Revenue Bonds	
Year Ending June 30,	Principal	Interest
2014	$ 30,765,000	$ 34,189,170
2015	31,500,000	36,030,810
2016	20,275,000	34,839,035
2017	28,795,000	33,692,385
2018	37,475,000	32,139,607
2019 - 2023	190,290,000	132,015,069
2024 - 2028	90,875,000	96,990,780
2029 - 2033	104,820,000	75,561,101
2034 - 2038	131,380,000	48,724,414
2039 - 2043	144,330,000	17,001,671
2044	16,945,000	338,900
	827,450,000	541,522,942
Deferred premium/(discount)	57,423,660	-
Total	$884,873,660	$541,522,942

E. BONDS AND NOTES PAYABLE - Continued

Commercial Paper

In November 2009, the Department instituted a revenue commercial paper (bond anticipation note) program. Commercial paper notes are issued to provide interim or short-term financing of various water and sewer capital projects. The notes may be refunded with new notes (rollover notes) until the Department is prepared to issue long-term bonds and thereby provide permanent financing for the capital projects financed under the commercial paper program. The Department entered into Standby Note Purchase Agreements with two banks to provide liquidity for the commercial paper program. If the commercial paper dealer was ever unable to market notes in the amount needed to pay the maturing notes, the liquidity providers would issue bank notes, the proceeds of which are applied to pay the principal of and interest on commercial paper notes on the respective maturity dates.

Revenue commercial paper is issued as federally tax-exempt notes. The commercial paper is sold at par as interest-bearing obligations in minimum denominations of $100,000 with interest payable at maturity. The commercial paper has varying maturities not to exceed 270 days, and all rollover commercial paper will not have a final maturity more than two years from the initial dates of issuance. The State has waived the two-year final maturity limitation and approved a final maturity not to exceed six years. Interest rates vary depending on the market. At June 30, 2013, the amount of principal outstanding could not exceed $183.4 million. The balance on the commercial payer obligations on June 30, 2013 was $-0-.

Commercial paper activity for the year ended June 30, 2013 was as follows:

	Balance July 1, 2012	Additions	Reductions	Balance June 30, 2013
Commercial paper payable	$60,352,500	$310,000,000	$(370,352,500)	$ -

Issuance of Bonds

On April 25, 2013, the Government issued $237,930,000 Water and Sewer Revenue Bonds, Series 2013, maturing on July 1, 2033, with interest rates ranging from 3.00% to 5.00%. The net proceeds of the Series 2013 Bonds totaled $266,852,355 (net of original issue premium and underwriting fees). $141,852,355 was deposited with the Government of which $125,000,000 was made available to fund capital improvements, $16,377,091 was deposited in debt service reserves, and $475,264 was used to cover other costs of issuance. Additionally, $125,000,000 of the net proceeds was used to fund maturing commercial paper notes.

E. BONDS AND NOTES PAYABLE - Continued

Defeased Bonds

In the current and prior years, the Department has defeased certain other obligation bonds by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service requirements on the retired bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Department's financial statements. As of June 30, 2013, $49,965,000 of revenue bonds are considered defeased.

Redemption Options

Certain bonds are subject to redemption prior to maturity at the option of the Department. The stated payments of principal and interest on the Department of Water and Sewerage Services Series 1992 and Series 2010A, B, C and D are insured by municipal bond insurance policies which cannot be canceled.

State Economic and Development Loan

In January 2009, the Department entered a loan agreement with the Tennessee Department of Economic Development for $330,000. The proceeds of the loan will be used to fund the installation of variable frequency drives on the raw water pumps at the K.R. Harrington water treatment plant. The energy savings resulting from the ability to gradually increase or decrease pump speeds rather than adding or dropping pumps at full capacity will be used to repay the loan. The loan is for seven years, and interest is calculated on the loan at 3%.

State economic and development loan principal maturities as of June 30, 2013 are summarized below:

Year Ending June 30,	Principal	Interest
2014	$ 48,472	$4,495
2015	49,927	3,041
2016	51,424	1,543
Total state economic and development loan	$149,823	$9,079

F. EMPLOYEE BENEFIT PLANS

Pension Plans

The Government sponsors or guarantees several single-employer pension plans, including (a) the closed City Plan ("City Plan"), (b) the Davidson County Employees' Retirement Fund (County Plan), both of which were closed to new members on April 1, 1963, and (c) The Metropolitan Employees' Benefit Trust Fund Division A or B ("Metro Plan"). Division A of the Metro Plan was established at the inception of The Government on April 1, 1963, and was closed to new members on July 1, 1995. Division B of the Metro Plan was established as of July 1, 1995.

All plans of the Government were established by or continue under the authority of the Metropolitan Charter, Article XIII, effective April 1, 1963. Approval of the Metropolitan Council is required to establish and amend benefit provisions. Article XIII also requires that all pension plans be actuarially sound. Administrative costs of the plans are financed by plan assets. The plans are administered by the Metropolitan Employee Benefit Board, an independent board created by the Metropolitan Charter. The financial position and results of operations of the pension plans are reported as fiduciary funds of the Government and, accordingly, are not included in the financial statements of the Department.

Substantially all employees of the Department are members of the Metropolitan Plan. Periodic contributions by the Department to the Metropolitan Plan are at actuarially determined rates that are designed to accumulate sufficient assets to pay benefits when due. Contributions to closed plans are made on a pay-as-you-go basis whereby contributions are made in amounts sufficient to cover benefits paid during the year. Actuarially required employer contributions are not computed because the plans are closed and there are few active employees. Employees do not contribute to any of the pension plans.

Normal retirement for employees occurs at age 65 – Division A, or 60 – Division B, and entitles employees to a lifetime monthly benefit as determined under the Plan. Benefits fully vest upon completing five years of service for employees employed on or between October 1, 2001 and December 31, 2012, who vest before leaving employment. Benefits fully vest on completing 10 years of service for employees and non-vested employees rehired on or after January 1, 2013.

Amounts of actuarially determined net pension obligation are reported in the government-wide financial statement of the Metropolitan Government. Accordingly, no additional liability has been accrued in the financial statements of the Department.

Contributions to the various pension plans totaled $5,141,003 for the year ended June 30, 2013.

F. EMPLOYEE BENEFIT PLANS - Continued

Other Post-Employment Benefit (OPEB) Plans

Retirees in the Metropolitan, City or County Plans may elect to participate in the Metropolitan Employees' Medical Benefit Plan, a single-employer defined benefit healthcare plan. The Metropolitan Plan is administered by the Employee Benefit Board and provides medical, dental and life insurance. The other post-employment benefits for Government employees were authorized by the Government's charter and code. The Metropolitan Plan does not issue a stand-alone financial report.

The post-employment benefits for the Metropolitan plans were authorized by the Government's Charter. As the Government has assumed the responsibility for funding these benefits, the Department has accrued no liability as of June 30, 2013.

The contribution requirements of Metropolitan Employees' Medical Benefit Plan members and the Government are established and may be amended by the Employee Benefit Board. The required contribution is based on projected pay-as-you-go financing requirements under which contributions are made in amounts sufficient to cover benefits paid, administrative costs and anticipated inflationary increases. For health insurance, the Government contributes 75% of all premium payments, and the retirees contribute 25%. The Government also provides a 50% matching contribution on dental insurance for any retiree who elects to participate. Finally, the Government provides life insurance at no charge to the retirees.

Deferred Compensation Plan

The Government offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits deferral of a portion of salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. Because the assets are not held in a trustee capacity by the Government, they are not included in the Government's financial statements. No contributions are made to this plan by the Government.

G. COMMITMENTS AND CONTINGENCIES

Litigation

The Department is a party to various litigation filed in the normal course of business. It is believed that the outcome of these cases will not have a material effect on the financial position of the Department.

Insurance and Benefits

The Department is subject to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; illnesses or injuries to employees; and natural disasters. The Department is a member of the Metropolitan Government's self-insurance program with respect to the first $3,000,000 of liability claims and casualty losses in any one year. Liabilities for accidents are generally limited under the Governmental Tort Liability Act of the Tennessee Code as follows; bodily injury - $300,000 per person, $700,000 per accident; and property damage - $100,000 per accident. Claims on real and personal property in losses to a $10,000 deductible.

The Department is also a member of the Government's self-insurance program with respect to medical benefits and employee blanket bond coverage. Premiums paid by the Department to the program were $6,267,462 for the year ended June 30, 2013.

Federal and State Financial Assistance

The Department has received federal and state financial assistance for specific purposes that is subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the programs, the Department believes that any required reimbursements would not be material to the Department's financial statements. Accordingly, no provision has been made for any potential reimbursements to the grantor agencies.

Prior to the issuance of the Water and Sewer Revenue Refunding Bonds, Series 2010A, on December 16, 2010, the full faith and credit of the Metropolitan Government was pledged for possible deficiencies in the collection of required state sewer user fees established in connection with certain grants received from the State Funding Board (TCA 68-221-202 through 68-221-214). The Department acted as a conduit with respect to sewer user fees imposed by the state. These user fees were set at an amount sufficient to recover the project costs, including related interest expense. A portion of the proceeds from the Series 2010A Bonds was used to fully prepay the Tennessee Local Development Authority ("TLDA") loans. The amount of prepayment is $68,351,969 at June 30, 2013 and is reported as other noncurrent assets. Subsequent to the issuance of the Bonds, the user fees are considered a general sewer charge and reflected as revenue. The amounts received were recorded as capital grants and contributions by the Department.

G. COMMITMENTS AND CONTINGENCIES - Continued

At June 30, 2013, the Department had commitments of $75,558,979 for construction contracts.

The Department, the Metropolitan Council, the State of Tennessee Department of Environment and Conservation ("TDEC"), and the United States Environmental Protection Agency ("EPA"), have agreed on a consent decree to address and correct deficiencies within the Department's sewer system that have caused violations of the Clean Water Act ("CWA"). The consent decree was approved by the Federal Court in March 2009. Per the original decree, the Department was required to fully develop, in two years, a Corrective Action Plan/Engineering Report ("CAP/ER") for its sanitary sewer system and a Long-term Control Plan ("LTCP") for its combined sewer system to achieve the goals of the CWA and meet water quality requirements in the Cumberland River. Upon submittal and approval of the Plans, the Department will have an additional nine years to complete the work as developed by the Plans.

Due to the historic floods that occurred in Nashville in May 2010, the Department petitioned EPA and TDEC for a six-month extension for developing the CAP/ER and LTCP and a two year extension for completing the work (final compliance) under the force majeure clause of the consent decree. Approval has been granted for both extensions. The due date for the CAP/ER and LTCP was September 11, 2011, and the due date for all work coming out of those two plans (final compliance) is eleven years after approval of the plans by EPA and TDEC. The Department submitted both plans on Friday, September 9, 2011, and is waiting for feedback from EPA and TDEC. The Department has hired an internal program director as well as an external program management team composed of engineering consultants to manage planning, design and oversight of the program. The Department has also contracted for a construction management team to protect the investment in construction projects. A group of project set designers has been selected to assist with the design of individual projects. A total of seventeen different design firms were selected for large projects and six additional small business design firms for smaller projects.

The future related capital expenditures are expected to be between $1 billion and $1.5 billion. Continuing to have sewer overflows along with failure to comply with the mandate and meet future established deadlines could result in stipulated penalties of up to $3,000 per occurrence for sanitary sewer overflows, and up to $5,000 per day for failure to implement the improvements on a timely basis. EPA sent a demand letter for $147,000 in stipulated penalties for sanitary overflow on September 9, 2011. This was for a negotiated 147 violations for 2010 and the first quarter of 2011. No penalties have been demanded for any delays in submitting reports and deliverables nor from the failure to timely implement work. Proposed plans to fund capital expenditures for the next few years include internally generated cash and borrowings.

H. RELATED PARTY TRANSACTIONS

The Department supplies water and sewerage services to the other departments of the Government, for which standard rates are charged.

The Government performs certain administrative functions for the Department. The cost of such services included in operating expenses is $8,381,604 for the year ended June 30, 2013.

In addition, in February 1996, the Metropolitan Government adopted a resolution which requires the Department to make an annual payment to the Government of $4,000,000, representing a payment in lieu of ad valorem taxes. This payment is included in operating expenses for the year ended June 30, 2013.

I. SUBSEQUENT EVENTS

Effective July 1, 2013, the Board of the Old Hickory Utility District (OHUD) resolved to consolidate its operations into the Department's operations. At the time of merger, OHUD reported a net position of approximately $5.1 million which was comprised of $1.3 million of cash and cash equivalents, $3.7 million in net capital assets, and $110,000 of accounts receivable.

The Department has evaluated subsequent events through October 31, 2013, the date the financial statements were available for issuance, and has determined that there are no other items requiring disclosure.

SUPPLEMENTARY INFORMATION

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
SCHEDULE OF UTILITY RATES (UNAUDITED)
JUNE 30, 2013

The rate structure is composed of a meter charge and a volume charge.

The Department had the following rate structure in effect at June 30, 2013:

METER:

	Water				Sewer			
Meter Size	Residential	Small Commercial	Intermediate Commercial	Large Commercial	Residential	Small Commercial	Intermediate Commercial	Large Commercial
5/8"	$3.13	$3.98	$13.85	$597.23	$7.62	$8.51	$27.89	$1,076.37
3/4"	10.62	11.32	19.64	603.69	21.63	24.22	39.55	1,088.01
1"	12.77	13.63	21.51	605.80	26.05	29.17	43.33	1,091.79
1 1/2"	18.77	20.03	26.71	611.60	38.29	42.89	53.81	1,102.25
2"	25.29	26.97	32.63	618.22	51.57	57.75	65.73	1,114.18
3"	33.38	35.6	140.84	624.04	68.04	76.21	82.26	1,124.65
4"	54.41	58.03	64.65	650.65	110.88	124.18	130.22	1,172.65
6"	85.42	91.12	99.81	689.96	174.12	195.01	201.05	1,243.48
8"	133.59	142.50	155.38	755.41	272.29	304.96	312.96	1,361.43
10"	133.59	142.50	155.38	755.41	272.29	304.96	312.96	1,361.43

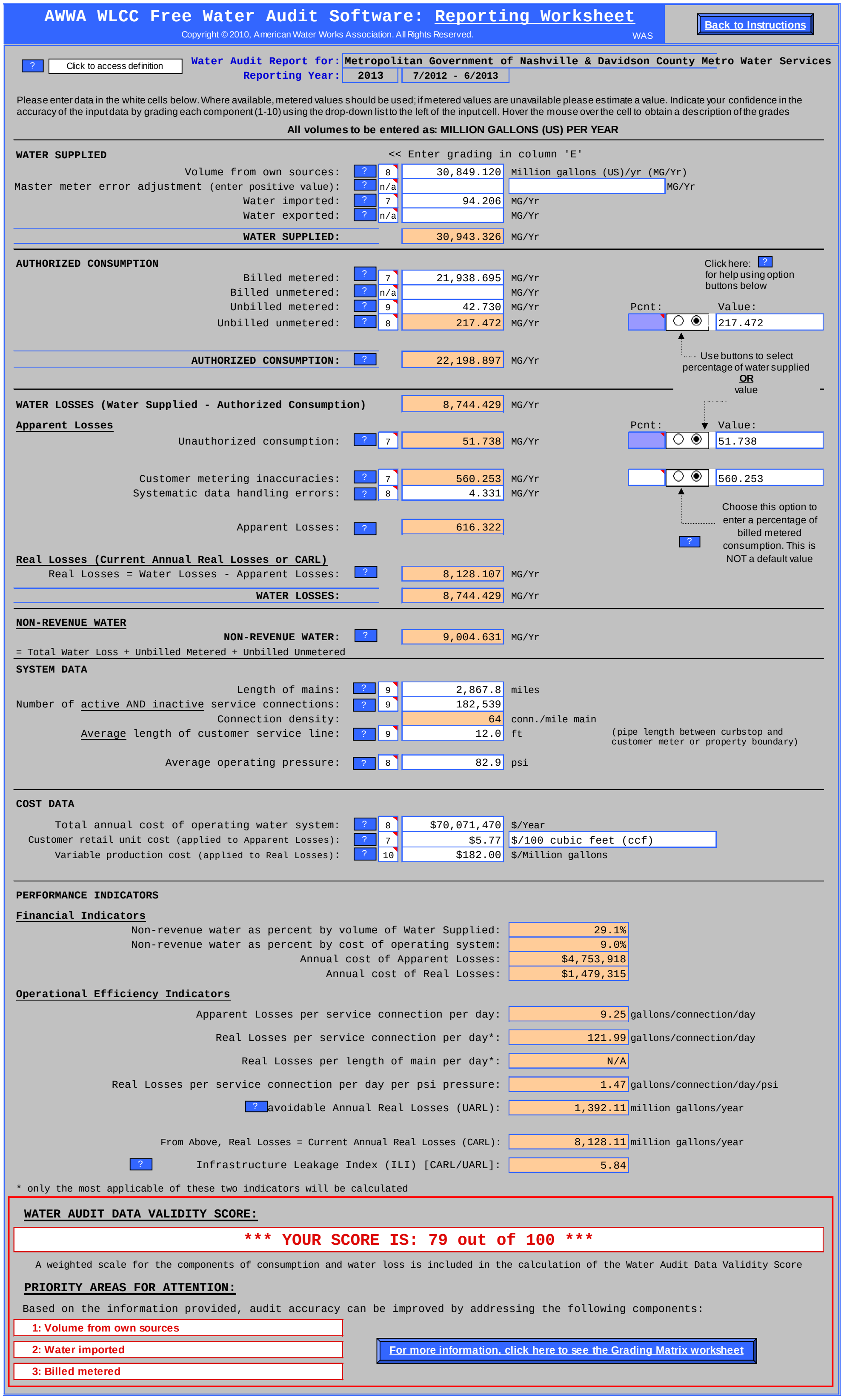
VOLUME:

Water usage charges per 100 cubic feet (For usage over 200 cubic feet)				Sewer usage charges per 100 cubic feet (For usage over 200 cubic feet)			
$2.33	$2.48	$2.14	$1.81	$4.74	$5.30	$4.32	$3.26

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
SCHEDULE OF NUMBER OF CUSTOMERS (UNAUDITED)
JUNE 30, 2013

	Residential	Commercial	Total
Water Customers	171,456	15,816	187,272
Sewer Customers	184,117	14,368	198,485
Total Customers	355,573	30,184	385,757

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
SCHEDULE OF UNACCOUNTED FOR WATER (UNAUDITED)
JUNE 30, 2013



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WAS

Water Audit Report for: Metropolitan Government of Nashville & Davidson County Metro Water Services
Reporting Year: 2013 7/2012 - 6/2013

Please enter data in the white cells below. Where available, metered values should be used; if metered values are unavailable please estimate a value. Indicate your confidence in the accuracy of the input data by grading each component (1-10) using the drop-down list to the left of the input cell. Hover the mouse over the cell to obtain a description of the grades

All volumes to be entered as: MILLION GALLONS (US) PER YEAR

WATER SUPPLIED << Enter grading in column 'E'

Volume from own sources:	8	30,849.120	Million gallons (US)/yr (MG/Yr)
Master meter error adjustment (enter positive value):	n/a		MG/Yr
Water imported:	7	94.206	MG/Yr
Water exported:	n/a		MG/Yr
WATER SUPPLIED:		30,943.326	MG/Yr

AUTHORIZED CONSUMPTION

Click here: ? for help using option buttons below

				Pcnt:		Value:
Billed metered:	7	21,938.695	MG/Yr			
Billed unmetered:	n/a		MG/Yr			
Unbilled metered:	9	42.730	MG/Yr			
Unbilled unmetered:	8	217.472	MG/Yr		○ ●	217.472
AUTHORIZED CONSUMPTION:		22,198.897	MG/Yr			

Use buttons to select percentage of water supplied
OR
value

WATER LOSSES (Water Supplied - Authorized Consumption) 8,744.429 MG/Yr

Apparent Losses

				Pcnt:		Value:
Unauthorized consumption:	7	51.738	MG/Yr		○ ●	51.738
Customer metering inaccuracies:	7	560.253	MG/Yr		○ ●	560.253
Systematic data handling errors:	8	4.331	MG/Yr			
Apparent Losses:		616.322				

Choose this option to enter a percentage of billed metered consumption. This is NOT a default value

Real Losses (Current Annual Real Losses or CARL)

Real Losses = Water Losses - Apparent Losses:	8,128.107	MG/Yr
WATER LOSSES:	8,744.429	MG/Yr

NON-REVENUE WATER

NON-REVENUE WATER: 9,004.631 MG/Yr

= Total Water Loss + Unbilled Metered + Unbilled Unmetered

SYSTEM DATA

Length of mains:	9	2,867.8	miles
Number of active AND inactive service connections:	9	182,539	
Connection density:		64	conn./mile main
Average length of customer service line:	9	12.0	ft
Average operating pressure:	8	82.9	psi

(pipe length between curbstop and customer meter or property boundary)

COST DATA

Total annual cost of operating water system:	8	$70,071,470	$/Year
Customer retail unit cost (applied to Apparent Losses):	7	$5.77	$/100 cubic feet (ccf)
Variable production cost (applied to Real Losses):	10	$182.00	$/Million gallons

PERFORMANCE INDICATORS

Financial Indicators

Non-revenue water as percent by volume of Water Supplied:	29.1%	
Non-revenue water as percent by cost of operating system:	9.0%	
Annual cost of Apparent Losses:	$4,753,918	
Annual cost of Real Losses:	$1,479,315	

Operational Efficiency Indicators

Apparent Losses per service connection per day:	9.25	gallons/connection/day
Real Losses per service connection per day*:	121.99	gallons/connection/day
Real Losses per length of main per day*:	N/A	
Real Losses per service connection per day per psi pressure:	1.47	gallons/connection/day/psi
Unavoidable Annual Real Losses (UARL):	1,392.11	million gallons/year
From Above, Real Losses = Current Annual Real Losses (CARL):	8,128.11	million gallons/year
Infrastructure Leakage Index (ILI) [CARL/UARL]:	5.84	

* only the most applicable of these two indicators will be calculated

WATER AUDIT DATA VALIDITY SCORE:

***** YOUR SCORE IS: 79 out of 100 *****

A weighted scale for the components of consumption and water loss is included in the calculation of the Water Audit Data Validity Score

PRIORITY AREAS FOR ATTENTION:

Based on the information provided, audit accuracy can be improved by addressing the following components:

1: Volume from own sources
2: Water imported
3: Billed metered

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
PLEDGED REVENUE COVERAGE (UNAUDITED)
LAST TEN FISCAL YEARS
(amounts expressed in thousands)

Fiscal Year	Gross Revenue(1)	Direct Operating Expense (2)	Net Revenue Available For Debt Service	Debt Service Requirement Principal	Interest	Total	Coverage
2003-04	$154,638	$71,273	$83,365	$21,680	$27,531	$49,211	1.69
2004-05	156,158	71,410	84,748	25,960	26,407	52,367	1.62
2005-06	161,727	78,293	83,434	27,280	25,034	52,314	1.59
2006-07	173,220	82,817	90,403	28,770	23,581	52,351	1.73
2007-08	180,862	88,416	92,446	31,185	19,646	50,831	1.82
2008-09	172,379	90,685	81,694	33,370	18,859	52,229	1.56
2009-10	171,966	88,603	83,363	35,525	16,527	52,052	1.60
2010-11	196,268	94,478	101,790	37,830	26,998	64,828	1.57
2011-12	201,263	102,485	98,778	42,410	29,386	71,796	1.38
2012-13	209,110	103,423	105,687	30,765	34,189	64,954	1.63

Note: Details regarding the Department’s outstanding debt can be found in the notes to the financial statements.

(1) Includes interest on investments and other income.

(2) Excludes depreciation and amortization expense.

DEPARTMENT OF WATER AND SEWERAGE SERVICES
THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY
SCHEDULE OF NONCURRENT RESTRICTED CASH AND CASH EQUIVALENTS
JUNE 30, 2013

Debt Service Fund	$ 33,607,067
Waterworks revolving fund	200,000
Extension and replacement fund	88,354,454
Debt service reserve funds	40,056,982
Construction funds	168,837,115
Total Restricted for Use	$331,055,618

CROSSLIN
&ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

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*

The Honorable Mayor and Members of Council
The Metropolitan Government of Nashville and
Davidson County, Tennessee

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 Department of Water and Sewerage Services (the "Department"), an enterprise fund of the Metropolitan Government of Nashville and Davidson County, Tennessee (the "Metropolitan Government"), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Department's basic financial statements, and have issued our report thereon dated October 31, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department'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 Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department'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 Department'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.

Crosslin + Associates, P.C.

Nashville, Tennessee
October 31, 2013