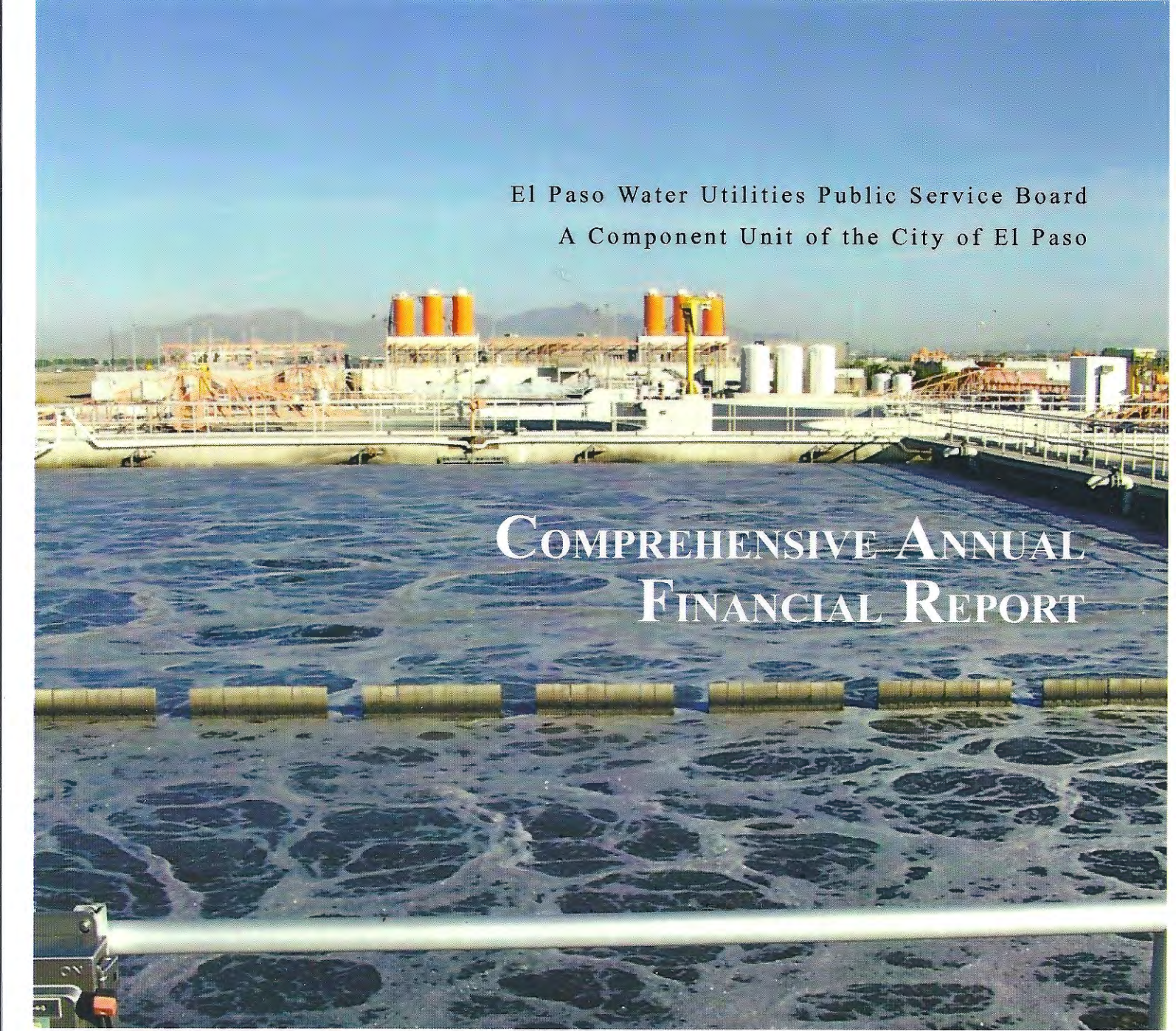


El Paso Water Utilities Public Service Board
A Component Unit of the City of El Paso



COMPREHENSIVE ANNUAL
FINANCIAL REPORT

for the Fiscal Year Ended February 28, 2011

El Paso, Texas



**Public Service Board
El Paso Water Utilities**

A Component Unit of the City of El Paso

**Comprehensive
Annual Financial Report
For the Fiscal Year Ended February 28, 2011**

El Paso, Texas

Prepared by:

Departments of Finance & Accounting

PUBLIC SERVICE BOARD - EL PASO WATER UTILITIES

A COMPONENT UNIT OF THE CITY OF EL PASO

Comprehensive Annual Financial Report

For the Fiscal Year Ended February 28, 2011

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EDMUND G. ARCHULETA, P.E.

July 13, 2011

Public Service Board
El Paso Water Utilities

Dear Public Service Board Member:

We are pleased to submit the Comprehensive Annual Financial Report of the Public Service Board - El Paso Water Utilities (EPWU) for the fiscal year ended February 28, 2011 pursuant to the City of El Paso Bond Ordinance 752, as amended and City Ordinance No. 016668 establishing the Municipal Drainage Utility System. Responsibility for the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with EPWU. This Comprehensive Annual Financial Report was prepared by the Finance Department of EPWU. We believe the data, as presented, is accurate in all material respects; that it is presented in a manner designed to fairly set forth the financial position and results of operations of the EPWU; and that all disclosures necessary to enable the readers to gain the maximum understanding of EPWU's financial activity have been included.

This report consists of management's representation concerning the finances of the Public Service Board – El Paso Water Utilities and its Water and Wastewater Utility Fund and the Municipal Drainage Utility Fund. Management assumes full responsibility for the completeness and reliability of all of the information presented in this report. To provide a reasonable basis for making these representations, management of the EPWU has established a comprehensive internal control framework that is designed both to protect the government's assets from loss, theft, or misuse and to compile sufficient reliable information for the preparation of EPWU's financial statements in conformity with Generally Accepted Accounting Principles (GAAP). Because the cost of internal controls should not outweigh their benefits, the EPWU's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

EPWU's financial statements have been audited by Gibson, Ruddock, Patterson LLC, a firm of licensed certified public accountants. The goal of the independent audit was to provide reasonable assurance that the financial statements of EPWU for the fiscal year ended February 28, 2011, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The independent auditor concluded, based upon the

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audit, that there was a reasonable basis for rendering an unqualified opinion that the EPWU's financial statements for the fiscal year February 28, 2011, are fairly presented in conformity with GAAP. The independent auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of EPWU was part of a broader, financially mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and legal requirements involving the administration of federal awards. These reports are available in the EPWU's separately issued Single Audit Report.

Governmental Accounting Standards Board (GASB) requires that the management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The EPWU's MD&A can be found immediately following the independent auditor's report.

Profile of the Government

City of El Paso Ordinance No. 752, adopted May 22, 1952, established the Public Service Board – El Paso Water Utilities. The board of trustees, known as the "Public Service Board (PSB)," was given complete management and control of the city's water system. Ordinance No. 017167 adopted August 11, 2009 increased the number of board members from five to seven. The PSB consists of the Mayor of the City of El Paso and six residents of El Paso County, Texas. With the exception of the Mayor, all other trustees are appointed by the City Council and serve staggered four-year terms. The PSB meets the second Wednesday of each month, except during holiday seasons, at EPWU's administrative office.

In June 2007, City Ordinance No. 016668 established a Municipal Drainage Utility for the City of El Paso. The Public Service Board – El Paso Water Utilities was given complete management and control of the city's drainage system, which EPWU assumed effective March 1, 2008.

Mission Statement - The mission of the Public Service Board - El Paso Water Utilities is to furnish at fair and reasonable costs to our customers:

- * High quality potable water in sufficient quantities and at adequate pressures to satisfy domestic, industrial, and fire protection requirements, and in accordance with the EPWU's Water Conservation Plan.
- * Collection of liquid waste from individual customers for treatment and disposal without hazard to the health of the community in a manner that will protect the environment.
- * Planning and management of all stormwater related functions within the City of El Paso and El Paso County, as contracted by EPWU and the County.

In the fall of 2010, the Public Service Board updated its Strategic Plan to reflect changing conditions and identify and address new initiatives. The PSB and its senior management staff update the Strategic Plan annually. The updated plan identifies driving forces and key issues and addresses how EPWU should proactively deal with these “critical success factors” on a prioritized basis.

The El Paso Water Utilities – Public Service Board provides for water, wastewater, reclaimed water and drainage service to its customers. For financial reporting purposes, the EPWU is considered a component unit of the City of El Paso. The PSB operates and manages EPWU on behalf of the City of El Paso. It adopts an annual combined operating, capital and debt service budget for both the Water and Wastewater Utility Fund and the Municipal Drainage Utility Fund, along with associated rates and fees for services; and also issues updates to its Rules and Regulations, which have the force of law. EPWU recovers the cost of providing water, wastewater, reclaimed water and drainage services primarily through user charges and fees. EPWU does not assess or collect ad valorem property taxes. As part of the mission and vision statements of the PSB, EPWU strives to balance customer needs with proper resource and financial management as well as regional leadership.

Budget process and controls - EPWU’s fiscal year starts March 1 and runs to the last day of February. The combined operating and capital budget preparation process starts in August with Strategic Planning update sessions held by the PSB and management. In September, budget documents with historical and current financial and statistical data are sent to all sections along with instructions on how to prepare the operating budget and identifying new initiatives. The capital budget is prepared in a similar fashion. Management reviews the operating and capital budgets and presents the recommended combined operating and capital budget to the Public Service Board over a series of public meetings. The PSB approves the combined annual operating and capital budget and accompanying updates to the Rules and Regulations, in February, effective March 1.

The budget and the annual financial report are prepared using the accrual basis of accounting. Revenue is recognized as it is earned and expenses are recognized as goods or services are delivered. The operating budget is prepared at the object level. The object is the good or service for which the expenditure was made. Operating or capital budget line item transfers are done on a memorandum basis, submitted by the requesting manager to Finance. The transfer is subject to approval by management but does not need approval by the PSB. Only the PSB can approve emergency funding authorizations and amendments to the approved operating and capital budgets.

Factors Affecting Financial Condition

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment with which the El Paso Water Utilities operates.

Local Economy - El Paso is currently the fifth largest city in Texas and the 19th largest city in the United States. El Paso County has an estimated population of over 800,000 people with another 1.1 million in El Paso’s sister city of Juarez, Mexico. With a population of over 200,000

in Southern New Mexico, the El Paso region constitutes the largest international border community in the world. The Fort Bliss expansion will bring an additional 60,000 new residents into the El Paso region by the year 2015.

The Government Sector continues to be the strongest performing sector of the local economy, adding over 2,100 jobs or 3.0% growth through 2010 while most sectors were either up or down 1%. During the fourth quarter of 2010, The Brookings Institute ranked El Paso in “The 20 strongest performing metro areas” for the third year in a row. Rankings were based on employment, foreclosure, and income data for the top 100 metro areas. As of December 2010, El Paso’s unemployment rate stood at 9.7%, substantially higher than the pre-recession levels and marginally higher than the national rate of 9.1%.

The El Paso Tri-State region is the fifth largest manufacturing center in North America. Ciudad Juarez *maquilas* employ about a quarter of a million workers, representing 20 percent of the total *maquila* jobs in Mexico. Roughly 25 percent of Mexico’s total production sharing output is manufactured in Cd. Juarez. The success of the *maquila* program has allowed the El Paso region to gain a globally competitive advantage in the manufacturing industry. Recent forecasts by the Federal Reserve Bank of Dallas showed a steady increase in *maquila* job growth throughout 2010 and well into 2011.

In addition to a strong, diverse economic base, El Paso ranks as the safest city with a population over 500,000 for 2010 in the United States according to the Morgan Quitno Corporation. The overall crime rate has continued to decrease in recent years despite the constant growth that the city has experienced.

Located in the northeastern region of El Paso, Fort Bliss currently stretches over 1.1 million acres of land, an area of land larger than the State of Rhode Island. By 2013, Fort Bliss will realize a net increase of over 28,000 active duty personnel – the largest net gain from any military installation in America. The Army also projects that approximately 16,000 spouses and 21,000 children will accompany these personnel as they transition to El Paso. An investment of over \$5 billion for construction projects will support the 300% base population increase by 2015. The El Paso Regional Economic Development Corporation estimated that Fort Bliss’ long term economic impact is estimated at \$6.3 billion annually. Fort Bliss is the first military post in the nation to be designated a Center for Renewable Energy. This designation could mean more federal funding and private sector investment that could total to more than \$400 million for the local economy. By 2015, Fort Bliss will utilize solar and geothermal energy and a waste-to-energy facility. These renewable sources of energy could provide enough power for the base to operate completely independent of the local power grid.

El Paso is home to the University of Texas at El Paso (UTEP), which is the second oldest member of the University of Texas System. It was founded in 1913 and became part of the U.T. system in 1919. UTEP has been an important part of the El Paso community since it was founded as the Texas School of Mines and Metallurgy more than 90 years ago. In 1914, the school opened with 27 students and a handful of faculty and staff. UTEP has grown into a dynamic urban university that today serves the needs of more than 22,000 students, offering 81 bachelors, 72 master and 16 doctoral programs.

As the nation's only major research university serving a student population that is predominantly Mexican-American, UTEP has also been named one of the top five Hispanic serving institutions to receive federal research money, according to the National Science Foundation (NSF). The NSF designated UTEP as a Model Institution for Excellence, one of only six in the country. This has resulted in a multimillion dollar NSF grant to support UTEP's science, computer science, engineering, and mathematics programs.

Growth is evident in all parts of El Paso. The city has experienced growth in the challenging economic environment and this will remain the case during the next year. UTEP and Fort Bliss expansions are two examples of multi-billion dollar expansions that have already started and will carry on through 2011 and beyond. A recent survey conducted by the Fort Worth Star-Telegram reported that El Paso is the only major city in Texas not facing a major budgetary shortfall in the upcoming fiscal year. The four largest Texas cities are facing budgetary shortfalls anywhere from 8 to 15 percent of their respective general funds. Because of the military and university investments made in our community, El Paso weathered the economic downturn very well and is in a great position for growth in the years to come.

Long-term financial planning - Region E was one of sixteen regions in Texas created in 1997 as part of Senate Bill 1 which required long term water planning by region. EPWU updated its 50-year plan as part of the update in 2011 of the Region E's 50-year water plan. This plan identifies projected water demand over the next 50 years and provides water supply alternatives to meet demand. The EPWU is currently focused on a 10 year planning horizon and has identified specific projects costing over \$638 million that will need to be constructed to meet the water and wastewater needs of the El Paso region, with an additional \$120 million in drainage projects to address deficiencies in the drainage system. While EPWU aggressively seeks grants and other alternative revenue sources, it is projected that water and wastewater rates will increase an estimated 10% over the next ten years to finance identified projects. In May 2009, City Council adopted water and wastewater impact fees to help pay for growth infrastructure. Once fully implemented, we estimate \$1 - \$2 million to be collected from impact fees annually, which depending on economic development, will affect future rate increases. EPWU does not project a drainage fee increase for the next five years, but possibly 10% over the next ten years to finance the drainage projects. The Utility has budgeted over \$89 million in fiscal year 2011-12 for water and wastewater facilities to meet the growth demands of the city and keep up with the rehabilitation of the system and \$44 million for drainage facilities to improve the drainage infrastructure throughout the city. EPWU will have to address the possibility of compliance with new disinfection byproduct rules and the capital costs associated with that in the next ten years. Wastewater plants are targeted for major rehabilitation over the next ten years, including the expansion of the Roberto Bustamante Wastewater Treatment Plant in 2014. This plant was once scheduled for expansion in 2000, but because of successful indoor conservation, the expansion has been delayed by several years.

Awards and Acknowledgements

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the El Paso Water Utilities for its comprehensive annual financial report (CAFR) for the fiscal year ended February 28, 2010. This was the fifteenth consecutive year that EPWU has received this prestigious award. In order to be awarded a

Certificate of Achievement, the government must have published an easily readable and efficiently organized CAFR. This report satisfied both GAAP and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

In addition, EPWU received the GFOA's Distinguished Budget Presentation Award for its annual budget document for fiscal year beginning March 1, 2010, which was the twelfth consecutive year EPWU has received this award. In order to qualify for the Distinguished Budget Presentation Award, the government's budget document must be judged to be proficient in several categories, including as a policy document, a financial plan, an operations guide, and a communications device.

The preparation of this report would not have been possible without the efficient and dedicated services of the entire staff of the finance and accounting department. We would like to express our appreciation to Arturo Duran, Fiscal Operations Manager, and all members of the department who contributed to the preparation of this report. Credit also must be given to the Mayor and Public Service Board for their support for maintaining the highest standards of professionalism in the management of the EPWU finances.



Edmund G. Archuleta, P.E.
President and Chief Executive Officer



Nicholas J. Costanzo
Vice President Strategic, Financial & Management Services



Marcela Navarrete, C.P.A.
Chief Financial Officer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

El Paso Water Utilities/Public
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For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
February 28, 2010

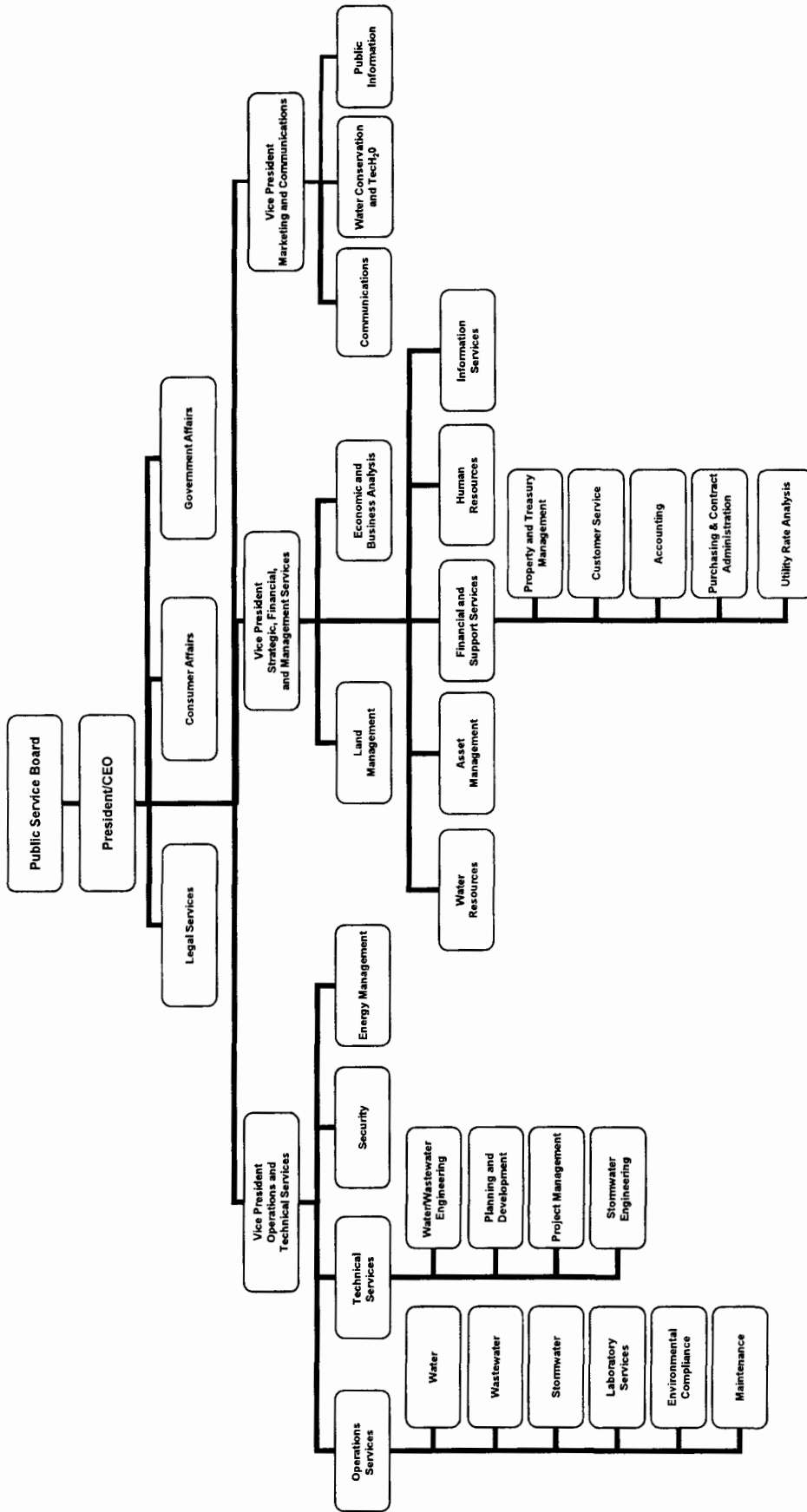
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President

Executive Director

El Paso Water Utilities Organizational Structure





COMPREHENSIVE ANNUAL FINANCIAL REPORT FOR FISCAL YEAR 2010-2011

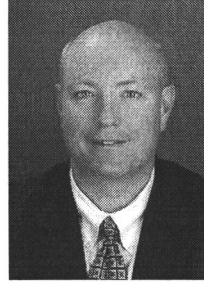
PUBLIC SERVICE BOARD



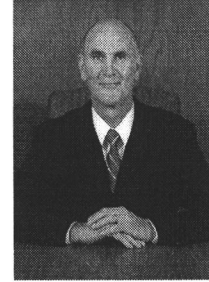
Edward Escudero, CPA
Chair



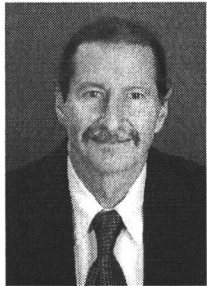
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Vice Chair



Dr. Richard Schoephoerster
Secretary-Treasurer



John F. Cook
Mayor, City of El Paso



Dr. Richard Bonart
Member



Ruth Katherine Brennand
Member



David Nemir
Member

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Edmund G. Archuleta, P.E.
President and CEO

Nicholas J. Costanzo, Vice President Strategic, Financial and Management Services

John E. Balliew, P.E. Vice President Operations and Technical Services

Christina Montoya, Vice President Communications

David R. Brosman, P.E., Chief Operations Officer

Daniel Avila, P.E., Chief Technical Officer

Marcela Navarrete, C.P.A. Chief Financial Officer

ACCOUNTING/ASSET MANAGEMENT

Arturo Duran, Fiscal Operations Manager

Jeff Tepsick, Accounting Manager

Leo Fierro, Asset Manager

GENERAL COUNSEL

Robert D. Andron, General Counsel

Lowell Stokes, Assistant General Counsel

