PASSAIC VALLEY SEWERAGE COMMISSION

Financial Statements

December 31, 2012

PASSAIC VALLEY SEWERAGE COMMISSION

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December 31, 2012

MERCADIEN, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Executive Director of
Passaic Valley Sewerage Commission

Report on the Financial Statements

We have audited the accompanying modified cash basis financial statements of the business-type activities of Passaic Valley Sewerage Commission (the "Commission"), as of and for the year ended December 31, 2012 and the related notes to the financial statements, which collectively comprise the Commission's 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 financial reporting provisions as described in Note A. Management is also responsible for 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.

Auditors' 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 auditors consider 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.

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Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described on Note A to the financial statements, the financial statements are prepared by the Commission on a basis of accounting other than accounting principles generally accepted in the United States of America.

The effects on the financial statements of the variances between the basis of accounting described in Note A and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles" paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Commission as of December 31, 2012, or the results of its operations for the year then ended.

Opinion on Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Commission, as of December 31, 2012, and the respective changes in financial position for the year then ended in accordance with the financial reporting provisions described in Note A.

Report on Supplementary and Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Commission's financial statements. The comments on page 20 are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements by us or other auditors, and accordingly, we do not express an opinion or provide any assurance on it.

Our audit was also conducted for the purpose of forming an opinion on the financial statements taken as a whole that collectively comprise the Commission's financial statements. The schedule of general fund expenditures by department as listed in the table of contents under supplementary information for the year ended December 31, 2012, is presented for purposes of additional analysis and is not a required part of the basic financial statements.

Such information is the responsibility of management and was derived from and relates directly to, the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole, on the basis of accounting described in Note A.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Report on Summarized Comparative Information

We have previously audited the Commission's 2011 financial statements, and we expressed an adverse audit opinion on those audited financial statements in our report dated December 14, 2012, as they were prepared on a basis of accounting other than accounting principles generally accepted in the United States of America. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2011, is consistent, in all material respects, with the audited financial statements from which it has been derived.

Wa A Broudy

Warren A. Broudy, CPA
Registered Municipal Accountant
License No. 554

MERCADIEN, P.C.
CERTIFIED PUBLIC ACCOUNTANTS

May 13, 2013

PASSAIC VALLEY SEWERAGE COMMISSION

STATEMENT OF ASSETS, LIABILITIES AND RESERVES

December 31, 2012
(With Comparative Totals for 2011)

	General Fund	Bond Reserve Fund	Insurance Trust Fund	Repair, Replacement & Improvement Fund	Capital Fund	Third Additional Project Fund	Wastewater Treatment Trust Fund	Fifth Additional Project Fund	Doremus Site Remediation Escrow Fund	Totals 2012	Totals 2011
Cash and cash equivalents	$ 83,656,454	$ 23,263,888	$ 697,277	$ 2,528,157	$ 1,344,428	$ 391,541	$ -	$ -	$ 1,014,639	$ 112,896,384	$ 118,253,746
Receivables											
Municipalities	-	-	-	-	-	-	-	-	-	-	42,170
Interfund receivables	5,838,148	-	4,000,000	9,215,488	8,000,000	-	-	-	-	27,053,636	3,497,042
Accounts receivable, net of allowance $722,285	1,461,526	-	-	-	-	-	-	-	-	1,461,526	3,452,758
Federal/state grants and loans	-	-	-	9,014,445	-	-	79,248,857	-	-	88,263,302	100,621,460
Inventory	8,582,114	-	-	-	-	-	-	-	-	8,582,114	8,472,624
Prepaid expenses	22,629	-	-	-	-	-	-	-	-	22,629	22,141
Property, plant and equipment											
Construction and acquisition cost	-	-	-	53,437,532	-	-	-	-	-	53,437,532	48,278,043
Buildings	252,159,560	-	-	-	-	-	-	-	-	252,159,560	252,159,560
Machinery and equipment	97,786,994	-	-	-	-	-	-	-	-	97,786,994	97,786,994
Improvements other than building	47,029,058	-	-	-	-	141,699,996	-	-	-	188,729,054	188,729,054
Projects authorized and in process	-	-	-	5,991,819	1,808,255	-	107,412,438	21,634,795	-	136,847,307	116,553,274
Other assets											
Amounts to be provided for bond and loan retirement	-	-	-	-	-	36,130,000	133,095,886	147,290,000	-	316,515,886	334,795,698
Total Assets	$ 496,536,483	$ 23,263,888	$ 4,697,277	$ 80,187,441	$ 11,152,683	$ 178,221,537	$ 319,757,181	$ 168,924,795	$ 1,014,639	$ 1,283,755,924	$ 1,272,664,564
Loans payable- current	$ -	$ -	$ -	$ -	$ -	$ -	$ 10,528,770	$ -	$ -	$ 10,528,770	$ 9,514,821
Bonds payable- current	-	-	-	-	-	700,000	-	8,635,000	-	9,335,000	8,765,000
Contracts payable	-	-	-	6,890,069	-	5,322	18,558,800	-	285,249	25,739,440	30,644,879
Accounts payable	4,014,101	-	-	3,279,001	1,152,683	-	-	-	13,915	8,459,700	9,000,169
Accrued expenses	10,529,885	-	-	-	-	-	-	-	-	10,529,885	9,691,002
Payroll deductions	414,951	-	-	-	-	-	-	-	-	414,951	553,921
Escrow deposits	-	-	-	-	-	-	-	-	712,350	712,350	712,350
Interfund payable	12,000,000	-	-	5,838,147	-	-	9,215,489	-	-	27,053,636	3,497,042
Total Current Liabilities	26,958,937	-	-	16,007,217	1,152,683	705,322	38,303,059	8,635,000	1,011,514	92,773,732	72,379,184
Loans payable- noncurrent	-	-	-	-	-	-	122,567,116	-	-	122,567,116	133,095,877
Bonds payable- noncurrent	-	-	-	-	-	35,430,000	-	138,655,000	-	174,085,000	183,420,000
Total noncurrent liabilities	-	-	-	-	-	35,430,000	122,567,116	138,655,000	-	296,652,116	316,515,877
Total Liabilities	26,958,937	-	-	16,007,217	1,152,683	36,135,322	160,870,175	147,290,000	1,011,514	389,425,848	388,895,061
Reserves											
Insurance trust	-	-	4,697,277	-	-	-	-	-	-	4,697,277	4,697,277
Investment in inventory	8,582,114	-	-	-	-	-	-	-	-	8,582,114	8,472,624
Investment in fixed assets	396,975,612	-	-	-	-	-	-	-	-	396,975,612	396,975,612
Construction and acquisition	-	-	-	53,437,532	-	141,699,996	-	-	-	195,137,528	189,978,039
Projects authorized	-	-	-	5,991,819	1,808,255	-	107,412,438	21,634,795	-	136,847,307	116,553,274
Debt service	-	23,263,888	-	-	-	-	-	-	-	23,263,888	23,269,529
Appropriated projects	-	-	-	4,750,873	8,191,745	386,219	51,474,568	-	3,125	64,806,530	84,762,681
Rate stabilization	64,019,820	-	-	-	-	-	-	-	-	64,019,820	59,060,467
Total Reserves	469,577,546	23,263,888	4,697,277	64,180,224	10,000,000	142,086,215	158,887,006	21,634,795	3,125	894,330,076	883,769,503
Total Liabilities and Reserves	$ 496,536,483	$ 23,263,888	$ 4,697,277	$ 80,187,441	$ 11,152,683	$ 178,221,537	$ 319,757,181	$ 168,924,795	$ 1,014,639	$ 1,283,755,924	$ 1,272,664,564

See Notes to Financial Statements.

PASSAIC VALLEY SEWERAGE COMMISSION

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN RESERVES

Year Ended December 31, 2012
(With Comparative Totals for the Year Ended December 31, 2011)

	General Fund	Bond Reserve Fund	Insurance Trust Fund	Repair, Replacement & Improvement Fund	Capital Fund	Third Additional Project Fund	Wastewater Treatment Trust Fund	Fifth Additional Project Fund	Doremus Site Remediation Escrow Fund	2012	2011
Revenues											
User charges billed	$ 128,242,265	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 128,242,265	$ 130,761,099
Sludge fees	25,647,438	-	-	4,680	-	-	-	-	-	25,652,118	30,782,889
Investment gains, net	-	(5,641)	-	-	-	8	-	-	-	(5,633)	304,223
Federal/state grants and loans/(cancellation)	-	-	-	6,203,557	-	-	-	-	-	6,203,557	(3,008,830)
Total	153,889,703	(5,641)	-	6,208,237	-	8	-	-	-	160,092,307	158,839,381
Expenditures											
Salaries	41,617,239	-	-	-	-	-	-	-	-	41,617,239	41,122,800
Payroll taxes	2,987,757	-	-	-	-	-	-	-	-	2,987,757	3,890,313
Employee benefits	12,536,123	-	-	-	-	-	-	-	-	12,536,123	17,420,935
Pension contribution	5,493,319	-	-	-	-	-	-	-	-	5,493,319	5,821,681
Supplies and postage	1,021,256	-	-	-	-	-	-	-	-	1,021,256	843,277
Replacement parts	4,626,328	-	-	-	-	-	-	-	-	4,626,328	4,004,447
Materials	4,222,971	-	-	13,110,874	-	-	-	-	-	17,333,845	7,142,313
Utilities	20,172,175	-	-	-	-	-	-	-	-	20,172,175	28,145,687
Rentals	107,309	-	-	-	-	-	-	-	-	107,309	106,415
Insurance	1,336,416	-	-	-	-	-	-	-	-	1,336,416	1,332,510
Equipment	2,618,287	-	-	-	-	-	-	-	-	2,618,287	1,152,485
Outside services	3,815,299	-	-	-	-	-	-	-	-	3,815,299	3,912,353
Professional fees	1,228,222	-	-	-	-	-	-	-	-	1,228,222	1,713,113
Permitting	902,629	-	-	-	-	-	-	-	-	902,629	883,445
Sludge disposal	3,150,088	-	-	-	-	-	-	-	-	3,150,088	5,383,674
Sundry	616,024	-	-	-	-	-	-	-	-	616,024	987,319
Advertising	57,488	-	-	-	-	-	-	-	-	57,488	33,716
Real estate taxes (in lieu)	840,795	-	-	-	-	-	-	-	-	840,795	836,949
Bad debt expense	55,515	-	-	-	-	-	-	-	-	55,515	925,920
Contingency	209,943	-	-	-	-	-	-	-	-	209,943	393,198
Subtotal	107,615,183	-	-	13,110,874	-	-	-	-	-	120,726,057	126,052,550
Bond debt service											
Principal	18,279,812	-	-	-	-	-	-	-	-	18,279,812	15,354,126
Interest	10,635,355	-	-	-	-	-	-	-	-	10,635,355	10,722,163
Total expenditures	136,530,350	-	-	13,110,874	-	-	-	-	-	149,641,224	152,128,839
Excess of revenues over (under) expenditures before interfund transfers	17,359,353	(5,641)	-	(6,902,637)	-	8	-	-	-	10,451,083	6,710,542
Interfund transfers	(12,400,000)	-	-	2,400,000	10,000,000	-	-	-	-	-	(400,000)
Excess of revenues over (under) expenditures	4,959,353	(5,641)	-	(4,502,637)	10,000,000	8	-	-	-	10,451,083	6,310,542
Reserves, beginning of year	59,060,467	23,269,529	4,697,277	68,682,861	-	142,086,207	158,887,006	21,634,795	3,125	478,321,267	472,010,725
Reserves, end of year	64,019,820	$ 23,263,888	$ 4,697,277	$ 64,180,224	$ 10,000,000	$ 142,086,215	$ 158,887,006	$ 21,634,795	$ 3,125	488,772,350	478,321,267
Investment in inventory	8,582,114									8,582,114	8,472,624
Investment in fixed assets	396,975,612									396,975,612	396,975,612
Total investments	$ 469,577,546									$ 894,330,076	$ 883,769,503

See Notes to Financial Statements.

PASSAIC VALLEY SEWERAGE COMMISSION

NOTES TO FINANCIAL STATEMENTS

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Organization

In 1902, by a special Act of the New Jersey State Legislature, the Passaic Valley Sewerage Commission (the "Commission") was formed as an Agency of the State of New Jersey to reduce pollution of the Passaic River and its tributaries. The Commission is one of the oldest and largest, in terms of operational capability, regional sewerage commissions in the United States and is directed by a Board of Commissioners ("Commissioners") appointed by the Governor and confirmed by the State of New Jersey Senate.

In order to protect and preserve local streams and rivers from water pollution, the Commission operates one of the United States largest treatment plants for the wastewaters of northern New Jersey. With many expansions and upgrading to secondary treatment, the facility has been striving, since beginning operations in 1924, to improve local water quality in accordance with federal and state water quality legislation.

Reporting Entity

The Commission establishes funds to account for significant activities within its jurisdiction. Specific funds are maintained at the direction of the Commissioners and are included in the financial statements presented.

Fund Accounting

The funds of the Commission are maintained in accordance with the principles of fund accounting to ensure observance of limitations and restrictions on the resources available. The principles of fund accounting require that resources be classified for accounting and reporting purposes into funds or account groups in accordance with activities or objectives specified for the resources. Each fund is a separate accounting entity with a self-balancing set of accounts. An account group, on the other hand, is a financial reporting device designed to provide accountability for certain assets and liabilities that are not recorded in the funds because they do not directly affect net expendable available financial resources.

The following are the various funds of the Commission:

<u>General Fund</u>

The General Fund accounts for the cost of providing sewerage collection and treatment services to its member municipalities. Services provided are financed primarily through user charges.

<u>Bond Reserve Fund</u>

In addition to the annual debt service payments made by the General Fund, the Commission has further secured the payment of its serial and term bonds by covenanting and establishing a Bond Reserve Fund. The amount maintained in this fund is equal to the maximum annual interest and principal payments required in any future year through the year 2032, the maturity date of the Series F Bonds.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund Accounting (Continued)

Insurance Trust Fund

The Insurance Trust Fund represents amounts set aside for possible damages resulting from liability claims.

Repair, Replacement and Improvement Fund

The Repair, Replacement and Improvement Fund represents amounts set aside for non-operating expenditures for equipment, accessories and appurtenances of the sewerage treatment plant.

Capital Fund

The Capital Fund represents expenditures for permanent improvements to the sewerage treatment plant.

Third Additional Project Fund

The Third Additional Project Fund was established for the purpose of constructing certain capital improvements and was funded principally by proceeds of the Series D Bonds, which have been refunded by the Series F Bonds.

Wastewater Treatment Trust Fund

The Wastewater Treatment Trust Fund was established for the purpose of funding the rehabilitation, renovation and improvement of the existing treatment facilities of the Commission. Funding was provided by the State of New Jersey, the New Jersey Wastewater Treatment Trust Fund, and the New Jersey Environmental Infrastructure Trust.

Fifth Additional Project Fund

The Fifth Additional Project Fund was established for the purpose of funding various capital improvements for the Commission's existing system and was funded principally by proceeds of the Series F Bonds.

Doremus Site Remediation Escrow Fund

The Doremus Site Remediation Escrow Fund was established to set aside funds for future environmental remediation of property adjacent to the PVSC site acquired by the Commission.

Basis of Accounting

The accounting policies of the Commission conform to a modified cash basis, which constitute a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. These principles and practices are designed primarily for determining compliance with legal and budgetary restrictions as a means of reporting on the stewardship of public officials with respect to public funds.

Had the Commission's financial statements been prepared under generally accepted accounting principles ("GAAP"), expenditures would be recorded when incurred, not when encumbered; federal and state grants would have been recognized when earned, not when awarded; and property and equipment expenditures made during the current year would be capitalized and depreciation expense recorded. Other post retirement plan benefit expense would be recognized on the accrual basis. Principal payments on debt would not be recorded as an expenditure.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents

The Commission considers all highly liquid investments, with maturities of three months or less from the date of purchase, to be cash equivalents.

Revenue Recognition

Revenue is recognized in accordance with the Act that created the Commission. This Act provides that each of the contracting municipalities or other users of the system reimburse the Commission annually for its proportionate share of the cost and expense of maintenance, repair and operation, including debt service, of the system.

Use of Estimates

The financial statements are prepared on a modified cash basis of accounting, which is an "other comprehensive basis of accounting" other than accounting principles generally accepted in the United States of America and which requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Accounts Receivable

The change in fund balance is charged with an allowance for estimated uncollectible amounts based on past experience and an analysis of accounts receivable collectibility. Accounts deemed uncollectible are charged to the allowance in the years they are deemed uncollectible.

Inventory

Inventory is made up of parts and supplies for the repair and maintenance of the facility. The costs of supplies, materials and replacement parts are recorded as expenditures in the year of purchase. The Commission values its inventories at cost, using the first-in, first-out method.

Property, Plant and Equipment

The Commission records capital additions in the year of acquisition. The balance of property, plant and equipment recorded in the general fund reflects the original construction costs of the system.

Compensated Absences

Employees of the Commission are entitled to paid vacation, sick days and personal days off, depending on length of service and other factors. The Commission has recorded the liability for accumulated sick leave, vacation pay and compensatory absences for all employees in accrued expenses.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Serial Bonds Payable

Debt service payments are made by the General Fund. Serial Bonds payable are carried in the Third and Fifth Additional Project Funds. Therefore, as payments are made to reduce debt, an adjustment is made in the corresponding fund.

Reserves

Reserves generally represent fund equity restricted for the stated purposes. Appropriated project reserves represent fund equity that has been pledged to future project costs. Reserve for insurance trust fund represents amounts set aside for possible damages resulting from claims. Reserve for rate stabilization represents the amount set aside to enable the Commission to stabilize user charges to its member municipalities in future years.

Reserve for Rate Stabilization

The Reserve for Rate Stabilization was established in 1996 by the Commissioners to enable the Commission to stabilize user charges to its member municipalities in future years. Funds from the Reserve for Rate Stabilization are expended as needed and represent a revenue source to offset monies needed to meet the current year's budget. Increases and decreases to this Reserve for Rate Stabilization are affected by companies leaving and entering the sewerage treatment system during a measurement year in addition to any unexpended funds and revenues from the General Fund remaining at year-end.

Other Post Employment Benefits ("OPEB") Other than Pensions

As required by the Governmental Accounting Standards Board's ("GASB"), the Commission implemented accounting and financial reporting requirements for government employers with post employment benefit expenses and obligations other than pensions. Since the Commission's basis of accounting is similar in nature to a New Jersey Municipality or County, the Commission implemented the GASB in accordance with New Jersey Division of Local Government Services Local Finance Notice #2007-15 requirements. New Jersey budget and financial reporting laws allow, but do not require local municipal units to budget post employment benefit amounts that exceed their current cash cost or reflect the long-term liability on their statement of assets, liabilities and reserves, thus no liability is recorded on these financial statements. However, there are financial statement disclosure requirements that are included in Note J of these audited financial statements.

Comparative Financial Information

The financial statements include certain prior year summarized comparative information in total but not by fund balance category. Such information does not include sufficient detail to constitute a presentation in conformity with the Commission's basis of accounting. Accordingly, such information should be read in conjunction with the Commission's financial statements for the year ended December 31, 2011, from which the summarized information was derived.

B. CASH AND CASH EQUIVALENTS

The carrying amount of the Commission's cash and cash equivalents consisted mainly of demand and money market accounts. The difference between the bank balance and the book balance is due primarily to the timing of deposits and outstanding checks.

All deposits in the JP Morgan bank accounts at December 31, 2012, were covered by the Federal Deposit Insurance Company (the "FDIC"). The Bank of New York money market funds are invested in the Goldman Sachs Financial Square Treasury Obligation Fund, which is comprised of Treasury Securities backed by the U.S. Government and a Federal Home Loan Bank Discount Note.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of failure of the counter party, the Commission will not be able to recover the value of its cash and cash equivalents that are in the possession of an outside party. Cash and cash equivalents are substantially restricted under the terms of the Commission's bond resolutions for the payment of bond principal and interest expense and the extension of project loans. The bond resolutions limit investments to direct obligations of the United States of America or other obligations in which payments of principal and interest are unconditionally guaranteed by the United States of America.

The amounts deposited in these accounts at December 31, 2012, are as follows:

	Book Balance	Bank Balance
JP Morgan Bank	$ 89,632,487	$ 90,155,004
Bank of New York	23,263,897	23,263,897
	$ 112,896,384	$ 113,418,901

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Because the Commission maintains only cash and cash equivalents, it is not subject to interest rate risk if interest rates fluctuate.

C. CONCENTRATION OF RISK AND UNCERTAINTIES

For the year ended December 31, 2012, the Commission received approximately 45% of its total user charges from two customers, City of Newark 29% and Jersey City 16%.

D. PENSION PLAN DESCRIPTION

The Commission contributes to a cost-sharing multiple-employer defined benefit pension plan administered by Public Employees' Retirement System ("PERS") of New Jersey, which is part of the Division of Pensions in the Department of the Treasury, State of New Jersey. It provides retirement, disability, annual-cost-of-living and death benefits to plan members and beneficiaries. The state-administered funds were established by an Act of the State Legislature that assigns the authority to establish and amend benefit provisions to the plan's board of trustees. PERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to PERS and is also available on the State of New Jersey website.

Plan members are currently required to contribute 6.64% of their annual covered salaries, and the Commission is required to contribute at an actuarially determined rate. The contribution requirements of plan members and the Commission are established and may be amended by the PERS board of trustees. The Commission's contributions to PERS for the years ended December 31, 2012, 2011 and 2010, were $5,487,242, $5,808,546 and $4,694,577, respectively, equal to the required contributions for the year.

E. AMOUNTS TO BE PROVIDED FOR LOAN AND BOND RETIREMENT

The Commission has established a mechanism to record future amounts to be provided by member municipalities to fund retirement of loan and serial bond principal. These amounts are presented in the statements of assets, liabilities and reserves and correspond to the outstanding balances payable for loans and serial bonds.

F. BONDS PAYABLE

Pursuant to an amendment to Title 58, Chapter 14 of the Revised Statutes of the State of New Jersey, the Commission was granted the authority to issue bonds. As of December 31, 2012, the following bond series were outstanding:

Series E Bonds

Series E Bonds, dated December 1, 1999, issued in the original amount of $43,300,000, were used primarily to defease a portion of the Series D bonds issued in 1992. These Series E Bonds consisted of serial bonds of $5,995,000 and term bonds of $37,305,000.

On November 30, 2010, the Commission issued $29,950,000 Sewer System Bonds (the "Series G Bonds") for the purpose of refunding a portion of the outstanding balance of the Commission Series E Bonds. The proceeds of the Series G Bonds together with funds made available by the Commission, were deposited in an escrow fund with a trustee, to pay the interest, purchase of the defeasance series, principal and interest of the defeasance securities. On January 10, 2011, the defeasance was completed.

The remaining balance of the Series E bonds principal and interest payments will be made until maturity as follows:

	Principal	Interest	Total
2013	$ 700,000	$ 344,653	$ 1,044,653
2014	820,000	307,028	1,127,028
2015	790,000	261,928	1,051,928
2016	775,000	217,688	992,688
2017	3,095,000	174,094	3,269,094
	$ 6,180,000	$ 1,305,391	$ 7,485,391

F. BONDS PAYABLE (CONTINUED)

Series F Bonds

Series F Bonds, dated January 15, 2003, issued in the original amount of $205,205,000, were used primarily to defease all of the remaining portion of the Series D bonds, issued in 1992 and for funding various capital improvements. These Series F Bonds consisted of serial bonds of $168,145,000 and term bonds of $37,060,000.

At December 31, 2012 and 2011, the outstanding principal balance was $147,290,000 and $155,460,000, respectively. Interest paid on the serial bonds for the years 2013 through 2024 will be paid at 5.00% per annum, and for 2025, interest will be paid at 3.75% per annum. Interest on the term bonds, due in years 2026 through 2032, will be paid at 2.50% per annum.

Principal and interest payments will be made until maturity as follows:

	Principal	Interest	Total
2013	$ 8,635,000	$ 6,378,813	$ 15,013,813
2014	9,115,000	5,947,063	15,062,063
2015	9,625,000	5,491,313	15,116,313
2016	10,160,000	5,010,063	15,170,063
2017	10,740,000	4,502,063	15,242,063
2018-2022	48,415,000	14,193,813	62,608,813
2023-2027	23,485,000	5,708,188	29,193,188
2028-2032	27,115,000	2,066,750	29,181,750
	$147,290,000	$ 49,298,066	$196,588,066

Series G Bonds

In December 2010, the Commission issued Sewer System Bonds, in the amount of $29,950,000 to currently refund a portion of the Commission's Series E bonds and to pay the cost of issuing the bonds. Interest is payable June 1 and December 1 until maturity. Interest rates range from 5.625% to 5.750%. No principal payments were made during 2012.

Principal and interest payments will be made until maturity as follows:

	Principal	Interest	Total
2013	$ -	$ 1,718,112	$ 1,718,112
2014	-	1,718,112	1,718,112
2015	-	1,718,112	1,718,112
2016	-	1,718,112	1,718,112
2017	-	1,718,112	1,718,112
2018-2022	29,950,000	6,093,000	36,043,000
	$29,950,000	$14,683,560	$44,633,560

F. BONDS PAYABLE (CONTINUED)

Summary of Future Maturities

Future maturities of bonds payable are as follows:

	Principal	Interest	Total
2013	$ 9,335,000	$ 8,441,578	$ 17,776,578
2014	9,935,000	7,972,203	17,907,203
2015	10,415,000	7,471,353	17,886,353
2016	10,935,000	6,945,863	17,880,863
2017	13,835,000	6,394,269	20,229,269
2018-2022	78,365,000	20,286,813	98,651,813
2023-2027	23,485,000	5,708,188	29,193,188
2028-2032	27,115,000	2,066,750	29,181,750
	$ 183,420,000	$ 65,287,017	$248,707,017

G. LOANS PAYABLE

1996 Loans

On November 1, 1996, the Commission entered into an interest-free loan agreement with the State of New Jersey Department of Environmental Protection ("State") that enables the Commission to borrow a maximum of $15,150,000. The funding has been appropriated by the State and is obligated and held separate from other commitments of the State. Payments on any outstanding borrowings are made in semi-annual installments.

On November 1, 1996, the Commission entered into a loan agreement with the New Jersey Environmental Infrastructure Trust that enables the Commission to borrow a maximum amount of $16,730,000 at an interest rate of approximately 4.4%. Principal and interest repayments are made in semi-annual installments.

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 2,115,330	$ 278,513	$ 2,393,843
2014	2,180,737	214,200	2,394,937
2015	2,252,084	146,475	2,398,559
2016	2,321,260	75,075	2,396,335
	$ 8,869,411	$ 714,263	$ 9,583,674

1998 Loans

On November 5, 1998, the Commission entered into an interest-free loan agreement with the State that enables it to borrow a maximum of $4,300,000. The funding was appropriated by the State is obligated and held separate from other commitments of the State. Payments on outstanding borrowings are made in semi-annual installments.

On November 5, 1998, the Commission entered into another loan agreement with the New Jersey Environmental Infrastructure Trust that enables it to borrow a maximum amount of $4,565,000 at interest rates ranging from 4.0% to 4.5%. Principal and interest repayments are made in semi-annual installments.

G. LOANS PAYABLE (CONTINUED)

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 285,000	$ 86,626	$ 371,626
2014	300,000	73,800	373,800
2015	315,000	60,300	375,300
2016	330,000	46,125	376,125
2017	340,000	31,275	371,275
2018	355,000	15,975	370,975
	$ 1,925,000	$ 314,101	$ 2,239,101

1999 Loans

On November 5, 1999, the Commission entered into an interest-free loan agreement with the State that enables the Commission to borrow a maximum of $11,600,000. The funding was appropriated by the State and is obligated and held separate from other commitments of the State. Payments on outstanding borrowings are made in semi-annual installments.

On November 5, 1999, the Commission entered into another loan agreement with the New Jersey Environmental Infrastructure Trust that enables the Commission to borrow a maximum amount of $12,925,000 at interest rates ranging from 4.75% to 5.70%. Principal and interest repayments are made in semi-annual installments.

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 1,491,224	$ 373,410	$ 1,864,634
2014	1,536,498	328,860	1,865,358
2015	1,588,312	281,835	1,870,147
2016	1,638,449	232,060	1,870,509
2017	1,686,910	179,535	1,866,445
2018-2019	3,543,228	188,100	3,731,328
	$11,484,621	$ 1,583,800	$13,068,421

2006 Loans

On November 9, 2006, the Commission entered into an interest-free loan agreement with the State that enables the Commission to borrow a maximum of $28,109,500. The funding was appropriated by the State and is obligated and held separate from other commitments of the State. Payments on outstanding borrowings are made in semi-annual installments.

On November 9, 2006, the Commission entered into another loan agreement with the New Jersey Environmental Infrastructure Trust that enables the Commission to borrow a maximum amount of $10,785,000 at interest rates ranging from 4.00% to 5.00%. As due, principal and interest repayments, are made in semi-annual installments.

G. LOANS PAYABLE (CONTINUED)

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 2,144,580	$ 414,350	$ 2,558,930
2014	2,170,034	389,600	2,559,634
2015	2,193,220	363,600	2,556,820
2016	2,228,208	336,350	2,564,558
2017	2,260,475	307,600	2,568,075
2018-2022	11,675,337	1,154,119	12,829,456
2023-2026	7,326,722	368,363	7,695,085
	$29,998,576	$ 3,333,982	$33,332,558

2007 Loans

On May 22, 2007, the Commission entered into an interest-free loan agreement with the State that enables the Commission to borrow a maximum of $18,141,867. The funding was appropriated by the State and is obligated and held separate from other commitments of the State. Payments on outstanding borrowings are made in semi-annual installments.

On May 22, 2007, the Commission entered into another loan agreement with the New Jersey Environmental Infrastructure Trust that enables the Commission to borrow a maximum amount of $6,785,000 at interest rates ranging from 3.40% to 5.00%. As due, principal and interest repayments, are made in semi-annual installments.

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 1,299,201	$ 268,313	$ 1,567,514
2014	1,308,930	258,163	1,567,093
2015	1,317,484	247,363	1,564,847
2016	1,331,580	231,863	1,563,443
2017	1,344,321	215,613	1,559,934
2018-2022	7,007,028	824,363	7,831,391
2023-2027	7,494,679	333,063	7,827,742
	$21,103,223	$ 2,378,741	$23,481,964

2010 Loans

On March 10, 2010, the Commission entered into an interest-free loan agreement with the State that enables the Commission to borrow a maximum of $8,037,621. The funding was appropriated by the State and is obligated and held separate from other commitments of the State. Payments on outstanding borrowings are made in semi-annual installments.

On March 10, 2010, the Commission entered into another loan agreement with the New Jersey Environmental Infrastructure Trust that enables the Commission to borrow a maximum amount of $4,505,000 at interest rates ranging from 3.00% to 5.00%. As due, principal and interest repayments, are made in semi-annual installments.

G. LOANS PAYABLE (CONTINUED)

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 621,534	$ 183,750	$ 805,284
2014	631,534	175,000	806,534
2015	636,534	165,750	802,284
2016	646,534	156,250	802,784
2017	656,534	146,250	802,784
2018-2022	3,452,672	574,400	4,027,072
2023-2027	3,717,672	311,600	4,029,272
2028-2029	1,568,069	40,800	1,608,869
	$11,931,083	$ 1,753,800	$13,684,883

On March 10, 2010, the Commission entered into an interest-free loan agreement with the State that enables the Commission to borrow a maximum of $23,776,707. The funding was appropriated by the State and is obligated and held separate from other commitments of the State. Payments on outstanding borrowings are made in semi-annual installments.

On March 10, 2010, the Commission entered into another loan agreement with the New Jersey Environmental Infrastructure Trust that enables the Commission to borrow a maximum amount of $8,205,000 at interest rates ranging from 3.00% to 5.00%. As due, principal and interest repayments, are made in semi-annual installments.

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 1,640,928	$ 334,800	$ 1,975,728
2014	1,655,928	318,800	1,974,728
2015	1,670,928	302,050	1,972,978
2016	1,690,928	284,550	1,975,478
2017	1,705,928	266,050	1,971,978
2018-2022	8,819,641	1,044,050	9,863,691
2023-2027	9,304,641	566,800	9,871,441
2028-2029	3,871,856	74,200	3,946,056
	$30,360,778	$ 3,191,300	$33,552,078

On December 2, 2010, the Commission entered into an interest-free loan agreement with the State that enables the Commission to borrow a maximum of $11,537,500. The funding was appropriated by the State and is obligated and held separate from other commitments of the State. Payments on outstanding borrowings are made in semi-annual installments.

On December 2, 2010, the Commission entered into another loan agreement with the New Jersey Environmental Infrastructure Trust that enables the Commission to borrow a maximum amount of $8,125,000 at an interest rate of 5.00% per annum. As due, principal and interest repayments, are made in semi-annual installments.

G. LOANS PAYABLE (CONTINUED)

The Commission pays for project expenditures as incurred and applies for reimbursements of those project costs from each lender. Projected estimated annual debt service requirements for these two loans are as follows:

	Principal	Interest	Total
2013	$ 930,972	$ 406,250	$ 1,337,222
2014	945,972	391,750	1,337,722
2015	960,972	376,500	1,337,472
2016	975,972	360,500	1,336,472
2017	990,972	343,750	1,334,722
2018-2022	5,239,861	1,437,750	6,677,611
2023-2027	5,488,473	875,000	6,363,473
2028-2030	1,890,000	192,000	2,082,000
	$17,423,194	$ 4,383,500	$21,806,694

Summary of Future Maturities

Future maturities of loans payable are as follows:

	Principal	Interest	Total
2013	$ 10,528,770	$ 2,346,012	$ 12,874,782
2014	10,729,634	2,150,173	12,879,807
2015	10,934,534	1,943,873	12,878,407
2016	11,162,927	1,722,773	12,885,700
2017	8,985,141	1,490,074	10,475,215
2018-2022	40,092,768	5,238,757	45,331,525
2023-2027	33,332,187	2,454,825	35,787,012
2028-2030	7,329,925	307,000	7,636,925
	$ 133,095,886	$ 17,653,487	$ 150,749,373

H. LONG-TERM LIABILITIES

Long-term liability activity for the year ended December 31, 2012 are is follows:

Type	Principal Outstanding January 1, 2012	Additions	Repayments	Principal Outstanding December 31, 2012	Due within One Year
Bonds and loans payable	$ 334,795,698	$ -	$ 18,279,812	$ 316,515,886	$ 19,863,770

I. SELF-INSURANCE

The Commission has established a reserve for self-insurance for general liability coverage to pay for claims up to their retention amount of $500,000. At December 31, 2012, the reserve balance was $4,697,277. There were no claims charged to the reserve for self-insurance for the year ended December 31, 2012.

J. POST EMPLOYMENT BENEFITS OTHER THAN PENSIONS

Commission had an actuarial valuation performed for the year ended December 31, 2012, to calculate the cost and liabilities attributable to post retirement benefits other than pensions. The required disclosure information from the plan document and the December 31, 2012, biannual actuarial valuation is as follows:

J. POST EMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

Plan Description

- Commission currently maintains an unfunded single-employer post employment benefits plan (the "Plan") other than pensions, named the Passaic Valley Sewerage Commission Retiree Welfare Plan.
- The Plan provides eligible retirees with medical, prescription drug, vision, dental and chiropractic coverage; as well as Medicare Part B reimbursement, after termination or retirement.
- The Plan does not issue stand-alone financial statements and is not included in the report of another entity.

Funding Policy

- It is Commission's policy at this time to fund this plan on a pay as you go basis.

Other Required Disclosures

- The annual required contribution for the year ended December 31, 2012, was $17,478,000, assuming a 30-year amortization using the level dollar method, of the actuarial accrued liability.
- The annual OPEB cost for the year ended December 31, 2012, was $16,586,000. There were no OPEB contributions made in 2012.
- The unfunded actuarial accrued liability, which includes retirees and active employees, totaled $192,659,000 as of December 31, 2012.
- The biannual actuarial valuation date was December 31, 2012.

Actuarial Assumptions and Methods

- An assumed discount rate of 4.5% was used for purposes of developing the liabilities and annual required contribution on the basis that the plan would not be funded.
- Health care cost trend rates were as follows:
    - Medical traditional, point of service and prescription ranged from 9.5% in 2012 to 5% in year 2021 and later.
    - Dental, vision and chiropractic rate is 5% in 2012 through 2021 and later.
    - Medicare Part B is 5% in 2012 through 2021 and later.
- These actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and that actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities.
- These calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation.
- The actuarial cost method used was the projected unit credit method.
- The unfunded actuarial accrued liability was amortized as a level dollar amount using an open period of 30 years.

Commission's contribution to the plan for the years ended December 31, 2012, 2011 and 2010 was $2,950,332, $4,402,061 and $3,114,025, respectively which equaled the required contribution for the year. There were approximately 199, 201 and 178 retired participants eligible for the years ended December 31, 2012, 2011 and 2010, respectively.

K. FORWARD DELIVERY AGREEMENT

On September 11, 1996, the Commission entered into a Forward Delivery Agreement (the 'Agreement") with First Union Bank, now Wells Fargo Bank (the "Bank) related to the Series D Bonds refunded by Series E Bonds. The Agreement stipulated that certain proceeds from the bond issuance would be deposited with the Bank in a debt service reserve fund (the "Fund"). The Commission was paid an upfront fee in exchange for interest earnings on the Fund until the year 2032. Under the terms of the Agreement the Commission is precluded from prematurely redeeming, defeasing, or refunding the Series G, F, or E Bonds unless it has sufficient funds to repurchase the Banks interest in the Agreement at the fair value at the date of termination. As of December 31, 2012, the fair value of the Commission's liability under the Agreement if terminated by the Commission was $3,506,525.

L. FUTURES CONTRACTS

The Commission has entered into two futures contracts for electricity and natural gas in order to hedge energy costs. The electricity contract is for a term of thirty-six months, beginning December 2011 and will expire December 2014. The natural gas contract is for a term of thirty-six months, beginning January 2012 and will expire March 2014.

M. COLLECTIVE BARGAINING AGREEMENTS

The Commission is a party in a collective bargaining agreement covering various employees at the Commission. The agreement between the Commission and Local 1158 - I.B.E.W. is for the period from January 1, 2010 through December 31, 2013.

The Commission is also in the process of negotiating with three (3) new bargaining units which were certified by the New Jersey Public Employment Relations Commission ("PERC") in January, 2011. The bargaining units are the Commission Professional Unit, the Commission Supervisors Group and the United Public Service Employers Union ("UPSEU"). Each of these groups is bargaining for the period beginning January 1, 2011 through December 31, 2014.

N. LITIGATION

The Commission is involved in various litigation and claims arising out of its operations. While the ultimate results of these matters cannot be predicted with certainty, management of the Commission expects that the ultimate resolution of these matters will not have a material adverse effect on their financial position or results of operations.

O. FEMA FUNDING

The Commission is involved in discussions with insurance companies and the Federal Emergency Management Agency ("FEMA") to determine eligible recovery costs for substantial damage incurred by the Commission during the Superstorm Sandy event in October of 2012. During 2013 the Commission has received $8,090,925 in reimbursements from the State of New Jersey for recovery costs under FEMA. All costs not covered by insurance or FEMA will be self-funded. Management is in the process of determining the total recovery costs.

P. SUBSEQUENT EVENTS

Management has evaluated events that occurred after December 31, 2012, but before May 13, 2013, the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

PASSAIC VALLEY SEWERAGE COMMISSION

COMMENTS

The Passaic Valley Sewerage Commission (the "Commission") is a body politic and corporate created by Chapter 14 of Title 58 of the New Jersey revised status (section 58:14-1 et seq.). The entity is normally administered by nine commissioners who are appointed by the Governor of New Jersey and who serve for a period of five years.

The following were commissioners and key personnel as of December 31, 2012:

Kenneth J. Lucianin	Commissioner
Michael DeFrancisci	Executive Director
Gregory A. Tramontozzi	General Counsel
Gregory A. Tramontozzi	Acting Clerk

Since August 1924, the Commission has operated and maintained the principal sewerage collection and disposal system in the Passaic Valley, a densely populated industrial and residential section of northern New Jersey.

Under the original Act, the Commission had no bond-issuing powers, and all outlays since completion of the system that might otherwise have been capitalized were included annually with current expenses for repairs, maintenance and operations charges.

Under the provisions of the Supplemental Act (Chapter 388, Laws of 1953, approved August 14, 1953), the pay-as-you-go procedure was modified to permit long-term payment of the cost of a rehabilitation program adopted in 1955. This Act permitted the Commission to issue up to $10,000,000 of bonds. As a result, $9,100,000 of bonds were issued and sold in March 1955, pursuant to a resolution of the Commission adopted October 22, 1954. The $9,100,000 bonds sold in 1955 have subsequently been retired. By legislation which went into effect in 1970, the $10,000,000 limitation was eliminated. The Commission may now issue bonds after a public hearing, provided that 25% (by amount paid) of the contracting municipalities do not object at the public meeting.

Insurance

The Commission carries insurance for possible loss or damage that, in its opinion, is sufficient. The Commission retains the risk of losses up to $500,000 in order to reduce premium expenses. A reserve for self-insurance was established for this purpose.

Advertisement of Bids

The Commission's minutes indicate that advertisement of bids occurred in the normal course of operations.

PASSAIC VALLEY SEWERAGE COMMISSION

SCHEDULE OF GENERAL FUND EXPENDITURES BY DEPARTMENT

Year Ended December 31, 2012
(With Comparative Totals for Year Ended December 31, 2011)

	Administration	Plant and Line Engineering	Plant Maintenance	Pollution and Treatment Control	Plant Operations	Total 2012	Total 2011
Salaries	$ 8,878,196	$ 1,301,175	$ 11,508,096	$ 4,430,135	$ 15,499,637	$ 41,617,239	$ 41,122,800
Payroll taxes	677,511	85,570	857,887	323,581	1,043,208	2,987,757	3,890,313
Health plan	5,392,418	292,805	2,570,042	966,734	3,314,124	12,536,123	17,420,935
Pension	5,493,319	-	-	-	-	5,493,319	5,821,681
Supplies and postage	288,205	13,765	222,891	167,443	328,952	1,021,256	843,277
Replacement parts	554,009	91	288,808	19,562	3,763,858	4,626,328	4,004,447
Materials	130,919	5,281	100,073	112,149	3,874,549	4,222,971	4,861,677
Utilities	393,613	5,212	325,752	95,692	19,351,906	20,172,175	28,145,687
Rentals	89,001	4,783	3,731	5,772	4,022	107,309	106,415
Insurance	1,336,416	-	-	-	-	1,336,416	1,332,510
Equipment	1,315,690	9,398	97,077	201,280	994,842	2,618,287	1,152,485
Outside services	1,366,616	228	195,153	152,566	2,100,736	3,815,299	3,912,353
Professional fees	1,228,222	-	-	-	-	1,228,222	925,463
Permitting	902,629	-	-	-	-	902,629	883,445
Sludge disposal	-	-	-	-	3,150,088	3,150,088	5,383,674
Sundry	616,024	-	-	-	-	616,024	987,319
Advertising	41,586	-	-	15,769	133	57,488	33,716
Real estate taxes	840,795	-	-	-	-	840,795	836,949
Bad debt expense	55,515	-	-	-	-	55,515	925,920
Contingency	209,943	-	-	-	-	209,943	393,198
Subtotals	29,810,627	1,718,308	16,169,510	6,490,683	53,426,055	107,615,183	122,984,264
Bond principal	18,279,812	-	-	-	-	18,279,812	15,354,126
Bond interest	10,635,355	-	-	-	-	10,635,355	10,722,163
Totals	$ 58,725,794	$ 1,718,308	$ 16,169,510	$ 6,490,683	$ 53,426,055	$136,530,350	$149,060,553