COASTAL WATER AUTHORITY

Management's Discussion and Analysis,
Independent Auditor's Report, and
Financial Statements and Supplemental Schedules

December 31, 2011

COASTAL WATER AUTHORITY

DECEMBER 31, 2011

Contents

MJ McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT

The Board of Directors of
Coastal Water Authority

We have audited the accompanying basic financial statements of the Coastal Water Authority ("CWA") as of and for the year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of CWA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CWA as of December 31, 2011, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedule of funding progress for other postemployment benefits on pages 3 through 5 and on page 37, respectively, 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The information included in Supplemental Schedules I and II on pages 30 through 32 is presented for purposes of additional analysis and is not a required part of the financial statements. The information in Supplemental Schedules I and II is the responsibility

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of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The 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. The information included in Supplemental Schedule III (see pages 33 through 36) has 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 Supplemental Schedule III.

McConnell & Jones LLP

Houston, Texas
April 2, 2012

COASTAL WATER AUTHORITY

Management's Discussion and Analysis (Unaudited)

Year Ended December 31, 2011

As management of the Coastal Water Authority (the "CWA"), we offer readers of CWA's financial statements this narrative overview and analysis of the financial activities of CWA for the year ended December 31, 2011. Please read this discussion and analysis in conjunction with CWA's basic financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- During 2008 CWA negotiated a contract with the City of Houston to authorize CWA to proceed with the Luce Bayou Interbasin Transfer Project. The contract authorizes CWA to take the necessary actions to complete the permitting and final design of the Project along with the land acquisition to secure the route of this new conveyance system. The Projects Contract was approved on January 28, 2009.
- As stipulated in the 2009 Luce Bayou Project contract, the Land and Mitigation Fund was established to finance the costs related to the acquisition of land and costs associated with environmental mitigation necessary for the Project.
- In conjunction with the Luce Bayou Interbasin Transfer Project, CWA applied for a $28 million loan from the State's Texas Water Development Board's Water Infrastructure Fund. The loan was closed on February 2009. The loan is being utilized for the preliminary engineering, permitting requirements and design of the Project.
- In support of the on-going Luce Bayou Interbasin Transfer Project, CWA applied for a second loan in the amount of $5.1 million from the Texas Water Development Board's Water Infrastructure Fund. This second loan was closed in July 2010. This loan supplements the funding for the permitting and design of the Project.
- The preliminary engineering phase of the Luce Bayou Interbasin Transfer Project is designed to determine the route and timing of transferring surface water from the Trinity River to Lake Houston for the projected needs of the Houston region. The preliminary engineering report was completed in 2010.
- In 2010, a supplemental internal loan of $524,135 was added to the original $2.3 million loan approved in 2009 to the Red Bluff Water Treatment Plant facility to fund the engineering, design and construction of significant capital improvements to the treatment plant. The loan will be reimbursed from a portion of the water treatment rate charged to the two industrial customers served by the treatment plant. The project was completed in 2011.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial section of this annual report consists of two parts: Management's Discussion and Analysis and the basic financial statements.

The financial statements provide both long-term and short-term information about CWA's financial status. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

CWA's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units on an accrual basis. Under this basis, revenues are recognized in the period in which they are earned, and expenses are recognized in the period in which they are incurred.

The Statement of Net Assets includes all assets and liabilities associated with the operations of CWA. The Statement of Revenues, Expenses, and Changes in Net Assets (Equity) reports CWA's net assets and how they have changed. Net assets are the difference between CWA's assets and liabilities.

FINANCIAL ANALYSIS OF CWA

TABLE A-1

Coastal Water Authority's Summarized Financial Information

	2011	2010
Current Assets	$ 68,305,038	$ 72,068,191
Capital Assets, net	271,276,931	273,520,935
Other Noncurrent Assets	14,137,924	14,042,543
Total Assets	353,719,893	359,631,669
Current Liabilities	11,713,264	13,268,453
Long-Term Liabilities	117,041,507	118,570,177
Total Liabilities	128,754,771	131,838,630
Net Assets:		
Invested in Capital Assets	157,691,826	158,219,626
Restricted	19,547,108	21,970,462
Unrestricted	47,726,188	47,602,951
Total Net Assets	$ 224,965,122	$ 227,793,039

During 2011, the decrease in capital assets was due to the net effect of depreciation expense and the impact of activities related to the Luce Bayou Interbasin Transfer Project. The decrease in current assets is primarily due to activities related to the Luce Bayou Interbasin Transfer Project. The decrease in current liabilities is primarily due to a decrease in deferred revenues.

Net assets may, over time, serve as a useful indicator of a government's financial position. In the case of CWA, assets exceeded liabilities by $225.0 million at the close of 2011. By far the largest portion of CWA's net assets (70%) reflects its investment in capital assets (e.g., land, water systems, vehicles, equipment, and construction in progress). CWA utilizes these assets to deliver surface water (river water) to its end users, the City of Houston (the "City") and its contracted water customers.

The ratio of current assets to cover current liabilities is a strong indicator of an ability to manage day-to-day expenses. As of December 31, 2011, that ratio was approximately 5.8:1. The ratio of total assets to total liabilities was approximately 2.7:1. These strong ratios reflect CWA's stable financial condition both in the short-term as well as in the long-term outlook.

TABLE A-2

Changes in Coastal Water Authority's Net Assets

	2011	2010
Operating Revenues	$ 25,966,280	$ 24,598,281
Operating Expenses - Field and Administration	(25,215,589)	(24,073,283)
Operating Expenses - Depreciation	(7,774,110)	(8,149,377)
Non - Operating Revenues	4,597,062	801,327
Non - Operating Expenses	(3,560,508)	(3,999,052)
Loss	(5,986,865)	(10,822,104)
Capital Contributions	3,158,948	15,561,938
(Decrease)/Increase in Net Assets	(2,827,917)	4,739,834
Net Assets - Beginning of Year	227,793,039	223,053,205
Net Assets - End of Year	$ 224,965,122	$ 227,793,039

During 2011, the increase in operating revenues was primarily due to increased water demand from City of Houston facilities. The increase in field and administration operating expenses was primarily due to electrical usage for CWA pumping stations to meet increased water demand. The decrease in capital contribution was primarily due to funds received from City of Houston in 2010 for Luce Bayou Project land purchase.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets - CWA's investment in capital assets as of December 31, 2011, amounted to $157.7 Million, (net of accumulated depreciation). This investment in capital assets included land, water systems, vehicles, equipment, and construction in progress.

Major capital asset events during the year included the following:

- Construction in progress involving the engineering, permitting and land purchasing for the Luce Bayou Interbasin Transfer Project.
- Replacement of several vehicles and pieces of equipment for field operations.

Long-Term Debt - At the end of 2011, CWA had total long- term debt outstanding of $112.8 million. The majority ($79.7 million) of this amount is backed by the Projects Contract with the City. The bonds are secured by a first lien on, and a pledge of gross revenues of, the City's water and wastewater systems. The remaining $33.1 million is backed by the Luce Bayou Projects Contract with the City. These bonds are secured by a pledge on the City's Combined Utility System General Purpose Fund.

Basic Financial Statements

COASTAL WATER AUTHORITY

Statement of Net Assets

December 31, 2011

ASSETS	
Current Assets – Unrestricted:	
Cash	$ 813,922
Investments	34,864,375
Receivables:	
Accounts receivable from City of Houston	4,659,328
Accounts receivable from other customers	1,040,938
Note receivable – current portion	74,612
Compensable absences – current portion	112,138
Other	19,420
Total receivables	5,906,436
Total current assets – unrestricted	41,584,733
Current Assets – Restricted:	
Cash – restricted for capital projects	72,941
Investments – restricted for contingencies	5,000,000
Investments – restricted for capital projects	21,647,364
Total current assets – restricted	26,720,305
Capital Assets, Net	271,276,931
Other Assets:	
Interest receivable from City of Houston	256,140
Long-term note receivable	45,632
Unamortized bond issue costs	982,619
Compensable absences receivable – non-current portion	2,238,985
Long-term loan receivable from City of Houston	10,614,548
Total other assets	14,137,924
Total assets	$ 353,719,893

Continued

The accompanying notes are an integral part of the financial statements.

COASTAL WATER AUTHORITY

Statement of Net Assets (Continued)

December 31, 2011

LIABILITIES	
Current Liabilities - Unrestricted:	
Accounts payable	$ 717,236
Operating reserve payable	5,768,367
Compensable absences payable – current portion	112,138
Deferred revenue	1,068,889
Total current liabilities – unrestricted	7,666,630
Current Liabilities - Restricted:	
Accounts payable	60,467
Retainage payable	245,147
Bonds payable – current portion	1,580,000
Bond interest payable	161,020
Contingent reserve payable	2,000,000
Total current liabilities – restricted	4,046,634
Long-Term Liabilities:	
Bonds payable – non-current portion	112,826,704
Compensable absences payable – non-current portion	2,238,985
Other postemployment benefits payable	1,975,818
Total long-term liabilities	117,041,507
Total liabilities	128,754,771
NET ASSETS	
Invested in capital assets, net of related debt	157,691,826
Restricted for:	
Capital projects, net of restricted liabilities	16,547,108
Contingencies, net of restricted liabilities	3,000,000
Unrestricted	47,726,188
Total net assets	$ 224,965,122

The accompanying notes are an integral part of the financial statements

COASTAL WATER AUTHORITY

Statement of Revenues, Expenses, and Changes in Fund Net Assets (Equity)

Year Ended December 31, 2011

Operating Revenues:	
Funds provided by City of Houston	$ 21,271,238
Funds provided by San Jacinto River Authority	74,351
Service revenues	4,620,691
Total operating revenues	25,966,280
Operating Expenses:	
Utilities	10,309,249
Field salaries	4,690,650
Administrative	2,478,845
General operating	2,833,043
Materials and supplies	2,794,931
Engineering, legal, and other professional	922,956
Contract labor and equipment	1,185,915
Depreciation	7,774,110
Total operating expenses	32,989,699
Operating loss	(7,023,419)
Non-Operating Revenues/(Expenses):	
Investment income	187,285
Interest income	482,388
Bond interest expense	(3,432,508)
Loan interest expense	(128,000)
Other income	3,927,389
Net non-operating revenues/(expenses)	1,036,554
Loss before contributions	(5,986,865)
Contributions Provided by City of Houston	3,158,948
Change in net deficits	(2,827,917)
Net Assets - beginning of year	227,793,039
Net Assets - end of year	$ 224,965,122

The accompanying notes are an integral part of the financial statements

COASTAL WATER AUTHORITY

Statement of Cash Flows

Year Ended December 31, 2011

Cash Flows from Operating Activities:	
Cash received from municipalities for services rendered	$ 19,880,842
Cash received from non-governmental customers	4,573,151
Cash payments to employees and suppliers for goods and services	(24,397,770)
Net cash provided by operating activities	56,223
Cash Flows from Capital and Related Financing Activities:	
Purchases of capital assets	(6,308,328)
Sale of capital assets	4,037,411
Cash restricted for capital projects & contingencies	342,822
Principal payments on bonds payable	(1,530,000)
Payments of interest on bonds payable	(3,689,095)
Payments of interest on an inter-fund loan	(128,000)
Capital contribution	1,118,389
Net cash used in capital and related financing activities	(6,156,801)
Cash Flows from Investing Activities:	
Purchase of investment securities	(296,024,333)
Proceeds from maturities or sale of investment securities	301,179,359
Advance to City of Houston	(344,869)
Payments received on note receivable	70,277
Investment income	669,673
Other income received	78,927
Net cash provided by investing activities	5,629,034
Net decrease in cash	(471,544)
Cash, beginning of year	1,285,466
Cash, end of year	$ 813,922
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	$ (7,023,419)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	7,774,110
Changes in assets and liabilities:	
Due from the City of Houston	(1,464,747)
Other receivables	(47,540)
Accounts payable	(306,408)
Operating reserve	454,180
Retainage payable	245,147
Bond interest payable	(3,755)
Other postemployment benefits payable	428,655
Net cash provided by operating activities	$ 56,223

The accompanying notes are an integral part of the financial statements

NOTE 1 – REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

In 1967, an act of the State of Texas Legislature (the "Act") created Coastal Water Authority ("CWA") as a conservation and reclamation district and political subdivision of the State of Texas covering a part of southwest Liberty County, southwest Chambers County, and most of Harris County. Under the Act, the primary purpose of creating CWA is to provide an agency to finance and construct a water conveyance and distribution system to transport surface water from Lake Livingston and the Trinity River into the above mentioned counties. CWA is also charged with conveying water to a point where it will be available for Galveston County. CWA is authorized to issue revenue bonds, improvement bonds, and special project bonds for the purpose of constructing or acquiring additional facilities that will enable CWA to distribute water to other customers.

In 2005, the Act was amended. Under the amended legislation, CWA may become involved in desalinization and reclamation projects, create a nonprofit corporation to aid and act on behalf of CWA in implementing a CWA project, and develop and generate electric energy with wind turbines or hydroelectric facilities to be used by CWA or the City of Houston, Texas. CWA may also incur indebtedness, such as bond anticipation notes, or other bonds, for the purpose of improving rivers, creeks, and streams to aid in and prevent overflow.

In 2011 the Act was amended, clarifying CWA's authority to participate in wetland mitigation under Chapter 221, Natural Resources Code.

Related Organizations

The City of Houston, Texas (the "City") is incorporated under the laws of the State of Texas and provides governmental services as authorized or required by its charter. The City appoints a voting majority of CWA's board members, but is not financially accountable for the actions of CWA. As a result, the City does not have a financial benefit in CWA and a burden relationship does not exist. All transactions with the City are evidenced by operating and construction project contracts for which the City compensates CWA for their services received pursuant to the contracts.

Basis of Accounting

The financial statements of CWA have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted primary standards-setting body for establishing accounting and financial reporting principles for state and local governments.

Under GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*, CWA qualifies as a special-purpose government engaged only in business-type activities, and accordingly, only the financial statements required for an enterprise fund are presented as basic financial statements.

CWA uses the accrual method of accounting whereby expenses are recognized when the liability is incurred, and revenues are recognized when earned under the flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation are included on the statement of net assets. CWA applies all applicable GASB pronouncements issued after November 30, 1989, and all applicable Financial Accounting Standard Board (FASB) statements and interpretations issued on or before November 30, 1989, unless they contradict GASB pronouncements. CWA has elected not to apply FASB pronouncements issued after November 30, 1989 unless specifically adopted by GASB.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities 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. Significant estimates included in the financial statements are depreciation expense which is based on the estimated useful lives of the underlying depreciable assets, annual Other Post Employment Benefits (OPEB) costs and related net OPEB obligations, and the assets and liabilities for compensable absences.

Cash and Cash Equivalents

For purposes of the statement of cash flows, CWA considers all highly liquid investments with a maturity when purchased of three months or less to be cash equivalents. CWA had no cash equivalents at December 31, 2011. Cash restricted by purpose is excluded from cash and cash equivalents.

Accounts Receivable

Accounts receivable at December 31, 2011 consisted of billings to customers for user charges and reimbursable expenses from the City.

No allowance for doubtful accounts has been recorded because management deemed all receivables to be collectible.

Capital Assets

Capital expenditures for the acquisition, construction, or improvement of capital assets are recorded at cost. Management estimates water systems to have a 30% salvage value. Depreciation is provided on a straight-line basis over the estimated useful lives. The estimated useful lives of CWA's capital assets are as follows:

Description	Useful Lives
Water systems	15-50 years
Trucks, equipment, and other	5-10 years

The cost of normal maintenance and repairs that do not add value to the asset or materially extend its life are not capitalized. When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in operations for the period. CWA continuously reviews the carrying value of its property and equipment for possible impairment. When applicable, the book amounts are reduced to fair values.

Balance of construction in progress represents costs incurred on the construction of assets which have not been completed or placed in service as of the end of the year (See Note 7.)

Unamortized Bond Issue Costs and Unamortized Bond Discount

Unamortized bond issue costs represent transaction costs of the bond issue. There were no bond issues during the year, therefore, no additional bond issue costs were incurred during the year. Unamortized bond discount resulted from the sale of the 2004 Bonds and is netted with total bonds payable on the accompanying statement of net assets. The costs and discount are capitalized and being amortized on a straight-line basis over the life of the bond agreements. For 2011, amortization expense of approximately $21,000 is included in bond interest expense on the accompanying statement of revenues, expenses, and changes in fund net assets (equity).

Unamortized Bond Premium

Unamortized bond premium resulted from the issuance of the $38,900,000 Coastal Water Authority Contract Revenue Refunding Bond Series 2010. The net premium in the amount of $3,921,765 has been capitalized and is being amortized on a straight-line basis over the 15-year term of the bond agreement. Balance outstanding as of December 31, 2011 in the amount of $3,649,052 has been recorded in the accompanying financial statements as an addition to the face value of the bonds to arrive at its carrying value.

Investments

CWA is authorized to invest in direct obligations of, or obligations guaranteed by, the United States of America, obligations of certain Federal agencies, and other investment instruments as authorized by CWA's investment policy, certain obligations of public housing authorities and related institutions, fully collateralized repurchase agreements, and interest bearing time deposits. Any cash balances and time deposits are required to be collateralized and secured by pledges of direct obligations of, or obligations guaranteed by, the United States of America, obligations of such Federal agencies, and certain obligations of public housing authorities and related institutions. Repurchase agreements are required to be fully collateralized by such securities held in a safekeeping account subject to the control and custody of CWA. Investments are valued at amortized cost, which approximates fair value, typically mature in one year or less, and are held to maturity. CWA's Board of Directors reviewed and amended the investment policy on September 14, 2011.

Compensable Absences

Employees receive 10 days of vacation and 15 days of sick leave each year. After five years of service, employees receive one additional vacation day for each additional year of service up to a maximum of twelve additional days. Employees may accumulate vacation leave from year to year and upon termination or resignation receive a lump sum vacation accrual payment up to a maximum of 720 hours. Upon termination or resignation, employees with two or more years of service may receive a lump-sum sick leave payment up to a maximum of 700 hours. Paid absences for employee vacation and sick leave are recorded as expenses when used. CWA's obligation for unused employee vacation and sick leave is reported as a long-term liability, net of current portion, and the sick leave is calculated using the vesting method which is 2 years for any new employees. Since these expenses are reimbursable/ billable to customers when payable to the employees, CWA records an equal amount of receivable for these compensable absences.

Revenues and Expenses

Operating revenues are those revenues generated from the primary operations of CWA. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations of CWA. All other expenses are reported as non-operating expenses. The principal operating revenues of CWA are revenues generated from transportation of surface water to its customers.

Contributions, which finance either capital or current operations, are reported based on GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. In applying GASB Statement No. 33 to contributions, the provider recognizes liabilities and expenses and the recipient recognizes receivables and revenues when the applicable eligibility requirements, including time requirements, are met. Resources that qualify to be recorded by CWA as receivables and revenues, which are transmitted by the provider before the eligibility requirements are met, are reported as deferred revenue. At December 31, 2011, CWA had deferred revenues of $1,068,889. The cash received has been included in restricted investments in the statement of net assets.

Restricted Assets

Proceeds of CWA's contract revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets because their use is limited per applicable bond covenants. The investments held for the construction account is used to report those proceeds of revenue bond issuances that are restricted for use in construction projects.

Funds received for CWA's operation and maintenance is set aside to create a reserve for major maintenance, repairs, replacement, and obligatory replacement fund per the Trinity River Water Conveyance System contract and the Lake Houston Pump Station contract between CWA and the City of Houston. These funds are shown as restricted investments in the financial statements.

Income Taxes

CWA is an organization described in Internal Revenue Code Section 115. Generally, no tax provision is necessary in regard to its excess revenue. Accordingly, none has been recorded in the accompanying financial statements.

Deferred Revenues

Contributions received and related to periods after December 31, 2011, have been deferred to the subsequent fiscal year.

Recent Accounting Pronouncements

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* The Statement provides financial reporting guidance for deferred outflows and inflows of resources. Concepts Statement No 4, *Elements of Financial Statements*, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period respectively. Previous financial reporting standards do not include guidance for those financial statement elements, which are distinct from assets and liabilities. Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. GASB Statement No 63 amends the net assets reporting requirements in Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The provisions of the Statement are effective for financial statements for periods beginning after December 15, 2011, with earlier application encouraged. Management of CWA is currently evaluating the impact, if any, on the financial statements resulting from this pronouncement.

In June 2011, GASB issued Statement No. 64, *Derivatives Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53.*Prior to the issuance of Statement No. 64, GASB Statement No. 53 require a government to cease hedge accounting upon the termination of the hedging derivative instrument, resulting in the immediate recognition of the deferred outflows of resources or deferred inflows of resources as a component of investment income. The objective of the Statement is to clarify whether an effective hedging relationship continues after the replacement of swap counterparty or swap counterparty's credit support provider. The Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. Furthermore, the requirements of this Statement enhance comparability and improve financial reporting by clarifying the circumstances in which hedge accounting should continue when swap counterparty, or swap counterparty's credit support provider, is replaced. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011, with earlier application encouraged. CWA does not anticipate any impact on the financial statements resulting from this new pronouncement.

NOTE 2 – TRINITY RIVER WATER CONVEYANCE SYSTEM CONTRACTS

City of Houston

CWA entered into a contract (the "Initial Contract") with the City in May 1968. The contract expires on the earlier date of June 15, 2035 or the date on which the debt service requirements have been paid in full. In consideration of CWA's agreement to construct the main water conveyance and distribution systems, the City agreed to pay, solely out of revenues received from the operation of the City's water and wastewater systems, all maintenance and operating costs and all debt service requirements for the Trinity River Water Conveyance System. Upon termination of the contract and upon payment of all bonds and other obligations issued by CWA for the Trinity River Water Conveyance System, CWA must assign and convey to the City, upon request, all of its rights, titles, and interest in the Trinity River Water Conveyance System.

In June 1995, CWA entered into an operating contract (the "Operating Contract") and a project financing and construction contract (the "Projects Contract") with the City. The Operating Contract expires on the earlier occurrence of the year 2035 or when both the Initial Contract and the Projects Contract terminate. The Projects Contract expires on the earlier occurrence of the year 2035 or when all bonds and other obligations issued by CWA pursuant to the Projects Contract to finance the cost of projects or refinance the cost of such projects are paid.

The Operating Contract amends, restates, and supersedes the Initial Contract relating to CWA's operation for the Trinity River Water Conveyance System. In the Operating Contract, CWA is required to operate and maintain the Trinity River Water Conveyance System and the facilities constructed and/or acquired (“Trinity River facilities”) pursuant to the Projects Contract and acquire and/or construct improvements to such facilities or other City facilities. In return, the City pays CWA for maintenance, operation, construction, improvement, and repair of the City projects, including reasonable overhead and administrative costs, as set forth in the annual operating budget. The City is entitled to credits against its obligations under the Operating Contract to the extent that excess revenues, including proceeds from third-party insurers and grants from any Federal or state agency, received by CWA from the operation of the Trinity River facilities are available and are used to pay maintenance, operation, construction, improvement, and repair expenses of the facilities pursuant to the terms of the Operating Contract.

Under the Projects Contract, CWA is required to construct and/or acquire, improve, and repair certain water conveyance and distribution facilities. In return, the City pays, solely from the gross revenues received from the operation of the City's water and wastewater systems, all amounts necessary to pay debt service requirements and reserve fund requirements for such facilities. Upon termination of the Projects Contract and upon payment of all bonds and other obligations issued by CWA, CWA must assign and convey to the City, upon request, all of its rights, titles, and interest in and to such facilities.

In 2009, CWA entered into another project financing and construction contract with the City to plan, design, acquire property, construct and finance project known as the Luce Bayou Interbasin Transfer Project (the “Luce Bayou Project”), which includes infrastructure sized to transfer approximately 450,000 acre feet per year of the City's permitted surface water from the Trinity River to Lake Houston. The Preliminary Project Costs of the Luce Bayou Project was financed and paid through the issuance of CWA contract revenue bonds which were purchased by the Texas Water Development Board (the "TWDB") through its Water Infrastructure Fund ("WIF") loan program, under which the TWDB loaned funds to CWA (the "WIF Bonds"). The WIF Bonds are secured by the City's pledge under this Projects Contract to pay Debt Service on the WIF Bonds from its Net Revenues held in the General Purpose Fund.

Under the Luce Bayou Project, CWA is required to advance funds, in the amount of $9,705,000, to pay for the City's share of Land and Mitigation Costs. The funds would be obtained from CWA’s revenues derived from the sale of certain Certificates of Participation, Series 1993A-J with respect to the City of Houston Water Conveyance System Contract. The City shall repay the advance to CWA along with interest, at a rate equal to the prime rate published by the Wall Street Journal on the respective January 1st or July 1st for the period June 15, 2009 through December 15, 2016 and the 10 year Bond Buyer Revenue Bond Index from December 15, 2016 for the period December 15, 2016 through December 15, 2038. The City’s payment schedule will start on June 15, 2019 and its repayment term is 20 years with one principal payment and two interest payments each year.

On February 3, 1999, CWA accomplished an escrow restructuring of certain securities in connection with the $270,960,000 City of Houston Water Conveyance System Contract Certificate of Participation, Series 1993 A-J Bonds, which were legally defeased and removed from the general long-term debt account group in 1993. CWA sold existing securities held in escrow accounts for the subject certificates in the amount of $252,460,758 and purchased $242,768,280 of U.S. Treasury Securities - State and Local Securities, which were deposited to replace the existing securities in the Escrow Fund held by the Escrow Agent. This restructuring activity resulted in approximately $9,695,000 (proceeds plus cash balance) of cash proceeds to CWA. Transaction costs amounted to $437,000, netting approximately $9,258,000 in cash to CWA.

In 1995, CWA issued $45,000,000 Coastal Water Authority Contract Revenue Bonds, Series 1995 ("Series 1995") to construct a 96-inch water line from near the San Jacinto Monument to the City's Southeast Water Purification Plant and reimburse CWA for certain costs incurred to repair flood damage to a pipeline under the Houston Ship Channel near the Lynchburg Pump Station.

On February 15, 1999, CWA issued $48,240,000 Coastal Water Authority Contract Revenue Refunding Bonds, Series 1999 to refund the Series 1995 bonds and to pay related costs of issuance. Of the proceeds, $47,216,086 was deposited in an escrow fund established pursuant to an escrow agreement; $299,228 was deposited in the Trinity River Bond Fund to be applied to accrued interest; and $225,740 was deposited into the Trinity River Construction Multiple Series Fund to pay issuance costs (see Note 8). Debt service of the bonds is payable by CWA from revenues received from the City pursuant to the Projects Contract. On December 15, 2010, proceeds from the issue of $38,900,000 Contract Revenue Refunding Bonds, Series 2010 were used to refund a portion of the Series 1999 bonds. During the year, the outstanding principal in the amount of $1,255,000 was paid.

On October 20, 2004, CWA issued $40,385,000 Coastal Water Authority Contract Revenue Bonds, Series 2004 at a discount of $140,993 to fund the design, construction management, and construction costs of the expansion of the Trinity River Pump Station and Lynchburg Pump Station. Of the proceeds, $255,254 was paid for insurance and $39,988,753 was deposited in the Trinity River Construction Fund, Series 2004 to pay for the construction costs (see Note 8). Additional closing costs of $265,360 were paid from the Trinity River Construction Fund; Series 2004 subsequent to collection of bond proceeds, resulting in total closing costs of $520,614 (see Note 8 Unamortized bond issue costs). Debt service of the bonds is payable by CWA from revenues received from the City pursuant to the Projects Contract.

On February 26, 2009 CWA issued $28,000,000 Coastal Water Authority Contract Revenue Bonds, Series 2009 Bonds to finance the cost of conveyance system and treatment facilities of the Luce Bayou Project. Of the proceeds, $300,000 was paid for issuance costs and $15,391,019 was deposited in the Luce Bayou Project Fund, Series 2009 to pay for the construction costs (see Note 8). Additionally, $12,308,981 was deposited in Project Escrow Account for the final design phase. Debt service of the bonds is payable by CWA from revenues received from the City pursuant to the Projects Contract.

In accordance with the terms of the various bond resolutions and City contracts, CWA is required to maintain, in the Trinity River Water Conveyance System operations account, an amount equal to three months' average operating costs, as applicable to the City, estimated from its annual operating budget. At the beginning of each year, CWA makes an adjustment to the operating reserves to meet the requirements. This adjustment is either paid by or credited to the City. This amount is being shown in the statement of net assets as part of line item 'operating reserves payable' (See Note 8).

On July 12, 2010 CWA issued $5,115,000 Coastal Water Authority Contract Revenue Bonds Series 2010 (Luce Bayou Project) to finance the implementation of a water supply project identified in the

2007 State Water Plan and regional water plan. Of the proceeds, $123,000 was paid as issuance costs, $1,792,000 was deposited in an Escrow Fund and the balance of $3,200,000 was deposited in the Construction Fund.

On December 15, 2010, CWA issued $38,900,000 Coastal Water Authority Contract Revenue Refunding Bonds, Series 2010 (City of Houston Projects). The proceeds of the Bonds are to be used to refund a portion of the Series 1999 Bonds, fund a portion of the Bond Reserve Fund requirement and pay the costs of issuing the Bonds and refunding the Series 1999 Bonds. The Bonds were issued at a premium. Balance on the premium at December 31, 2011 in the amount of $3,649,052 has been recorded in the accompanying financial statements as an addition to the face (par) value of the bonds to arrive at its carrying value.

San Jacinto River Authority

Effective February 10, 1998, CWA entered into a water conveyance contract with San Jacinto River Authority ("SJRA") whereas SJRA reserved 50 million gallons per day (MGD) of capacity in the CWA main canal system. In 1998, SJRA paid CWA a capital recovery fee of $3,663,860 for this capacity reservation. SJRA paid $796,087 for the costs of engineering, design, and construction of a diversion point to accommodate this conveyance of water from CWA's main canal to SJRA's canal. Upon completion of the construction project in February 2000, CWA began operating and maintaining this diversion point structure. In return, SJRA began paying a monthly operating charge to CWA for the conveyance of this water. Termination of the contract is the earlier date of January 1, 2035 or the date the City acquires the CWA main canal system.

In accordance with the terms of the contract, CWA is required to maintain, in the Trinity River Water Conveyance System operations account, an amount equal to three months' average operating costs, as applicable to SJRA, estimated from its annual operating budget. At the beginning of each year, CWA makes an adjustment to the operating reserves to meet the requirements. This adjustment is either paid by or credited to SJRA. This amount is being shown in the statement of net assets as part of line item 'operating reserve payable' (see Note 8).

NOTE 3 – LAKE HOUSTON FACILITIES

Effective January 1, 1996, CWA entered into an operating contract with the City to assume the responsibility of operating, maintaining, and keeping the Lake Houston Pump Station, West Canal, and related facilities (the "Facilities") in good repair and to assume the responsibility of transporting water through the Facilities. The City pays, solely out of revenues received from the operation of the City's water and wastewater system, all maintenance and operating costs of the Facilities. The City is entitled to credits against obligations for interest received on Lake Houston Facilities fund investments. The contract has been renewed until 2015.

In accordance with the terms of the contract, CWA is required to maintain, in the Lake Houston operations account, an amount equal to three months' average operating costs as estimated from its annual operating budget. At the beginning of each year, CWA makes an adjustment to the operating reserves to meet the requirements. This adjustment is either paid by or credited to the City. This amount is being shown in the statement of net assets as part of line item 'operating reserve payable' (see Note 8).

Effective January 1, 2004, the Operating Contract with the City was amended to extend responsibility for operating, maintaining, performing inspections, and implementing security of Lake Houston and the Lake Houston Dam to CWA. Further, the work under the Operating Contract may be paid by the City either as a capital project or from revenues received from the operation of the City's water and wastewater systems.

NOTE 4 – BAYPORT WATER SYSTEM

In 1979, CWA issued $10,000,000 of special project bonds to acquire an existing water distribution system, the Bayport Water System, from the Friendswood Development Company and to extend the system to service additional customers. The Bayport Water System is attached to CWA's distribution system and its customers consist primarily of large national company chemical plants.

In 1985, CWA issued $1,700,000 of Special Project First Mortgage Revenue Bonds to improve the Bayport Water System by construction of crossover connections to interconnect the three CWA systems and bypass the Bayport reservoir and pump station. This change resulted in a more efficient and reliable system. In 2000, CWA redeemed all outstanding debt service requirements. The Bayport Water System has been debt free since this redemption date.

A Capital Improvement Fund was established by CWA in the Bayport Water System to provide funds for future renovations, improvements, and repairs to the system. Maintenance and operating costs are paid from revenues received from the operations of the Bayport Water System.

NOTE 5 – WATER TREATMENT PLANT

In 1979, CWA acquired an existing water treatment plant from Crown Central Petroleum Company. Maintenance and operating costs of the plant and all debt service requirements are paid by CWA from revenues received from the operation of the plant. Currently, there is no outstanding debt related to this plant.

In November 2002, Air Products and Chemicals, Inc., (“Air Products”) entered into an agreement with CWA to receive and treat untreated surface water. In return, Air Products will take delivery of the treated surface water and make monthly payments to CWA for water treatment services. To compensate for Air Products' water requirements, the Water Treatment Plant had to be expanded. Total costs for the expansion were $598,968. Air Products is reimbursing these costs in monthly installments of $6,650, including interest at 6%, and maturing in July 2013. As of December 31, 2011, the remaining balance was $120,244.

In accordance with the Air Products contract, CWA will establish and maintain in the Water Treatment Plant operations account an amount equal to two months' average operating costs, as applicable to Air Products, estimated from its annual operating budget. At the beginning of each year, CWA will make an adjustment to the operating reserves to meet the requirements. This adjustment will either be paid by or credited to Air Products (see Note 8).

In January 2005, Pasadena Refining Systems, Inc. (“PRSI”) entered into an agreement with CWA to receive and treat 1.15 to 6.0 million gallons of untreated surface water per day for PRSI's production requirements. In return, PRSI will take delivery of the treated surface water and make monthly payments to CWA for water treatment services. The termination date for the agreement is December 2017. The agreement may be renewed for two additional five-year periods.

In accordance with the PRSI contract, CWA will establish and maintain in the Water Treatment Plant operations account an amount equal to two months' average operating costs, as applicable to PRSI, estimated from its annual operating budget. At the beginning of each year, CWA will make an adjustment to the operating reserves to meet the requirements. This adjustment will either be paid by or credited to PRSI (see Note 8).

In 2010, a supplemental internal loan of $524,135 was added to the original $2.3 million loan approved in 2009 to finance the design and construction of a major repair to the Water Treatment Plant facility. The primary objective of the construction project is to replace the filtering equipment and install improved control mechanisms in the plant. Construction work on the project was completed during the year.

NOTE 6 – DEPOSITS AND INVESTMENTS

As of December 31, 2011, CWA had the following deposits and investments:

Deposits	Fair Value	Average Maturity in Days
Cash and cash equivalent	$ 813,922	-
Cash restricted	72,941	-
Total Value	$ 886,863	

Investment Type	Fair Value	Average Maturity in Days
U.S. government and agency securities	$ 8,860,693	112
Commercial papers issued by municipality	50,055,031	76
Investment pool	2,596,015	-
Total Value	$ 61,511,739	

Custodial credit risk-Deposits: Custodial credit risk is the risk that in the event of a bank failure, CWA’s deposits may not be returned to it. As of December 31, 2011 all CWA’s bank balances were fully insured by the Federal Deposit Insurance Corporation (FDIC). In addition, consistent with CWA’s investment policy, all deposits are also collateralized.

Interest rate risk: CWA’s formal investment policy limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. Financial assets are invested only in authorized investments whose maturities do not exceed one year at the time of purchase.

Texas Short Term Asset Reserve Program Cash Reserve Fund (“TexStar”) is a local government investment pool organized under the authority of the Interlocal Cooperation Act, Chapter 791 of the Texas Government Code (“Code”), and the Public Funds Investment Act (PFIA), Chapter 2256 of the

Code. TexStar was created in April 2002 through a contract among its participating governmental units, and is governed by a board of directors ("board"), to provide for the joint investment of participant's public funds and funds under their control. It is the policy of TexStar to invest pooled assets in a manner that will provide for preservation and safety of principal and competitive investment returns while meeting the daily liquidity needs of its participants. Portfolio of TexStar is a government-repo fund, utilizing primarily U.S. treasury securities, U.S. agency securities both fixed and floating, and repurchase agreements collateralized by such obligations. In order to meet the liquidity needs of the pool's shareholder base and limit its exposure to significant market price fluctuations occurring during the periods of volatile interest rate movement, the weighted average maturity of the pool's assets is limited to 60 days or less. TexStar is rated AAAm by Standard and Poor's. J.P. Morgan Fleming Asset Management and First Southwest Asset Management serve as co-administrators for TexStar under an agreement with the TexStar board.

TexStar is not registered with the SEC as an investment company but has a conservative investment policy which is consistent with the SEC's Rule 2a7 of the Investment Company Act 1940. GASB 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, allows 2a7-like pools to use amortized cost (which excludes unrealized gains and losses) rather than market value to report net assets to compute share price.

NOTE 7 – CAPITAL ASSETS

Capital assets consisted of the following at December 31, 2011:

	Balance December 31, 2010	Additions	Retirements	Balance December 31, 2011
Land	$ 16,844,973	$ -	$ (142,931)	$ 16,702,042
Water systems	376,062,306	3,594504	(100,259)	379,556,551
Trucks, equipment, and other	8,132,259	226,426	(68,678)	8,290,007
Construction in progress	30,530,481	1,885,580	-	32,416,061
	431,570,019	5,706,510	(311,868)	436,964,661
Accumulated depreciation:				
Water systems	(153,280,596)	(6,889,588)	70,181	(160,100,003)
Trucks, equipment, and other	(4,768,488)	(876,034)	56,796	(5,587,726)
	(158,049,084)	(7,765,622)	126,977	(165,687,729)
Total capital assets, net	$ 273,520,935	$ (2,059,112)	$ (184,891)	$ 271,276,931

NOTE 8 – LONG-TERM DEBT AND OTHER LIABILITIES

The following is a summary of long-term debt and other liabilities for the year ended December 31, 2011:

	Balance as of December 31, 2010	Additions	Reductions	Balance as of December 31, 2011	Due within One Year
Bonds:					
Series 1999 Contract Revenue Refunding Bonds	$ 1,255,000	$ -	$ (1,255,000)	$ -	$ -
Series 2004 Contract Revenue Bonds	39,125,000	-	(275,000)	38,850,000	280,000
Series 2009 Contract Revenue Bonds	28,000,000	-	-	28,000,000	-
Series 2010 Contract Revenue Bonds	5,115,000	-	-	5,115,000	-
Series 2010 Contract Revenue Refunding Bonds	38,900,000	-	-	38,900,000	1,300,000
Sub-total	112,395,000	-	(1,530,000)	110,865,000	1,580,000
Less: Unamortized discount	(112,021)	-	4,673	(107,348)	-
Add: Unamortized premium	3,910,312	-	(261,260)	3,649,052	-
	116,193,291	-	(1,786,587)	114,406,704	1,580,000
Other liabilities:					
Compensated absences	2,425,655	-	(74,532)	2,351,123	112,138
Other postemployment benefit payable	1,547,163	428,655	-	1,975,818	-
Total long-term liabilities	$ 120,166,109	$ 428,655	$ (1,861,119)	$ 118,733,645	$ 1,692,138

The annual debt service requirements for bonds payable as of December 31, 2011 are as follows:

Year Ending December 31,	Principal	Interest
2012	$ 1,580,000	$ 3,568,885
2013	1,615,000	3,533,925
2014	1,645,000	3,497,565
2015	2,215,000	3,433,265
2016	3,290,000	3,347,905
2017-2021	27,160,000	16,742,505
2022-2026	41,565,000	11,984,669
2027-2031	21,915,000	4,759,827
2032-2034	9,880,000	953,325
Total	$ 110,865,000	$ 51,821,871

The Series 2004 bonds carry a fixed interest rate of 2% - 5%, Series 2009 bonds carry a fixed interest rate of 2%-3%, Series 2010 Contract Revenue Bonds carry a fixed interest rate of 1.64%-2.82%, Series 2010 Contract Revenue Refunding Bonds carry a fixed interest rate of 2%-5% and are payable on June 15 and December 15 of each year. Bond issuance costs on Series 2004, 2009 and 2010 were incurred and consisted of underwriters' discount, insurance premiums legal fees and cost of issuance. These bond issuance costs, net of amortization, are recorded in other assets.

Optional Redemption: The Series 2004 Bonds (City of Houston Projects) maturing on December 15, 2015 and thereafter shall be subject to redemption in whole or in part at the option of CWA prior to maturity on any Interest Payment Date on or after December 15, 2014 at a price of par, plus accrued interest to the date of redemption.

CWA reserves the option to redeem the Series 2009 Bonds (Luce Bayou Project) maturing on and after December 15, 2019, in whole or in part in inverse order of maturity, before their respective scheduled maturity dates on June 15, 2019 or on any date thereafter, such redemption date or dates to be fixed by CWA, at a price equal to the principal amount of the Bonds so called for redemption plus accrued interest to the date fixed for redemption.

The Series 2010 Bonds (Luce Bayou Project) maturing on June 15, 2020 and thereafter shall be subject to redemption in whole or in part at the option of CWA in inverse order of maturity, before their respective scheduled maturity dates, on December 15, 2019, or on any date thereafter, such redemption date or dates to be fixed by CWA, at a price equal to the principal amount of the Bonds so called for redemption plus accrued interest to the date fixed for redemption.

The Series 2010 Bonds (City of Houston Projects) maturing on or after December 15, 2021 are subject to redemption at the option of CWA prior to maturity, in whole or in part, on any date on or after December 15, 2020 at a price of par, plus accrued interest to the date of the redemption.

Mandatory Redemption: The Series 2004 Bonds issued as term bonds and described below ("Term Bonds") are subject to mandatory redemption in whole or in part prior to maturity, at a price equal to the aggregate principal amount thereof plus accrued interest to the redemption date, without premium, on the dates and in the respective aggregate principal amounts set forth below and in the manner provided in the resolutions:

Term Bonds Due at December 15, 2029 Through 2034

Mandatory Redemption Date (December 15)		Mandatory Redemption Amount	
2029		$	2,735,000
2030		$	2,865,000
2031		$	3,000,000
2032		$	3,140,000
2033		$	3,290,000
2034	(Maturity)	$	3,450,000

The Series 2004, 2009, 2010 and 2010 refunding Bonds (the "Bonds") are special limited obligations of CWA which are payable as to principal and interest solely from certain payments to be made by the City of Houston (the "City") to CWA under the Projects Contract. Concurrently with the issuance of the Bonds, Financial Guaranty Insurance Company (FGIC) for 2004 Series Bonds, issued a Municipal Bond Insurance Policy (the "Policy") for the Bonds. The Policy guarantees the payment of the principal and interest on the Bonds which become due for payment, and are unpaid by reason of nonpayment by the issuer of the Bonds. The Policy is non-cancelable and the premium was fully paid at the time of delivery of the Bonds.

Bond Reserve Fund Surety Policy

The Bond Reserve Fund Requirement immediately prior to the issuance of the 2010 Refunding Bonds was $6,344,013. Upon the issuance of the Bonds, the Bond Reserve Fund Requirement was established at $7,178,470. At the time of issuance of the Bonds, the Authority did apply bond proceeds to partially fund the Bond Reserve Fund Requirement. In the Fourth Supplemental Bond Resolution adopted on October 13, 2010, the Authority reserves the right to review and recalculate the Bond Reserve Fund Requirement at a later date in a manner consistent with the definition of Bond Reserve Fund Requirement. In order to satisfy the Bond Reserve Fund Requirement for the Prior Bonds, the Authority has previously acquired Reserve Fund Surety Policies from Financial Security Assurance, Inc. ("FSA") and Financial Guaranty Insurance Company ("FGIC"). The Reserve Fund Surety Policy provided by FSA was acquired upon the issuance of the Authority's Contract Revenue Refunding Bonds, Series 1999 (City of Houston Projects) ("the Series 1999 Bonds") ("Refunded Bonds"), a portion of which was refunded with the Bonds. Upon the refunding of the Refunded Bonds and the payment of the principal of the remaining outstanding Series 1999 Bonds on December 15, 2011, the Reserve Fund Surety Policy provided by FSA expired. The Bond Reserve Fund includes:

FGIC Reserve Fund Surety Policy	$	2,857,143
Estimated amount of cash deposit		4,321,885
Total	$	7,179,028

Under the terms of the various bond resolutions, contracts, and board designations, CWA is required to maintain the following reserves:

System	Required Reserve
Trinity River Water Conveyance System	
Operating Reserve ($5,163,873 at December 31, 2011)	25% of the annual budgeted operating expenses applicable to each municipality (the City and SJRA).
Repair, Replacement, and Renewal Reserve ($3,000,000 at December 31, 2011)	A minimum of $3,000,000.
Lake Houston Facilities	
Operating Reserve ($604,494 at December 31, 2011)	25% of the annual budgeted operating expenses.
Repair, Replacement, and Renewal Reserve ($2,000,000 at December 31, 2011)	A minimum of $2,000,000.

During 2011, CWA complied with the aforementioned required reserves of the Trinity River Water Conveyance System and Lake Houston Facilities. The required reserves of the Trinity River Water Conveyance System and Lake Houston Facilities were reclassified as Operating reserve payable during the year.

The Bond Indentures contain certain covenants requiring CWA to maintain: (1) separate funds as specified in bond documents, and (2) the Project Contract in effect and use reasonable diligence to ensure duties and obligations imposed upon the City by the Project Contract are performed and discharged, and timely payments from the City are obtained.

Prior-year Defeasance of Debt

CWA has at various times entered into transactions to refund certain issues of its bonded debt. Generally, these transactions involve putting funds in trust to be used to purchase securities to meet all the debt service requirements of the refunded debt, until that debt either matures or is redeemed. The liability for such refunded bonds and the related securities and escrow accounts were not included in the accompanying financial statements, as CWA defeased its obligations for payment of the refunded debt upon completion of the refunding transactions.

At December 31, 2011, refunded bond issues and the related principal payable from escrow accounts were as follows:

	Principal Balance Outstanding
Series 1986	$ 730,000
Series 1991	$ 24,310,000

NOTE 9 – EMPLOYEE BENEFIT PLANS

CWA has a single-employer defined contribution plan (the "Plan") under which all full-time employees are eligible to participate upon completion of 90 days of service. All employees are required to contribute 4% of their annual compensation and may make additional voluntary contributions up to a maximum of 10% of that compensation received during all years of plan participation when added to their prior employee contributions.

CWA contributes 11.8% of each employee's gross compensation, which is 18% less a fixed rate of 6.2%, until eligible compensation is no longer subject to the Federal Insurance Contribution Act (FICA). When CWA is not required to contribute to FICA, with respect to each employee, CWA contributes the additional 6.2% to the employee's account. Maximum annual employee contributions are limited to 100% of the employee's compensation. Participants are 100% vested in their contributions and earnings thereon. For the employer contributions, participants are vested at the rate of 20% per year, beginning subsequent to the completion of one year of service, allowing 100% vesting after five years. Participants also become 100% vested upon death, disability, or reaching 65 years of age. In the event of termination of the plan, the vested interest of each participant shall be 100% and no part of the plan's assets will revert to CWA.

Total payroll expense for the year ended December 31, 2011 (100% covered by the plan) was $5,592,338. Accordingly, the 2011 required contributions for employees were $223,694 and CWA's requirement, net of forfeitures, was $659,896. Actual contributions from employees and CWA during 2011 were $332,857 and $677,554, respectively. Below is the Statement of Net Assets Available for Benefits and the Statement of Changes in Net Assets Available for Benefits derived from the Plan's financial statements for the year ended September 30, 2011.

Statement of Net Assets Available for Benefits

	Year Ended September 30, 2011
Assets	
Investments, at fair value	$ 10,015,943
Employer's contribution receivable	23,620
Net Assets Available for Benefits	$ 10,039,563

Statement of Changes in Net Assets Available for Benefits

	Year Ended September 30, 2011
Additions to Net Assets	
Contributions	
Employer	$ 685,211
Participants	337,150
Total Contributions	1,022,361
Net appreciation in fair value of investments in U.S. government securities and U.S. government agency securities	79,168
Total additions to net assets	1,101,529
Deductions from Net Assets	
Benefits paid	(508,816)
Total deductions from net assets	(508,816)
Change in net assets	592,713
Net Assets Available for Benefits	
Beginning of year	9,446,850
End of year	$ 10,039,563

Plan's investments at September 30, 2011 were as follows:

September 30, 2011	Face Value	Fair Value	Amortized Cost
Federal Home Loan Bank Coupon Note, CUSIP #313372QC1; 1.4000%; due 11/22/2013	$ 1,250,000	$ 1,255,550	$ 1,256,214
Federal Home Loan bank Coupon Note, CUSIP #313373YB2; 1.1500%; due 06/13/2014; Callable 06/13/2012	4,000,000	4,021,160	4,013,850
Federal national Mortgage Association Discount Note, CUSIP #313588SA4;0.1420; due 01/20/2012	687,419	687,959	687,703
City of Houston Tex Hotel occupancy & parking Revenue Notes – Series A; CUSIP #44237R5W9; 0.2100%; due 10/25/2011.	1,500,000	1,500,000	1,500,319
Cash Equivalents; SEI Daily Income TR Treasury II; 0.01%	2,551,274	2,551,274	2,551,274
	$ 9,988,693	**$ 10,015,943**	**$ 10,009,360**

Employees of CWA may also participate in a deferred compensation plan, created in accordance with Internal Revenue Code Section 457, which permits the deferral of a portion of their salaries until future years. The deferred compensation is not available to employees until retirement, termination, death, or an unforeseeable emergency. All assets and income of the plan shall be held for the exclusive benefit of the plan's participants and their beneficiaries. The plan is administered by an independent contractor using the investment programs selected by the participants.

NOTE 10 – POSTEMPLOYMENT BENEFITS

Plan Description: CWA administers a single-employer defined benefit healthcare plan ("the Retiree Health Plan"). The Retiree Health Plan provides healthcare insurance for eligible retirees and their spouses through CWA's group health insurance plan, which covers both active and retired members. Substantially all of CWA's employees become eligible for these benefits if they reach normal retirement age while working for CWA. CWA issues a publicly available financial report that includes financial statements and required supplementary information for the Retiree Health Plan. The report may be obtained by writing to CWA, 1801 Main Street, Suite 800, Houston, Texas 77002.

Funding Policy: The contribution requirements of plan members are established and may be amended by the CWA's Board of Directors. These costs are funded on a pay-as-you-go basis. Contributions are recognized in the year paid. The cost of retiree health care premiums incurred by CWA amounted to $204,731 for the year ended December 31, 2011.

Annual OPEB Cost and Net OPEB Obligation: CWA's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer. CWA has elected to calculate the ARC and related information using the alternative measurement method permitted by GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, for employers in plans with fewer than one hundred total plan members. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. CWA had its OPEB actuarial valuation performed as of December 31, 2011 as required by GASB Statement No. 45. CWA's annual cost for the current year is as follows:

Annual required contribution	$	554,239
Interest on OPEB obligation		38,679
Adjustment to ARC		-
Annual OPEB cost (expense)		592,918
Contributions made		(164,262)
Increase in net OPEB obligation		428,655
Net OPEB obligation – beginning of year		1,547,163
Net OPEB obligation – end of year	$	1,975,818

CWA's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the fiscal year 2011 and the preceding years were as follows:

Fiscal Year Ended	Annual OPEB Cost		Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation	
2009	$	688,364	26%	$	1,029,540
2010	$	703,620	26%	$	1,547,163
2011	$	592,918	28%	$	1,975,818

Funded Status and Funding Progress: As of December 31, 2011, the actuarial accrued liability for benefits was $6,537,909, all of which was unfunded. The covered payroll (annual payroll of active employees covered by the plan) was $5,592,338, and the ratio of the unfunded actuarial accrued liability to the covered payroll was 116.91percent.

Methods and Assumptions: The entry age actuarial cost method is used to calculate the ARC for the CWA's retiree health care plan. Under this method, the actuary calculates the present value of expected benefits for each employee. These calculations include estimated future salary increases and estimated future service. This method spreads the total cost over the employee's anticipated career as a level percentage of payroll. If experience is in accordance with the assumptions used, the cost will be paid as a constant percentage of payroll over the employee's whole career, and ARC as a percentage of payroll will remain basically level on a year to year basis.

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

Actuarial Methods and Assumptions:

Average retirement age for active employees	65 years
Marital assumption	Marital status of members at the calculation date was assumed to continue throughout retirement.
Investment rate of return	2.5%
Salary increases	1%
Mortality	RP 2000 Mortality Table for Males and Females projected 10 years
Healthcare cost trend rate	5%
Health insurance premiums	2011 health insurance premiums for retirees were used as the basis for calculation of the present value of total benefits to be paid.
Inflation rate	3%
Turnover	Non-group-specific age-based turnover data from GASB Statement No. 45 was used as the basis for assigning active members a probability of remaining employed until the assumed retirement age and for developing an expected future working lifetime assumption for purposes of allocating to periods the present value of total benefits to be paid.
Actuarial cost method	Entry age
Amortization method	Level percentage of payroll
Amortization period	30 years

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Amounts determined regarding the funded status and the annual required contributions of CWA’s retiree health care plan are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress presented as required supplementary information provides multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

NOTE 11 – COMMITMENTS AND CONTINGENCIES

Leases Commitments

CWA leases its office space and equipment under non-cancelable operating leases. On June 15, 2011 CWA signed a new ten (10) year office space lease agreement commencing March 1, 2012 and ending June 30, 2022. The future minimum lease rental payments under non-cancelable operating leases are as follows:

For the Year Ending December 31,	Amount
2012	$ 147,085
2013	195,192
2014	195,192
2015	207,420
2016	207,420
2017 and thereafter	1,201,950
Total	$ 2,154,259

Total expense for the year ended December 31, 2011, including taxes and other fees, for the lease was approximately $217,440.

NOTE 12 – CONCENTRATIONS

The Trinity River Water Conveyance System and Lake Houston Facilities have one major customer, the City of Houston (the "City"). Revenues from the City represent approximately 100% of total revenues in the two systems combined. The Water Treatment Plant currently has only two customers. In addition, the Bayport Water System has two major customers. Revenues from these customers represent approximately 77% of total revenues in the Bayport Water System. CWA believes that the possibility of losing any one of these customers is remote.

NOTE 13 – SUBSEQUENT EVENTS

On March 14, 2012 the Board of Directors approved additional funding in the amount of $3,235,000 to be transferred from the Special Project Equity Fund to the benefit of Luce Bayou Land and Mitigation fund. This amount is to be used for the acquisition of right-of-way for the Luce Bayou Project.

Management has evaluated subsequent events through April 2, 2012; the date financial statements were available to be issued. No changes were made, or are necessary to be made, to the financial statements, as a result of this evaluation.

Supplemental Schedules

COASTAL WATER AUTHORITY

Schedule of Net Assets by System

December 31, 2011

	Luce Bayou Interbasin Transfer Project	Trinity River Water Conveyance System Project	Lake Houston Facilities Project	Bayport Water System Project	Red Bluff Water Treatment Plant Project	Totals
ASSETS						
Current Assets – Unrestricted						
Cash	$ -	$ 485,389	$ 5,371	$ 163,684	$ 159,478	$ 813,922
Investments	-	29,428,899	208,176	4,292,398	934,902	34,864,375
Receivables:						
Accounts receivable from City of Houston	-	4,240,360	418,968	-	-	4,659,328
Accounts receivable from other customers	637,131	-	-	222,779	181,028	1,040,938
Note receivable-current portion	-	74,612	-	-	-	74,612
Compensable absence –current portion	-	80,739	14,578	6,728	10,093	112,138
Other	10,101	8,724	237	353	5	19,420
Total Current Assets – Unrestricted:	647,232	34,318,723	647,330	4,685,942	1,285,506	41,584,733
Current Assets – Restricted						
Cash – restricted for capital projects	-	3,557	-	69,384	-	72,941
Investments – restricted for contingencies	-	3,000,000	2,000,000	-	-	5,000,000
Investments – restricted for capital projects	17,596,745	4,050,619	-	-	-	21,647,364
Total Current Assets – Restricted	17,596,745	7,054,176	2,000,000	69,384	-	26,720,305
Capital Assets	30,065,556	225,602,852	1,404,748	9,880,784	4,322,991	271,276,931
Other Assets:						
Interest receivable from City of Houston	-	256,140	-	-	-	256,140
Note receivable	-	45,632	-	-	-	45,632
Unamortized bond issue cost	362,123	620,496	-	-	-	982,619
Obligation for comp. absences	-	1,604,580	290,971	133,095	210,339	2,238,985
Long-term loan receivable from City of Houston	-	10,614,548	-	-	-	10,614,548
Total Other Assets	362,123	13,141,396	290,971	133,095	210,339	14,137,924
Total Assets	$ 48,671,656	$ 280,117,147	$ 4,343,049	$ 14,769,205	$ 5,818,836	$ 353,719,893

Continued

COASTAL WATER AUTHORITY

Schedule of Net Assets by System

December 31, 2011

LIABILITIES:	Luce Bayou Interbasin Transfer Project	Trinity River Water Conveyance System Project	Lake Houston Facilities Project	Bayport Water System Project	Red Bluff Water Treatment Plant Project	Totals
Current Liabilities - Unrestricted:						
Accounts payable	$ (122,937)	$ (430,693)	$ (31,778)	$ (79,683)	$ (52,145)	$ (717,236)
Operating reserve payable	-	(5,163,873)	(604,494)	-	-	(5,768,367)
Compensable absence – current portion	-	(80,739)	(14,578)	(6,728)	(10,093)	(112,138)
Deferred revenue	(1,068,889)	-	-	-	-	(1,068,889)
Total Current Liabilities-Unrestricted	(1,191,826)	(5,675,305)	(650,850)	(86,411)	(62,238)	(7,666,630)
Current Liabilities - Restricted:						
Accounts payable	(60,467)	-	-	-	-	(60,467)
Retainage payable	-	-	-	-	(245,147)	(245,147)
Current portion of bonds payable	-	(1,580,000)	-	-	-	(1,580,000)
Bond interest payable	-	(161,020)	-	-	-	(161,020)
Contingent reserve payable	-	-	(2,000,000)	-	-	(2,000,000)
Total Current Liabilities – Restricted	(60,467)	(1,741,020)	(2,000,000)	-	(245,147)	(4,046,634)
Long-Term Liabilities:						
Bonds payable	(33,115,000)	(79,711,704)	-	-	-	(112,826,704)
Comp. absences payable	-	(1,604,580)	(290,971)	(133,095)	(210,339)	(2,238,985)
Other postemployment benefits	-	(1,205,247)	(256,857)	(256,857)	(256,857)	(1,975,818)
Total long-Term Liabilities	(33,115,000)	(82,521,531)	(547,828)	(389,952)	(467,196)	(117,041,507)
Total Liabilities	(34,367,293)	(89,937,856)	(3,198,678)	(476,363)	(774,581)	(128,754,771)
Net Assets	$ 14,304,363	$ 190,179,291	$ 1,144,371	$ 14,292,842	$ 5,044,255	$ 224,965,122

SCHEDULE II

COASTAL WATER AUTHORITY

Schedule of Revenues, Expenses, and Changes in Net Assets by System

For the Year Ended December 31, 2011

	Luce Bayou Interbasin Transfer Project	Trinity River Water Conveyance System Project	Lake Houston Facilities Project	Bayport Water System Project	Red Bluff Water Treatment Plant Project	Totals
Operating Revenues:						
Funds provided by City	$ -	$ 19,161,992	$ 2,109,246	$ -	$ -	$ 21,271,238
Funds by San Jacinto	-	74,351	-	-	-	74,351
Service revenues	-	-	-	2,196,296	2,424,395	4,620,691
Total Operating Revenues	-	19,236,343	2,109,246	2,196,296	2,424,395	25,966,280
Operating Expenses:						
Utilities	-	9,813,655	169,771	84,980	240,843	10,309,249
Field salaries	-	2,988,861	741,994	415,666	544,129	4,690,650
Administrative	4,217	1,429,282	401,020	317,584	326,742	2,478,845
General operating	530	1,912,181	316,920	276,190	327,222	2,833,043
Material and supplies	-	2,088,761	183,077	146,616	376,477	2,794,931
Eng. legal, and prof.	-	676,642	120,819	76,323	49,172	922,956
Contract labor and equipment	-	754,923	259,949	140,004	31,039	1,185,915
Depreciation	-	7,238,817	122,947	316,741	95,605	7,774,110
Total Operating Expenses	4,747	26,903,122	2,316,497	1,774,104	1,991,229	32,989,699
Operating Income (loss)	(4,747)	(7,666,779)	(207,251)	422,192	433,166	(7,023,419)
Non-Operating Revenues (Expenses):						
Investment income	76,214	92,765	7,904	7,643	2,759	187,285
Interest income	-	482,388	-	-	-	482,388
Bond interest expense	(20,838)	(3,411,670)	-	-	-	(3,432,508)
Gain/Loss on Sale of Assets	-	3,846,039	2,423	-	-	3,848,462
Loan interest expense	-	-	-	-	(128,000)	(128,000)
Other income	236	70,843	951	5,946	951	78,927
Total Non-Operating Revenues (expenses)	55,612	1,080,365	11,278	13,589	(124,290)	1,036,554
Income (loss) Before Contributions:	50,865	(6,586,414)	(195,973)	435,781	308,876	(5,986,865)
Contributions	1,576,775	1,052,643	529,530	-	-	3,158,948
Changes in net assets	$ 1,627,640	$ (5,533,771)	$ 333,557	$ 435,781	$ 308,876	$ (2,827,917)

COASTAL WATER AUTHORITY
Schedule of Revenues, Expenses,
And Changes in Net Assets –
Budgetary and Actual (Cash Basis) – All Systems (Unaudited)
For the Year Ended December 31, 2011

	Trinity River Water Conveyance System Project		
	Budget	Actual	Variance Favorable (Unfavorable)
Operating Revenues:			
Funds provided by City of Houston	$ 26,062,654	$ 25,743,757	$ (318,897)
Funds provided by San Jacinto River Authority	110,000	74,351	(35,649)
Interest on investments	5,900	15,118	9,218
Other	20,000	70,843	50,843
	26,198,554	25,904,069	(294,485)
Operating Expenses:			
Utilities	8,864,126	9,816,194	(952,068)
Field salaries	2,943,506	2,975,266	(31,760)
Administrative	1,385,819	1,404,523	(18,704)
General operating	1,746,098	1,576,618	169,480
Materials and supplies	2,128,295	2,112,216	16,079
Engineering, legal, and professional	611,260	575,289	35,971
Contract labor and equipment	2,862,700	858,790	2,003,910
	20,541,804	19,318,896	1,222,908
Non-Operating Revenues / (Expenses):			
SJRA expenditures	-	(4,594)	(4,594)
Proceeds from land sales	-	4,017,690	4,017,690
Land sale proceeds to COH	-	(4,017,690)	(4,017,690)
Bond interest expense	(3,638,714)	(3,638,714)	-
Bond principal retirement	(1,530,000)	(1,530,000)	-
Paying agent fees	-	(2,000)	(2,000)
Construction program	(400,000)	-	400,000
	(5,568,714)	(5,175,308)	393,406
Excess of revenues over expenses	$ 88,036	$ 1,409,865	$ 1,321,829

COASTAL WATER AUTHORITY
Schedule of Revenues, Expenses,
And Changes in Net Assets –
Budgetary and Actual (Cash Basis) – All Systems (Unaudited)
For the Year Ended December 31, 2011

	Lake Houston Facilities Project		
	Budget	Actual	Variance Favorable (Unfavorable)
Operating Revenues:			
Funds provided by City of Houston	$ 2,377,043	$ 2,236,145	$ (140,898)
Interest on investments	5,675	8,186	2,511
Other	-	951	951
	2,382,718	2,245,282	(137,436)
Operating Expenses:			
Utilities	207,717	170,994	36,723
Field salaries	888,968	739,994	148,974
Administrative	346,232	360,633	(14,401)
General operating	275,528	261,195	14,333
Materials and supplies	172,300	188,070	(15,770)
Engineering, legal, and professional	102,830	139,280	(36,450)
Contract labor and equipment	424,400	266,379	158,021
	2,417,975	2,126,545	291,430
Non-Operating Revenues / (Expenses):			
Construction program	(651,915)	(606,633)	45,282
	(651,915)	(606,633)	45,282
Excess (Deficiency) of revenues over expenses	$ (687,172)	$ (487,896)	$ 199,276

COASTAL WATER AUTHORITY
Schedule of Revenues, Expenses,
And Changes in Net Assets –
Budgetary and Actual (Cash Basis) – All Systems (Unaudited)
For the Year Ended December 31, 2011

	Bayport Water System Project		
	Budget	Actual	Variance Favorable (Unfavorable)
Operating Revenues:			
Service revenues	$ 1,995,418	$ 2,153,106	$ 157,688
Interest on investments	6,500	7,652	1,152
Other	-	5,946	5,946
	2,001,918	2,166,704	164,786
Operating Expenses:			
Utilities	96,352	85,053	11,299
Field salaries	597,758	415,666	182,092
Administrative	289,592	316,584	(26,992)
General operating	289,987	220,465	69,522
Materials and supplies	116,500	163,199	(46,699)
Engineering, legal, and professional	130,430	93,540	36,890
Contract labor and equipment	155,900	171,455	(15,555)
	1,676,519	1,465,962	210,557
Non-Operating Revenues / (Expenses):			
Construction Program	(500,000)	(390,373)	109,627
	(500,000)	(390,373)	109,627
Excess (deficiency) of revenues over expenses	$ (174,601)	$ 310,369	$ 484,970

COASTAL WATER AUTHORITY
Schedule of Revenues, Expenses,
And Changes in Net Assets –
Budgetary and Actual (Cash Basis) – All Systems (Unaudited)
For the Year Ended December 31, 2011

	Red Bluff Water Treatment Plant Project		
	Budget	Actual	Variable Favorable (Unfavorable)
Operating Revenues:			
Service revenues	$ 2,357,340	$ 2,435,819	$ 78,479
Interest on investments	1,218	2,779	1,561
Other	-	951	951
	2,358,558	2,439,549	80,991
Internal CWA Loan	1,968,101	2,337,718	369,617
Operating Expenses:			
Utilities	255,887	241,694	14,193
Field salaries	547,946	543,129	4,817
Administrative	279,904	325,742	(45,838)
General operating	314,086	271,497	42,589
Materials and supplies	423,600	362,732	60,868
Engineering, legal, and professional	94,430	64,117	30,313
Contract labor and equipment	47,900	31,039	16,861
	1,963,753	1,839,950	123,803
Non-Operating Revenues/(Expenses):			
Loan interest expense	(128,000)	(128,000)	-
Loan retirement principal	(329,412)	(329,412)	-
Construction program	(2,624,135)	(2,337,718)	286,417
	(3,081,547)	(2,795,130)	286,417
Excess (deficiency) of revenues over expenses	$ (718,641)	$ 142,187	$ 860,828

COASTAL WATER AUTHORITY

Schedule of Funding Progress for Other Postemployment Benefits

(Unaudited)

December 31, 2011

Actuarial Valuation date	Actuarial Value of Assets {a}	Actuarial Accrued Liability (AAL)* {b}	Unfunded (Funded) AAL (UAAL) {b-a}	Funded Ratio {a/b}	Covered Payroll {c}	UAAL as a percentage of Covered Payroll {(b-a)/c}
Dec 31, 2009	-	$ 7,946,090	$ 7,946,090	0%	$ 5,210,968	152.49%
Dec 31, 2010	-	$ 7,946,090	$ 7,946,090	0%	$ 5,490,827	144.72%
Dec 31, 2011	-	$ 6,537,909	$ 6,537,909	0%	$ 5,592,338	116.91%

*The aggregate actuarial cost method is used for funding purposes. However, because this method does not identify or separately amortize unfunded actuarial liabilities, the entry age actuarial cost method has been used to provide required information about funded status and funding progress. The information presented in this schedule is intended to approximate the funding progress of the plan based on the use of the aggregate actuarial cost method.