

## **Audited Financial Statements**

### **Companhia de Saneamento de Minas Gerais – COPASA**

Financial Statements for the years ended  
December 31, 2008 and 2007

## Message from Management

COPASA has been working to make water supply and sewage services into a business every time more beneficial to population using these services. In addition to providing sanitation solutions through rendering of public water and sewage services, as well as technical cooperation with other entities in the sector, thus contributing to improve life quality, environmental conditions and social and economic development, the Company started in 2008 two new activities; to wit, mineral water bottling and sale, and management and operation of irrigation projects, such as the Jaíba project, in the north of Minas Gerais state, which is considered the major irrigation project in Latin America.

This business diversification and the Company's good performance result from medium and long-term strategic planning, adoption of effective governance practices, ongoing employee training and other initiatives, such as the "Administration Chock" initiative from Minas Gerais state government, implemented as a public policy by the current government at the beginning of its administration in 2003. The Company started to be managed based on indicators that seek to continuously reduce costs and increase efficiency of all processes.

The results that have been attained to date and more specifically those for 2008, evidence the success of this administration approach. The Company posted at 2008 end net operating revenue of R\$ 2,060.2 million, up 10.6% in relation to 2007, unprecedented net income of R\$ 407.8 million and EBITDA (earnings before interest, taxes, depreciation and amortization) of R\$ 828.0 million, up 24.3% as compared to R\$ 666.1 million posted in the prior year. In relation to investments, the funds used in 2008, of approximately R\$ 805.0 million, allowed significant expansion of the services rendered to the population.

The results show that the Company increased its excellence in treated water supply. The population receiving water supply services increased 3.5%, reaching 12.4 million customers connected to the water distribution network. This performance resulted in the increase in the number of water connections billed by the Company, totaling 3.28 million connections, up 3.3% as compared to prior year. The water distribution network was expanded, reaching 40,716 km, an increase of 2.6%. In order to ensure high quality services, investments in water supply systems totaled R\$ 397.0 million.

In relation to sewage systems, considered a priority by the Company, the advances were even more significant, as a result from the initiatives to expand these services in the area of Company actuation. The funds applied totaled R\$ 382.9 million, allowing services to be provided to further 547 thousand people in 2008, thus totaling 6.8 million customers connected to the sewage network. These services are rendered through 1.67 million billed sewage connections, corresponding to an increase of 149 thousand connections (9.8%). The sewage network was expanded by 1,502 km, totaling 14,725 km, up 11.4% as compared to 2007.

Worthy of mention is the increase in treated sewage volume by 12.0% in relation to prior year, mainly due to the increase in the treated volume by the Sewage Treatment Stations (ETEs) in operation, as well as start-up of operation of 11 new stations in several Minas Gerais state cities, totaling 86 ETEs in operation in December 2008. Currently, sewage treatment percentage is of approximately 49% of total collected sewage. The Company

intends to reach 70% in December 2010, and 100% up to 2015. Treated sewage percentage at the beginning of the current administration in 2003 was only 26%, when annual treated sewage volume was of approximately 55 million cubic meters.

COPASA developed and implemented several programs and initiatives. Highlights for the year are as under:

- beginning of Blue Line construction, a venture that will link the main water supply systems of the Metropolitan Region of Belo Horizonte (RMBH). With investments of R\$ 160 million, two reservoirs will be built and a water supply main with length of twenty-six km will be implemented that will link the systems from the basins of Das Velhas and Paraopeba rivers;
- contracting of implementation of secondary treatment of ETE Onça, in the metropolitan region of Belo Horizonte (RMBH), which will contribute even more for the revitalization of Das Velhas river, an important tributary of São Francisco river. The amount to be invested will total approximately R\$ 64 million;
- continuity of implementation of the Integração water main, which will increase water supply to the north area of the metropolitan region of Belo Horizonte, with forecast investments of R\$ 85 million;
- contracting of modernization and water treatment capacity expansion of Das Velhas river system, with funds aggregating approximately R\$ 150 million. This work together with the construction of the Integração water main and the Blue Line work will ensure continuous water supply to the population of the metropolitan region of Belo Horizonte for several years;
- resumption of sale of Caxambu mineral water, a historic and cultural asset of the state, which has been explored since 1776 and is a benchmark in the *Premium* water market, now bottled and sold by the subsidiary Águas Minerais de Minas;
- beginning of operation of the irrigation system of Jaíba II project, by subsidiary COPASA Serviços de Irrigação, in March/2008, contributing to the economic and social development of the north of Minas Gerais.

Worthy of special mention are the initiatives of subsidiary COPASA Serviços de Saneamento Integrado do Norte e Nordeste de Minas Gerais S/A - Copanor, which already operates 42 water supply and sewage systems. Altogether, there are 65 municipalities whose local laws have authorized transfer of services to Copanor. Among these, 17 have already entered into formal contracts for this. Until 2010, there will be more than 400 thousand people benefited in communities that did not use to have access to basic sanitation services.

The Company also focused on initiatives to improve internal processes, seeking to optimize production units management and thus reduce operating costs. An example is the continuity in the implementation of the “3T – Tele-measurement, Tele-supervision and Tele-command” program, which allows real time monitoring from a single place of all the water treatment and distribution processes, such as water flow, pressure and quality, energy consumption, level of water in reservoirs, valves control, electronically integrating approximately 800 operating units in the Metropolitan Region of Belo Horizonte (RMBH).

The program for reducing billing losses and increasing energetic efficiency, focusing on improvement of consumer units performance, as well as use of the hourly seasonal tariff benefit and management of bills from electricity distribution concessionaires are other examples of such initiatives. In addition, approximately R\$ 2.0 million was invested in professional training and development activities, corresponding to nearly 300 thousand training hours.

The managerial approach adopted by the Company also led to several awards received in 2008, the highlights are as under:

- Best Company of Isto é Dinheiro magazine – COPASA was considered for the fourth time in a row the best “Public Services” company by Isto é Dinheiro magazine;
- National Award for Sanitation Quality – PNQS, granted to several operating units in almost all regions of the State, including in the RMBH region. With the results from this year we obtained 36 awards, a number that well exceeds that attained by any other company in the sector. This award was granted by the Brazilian Association of Sanitary and Environmental Engineering - ABES;
- Award for Value Added granted by the Brazilian Association of Publicly-Traded Companies - ABRASCA, as the best company in the sanitation and water and gas supply sector;
- Company of Value Award – granted by Valor Econômico newspaper, acknowledging the Company’s efficient management, considered the best in terms of several economic and financial aspects taken into consideration; to wit sustainable growth, profitability, current liquidity, assets turnover and activity margin, among others. COPASA was also awarded due to its environmental and human development policies.

Other important awards were the Certificate for Environmental Merit from the Intermunicipal Committee of Piracicaba, Capivari and Jundiá River Basins acknowledging environment preservation initiatives of the Company in tributaries of these rivers basins; and attainment of the gold level of the Quality Award from Minas Gerais State – PMQ with the East Operating Department, located in Ipatinga. Introduced in 2003 by the Minas Gerais state, the PMQ is awarded to organizations in the Minas Gerais state that seek to attain ongoing improvement of their products and services, based on the implementation of systematic management improvement initiatives.

In relation to the macro-economic environment in 2009, the prospects evidence a prolonged recession in the American economy, with economic impacts worldwide. In Brazil the most probable consequence will be a slowdown in the domestic economy, which despite this will continue strong, thus minimizing the effects from the international financial crisis. Despite this unstable scenario, the Company is confident in the future and prepared for the challenge of maintaining COPASA as the best sanitation company in Brazil. The Company intends to fulfill its growth plans for consolidation of its activities in the Minas Gerais state and believes that it will navigate and survive the crisis even stronger.

The Company also takes this opportunity to thank the dedication and commitment of its employees and the support and trust from the Minas Gerais state government, which were invaluable for the attainment of the 2008 results, as well as its shareholders, customers, suppliers and other collaborators, which along the year helped COPASA consolidate its operating excellence in the national and international scenarios.

## **2. Economic Scenario**

In 2008, an international financial crisis prevailed, more markedly in the second half, when there were significant liquidity problems in the international financial markets generated by the crisis in the American real estate market (*subprime*), thus generating high volatility in the capital markets.

The Brazilian economy is not immune from the global crisis. According to the Brazilian Institute of Geography and Statistics (IBGE) and the João Pinheiro Foundation, data from the fourth 2008 quarter evidence a marked economic slowdown in Brazil and in the Minas Gerais state, with decrease in consumption, investments, exports, imports and an increase in the cost of money, thus making loans more difficult to be raised. However, despite the uncertainties about the crisis, Brazilian economy is more solid now to survive the crisis, with significant international reserves and a dynamic domestic economy, thus being less dependent on foreign funds.

Brazilian economy grew 5.1% in 2008 as compared to the 5.7% GDP increase in 2007. The target Selic rate at year end established by the Monetary Policy Committee (COPOM) was 13.75%. There was US dollar appreciation to Brazilian real of 29.3% in the period, reaching R\$ 2.34/US\$ 1.00. Inflation measured by the IPCA index reached 5.9%, above the target established by COPOM and that for 2007 (4.46%). Brazil risk at 12/31/2008 reached 418 points (222 points at 12/31/2007).

The 2009 prospects evidence a prolonged slowdown in the American economy with impacts worldwide. In Brazil the most probable forecast is that there will be a slowdown in the domestic economy, but which despite this will continue solid, thus minimizing the effects from the crisis. According to the Focus Bulletin from the Central Bank of Brazil of 03/13/2009, there will be GDP increased in 2009 by 0.6%, inflation measured by IPCA

index will reach 4.52%, approximating the Federal Government target of 4.5%, and the foreign exchange rate will be around R\$ 2.30/US\$ 1.00.

In the Minas Gerais state, where COPASA operates, the 2009 prospects are not much different from those for Brazil, as such will probably experience a growth slowdown. The most affected sectors will probably be those related to commodities and capital goods, while the less affected sectors will be those related to essential household elements, such as food, medicines, education and water (our business), among others. In order to minimize the crisis effects, the federal and state governments have been adopting policies to promote consumption, reducing taxes, expanding credit and investments in infrastructure.

In this context, the Minas Gerais state government timely announced in November 2008 a series of tax reduction and credit extension measures for the production sector, with the objective of helping companies from several sectors to navigate the crisis. The package injected R\$ 1.3 billion in the Minas Geris state economy. Further measures were also announced to support pig iron production companies, ensuring maintenance of the 2009 budget forecast investments of R\$ 11 billion.

Despite the crisis, 2008 was quite positive for Minas Gerais state in terms of economic growth. According to data for the 4th 2008 quarter, disclosed by the Statistics and Information Center from João Pinheiro Foundation, GDP from Minas Gerais remained almost unaltered in the 4th 2008 quarter, as compared to prior year, up 0.04%. In the same period, Brazilian GDP was up 1.27%. Even so, at 2008 end, Minas Gerais state growth was of 6.28% as compared to Brazilian growth of 5.08%, confirming the trend in the last years of Minas Gerais state GDP growth above that of Brazilian economy.

## **GROSS DOMESTIC PRODUCT GROWTH RATES AT MARKET PRICES**

### **MINAS GERAIS AND BRAZIL - 2008 - (%)**

Growth rates	Minas Gerais - 2008				Brazil - 2008			
	1 <sup>st</sup> Q	2 <sup>nd</sup> Q	3 <sup>rd</sup> Q	4 <sup>th</sup> Q	1 <sup>st</sup> Q	2 <sup>nd</sup> Q	3 <sup>rd</sup> Q	4 <sup>th</sup> Q
Quarterly	6.19%	9.65%	8.87%	<b>0.04%</b>	6.12%	6.20%	6.81%	<b>1.27%</b>
Accumulated in the year	6.19%	8.00%	8.30%	<b>6.28%</b>	6.12%	6.16%	6.38%	<b>5.08%</b>
Accumulated in four quarters	5.93%	7.31%	8.16%	<b>6.28%</b>	5.87%	5.96%	6.32%	<b>5.08%</b>

Source: João Pinheiro Foundation (FJP), Brazilian Institute of Geography and Statistics (IBGE).

In relation to sanitation, the sector will not probably be significantly affected by the international financial crisis, since it involves long-term projects supported by funding from official sources and sponsoring banks. According to Federal Government, FGTS funds were made available together with those from the Growth Acceleration Program (PAC). A concern, according to sector analysts, is the increase in input prices caused by the crisis, which may increase cost of works. Financing contracting was not affected, however this price instability may make projects more expensive.

Another concern is that, in case of a prolonged crisis, the decrease in household income tends to affect basic sanitation companies due to decrease in consumption or increase in default. In addition, the increase in exchange rates may affect operating costs related to electricity, chemicals, equipment items, etc.

Despite this scenario, COPASA is in a comfortable position in relation to continuity of its plans aiming at growth and consolidation of its activities in the Minas Gerais state due to the following reasons:

- The Company maintains strict control over all of its activities in order to minimize any negative impact on its performance;
- Spread customers base mainly comprising residential consumers which use Company services in domestic activities that are not significantly affected by the economic slowdown;
- Stable cash generation and US dollar denominated debt of only 5% of total debt, repayable until 2024;

- We believe that in 2009, with the conclusion of the municipal electoral process and the beginning of the new terms of office, COPASA will find ideal conditions to negotiate new water supply and sewage service concessions.

The Company intends to fulfill the 2009/2010 expansion plan using FGTS and BNDES funding, own funds from the Initial Public Offering – IPO of R\$ 786 million and future cash generation, as well as R\$ 1.1 billion funding already contracted from FGTS and BNDES at average cost of TR + 7.5% p.a. and TJLP + 1.9% p.a., respectively.

### 3. Business Expansion

#### Strategies

Actuating as main agent promoting basic sanitation in Minas Gerais and under the commitment of “Being the best sanitation company in Brazil, and an excellence benchmark in the sector”, COPASA bases its initiatives on the following prospects and strategic objectives:

Prospects	Strategic Objectives
Economic and financial	<ul style="list-style-type: none"> <li>Ensure COPASA's sustainable growth</li> <li>Cost optimization</li> <li>Cash generation increase</li> <li>Revenue/collection maximization</li> </ul>
Customers and granting authc	<ul style="list-style-type: none"> <li>Expand operations in the sanitation market</li> <li>Ensure customer fidelization</li> <li>Create new business alternatives</li> <li>Consolidate Company image</li> <li>Increase customer satisfaction</li> </ul>
Internal processes	<ul style="list-style-type: none"> <li>Achieve excellence in water supply systems management</li> <li>Develop sewage system management</li> <li>Improve continuous service rendering</li> <li>Optimize supplies management</li> <li>Compatibilize technological project solutions with economic feasibility</li> <li>Improve business management focusing on the market</li> <li>Recover and preserve water resources and environment</li> <li>Operate with social responsibility</li> </ul>
Learning and Growth	<ul style="list-style-type: none"> <li>Seek ongoing business development</li> <li>Seek ongoing human resources development</li> </ul>

To attain such objectives, COPASA seeks to expand and improve its operations so as to maximize value for its shareholders and fulfill the mission of “Being a sanitation solutions provider by rendering public water supply and sewage services and through technical cooperation, contributing to improve life quality, environmental conditions and social and economic development”. Its strategies are the following:

- *Expand its actuation in the sanitation sector in the Minas Gerais State:*
  - ✓ operate in 2009 water supply and sewage service concessions obtained before December 31, 2007 and that were not yet operational until that date;
  - ✓ increase until 2010 the level of service to populations in the areas in which it already operates to 100% in relation to water supply and 95% for sewage services;
  - ✓ reach until 2010 full tariff collection for sewage service in the municipalities in which, for not treating sewage, it grants discounts on such tariff;
  - ✓ obtain until 2010 the concessions to render sewage services in (i) 51 municipalities with more than 15 thousand inhabitants and, (ii) other 108 municipalities with less than 15 thousand inhabitants;
  - ✓ obtain until 2010 the concessions for water supply and sewage services in 33 municipalities in Minas with less than 15 thousand inhabitants.
- *Continue improving efficiency and quality of its services.* Aligned with this strategy, there was implementation in 2003 of the “Program Against Losses”, which aims at implementing an integrated management model against billing losses, monitor evolution of water loss indicators and implement initiatives to eliminate most frequent causes of these losses. Another highlight was the implementation of the “Program for Generated Slurry Identification” for proper identification of slurry generated in the sewage treatment process, consequently improving the final disposal thereof. In addition, the “Clandestine Sewage Detection Program”, with the objective of detecting and correcting clandestine sewage discharges, taking them to the official sewage system. Thus the Company operates on a safe and efficient basis to meet the needs of its customers and offer new products and services to ensure customer satisfaction and fidelity.
- *Continue to improve its management system.* Since 2003, the Company believes to have evolved in terms of quality, with the implementation of its strategic planning, with which it established objectives, targets and strategic business conduction measures. Through this plan, which is periodically reviewed, there is the establishment of performance indicators, which are also taken into consideration to determine employees’ remuneration. In line with this strategy, an integrated management program was implemented in October 2006 for business management using Enterprise Resource Planning (ERP) software, which led to significant improvement of processes and

internal controls. In addition, the Company permanently seeks to implement new cost control measures in order to reduce expenses with services and materials.

- *Strengthen the “COPASA” name associating it with high quality services and products.* Due to the acknowledged quality work of the Company, cooperation agreements were executed with partners, which lead to increased Company visibility in Brazil and abroad. In addition, COPASA Águas Minerais represents a business opportunity allowing commercial exploration of four mineral water fountains renowned internationally for their water quality.
- *Continue expanding its operations outside Minas Gerais state.* COPASA intends to continue expanding its operations through technical cooperation with municipalities outside Minas Gerais state and abroad, as well as with the private sector, using its renowned technical capacity to provide several solutions in the sanitation area. In addition, the Company intends to operate water supply and sewage systems outside Minas Gerais state, meeting the profitability standards of the Company, resorting to its managerial and operating expertise.

COPASA believes that the overall strategy that it has been adopting will allow meeting the high demand for basic sanitation services with higher quality and agility and, at the same time, improving the Company’s operating results and financial situation.

## **Concessions**

Fulfilling its institutional mission of being an agent for the economic and social development of the Minas Gerais state, COPASA has expanded and also ensured services in the areas in which it already operated, and also expanded its market, obtaining new sewage service concessions in several municipalities, such as in Brumadinho, Carmo do Rio Claro, Patos de Minas and São Gotardo, among others. The contracts were entered into in accordance with the Federal Basic Sanitation Law No. 11445.

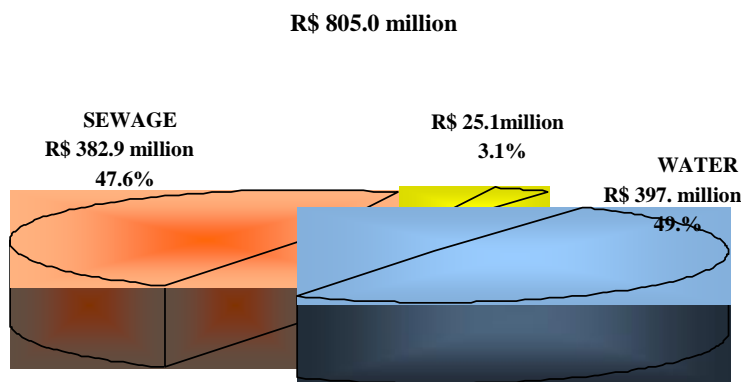
Also in 2008, there was renewal of municipal concessions, 12 of which for water supply services and 01 for sewage services in the city of Almenara. The renewed water supply concessions are those of Almenara, Barra Longa, Brumadinho, Carmo do Rio Claro, Cristais, Ipuíuna, Jequitinhonha, Monsenhor Paulo, Patos de Minas, Pirapetinga, Rio Casca and São Gotardo.

Due to this, at 2008 end, COPASA held the concession for rendering water supply services in 611 municipalities in Minas Gerais and for rendering sewage services in 192 municipalities in the Minas Gerais state.

## **Investments**

Investments made in 2008 aggregated R\$ 805.0 million. Out of this amount, R\$ 397 million was invested in water supply systems, R\$ 382.9 million in sewage collection and treatment

systems and R\$ 25.1 million in programs for operating improvement, business development and general use goods, among others.



The main sources of funds used to make investments in 2008 were own funds, including the funds obtained from the Initial Public Offering – IPO concluded in March 2006 and loans from Caixa Econômica Federal and BNDES.

In relation to investments in water supply systems, the highlights are those destined to increase the capacity of the Metropolitan Integrated System of the RMBH region and the capacity of the water supply systems of several cities in the interior of the state, such as in Montes Claros, Três Corações, Araxá and Teófilo Otoni, among others.

In relation to sewage systems, investments were mainly destined to expand the systems of Contagem, Betim, Diamantina, Lavras and Montes Claros, the implementation of the systems of Alfenas and Pedro Leopoldo, implementation of the sewage treatment station of Montes Claros and the expansion in the secondary treatment of the Onça ETE unit in the RMBH region.

Projected investments for 2009 and 2010 are presented in the chart below:

(R\$ million)	2009	2010
<b>Current Concessions</b>	<b>447</b>	<b>365</b>
Water supply systems	154	105
Sewage systems	261	228
Other	32	32
<b>New Concessions</b>	<b>598</b>	<b>480</b>
Water supply systems	185	151
Sewage systems	413	329
<b>Total</b>	<b>1.045</b>	<b>845</b>

## **Main programs and initiatives**

COPASA developed and implemented several programs and initiatives in 2008, the highlights being the following:

- Beginning of Blue Line works, which will link the systems of the Das Velhas and Paraopeba river basins, responsible for 96% of treated water supplied to 5 million people in the RMBH region. With forecast investments of R\$ 160 million, two reservoirs and a water main with 26km will be built. The Blue Line is part of the strategic initiative of COPASA to ensure continuous treated water supply to the population through expansion of the water distribution and storage process.
- Continuity of the Integration main works, which will link water supply of Confins airport and the cities of Lagoa Santa, São José da Lapa and Vespasiano to the integrated system of Paraopeba river basin. The water main will also supply the State Administrative Center, in Serra Verde district, in Belo Horizonte, and also increase water supply to the north area of the RMBH region. These will involve estimated investments of approximately R\$ 85 million.
- Implementation of the secondary treatment of Onça ETE. This work will contribute to the revitalization of Das Velhas river, an important tributary of São Francisco river, in the track along the RMBH region. The amount to be invested in this new phase will be of approximately R\$ 64 million, with scheduled work conclusion after 24 months.
- Continuity of the modernization and increase the treatment capacity of the Water Treatment Station of Das Velhas river, with investments of approximately R\$ 150 million.
- Development of the Clandestine Sewage Discharge Detection program to eliminate undue sewage discharges in water courses of the RMBH region, directing them to the sewage treatment stations. In addition, COPASA participates in agreements with municipal governments, in the urbanization of valleys and de-polluting of water courses which, together with the implementation of new sewage treatment stations, contribute to improve water quality in Minas Gerais, with forecast investments of approximately R\$ 60 million.
- Continuity of the “3T – Tele-measurement, Tele-supervision and Tele-command” program, supported by the Supervisory Control and Data Acquisition (SCADA) technology, together with the Geo-processing technology as well as Simulation and

Hydraulic Modeling. With full operation of this system, the Company will be able to optimize management of production and water distribution units in the Metropolitan Region of Belo Horizonte, with real time monitoring from the same point of all the water treatment and distribution processes, electronically integrating approximately 800 operating units.

- Implementation of the Integrated Program for Reduction of Water Loss and Electricity Costs, with initiatives aimed at increasing energetic and operating efficiency of systems, thus optimizing resources applied. Forecast investment of approximately R\$ 100 million.
- Beginning of static sewage system operation, which is an individualized sewage system. For properties located in places with sewage collection networks but not connected to the public network, COPASA has been carrying out inspections to negotiate the most adequate sewage system, be it through the dynamic process (connection to network) or the static one. In case of lack of a collection network in the place, COPASA is building septic tanks free of charge, observing applicable sanitary standards. The tariff applied results from static sewage cleaning, made at least once a year, calculated at 20% of the water tariff for the monthly water volume consumed by customer. Until 12/31/2008, approximately 19 thousand properties had been registered for static sewage tariff billing purposes.
- Implementation of individualized measurement points in buildings. The Company accelerated such implementation in relation to the term prescribed by State Law No. 17506, dated 05/29/08. Interested customers may obtain further details and request the service in the Company's service points all over the state. In order to request the individualized water consumption measurement, all apartment owners in the building must agree with this in a general owners' meeting and also hire a specialized company to make the necessary hydraulic adjustments. After this, COPASA will install the water meters for each apartment and start making consumption measurements and issuing water bills on an individualized basis.
- Implementation of the Feasible Property Policy – feasible properties are construed to be those which have public water and/or sewage network available but are not connected to them. Customers are offered special conditions for payment of debts and negotiation of water and sewage connection services, reconnections and construction of the internal sewage line, including free of charge connection for new customers. In 2008, there were 28,366 water supply and 4,194 sewage supply connections.
- Continuity of initiatives against pollution and for environment preservation, focusing on the recovery and preservation of water resources, supported by sanitary and environmental education initiatives.

- Publication of the fourth Social Balance, making of the Company one of those that develop critical conscience and promote ideas and initiatives that contributed to social and environmental responsibility practices.
- Continuity of cooperation with state government in providing sanitary infrastructure to small localities, under agreements that provide for Company refund for expenses incurred. These initiatives are provided for by the infra-structure development program of Minas Gerais state denominated “Basic Sanitation: better health to all”.

### **Technical Cooperation**

COPASA carries out several technical cooperation activities with municipalities, companies and private sector, in Brazil and abroad, such as technical assistance, water analysis, chlorine bottling, water meter maintenance, artesian well drilling, artesian well construction and maintenance, communitarian assistance projects and works, sanitary and environmental education, water supply through water transportation trucks and technical publications. In 2008, the Company continued rendering services through cooperation and technical assistance, entering into contracts or agreements with sanitation sector companies, among which we highlight:

#### *EPAL – Water Public Utility (Luanda - Angola)*

As from execution of the agreement on December 1, 2006, in the amount of US\$ 276 thousand, COPASA started cooperation initiatives, involving technical assistance and technology transfer for public water supply in the city of Luanda. In June 2007, we held our first technical visit to Angola to start training EPAL employees. Then, completing the exchange, several COPASA employees were sent to Angola to carry out work stages contractually provided for. In 2008, the agreement was renewed for US\$1,636 thousand, for this work to be continued.

The agreement provides for technology transfer in the areas of engineering, construction and operation of the water supply system, preparation of institutional development projects in administrative, transportation, human resources, planning, commercial, financial, IT and environmental areas, among others.

#### *SANECAP - Cuiabá (Mato Grosso do Sul State)*

A technical assistance contract was entered into on October 5, 2007, with the municipal government of Cuiabá, with the objective of assisting in the Program for Business Reorganization of Companhia de Saneamento da Capital (Sanecap). This contract value is of R\$ 700 thousand, covering works lasting two years. COPASA renders consulting services and provides solutions to improve quality of services rendered.

The contract purpose is to rationalize, modernize and improve operating, commercial and managerial processes of Sanecap, in order to increase operating income. COPASA has been promoting employee training and process optimization, thus improving Sanecap's results. In 2008, the main initiatives were related to the financial, commercial, IT and human resources areas.

## **Subsidiaries**

### **COPASA Águas Minerais de Minas S/A**

In 2008, there was start up of operations of "COPASA Águas Minerais de Minas", a wholly-owned subsidiary and closely-held corporation, in its plant in Caxambu, with beginning of sales of the Caxambu mineral water.

After the reorganization of the Caxambu plant in August 2008, the National Sanitary Surveillance Agency (ANVISA) granted the license for mineral water bottling and sale, in the following types: mineral sparkling water and natural mineral water, both in exclusive bottles with 300 ml and 500 ml. Concurrently, ongoing efforts were made along the year for the plants in Cambuquira, Lambari and Araxá to become operational in 2009. In the four producing cities, the technological installations of the plants are being fully reorganized, with new installations and equipment items.

Our objective is that of recovering the market share of these mineral waters, which are among the best in the world. In a survey conducted in 1997 by the Exame VIP magazine, among sparkling mineral waters of highest quality available in the market of São Paulo (national and imported), Cambuquira mineral water ranked second, Caxambu ranked third and Lambari ranked eleventh. Thus our mineral waters will be available in the main Brazilian sales points, with differentiated quality, suavity and therapeutic features, aggregating value to the "COPASA" brand.

Investments aggregated R\$ 35 million (R\$ 21.1 million in 2008). The result corresponds to modern installations with high potential of conquering a significant market share. Always focusing on social and environmental responsibility, "COPASA Águas Minerais de Minas" intends to identify new opportunities in the mineral water market.

## **Copanor**

In April 2007, Law No. 16698/07 was enacted, which authorized the creation of a wholly-owned subsidiary with the business purpose of planning, rendering, expanding, remodeling and exploring water supply and sewage services, in addition to urban, domestic and industrial litter collection, recycling, treatment and final disposal as well as urban rain water drainage and treatment, in the north of Minas Gerais state and the hydrographic basins of Jequitinhonha, Mucuri, São Mateus, Buranhém, Itanhém and Jucuruçu rivers.

As a consequence, there was creation on June 26, 2007, of COPASA Serviços de Saneamento Integrado do Norte e Nordeste de Minas Gerais S/A - Copanor, a wholly-owned subsidiary and closely-held corporation headquartered in Teófilo Otoni, Minas Gerais state.

Copanor's objective is to operate water and sewage systems in places with population from 200 to 5,000 inhabitants and to render high quality services at reduced tariffs, mainly allowed by investments sponsored by the Minas Gerais state.

The initial operation of Copanor is focused on the northeast region of Minas Gerais state, in order to benefit approximately 400 thousand people. To allow project implementation, on December 26, 2007, a technical cooperation agreement was entered into with the Minas Gerais state. This agreement involves investments for the implementation of water supply and sewage collection and treatment systems, estimated at approximately R\$ 545 million, using state Government funds. Start-up of operations of all systems is scheduled for 2010.

The subsidiary is already operating 42 water supply and sewage systems. In all, the municipal law of 65 municipalities authorized transfer of services to Copanor, and with 17 of which formal contracts have already been entered into.

Through Copanor operations, communities that did not use to have access to basic sanitation will have the opportunity of significantly improving their life quality, health and education standards.

### **COPASA Serviços de Irrigação S/A**

On August 27, 2007, there was creation of Copasa Serviços de Irrigação S/A, a wholly-owned subsidiary and closely-held corporation, for the operation and management of the irrigation system for common use of Stage II of Jaíba Project. The project involves total area of 34.8 thousand hectares of which 11.3 thousand correspond to environmental reserve area and 19.3 thousand hectares are effectively destined to irrigation. Jaíba is a joint irrigation project, promoted by the Federal Government and the Minas Gerais State Government, developed to be a catalyst for economic and social development of the north region of Minas Gerais.

In March 2008, the wholly-owned subsidiary COPASA Serviços de Irrigação S/A started the operation of Jaíba II project irrigation system, with a formal Technical and Financial Cooperation Agreement with the Minas Gerais state, through its State Planning and Management Office - SEPLAG, the State Agriculture, Cattle Farming and Supply Office – SEAPA and Fundação Rural Mineira - RURALMINAS. Under this agreement, with the

support of the state Government, investments of approximately R\$ 7.5 million will be made to improve operating infrastructure, as well as purchase machinery and equipment.

In August 2008, there was publication of Joint Resolution No. 6.677 of SEPLAG and SEAPA, effective until February 2009, defining tariff amounts and authorizing collection thereof by COPASA Serviços de Irrigação S/A.

Due to the Jaíba Project, which created a strong agri-business complex in the region, the city of Jaíba, located approximately 600 km away from Belo Horizonte, reached great importance and started to attract interest and investments from other sectors, thus increasing demand for sanitation services. Thus, in December 2008, COPASA and the municipal government of Jaíba entered into an agreement in the amount of R\$ 13.8 million for the expansion of the water supply systems of that city. The agreement provides for installation of a new water catching system and the implementation of a water main with 23 km, thus increasing water supply to the population, which will directly benefit more than 20 thousand people in the region.

COPASA will invest more than R\$ 8.5 million to build a new water treatment station and reservoir that will allow demands to be met until 2030.

In addition, investments of approximately R\$ 10 million are being made to allow the city to have a modern and complete sewage system, including sewage treatment before discharge into Verde Grande river, thus contributing to improve public health and revitalization of São Francisco river.

## **4. Operating Performance**

### **Service Data**

In 2008, the Company's consumer market significantly increased. In relation to water supply, the served population increased by 419 thousand people, up 3.5% in the period, reaching 12.4 million inhabitants connected to the water distribution network. This increase resulted from the beginning of operation of the new water supply systems, supply coverage and population increase in the places where the Company already operated. The number of municipalities with water services increased from 596 in 2007 to 600 in 2008, corresponding to supply coverage of 63.7% in relation to total state population.

This performance results from the increase in the number of Company connections, which reached 3.28 million billed water connections, with an increase of 104 thousand

**COPASA**  
**General Water Supply Data**  
**2007 - 2008**

Items	Units	2007	2008
Municipalities with concession (1)	number	611	611
Municipalities with operation (2)	number	596	600
Population served (3)	thousand inhabitants	11.983	12.402
% of served state population (4)	%	61,4	63,7
Billed connections	thousand units	3.174	3.278
Network extension	km	39.698	40.716
Billed water volume	1.000 m <sup>3</sup> /year	589.718	594.645
Water volume produced	1.000 m <sup>3</sup> /year	862.234	860.262

(1) - Total municipalities in which the Company holds a concession: capital, villages, communities or other

(2) - Total municipalities in which the Company holds any operation: capital, villages, communities or other

(3) - Population connected to water supply system.

(4) - Population served in relation to total population (urban + rural) of the state.

connections in the year, of which 23.1 thousand connections refer to beginning of new water system billing. The water distribution network was expanded by 2.6% (1,018 km), totaling 40,716 km. The table below presents the main data on water supply:

In relation to sewage systems, the expansion was well above, as a result from the initiatives to expand rendering of these services in the area in which the Company operates. The number of municipalities in which the Company carries out operations increased 29.4%, from 109 in 2007 to 141 in 2008, serving a population of 6.8 million inhabitants connected to the sewage collection system, an increase of 8.8% or by 547 thousand people in the year. The percentage of served population in relation to total state population increased from 32.0% to 34.9% in December 2008.

This service is rendered through 1.69 million billed sewage system connections, representing an increase of 149 thousand connections (9.8%) in relation to 2007. Out of these, 70.2 thousand refer to beginning of billing of the new connections. The sewage collection network was expanded by 1,502 km, totaling 14,725 km.

The table below presents main sewage service data:

**COPASA**  
**General Sewage Service Data**  
**2007 - 2008**

Items	Units	2007	2008
Municipalities with concession (1)	number	184	192
Municipalities with operation (2)	number	109	141
Population served (3)	thousand inhabitants	6.244	6.791
% of served state population (4)	%	32,0	34,9
Billed connections	thousand units	1.519	1.668
Network extension	km	13.223	14.725
Billed sewage volume	1.000 m <sup>3</sup> /year	317.726	326.406
Treated sewage volume	1.000 m <sup>3</sup> /year	100.916	113.032

(1) - Total municipalities in which the Company holds any concession: capital, villages, communities or other

(2) - Total municipalities in which the Company holds any operation: capital, villages, communities or other.

(3) - Population connected to the sewage collection network.

(4) - Population served in relation to total population (urbana + rural) of the state.

Worthy of mention is the increase in treated sewage volume, which reached 113.0 million m<sup>3</sup>, up 12.0% in relation to prior year, due to the beginning of operation of 11 sewage treatment stations (ETEs) in several cities in the Minas Gerais state, such as Contagem, Coração de Jesus, Coronel Murta, Porteirinha, São Francisco and Varginha. This increase is also due to the increase in sewage volume treated by the Arrudas and Onça ETEs, in the Metropolitan Region of Belo Horizonte, mainly due to conclusion of the interceptors of Serra and Isidoro streams and also due to the investments in the Program for Detection of Clandestine Sewage Discharge. At 2008 end, the Company had 86 ETEs in operation and other 45 in construction, whose conclusion is scheduled for 2009 and 2010. In addition, other 18 ETEs are in the bidding phase, 21 have concluded projects and other 34 have projects being prepared.

### **Operating and Commercial Performance Indicators**

Company expansion in the last year increased billed volume by 13.6 million m<sup>3</sup>, of which 4.9 million m<sup>3</sup> of water and 8.7 million m<sup>3</sup> of sewage. This result was allowed by the extension in water supply and sewage services in the places in which it already carries out operations and the beginning of billing of 14 new water supply systems, mainly those of Barbacena, Guidoal, Pedras de Maria da Cruz, Poté and Rio Novo, and 33 new sewage systems in Barbacena, Botelhos, Brumadinho, Capelinha, Carmo do Rio Claro, Joáima, Várzea da Palma and Vazante.

In relation to performance indicators, initially worthy of mention is the employees' productivity, measured by the ratio employees/1,000 connections (water + sewage), which improved 3.8%, from 2.36 employees /1,000 connections in 2007 to 2.27 in 2008, due to the increase in the number of connections and the administrative personnel policy. The table below presents the evolution of certain operating and commercial indicators in the period indicated:

**COPASA**  
**OperatingCommercial Performance Indicators**  
**2007 - 2008**

Indicator	Units	2007	2008
1-Employees	n°	11.080	11.116
2-Employees/connections (A+E)	emp/1,000 connections	2,36	2,27
3-Billed volume			
Water	1.000 m <sup>3</sup> /year	589.718	594.645
Sewage	1.000 m <sup>3</sup> /year	317.726	326.406
Total	1.000 m <sup>3</sup> /year	907.444	921.051
4-Water volume produced	1.000 m <sup>3</sup> /year	862.234	860.262
5-Water meter index	%	99,74	99,64
6-Billing loss index (1)	%	31,6	30,9
7-Water not converted into revenue - ANCR (1)	l/connection/day	261,0	246,6

(1) - Annual average.

An important result attained by the Company was the percentage of water connections with water meters, which remained high, reaching 99.64% customers with water meters in their water connections. Although slightly lower than that in 2007, due to the beginning of operations in places with low water meter level and that are in the process of standardization, this index is one of the best among sanitation companies, which means that out of a total of 3.28 million billed water connections, only 11.7 thousand do not have installed water meters. This improvement was made even more important due to the improvement in both micro and macro metering, resulting from a policy introduced in 2003 of reducing the average age of the water meters, currently of less than 5 years.

Another highlight was the water not converted into revenue (ANCR) indicator, i.e. the difference between distributed water volume and water volume effectively consumed divided by the average number of connections in the period, which reached 246.6 l/connection/day in 2008, representing an improvement of 5.5% in relation to that for prior year of 261.0 l/connection/day. The indicator includes actual water losses, apparent losses, as well as the volume of services, being one of the lowest among sanitation companies in Brazil.

<b>ANCR (l/con./day)</b>	
2007	261.0
2008	246.6

This performance stems from the Program for Water Loss Reduction (PRPA), which started being developed and implemented in 2003 based on concepts from the National Program Against Water Waste (PNCDA) and the International Water Association (IWA). Through the PRPA program we seek to implement an integrated management model against losses, monitor evolution of water loss indicators and implement initiatives to eliminate the most frequent causes of these losses. The Company also presents very high micro and macro metering indices, which are indispensable to allow accurate and reliable water loss index in the water distribution process.

This result confirms the increase in the Company's operating efficiency, allowing it to supply water to more than 419 thousand people in 2008, with treated water volume lower two million m3 as compared to that of 2007. The billing loss index in 2008 of 30.9% was down 2.1% in relation to that for 2007 of 31.6%.

Another positive result worthy of mention is the total default index, which significantly decreased in 2008, to 1.59% in December 2008. This indicator corresponds to the division of the accounts receivable balance by the total billed amount, considering accumulated data since January 1998, being one of the lowest default indices in the sector.

<b>Total default</b>	
2007	1.65%
2008	1.59%

The decrease in the default index arises from the adjustment in the Company's collection system, due to enactment of Federal Law No. 11445, dated February 5, 2007, with the implementation of initiatives to perform all debt collection services, such as Debt Warning, water supply suspension and interruption and the increase in debt negotiation initiatives with large customers in 2008.

## **Water Quality Control**

In 2008, COPASA inaugurated in the city of Almenara one more district laboratory to serve 26 systems in the Low Jequitinhonha river region. Investments in this venture aggregated more than R\$ 300 thousand in works and leading edge equipment items. This new unit will be able of carrying out approximately two thousand bacteriological and physical-chemical analyses per month, such as to determine total and fecal coliform bacteria, color, ph, turbidity and fluorine levels, among others. Other laboratories are being built, mainly the regional laboratory of Montes Claros, scheduled to be inaugurated in March 2009.

COPASA laboratorial network comprises central, regional and district laboratories, totaling 29 laboratories, plus hundreds of local laboratories distributed in the state of Minas Gerais and covering all the places in which the Company operates. These laboratories were improved both physically and technically, with investments of around R\$16.3 million. These are modern laboratories with cutting edge fully operational equipment, which carry out more than one million analyses per month.

Administrative Ruling No. 518, dated March 25, 2004, edited by the Brazilian Ministry of Health, which regulates quality of water to be distributed to the population, establishes water drinkability standards for human consumption in Brazil, which are equivalent to international standards adopted in developed countries.

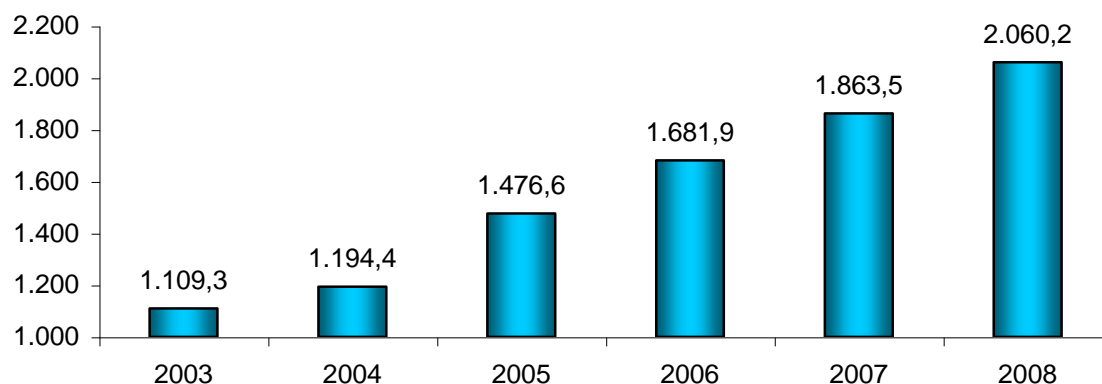
COPASA seeks to comply with regulations in force, as such has a strict quality control system that makes quality analyses before, during and after the water treatment process, as well as in thousands of points, technically selected, all over the water distribution network through which water flows to be supplied to the population. The strict quality monitoring and control in all water catching, treatment and distribution stages was certified by the British Standards Institution (BSI), which granted in 2006 the ISO 9001 – 2000 certification to the quality management systems of the Central Laboratory in Belo Horizonte, which is in charge of managing all COPASA's laboratories.

Since March 2006, our customers have received information about quality of water consumed by them. Water bills now bring the main parameters established by Ministry of Health Administrative Ruling No. 518; to wit chlorine, color, fluorine, total coliform bacteria, turbidity, pH and Escherichia coli levels. In addition, we disclose on our Internet site information about basic water quality parameters for each of the places in which we provide public water supply services. In the Report on Water Quality, issued annually and delivered together with the water bills, customers receive more information about water quality, water source protection situation, description of treatments applied, with relevant explanations and general information about the place.

## **5. Financial Performance in the Consolidated Financial Statements**

COPASA's economic and financial results in 2008 evidence that the Company obtained good financial indicators in the year. Net operating revenue reached R\$ 2,060.2 million, up 10.6% in relation to R\$ 1,863.5 million in 2007. This increase is due to the increase in services to further 419 thousand people in terms of water supply and further 547 thousand customers in relation to sewage services, giving continuity to the Expansion Plan and also due to the average tariff adjustment of 9.47% applied to water and sewage tariffs in March 2008.

### Net Revenue (R\$/million)



### Operating Costs

Total operating costs, which comprise cost of services rendered, administrative, selling and other operating expenses, totaled R\$ 1,526.1 million in 2008, up 5.0% as compared to R\$ 1,453.4 million in 2007. The table below presents breakdown of the Company's costs and their evolution in the last years:

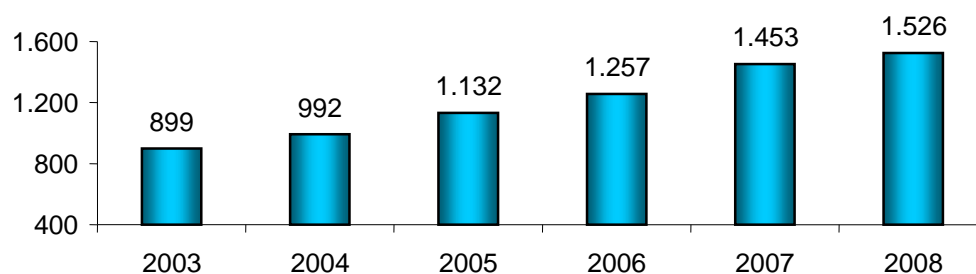
R\$ thousand	2003	2004	2005	2006	2007	2008
<b>Total Operating Costs</b>	<b>899,144</b>	<b>991,825</b>	<b>1,131,642</b>	<b>1,256,520</b>	<b>1,453,358</b>	<b>1,526,079</b>
Personnel	369,362	414,390	460,340	509,860	545,823	596,490
Depreciation and amortization	174,274	196,933	206,199	199,457	222,337	250,049
Electricity	120,481	138,497	163,304	190,987	217,121	210,922
Outsourced services	103,962	124,522	148,917	174,198	180,253	204,068
Materials	55,216	59,935	67,166	73,571	78,408	89,917
Sundry operating costs	10,413	12,269	15,668	23,827	20,265	29,219
Tariff pass over to municipalities	26,237	27,641	35,362	36,091	48,115	54,348
Tax credits	(4,487)	(39,626)	(36,930)	(44,265)	(45,223)	(41,953)
Allowance for doubtful accounts	19,528	40,277	50,629	48,667	26,156	52,570
Other operating expenses	24,158	16,987	20,987	44,128	160,103	80,449

The items that most contributed to the increase in COPASA's costs in 2008, as compared to 2007, were:

- personnel costs, which increased 9.3% due to the salary raise in May 2008 based on the INPC index variation;
- depreciation and amortization charges that increased 12.5% in relation to 2007, due to conduction of works concluded in the year and the purchase of assets;
- outsourced services, which increased 13.2%, mainly due to the increase in conservation and maintenance services of water and sewage networks and connections, bill collection services, property rental and professional technical services;
- costs with materials, which increased 14.7%, due to the increase in chemicals consumption with the beginning of operation of new water treatment stations and the increase in price of these products;
- allowance for doubtful accounts which reached normal level in 2008. It should be highlighted that in 2007 the amount was reduced due the reversal of R\$ 20.0 million in this account.

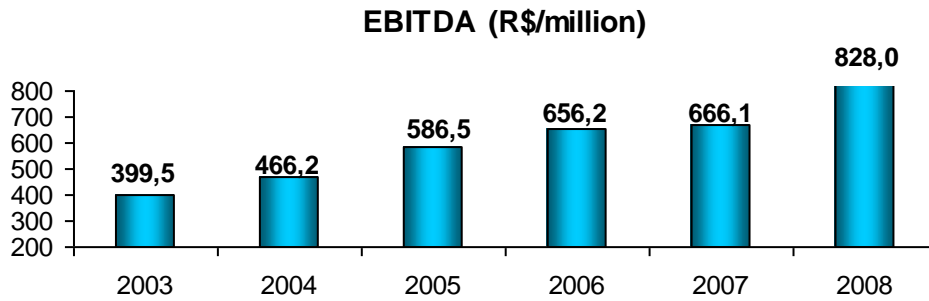
On the other hand, electricity cost decreased 2.9 % due to the tariff reduction in April 2008, determined by the National Electric Energy Agency (ANEEL).

#### Total Operating Costs (R\$/million)



#### Company Operating result

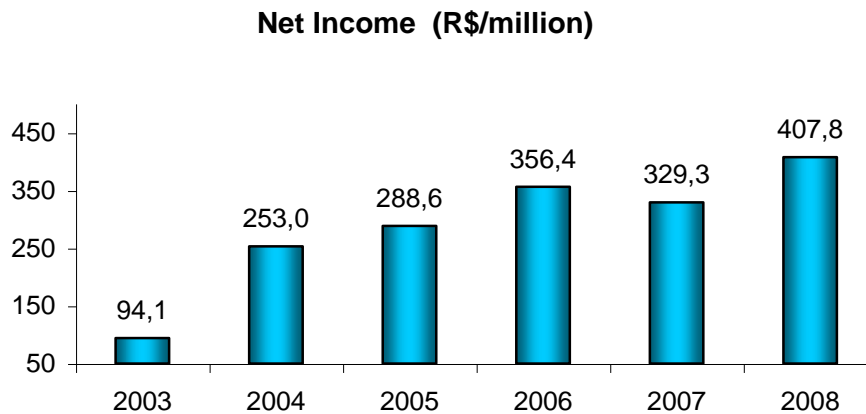
In relation to the result of operations, COPASA posted in 2008 total net revenue (net operating revenue + other operating revenues) increase by 10.9%, while total operating costs net of depreciation and amortization charges increased 3.7%, since in 2007 non-recurrent provisions were set up (IPI, PIS/PASEP and COFINS premium credits), which affected the results for that year. With this, the Company's result of operations measured by EBITDA (earnings before interest, taxes depreciation and amortization) totaled R\$ 828.0 million in 2008, up 24.3% as compared to R\$ 666.1 million in 2007. EBITDA margin reached 39.4% in 2008.



### Net Income and Profitability

Net income for 2008 amounted to R\$ 407.8 million, up 23.8% in relation to R\$ 329.3 in 2007, due to the increase in operating revenues in excess of operating costs and financial income from financial investment of the Company's cash surplus.

The



Company's return on equity rate for 2008 was 10.7%.

## **Capital Market**

2008 was marked by the crisis started in the USA and that also reached other countries and markets. With this, the value of Company shares traded on stock exchange decreased in 2008. COPASA's shares also followed this trend and devaluated by 37.1% in the year, Ibovespa was down 41.2% and Dow Jones Industrial Average (DJIA) decreased 33.8%.

In May 2008, the secondary stock offer by the Company was concluded, in which a total of 18,776,521 shares held by the municipality of Belo Horizonte and Companhia de Desenvolvimento Econômico de Minas Gerais (CODEMIG) were offered. The total amount of the operation was R\$ 460.0 million. With this, COPASA's free float (outstanding shares) increased to 46.5% and the ownership interest of Minas Gerais state in the Company became 53.1%. The Company also has 370,176 (0.32%) treasury stock.

In 2008, COPASA's shares were traded in 100% of the floor based systems, and the average daily trading volume was of R\$ 4.1 million, with average of 181 trades per day. As a consequence, as from January 2009, COPASA's shares started to be included in the IBR-X index from the São Paulo State Stock Exchange (Bovespa), which is the price index that measures the return of a theoretical portfolio composed of 100 shares selected among the most traded ones on Bovespa in terms of number of trades and financial volume.

## **Remuneration to Shareholders**

Dividends distributed by COPASA in the last years have been limited to the minimum prescribed by its Charter, justified by the need of funds for the high investments planned until 2010 to allow expansion of the Company's operations.

In 2008, Company management declared interest on shareholders' equity included in minimum mandatory dividends in the total amount of R\$ 51.7 million (R\$ 0.45 per share) to holders of shares on August 4, 2008 and R\$ 25.3 million (R\$ 0.220003496 per share) to holders of shares on September 26, 2008.

The Company's Board of Directors also declared on March 27, 2009, the amount of R\$ 38.9 million (R\$0.339282871 per share) to holders of shares on March 31, 2009. The amount of interest on shareholders' equity included in mandatory dividends totaled R\$ 115.9 million in 2008 or 28.4% of the Company's net income.

## **Corporate Governance and Investor Relations**

COPASA has endeavored to continuously improve its Corporate Governance practices, its management quality and satisfaction of its employees, shareholders, investors, customers, suppliers and other stakeholders. COPASA's governance approach is based on transparency, equal treatment to shareholders and accountability, since it believes that good governance practices generate value for the Company and contribute to continuity of its operations.

Company shares are traded in the New Bovespa Market, which corresponds to the highest Corporate Governance level of Bovespa, comprising companies that voluntarily commit themselves to abide by good corporate governance practices and increased information disclosure requirements in relation to those imposed by ruling Brazilian legislation.

Company shareholders are assured of voting rights, since it only has common shares, tag along of 100% (identical conditions as those offered to majority shareholder in case of control disposal) and operation with a Board of Directors with at least 20% of independent members. At December 31, 2008, the Company had only four dependent members out of nine Board members.

Further to these rights, the Company, its shareholders, officers and Supervisory Board members are committed to resolve, through arbitration, any and all disputes or controversies that may arise among them, as long as not involving unavailable rights, according to the binding clause in the Company's Charter.

Aligned with good governance practices, the relationship with the capital markets is also based on transparency, equal treatment and accountability. As such, the Company maintains an updated investor relations site on Internet with relevant operating, financial, commercial and organizational information, in Portuguese and English. Quarterly, after disclosing its results, these are analyzed with simultaneous translation to English. The Company also discloses monthly the Operating Release on sales volume, customer base increase and concessions held by the Company.

Thus, in order to develop a closer relationship with analysts and investors, in 2008 the Company participated in several events, such as meetings in the Association of Capital Markets Analysts and Investment Professionals (Apimec), to present and discuss COPASA's performance and results in Belo Horizonte, São Paulo, Rio de Janeiro, as well as in several other seminars and national and international conferences. The Company also participated in the Week to Promote Relationship with Investors in Minas Gerais, together with other companies of the state.

## **6. Research and Technological Development**

COPASA carries out several research and innovation activities aiming at technological development of water production and distribution processes, as well as sewage collection and sewage treatment processes and environment preservation, among which we highlight the programs against water and billing losses, to increase energetic efficiency, improve customers services, informatization of operating and electromechanical maintenance areas and operating units automation. In addition, we conducted several scientific researches through partnerships with equipment and material suppliers as well as renowned educational and research institutes, such as the Pontifical Catholic University of Minas Gerais and the Federal University of Minas Gerais.

Among the above-mentioned programs, we highlight the Integrated Service System (SATI), with the objective of attaining productivity gains, reducing water distribution losses, increasing service quality and ensuring customer satisfaction through improvement in processes and service techniques. Another highlight is our Electromechanical Maintenance Managerial System (SIGMA), which has been restructuring and informatizing the operating equipment maintenance areas, currently included in the integrated Enterprise Resource Planning (ERP) system, operational since October 2006.

Another important project is that for wireless data transmission, via GPRS, denominated SILEIM (System for Simultaneous Read and Print), which allows water meters reading, processing, issue and delivery of water bills to customers upon water meter reading. Among the results expected after implementation of this new project, which is in the phase of being developed in all the Minas Gerais state, we highlight: (i) reduction by approximately 43% in the direct water meter reading and water bill delivery costs (nearly R\$ 16.0 million/year); (ii) reduction in the time for reading water meters and issuing water bills, currently delivered upon water meter reading; and (iii) possibility of billing cycle reduction from 14 to 9 days.

With the objective of increasing automation in customer and supplier services, COPASA maintains a virtual service unit available on its Internet site ([www.copasa.com.br](http://www.copasa.com.br)), which offers fast access by users to quality services. Among the services rendered we highlight three recently incorporated ones; to wit, service rendering forecast, “Consultation to the Statement of Payments to Suppliers” and the request of “Issue of Water Bills in Braille”.

To render quality services, COPASA has ongoing commitment to its data and information security. As such, the Company has been developing processes and acquiring software and hardware allowing security infrastructure modernization for Internet access and remote connections, as well as reviewing and updating its Information Security Rules and Policies.

In 2008, the highlights were the development of the Corporate Portal and Data Center projects, both to ensure increased security, accuracy and agility of its IT processes and systems.

The Corporate Portal corresponds to an automation software set allowing the creation of a sole and centralized environment for integration of the Company's IT systems, customized services available on Internet, swift and secure information disclosure to COPASA's employees and customers, in addition to tools that facilitate team work, such as corporate agenda, chats, video conferences and process automation via workflow (data flow). The construction of the new Data Center corresponds to modernization of the infrastructure necessary to house the central computers of the data communication network, ensuring a technologically advanced structure aligned with best security practices to store COPASA's strategic information.

Further as regards service quality improvement, COPASA entered into an agreement to test the "Mobile Data Terminal (TDM)" in some Company vehicles that provide water and sewage system maintenance. The terminal allows implementation of an integrated system for monitoring vehicles, programming and control of maintenance service requests by districts, generated by SATI integrated with the Enterprise Resource Planning (ERP) system.

When installed, the equipment is linked to a monitoring center and allows data sending and receipt via cellular telephony (GPRS technology) and satellite, as well as high speed data storage. Thus, maintenance data started to be programmed and stored in the vehicle, ensuring process agility and efficiency, together with monitoring of information about vehicle speed and location, among others. Service orders may also be sent and received through the data terminal. With this system it will be possible to obtain data that allows reducing maintenance costs and halts for maintenance, as well as rational use of Company vehicles.

The technological development area has entered into technical cooperation contracts with several companies in the sanitation sector for the implementation of new technologies. Among the activities being developed by the Company, we highlight the following:

- **Hot tar transportation trucks** – these transport hot tar at proper temperatures for smaller repairs, significantly increasing service quality.
- **Biodiesel production using used edible oil** – this aims at minimizing used edible oil discharges in sewage collection networks. The project involves communities in used edible oil collection, promoting environment preservation awareness. Biodiesel generated in this process may be used in Company vehicles since refineries for biodiesel production have already been identified.
- **Slurry dewatering at ETA and ETE** – this aims at identifying technological solutions for slurry dewatering. This technology may be applied in several water or sewage treatment stations, thus avoiding investments in the acquisition of areas for slurry dewatering and lagoon construction.

- **Microvault** – this aims at developing a methodology to reduce the size of vaults in the Company’s construction works, thus resulting in reduced pavement damages and inconveniences to the public.
- **Well maintenance vehicle** – aims at carrying out preventive or corrective cleaning and maintenance services to avoid occurrences affecting public supply.
- **Use of biogas for energy generation** – technical and scientific agreement with the German Agency for Technical Cooperation and Berlinwasser Internacional AG for the exchange of experiences and the development of techniques and concepts for biogas use in energy generation in sewage treatment stations.

## 7. Social and Environmental Responsibility

### Human Resources

At 2008 end, COPASA had 11,116 employees, up 36 employees as compared to 2007. The table below presents headcount changes in the periods indicated:

	<b>At December 31</b>	
	<b>2008</b>	<b>2007</b>
<b>Number by professional category</b>		
Technical and operating	6,699	6,682
Administrative	4,417	4,398
<b>Number of employees by geographic location</b>		
Administrative head office	1,552	1,534
Metropolitan Region of Belo Horizonte (except Administrative head office )	3,188	3,239
Interior	6,376	6,307
<b>Total</b>	<b>11,116</b>	<b>11,080</b>

COPASA continued in 2008 two remuneration plans created in 2003 which, for being linked to the attainment of targets established by the Strategic Planning area, directly affect Company results, to wit: Institutional Performance Bonus (GDI) – bonus granted to all employees due to collective work result, and the Managerial Performance Bonus (GDG) – bonus granted to employees in trustworthy positions (selected among Company employees through an internal selective process) based on the performance of the organizational unit managed by them. The GDI and GDG are evaluation mechanisms directly linked to the strategic targets established, rewarding the work force to allow achieving successful strategy results.

Another program linked to business performance indicators is the Profit Sharing Program (PL), which also benefits all employees, introduced in 2005, abiding by applicable labor legislation.

The Company carries out every year the Corporate Education Program, one of the objectives of which is to develop essential skills, observing priorities. The program also aims at optimizing use of resources through corporate education agents, empowering professionals to teach and train other professionals internally, encompassing from basic education to post-graduate courses, including the participation of employees in technical high school courses, congresses and seminars. In 2008, approximately R\$ 2.0 million was invested in work training and professional development, corresponding to almost 300 thousand training hours.

With a view to preparing employees for the succession process at the Company, 28 employees have already participated in 2 years in the trainees program, of which six currently have managerial positions. This program has the objective of developing participants' business management skills and potential, seeking to provide a systematic view of the organization and its processes, as well as allow better understanding of Company business. In 2008, the program benefitted 16 employees.

Also in 2008, the Company, employees and Union entities entered into a Salary Agreement effective for 2008/2009, bringing tranquility and certainty in relation to benefits and advantages already conquered and maintenance of a proper organizational climate to give continuity to the business programs.

It was a year of significant innovations in the employee functional mobility and professional growth processes. The introduction of the Master Analyst and Specialized Technical Assistant positions expanded professional growth prospects for employees having university degrees or high school education. Another innovation introduced in 2008 was the employee performance evaluation process – Learning Evaluation, which was extended to all professional specializations. More than 4,000 employees went through this performance evaluation.

### **Social Programs**

COPASA maintains focus on social programs pervaded by ethics and social and business responsibility objectives. It makes several investments in cultural and social projects and in the formation and development of communities with which it interrelates. The main such projects are:

- **Projects developed for the community:**

**Confiágua** – Along the Royal Road, COPASA implemented, in collaboration with Sebrae, Sesi and Royal Road Institute, this program created by the Minas Gerais state to promote tourism and contribute to the generation of new jobs. Hotels, inns, restaurants and other establishments started to have “after sale” services from COPASA. The Company, which already ensures quality of water supplied to the establishments, started the control of internal hydraulic installations of these establishments and to certify, through own seal bearing the program name, that water is proper for all uses.

**Trainees Program** – destined to technical high school and university students, this program integrates theoretical and practical learning and promotes professional experience to facilitate entry of these professionals in the work market. Allowing the development of practical experience compatible with the theoretical formation in all areas of the Company, the Trainees Program of COPASA offered 150 openings for preparation of technical high school and university students to the labor market in 2008.

**COPASA Art Gallery** – site destined to present new talents in plastic arts in Minas Gerais, with regular exhibition programs based on Public Calls for Bid.

**Program for Donation of Reusable Paper** – collection and donation of paper, cardboard and other reusable materials to several entities in need.

**Program for Recovery of Poor Communities** – environmental education initiatives in poor communities aiming at improving sanitary, environmental and visual conditions of small communities, recovering self-esteem and citizenship of local inhabitants.

**Program for Implementation of Alternative Technologies for Small Communities** – use of alternative low cost technologies, such as the construction of water and sewage treatment stations using reinforced concrete, in small communities.

**Citizen Service Center (*Centro de Referência do Cidadão – CRC*)** - program developed together with the Minas Gerais State Office for Social Development and Sports, CEMIG, Military Police and the Law School of UFMG for the implementation of service centers in villages and slums with high violence rates.

- **Projects developed for Company employees and their relatives:**

**Educational Program** – promotes alphabetization of employees from 1st to 8th elementary school grades, after working hours, in classrooms inside the Company.

**Assistance Program Against Alcohol and Drugs Consumption (PASA)** – seeks to avoid and treat alcoholism, cigarette and other chemical dependencies that affect interpersonal and work relationships of employees, based on a bio-psycho-social

approach aiming at improving life quality and health of chemical dependents. In 2008, there was continuity of the initiatives against excessive use of psychoactive substances, with the formation of more than 60 agents spreading this program.

**Assistance Program Against AIDS (APA)** – works against the disease with informative initiatives to allow employees to have conditions to avoid contamination by sexually transmitted diseases, such as AIDS. Provides assistance to HIV positive employees, AIDS patients and their relatives.

**Family and Adolescents Support Program** – provides medical, psychological and social orientation to groups of adolescents that are relatives of Company employees.

**COPASA's Employees Art Gallery** – site to promote employees' artistic expression, discover new talents and humanize business relations.

**COPASA Choir** – comprising employees and their dependants, to participate in social and cultural events to promote the Company's name.

**Água Viva Theater Company** – composed of COPASA's employees, it has been promoting, on a playful basis, considerations about matters related to workers' occupational health.

**Family Financial Planning Program** – it aims at making employees aware of the need of personal and family budget planning and the importance of financial liquidity, through the formation of educators, conduction of workshops, provision of individual guidance and presentation of a play on this matter. In 2008, the Program was presented to more than 3,000 employees all over Minas Gerais state as well as to professionals of other companies.

In the health and safety area, three new projects were the highlights for 2008. They were created as a consequence of management of information generated by the Occupational Health Control Program (PCMSO) and the Program Against Environmental Risks (PPRA), which manage occupational medical examinations and environmental risks, respectively. One of the projects is the Plan for Management of Residues from Health Care Services (PGRSS). The objective of this project is to meet the needs of the outpatient care services of the Metropolitan Regional and Cercadinho units, in accordance with legislation from CONAMA, ANVISA and the Municipal Sanitary Surveillance Authorities. The other two projects are the Anti-Smoking Program and the program related to sleep problems of employees. In this case, the program focuses on the consequences of this event on occupational health and production performance, evidencing how sleep disorders affect people's life quality.

In addition, the Manual on Comfort, Health and Efficiency was edited in 2008. This was prepared by the Group Specialized in Work Ergonomics and provides guidance about furniture and fixtures as well as recommendations about comfortable work positions.

COPASA also has a library and a technical file. The first stores bibliographic materials, with approximately 33,000 titles, including books, periodicals, technical standards and audio-visual materials, among others. The library specializes in sanitary and environmental engineering and has maintained updated publications, not only related to this matter but also others in connection with the activities carried out by the Company, such as management, finance, planning and human resources, among others. It is considered a state and municipal benchmark in its specialty and has been used not only by Company employees but also technical students from all levels and researchers from other institutions interested in the matter.

The technical file contains COPASA projects, which include 197 thousand designs and floor plans of varying sizes as well as the descriptive reports of these projects and 22 thousand A4 size volumes. All of these materials are consulted by the project and construction units of the Company, fact evidenced by the average supply of copies of designs and floor plans to several Company units of nearly 1,500/month. The original copies, for information security purposes, are not lent. The technical file received 5,989 further floor plans in 2008.

In addition to these initiatives, COPASA sponsored in 2008 several cultural, artistic, social and sports events which, besides allowing community cultural development, also provided leisure, health and entertainment to the population, the main highlights are as under:

- **History Fair Project** – Partnership agreement signed by and between COPASA and Aletria Cultural Institute to support the “History Fair” Project, which takes place on Saturdays, from 11 am to 1 pm, at the Tom Jobin Fair (Av. Bernardo Monteiro, in Belo Horizonte), with the objective of fostering popular culture by means of storytelling, disclosing the art of storytelling to adults and children and valuing the storytelling profession. The “COPASA Moment” takes place whereby a storyteller narrates stories related to flora, fauna and environment conservation.
- **“Express Citizenship Project** – A project developed by the Legislative Assembly to encourage participation in politics and value the full exercise of citizenship rights and of conscious voting of 16 and 17 year old individuals. This Project mobilized close to 19 thousand students of 17 cities in the Minas Gerais state, through partnerships with the Regional Electoral Court of Minas Gerais (TRE-MG) and with the State Education Office. Between March and April of the current year, the project enabled the issuance of 4,818 voter’s registration cards and 2,855 identity cards. Furthermore, several activities were promoted, such as lectures, thematic panels and text, reading, video and

photography workshops. The Project is the winner of the National Phase of the Aberje Prize.

- **World Swimming Cup** – As in the past four years, COPASA sponsors the World Swimming Cup, considered one of the world’s major swimming events, which took place in the Minas Tênis Clube from October 10 to 12, 2008. The Company was also responsible for the hydration of athletes and of the public in general who attended the event.
- **1<sup>st</sup> Half Marathon of the “Linha Verde”** – Once again, COPASA was present in a major sports event in the state, supporting this race that gathered the most important Brazilian athletics stars and that included the Minas Gerais state capital in the international sports calendar. The event included a 21 km half marathon and a 5 km family race.
- **International Choir Encounter – FIC** – The theme of the Festival was “Fifty Years of Bossa Nova”, and approximately 100 choirs, both national and international, made presentations from August 15 to 24, 2008 in the cities of Belo Horizonte, Contagem, Itabira, Ouro Preto, Mariana and Sete Lagoas. The shows were performed in 26 public areas, such as economy restaurants, squares, parks, churches, central markets and theaters, with free public access.
- **Concerts in the Park** – These are concerts staged by the Minas Gerais Symphonic Orchestra in the Renné Gianetti Municipal Park, in Belo Horizonte. The concerts are held on the first Sunday of every month, in the period from March to October, in a partnership with Clóvis Salgado Foundation/Palácio das Artes (Public Theater House) already lasting for four years.
- **Palácio das Artes–Presentation of Artistic Groups and Smaller Groups** – Artistic and Smaller Groups make chamber music, theater and dance presentations in the Clóvis Salgado Foundation. The shows are held in public squares, churches or theaters, with free access to the entire population of the 150 beneficiary cities in the Minas Gerais state.
- **Maintenance of the Child Program of the Minas Network (Dango Balango)** – This Project is directed to the children and is widely appreciated due to the use of puppets developed by the Teatro Giramundo Group, having reached national and international acknowledgment.
- **Tribute to Godofredo Guedes** – Gabriel Guedes, an instrument-playing musician from Minas Gerais, makes tours accompanied by a string quartet. The shows are performed in public squares, with free public access.

- **Minas Gerais Performing Arts Prize – CENA MINAS** – This is a State Government Project, together with the State Culture Office, the objective of which is to foster and strengthen performing arts productions in Minas Gerais, including theatrical, dance and circus performances, by providing and maintaining the spaces, encouraging the formation of audience, granting better working conditions and giving new opportunities to the Minas Gerais population for cultural growth and access to information. In 2008, a total of 38 projects were approved, 15 of which from the inland area and 23 from the capital of Minas Gerais.
- **“Clube da Esquina” Museum** – The Clube da Esquina Project, sponsored by COPASA since 2004, has cultural memorabilia on the 30 years of the Clube da Esquina musical movement and of the cultural backgrounds that generated such movement in all Brazilian capitals. The purpose of this project phase is to continue with the maintenance to and offer adequate handling of the physical (pictures, documents, magnetic tapes, betamax and other perishable and volatile media) and virtual assets from the fifties to date. The Clube da Esquina is a musical movement that placed the Minas Gerais state in the national and international scenario, and Belo Horizonte in the country’s cultural itinerary.

Still in the social area, another relevant initiative was the support to cities devastated by heavy rains, such as for example, 225 thousand cups of treated water sent to Itajaí/Santa Catarina state; 60 thousand cups of treated water sent to Muriaé, in addition to a jet water cleaning truck to clear water galleries that have been obstructed due to floods and thus delay water draining, and to clean the streets and houses; and water trucks made available to help transport drinkable water and for emergency supply.

Lastly, following up on the agreement entered into with SENAI in 2007, COPASA offered the course on Basic Sanitation Social Learning to 20 young people from communities facing social risk.

## **Environment**

COPASA is engaged with the control of environmental, safety and occupational health impacts arising from its activities, products and services. It has also an ongoing concern relating to strict compliance with all environment-related legislation, whether federal, state or local.

The major objectives of the environmental policy, approved by the Company’s Board of Directors in June 2005, is compliance with environmental legislation, assessment of the environmental performance of its production systems, reduction of environmental impacts and prevention of pollution in all its processes, products and services, implementation of an Environmental Management System, working together with the community and federal, state and local institutions in the drainage basins where it operates seeking the recovery and

conservation of water sources, in addition to promoting discussions with shareholders, suppliers, clients, government agencies and the community, with the ultimate objective of motivating and spreading environmental conservation and defense actions.

In 2008, approximately R\$ 138 million was invested in the preparation of diagnoses, studies and projects, research and monitoring of water resources, protection and conservation of water sources, sewage treatment, among other actions with a positive impact on the environment. The Company's environmental policy is comprehensive, providing for population awareness activities and internal awareness programs for its more than 11 thousand employees.

In this regard, we highlight the following projects developed by the Company:

- **Chua Project** – environmental and sanitation education program, supported by the Regional Teaching Authorities, providing to students of the 5<sup>th</sup> grade of the elementary school their first contact with the basic sanitation system, with a view to developing awareness of the consumers of the future. The Company provides study material to teachers and students, visits to the Company's water treatment stations in several cities of the state, in addition to promoting a water booklet competition in the inland cities, awarding prizes to the winners.
- **Integrated Water Source Protection Program – SIPAM** – developed in association with EMATER, Environmental Military Police, IEF, environmental entities and the communities of the selected drainage basins. Its purpose is to recover basins by means of different community awareness and mobilization actions, leading to plantation of riparian forests, recovery of springs, rational use of pesticides, fire prevention and environmental education, among others. In 2008, the Program made 50 interventions in sub-basins of detected water sources.
- **Program of Visits to the Environmental Education Center – CEAM** – promotes environmental education by means of monitored visits of students of the Belo Horizonte metropolitan region, of all levels, to COPASA environmental reserves. In 2008, the Center received almost 2000 visits from students of different schools.
- **Water Discount Program** – a program created in June 2006 that grants discounts in water and sewage bills in exchange for pet bottles and aluminum cans. The pilot project benefited close to 30 thousand people. When implemented in the Cafezal community in Belo Horizonte, the benefitted parties rose to 80 thousand people. In addition to benefitting low-income clients by granting discounts in water bills, the Water Discount Program enables reduction in the volume of garbage produced by such communities, increasing environmental awareness of the population benefitting from this Program.

- **Project for collection of used kitchen oil and its transformation into biofuel** – the objective of this program is to develop and implement a recycling system for kitchen oil used in homes, bars and restaurants, currently thrown away into the sewage networks, causing obstruction and requiring maintenance. The oil flows through the ETEs and contaminates the water flows and water tables. The Project turns the polluting element into an important alternative for compliance of requirements to include biofuel in the Brazilian energy matrix.

We should also make a special mention of the **Manuelzão Project**, developed in association with the Federal University of Minas Gerais – UFMG, which promotes integrated actions for revitalization and conservation of the Rio das Velhas basin, major water production source for the metropolitan region of Belo Horizonte.

## **Rural Sanitation**

COPASA is the State Government’s means of servicing the small cities lacking sanitation infrastructure, through the “Basic Sanitation Program: more health for everyone”. This Program aims at implementing water supply and sanitary sewage systems, plants for recycling and composting of solid residues, and residential sanitary models in rural communities, municipal offices and settlements, which are mostly located in the north of Minas Gerais and in the Vale do Jequitinhonha region.

In 2008, COPASA followed up on actions related to the agreement entered into with the State Office for Regional Development and Urban Policy (SEDRU), with funds provided by the State Government, in the amount of R\$ 27.9 million, aiming at implementing sanitation measures in needy locations outside the Company’s concession area.

## **Other programs**

- **PROÁGUA** – in Minas Gerais, the “PROÁGUA/Semi-Árido” Program is coordinated by the Water Management Institute of the State of Minas Gerais – IGAM, with the COPASA technical support. In 2008, 13 water supply systems, 12 sanitary sewage systems/sewage treatment stations and 416 sanitary modules were implemented, benefitting 48,000 people. Investments totaling R\$ 24.5 million were made with funds provided by the Ministry of National Integration and the State Government.
- **INCRA** – the Project is part of the agreement entered into by and between COPASA, the National Colonization and Agrarian Reform Institute (INCRA) and the SEDRU. It provides for the drilling of deep wells, installation of water collection equipment, storage and distribution of water through showers in 19 Settlement Projects. The investment amounts to approximately R\$ 1 million.

- **SEF** – Agreement for Provision of Services and Technical Assistance, entered into by and between the State Finance Office (SEF) and COPASA, with the objective of improving the quality of water used by the SEF teams working at 25 tax collection offices throughout the state.
- **Water at Schools** – the program seeks partnerships with SEPLAG, SEDRU and COPASA, in order to determine the actual conditions of the water supply to 423 state schools, with a view to assisting in the preparation of an investment plan that solves the water supply issue in such schools.

## 8. Awards

In 2008, COPASA was awarded several prizes, shown below, listing it among the best companies in the country:

- **Best Company of Isto é Dinheiro magazine** – COPASA was chosen, for the fourth consecutive year, the best “public utility” company. The prize, awarded annually by the Isto é Dinheiro Magazine, Editora Três, selects the companies based on their social report, considering the social responsibility, environmental, technical innovation, financial management, corporate governance and human resources aspects.
- **National Award for Sanitation Quality - PNQS** - COPASA once again confirms the excellence of the services provided in the state of Minas Gerais, being granted the National Sanitation Quality Prize. Such prize was awarded to the Operating Departments of the Northeastern and Southern regions, in the Gold category, level II, and to the Operating Departments of the Metropolitan and Southern regions, in the Silver category, level II, for their performance and structure to service the population of 460 cities of the state.

In addition to the four departments awarded the PNQS prizes, the Mid-Western Operating Department, in charge of water services to 84 cities of Minas Gerais, will be granted the distinction certificate “On the Way to Excellence” for the significant points obtained in the category in which it participated.

Created in 1997, the objective of the PNQS is to award prizes to the best sanitation companies. It specially aims at adding value, encouraging measures for improvement of operating and management processes of the companies and promoting excellence of the services provided to the population, consequently leading to improvement in the quality of life. The PNQS was the first Latin American prize conceived specially for the sanitation sector, awarded by the National Quality Committee of the Brazilian Association of Sanitary and Environmental Engineering - ABES.

- **Award for Value Added granted by ABRASCA** – COPASA was chosen the best company in the sanitation and water and gas service sector, being awarded in the first edition of the Brazilian Association of Publicly-Traded Companies (ABRASCA). The objective of the award is to emphasize value added governance initiatives.
- **Company of Value Award** – granted by Valor Econômico newspaper, acknowledging the Company’s efficient management, considered the best in terms of several economic and financial aspects taken into consideration; to wit sustainable growth, profitability, current liquidity, assets turnover and activity margin, among others. COPASA was also awarded due to its environmental and human development policies.
- **Environmental Merit Certificate** - COPASA was awarded the Certificate for Environmental Merit from the Inter-municipal Committee of Piracicaba, Capivari and Jundiá river basins acknowledging environment preservation initiatives of the Company in tributaries of these rivers basins. In such river basins, COPASA operates the water supply and sanitary sewage systems of the cities of Camanducaia and Toledo.
- **Quality Award from Minas Gerais State** – COPASA attained the gold level of the Quality Award from Minas Gerais State – PMQ with the East Operating Department, located in Ipatinga. Among other aspects, the prize evaluated leadership, client relationship, social and environmental responsibility, qualification and development of people and attainment of goals – criteria set by the benchmark “On the way to Excellence” of the National Quality Foundation. Introduced in 2003 by the Minas Gerais state, the PMQ is awarded to organizations in the Minas Gerais state that seek to attain ongoing improvement of its products and services, based on the implementation of systematic management improvement initiatives.

## 9. Relationship with Independent Auditors

In conformity with CVM Rule No. 381, of January 14, 2003, COPASA and its subsidiaries inform that Ernst & Young Auditores Independentes S/C audited the Company financial statements for the year ended December 31, 2008. The contract entered into with the Company includes financial statement auditing services, and the effectiveness began as of the review of the financial information for the first quarter of 2008. Ernst & Young Auditores Independentes S/C did not provide other services to COPASA during 2008.

## Companhia de Saneamento de Minas Gerais – COPASA

Audited Financial Statements

December 31, 2008 and 2007

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A free translation from Portuguese into English of report of independent auditors on financial statements prepared in Brazilian currency in accordance with the accounting practices adopted in Brazil

## REPORT OF INDEPENDENT AUDITORS

To

The Board of Directors and Shareholders of

### **Companhia de Saneamento de Minas Gerais - COPASA**

1. We have audited the accompanying balance sheet of Companhia de Saneamento de Minas Gerais – COPASA and the consolidated balance sheet of Companhia de Saneamento de Minas Gerais – COPASA and its subsidiaries as of December 31, 2008, and the related statements of income, shareholders' equity, cash flow and value added for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements.
2. Our audit was conducted in accordance with generally accepted auditing standards in Brazil and included: (a) the planning of our work, taking into consideration the materiality of balances, the volume of transactions and the accounting and internal control systems of the Company and its subsidiaries; (b) the examination, on a test basis, of the evidence and accounting records supporting the amounts and disclosures in the financial statements; and (c) an assessment of the accounting practices used and significant estimates made by management, as well as an evaluation of the overall financial statements presentation.
3. In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of Companhia de Saneamento de Minas Gerais – COPASA and the consolidated financial position of Companhia de Saneamento de Minas Gerais – COPASA and its subsidiaries at December 31, 2008, and the related results of operations, changes in shareholders' equity, cash flows and value added for the year then ended, in accordance with the accounting practices adopted in Brazil.
4. As mentioned in Note 27, effective September 20, 1989, the Company, began being taxed, under a special taxation regime, for State Value-Added Tax (ICMS) on water supply. Based on the opinion of its legal advisors, the referred to VAT tax would require specific rules regulating the subject. To date, there has been no definition by the State Executive Branch concerning computation criteria and required collection of such tax; also, such tax has not been included in the Company's water and wastewater rates, which are determined by the State of Minas Gerais. Consequently, such tax has neither been collected from customers, nor provided for by the Company or remitted to the State Government.

5. The audit of the financial statements for the year ended December 31, 2007, including the balance sheet, the statements of income, changes in shareholders' equity and changes in financial position for the year then ended, in addition to supplementary information comprising the statements of cash flows, presented for comparison purposes, was conducted under the responsibility of other independent auditors, who expressed an unqualified opinion thereon dated March 18, 2008, except for note 29, which date is March 26, 2009, containing an emphasis paragraph with respect to the same matter mentioned in paragraph 4 above. As described in Note 2, effective January 1, 2008, the accounting practices adopted in Brazil were changed. The financial statements for the year ended December 31, 2007, excepting the statement of changes in financial position, presented together with the 2007 financial statements, were prepared in accordance with the accounting practices adopted in Brazil in force until December 31, 2007 and, as allowed by Technical Pronouncement CPC 13 – First Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08, have not been restated with the adjustments for comparison purposes.
6. The statement of value added for the year ended December 31, 2007, prepared in connection with the financial statements for the year ended December 31, 2008, was submitted to the same auditing procedures outlined in the second paragraph above and, in our opinion, is fairly presented, in all material respects, in relation to the overall financial statements mentioned in paragraph 5.
7. The accounting practices adopted in Brazil differ, in certain aspects, from the accounting principles generally accepted in the United States of America. The information about the nature and the effect of these differences is presented in Note 29 to the financial statements.

Belo Horizonte (MG), March 16, 2009, except for the  
Note 29 to the financial statements, which date is May 29, 2009

ERNST & YOUNG  
Auditores Independentes S/S  
CRC 2SP015199/0-6-F-MG

João Ricardo Pereira da Costa  
Accountant CRC - 1RJ 066.748/O-3-S-MG

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## Companhia de Saneamento de Minas Gerais – COPASA

### Balance Sheets

December 31, 2008 and 2007

(In thousands of Brazilian reais)

	Company		Consolidated	
	2008	2007	2008	2007
<b>Assets</b>				
<b>Current Assets</b>				
Cash and cash equivalents (Note 4)	31,924	166,378	36,832	166,792
Marketable securities (Note 4)	754,204	823,115	754,204	823,115
Accounts receivable (Note 5)	368,947	335,819	371,670	335,819
Inventories	24,856	26,512	27,489	28,066
Taxes recoverable	7,862	8,658	7,889	8,658
Deferred income tax and social contribution (Note 20)	1,320	376	1,320	376
Other credits (Note 6)	39,423	13,358	51,762	13,510
<b>Total Current Assets</b>	<b>1,228,536</b>	<b>1,374,216</b>	<b>1,251,166</b>	<b>1,376,336</b>
<b>Non-current Assets</b>				
<b>Long-term assets:</b>				
Accounts receivable (Note 5)	201,966	185,574	201,966	185,574
Collateral for financings (Notes 11 and 12)	82,085	50,700	82,085	50,700
Escrow deposits (Note 14)	8,912	13,899	8,912	13,899
Deferred income tax and social contribution (Note 20)	57,221	52,352	57,221	52,352
Other credits (Note 6)	70,280	42,538	44,084	39,614
<b>Permanent assets</b>				
Investments (Note 8)	13,761	15,150	260	1,219
Property, plant and equipment (Note 9)	4,397,861	3,846,815	4,422,766	3,859,219
Intangible assets (Note 10)	190,020	182,868	190,035	182,868
Deferred charges	-	-	-	3,186
<b>Total non-current assets</b>	<b>5,022,106</b>	<b>4,389,896</b>	<b>5,007,329</b>	<b>4,388,631</b>
<b>Total assets</b>	<b>6,250,642</b>	<b>5,764,112</b>	<b>6,258,495</b>	<b>5,764,967</b>

See accompanying notes.

	Company		Consolidated	
	2008	2007	2008	2007
Liabilities and Shareholders' Equity				
Current Liabilities				
Loans and financing (Note 11)	122,546	95,760	122,546	95,760
Debentures (Note 12)	55,327	48,590	55,327	48,590
Suppliers	70,117	92,600	74,194	93,332
Taxes payable	34,699	39,434	35,306	39,544
Vacation accrued	58,060	51,054	58,076	51,054
Employees' Bonus (Note 15)	24,612	20,821	24,612	20,821
Technical cooperation agreement (Note 16)	7,520	37,726	13,970	37,726
Pension plan (Note 17)	15,922	12,887	15,922	12,887
Interest on equity (Note 19)	111,008	77,135	111,008	77,135
Electric power (Note 18)	33,165	33,134	33,165	33,134
Other payables (Note 18)	15,075	12,529	15,174	12,542
Total current liabilities	548,051	521,670	559,300	522,525
Non-current liabilities				
Long-term liabilities:				
Loans and financing (Note 11)	860,982	765,324	860,982	765,324
Debentures (Note 12)	604,621	549,411	604,621	549,411
Tax provisions (Note 13)	111,455	104,767	111,455	104,767
Provision for contingencies (Note 14)	30,351	32,737	30,351	32,737
Advance for future capital increase	8,797	8,797	8,797	8,797
Pension plan (Note 17)	178,826	153,896	178,826	153,896
Deferred income and social contribution taxes (Note 20)	6,427	15,855	6,427	15,855
Electric power (Note 18)	51,109	59,723	51,109	59,723
Other payables (Note 18)	40,473	40,574	37,077	40,574
Deferred revenue (Note 18)	6,249	-	6,249	-
Total non-current Liabilities	1,899,290	1,731,084	1,895,894	1,731,084
Shareholders' equity (Note 19)				
Capital	2,632,265	2,632,242	2,632,265	2,632,242
Capital reserves	70,388	70,388	70,388	70,388
Profit reserves	1,100,648	808,728	1,100,648	808,728
Total shareholders' equity	3,803,301	3,511,358	3,803,301	3,511,358
Total liabilities and shareholders' equity	6,250,642	5,764,112	6,258,495	5,764,967

See accompanying notes.

A free translation from Portuguese into English

## Companhia de Saneamento de Minas Gerais – COPASA

Statements of Income  
Years ended December 31, 2008 and 2007  
(In thousands of Brazilian reais)

	Company		Consolidated	
	2008	2007	2008	2007
Gross revenue				
Water supply services	1,734,441	1,559,249	1,739,148	1,559,249
Wastewater services	556,620	517,584	556,620	517,584
Product sales	-	-	622	-
	<b>2,291,061</b>	2,076,833	<b>2,296,390</b>	2,076,833
Deductions from gross revenue				
Taxes on sales/services	(209,497)	(189,941)	(209,877)	(189,941)
Discounts and rebates	(26,235)	(23,416)	(26,307)	(23,416)
	<b>(235,732)</b>	(213,357)	<b>(236,184)</b>	(213,357)
Net operating revenue	<b>2,055,329</b>	1,863,476	<b>2,060,206</b>	1,863,476
Cost of services	<b>(971,053)</b>	(886,127)	<b>(974,156)</b>	(886,127)
Gross profit	<b>1,084,276</b>	977,349	<b>1,086,050</b>	977,349
Selling expenses	(159,311)	(118,319)	(159,328)	(118,319)
Administrative expenses	(294,504)	(288,809)	(308,961)	(288,809)
Other operating expenses	(79,442)	(160,103)	(83,634)	(160,103)
Equity pick-up adjustments (Note 8)	(18,424)	-	-	-
Other operating income	43,856	33,632	43,856	33,632
Income from operations before financial expenses and income	<b>576,451</b>	443,750	<b>577,983</b>	443,750
Financial expenses (Note 21)	(84,823)	(73,444)	(86,001)	(73,444)
Financial income (Note 21)	150,416	116,242	150,426	116,242
Interest on equity (Notes 19 and 21)	(115,861)	(79,208)	(115,861)	(79,208)
Income from operations before monetary and exchange variations	<b>526,183</b>	407,340	<b>526,547</b>	407,340
Result of monetary and exchange variations				
Expenses on monetary and exchange variations (Note 21)	(58,894)	(32,205)	(58,894)	(32,205)
Income from monetary and exchange variations (Note 21)	34,847	37,818	34,847	37,818
	<b>(24,047)</b>	5,613	<b>(24,047)</b>	5,613
Operating Income	<b>502,136</b>	412,953	<b>502,500</b>	412,953
Nonoperating income	-	25	-	25
Income before taxes	<b>502,136</b>	412,978	<b>502,500</b>	412,978
Provision for income taxes (Note 20)	(136,957)	(116,393)	(137,205)	(116,393)
Provision for social contribution taxes (Note 20)	(48,647)	(25,649)	(48,763)	(25,649)

A free translation from Portuguese into English

## Companhia de Saneamento de Minas Gerais – COPASA

Statements of Income (Continued)  
Years ended December 31, 2008 and 2007  
(In thousands of Brazilian reais)

	Company		Consolidated	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
Income after taxes	<b>316,532</b>	270,936	<b>316,532</b>	270,936
Reversal of interest on equity	<b>115,861</b>	79,208	<b>115,861</b>	79,208
Income before employees' bonus	<b>432,393</b>	350,144	<b>432,393</b>	350,144
Employee's bonus (Note 15)	<b>(24,612)</b>	(20,821)	<b>(24,612)</b>	(20,821)
Net Income	<b>407,781</b>	329,323	<b>407,781</b>	329,323
Number of shares outstanding at year end	<b>114,795,524</b>	114,794,772	<b>114,795,524</b>	114,794,772
Earnings per share (R\$)	<b>3.55</b>	2.87	<b>3.55</b>	2.87

See accompanying notes.

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## Companhia de Saneamento de Minas Gerais – COPASA

Statements of Changes in Shareholders' Equity  
 Years ended December 31, 2008 and 2007  
 (In thousands of Brazilian reais)

	Capital Reserves			Profit reserves			Retained Earnings	Total shareholders' equity		
	Capital	Donations and grants	Treasury shares	Total	Legal	Tax incentives			Profit Retention	Total
Balances as of december 31, 2006	2,632,242	56,593	(9,190)	47,403	49,611	-	527,795	577,406	-	3,257,051
Donations and grants	-	22,985	-	22,985	-	-	-	-	-	22,985
Prior year adjustments (Note 19)	-	-	-	-	-	-	(18,793)	(18,793)	-	(18,793)
Net income	-	-	-	-	-	-	-	-	329,323	329,323
Proposed allocation:	-	-	-	-	-	-	-	-	-	-
Legal reserve	-	-	-	-	16,466	-	-	16,466	(16,466)	-
Interest on equity (Note 19)	-	-	-	-	-	-	-	-	(79,208)	(79,208)
Profit retention	-	-	-	-	-	-	233,649	233,649	(233,649)	-
Balances as of december 31, 2007	2,632,242	79,578	(9,190)	70,388	66,077	-	742,651	808,728	-	3,511,358
Capital increase – convertible debentures	23	-	-	-	-	-	-	-	-	23
Net income	-	-	-	-	-	-	-	-	407,781	407,781
Proposed allocation:	-	-	-	-	-	-	-	-	-	-
Legal reserve	-	-	-	-	20,389	-	-	20,389	(20,389)	-
Tax incentives (Note 19)	-	-	-	-	-	1,250	-	1,250	(1,250)	-
Profit retention	-	-	-	-	-	-	270,281	270,281	(270,281)	-
Interest on equity (Note 19)	-	-	-	-	-	-	-	-	(115,861)	(115,861)
Balances as of december 31, 2008	2,632,265	79,578	(9,190)	70,388	86,466	1,250	1,012,932	1,100,648	-	3,803,301

See accompanying notes.

## Companhia de Saneamento de Minas Gerais - COPASA

### Statements of Cash Flows

Years ended December 31, 2008 and 2007

(In thousands of Brazilian reais)

	Company		Consolidated	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
Cash flows from operating activities:				
Net income on the year	407,781	329,323	407,781	329,323
Adjustments to reconcile net income to net cash provided by operating activities:				
Allowance for doubtful accounts	10,811	3,021	10,811	3,021
Interest income on account receivables	(12,261)	(11,263)	(12,261)	(11,263)
Monetary and exchange adjustment of receivables	(12,625)	(11,713)	(12,625)	(11,713)
Deferred income tax and social contribution	(15,241)	(36,873)	(15,241)	(36,873)
Exchange variation on financing collaterals	(6,741)	3,791	(6,741)	3,791
Interest income on financing collaterals	(4,233)	(1,777)	(4,233)	(1,777)
Interest income BNY collateral	(7,664)	-	(7,664)	-
Exchange variation on loans and financing subsidiaries	(1,473)	-	-	-
Equity pick up adjustments	18,424	-	-	-
Investments disposals	959	-	959	-
Property, plant and equipment, disposals	552	334	552	334
Depreciation and amortization	238,992	222,337	239,967	222,337
Interest on loans and financing	70,664	52,631	70,664	52,631
Monetary and exchange variation of loans and financing	40,494	(4,919)	40,494	(4,919)
Tax provisions	6,688	104,767	6,688	104,767
Provision for contingencies	(2,386)	18,959	(2,386)	18,959
Interest income on pension plan	24,133	18,154	24,133	18,154
Interest on Previminas/Cemig	7,563	7,415	7,563	7,415
Monetary variation of Previminas/Cemig	18,294	14,556	18,294	14,556
Adjusted Income	<b>782,731</b>	708,743	<b>766,755</b>	708,743
Decrease (increase) in assets:				
Increase on accounts receivable – current and non-current	(35,445)	(57,082)	(38,168)	(57,082)
Decrease on inventories	1,656	268	577	(1,286)
Decrease on taxes recoverable	796	9,132	769	9,132
Decrease on prepaid expenses	4,430	(5,519)	4,427	(5,524)
Decrease on escrow deposits	4,987	(13,899)	4,987	(13,899)
Increase on financing collaterals	(12,747)	(18,409)	(12,747)	(18,409)
Increase on related parties	(22,745)	-	-	-
Decrease on other receivables – current and non-current	14,319	(23,583)	1,189	(20,806)
Increase (decrease) in liabilities:				
Decrease on suppliers	(22,483)	(29,714)	(19,142)	(28,982)
Increase on taxes payable	657	6,830	1,005	6,940
Decrease on tax provisions	(5,392)	5,392	(5,242)	5,392
Increase on accrued vacation pay	7,006	3,089	7,022	3,089
Increase on employees bonus	3,791	(3,109)	3,791	(3,109)
Decrease on technical cooperation agreement	(30,206)	(13,624)	(22,543)	(13,624)
Increase on pension plan – current and non-current	2,310	2,371	2,310	2,371
Decrease on electric power – current and non-current	(2,629)	17,207	(2,629)	17,207
Increase on other liabilities – current and non-current	5,303	6,333	5,388	6,346
Net cash provided by operating activities	<b>696,339</b>	594,426	697,749	596,499

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## Companhia de Saneamento de Minas Gerais - COPASA

Statements of Cash Flows (Continued)  
Years ended December 31, 2008 and 2007  
(In thousands of Brazilian reais)

	Company		Consolidated	
	12/31/2008	12/31/2007	12/31/2008	12/31/2007
Cash flows from investing activities:				
Capital increase – convertible debentures	23	-	23	-
Acquisition of investments	(14,603)	(254)	-	(254)
Acquisition of property, plant and equipment	(745,888)	(642,817)	(760,613)	(653,988)
Increase of deferred assets	-	-	3,206	(4,419)
Capital increase in subsidiary	-	(13,931)	-	-
Net cash used in investing activities	<b>(760,468)</b>	(657,002)	(757,384)	(658,661)
Cash flows from financing activities:				
Proceeds from loans and financing	286,402	566,359	286,402	566,359
Repayments of principal – loans and financing	(147,166)	(130,665)	(147,166)	(130,665)
Repayments of interest – loans and financing	(117,857)	(106,433)	(117,857)	(106,433)
Interests on capital paid	(81,988)	(80,988)	(81,988)	(80,988)
Repayments of principal - Previminas/cemig	(22,734)	(19,080)	(22,734)	(19,080)
Repayments of interest - Previminas/cemig	(7,555)	(7,416)	(7,555)	(7,416)
Net cash provided (used) by financing activities	<b>(90,898)</b>	221,777	(90,898)	221,777
(Decrease) increase in cash and cash equivalents	<b>(155,027)</b>	159,201	(150,533)	159,615
Cash and cash equivalents at beginning of the year	<b>941,155</b>	830,292	941,569	830,292
Cash and cash equivalents at end of the year	<b>786,128</b>	989,493	791,036	989,907
Supplementary cash flow information:				
Interest paid on loans and financing	117,857	106,433	117,857	106,433
Income and social contribution taxes paid	178,334	148,527	178,379	148,527
	<b>296,191</b>	254,960	296,236	254,960
Transactions not affecting cash				
Capitalization of financial expenses	69,135	48,485	69,135	48,485
Property, plant and equipment received as donations	25,999	22,985	25,999	22,985
	<b>95,134</b>	71,470	95,134	71,470

See accompanying notes

A free translation from Portuguese into English

## Companhia de Saneamento de Minas Gerais - COPASA

Statements of Value Added  
Years ended December 31, 2008 and 2007  
(In thousands of reais)

	Company		Consolidated	
	2008	2007	2008	2007
1 Revenue	<b>3,093,065</b>	2,821,130	<b>3,097,076</b>	2,821,130
1.1 Water and wastewater services	<b>2,264,826</b>	2,053,418	<b>2,268,827</b>	2,053,418
1.2 Other revenues	<b>27,870</b>	13,410	<b>27,880</b>	13,410
1.3 Revenues from construction of assets	<b>836,953</b>	760,211	<b>836,953</b>	760,211
1.4 Allowance for doubtful accounts	<b>(36,584)</b>	(5,909)	<b>(36,584)</b>	(5,909)
2 Inputs purchased from third parties	<b>(653,420)</b>	(697,963)	<b>(656,459)</b>	(697,963)
2.1 Cost of services	<b>(461,079)</b>	(431,044)	<b>(461,079)</b>	(431,044)
2.2 Material energy, third-party services and other	<b>(114,308)</b>	(111,187)	<b>(116,615)</b>	(111,187)
2.3 Other operational expenses	<b>(78,033)</b>	(155,732)	<b>(78,765)</b>	(155,732)
3 Value added	<b>2,439,645</b>	2,123,167	<b>2,440,617</b>	2,123,167
4 Depreciation and amortization	<b>(238,992)</b>	(222,337)	<b>(238,992)</b>	(222,337)
5 Value added, net	<b>2,200,653</b>	1,900,830	<b>2,201,625</b>	1,900,830
6 Value added receivable in transfer	<b>165,642</b>	153,316	<b>165,642</b>	153,316
6.1 Equity pick up	<b>(18,424)</b>	-	<b>(18,424)</b>	-
6.2 Financial income	<b>184,066</b>	153,316	<b>184,066</b>	153,316
7 Value added to distribution	<b>2,366,295</b>	2,054,146	<b>2,367,267</b>	2,054,146
8 Distribution:	<b>2,366,295</b>	2,054,146	<b>2,367,267</b>	2,054,146
8.1 Total Payroll	<b>1,305,260</b>	1,183,636	<b>1,305,260</b>	1,183,636
8.1.1 Payroll	<b>1,144,770</b>	1,038,108	<b>1,144,770</b>	1,038,108
8.1.2 Benefits	<b>131,566</b>	119,947	<b>131,566</b>	119,947
8.1.3 FGTS	<b>28,924</b>	25,581	<b>28,924</b>	25,581
8.2 Income taxes and contributions	<b>460,297</b>	400,523	<b>460,822</b>	400,523
8.2.1 Federal	<b>456,958</b>	397,394	<b>457,483</b>	397,394
8.2.2 State	<b>3,304</b>	3,128	<b>3,304</b>	3,128
8.2.3 Municipal	<b>35</b>	1	<b>35</b>	1
8.3 Remuneration loan capital	<b>192,958</b>	140,664	<b>193,128</b>	140,664
8.3.1 Interest and monetary variation	<b>190,805</b>	138,657	<b>190,975</b>	138,657
8.3.2 Rental	<b>2,153</b>	2,007	<b>2,153</b>	2,007
8.4 Remuneration equity capital	<b>407,780</b>	329,323	<b>408,057</b>	329,323
8.4.1 Interest on equity payable	<b>115,861</b>	79,208	<b>115,861</b>	79,208
8.4.2 Profit retention	<b>291,919</b>	250,115	<b>292,196</b>	250,115

See accompanying notes

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 1. Operating context

Companhia de Saneamento de Minas Gerais - COPASA (the “Company”) is a publicly-traded, mixed-capital company, controlled by the Government of the State of Minas Gerais. The Company is engaged in planning, designing, performing, expanding, remodeling, managing and providing public utility services comprising water supply and wastewater services, and can operate in Brazil and abroad. The Company is subject to the arbitration of São Paulo Stock Exchange’s Market Arbitration Chamber, as set forth in an arbitration clause included in its bylaws.

At December 31, 2008, the Company has the following wholly-owned subsidiaries:

- ▶ COPASA Águas Minerais de Minas S/A, established by the State Law 16,693, of January 11, 2007, is engaged in producing, bottling, distributing and selling mineral water from the springs it owns or has license to explore, and managing and exploiting the water and spring parks of Caxambu, Araxá, Cambuquira and Lambari.
- ▶ COPASA Serviços de Saneamento Integrado do Norte e Nordeste de Minas Gerais S/A COPANOR, established by the State Law 16,698, of April 17, 2007, is engaged in planning, designing, executing, expanding, remodeling and exploiting public utility services comprising water supply and wastewater collection, collection, recycling, treatment and final disposal of urban, domestic and industrial waste, draining and management of rain water in urban areas in cities of the North of Minas Gerais and the water basins of the Jequitinhonha, Mucuri, São Mateus, Buranhém, Itanhém and Jucuruçu rivers.
- ▶ COPASA Serviços de Irrigação S/A, established by the State Law 16,698, of April 17, 2007, is engaged in managing, executing and exploiting the irrigation systems of the Jaíba’s Project, and conducting its maintenance, using both personal and outsourced personnel and resources. This subsidiary may contract, when economically viable, through regular bidding processes, the execution of services and construction work necessary to the operation of the system, and purchase products, equipment and materials required to the execution of its purposes.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 1. Operating context (Continued)

The Company operates in 883 locations in the State of Minas Gerais (unaudited) (879 at December 31, 2007 - unaudited), in water supply and/or sanitary wastewater activities. The twenty major water and wastewater concessions the Company holds are:

Unaudited				
Water Concessions		Waterwaste Concessions		
Location	Connections (unaudited)	Expiration	Location	Expiration
Belo Horizonte	885.382	2032	Belo Horizonte	2032
Contagem	198.986	2073	Contagem	2073
Betim	114.829	2042	Montes Claros	2028
Montes Claros	105.736	2028	Betim	2042
Divinópolis	77.945	2033	Ipatinga	2022
Ribeirão das Neves	76.273	2034	Ribeirão das Neves	2034
Ipatinga	70.493	2022	Santa Luzia	2013
Santa Luzia	60.742	2013	Varginha	2013
Patos de Minas	47.389	2038	Pouso Alegre	2026
Varginha	43.528	2013	Cons. Lafaiete	2009
Pouso Alegre	42.859	2026	Lavras	2034
Ibirité	42.493	2034	Teófilo Otoni	2034
Cons. Lafaiete	40.716	2009	Ibirité	2034
Teófilo Otoni	37.309	2034	Itajubá	2034
Sabará (*)	36.476	2007	Alfenas	2033
Lavras	33.931	2034	Pará de Minas	2009
Araxá	33.105	2032	Coronel Fabriciano	2033
Itajubá	30.583	2034	Vespasiano	2034
Ubá	30.348	2014	Nova Serrana	2027
Coronel Fabriciano	28.558	2033	Paracatu (*)	2007

- (\*) The concession agreements with the Cities of Paracatu and Sabará terminated on December 1, 2007 and August, 3, 2007, respectively. However, the Company has already started negotiating their renewals, which should be concluded soon. The total revenue for the year 2008 was R\$14,543 for Paracatu and R\$15,258 for Sabará, or 0.60% and 0.63% of the Company's total revenues, respectively.

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **1. Operating context (Continued)**

In the systems operated by the Company, the assets owned by the Municipalities were incorporated into the Company's property, plant and equipment assets, at amounts determined by financial-economic technical appraisal reports, and are depreciated at the straight-line method, based on their estimated useful lives, except for the assets belonging to the Além Paraíba and Ipatinga systems, which are depreciated over the duration of the agreements.

Under most of the agreements, local cities participate with 20% of the water and wastewater investments made in the municipality, as a capital contribution to the Company. At the end of the concession, should the concession not be renewed, the assets incorporated by the Company, as well as those deriving from the Company's investments, are to be returned to the cities, net of their shares in the Company's capital, through a refund to Copasa, except for Além Paraíba and Ipatinga, which are to be returned free of charge. For agreements entered into until June 2006, this refund is equivalent to each system's net assets. As for the agreements entered into since July 2006, the refunds due by the cities are to be calculated based on technical appraisal reports of the systems' assets at the time of their returns. The concession contract with the City of Belo Horizonte was renewed in 2002 (see additional comments in Note 22).

### **2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08**

The financial statements were prepared in accordance with the accounting practices adopted in Brazil and with the standards and pronouncements of the Brazilian Securities and Exchange Commission – CVM, observing the accounting guidelines from Brazil's corporation law (Law No. 6404/76), which include the new provisions introduced, amended and superseded by Law No. 11638, dated December 28, 2007 and Provisional Executive Act (MP) No. 449, dated December 3, 2008.

These financial statements were approved by the officers' meeting held on March 13, 2009.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08 (Continued)

In accordance with CVM Rule No. 565 dated December 17, 2008, which approved the Accounting Pronouncement CPC 13 – First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08, the Company determined its *transition date* for the adoption of new accounting practices as being January 1, 2008. The *transition date* is defined as the starting point for the adoption of the changes in accounting practices adopted in Brazil and represents the base date at which the Company prepared its initial adjusted balance sheet under these new accounting provisions of 2008.

Accounting Statement CPC 13 allowed Companies not to compulsorily apply the provisions of NPC 12 – Accounting Practices, Changes in Accounting Estimates and Correction of Errors, in the first-time adoption of Law No. 11638/07 and MP No. 449/08. This rule requires that, besides disclosing the effects of the adoption of the new accounting practice on retained earnings (accumulated losses), Brazilian companies must disclose the beginning balance of each account or group of accounts at the oldest date for comparison purposes, as well as the other comparative amounts disclosed, as if the new accounting practice had always been in use.

The financial statements for the year ended December 31, 2007, presented together with the 2008 financial statements, were prepared in accordance with accounting practices adopted in Brazil in force up to December 31, 2007 and, as allowed by Technical Pronouncement CPC 13 – First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08, have not been restated with the adjustments for comparison purposes.

The referred changes in accounting practices that affected the preparation or presentation of the financial statements for the year ended December 31, 2008 and the beginning balance at January 1, 2008, were measured and recorded by the Company based on the following accounting pronouncements issued by the Accounting Pronouncements Committee (“Comitê de Pronunciamentos Contábeis”) and approved by the Brazilian Securities and Exchange Commission (“CVM”) and by the Federal Accountancy Board (“IBRACON”):

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08 (Continued)

- ▶ Framework for Preparation and Presentation of Financial Statements, approved by CVM Rule No. 539, dated March 14, 2008;
- ▶ CPC 01 Reduction to Recoverable Value of Assets, approved by CVM Rule No. 527, dated November 1, 2007;
- ▶ CPC 03 Statement of Cash Flows, approved by CVM Rule No. 547, dated August 13, 2008;
- ▶ CPC 04 Intangible Assets, approved by CVM Rule No. 553, dated November 12, 2008;
- ▶ CPC 05 Disclosure of Transactions with Related Parties, approved by CVM Rule No. 560, dated December 11, 2008;
- ▶ CPC 07 Government Grants and Government Assistance, approved by CVM Rule No. 555 dated November 12, 2008;
- ▶ CPC 09 Statement of Value Added, approved by CVM Rule No. 557, dated November 12, 2008;
- ▶ CPC 12 Adjustment to Present Value, approved by CVM Rule No. 564, dated December 17, 2008;
- ▶ CPC 13 First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08, approved by CVM Rule No. 565, dated December 17, 2008;
- ▶ CPC 14 Financial Instruments: Recognition, Measurement and Disclosure, approved by CVM Rule No. 566, dated December 17, 2008.

The opening balance sheet as of January 1, 2008 (*transition date*) was prepared taking into consideration the exceptions required and some of the optional exemptions allowed by accounting pronouncement CPC 13, such as:

a) Exemption from presenting comparative financial statements:

The 2007 financial statements are presented considering the accounting standards in force in 2007. The option granted by CPC 13 of not adjusting the 2007 financial statements to the accounting standards in force in 2008 was adopted by the Company and its subsidiaries as disclosed above. However, for comparison purposes, the Company disclosed the changes introduced and related effects on its income and equity in a note to the financial statements.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08 (Continued)

b) Exemption for classification of financial instruments on the original date of their recording:

Although CPC 14 establishes that financial instruments should be classified on the original date of their recording, for first-time adoption purposes, CPC 13 allows for such classification at the transition date, and this was the option adopted by the Company and its subsidiaries.

c) Exemption from maintaining deferred assets until realization:

The Company did not have deferred assets at the transition date, and its subsidiaries chose to write off their deferred assets at the date of transition, against accumulated losses.

d) Exemption on considerations for calculating the discount to present value:

The Company and its subsidiaries reviewed the balances for each group of monetary assets and liabilities and concluded that due to the receipt and payment cycles for its operations, the amounts recorded in each account group have already been largely demonstrated at their net present value and do not generate any material impact on the financial statements.

e) Exemption for presentation of the statements of cash flows and of value added with no indication of the previous year amounts:

The Company has annually reported its statements of cash flows and elected to prepare and report the statement of value added for the year ended December 31, 2007 in accordance with CPC 03 and CPC 09, respectively. The Company has also opted for not longer reporting the statement of changes in financial position for the years ended on or after January 1, 2008.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08 (Continued)

f) Neutrality for tax purposes of first-time adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08:

The Company and its subsidiaries opted to adopt the Transition Tax Regime (RTT) introduced by Provisional Executive Act No. 449/08, under which the computation of Corporate Income Tax (IRPJ), Social Contribution Tax on Net Income (CSLL), Social Contribution Tax on Corporate Revenues for Social Integration Purposes (PIS) and the Social Contribution Tax on Corporate Revenues for Social Security Financing (COFINS) for the two-year period 2008-2009, continued to be performed based on accounting methods and criteria defined by Law No. 6404, dated December 15, 1976, in force at December 31, 2007. As such, deferred income and social contribution taxes, calculated on the adjustments resulting from adoption of the new accounting practices originating in Law No. 11638/08 and MP 449/08 were recorded in the Company's financial statements and its subsidiaries, as applicable in accordance CVM Rule 371. The Company and its subsidiaries will disclose such option in its Corporate Income Tax Return for 2009.

g) Exception on the treatment of earned premiums on the debenture issue and donations and investment grants:

For donations and investment grants received before December 31, 2008, the Company and its subsidiaries have maintained the accounting policy in force on the date they were originated, including the maintenance of the respective balances as Capital reserve.

h) Exception for application of the first periodic review of the economic useful lives of permanent assets:

Until December 31, 2009, the Company and its subsidiaries will review the estimated economic useful lives of its permanent assets, used to determine its depreciation rates. Any significant changes in the estimated economic useful lives of assets, resulting from such review, will be treated as change in accounting estimates to be recognized on a prospective basis.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08 (Continued)

In compliance with the disclosure requirements for the first-time adoption of the new accounting practices, the Company presents in the tables below, for comparison purposes, a brief description and corresponding amounts of the impacts in the consolidated balance sheets of the years 2007 and 2008 on the equity of the Company and consolidated for the years 2007 and 2008 and on the income statement of the Company and consolidated for 2008, according to the amendments introduced by Law No. 11638/07 and the Provisional Executive Act No. 449/08. The impacts on the income of the Company and consolidated are stated on the income statement of 2008 only due to the option adopted for the transition date. The effects on the 2008 balance sheet are reflected on the financial statement presentation.

<b>Balance sheet – consolidated</b>			
<b>ASSETS</b>	<b>Balances originally disclosed at 12.31.07</b>	<b>Adjustments for Law No. 11638/07</b>	<b>Balances of 2007 adjusted for effects of Law No. 11638/07</b>
Cash and cash equivalents	989,907	(48,338)	941,569
Other credits (technical corporation agreement)	-	48,338	48,338
<b>ASSETS</b>	<b>Balances on 12.31.08</b>	<b>Adjustments for Law No. 11638/07</b>	<b>Balance of 2008 adjusted for effects of Law No. 11638/07</b>
Cash and cash equivalents	<b>820,273</b>	(29,237)	791,036
Other credits (technical corporation agreement)	-	29,237	29,237
Investment, net	<b>1,219</b>	(959)	260
Property, plant and equipment, net	<b>4,448,198</b>	(25,432)	4,422,766
Deferred charges, net	<b>10,129</b>	(10,129)	-

<b>Balance sheet – consolidated</b>			
<b>LIABILITIES – NON-CURRENT</b>	<b>Balances on 12.31.08</b>	<b>Adjustments for Law No. 11638/07</b>	<b>Balance of 2008 adjusted for effects of Law No. 11638/07</b>
Other liabilities (PRODES)	<b>44,576</b>	(7,499) 5	37,077
Deferred revenue grant (PRODES)	-	6,249 5	6,249

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08 (Continued)

Shareholders' equity	Company		Consolidated	
	2008	2007	2008	2007
	Brief description of the adjustments			
Equity before adjustments for Law No. 11638/07 and MP No. 449/08	3,812,571	3,511,358	3,802,442	3,511,358
Net effects resulting from full implementation of Law No. 11638/07 and MP No. 449/08	(9,270)	-	859	-
Equity after full implementation of Law No. 11638/07 MP No. 449/08	3,803,301	3,511,358	3,803,301	3,511,358

Income statement	Company		Consolidated	
	Year ended December 31			
	2008	2007	2008	2007
Brief description of the adjustments				
Net income before adjustments for Law No. 11638/07 and MP No. 449/08	417,051	329,323	406,922	329,323
Provision for loss – investments	(959)	-	(959)	-
Reversal of depreciation	568	-	568	-
Equity pickup over adjustments for Law No. 11638/07 and MP No. 449/08	(10,129)	-	-	-
Income from donations and grants	1,250	-	1,250	-
Net effects resulting from full implementation of Law No. 11638/07 and MP No. 449/08	(9,270)	-	859	-
Net income after full implementation of Law No. 11638/07 and MP No. 449/08	407,781	329,323	407,781	329,323

1. Includes amounts received by the Company in connection with agreement ventures that were reclassified to the Other assets group since they are construed as cash and cash equivalents;
2. Recognition of provision for loss on nonrecoverable assets, pursuant to CPC 01 guidelines;
3. Includes donations and grants amounts net of depreciation, received by the Company in year 2008, pursuant to CPC 07 guidelines;
4. Write-off of deferred charges from Copasa Águas Minerais de Minas S/A, pursuant to CPC 13 guidelines;

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 2. Basis of Preparation and Presentation of the Financial Statements and First-Time Adoption of Law No. 11638/07 and Provisional Executive Act No. 449/08 (Continued)

5. Includes amounts related to the grant earned by PRODES: (i) recognition of reduction in the obligation recorded under liabilities; (ii) recording of revenues from grants for the year; (iii) recognition of deferred revenue to be appropriated in the next year;
6. Includes depreciation adjustment amounts related to goods received through donations and grants under item 3;
7. Net result of all adjustments described above.

The Consolidated Financial Statements include the financial statements of the Company and the following wholly-owned subsidiaries:

Subsidiaries:	% of equity held	
	Total	Voting
Copasa Águas Minerais de Minas S/A	100	100
Copasa Serviços de Saneamento Integrado do Norte e Nordeste de Minas Gerais S/A – COPANOR	100	100
Copasa Serviços de Irrigação S/A	100	100

The financial statements of the subsidiaries included in the consolidation process were prepared as of the same date as those of the Company, and the Company's accounting practices are consistently adopted by the subsidiaries.

The Consolidated Financial Statements were prepared in conformity with the Accounting Standard and Procedure 21 (NPC 21) - Rules for Consolidation, issued by the Brazilian Institute of Public Accountants (IBRACON) in March 1982, and CVM Instruction No. 247, of March 27, 1996. The following criteria were followed in consolidation:

- ▶ Elimination of intercompany balances;
- ▶ Elimination of investments and equity in subsidiaries, against the investee's shareholders' equity; and
- ▶ Elimination of intercompany transactions

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 3. Summary of Significant Accounting Practices

(a) Results of operations

Income and expenses are recorded on the accrual basis of accounting. Income from unbilled water supply and sanitary wastewater services are recorded as unbilled trade accounts receivable, based on monthly estimates, so as to match income and expenses in the proper period. Interest income/expenses are recorded by the method of effective interest rate under financial income/expenses.

(b) Transactions denominated in foreign currency

Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency (Brazilian real) at the exchange rate at the balance sheet date. Gains and losses resulting from the restatement of these assets and liabilities for exchange variation between transaction date and year end, are recognized in the statement of income as financial income (expenses).

(c) Cash and cash equivalents

These comprise current account balances and short-term investments redeemable up to 90 days from the date of balance sheet and with immaterial risk of changing in market value. The short-term investments included in cash and cash equivalents are mostly classified as “financial assets” at their fair value through P&L.

(d) Allowance for doubtful accounts

Calculated based on the analysis of receivables and recorded in an amount considered by Management sufficient to cover possible losses on receivables, according to the following criteria:

Trade accounts receivable

Amounts up to R\$5, over 180 days past due:

These receivables, except those related to the State Government and the Belo Horizonte Municipal Government, are considered losses when they reach 180 days past due, and are directly written off against income, under selling expenses.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 3. Summary of Significant Accounting Practices (Continued)

(d) Allowance for doubtful accounts (Continued)

Amounts over R\$5, over 180 days past due:

The allowance for doubtful accounts is recognized for all receivables, except those related to the State Government and the Belo Horizonte Municipal Government, from 180 to 360 days past due, as a credit to the caption allowance for doubtful accounts and as a charge to income. When the receivables exceed 360 days past due they are written off against income.

Other receivables from the Municipal and Federal Governments:

Effective September 1, 2003, according to the position adopted by Management, receivables from the Federal and Municipal Governments, arising from special agreements, contracts and other operations, over 360 days past due, started to be fully accrued.

Amounts receivable from the Government of Minas Gerais and the Municipality of Belo Horizonte (PBH):

The Company does not set up any allowance for doubtful accounts in relation to receivables from the Government of Minas Gerais State since there is no history of default. Receivables from PBH not paid until the date of the tariff transfer to the Municipal Water and Sewerage Fund are fully deducted from the value to be transferred, reason why no provision for losses is required.

Supplementary provision:

Management also recognized a supplementary provision for other receivables falling due and for receivables past due for less than 180 days, for specific customers included in the allowance for doubtful accounts.

(e) Inventories

Maintenance inventories are stated at average cost, not exceeding the market value. Provisions for slow-moving or obsolete inventories are set up when deemed necessary by management.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 3. Summary of Significant Accounting Practices (Continued)

(f) Other current assets

Other assets are disclosed at their historical value, including, when applicable, the earnings and monetary and exchange variations incurred on a daily *pro rata* basis.

(g) Investments

The investments in controlled companies are evaluated by the equity method. The other permanent investments are evaluated by the acquisition cost method less loss provision, when applicable.

(h) Property, plant and equipment

Stated at acquisition cost, monetarily restated through December 31, 1995, at official rates, combined with the following aspects:

- ▶ depreciation of property, plant and equipment at the rates mentioned in Note 9;
- ▶ Interest over construction works financing is added to fixed assets, incurred through the date the works start up. Capitalized interest is depreciated under the same criteria and useful lives determined to the fixed asset item into which they have been incorporated.
- ▶ Repairs and maintenance expenses are not recognized unless the economic benefits associated therewith are likely to occur and their amounts may be reliably measured. Other expenses are directly posted to income as incurred.

(i) Provision for impairment of assets

Management reviews the net book value of assets in order to evaluate events or changes in economic, operating or technological circumstances that may evidence deterioration or impairment. When such evidence is identified and the net book value exceeds the recoverable value, a provision for impairment is set up to adjust the net book value to recoverable value. These losses are classified as other operating expenses.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 3. Summary of Significant Accounting Practices (Continued)

(j) Intangible assets

Stated at acquisition cost, less amortization, as disclosed in Note 10.

(k) Current and non-current liabilities

These are stated in the balance sheet when the Company has a legal or constituted obligation as a result of a past event, being probable that funds will be required to settle it. Certain liabilities involve uncertainties in relation to term and amount, being estimated as incurred and recorded through a provision. The provisions are recorded based on best estimates of the risk involved.

(l) Interest on equity

Interest on equity payable to shareholders under Law No. 9249/95 was recorded in the statement of income under the caption financial expenses, in conformity with tax legislation. For purposes of publishing the financial statements, interest on equity is recorded as a charge to retained earnings.

(m) Actuarial liability

The Company takes part in a private pension plan administered by a private entity that provides their employees with pensions and other post employment-benefits. The Company records as actuarial liabilities, under Current and Noncurrent liabilities, the amount contracted with these entities to cover insufficient reserves whenever such amount exceeds that calculated under the responsibility of independent actuaries, adopting the projected unit credit method, in accordance with CVM No. 371/2000, as per Note 17. Actuarial gains or losses are recorded under the accrual basis of accounting.

(n) Employees' Bonus

The Company accrues the employees' bonus according to operational and financial targets disclosed to its employees. These amounts are recorded as "Employees' Bonus" under Current Liabilities and in Income.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 3. Summary of Significant Accounting Practices (Continued)

#### (o) Taxation

Revenue from sales and services are subject to the taxes and contributions below, at the following statutory rates:

<b>Taxes</b>	<b>Rate</b>
PASEP – Social integration program	1.65%
Social Contribution Tax on Corporate Revenues for Social Security Financing – COFINS	7.60%
State VAT – ICMS (subsidiaries)	7.00% to 18.00%

These charges are presented as sales deductions in the statement of operations. The credits resulting from non-cumulative PIS/COFINS are stated deducting cost of service in the statement of operations. The debits from financial income and the credits from financial expenses are disclosed deductively on these lines in the income statement.

Taxation on profits includes income tax and social contribution. Income tax is computed on taxable income at 15%, plus a 10% surtax on profits in excess of R\$ 240 in the period of 12 months, while social contribution is computed at 9% on taxable income, and recognized on the accrual basis, therefore the inclusion of temporarily nondeductible expenses for book profit, or temporarily nontaxable exclusions from income considered for calculating current taxable profit generate deferred tax credits or debits.

Tax prepayments or recoverable amounts are stated under current assets when exceeding the amount of tax payable.

Deferred income and social contribution taxes are recognized on temporary differences, tax losses and social contribution tax loss carryforwards (“deferred tax credits”).

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **3. Summary of Significant Accounting Practices (Continued)**

(p) Government grants and government assistance:

Government grants and assistance are recognized when there is reasonable assurance that the conditions established by the government have been met and that they will be earned. Initially they are recorded as revenue in income for the time necessary to compare with the expenditure that the government intends to compensate, then they are allocated to the tax incentives reserve in equity, except those guaranteed until December 31, 2007 that were recognized directly in equity as disclosed in Note 2.

(q) Accounting estimate:

Accounting estimates are used in the measurement and recognition of certain assets and liabilities in the Company's financial statements and its subsidiaries. These estimates take into consideration the experience from past and current events, assumptions related to future events and other objective and subjective factors. Significant items subject to estimates include the selection of useful lives of fixed and intangible assets; the allowance for doubtful accounts; the provision for inventory losses; the provision for investment losses; analysis of recoverable value of fixed and intangible assets; deferred income and social contribution taxes; the provision for contingencies and actuarial liabilities. The settlement of transactions involving these estimates may result in amounts significantly different from those recorded in the financial statements due to the inaccuracies inherent to the estimate process. The Company reviews its estimates and assumptions at least on a quarterly basis.

(r) Statements of cash flows and value added:

The statements of cash flows were prepared and are presented in accordance with CVM Rule No. 547 of August 13, 2008, which approved accounting pronouncement CPC 03 – Statement of Cash Flows, issued by the Brazilian FASB (CPC). The statements of value added were prepared in accordance with CVM Rule No. 557 of November 12, 2008, which approved accounting pronouncement CPC 09 – Statement of Value Added, issued by CPC.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 3. Summary of Significant Accounting Practices (Continued)

(s) Financial Instruments:

Financial instruments are recognized on the date the Company becomes party to the contractual provisions of the financial instruments. When recognized, they are initially recorded at their fair value plus transaction costs that are directly attributable to its purchases or emissions, except for financial assets and liabilities classified as at fair value through profit and loss (FVTPL), that have their costs recognized directly at P&L for the year. Their subsequent measurement occurs at the time of each balance sheet in accordance with the rules established for each type of classification of financial assets and liabilities. The principal financial assets recognized by the Company are cash and cash equivalents, bank deposits, marketable securities and trade accounts receivable. The principal financial liabilities recognized by the Company are: trade accounts payable, loans and financing, and debentures.

### 4. Cash and Cash Equivalents

	Company		Consolidated	
	2008	2007	2008	2007
Cash and banks	<b>31,924</b>	166,378	<b>36,832</b>	166,792
Securities (*)	<b>754,204</b>	823,115	<b>754,204</b>	823,115
<b>Total</b>	<b>786,128</b>	989,493	<b>791,036</b>	989,907

(\*) The Company keeps own funds from its activity - in addition to those earned by the sale of shares in February 2006 - invested in Bank Deposit Certificates - CDBs, which consist of fixed-income securities substantially remunerated by reference to the variation in the Interbank Deposit Certificate - CDI, which ranged from 98% to 106% in 2008. Financial income in 2008 from investment of own funds totaled R\$ 98,929 (R\$ 86,944 in 2007).

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 4. Cash and Cash Equivalents (Continued)

In view of the reclassified accounts in December 2008, the balance of the "Cash and banks" and "Marketable securities" accounts stated by the parent company in 2007, amounting to R\$ 166,378 and R\$ 823,115, were changed to R\$149,932 and R\$ 791,223 respectively, whereas the amounts of R\$ 16,446 relating to special agreement accounts, and R\$ 31,892, relating to special agreements' short term investments, were transferred to the "miscellaneous claims" group (see Note 6), since the transactions involving these funds are conditioned to provisions set forth in agreements executed with the government agencies authorized as parties thereto.

The Company classifies its marketable securities as available for sale and records them at fair value.

As a financing additional collateral, the Company has R\$ 35,557, secured at Banco do Brasil (R\$ 21,152 in 2007).

### 5. Trade Accounts Receivable

Trade accounts receivable mature as follows:

	Company		Consolidated	
	2008	2007	2008	2007
a) Current assets				
Billed amounts				
Falling due	<b>97,280</b>	89,558	<b>98,526</b>	89,558
Up to 30 days past due	<b>58,007</b>	52,191	<b>58,527</b>	52,191
From 31 to 60 days past due	<b>25,330</b>	22,297	<b>25,700</b>	22,297
From 61 to 90 days past due	<b>12,326</b>	11,170	<b>12,632</b>	11,170
From 91 to 180 days past due	<b>23,152</b>	16,371	<b>23,433</b>	16,371
Over 180 days past due	<b>19,277</b>	11,556	<b>19,277</b>	11,556
	<b>235,372</b>	203,143	<b>238,095</b>	203,143
Unbilled amounts	<b>159,453</b>	147,743	<b>159,453</b>	147,743
	<b>394,825</b>	350,886	<b>397,548</b>	350,886
(-) Allowance for doubtful accounts (*)	<b>(25,878)</b>	(15,067)	<b>(25,878)</b>	(15,067)
Total current assets	<b>368,947</b>	335,819	<b>371,670</b>	335,819
b) Non-current assets				
Long-term				
Unbilled amounts	<b>201,966</b>	185,574	<b>201,966</b>	185,574
Accounts receivable - current and non-current	<b>570,913</b>	521,393	<b>573,636</b>	521,393

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 5. Trade Accounts Receivable (Continued)

Trade accounts receivable includes R\$7,008 of invoices issued to the State of Minas Gerais, and R\$ 2,741 billed to the Belo Horizonte Municipal Government (R\$ 5,497 e R\$ 2,395 as of 2007, respectively).

The balance of unbilled amounts recorded in long-term assets refers to debts renegotiated with the Belo Horizonte Municipal Government, as mentioned in Note 22.

- (\*) In addition to the amount of the reversal of allowance for doubtful accounts, the Company recorded R\$ 36,565 related to losses on realization of receivables, charged directly to the statement of income in year ended December 31, 2008, under the caption selling expenses (R\$29,177 in year ended December 31, 2007). Since the year of 2005, the Company started recording write-offs of invoices referring to installment payments to municipal governments due to default on the payment established in the contract.

These amounts are detailed as follows:

	<b>Company</b>	
	<b>12/31/2008</b>	<b>12/31/2007</b>
(a) Direct write-off of amounts up to R\$5, over 180 days past due, and over R\$5, over 360 days past due	<b>25,754</b>	29,177
(b) Supplementary allowance for doubtful accounts for amounts falling due and amounts less than 180 days past due, related to specific default customers	<b>10,811</b>	(3,021)
<b>Total</b>	<b>36,565</b>	26,156

In 2008, written-off receivables of R\$15,986 (R\$20,246 in 2007) were recovered, recorded as other operating income.

Changes in the allowance for doubtful accounts were as follows:

	<b>Company</b>	
	<b>2008</b>	<b>2007</b>
1. Total at the beginning of the year	<b>15,067</b>	18,088
2. Provision (reversion) of the year	<b>10,811</b>	(3,021)
3. Total at the end of the year	<b>25,878</b>	15,067

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 6. Current Assets - Other Receivables

Represented by:

	Company		Consolidated	
	2008	2007	2008	2007
Prepaid expenses (*)	1,089	5,519	1,097	5,524
Bank account – agreements (**)	1,713	-	1,742	-
Short term investments - agreements (**)	27,524	-	38,387	-
Advances to employees (***)	7,872	6,932	9,311	7,079
Sundry	1,225	907	1,225	907
<b>Total</b>	<b>39,423</b>	<b>13,358</b>	<b>51,762</b>	<b>13,510</b>

(\*) Refers to expenses with the “health program” of the employees of the Company that will be discounted in the subsequent months.

(\*\*) As a consequence of the reclassified accounts in December 2008 (see Note 4), the amounts of R\$ 16,446 concerning accounts related to special agreements, and R\$ 31,892 to agreements’ short term investments should be added to balances at December 31, 2007.

Subsidiary COPANOR received R\$ 20,500 funds in 2008 deriving from an agreement with the State Department of Health, of which R\$ 9,501 are applied at December 31, 2008, having generated gross earnings of R\$ 789 in the year, credited to the said agreement funds.

(\*\*\*) Refers mainly to the advanced vacation pay of R\$ 7,628 to employees that had their vacation in December 2008.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 7. Noncurrent Assets - Other Receivables

	Company		Consolidated	
	2008	2007	2008	2007
Restricted investment (*)	<b>43,138</b>	39,137	<b>43,138</b>	39,137
Loan to Águas Minerais (**)	<b>16,464</b>	1,691	-	-
Loan to Copanor (***)	<b>8,817</b>	1,233	-	-
Loan to Jaíba (****)	<b>1,861</b>	-	-	-
Sundry	-	477	<b>946</b>	477
Total	<b>70,280</b>	42,538	<b>44,084</b>	39,614

- (\*) Refers to funds from the ANA (National Water Agency) held by COPASA in the context of the Water Basin Depollution Program (PRODES), to be transferred as payment for the treated waterwaste from the Onça waterwaste treatment station, in the Municipality of Belo Horizonte, and treated waterwaste of treatment station of “Betim Central”, in the Municipality of Betim, through the attainment of treated waterwaste and abatement of polluting emissions goals. Because these goals were not attained, the Company records these funds in long-term liabilities, under the caption Deposits for construction work (Note 18).
- (\*\*) It refers to contracts of mutual and payroll related charges relating to employees assigned by the Company to its wholly-owned subsidiary Copasa Águas Minerais de Minas in 2008, which will be reimbursed as provided for contractually.
- (\*\*\*) It refers to contracts of mutual and payroll and related charges relating to employees in 2008 and well drilling expenses assumed by the Company in the municipalities covered by COPANOR’s concession area, which will be subsequently reimbursed by the subsidiary as provided for contractually.
- (\*\*\*\*) It refers to contracts of mutual and payroll and related charges relating to employees assigned by the Company to its wholly-owned subsidiary Copasa Serviços de Irrigação S.A. in 2008, which will be reimbursed by the subsidiary as provided for contractually.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 8. Investments

	Company		Consolidated	
	2008	2007	2008	2007
Subsidiaries accounted for under the equity method				
Copasa Águas Minerais de Minas S.A.	13,222	13,929	-	-
Copanor	1	1	-	-
Copasa Serviços de Irrigação S.A.	278	1	-	-
Subtotal	13,501	13,931	-	-
Investments accounted for under the cost method				
Prodemge - Cia. Processamento de MG	959	959	959	959
Brasil Telecom	66	66	66	66
Telesp	99	99	99	99
Vivo Participações	43	43	43	43
TIM Participações	30	30	30	30
Other	22	22	22	22
Provision for loss	(959)	-	(959)	-
Subtotal	260	1,219	260	1,219
<b>Total</b>	<b>13,761</b>	<b>15,150</b>	<b>260</b>	<b>1,219</b>

The main information on the investments in subsidiaries is as follows:

	2008			2007		
	Águas Minerais	Copanor	Serviços de Irrigação	Águas Minerais	Copanor	Serviços de Irrigação
Shareholders' Equity	13,222	(3,390)	278	13,929	1	1
Capital	13,929	1	1	1	1	1
Advance for future capital increase	14,603	-	-	13,928	-	-
Profit(loss)	(15,310)	(3,391)	277	-	-	-
Number of shares	13,222	1	278	13,929	1	1
COPASA's interest (%)	100	100	100	100	100	100

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 8. Investments (Continued)

Changes in investments:

	31/12/2007	Equity method	Advance for future capital increase	31/12/2008
Águas Minerais	13,929	(15,310)	14,603	13,222
Copanor	1	-	-	1
Serviços de Irrigação	1	277	-	278
<b>Total</b>	<b>13,931</b>	<b>(15,033)</b>	<b>14,603</b>	<b>13,501</b>

At December 31, 2008, subsidiary COPANOR had an uncovered liability of R\$ 3,390. The Company set up a provision for loss of R\$ 3,390 in order to offset its share in the aforementioned uncovered liability. This provision was accounted for as current liabilities, under miscellaneous obligations.

COPASA's subsidiary Copasa Águas Minerais shows accumulated loss and working capital deficiency. The operations of Copasa Águas Minerais started up in September 2008, and due to high costs it could not reach its sales targets.

This subsidiary is having its cost structure reviewed and feasibility studies are underway. Continuity of its business operations is contingent upon operational restructuring aiming at its adequacy to the market in which it is engaged, and financial support from its parent company. The financial statements of Copasa Águas Minerais, which serve as basis for the Company's equity pickup and consolidation were prepared premised on its continuity and include neither adjustments to realization and classification of its assets nor valuation of its liabilities, which could be requested in the event of discontinuance of its business operations.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 9. Property, Plant and Equipment

Description	Company			
	2008	2007	2008	2007
	Cost	Accumulated depreciation and amortization	Net	Net
<b>Water systems</b>				
Forest/environmental preservation land	98,899	-	98,899	95,379
Constructions and deep tubular wells	3,183,092	(1,693,282)	1,489,810	1,372,636
Electrical installations	15,679	(12,586)	3,093	3,160
Machinery and equipment (ND) *	21,272	(10,530)	10,742	8,700
Machinery and equipment (AD) *	384,465	(320,247)	64,218	61,978
Well drilling equipment	1,801	(1,157)	644	773
Subtotal	3,705,208	(2,037,802)	1,667,406	1,542,626
<b>Waterwaste systems</b>				
Land	4,085	-	4,085	3,565
Constructions	1,620,608	(460,450)	1,160,158	1,008,854
Electrical installations	251	(87)	164	175
Machinery and equipment (ND) *	6,685	(3,368)	3,317	1,208
Machinery and equipment (AD) *	32,280	(27,097)	5,183	8,802
Subtotal	1,663,909	(491,002)	1,172,907	1,022,604
<b>Items general use</b>				
Land	3,309	-	3,309	1,537
Constructions	100,312	(65,062)	35,250	35,033
Electrical installations	25	(21)	4	6
Furniture and Fixtures	5,753	(3,595)	2,158	2,131
Machinery and equipment (ND) *	38,147	(22,974)	15,173	13,443
Tools	108	(85)	23	-
IT equipment	47,595	(35,006)	12,589	15,559
Vehicles	93,831	(72,769)	21,062	34,553
Motorcycles	6,065	(4,685)	1,380	2,233
Heavy equipment	4,988	(3,565)	1,423	1,803
Subtotal	300,133	(207,762)	92,371	106,298
Investment grants and donations	(25,999)	567	(25,432)	-
Subtotal	(25,999)	567	(25,432)	-
Other	44,598	-	44,598	52,483
Construction inventories	79,354	-	79,354	69,451
Construction in progress	1,366,657	-	1,366,657	1,053,353
Subtotal	1,490,609	-	1,490,609	1,175,287
<b>Total</b>	<b>7,133,860</b>	<b>(2,735,999)</b>	<b>4,397.861</b>	<b>3,846,815</b>

(\*) ND - Normal depreciation; AD - accelerated depreciation.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 9. Property, Plant and Equipment (Continued)

Description	Consolidated			
	2008		2007	
Cost	Accumulated depreciation	Net	Net	
Water Systems	3,705,208	(2,037,802)	1,667,406	1,542,626
Waterwaste Systems	1,663,909	(491,002)	1,172,907	1,022,604
Items general use	317,439	(208,038)	109,401	107,960
Investment donations and grants	(25,999)	567	(25,432)	-
Other	44,598	-	44,598	52,618
Advance to suppliers	4,400	-	4,400	-
Construction inventories	79,354	-	79,354	69,451
Construction in progress	1,370,132	-	1,370,132	1,063,960
<b>Total</b>	<b>7,159,041</b>	<b>(2,736,275)</b>	<b>4,422,766</b>	<b>3,859,219</b>

Other is basically advances for acquisition of land.

Assets allocated to the municipalities where the agreements do not establish refund at the end of the concession, Além Paraíba and Ipatinga systems, are amortized over contractually established terms. Other assets included in property, plant and equipment are depreciated under the straight-line method, based on their estimated useful lives, at the rates shown below:

	<u>% annual</u>
Construction	4
Deep tubular wells	4
Furniture and fixtures	10
Machinery and equipment (ND)	10
Machinery and equipment (AD)	20
Electrical installations	10
Well drilling equipment	15
Vehicles and tools	20
IT equipment	20
Heavy equipment	25

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 9. Property, Plant and Equipment (Continued)

Depreciation for year ended 2008 totaled R\$ 227,998 (R\$ 207,220 in 2007) and were recorded in income.

Water systems refer to assets and installations in 883 locations (unaudited) (879 in 2007) of the State of Minas Gerais, which are operated under the concession agreements signed with the municipalities, for periods ranging from 18 to 99 years, but mostly 30 years.

The balance of construction in progress refers mainly to the expansion and implementation of water systems, in the amount of R\$ 446,919 (R\$ 394,770 in 2007), and wastewater systems, in the amount of R\$ 602,083 (R\$ 472,863 in 2007).

In this year, the Company capitalized in the account of Construction in progress, interest and charges in the amount of R\$ 69,135 (R\$ 48,485 in 2007).

### 10. Intangible assets

Description	Company			
	2008		2007	
	Cost	Accumulates amortization	Net	Net
Software license	45,793	(21,230)	24,563	31,521
Guidelines, methods and processes	18,318	(15,749)	2,569	3,478
Expropriations	3,890	(1,897)	1,993	1,906
Concession rights	179,846	(19,079)	160,767	145,761
Other intangibles	390	(262)	128	202
<b>Total</b>	<b>248,237</b>	<b>(58,217)</b>	<b>190,020</b>	<b>182,868</b>
Description	Consolidated			
	2008		2007	
	Cost	Accumulated amortization	Net	Net
Intangibles assets	248,254	(58,219)	190,035	182,868
<b>Total</b>	<b>248,254</b>	<b>(58,219)</b>	<b>190,035</b>	<b>182,868</b>

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 10. Intangibles assets (Continued)

Expropriations refer to amounts paid to owners of land areas used by the Company for installation of water mains. These assets are amortized over the effective period of the concession agreements with the municipalities where they are located.

Concession rights reflect the financial participation in waterwaste construction work and treatment of vale floors, to be performed by the municipalities, and are amortized over the effective period of the concession agreements with the municipalities (Note 24).

Amortization of other intangibles is calculated at the rates shown below:

	<u>% annual</u>
Software license	20
Guidelines, methods and processes	10

The amortization of the year ended is in the amount of R\$10,994 (R\$15,117 in 2007) and were recorded in income.

### 11. Loans and Financing

a) The total was following:

	<u>Company</u>			
	<u>2008</u>		<u>2007</u>	
	<u>Current</u>	<u>Noncurrent</u>	<u>Current</u>	<u>Noncurrent</u>
In local currency				
For property, plant and equipment				
Federal Savings and Loans Bank (CEF)	72,317	601,531	49,234	499,266
State Government/BDMG	7,524	21,435	7,576	25,542
National Treasury	31,151	142,126	29,244	169,761
National Bank for Economic and Social Development - BNDES – BNE				
	47	13,347	-	-
Subtotal	<u>111,039</u>	<u>778,439</u>	86,054	694,569
In foreign currency				
For property, plant and equipment				
Banco do Brasil S.A.	2,675	-	2,039	2,037
Federal Government - bonds	8,832	82,543	7,667	68,718
Subtotal	<u>11,507</u>	<u>82,543</u>	9,706	70,755
Grand total	<u>122,546</u>	<u>860,982</u>	95,760	765,324

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 11. Loans and Financing (Continued)

#### b) Interest rates

<b>Bank</b>	<b>Rates % p.a.</b>	<b>Index</b>	<b>Maturity</b>
Federal Savings and Loans Bank (CEF)	Rates ranging from 6.50% to 11.00% plus 2% administration fee - at 12/31/2008 - average of 10.24% per annum (10.68% at 12/31/2007).	TR	2029
State government /BDMG	Rates ranging from 8.21% to 10.07% - 12/31/2008 - average of 8.85% p.a. (8.87% at 12/31/2007).	IGP-M	2016
National treasury	5.38%	TR	2014
National Bank for Economic and Social Development - BNDES – BNE	Rates ranging from 8.21% to 10.07% - 12/31/2008 - average of 7.81% p.a. (not available at 12/31/2007).	TJLP	2023
Banco do Brasil S.A.	Libor + 13/16 of 1% spread p.a.	Foreign Exchange	2009
Federal Government – bonus (c)	Basket of interest rates (*)	Foreign Exchange	2024

(\*)Basket of interest rates - Federal Government - bonds

<b>Bonds</b>	<b>Interest Rate</b>	<b>Commission</b>
Debt Conversion Bond	Libor + 7/8 of 1% p.a. spread	0.2% p.a.
New Money Bonds	Libor + 7/8 of 1% p.a. spread	0.2% p.a.
Flirb	Libor + 13/16 of 1% p.a. spread	0.2% p.a.
C-Bond	8% p.a.	0.2% p.a.
Discount Bond	Libor + 13/16 of 1% p.a. spread	0.2% p.a.
Par Bond	6% p.a.	0.2% p.a.
EI Bond	Libor + 13/16 of 1% p.a. spread	0.2% p.a.
Brazilian Investment Bonds	6% p.a.	0.2% p.a.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 11. Loans and Financing (Continued)

#### (c) Federal Government-bonds

This debt, originally contracted with foreign institutions, was included in the agreement concluded by the Brazilian Government with the international financial community, for renegotiation of the Brazilian public sector's external debt with foreign private creditors. Under the provisions of this agreement, approved by the Federal Senate through Rule No. 98, of December 29, 1992, the debt was exchanged for bonds issued by the Federal Government, which became a debtor to foreign creditors.

In substitution for the installments of the principal, several types of bonds were issued, at rates consistent with those usually practiced by the international financial market, as follows:

Type of bond	Amount (US\$)	Issue date	Term years	Grace Period years	Amortization
Debt Conversion Bond	4,961,500,88	15.04.94	18	10	17 semiannual installments
New Money Bonds	186,928,08	15.04.94	15	7	17 semiannual installments
Flirb	189,683,72	15.04.94	15	9	13 semiannual installments
C-Bond	7,028,290,16	15.04.94	20	10	21 semiannual installments
Discount Bond	10,387,935,56	15.04.94	30	-	1 single installment after 30 years
Par Bond	14,966,432,54	15.04.94	30	-	1 single installment after 30 years
Brazilian Investment Bonds	1,301,928,13	31.08.89	25	10	30 semiannual installments
<b>Total</b>	<b><u>39,022,699,07</u></b>				

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 11. Loans and Financing (Continued)

#### (d) Maturity non-current amounts

The long-term portion matures as follows:

Maturity	Company	
	2008	2007
2009	-	107,709
2010	121,617	111,749
2011	125,177	115,926
2012	131,198	119,132
2013	129,938	117,530
2014	91,681	78,117
2015	59,397	40,549
2016	35,834	28,191
After 2017	166,140	46,421
Total	860,982	765,324

#### (e) Guaranties

As collateral for the financing, the Company has pledged the following:

##### 1. Federal Government - bonds:

These are backed up to the contract balance by the Minas Gerais State Government and by the Company tariff revenues, up to the limit sufficient for payment of the installments and other charges due on the maturity dates.

##### 1.1. Discount Bond and Par Bond:

As accessory guarantee for this financing, the Company keeps at Banco do Brasil the amount of R\$35,557 as collateral, restated through December 31<sup>st</sup>, 2008 (R\$21,152 in December 31<sup>st</sup>, 2007) by applying the average price of the Zero Coupon Bond of the US Treasury, recorded under the caption "collateral for financing".

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 11. Loans and Financing (Continued)

#### e) Guaranties (Continued)

##### 2. Fiduciary transfer of receivables and receivables restriction agreement.

In order to ensure the performance of the Company's obligations, undertaken in the FGTS funds transfer agreements, in the context of the Sanitation for All Program, entered into by the Federal Savings and Loans Bank (CEF) as designated administrator and Unibanco, Fiduciary transfer of receivables and receivables restriction agreements have been entered into on July 4, 2006 with the managing agents Bradesco, Itaú and CEF, as follows:

Contract	Number	Original amount	Contract		
			Fiduciary transfer	Restricted Account	Reserve Account
Credit facility I		256,428			
Fiduciary transfer	2006 1637		17,000	17,000	20,306
Amendment	2006 2933		17,000	17,000	
Credit facility II		284,593			
Fiduciary transfer	2006 1639		15,300	15,300	
Amendment	2006 2934		15,300	15,300	
Total		<u>541,021</u>			<u>20,306</u>

The Company made the following pledges for these agreements:

- ▶ Fiduciary collateral transfer of part of COPASA's receivables from water supply and wastewater collection public utility services provided to its private consumers, in the minimum amount of R\$ 17,000 and R\$ 15,300 per month, noncumulative, adjusted based on the variation of IPCA (Extended Price Consumer Index) disclosed by FIP.
- ▶ Fiduciary transfer of part of the assignors receivables from CEF, related to the funds deposited in the Restricted Account and Reserve Account in funds, temporary cash equivalents or held under any other type of investment, arising from payments of transferred receivables. As of December 31, 2008 the liquidity fund consisting of the amount of reserve account, which corresponds to three times the amount of the installments falling due and is recorded under the caption Collateral for financing in the amount of R\$ 20,306 (R\$ 9,708 in December 2007).

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 11. Loans and Financing (Continued)

#### e) Guaranties (Continued)

##### 3. Other financing:

- ▶ The loans and financing agreements entered into with the Federal Savings and Loans Bank (CEF), to the carry out the institutional development actions in several cities of Minas Gerais and to the performance of works and services for the expansion of the building supply grid, are collateralized by deposits in a collateral account whose minimum balance corresponds to one (1) time the value of the monthly charge, for the agreement executed on December 9, 2003 and three (3) times the value of the monthly charge, for the agreement executed on June 30, 2004, calculated based on the collection available for these agreements. The balance of this account, recorded under the caption Collateral for Financing as of December 31, 2008 is R\$ 2,872 (R\$ 714 in December 31, 2007).
- ▶ Loans and financing contracts with the National Bank for Economic and Social Development - BNDES for optimization and expansion of water supply systems and sanitation in the concession areas are guaranteed by the sale of part of fiduciary duties arising out of the public service of providing water supply and sanitation, in an amount equivalent to the minimum value of R\$ 3,000 and R\$ 23,000 per month, adjusted annually by the IPCA / IBGE, and by security deposits on account of the minimum balance corresponding to three (3) times the value of the installments falling due. The balance of this account recorded as financing bond guarantees, at December 31, 2008 is R\$ 283 (in 2007 there was no bond guarantee).
- ▶ Other financing is collateralized by the Minas Gerais State Government and by the Company's tariff revenues.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 11. Loans and Financing (Continued)

#### f) Contractual covenants

The Company's financing agreements have covenants that require the performance of special guarantees, as follows:

##### (a) Covenants of syndicated agreements:

Ratio	Limit
Total liabilities/shareholders' equity	Equal or less than 1.0
EBITDA/debt service	Equal or greater than 1.55
Water and wastewater connections/Headcount	Equal or greater than 350

##### (b) Contractual Covenants with CEF - the contracts previously signed with Unibanco, with funds from FGTS (severance pay fund), were transferred to CEF's management, as described in item 2 above.

Ratio	Limit
Total liabilities/shareholders' equity	Equal or less than 1.0
EBITDA/debt service	Equal or greater than 1.7
Current liquidity, adjusted	Greater than 0.9
Water and wastewater connections/Headcount	Greater than 365

##### (c) Contractual covenants with - BNDES/BNE:

Ratio	Limit
Net debt/EBITDA	Equal or less than 3.0
EBITDA/ROL	Equal or greater than 36%
EBITDA/debt service	Equal or greater than 1.5

Note that through December 31, 2008, none of the covenants above was breached

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 12. Debentures

Series	Subscription date	2008		2007	
		Current	Non-Current	Current	Non-Current
Nonconvertible Debentures					
Subscriptions made - 1st issuance					
1st and 2 <sup>nd</sup>	30/06/2004	7,900	35,402	7,886	43,023
3rd and 4 <sup>th</sup>	09/11/2004	7,900	35,402	7,886	43,023
5th and 6 <sup>th</sup>	29/07/2004	7,900	35,402	7,886	43,023
7 <sup>th</sup>	19/12/2005	3,950	17,701	3,943	21,511
8th and 9 <sup>th</sup>	24/04/2006	7,900	35,402	7,887	43,022
10 <sup>th</sup>	19/12/2006	3,950	17,701	3,943	21,511
11 <sup>th</sup> and 12 <sup>th</sup>	23/03/2007	7,900	35,403	7,887	43,022
		<b>47,400</b>	<b>212,413</b>	<b>47,318</b>	<b>258,135</b>
Subscriptions made - 3 <sup>rd</sup> issuance					
1st to 6 <sup>th</sup>	06/12/2007	534	150,387	833	150,025
7 <sup>th</sup>	25/09/2008	89	25,058	-	-
8 <sup>th</sup>	06/12/2008	6,802	75,194		
		<b>7,425</b>	<b>250,639</b>	<b>833</b>	<b>150,025</b>
Nonconvertible Total		<b>54,825</b>	<b>463,052</b>	<b>48,151</b>	<b>408,160</b>
Convertible Debentures					
Subscriptions made - 2 <sup>nd</sup> issuance					
Single Subscription	28/08/2007	316	89,147	276	88,955
Single Subscription	06/09/2007	177	49,944	155	49,824
Single Subscription	03/12/2007	9	2,478	8	2,472
Convertible Total		<b>502</b>	<b>141,569</b>	<b>439</b>	<b>141,251</b>
Total		<b>55,327</b>	<b>604,621</b>	<b>48,590</b>	<b>549,411</b>

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 12. Debentures (Continued)

▶ Nonconvertible Debentures

(a) Subscriptions made – 1<sup>st</sup> issuance:

In June 2004, the Company placed 300 nonconvertible simple debentures of R\$1,000 each, in a private issue, through exclusive subscription by the BNDES (National Bank for Economic and Social Development). These debentures were issued in 12 series of R\$25,000 each.

The subscription price of each series was equivalent to the nominal value plus the interest mentioned below, calculated on a *pro rata* basis from the issuance date to the effective subscription date, the contractual terms and conditions being the following:

▶ Issue date	- June 15, 2004
▶ Term	- 10 years
▶ Grace period of the principal	- 36 months
▶ Amortization	- 84 months
▶ Final expiration	- July 15, 2014
▶ Yield	- TJLP + 3.58% p.a.
▶ Guarantee	- 20% of revenue, plus reserve account

This first issue is guaranteed by 20% of the Company's tariff revenue and a reserve account, the amount of which is equivalent to three installments falling due, deposited in an investment fund, recorded under the caption "collateral for financing". As of December 31, 2008, the amount pledged as collateral totaled R\$17,644 (R\$19,126 in December 31, 2007).

The funds from this issuance are earmarked for financing of projects for expansion and modernization of water supply and sanitary wastewater systems in the concession areas.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 12. Debentures (Continued)

▶ Nonconvertible Debentures

(b) Subscriptions made – 3<sup>rd</sup> issuance:

The simple debentures, not convertible into common shares, negotiated in a private deal under exclusive subscription by BNDES – National Bank for Economic and Social Development, are composed of 450 simple debentures of R\$1,000 each, whose issuance is being made in 18 (eighteen) series of R\$25,000 each. The contractual terms and conditions were as follows:

Issue date	June 1, 2007
Term	12 years
Grace Period of the principal	30 months
Amortization	114 months
Final expiration	December 15, 2019
Yield	TJLP + 2.3% p.a.
Guarantee	Floating, with assignment and binding of receivables, plus reserve account

This 3<sup>rd</sup> issuance is guaranteed by mensal minimum deposits of R\$18,000, related to revenues of the Company, updated annually by the IPCA, and by a reserve account, in which the minimum balance must be equal to 3 (three) undue installments, related to all debentures of all series issued and subscribed, deposited in a investment fund, recorded in the account balance “Collateral for Financing”. As of December 31, 2008, the amount pledged as collateral totaled R\$5,423 (in 2007 there was no guaranteed value).

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 12. Debentures (Continued)

► Convertible Debentures

(c) Subscriptions made - 2<sup>nd</sup> issuance:

On June 16, 2007, the Company executed a Convertible Debentures Indenture in the amount of R\$141,024 under the following terms and conditions:

Issue date	June 1, 2007
Quantity	1,130,000
Nominal unit amount in reais	R\$124.80
Grace Period of the principal	59 months
Amortization	June 1, 2012 and June 1, 2013
Yield	TJLP + 2.3% p.a.
Guarantee	Floating

The shareholders of the Company were granted the preemptive right to subscribe debentures on the same proportion to the number of COPASA shares held on July 30, 2007, so that to subscribe one (1) debenture, it would be necessary that a shareholder holds 102 shares of COPASA. The deadline to exercise the preemptive right is 30 days after July 30, 2007, day of publication of the Notice to Shareholders, hence, maturing at 04:00 p.m. of August 28, 2007. COPASA's shares (under the tick symbol CSMG3 at the São Paulo Stock Exchange) were traded ex-rights of debentures subscription since July 31, 2007.

The conversion option is available for the period between June 23, 2008 and May 31, 2012, when each debenture can be converted into four common shares of our issue, and between June 1, 2012 and May 31, 2013, when each debenture can be converted into two common shares of our issue, at the price of R\$ 31.20 per share, as restated under the indenture terms. On August 4, 2008, 188 debentures were converted into 752 common shares, as per the request received on June 30, 2008.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 12. Debentures (Continued)

► Convertible Debentures (Continued)

The funds provided by the 2<sup>nd</sup> and 3<sup>rd</sup> issuances will be used in the Company's Investment Plan for the 2007/2010 period to modernize, increase and implement new water treatment stations and wastewater treatment stations, optimize operations with improvements in the control of loss reduction and for water supply studies and projects and sanitation services, as well as investments in new concessions and institutional development.

► *Covenants*

Under debentures contracts, the Company has covenants requiring that the following specific ratios are obtained, as follows:

Ratio	Limit
EBITDA/debt service	Equal or greater than 1.5
EBITDA margin	Equal or greater than 33%
Indebtedness ratio	Equal or less than 70%
EBITDA/net revenue	Equal or greater than 36%
Net indebtedness/EBITDA	Equal or less than 3.0

Note that through December 31, 2008, none of the covenants above was breached.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 13. Tax Provisions

	Company		Consolidated	
	2008	2007	2008	2007
Noncurrent				
PIS/PASEP/COFINS (*)	<b>43,352</b>	40,163	<b>43,352</b>	40,163
IPI Premium Credit (**)	<b>68,103</b>	64,604	<b>68,103</b>	64,604
<b>Total</b>	<b>111,455</b>	104,767	<b>111,455</b>	104,767

(\*) As of December 31, 2008, the utilization of PIS/PASEP and COFINS deemed credits to offset taxes in January 2004 August 2007 represented R\$43,352 (R\$40.163 as of December 31, 2007). The Company understands that prevailing legislation fails to address whether such credits may be used with respect to inputs consumed in its core business. Based on a study conducted by independent consultants, which resulted in the refinement of the estimate of the tax bases, the Management decided to provide for the use of these tax credits until the legal basis of such credits is defined.

(\*\*) In 2001, we acquired from third parties, at a 15% discount, R\$65,800 million worth of credit premiums relating to IPI (Federal VAI), or IPI, an excise tax, which we offset against other federal tax debts. As of December 31, 2007, the total amount of these federal tax debts was R\$137,900 million, including the amounts already offset by us, and including penalty fines and default interest pursuant to the SELIC rate. Although the Brazilian IRS (Secretaria da Receita Federal) issued the relevant documents evidencing the offsetting request, in other instances it has adopted the view that either because of the origin of the credits (i.e., acquisition from third parties), the legal nature of IPI credit premiums, or because of the still pending underlying court proceedings, such IPI credit premiums may not be offset. In addition, the trend in similar court cases has been for the Superior Court of Justice to decide that the IPI credit premium was terminated in 1990.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 13. Tax Provisions (Continued)

We understand that the subject depends upon conclusive judgment by the Federal Supreme Court.

Considering the current legal scenario, our outside lawyers assessed the chances of loss involving this matter as probable. However, we have sound legal grounds to claim that part of the compensation was tacitly approved. Thus, there are fairly tenable arguments to assert the termination of obligations with the Brazilian IRS in relation to cases in which more than five years have elapsed between the date of the offsetting statement and any notice by the Brazilian IRS to disallow the tax amount offset. As regards the approval of offsetting requests claimed for more than five years without any notice to disallow the claim being served by the Brazilian IRS, our outside lawyers estimate the chances of loss on this part of the contingency as possible. At December 31, 2008, the balance of this provision is R\$ 68,103 (R\$ 64,604 at December 31, 2007), as per the Company calculations, including late-payment fine and interest charges by reference to the SELIC rate, and not considering tax credit amounts offset for more than five years without any approval or rejection expressed by the Brazilian IRS.

### 14. Contingencies

The Company's criterion, based on the opinion of its legal counsel, is to accrue amounts for civil and tax lawsuits with probable likelihood of loss, and for labor lawsuits with probable and possible likelihood of loss, as well as legal tax obligations.

- (a) Lawsuits with probable likelihood of loss and labor lawsuits with possible likelihood of loss

The Company is a party to various lawsuits arising in the normal course of its operations, including civil, labor and tax lawsuits.

The Company, based on the opinions of its legal counsel and Management, recognized a reserve for these contingencies in an amount sufficient to cover probable losses. The accrued amounts are presented according to the nature of the corresponding lawsuits, as follows:

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 14. Contingencies (Continued)

(a) Lawsuits with probable likelihood of loss and labor lawsuits with possible likelihood of loss (Continued)

Nature	Company					
	2008			2007		
	Reserve	Escrow Deposits	Net	Reserve	Escrow Deposits	Net
Civil (*)	12,065	-	12,065	4,807	(659)	4,148
Labor (**)	14,818	(742)	14,076	23,766	(743)	23,023
Tax (***)	4,335	(125)	4,210	5,569	(3)	5,566
Total	31,218	(867)	30,351	34,142	(1,405)	32,737

Changes in contingencies and escrow deposits at the year are as follow:

Nature	12/31/2007	Additions	Reversions	Use	12/31/2008
Civil	4,807	11,174	1,748	2,168	12,065
Labor	23,766	458	8,041	1,365	14,818
Tax	5,569	993	433	1,794	4,335
Subtotal	34,142	12,625	10,222	5,327	31,218
Escrow deposits	(1,405)	(399)	-	(937)	(867)
Total	32,737	12,226	10,222	4,390	30,351

The details on the recognized reserves are as follows:

- (\*) Reserves for civil lawsuits are related to claims for compensation for property damage or pain and suffering or claims for reimbursement of amounts paid to the Company due to overpayment or duplicate payment. The Company estimates the amounts to be accrued based on the billed amounts subject to questioning and on recent court decisions.

In 2003, the Public Prosecution Office of the State of Minas Gerais filed a public civil action questioning the 2003 tariff increase for the City of Belo Horizonte, since COPASA applied the increase rate to the first bills issued after the increase date, rather than billing the consumption subsequent to the increase date. In challenging the legality of the tariff increase, the Public Prosecution Office proposed the cancellation thereof. The final decision found for the partial validity of the claim and required the Company to return to customers the portion of the tariff increase corresponding to the consumption preceding the increase date. The proceedings for execution of the award are currently ongoing. This contingency, as of December 31, 2008, was estimated at R\$2,295, which has been fully provisioned (R\$2,481 of December 31, 2007).

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 14. Contingencies (Continued)

- (a) Lawsuits with probable likelihood of loss and labor lawsuits with possible likelihood of loss (Continued)

Environmental Protection Association Verde Gaia filed a public civil action against COPASA questioning the breach of Article 2 of State Law No. 12503/97, whereby water supply utilities are required to invest 0.5% of their operating revenue in environmental protection and conservation of the water basin explored. During the process, procedural changes, such as the lower court decision that was favorable to plaintiff, and the current position of the Minas Gerais State Court of Justice (TJMG) on the environmental matter under concern, the process had to be reclassified to a probable loss contingency. Accordingly, the Company set up a provision deemed sufficient to cover the likely loss on this suit, which amounts to R\$2,226 at December 31, 2008 (R \$2,076 at December 31, 2007).

- (\*\*) The claims in which the Company has direct responsibility relate, in the majority, to pain and suffering and material damages due to work related diseases or occupational accidents, overtime, commuting, unhealthy work conditions and hazard allowances, prior notice payments, salary differences deriving from job equality, challenge of instances of termination for cause, reinstatement of low risk healthcare plan and continuity of staples basket payment. COPASA has provisioned all labor claims where the outcome was considered a probable and/or possible loss, which represents approximately 36,51% of the potential liabilities estimated for all labor claims.

We also appear as a co-liable joint defendant, with the principal liability lying with outsourced contractors that provide maintenance and construction services to the Company. In these cases, if the claims are upheld, these contractors are usually liable for paying the award. However, if the contractors are financially unable to make payment, COPASA may be legally compelled to settle the labor liability, for which reason the prospects for loss in these cases are considered possible. As of December 31, 2008, the Company recorded a reserve for contingencies in the amount of R\$2,355 (R\$1,189 as of December 31, 2007), for potential liability concerning these cases, taking into account the existence of contractors that are undergoing financial difficulties and could potentially default.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 14. Contingencies (Continued)

- (a) Lawsuits with probable likelihood of loss and labor lawsuits with possible likelihood of loss (Continued)

In addition, we are currently a party to twelve administrative proceedings initiated after an inspection by officials representing the Regional Labor Office, which resulted in infringement notices on allegation that we failed to compute the effects of overtime worked over the employees' weekly rest remuneration, such that this would represent undue reductions in salaries, leading to the notices and a fine for each employee found to be in the same situation. This in turn affects our contributions to the Severance Pay Fund (FGTS), which is payable per employee, plus a fine per employee, therefore totaling potential contingent liability, as of December 31, 2008, corresponding to R\$6,776. The likelihood of loss in eleven of these lawsuits was assessed as possible, and a reserve in the amount of R\$ 6,773 (R\$ 5,962 as of December 31, 2007).

There is also a labor claim related to a public civil lawsuit in course at the 24<sup>th</sup> labor court of Belo Horizonte, whereby SINDÁGUA and the Public Prosecution Office claim that the dismissal policy and motivational program adopted by the Company are discriminatory. We estimate that the loss on this lawsuit totals R\$ 1,000, which is duly provided for at December 31, 2008 (at December 31, 2007 this lawsuit did not exist).

- (\*\*\*) The most significant are as follow:

In 1992, the Federal Revenue Service issued an assessment notice to the Company for insufficiency of collection of Contribution for Social Security Funding (FINSOCIAL) between 01/01/1983 and 03/30/1989, since said agency considered that the basis of the contribution should be the gross revenue and not the income tax due or supposedly due. The Company brought an administrative appeal against the decision but did not reach a favorable decision from the board of tax appeals. In August 1994, a Declaration Action was filed against the Federal Government for recovery of unduly paid debt with the purpose of recovering the amounts overpaid due to undue and unconstitutional increase in the rates of FINSOCIAL, as well as declaration of inexistence of mandatory legal relationship regarding application of laws that increased it. The lawsuit was examined in various court levels and, in December 2004, reached an unappeasable decision and the National Treasury brought a collection lawsuit against the Company, which is negotiating the installment payment of attorney fees in the amount of R\$3,843 as of December 31, 2008.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 14. Contingencies (Continued)

#### (b) Lawsuits with possible likelihood of loss

The Company is a party to other lawsuits for which the likelihood of loss is possible. For these lawsuits, no reserves for contingencies were recognized to cover possible losses, as the Company considers that it has a solid legal basis for the procedures adopted for its legal defense.

Ongoing lawsuits at various administrative and judicial levels, in which the Company is a defendant, are as follows:

Nature	Company	
	2008	2007
Civil (*)	462,216	281,937
Tax (**)	7,774	7,322
Total	469,990	289,259

(\*) Refer to lawsuits for compensation for property damage, pain and suffering and loss of profits caused to third parties, and which are at various court levels, summarized as follows:

#### a. Individual Lawsuits

We are parties to a significant number of individual lawsuits claiming damages for the disconnection of water service, occupational accidents and damages caused by construction. These lawsuits were filed in the normal course of our business, and involve pain and suffering and material damages, such as for damages to property (real property or cars) and accidents caused during the operation of our activities, among other matters. We do not believe that an unfavorable outcome in these legal actions, either individually or in the aggregate, would have a material adverse effect on our business, results of operations, financial condition or prospects.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 14. Contingencies (Continued)

(b) Lawsuits with possible likelihood of loss (Continued)

(b) Public Civil Actions and Class Actions

In addition, we are parties to public civil actions and class actions that challenge, and seek to annul, declare void or suspend 12 of our concession agreements, namely those executed with the municipalities of Almenara, Caratinga, Campina Verde, Cataguases, Divinópolis, Frutal, Lavras, Leopoldina, Nanuque, Ribeirão das Neves, São Gotardo and Três Corações. Moreover, we, the City of Belo Horizonte and SUDECAP are parties to a class action that seeks to have the cooperation services agreement declared void. In this latter case, the parties submitted their final arguments and the lawsuit is currently pending judgment. Our summation claims for dismissal on the grounds of impropriety of the class action and, as to the merits, for denial of the complaint based on the argument that the cooperation services agreement is a lawful and valid instrument. As of December 31, 2008, no judgment had been rendered on any of these lawsuits, except Caratinga, and we had not made any provisions because we consider that our prospects of a defeat are either remote or possible. The opinions of renowned jurists and a precedent of the Court of Appeals of the State of Minas Gerais concerning a similar case are all in favor of our position that the concession agreements and the cooperation services agreements are lawful, valid and binding instruments. In any event, an unfavorable outcome in any of these lawsuits could adversely affect our business and financial condition, as it would result in the loss of our concessions or the cooperation agreement.

Furthermore, we are parties to an execution action for collection of a sum certain and to a specific performance claim, both of which result from noncompliance with a TAC entered into with the Public Attorneys' Office of the municipality of Betim, which, as of December 31, 2008, amounted to R\$34,200. We filed a motion to stay the execution and dispute the allegation of noncompliance arguing that, to the extent of our ability, we did implement the construction work required from us so as to meet the increase in demand resulting from population growth within the municipality, though having had no control over the implementation of certain infrastructure work it was incumbent on the municipality to provide. We are currently awaiting the report to be submitted by the court-appointed expert in respect of his investigation of the facts. The likelihood of loss was assessed as possible. Accordingly, no reserve has been recorded in connection with this lawsuit.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 14. Contingencies (Continued)

(b) Lawsuits with possible likelihood of loss (Continued)

(c) Environmental Actions

We are a party to a number of public civil actions and class actions concerning environmental matters, which were filed against us in the normal course of our business. For the most part, these proceedings involve claims for compensation and investments in preservation of the environment for alleged environmental damages resulting from the construction of wastewater treatment plants. Though these claims generally do not involve significant amounts, we may be required to make substantial investments and/or to abstain from certain operating practices.

One of these environmental class actions involve material contingencies amounting to R\$58,277 as of December 31, 2008. We dispute in these proceedings claims for compensation of environmental damages related to effluents discharged in the São Francisco River. Until the moment no decision was sentenced for this case, which we assess the likelihood of loss as possible.

(d) Instruments of Adjustment of Conduct - TACs

In the past we executed several TACs, with the Prosecution Office of the State of Minas Gerais concerning environmental issues arising out of administrative and civil investigations of our operations. We also settled a public civil action by means of an instrument of adjustment of conduct entered into with the Prosecution Office, which provides for completion of the sanitary wastewater system in the municipality of Paracatu in addition to payment of a civil indemnity.

In most cases, these compliance agreements require us to implement or improve local sanitary wastewater systems or wastewater treatment plants in order to prevent discharges of untreated effluents into bodies of water (rivers, creeks, etc.). The investments required for compliance with our undertakings in these TACs are included in our capital expenditure plan.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

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### 14. Contingencies (Continued)

(b) Lawsuits with possible likelihood of loss (Continued)

(d) Instruments of Adjustment of Conduct – TACs (Continued)

(\*\*) The most significant ones are as follows:

In April 2004, the Company was assessed by the Federal Revenue Service for not including in the PASEP and COFINS (taxes on revenue) tax basis the financial income from monetary variations of liabilities, generated by the decrease in the US dollar rate. The tax liability as of December 31, 2008 amounts to R\$25,475 and may be classified as a possible contingency, since there are no previous decisions on the matter. However, the Company filed an administrative appeal for rejection and contestation of the tax assessment notice and will sustain its position at higher courts, if necessary, until the final decision. Based on the opinion of legal counsel, management believes that the recognition of a reserve for this assessment is not presently necessary.

In relation to COFINS, it is important to mention that the administrative appeal filed was denied on June 14, 2005, and concerning PIS/PASEP, the administrative appeal is still awaiting decision before the Second Board of Tax Appeals. However, the Superior Justice Court, in a recent decision, declared the unconstitutionality of Law No. 9,718/98 related to the extension of the tax basis of said contribution. Accordingly, the Company intends to appeal in court for voiding of the administrative act that recognized the tax credit supported by unconstitutional legislation.

### 15. Employees' Bonus

The Company's management, pursuant to the 2005/2007 Collective Agreement signed with its employees' unions, approved the rules of the Company Employees' Bonus Program ("Programa de Participação dos Empregados nos Lucros da Empresa"), as decided in a meeting held on October 28, 2005 and in accordance with prevailing legislation. The amount to be distributed is equivalent to 25% of the mandatory minimum dividends paid to shareholders, or 6.25% of net income for the year, after deduction of the legal reserve, and will have as computation basis for measurement of goals achievement, the percentage of completion of the investment program approved by the Company for the year, the number of connections per employee and operating profit.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 15. Employees' Bonus (Continued)

However, the 2008/2010 Collective Agreement introduced changes to the previous regulation, which was approved on the meeting of July 25, 2008, establishing that the computed amount shall be linearly distributed among all employees, in equal two installments, the first one payable in April and the second one in October.

At December 31, 2008, the Company provided R\$24,612 (R\$ 20,821 in 2007), to honor this commitment.

### 16. Technical Cooperation Agreements

Refers mainly to funds received, after July 2006, related to the agreements entered into by the Company with the State Regional Development and Urban Policy Department, the main purpose of which is the technical and financial cooperation for the expansion of the public sanitation system in the regions of Vale do Jequitinhonha, Estrada Real (in Ouro Preto) and another interior regions of the State of Minas Gerais.

The amounts received from agreements are applied on specified works on the terms under the agreements themselves, and their amounts, when received, are recognized in the Technical cooperation agreement accounts under Current liabilities, and when used, in Current assets pending matching of accounts.

The amounts were following:

	Company					
	2008			2007		
	State	Other	Total	State	Other	Total
Assets	157,971	18,004	175,975	96,482	8,543	105,025
Liabilities	171,412	12,083	183,495	132,324	10,427	142,751
Net	13,441	5,921	7,520	35,842	1,884	37,726

	Consolidated					
	2008			2007		
	State	Other	Total	State	Other	Total
Assets	175,543	18,004	193,547	96,482	8,543	105,025
Liabilities	195,434	12,083	207,517	132,324	10,427	142,751
Net	19,891	5,921	13,970	35,842	1,884	37,726

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

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### 17. Pension Plan

On December 7, 1982, the Company signed an agreement and became sponsor of Fundação de Seguridade Social de Minas Gerais - FUNDASEMG, whose rights and obligations were later assumed by PREVIMINAS, which was created with the purpose of supplementing the retirement of participating employees, ensuring the maintenance of their benefit plan in said Foundation. The Company's contribution is equal to the one made by participating employees, pursuant to Supplementary Laws No. 108 and 109, of May 29, 2001 and previously prepared actuarial reports.

The benefits offered in the plan are: supplementary retirement payouts (due either to disability, age or years of contribution and special), as well as sickness benefits, pension, imprisonment benefit and death benefit.

At December 31, 2008 based on an actuarial report prepared by an independent actuary, the Company recognized in its financial statements a net actuarial liability of R\$184,799, in accordance with IBRACON NPC 26, approved by CVM Rule No. 371 of 13 December 2000, which represented the difference between the present value of the obligations of the Company for participating employees, retirees, pensioners and the reserve assets. According to these calculations, COPASA should also record liabilities of R\$ 89,592 (R\$ 239,052 in 2007) in future years, corresponding to the portion of actuarial costs deferred by the average remaining years of service for employees participating in the plan.

The calculations are as follows:

#### 1. Accounting policy adopted by the Company to recognize actuarial gains and losses

The amount of the recognition of actuarial gains or losses will correspond to the portion of gain or loss that exceeds whichever higher between 10% of the Present Value of the Actuarial Liability or 10% of the Fair Value of Plan Assets, amortized by the average future service of the plan participants, as stated on item 53 of the pronouncement.

#### 2. Reconciliation of assets and liabilities

	12/31/2008	12/31/2007
2.1 Present value of actuarial liabilities	<b>972,586</b>	1,032,073
2.2 Fair value of the plan assets	<b>(698,195)</b>	(633,869)
2.3 Present value of the obligations in excess fair value of the plan assets (2.1 + 2.2)	<b>274,391</b>	398,204
2.4 Adjustments for allowed deferment		
a) Actuarial (gain) or loss not recognized	<b>89,592</b>	239,052
<b>2.5 Net liabilities to be recognized in the balance sheet (2.3 - 2.4 a)</b>	<b>184,799</b>	159,152

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

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### 17. Pension Plan (Continued)

#### 3. Terms for recognition starting 12/31 (in years)

3.1 Actuarial (gain) or loss not recognized	14.50	14.47
3.2 Cost last service not recognized	N/A	N/A
3.3 Increase in liabilities due to the adoption of the unknown pronouncement	N/A	N/A

	12/31/2008	12/31/2007
<b>4. Changes in net actuarial liabilities / (assets)</b>		
4.1 Net Actuarial liabilities / (assets), at the beginning of the year	159,152	141,190
4.2 Expense (income) recognized in prior-year income statement	59,131	43,907
4.3 Contributions paid by the sponsoring employer during the year	33,484	25,945
<b>4.4 Actuarial liabilities / (assets), net at the end of the year (4.1 + 4.2 - 4.3)</b>	<b>184,799</b>	159,152

#### 5. Reconciliation fair value assets

5.1 Fair value of assets at the beginning of year	633,869	529,854
5.2 Benefits paid	28,366	26,067
5.3 Contributions from participants in the year	22,810	16,146
5.4 Contributions paid by the sponsoring employer during the year	33,484	25,945
5.5 Net asset earnings (5.6 - (5.1 - 5.2 + 5.3 + 5.4))	36,398	87,991
<b>5.6 Fair value assets at the end of the year</b>	<b>698,195</b>	633,869

#### 6. Reconciliation present value obligations

6.1 Value of obligations at the beginning of the year	1,032,073	846,834
6.2 Cost of gross current service (Interest included)	35,530	28,894
6.3 Interest on actuarial liabilities	104,310	86,716
6.4 Benefits paid during the year	28,366	26,067
6.5 Impact from change in actuarial assumptions	(183,657)	-
6.6 Obligations – (G)/P (6.5 - (6.1 + 6.2 + 6.3 - 6.4))	12,696	95,696
<b>6.7 Total obligations at year end</b>	<b>972,586</b>	1,032,073

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 17. Pension Plan (Continued)

#### 7. Calculation of (gain) / loss

7.1 Amount (gain) / loss at the beginning of the year	<b>239,052</b>	175,790
7.2 Amortization of the year	<b>9,391</b>	5,521
7.3 (Gain) /loss – actuarial liabilities	<b>(170,960)</b>	95,696
7.4 (Gain) / loss – plan assets	<b>35,900</b>	(24,605)
7.5 (Gain) / loss – contribution employee	<b>(5,009)</b>	(2,308)
<b>7.6 (Gain) / loss at the end of the year</b>	<b>89,592</b>	239,052
7.7 Calculation of the “corridor” (10% of whichever higher between equity or value of the obligation)	<b>97,259</b>	103,207
7.8 Amortizable portion (0; {7.6} - 7.7)	-	135,844
7.9 Amortization amount (7.8 / 3.10)	-	9,391

#### 8. Next year's expected asset earnings

8.1 Fair value of the plan assets (at 12/31)	<b>698,195</b>	633,869
8.2 Next year's expected contribution from participants	<b>28,923</b>	17,801
8.3 Next year's expected contribution from sponsoring employer	<b>40,361</b>	28,605
8.4 Benefits expected for next year	<b>38,029</b>	28,834
<b>8.5 Expected asset earnings (8.1 * rate + (8.2 +8.3 - 8.4) * rate^1/2)</b>	<b>100,319</b>	72,299

#### 9. Interest on actuarial liabilities expected for next year

9.1 Present value of the actuarial liabilities at 12/31	<b>972,586</b>	1,032,073
9.2 Expected benefit payouts for next year	<b>38,029</b>	28,834
<b>9.3 Interest on actuarial liabilities (9.1 * interest - 9.2 * interest^1/2)</b>	<b>113,603</b>	104,310

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 17. Pension Plan (Continued)

<b>10. Expected expenses (income) will be registered in financial statements of the year</b>	<b>2009</b>	<b>2008</b>
10.1 Cost of current services (interest included)	<b>34,641</b>	35,530
10.2 Interest actuarial liabilities	<b>113,602</b>	104,310
10.3 Expected return on plan assets	<b>100,319</b>	72,299
10.4 Amortization cost		
a) Actuarial (gain) or loss not recognized	-	9,391
10.5 Total gross expenditure (revenue) to be recognized (10.1 + 10.2 - 10.3 + 10.4a)	<b>47,924</b>	76,932
10.6 Expected contributions from participants for next year	<b>28,923</b>	17,801
<b>10.7 Total net expenditure (income) to be recognized (10.5 - 10.6)</b>	<b>19,001</b>	59,131

**Note: Administrative expenses expected for next year not included**

<b>11. Summarized master data of participants assessed (in R\$)</b>	<b>12/31/2008</b>	<b>12/31/2007</b>
Active + related participants		
Number	<b>10,490</b>	10,615
Average age (years)	<b>42.63</b>	41.63
Average working time (years)	<b>15.31</b>	14.29
Average future working time (years)	<b>14.50</b>	14.47
Average monthly wage	<b>2,231</b>	2,032
Annual payroll (13x)	<b>304,211,469</b>	280,463,483
Retired/beneficiary participants receiving death benefits		
Number	<b>2,244</b>	2,082
Average age (years)	<b>59</b>	58
Average monthly benefit	<b>981</b>	893
Annual benefits payroll (13x)	<b>26,623,566</b>	24,160,593
Effective income (present year)	<b>56,294,016</b>	42,091,438
Employees' contribution	<b>22,809,611</b>	16,146,058
Employer's contribution	<b>33,484,405</b>	25,945,379
Effective expenses (current year)	<b>28,366,463</b>	26,066,991

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 17. Pension Plan (Continued)

#### 12. Actuarial assumptions used in the calculations

Nominal discount rate for the actuarial liabilities:	<b>11.82%</b>	10.25%
Nominal earnings rate expected for the plan assets	<b>13.94%</b>	11.25%
Estimated growth rate of nominal wage:	<b>6.40%</b>	6.30%
Estimated nominal rate of increase of benefits:	<b>4.50%</b>	4.50%
Estimated inflation for the long term (basis for determination of nominal rates above)	<b>4.50%</b>	4.50%

	<u>12/31/2008</u>	<u>12/31/2007</u>
Actuarial table - general mortality:	AT-2000 separate by gender	AT-2000 separate by gender
Actuarial table - disability:	Zimmermann	Wyatt 1985 Disability Class 1 specific by gender
Expected turnover rate:	4.5% / (service time + 1)	T1 Withdrawal Table
Probability of retirement:	100% at the first eligibility for retirement.	100% at the first eligibility for retirement.
Actuarial rate of mortality / disability Morbidity rate:	RP-2000 Disabled Stea Experience -	RP-2000 Disabled Stea Experience -

#### 13. Additional information

- 1) The plan assets are stated as at December 31, 2008.
- 2) The individual master data used are of July 31, 2008, projected for December 31, 2008.
- 3) The master data statistics presented consider the family group of beneficiaries as a single benefit.

The Company's actuarial assumptions are reviewed regularly and may differ significantly from current results due to changes in market and economic conditions, regulatory events, court decisions, increase or decrease on termination rates and on expected participants' lifespan. Such differences may significantly impact Company's expenses recorded under the pension plan caption.

Of the total of R\$194,748 of net actuarial liabilities recognized by COPASA, adjusted until December 31, 2008, R\$ 6,464 (this amount includes R\$ 490 of short term interest ) and R\$ 94,805 are recorded in Previminas / special contribution account under current and noncurrent liabilities, respectively, on top of the provision recorded in the Previminas / net actuarial liabilities account, recorded in long term liabilities in the amount of R\$ 84,021, consisting of the amounts of R\$ 8,569, recorded at December 31, 2007, R\$ 51,319 (R\$ 33,165 posted against prior-year adjustments, and R\$ 18,154 posted to income for year 2007) and R\$ 24,133 posted to income for year 2008. The Company has recorded in other obligations due the amount of R\$ 9,458, referring to regular contributions.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 18. Other Payables

	Company		Consolidated	
	2008	2007	2008	2007
Current				
Electric power (*)	33,165	33,134	33,165	33,134
Municipal governments (**)	11,203	8,255	11,203	8,255
Other	3,872	4,274	3,971	4,287
Total Current	48,240	45,663	48,339	45,676
Noncurrent				
Electric power (*)	51,109	59,723	51,109	59,723
Construction work (***)	37,077	40,574	37,077	40,574
Deferred revenue	6,249	-	6,249	-
Provision loss	3,391	-	-	-
ITCD	5	-	5	-
Total Noncurrent	97,831	100,297	94,435	100,297

(\*) Refers to the installment payment of the debt arising from past-due bills, in conformity with the agreement and acknowledgement of debt formalized with Companhia Energética de Minas Gerais - CEMIG, through which the Company recognized the debt of R\$78,495, which was agreed to be divided into 96 monthly and consecutive installments until September 2012, restated based on the IGP-M, plus interest of 0.5% per month. As of September 30, 2008, there are 45 installments to be paid.

(\*\*) Part of this debt refers to offset of accounts and obligation assumed in renovation of concession agreements with several municipalities.

(\*\*\*) In December 2003, the Company received funds amounting to R\$ 12,636 transferred from the National Water Agency - ANA, in return for the Federal Government participation in the construction of the Waterwaste Treatment Plant of Ribeirão Arrudas, in the City of Belo Horizonte. In accordance with clause 6 of contract 012/2003 signed with the National Water Agency - ANA on November 21, 2003, the payment for treated waterwaste will be made to the Company in two quarterly consecutive installments after certification of the goals of reduction of pollutant loads to be issued by that agency. The term of contract originally scheduled for December 31, 2007 was postponed to July 1<sup>st</sup>, 2013, changing the date of the request for issuance of certification by the Company to July 1<sup>st</sup>, 2009, as provided for in the 3<sup>rd</sup> Addendum to the contract signed on August 15, 2007. As the Company already has, since November 2008, studies that prove the achievement of 1<sup>st</sup> stage of the goals, planned for July 2009, the right to 1 / 3 of the amount passed on by ANA was recognized, corresponding to R\$ 7,499, of which R\$ 1,250 was credited in financial income and R\$ 6,249 in deferred income. The amount adjusted through December 31, 2008 for this transfer is R\$ 22,498 (Note 7) (R\$ 21,783 in 2007).

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 18. Other Payables (Continued)

As of December 31, 2007, the Company received additional R\$18,720 of a new transfer of funds from ANA (National Water Agency), as a counterpart to the participation of the Federal Government in the construction of the wastewater treatment station of “Betim Central”, in the municipality of Betim. Under clause 6 of the agreement 039/2007, signed with ANA on December 11, 2007, settlement of sanitary wastewater will be made in 12 quarterly, successive installments, contingent to the certification of the limit reduction of pollution emissions to be established by ANA. The request to issue the certificate should be made by the Company until June 30, 2009, as provisioned in the mentioned agreement. The updated balance of the funds transferred, as of December 31, 2008, is R\$20,640 (Note 7) (R\$ 18,791 in 2007).

### 19. Shareholders' Equity and Dividends

#### (a) Capital

	<u>Company</u>	
	<u>2008</u>	<u>2007</u>
Authorized capital	<b>3,000,000</b>	3,000,000
Unsubscribed capital	<b>(367,735)</b>	(367,758)
Subscribed and paid-up capital	<b>2,632,265</b>	2,632,242

Subscribed and paid-up capital is represented by 114,795,524 common shares, as follows:

Shareholders	<u>Company</u>			
	<u>12/31/2008</u>		<u>12/31/2007</u>	
	Amounted	%	Amounted	%
State of Minas Gerais	61,188,867	53.13	61,188,867	53.13
Other	53,606,657	46.55	53,605,905	46.55
Subtotal	<b>114,795,524</b>	<b>99.68</b>	114,794,772	99.68
Treasury Shares	370,176	0.32	370,176	0.32
Total	<b>115,165,700</b>	<b>100.00</b>	115,164,948	100.00

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 19. Shareholders' Equity and Dividends (Continued)

#### (a) Capital

As of December 2007, the Municipal Government of Belo Horizonte and CODEMIG held 9,67% and 6,64% interest in the Company, respectively. On May 27, 2008, after exercising of the supplementary shares by the Global Coordinator, the Announcement of the Closing of Public Offer for Secondary Distribution of Common Registered Book-entry Shares with no par value, free and clear from any lien or encumbrance, issued by Companhia de Saneamento de Minas Gerais – COPASA MG and held by the shareholders CODEMIG and Belo Horizonte Municipality, through which 18,776,521 shares were distributed, of which 7,641,537 are held by CODEMIG and 11,134,984 by the Belo Horizonte Municipality, at the unit price of R\$24.50, totaling R\$460,025. With this, the Company's free float increased to 46.55%.

At May 05, 2008, Mackenzie Financial Corporation, in the capacity of mutual fund administrator advisor and/or sub-advisor, informed us that participation of such funds in the total Company capital reached 5.02%.

#### (b) Treasury Shares

The Company holds 370,176 own shares in treasury, in the amount of R\$9,190, mainly acquired from the shareholder State of Minas Gerais, through transactions related to settlement of debts originated from the provision of water and wastewater services and technical cooperation agreements.

#### (c) Profit retention

Management approved a proposal for a profit retention of R\$270,281, for future investments by the Company, in line with the "action plan" approved by the Board of Directors, to be performed in the long term.

#### (d) Tax Incentive Reserve

It consists of the allocation of tax incentives deriving from government grants and donations appropriated to income for the year in accordance with Article 195-A of the Corporation Law, included by Law No. 11638/07, effective from January 1, 2008.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 19. Shareholders' Equity and Dividends (Continued)

#### (d) Tax Incentive Reserve (Continued)

In year 2008, R\$1,250 was allocated to income relating to the incentive for the fulfillment of the 1<sup>st</sup> stage of the goal of reduction of pollutant loads at Betim Waterwaste Treatment Plant, scheduled for July 2009 (Note 18). This incentive was granted by the Water National Agency – ANA with funds from the National Program of Water Basins Depollution (PRODES).

#### (e) Shareholders' remuneration

Under the Bylaws, shareholders of any type are entitled to a mandatory minimum dividend of 25% of net income, as adjusted in accordance with corporate legislation. The approved dividends bear no interest and the amounts not claimed within 3 years from the date of the Shareholders' General Meeting that approved them become time-barred in favor of the Company.

In December 2008 and 2007, mandatory minimum dividends are as follows:

	<u>2008</u>	<u>2007</u>
Income for the year	<b>407,781</b>	329,323
Legal reserve - (5%)	<b>(20,389)</b>	(16,466)
Net income	<b>387,392</b>	312,857
Minimum dividend – 25%	<b>96,848</b>	78,214

The Company's Board of Directors proposed to the Shareholders' General Meeting that interest on equity allocated to dividends should be credited in the amount of R\$ 115,861 (R\$1.01 per share) net of withholding income tax in the amount of R\$6,724. In 2007 the amount was R\$75,609, net of withholding income tax in the amount of R\$3,599.

As provided for in Article 9 of Law No. 9249/95, and observing the Long Term Interest Rate – TJLP, interest was recorded as financial expenses deductible for the calculation of income tax and social contribution, generating a tax benefit of R\$ 39,393. For corporate purposes, the interest on equity is being disclosed as a debit to retained earnings, under shareholders' equity.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 19. Shareholders' Equity and Dividends (Continued)

#### (e) Shareholders' remuneration (Continued)

The breakdown of the balance of interest on equity at December 31, 2008 and 2007 is as follows:

	<b>2008</b>	<b>2007</b>
Interest on equity	<b>115,861</b>	79,208
Withholding income tax in advance	<b>(4,880)</b>	(2,121)
Remaining balance for years 2006 to 2008	<b>27</b>	48
Balance of interest on equity in current liabilities	<b>111,008</b>	77,135

#### (f) Prior-year adjustments

In year 2007, the Company recognized prior-year adjustments relating to adjustments to actuarial liabilities for the year ended December, 31, 2006, based on an actuarial report issued by an independent actuary, and adjustments from write-offs against result (losses), held wrongly at the time, concerning monetary restatements and interest over water and sewer bills, as detailed below:

- 1) Actuarial liabilities for the year ended December 31, 2006 were adjusted since the method of calculation used in the actuarial report preparation was questioned by the Company's independent auditors. That methodology used the actual earnings from the plan assets at those periods, limited to the effective performance of the investment plan assets instead of using the actuarial assumptions previously set. This procedure resulted in the anticipation of actuarial gains on results of 2006 and 2005 and deferral of actuarial losses for the future, with consequent decrease in actuarial liabilities, which is not accepted by the accounting practices adopted in Brazil.
- 2) From year 2003 onwards, the Company introduced a standard for recognition of monetary restatement and implementation of interest on debt installments, where such financial revenues are recognized by the time of the invoices receipt (cash basis), since there is default and no real guarantee of receipt, which occurs in almost all of the installment payment processes. However, when billed at the time, these amounts incorporated, by mistake, the Company's accounts receivable, but not the financial result. Accordingly, by the time the invoices are written off, the monetary restatement and interest amounts were written off without having been previously obtained.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 19. Shareholders' Equity and Dividends (Continued)

(f) Prior-year adjustments (Continued)

Therefore, in compliance with CVM Rule No. 506 of June 19, 2006, the Company shows below the effects of the adjustments described in items “1” and “2” above, retroactively to January 1, 2007:

	<b>Balance at 1.1.2007 before the adjustments</b>	<b>Adjustments</b>	<b>Adjusted Balance at 1.1.2007</b>
	<b>D/(C)</b>	<b>D/(C)</b>	<b>D/(C)</b>
Item 1			
Complementary retirement plan - long term liability	103,292	33,165	136,457
Expense on provision for net actuarial liabilities	(8,569)	(33,165)	(41,734)
Item 2			
Reversal of incorrect write-off of invoices	(50,051)	14,372	(35,679)
Credit on trade accounts receivable	257,783	14,372	272,245
Equity - profit reserve	577,406	(18,793)	558,613

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 20. Income and Social Contribution Taxes

#### (a) Income Tax

The amount recorded as income tax expenses in the Financial Statements is calculated as follows:

	<u>Company</u>	
	<u>2008</u>	<u>2007</u>
Income of 2008 before taxes	<b>502,135</b>	412,978
Employees' Bonus	<b>(24,612)</b>	(20,821)
	<b>477,523</b>	392,157
<u>Additions</u>		
Realization of the special monetary adjustment reserve	<b>12,665</b>	14,098
Donations/grants recorded in shareholders' equity	<b>25,964</b>	22,774
Revenue previous years	-	14,372
Temporary nondeductible provisions	<b>89,610</b>	171,818
Deferred exchange rate variation expenses related to loss on unsettled transactions	<b>27,728</b>	4,823
Equity Result	<b>18,701</b>	-
Other	<b>4,230</b>	3,844
	<b>178,898</b>	231,729
<u>Deductions</u>		
Nondeductible provisions - write-off of settled lawsuits	<b>5,328</b>	4,891
Reversal of nondeductible provisions	<b>10,222</b>	1,583
Reversal of unchargeable accounts	<b>26,522</b>	27,256
Other	<b>20,593</b>	17,292
	<b>62,665</b>	51,022
Tax basis	<b>593,756</b>	572,864
Rate (25%)	<b>148,439</b>	143,216
Complementary income provision years 2005/2006	-	13
Deferred Income Tax	<b>(11,482)</b>	(26,836)
Total accrued	<b>136,957</b>	116,393

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 20. Income and Social Contribution Taxes (Continued)

(b) Social contribution

The amount recorded as social contribution expenses in the Financial Statements is calculated as follows

	<u>Company</u>	
	<u>2008</u>	<u>2007</u>
Income of 2008 before taxes	<b>502,135</b>	412,978
Employees' Bonus	<b>(24,612)</b>	(20,821)
	<b>477,523</b>	392,157
<u>Additions</u>		
Realization of the special monetary restatement reserve	<b>12,665</b>	14,098
Revenue previous years	-	14,372
Temporary nondeductible provisions	<b>89,610</b>	171,818
Deferred exchange rate variation expenses, related to loss on unsettled transactions	<b>27,728</b>	4,823
Equity Result	<b>18,701</b>	-
Other	<b>3,556</b>	3,206
	<b>152,260</b>	208,317
<u>Deductions</u>		
Nondeductible provisions - write-off of settled lawsuits	<b>5,328</b>	4,891
Reversal of nondeductible provisions	<b>36,744</b>	28,839
Other	<b>1,250</b>	286
	<b>43,322</b>	34,016
Subtotal	<b>586,461</b>	566,458
Offset of tax loss	<b>(4,183)</b>	(169,937)
Tax basis	<b>582,278</b>	396,521
Rate (9%)	<b>52,405</b>	35,687
Deferred Social Contribution	<b>(3,758)</b>	(10,038)
Total accrued	<b>48,647</b>	25,649

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 20. Income and Social Contribution Taxes (Continued)

(c) Deferred income and social contribution taxes

In compliance with Executive Act No. 2,158/99, since 2003 the Company determines the exchange variation for tax purposes on a cash basis. In light of the above, the excess of exchange variation recorded on an accrual basis accumulates a balance, as of December 30, 2008, of R\$18,903 related to credits arising from deferred exchange gains. The Company accrues in long-term liabilities income tax at the rate of 25% and social contribution tax at the rate of 9% of said balance.

As of December 31, 2008, the Company has also tax credits of income tax, accrued at the rate of 25%, and social contribution at the rate of 9%, as follows:

	<b>Company</b>			
	<b>Assets</b>		<b>Liabilities</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Basis accrual				
1. Income from deferred exchange variation related to gains on unsettled transactions	-	-	<b>18,903</b>	46,631
2. Negative basis social contribution	-	4,183		-
3. Allowance for doubtful account	<b>25,878</b>	15,067	-	-
4. Reserves for contingencies	<b>31,217</b>	34,142	-	-
5. Tax provision – IPI premium-credit	<b>68,102</b>	64,604	-	-
6. Tax provision - PASEP/COFINS	<b>43,352</b>	40,163	-	-
7. Provision for loss – investments	<b>959</b>	-	-	-
8. Provision for loss - inventory	<b>2,671</b>	-	-	-
<b>Total</b>	<b>172,179</b>	158,159	<b>18,903</b>	46,631
Deferred income and social contribution taxes:				
On debits				
Income tax (18.903 x 25%)	-	-	<b>4,726</b>	11,658
Social contribution tax (18.903 x 9%)	-	-	<b>1,701</b>	4,197
On credits				
Income tax (172.179 x 25%)	<b>43,045</b>	38,494	-	-
Social contribution tax (172.179 x 9%)	<b>15,496</b>	14,234	-	-
<b>Total</b>	<b>58,541</b>	52,728	<b>6,427</b>	15,855
Short term	<b>(1,320)</b>	(376)	-	-
Long term	<b>57,221</b>	52,352	<b>6,427</b>	15,855

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 20. Income and Social Contribution Taxes (Continued)

#### (c) Deferred income and social contribution taxes (Continued)

In meetings convened for March 26 and 27, 2009, a technical study will be submitted to approval of the Supervisory Board and the Board of Directors, respectively. Prepared by the Finance Board and Investor Relations, this study addresses the projection of future profitability adjusted to present value, which demonstrates the ability to have the Company's deferred tax assets realized over a maximum 10-year period, as defined in CVM Instruction No. 371.

According to the aforementioned technical study, the future taxable income allows realization of deferred tax assets existing at December 31, 2008, as estimated below:

<b>Parent Company</b>	
Years	Expected Realization - Company
2009	1,320
2010	13,282
2011	18,533
2012	5,633
2013	8,833
2014 to 2018	10,940
Total	<u>58,541</u>

In case relevant events occur that modify these projections, these will be revised on a timely basis.

The realization of tax credits related to reserve for contingencies was allocated to the last years of the projections due to the difficulty in anticipating the outcome of these litigations.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

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### 21. Financial Income, (Expenses)

The change in financial income (expenses) in the 2008 year in relation to the 2007 year as follows:

Description	Company		
	01/01/2008 to 31/12/2008	01/01/2007 to 31/12/2007	Variation
Financial income	185,263	154,060	31,203
Income of exchange and monetary variation	34,847	37,818	(2,971)
Income – sub total	220,110	191,878	28,232
Financial expenses	(259,578)	(184,857)	(74,721)
Expenses of exchange and monetary variation	(58,894)	(32,205)	(26,689)
Expenses – sub total	(318,472)	(217,062)	(101,410)
Result	(98,362)	(25,184)	(73,178)

### 22. Provision of Public Water and Waterwaste Services in Belo Horizonte

On November 13, 2002, the State and the Municipality signed a cooperation agreement to ensure that the Company will continue to provide water supply and sanitary waterwaste services in Belo Horizonte for another 30 years.

On April 30, 2004, the First Amendment to this agreement was signed. The main items of the cooperation agreement, consolidated by the amendment, are as follows:

- 1) All water and sanitary waterwaste piping own by the Municipality, existing on May 23, 2000, was transferred, upon sale, to the Company's assets after they have been duly evaluated, upon payment by means of the Municipality's ownership interest in the Company's capital, according to the provisions of Municipal Law No. 8,754, of January 2004, 16. The purchase of said assets was approved in the Extraordinary Shareholders' Meeting held on April 30, 2004 and was performed in the amount of R\$280,220, according to an appraisal report prepared by a specialized company.

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **22. Provision of Public Water and Waterwaste Services in Belo Horizonte (Continued)**

- 2) After the end of the term of this agreement the assets sold to the Company and merged into its assets will be reversed to the Municipality's assets upon repurchase after valuation at that time.
- 3) The assets arising from investments performed by the Company, beginning May 24, 2000, through the end of the effective period of this agreement, will also be merged into the Municipality's assets and reimbursed to the Company after valuation at that time.
- 4) The Municipality declared and recognized the debt under its responsibility in the total amount of R\$70,662, related to November 30, 2002, corresponding to invoices of the water and waterwaste services issued through November 2002, still pending payment. This debt will be paid in 335 monthly, consecutive installments, each equivalent to 202,838.77m<sup>3</sup> of water, beginning January 2005. The amount of each installment in local currency will be calculated by multiplying the volume to be settled by the average tariff billed per m<sup>3</sup> in Belo Horizonte, plus simple interest of 0.5% per month, beginning November 2002. In December 31, 2008 the total amount to receivable registered were R\$ 210,811 (R\$ 8,845 in current assets and R\$ 201,966 in non current assets) (Note 5), R\$ 193,360 in December 31, 2007 ( R\$ 7,786 in current assets and R\$ 185,574 in non current assets).
- 5) The Company will assume the costs of the DRENURBS (Environmental Rehabilitation and Sanitation Program for Valley Floors and Natural Bed Streams of Belo Horizonte) up to the amount of R\$170,000. The Company and the Municipality are negotiating the installment adjustment index and a new date to begin payments, which, according to contract, should have begun in January 2008, in monthly installments over a 24-year period. The amounts will be monetarily restated according to the index to be established by the parties before the beginning of payments.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

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### 23. Financial Instruments

#### (a) Fair value of financial instruments

The fair values of the Company's financial instruments are as follows:

	<b>Company</b>	
	<b>12/31/2008</b>	
	Carrying value	Fair value
<b>Assets:</b>		
Temporary cash investments (Note 4)	754,204	755,513
Collateral for financing (Note 11 and 12) and restricted investments (Note 7)	125,223	125,223
<b>Total</b>	<b>879,427</b>	<b>880,736</b>
<b>Liabilities:</b>		
Loans and financing (Note 11)	983,528	1,108,537
Non convertible debentures (Note 12)	517,877	537,465
Convertible debentures (Note 12)	142,071	144,707
<b>Total</b>	<b>1,643,476</b>	<b>1,790,709</b>

The market values of liabilities are calculated through the projection of the balance due as adjusted by the contractually established rate over the months remaining to pay. The amount identified retroacts to the current period using the market rates indicated below:

	Contractual rate	Period (months)	Market rate	Notes
CEF/FGTS	10.24%	225	7.50%	Federal Savings and Loans Bank (CEF) rate at Dec/08
State Government/BDMG	8.85%	75	8.85%	Same rate once there is no similar tax
Brazilian Treasury	5.38%	61	7.50%	Same as CEF rate as there is no similar tax
BNDES/BNE	7.81%	123	7.77%	National Bank for Economic and Social Development (BNDES) rate at Dec/08
Banco do Brasil (Bank of Brazil)	4.77%	12	7.50%	Same as CEF rate as there is no similar tax
União Federal (Federal Union)	6.48%	192	7.50%	Same as CEF rate as there is no similar tax
Debentures	9.20%	67	7.77%	BNDES rate at Dec/08
Debentures – shares	8.55%	60	7.77%	BNDES rate at Dec/08

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 23. Financial Instruments (Continued)

#### (a) Fair value of financial instruments (Continued)

As of December 31, 2008, the Company's indebtedness was subject to the following:

Index	Related indebtedness (%)
TR	51.5
IGP-M	1.8
US dollar	5.7
TJLP	41.0

The Company does not have swap contracts for indexes, interest and/or indicators, or any other financial instruments that may be classified as derivatives.

#### (b) Concentration of credit risk

A significant portion of sales is distributed among a large number of customers. In the case of these customers, the credit risk is minimal due to the large portfolio and the control procedures, which monitor this risk.

Doubtful accounts are adequately covered by an allowance for possible losses on their realization.

#### (c) Foreign currency

Transactions in foreign currency consist of loans financings for specific work to improve and expand water supply and wastewater collection and treatment systems. The Company does not hedge exchange risks.

The Company's exposure in foreign currency, represented by its US dollar-denominated debt, amounts to R\$ 94,050 as of December 31, 2008 (R\$ 80,461 in December 31, 2007), approximately 5.7% of its total debt (approximately 5.5% in December 31, 2007). As of December 31, 2008, the Company maintains collateral of R\$35,557 (R\$21,152 in December 31, 2007) as guarantee of part of foreign currency-denominated financing (Note 11).

#### (d) Interest rate risk

The Company is exposed to the elevation of the international interest rates, with the impact to loans and financings in foreign currency with floating interest rates (mostly referred to the contracts linked to the Federal Union – Bonds).

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 23. Financial Instruments (Continued)

#### (d) Interest rate risk (Continued)

The increase of national interest rates was partially reduced, due to the indexation of the assets to the interest rates as follows:

Company's exposure to national interest taxes	Company	
	2008	2007
Assets:		
Investments (Note 4)	754,204	791,223
Liabilities:		
Loans and financing and debentures (notes 11 and 12)	1,549,426	1,378,624
Obligations than assets	795,222	587,401

#### (e) Sensitivity Analysis

▶ Credit concentration risk

The Company's financial instruments that are exposed to credit concentration risk are represented by loans indexed to the exchange rate in the amount of R\$ 94,050, which risk in an unexpected significant US dollar appreciation will be at levels compatible with its existing financial resources, as mentioned in Note 4.

▶ Fair market value

At December 31, 2008, the Company has R\$ 754,204 invested in Bank Deposit Certificates - CDBs. For these investments, fair value tests were performed, resulting in an immaterial difference.

▶ Nonderivative financial instruments

At December 31, 2008 and 2007 the Company has only nonderivative financial instruments, duly recognized in the financial statements, such as: Cash and cash equivalents (Note 4), Marketable securities (Note 4), Loans and financing (Note 11) and Debentures (Note 12).

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 24. Commitments (Unaudited)

COPASA signed agreements to build new systems whereby liabilities are recorded as services are provided. Following are the main agreements with contractors (unaudited):

Contractor	Amount	Signature Date	Term in days (1)
Comim Construtora Ltda.	118,956	11/25/2008	720
Saint Gobain Canalização Ltda.	49,570	12/18/2008	365
Construtora EMCCAMP Ltda.	41,330	12/30/2008	540
Comim Construtora Ltda.	40,951	11/28/2008	720
SONEL Soc. Nacional Eletric. Hidr. Ltda.	30,851	12/29/2008	720
Socienge Construções Ltda.	18,811	12/29/2008	900
Construtora Integral Ltda.	17,090	12/29/2008	900
Sanesc Saneamento e Constr. Ltda.	16,149	12/05/2008	540
Engesolo Engenharia Ltda.	12,792	07/22/2008	1.080
Tom Comunicação Ltda.	12,000	12/15/2008	360

(1) Counted from the date established in the first service order.

Upon renewal or revision of certain concession agreements, the Company assumed commitments to financially participate in works related to sanitary wastewater services and to valley floor treatment, to be performed by the municipal governments. Of the executed work, those pertaining to public places (sewerage of streamlets, sanitation avenues) are treated as intangible assets, under the title concession right, and amortized over the concession period. The wastewater interceptors are incorporated into the Company's fixed assets.

The main amounts refer to the following municipalities:

Municipalities	Amount		% Realization
	Committed	Amount Realized	
Betim	80,286	73,521	91.57
Belo Horizonte (note 22)	170,000	-	-
Contagem	81,363	63,025	77.46
Montes Claros	121,941	55,873	45.82
Ribeirão das Neves	86,411	70,319	81.38
Teófilo Otoni	54,360	-	-

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 25. Related-Party Transactions

In addition to the balance payable to CEMIG, as mentioned in Note 18, and the technical cooperation agreements, in Note 18, the other transactions with related parties are basically those conducted with the State of Minas Gerais and the Municipality of Belo Horizonte. The most significant balances and transactions are as follows:

	Company				
	12/31/2008				
	Subsidiaries			Other	
	Águas Minerais	Copanor	Serviços Irrigação	Estado - MG	PBH
Assets					
Current					
Trade account receivables					
- Billed amounts	-	-	-	7,008	2,741
- Unbilled amounts	-	-	-	-	8,845
Noncurrent					
Long-term assets					
Trade accounts receivable – unbilled amounts	-	-	-	-	201,966
- Loans	16,464	8,817	1,861	-	-
Investments	13,222	1	278	-	-
<b>Total assets</b>	<b>29,686</b>	<b>8,818</b>	<b>2,139</b>	<b>7,008</b>	<b>213,552</b>
Liabilities					
Current					
Interest on equity	-	-	-	61,757	-
Advance for future capital increase	-	-	-	-	8,797
Other payables					
- Municipal governments - tariff pass-throughs	-	-	-	-	4,519
- Agreements (note 16)	-	-	-	13,441	-
<b>Total liabilities</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>75,198</b>	<b>13,316</b>
Transactions					
Income from water supply and wastewater services	-	-	-	76,955	25,441
Cost of services	-	-	-	-	(52,212)
Financial income - interest	-	-	-	-	13,045
Income from monetary variations	815	523	134	-	12,625

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 25. Related-Party Transactions (Continued)

	Company				
	31/12/2007				
	Subsidiaries		Other		
	Águas Minerais	Coponor	SUDECAP	Estado - MG	PBH
<b>Assets</b>					
Current					
Trade account receivables					
- Billed amounts	-	-	-	5,497	2,395
- Unbilled amounts	-	-	-	-	7,786
Noncurrent					
Long-term assets					
Trade accounts receivable – unbilled amounts	-	-	-	-	185,574
Loans	1,691	1,233	-	-	-
Investments	13,929	1	-	-	-
<b>Total assets</b>	<b>15,620</b>	<b>1,234</b>	<b>-</b>	<b>5,497</b>	<b>195,755</b>
<b>Liabilities</b>					
Current					
Suppliers	-	-	1,836	-	-
Interest on equity	-	-	-	47,493	7,683
Advance for future capital increase	-	-	-	-	8,797
Other payables					
Municipal governments - tariff pass-throughs	-	-	-	-	3,808
Agreements (note 22)	-	-	-	35,842	-
<b>Total liabilities</b>	<b>-</b>	<b>-</b>	<b>1,836</b>	<b>83,335</b>	<b>20,288</b>
<b>Transactions</b>					
Income from water supply and wastewater services	-	-	-	63,045	22,273
Cost of services	-	-	-	-	(46,777)
Financial income - interest	-	-	-	-	11,264
Income from monetary variations	-	-	-	-	11,713

Balances and transactions with related parties are conducted under prices and conditions considered by Management as compatible with those prevailing in the market, except concerning the form of financial settlement, which may occur through special negotiations (offset of accounts), as provided for and commented in notes 22.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 25. Related-Party Transactions (Continued)

Compensation paid to Company directors in year 2008 amounted to R\$ 2,720 (R\$ 2,585 in 2007).

- ▶ Cooperation agreement with the Belo Horizonte municipality

We signed a cooperation agreement with the Belo Horizonte municipality for the execution of water supplying and sanitation services, as mentioned in Note 22.

- ▶ Cooperation service agreement with the Belo Horizonte municipality

On February 7, 2006, the Company executed an operational agreement with the municipality of Belo Horizonte for the integration and convergence of planning, control and execution of undertakings of SUDECAP - Superintendência e Desenvolvimento de Capital (the local development agency), and other municipal agencies, and COPASA, for design of projects, performance of services involving the implementation and maintenance of infra-structure for water supply, sanitation, urbanizing, treatment of valley floors, pluvial draining and development of activities of sanitation education. services under COPASA's responsibility may be executed by SUDECAP, and vice versa. Annually, the parties will offset accounts relating to services completed, and any debit balances determined shall be adjusted and paid within thirty (30) days from the account offset. However, on March 20, 2007, an amendment to the service agreement was made to include a new paragraph in clause 5 under which any debits derived from social programs shall be paid 30 (thirty) days after measurement of the work performed is authorized, rather than an annual basis, at the time accounts are offset. In line with this amendment, the Company made payments to SUDECAP on May 8, 2007, of R\$1,257, and on November 9, 2007, of R\$1,816, and on March 10, 2008 of R\$1,836. These payments refer to works performed by SUDECAP relating to the construction of water pipelines and sanitation in Aglomerado da Serra in the Municipality of Belo Horizonte, which were incorporated into the Company's equity. On November 17, 2008, two account matchings were signed, resulting in the amounts of R\$ 51 and R\$ 315 received by COPASA on December 30, 2008 and credited to income for the year.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 25. Related-Party Transactions (Continued)

▶ Electric Power Supply

COPASA is one of the major consumers of electric power in the State of Minas Gerais, where electricity is supplied primarily by the Minas Gerais electric power utility company CEMIG, controlled by COPASA's controlling shareholder, i.e., the State of Minas Gerais. More than 300 electric power supply agreements were signed, each one for a specific consumer unit, as mentioned in Note 18.

▶ Financing agreements with BDMG

Varying financing agreements were made with BDMG during the normal course of business.

▶ Agreements with CODEMIG

As of March 22, 2006, the Company signed an intention protocol for technical cooperation and, as of June 30, 2006, a lease agreement was made to take over the rights related to mineral waters of Araxá, Cambuquira, Caxambu and Lambari, as mentioned in Note 1.

▶ Agreements with the Brazilian Government guaranteed by the State of Minas Gerais

The following agreements describe the guarantees given by the State of Minas Gerais for agreements between COPASA and the federal government:

Agreement of debt financing and refinancing as of July 11, 1990: as an alternative to pay the debt, the State of Minas Gerais assigned and transferred to the Federal Government credits related to deposits from its shares in the States Participation Fund, up to the limit sufficient to pay monthly installments and other monthly financial charges. As of December 31, 2008, the remaining debt is of R\$2,675, as mentioned in Note 11.

Debt acknowledgement and settlement agreement with the Federal Government as of January 20, 1994: in case of default, the Federal Government was authorized by the State of Minas Gerais to: (i) offset any amounts with own revenues and portions of certain taxes collected, in amounts sufficient to settle any past due installments; and (ii) request the transfer of existing balances in the State's revenue centralizing accounts maintained in a certain financial institution, in amounts sufficient to settle any installment in default. As of December 31, 2008, the outstanding balance under these agreements totals R\$173,277, as mentioned in Note 11.

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **25. Related-Party Transactions (Continued)**

- ▶ Agreements with the Brazilian Government guaranteed by the State of Minas Gerais

Debt acknowledgement and consolidation agreement with the Federal Government as of August 5, 1998: the State of Minas Gerais assigned and transferred to the Federal Government credits from certain taxes collected, in amounts sufficient to pay installments and charges due on each maturity date. As of December 31, 2008, the outstanding balance of these agreements is R\$91.375, as mentioned in Note 11.

### **26. Insurance**

The Company has no insurance to cover damage to their buildings and/or facilities at the closing date of the financial statements for the year ended December 31, 2008.

### **27. ICMS Levy (State VAT)**

According to State Law No. 9944 of September 20, 1989, and State Decree No. 38104/96, the Company started contributing to ICMS (State VAT) under a special taxation regime, whereby this tax was levied and collected on the supply of piped water from years 1989 to 1991. In 1991, the Company suspended the tax collection as a result of a preliminary decision on Direct Unconstitutionality Proceeding (ADIN) No. 567-7, which established that this collection needed a particular law to regulate it. ADIN was declared impaired by loss of the subject matter, and this issue has been clearly provided for by a Supreme Court decision awarded on Direct Unconstitutionality Proceeding No. 2224, published on March 21, 2007, whereby the supply of treated water to final consumers is an essential public service, by express constitutional determination. However, as the merits of the action have not yet been adjudged, and although there are pronouncements from the STF ( Supreme Court ) and the STJ ( Supreme Court of Justice ), and repeated understanding of the state law that there would be no impact of the ICMS (State VAT) on the supply of drinking water by companies that provide this public service, so far there is no definitive understanding of the Judiciary. Due to the suspension of the tax collection, the amount of the referred to tax is not currently included in the calculation of tariffs of the Company, and it is not being charged either from customers or passed on to the State Government. Furthermore, there is no tax deficiency notice from the state tax authorities that would render the establishment of a provision for this tax justifiable.

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **28. Subsequent Events**

The tariff adjustment announced by COPASA that would apply to consumption billed as from March 2, 2009 has been suspended, not taking effect on the planned date, in compliance with the preliminary court order by the Court of Justice of the State of Minas Gerais via interlocutory appeal brought by the Public Prosecution Office, which claimed that it was not in accordance with Law No. 11445/2007, as regards the establishment of regulatory body.

COPASA understands that the announced adjustment is in accordance with the existing regulations and is based on studies that evaluated inflationary losses and the increase in prices for the key inputs of the sanitation sector. These studies were approved by the Secretary of Regional Development and Urban Policy, according to article 99 of State Decree No. 44884/2008, which authorized the tariff adjustments through Rule No. 02/2009 of January 30, 2009, published on the Minas Gerais State Official Gazette (DOE). The Company has taken the appropriate legal remedies to protect its interests in order to avoid any financial losses, and now expects a decision favorable to the tariff increase.

### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)**

The Company has prepared its primary financial statements and primary consolidated financial statements in accordance with accounting practices adopted in Brazil (“BR GAAP”). The primary financial statements and primary consolidated financial statements are used for statutory and regulatory purposes. In order to comply with the New Market requirements of BOVESPA (“Novo Mercado”), the Company is presenting the reconciliation of shareholders’ equity as of December 31, 2008 and 2007 and the reconciliation of net income as of and for the years then ended between BR GAAP and US GAAP. This note is not required by BR GAAP and has not been presented in the financial statements for statutory and regulatory purposes of the Company which were published on March 28, 2009.

A narrative description of the reconciling items between BR GAAP and US GAAP is also provided as required by BOVESPA. The narrative descriptions should not be used for any other purposes.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### I. Reconciliation of net income in accordance with the Accounting Practices adopted in Brazil and the US GAAP:

		Company		Consolidated	
		2008	2007	2008	2007
Net income under BR GAAP		<b>407,781</b>	329,323	<b>407,781</b>	329,323
Depreciation effects and write-off of the inflationary effects of 2006 and 2007.	(a)	<b>(12,882)</b>	(19,017)	<b>(12,882)</b>	(19,017)
Additional capitalized Interest on fixed assets	(b-i)	<b>31,630</b>	29,265	<b>31,630</b>	29,265
Depreciation of additional capitalized interest on fixed assets.	(b-i)	<b>(14,262)</b>	(13,619)	<b>(14,262)</b>	(13,619)
Reversal of expenses with depreciation of donations	(b-ii)	<b>8,888</b>	8,678	<b>8,888</b>	8,678
Reversal of deferred costs of guidelines, methods and procedures recorded under fixed assets in accordance with BR GAAP	(c)	-	(260)	-	(260)
Reversal of the amortization of deferred costs of guidelines, methods and procedures recorded under fixed assets in accordance with BR GAAP	(c)	<b>909</b>	984	<b>909</b>	984
Supplement of retirement benefits	(d)	<b>5,190</b>	34,536	<b>5,190</b>	34,536
Capitalization of debt issuance costs	(e)	-	473	-	473
Amortization of capitalized debt issuance costs	(e)	<b>(385)</b>	(352)	<b>(385)</b>	(352)
Reversal of deferred charges of subsidiaries, relating to pre-operating expenses.	(f)	<b>3,186</b>	(3,186)	<b>3,186</b>	(3,186)
Deferred income tax on accounting practice differences	(g)	<b>(7,573)</b>	(12,751)	<b>(7,573)</b>	(12,751)
Deferred income tax assets not recorded in accordance with BR GAAP	(g)	-	(12,664)	-	(12,664)
Net income under US GAAP		<b>422,481</b>	341,410	<b>422,481</b>	341,410
Earnings per share:	(h)				
Basic (in Reais)		<b>3.68</b>	2.97	<b>3.68</b>	2.97
Weighted average of outstanding shares (in thousands)		<b>114,795</b>	114,795	<b>114,795</b>	114,795
Diluted (in Real)		<b>3.69</b>	2.95	<b>3.69</b>	2.95
Weighted average of outstanding shares (in thousands)		<b>116,679</b>	117,432	<b>116,679</b>	117,432

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### II. Reconciliation of shareholders’ equity in accordance with the Accounting Practices adopted in Brazil, and the US GAAP:

		Company		Consolidated	
		2008	2007	2008	2007
Shareholders’ equity under BR GAAP		<b>3,803,301</b>	3,511,358	<b>3,803,301</b>	3,511,358
Adjustments from inflationary effects over costs of fixed assets, in 1996 and 1997	(a)	<b>419,318</b>	419,478	<b>419,318</b>	419,478
Accumulated depreciation of 1996 and 1997 inflationary effects.	(a)	<b>(335,854)</b>	(323,131)	<b>(335,854)</b>	(323,131)
Additional capitalized interest on fixed assets in accordance with US GAAP	(b-i)	<b>427,063</b>	395,433	<b>427,063</b>	395,433
Accumulated depreciation of additional capitalized interest on fixed assets in accordance with US GAAP.	(b-i)	<b>(179,872)</b>	(165,610)	<b>(179,872)</b>	(165,610)
Reclassification of donations recorded directly in shareholders’ equity to offset fixed assets (with no impact on the statement of income)	(b-ii)	<b>(206,174)</b>	(206,173)	<b>(206,174)</b>	(206,173)
Adjustments of donation inflation up to December 31, 1997. Calculation based on IGP-M (with no impact on the statement of income)	(b-ii)	<b>(48,503)</b>	(48,503)	<b>(48,503)</b>	(48,503)
Accumulated amortization of donations	(b-ii)	<b>120,699</b>	111,811	<b>120,699</b>	111,811
Reversal of deferred costs of guidelines, methods and procedures recorded as fixed assets in accordance with BR GAAP	(c)	<b>(18,318)</b>	(18,317)	<b>(18,318)</b>	(18,317)
Reversal of accumulated amortization of deferred costs with guidelines, methods and procedures recorded as fixed assets in accordance with BR GAAP	(c)	<b>15,749</b>	14,839	<b>15,749</b>	14,839
Supplement of retirement benefits	(d)	<b>(127,540)</b>	(132,730)	<b>(127,540)</b>	(132,730)
Supplement of retirement benefits - OCI	(d)	<b>47,896</b>	(98,692)	<b>47,896</b>	(98,692)
Capitalization of costs of debt issuance in accordance with US GAAP.	(e)	<b>4,368</b>	4,368	<b>4,368</b>	4,368
Amortization of costs of debt issuance, capitalized in accordance with US GAAP	(e)	<b>(1,416)</b>	(1,031)	<b>(1,416)</b>	(1,031)
Reversal of pre-operating expenses of subsidiary, recorded as deferred charges in accordance with BR GAAP	(f)	-	(3,186)	-	(3,186)
Deferred income tax on GAAP differences	(g)	<b>(93,736)</b>	(86,163)	<b>(93,736)</b>	(86,163)
Deferred income tax on GAAP differences recorded directly against OCI	(g)	<b>(16,285)</b>	33,555	<b>(16,285)</b>	33,555
Shareholders’ equity under US GAAP		<b>3,810,697</b>	3,407,306	<b>3,810,697</b>	3,407,306

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### III. Statements of changes in shareholders’ equity in accordance with Generally Accepted Accounting Principles in the United States of America.

	Company		Consolidated	
	2008	2007	2008	2007
Balance at beginning of year	<b>3,407,306</b>	3,186,199	<b>3,407,306</b>	3,186,199
Capital increase	<b>23</b>	-	<b>23</b>	-
Net income for the year	<b>422,481</b>	341,410	<b>422,481</b>	341,410
Other items of comprehensive P&L for the year	<b>96,748</b>	(41,095)	<b>96,748</b>	(41,095)
Interest on equity/dividends	<b>(115,861)</b>	(79,208)	<b>(115,861)</b>	(79,208)
Balance at year end	<b>3,810,697</b>	3,407,306	<b>3,810,697</b>	3,407,306

#### IV. Narrative Description of the differences in accounting practices.

##### (a) Methodology and rates used in determining the inflationary effects

According to the accounting practices adopted in Brazil, accounting for inflation effects was discontinued on January 1, 1996. Before that date, the financial statements prepared in accordance with accounting practices adopted in Brazil included indexation adjustments that partially accounted for inflation effects on fixed assets, investments, deferred charges (together named permanent assets) and shareholders’ equity, which net effect was recorded against the statement of income. However, in accordance with US GAAP, Brazil has no longer been treated as a “hyperinflationary economy” since January 1, 1998. The financial information for US GAAP purposes include additional inflation adjustments of permanent assets and shareholders' equity for the period between January 1, 1996 and December 31, 1997, based on IGP-M.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

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### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)** (Continued)

#### IV. Narrative Description of the differences in accounting practices (Continued)

##### (b) Fixed Assets

##### (i) Difference in criteria for capitalization and depreciation of interest

According to accounting practices adopted in Brazil, the Company capitalized interest incurred during (i) the grace period for loans and financing directly related to the construction of fixed assets (construction in progress) until December 31, 2004 and (ii) the subsequent construction period. Until December 31, 2004, the grace period for loans and financing was substantially similar to the periods corresponding to the construction. The Company did not capitalize the charges of monetary restatement on loans and financing denominated in Reais and the foreign exchange on loans and financing denominated in foreign currencies.

According to US GAAP as per SFAS No. 34, "Capitalization of Interest Cost", interest incurred on loans is capitalized as part of the cost of the assets in question. Pursuant to US GAAP, the amount of interest capitalized excludes the monetary costs resulting from currency restatement associated with loans and financing and foreign exchange gains and losses on loans and financing denominated in foreign currency.

##### (ii) Donations

Donations refer primarily to contributions of land and equipment from municipal governments and consumers of consumers in support of the construction necessary to meet the requests for water and wastewater connections.

According to the accounting practices adopted in Brazil, until December 31, 2007, donations were recorded as an increase in fixed assets directly against shareholders' equity. Since January 31, 2008 donations are recorded as a reduction of fixed assets in accordance with CPC 07 Government Grants and Government Assistance, approved by CVM Rule No. 555 dated November 12, 2008

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)** (Continued)

#### IV. Narrative Description of the differences in accounting practices (Continued)

##### (ii) Donations (Continued)

According to US GAAP, donations are recorded as a reduction of fixed assets and are amortized using the same depreciation rate of the corresponding fixed assets - in service. Amortization is recorded as a reduction of depreciation expenses for the period.

##### (c) Deferred Expenses

Effective 2008, with the new provisions introduced by Law 11638 and Provisional Executive Act (MP) 449/08, accounting practices adopted in Brazil, no longer allow the deferral of costs with guidelines, methods and processes and pre-operating expenses incurred in the construction or expansion of new installations. Such deferral was allowed up to December 31, 2007, until its business operations start up. Deferred charges are amortized over a period of five to ten years.

According to US GAAP, these costs do not meet the conditions established for deferral and, thus, are recorded in P&L when incurred.

##### (d) Retirement Benefits

According to the accounting practices adopted in Brazil, before 2002, amounts relating to pension plans were recorded on the accrual basis, at the due date of the contributions. According to accounting standards issued by the Brazilian Institute of Independent Auditors (IBRACON) and approved by the Brazilian Securities and Exchange Commission (CVM), effective as from January 1, 2002, Brazilian publicly-held companies shall record obligations based on actuarial calculations and provide specific reports on their pension plans. According to the standard, actuarial pension liabilities computed on the date of adoption can be recorded directly in shareholders' equity or prospectively in the statement of income during the five-year period ended December 31, 2006. As permitted, the Company has chosen to recognize this obligation by the straight-line method in the statement of income for the five-year period started in 2002. Amortization is presented as "Administrative Expenses" in the statement of income.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)** (Continued)

#### IV. Narrative Description of the differences in accounting practices (Continued)

##### (d) Retirement Benefits (Continued)

Pursuant to US GAAP, the Company recognizes its pension plans in accordance with the provisions of SFAS No. 87, "Employers' Accounting for Pensions", and SFAS 158, "Employers' Accounting for Defined Benefit Pension and Other Post Retirement Plans", an amendment to FASB Pronouncements No. 87, 88, 106 and 132 (R), which, among other requirements, requires Companies to recognize the actuarial liability determined by the obligations of the pension plan. SFAS No. 87 also requires that an additional liability (minimum pension liability) be recorded when accumulated benefit obligations exceed the fair value of assets of the plan, less amounts provisioned. This additional minimum liability is recorded against Other Comprehensive Income (Losses), in shareholders' equity. The additional disclosures required by SFAS 158 are presented in Note V (a).

Although the accounting practices adopted in Brazil require that companies recognize an obligation based on actuarial methods effective as from January 1, 2002, the differences, according to these practices, regarding the prescribed actuarial methods, first-time adoption date and amortization of transition obligations, among others, in comparison with those from generally accepted accounting principles in the United States, generate reconciliation adjustments for the purposes of US GAAP.

##### (e) Debt Issuance Costs

In July and August 2004, the Company issued debentures, all maturing July 2014. In addition, in February, March and April 2005, the Company took out long-term loans, all with effective terms until December 2022. In June and December 2007, new loans maturing June 2013 and December 2019, respectively, were taken out.

According to the accounting practices adopted in Brazil, costs of debenture issuance and obtaining additional loans are considered as costs of debt issuance and are recognized as expenses when incurred.

Pursuant to US GAAP, costs of debt issuance are deferred and amortized over the debt period by the straight-line method. The results of such amortization do not significantly differ from those obtained by the exponential method.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)** (Continued)

#### IV. Narrative Description of the differences in accounting practices (Continued)

(f) Reversal of subsidiary deferred expenses

This relates to the reversal of implementation and pre-operating expenses deferred charges by the subsidiary Copasa Águas Minerais de Minas. Pursuant to US GAAP, these figures do not meet the conditions established for deferral and, thus, are recorded in P&L when incurred.

(g) Deferred income and social contribution taxes

According to the accounting practices adopted in Brazil, NPC 25 – Recording of Income and Social Contribution Taxes, the Company shall recognize deferred tax assets related to tax losses as it is probable that future taxable profit will be sufficient to offset these losses. In addition, deferred income tax is stated by its gross amount.

Pursuant to US GAAP, as required by SFAS No. 109, "Accounting for Income Tax", deferred taxes are recorded on all temporary differences, and provisions for loss shall be recorded when deferred tax assets, including tax losses, will probably not be recovered. Deferred tax assets and liabilities are classified as current or noncurrent, based on the asset or liability classification relating to the temporary difference and are disclosed at their net values among assets and liabilities of the same classification.

The effect of adjustments made to reflect the requirements of US GAAP, as well as differences between the reporting basis of assets and the amounts included in the tax records, are recognized as temporary differences for the purpose of recording deferred income taxes. This effect amounted to R\$ 7,573 and R\$ 12,751 in 2008 and 2007, respectively.

In 2006, the Company recognized a deferred tax asset on net operating losses under US GAAP which was recorded in the statutory books of account in 2007. This resulted in a reconciling adjustment of R\$ 12,664 in the 2007 reconciliation.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### IV. Narrative Description of the differences in accounting practices (Continued)

##### (h) Earnings per share

Earnings per share, in accordance with accounting practices adopted in Brazil, is calculated based on the number of shares outstanding at the end of each period.

Pursuant to generally accepted accounting principles in the United States, SFAS No. 128, "Earnings per share", the basic earnings per share is calculated based on the weighted average number of shares outstanding during the period. The diluted earnings per share is calculated based on the weighted average number of common shares outstanding during the period plus the weighted average number of common shares that would be issued in case the right to convert the convertible debentures was exercised.

	Company		Consolidated	
	2008	2007	2008	2007
<b>Basic Income</b>				
Net Income — US GAAP	422,481	341,410	422,481	341,410
Weighted average per thousand common shares outstanding during the year	114,795	114,795	114,795	114,795
Basic earnings per share	3.68	2.97	3.68	2.97
<b>Diluted Earnings</b>				
Net Income — US GAAP	422,481	341,410	422,481	341,410
Effect on net income related to convertible debentures	7,724	4,490	7,724	4,490
Net income US GAAP adjusted by the effect of convertible debentures	430,205	345,900	430,205	345,900
Weighted average per thousand common shares outstanding during the year	114,795	114,795	114,795	114,795
Effect of conversion of convertible debentures	1,883	2,637	1,883	2,637
Weighted average per thousand common shares outstanding during the year adjusted by the effect of convertible debentures	116,679	117,432	116,679	117,432
Diluted earnings per share	3.69	2.95	3.69	2.95

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)** (Continued)

#### IV. Narrative Description of the differences in accounting practices (Continued)

##### (i) Classification of balance sheet items

In accordance with accounting practices adopted in Brazil, the classification of certain assets and liabilities is presented in a different way from US GAAP.

In accordance with accounting practices adopted in Brazil, deferred income and social contribution tax assets are presented separately from liabilities. For US GAAP purposes, deferred income and social contribution tax assets and liabilities are presented net and classified between short and long-term based on the classification of assets or liabilities for the temporary difference.

In accordance with accounting practices adopted in Brazil, some taxes were offset; such offsetting would not be permitted in accordance with US GAAP.

In accordance with Accounting Practices adopted in Brazil, the classification of certain income and expense items is presented in a different way from the US GAAP.

- (i) Interest assets and liabilities, including monetary and foreign exchange rate variations, are presented as part of the operating income in accordance with accounting practices adopted in Brazil. These interest assets and liabilities are stated after operating income for US GAAP purposes.
- (ii) Gains and losses on disposals or impairment of permanent assets are presented as non-operating expenses in accordance with accounting practices adopted in Brazil. These gains and losses on disposals or impairment of fixed assets are presented as operating revenues or expenses for US GAAP purposes.
- (iii) Profit sharing is not classified as operating expenses, however, for US GAAP purposes it is presented as cost of sales or operating expenses.
- (iv) In accordance with accounting practices adopted in Brazil, amounts related to the recovery of credit (accounts written off) are stated as other operating income (expenses). In accordance with US GAAP, these amounts are presented in the same account in which the provision had been set up.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### V. Additional disclosures required by US GAAP

##### (a) Retirement Benefits

COPASA sponsors the Pension Plan RP1 (exclusive for COPASA), managed and operated by PREVIMINAS – Social Security Foundation of Minas Gerais State. RP1 is a defined benefit plan, in which both participants and COPASA equally contribute, in accordance with Supplementary Laws No. 108 and 109, of May 29, 2001, with amounts determined based on actuarial studies previously prepared. The Company, as sponsor of the plan, and the participants are responsible for all expenses related to the pension plan, including disability and death risks, at the total cost of the plan, calculated based on the actuarial valuation and approved by PREVIMINAS Board and COPASA.

COPASA has no plans for post-retirement health and life insurance policies for retirees.

The Company uses December 31 as the reporting date for calculating the pension benefits of employees. Changes in projected benefit obligations for the years ended December 31, 2008 and 2007 are as follows:

	<b>Pension Plan with defined benefits</b>			
	<b>Year ended December 31</b>			
	<b>Company</b>		<b>Consolidated</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Projected benefit obligations				
Beginning of year	<b>1,032,073</b>	846,834	<b>1,032,073</b>	846,834
Cost of service	<b>35,530</b>	28,894	<b>35,530</b>	28,894
Interest cost	<b>104,310</b>	86,716	<b>104,310</b>	86,716
Actuarial gain	<b>12,697</b>	95,696	<b>12,697</b>	95,696
Impact arising out of assumption changes	<b>(183,657)</b>	-	<b>(183,657)</b>	-
Benefits paid to participants	<b>(28,367)</b>	(26,067)	<b>(28,367)</b>	(26,067)
End of year	<b>972,586</b>	1,032,073	<b>972,586</b>	1,032,073

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### V. Additional disclosures required by US GAAP (Continued)

##### (a) Retirement Benefits (Continued)

At December 31, 2008 and 2007, the accumulated benefit obligation for the defined benefit plan is R\$ 891,875 and R\$ 925,765, respectively.

Changes in plan assets for the years ended December 31, 2008 and 2007 are as follows:

	<b>Pension Plan with defined benefits</b>			
	<b>Year ended December 31</b>			
	<b>Company</b>		<b>Consolidated</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Fair market value of plan assets				
Beginning of year	<b>633,868</b>	529,854	<b>633,868</b>	529,854
Employer contributions	<b>33,484</b>	25,945	<b>33,484</b>	25,945
Employee contributions	<b>22,810</b>	16,146	<b>22,810</b>	16,146
Actual return on plan assets	<b>72,299</b>	63,386	<b>72,299</b>	63,386
Actuarial gain (loss)	<b>(35,900)</b>	24,604	<b>(35,900)</b>	24,604
Benefits paid to participants	<b>(28,366)</b>	(26,067)	<b>(28,366)</b>	(26,067)
End of year	<b>698,195</b>	633,868	<b>698,195</b>	633,868

The estimated contribution to the defined benefit pension plan during the next fiscal year is of R\$ 38,029.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### V. Additional disclosures required by US GAAP (Continued)

##### (a) Retirement Benefits (Continued)

The total accrued pension liabilities according to accounting practices adopted in Brazil and generally accepted accounting principles in the United States are reconciled as follows:

	Pension Plan with defined benefits Year ended December 31			
	Company		Consolidated	
	2008	2007	2008	2007
Total accrued pension liabilities using accounting practices adopted in Brazil	<b>194,748</b>	166,782	<b>194,748</b>	166,782
Supplement of retirement benefit	<b>79,643</b>	231,422	<b>79,643</b>	231,422
Total accrued pension liabilities according to US GAAP	<b>274,391</b>	398,204	<b>274,391</b>	398,204

The components of net periodic benefit cost for the years ended December 31, 2008 and 2007 are:

	Pension Plan with defined benefits Year ended December 31			
	Company		Consolidated	
	2008	2007	2008	2007
Service cost	<b>35,530</b>	28,894	<b>35,530</b>	28,894
Interest cost	<b>104,310</b>	86,716	<b>104,310</b>	86,716
Estimated return on plan assets	<b>(72,299)</b>	(63,386)	<b>(72,299)</b>	(63,386)
Amortization of transition obligation	<b>6,519</b>	6,519	<b>6,519</b>	6,519
Estimate of employees contribution	<b>(17,801)</b>	(13,837)	<b>(17,801)</b>	(13,837)
Net periodic cost of benefits	<b>56,259</b>	44,906	<b>56,259</b>	44,906

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### V. Additional disclosures required by US GAAP (Continued)

##### (a) Retirement Benefits (Continued)

The weighted average asset allocation per category of assets is as follows:

	<b>Pension Plan with defined benefits</b>		<b>Allocation of Assets as established by the Board of PREVIMINAS - percentage or percentage range</b>
	<b>Allocation of assets at December 31</b>		
	<b>2008</b>	<b>2007</b>	
Fixed income	83.07%	76.23%	Until 100%
Variable income	9.15%	14.22%	Until 50%
Portfolio of properties	4.54%	5.24%	Until 8%
Loans to participants	3.24%	4.31%	Until 15%
<b>Total</b>	<b>100.00%</b>	<b>100.00%</b>	

Investment strategies:

- ▶ The Board of PREVIMINAS provides guidelines for investments;
- ▶ Purpose of investment: achieving minimum actuarial income (INPC plus 6% per year), both in short and long-term;
- ▶ Types of investments permitted: Fixed income - low credit risk assets, shares, real estate and loans to participants;
- ▶ Types of investments not permitted: medium and high risk credit assets, foreign currency and others according to Brazilian legislation;
- ▶ Use of derivatives: For hedging exposure purposes.

Benchmarks for assets in investment plan:

- ▶ Debt securities: Interbank Deposit Certificate (CDI);
- ▶ Equity securities: Average IBOVESPA;
- ▶ Real state: INPC + 6% per year;
- ▶ Loans to participants: INPC + 6% per year.

At December 31, 2008 and 2007, pension plan assets included paper issued by COPASA, in the amount of R\$ 4,847 and R\$ 7,272, respectively.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### V. Additional disclosures required by US GAAP (Continued)

##### (a) Retirement Benefits (Continued)

The assumptions used by the Company in 2008 were as follows (percentage, including the projected inflation of 4.5% per year, 2007, 4.5% per year):

	<b>Projected unit credit - 2008</b>	<b>Projected unit credit - 2007</b>
Actuarial method		
Annual rate discount	11.82% per year.	10.25% per year.
Expectation of annual return on plan assets	13.94% per year.	11.25% per year.
Annual increase in salary		
Employees	6.40% per year.	6.297% per year.
Self-sponsored	4.50% per year.	4.50% per year.
Annual increase in benefits	4.50% per year.	4.50% per year.
Mortality table	AT - 2000	AT - 2000
Rate of disability	Zimmermann	Wyatt 1985 Class 1*
Rate of disability and death	RP 2000 Disabled*	RP 2000 Disabled*
Rotation	4.5% / (length of service + 1)	T-1 Withdrawal Table

\* Genre-specific tables.

The following payments of benefits that reflect the estimated future service, as appropriate, shall be made:

	<b>Retirement Benefits</b>
2009	38,029
2010	45,337
2011	53,650
2012	63,048
2013	72,850
2014-2018	542,684
	<b>815,598</b>

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### V. Additional disclosures required by US GAAP (Continued)

##### (b) Others

Labor unions - Substantially all employees not members of the Executive Board are members of unions. The main labor union representing the employees of the Company is SINDÁGUA. The most recent collective bargaining agreement of the Company, which became effective as from May 1, 2008, whose effective term ends on April 30, 2010, includes the Company's commitment to (i) training and relocating its employees affected by the implementation of the ERP system in 2006, and (ii) not implementing any program of massive layoffs.

##### (c) Intangible assets

At December 31, 2008 and 2007, the Company had the following intangible assets according to US GAAP:

	Weighted average of the amortization period in years	December 31					
		Consolidated and Company - 2008			Consolidated and Company - 2007		
		Cost	Accumulated Amortization	Total	Cost	Accumulated Amortization	Total
Software licenses	5	45,793	(21,230)	24,563	45,688	(14,167)	31,521
Administrative easement	25.4	3,890	(1,897)	1,993	3,643	(1,737)	1,906
Right of exploitation of concessions	26.9	179,846	(19,079)	160,767	162,052	(16,291)	145,761
Other intangible assets	5	390	(262)	128	391	(189)	202
		<b>229,919</b>	<b>(42,468)</b>	<b>187,451</b>	211,774	(32,384)	179,390

Amortization expense for the years ended December 31, 2008 and 2007, according to US GAAP, totaled R\$ 10,084 and R\$ 14,133, respectively.

## Companhia de Saneamento de Minas Gerais - COPASA

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### 29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”) (Continued)

#### V. Additional disclosures required by US GAAP (Continued)

##### (c) Intangible assets (Continued)

The estimate of total amortization expenses for each of the subsequent five years, according to US GAAP, is as follows:

	<u>Estimated expenditure on amortization</u>
2009	13,341
2010	13,341
2011	13,341
2012	11,740
2013	6,936

### New US GAAP accounting pronouncements

In September 2006, the FASB issued Statement No. 157, "fair value measurement" (SFAS 157 "). SFAS No. 157 defines fair value, establishes a framework for measuring fair value for generally accepted accounting principles, and expands disclosure on fair value measurement. SFAS No.157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and intermediate periods within those fiscal years.

In February 2007, FASB issued SFAS No. 159 that provides entities with an option to report selected financial assets, including investment securities designated as available for sale, and liabilities, including most insurance contracts, at fair value. SFAS No. 159 establishes presentation and disclosure requirements to facilitate comparisons between the companies that choose different measurement attributes for similar types of assets and liabilities. The standard also requires additional information to assist financial statements users in understanding the choice of an entity to use the value. SFAS No. 159 is effective in the first fiscal year starting after November 15, 2007. The Company has chosen not to adopt the procedure of recording eligible items at fair value on the transition date (01/01/2008 for the Company).

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)** (Continued)

#### **New US GAAP accounting pronouncements (Continued)**

In December 2007, FASB issued Statement No. 141 (Revised in 2007), "Business Combination", which requires that the merging company in a business combination recognize all (and only) assets acquired and liabilities assumed in the transaction; establishes the fair value on the acquisition date as measurement objective for all assets acquired and liabilities assumed, and requires that the acquirer disclose to investors and other users all information necessary to evaluate and understand the nature and financial effect of the business combination. SFAS 141 (R) applies to fiscal years and intermediate periods covering such fiscal years, beginning on or as from December 15, 2008. Currently, the Company has no business combination operations. If in the future the Company decides to have such operations, the procedures contained in this statement will be applied.

In December 2007, FASB issued the amendment of ARB No. 51 (SFAS 160 – Non-controlling Interest in Consolidated Financial Statements). SFAS 160 establishes information disclosure and recording standards with respect to non-controlling interest in a subsidiary in consolidated financial statements and to the deconsolidation of a subsidiary and clarifies that a non-controlling interest in a subsidiary represents equity interest in a consolidated entity that shall be reported as equity in the consolidated financial statements. SFAS 160 applies to fiscal years beginning on or as from December 15, 2008. The Company adopted this statement from the first fiscal year starting after December 15, 2008 (01/01/2009 for the Company).

On March 19, 2008, FASB issued SFAS No. 161, which amends Pronouncement 133 requiring expanded disclosure of derivative instruments in an entity, as well as hedge activities, but does not change the scope or recording of SFAS No. 133. This Statement requires qualitative and quantitative disclosures as well as a more comprehensive credit risk analysis. SFAS No. 161 also amends SFAS No. 107, clarifying that derivative instruments are subject to the disclosures on credit risk concentration according to SFAS No. 107. Although FASB intended that SFAS No. 107 would apply to all financial instruments, including derivatives, the Board believes that clarification is necessary in order to understand different views on the disclosures of entities regarding whether the concentration of credit risk shall include derivative instruments. This Statement applies to financial statements issued for fiscal years and intermediate periods beginning after November 15, 2008. The Company adopted this Statement as from the first fiscal year starting after November 15, 2008 (01/01/2009 for the Company).

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### **29. Summary of the differences between Accounting Practices Adopted in Brazil (“BR GAAP”) and Accounting Principles Generally Accepted in the United States of America (“US GAAP”)** (Continued)

#### **New US GAAP accounting pronouncements (Continued)**

On April 25, 2008, FASB issued FSP FAS 142-3 which changes the list of factors to be considered by the Company when developing renewal or extension assumptions used in determining the useful life of intangible assets recognized pursuant to SFAS No. 142. The new guideline applies to (1) intangible assets acquired individually or together with a group of other assets and (2) intangible assets acquired in business combination and acquisitions of assets. This FSP applies to financial statements issued for fiscal years beginning after December 15, 2008. The Company adopted this Statement from the first fiscal year starting after December 15, 2008 (01/01/2009 for the Company).

On May 9, 2008, FASB issued Statement No. 162, which reorganizes the hierarchy of GAAP. The objective of the new standard is improving the disclosure of financial information by providing a consistent framework for determining what accounting principles should be used to prepare the financial statements in US GAAP.

A free translation from Portuguese into English

## **Companhia de Saneamento de Minas Gerais - COPASA**

Notes to the Financial Statements (Continued)

December 31, 2008 and 2007

(Amounts in thousands of Brazilian reais – R\$, unless otherwise stated)

### EXECUTIVE BOARD

MÁRCIO AUGUSTO VASCONCELOS NUNES	Chief Executive Officer
HERCULANO ANGHINETTI	Vice Chief Executive Officer
CARLOS GONÇALVES DE OLIVEIRA SOBRINHO	Technical and Environment Officer
DIEGO LEONARDO DE ANDRADE CARVALHO	Southwest Operations Officer
GELTON PALMIERI ABUD	Corporate Management Officer
JUAREZ AMORIM	Metropolitan Operations Officer
MARCIO LUIZ MURTA KANGUSSU	North Operations Officer
MARCOS ANTÔNIO TEIXEIRA	Planning and Venture Management Officer
RICARDO AUGUSTO SIMÕES CAMPOS	Chief Financial and Investor Relations Officer

### ACCOUNTANT IN CHARGE

GERALDO MAGELA MOREIRA CALÇADO	Accountant - CRCMG - 36.109
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