

**THE METROPOLITAN SEWER DISTRICT
OF GREATER CINCINNATI**

SINGLE AUDIT REPORTS

for the year ended December 31, 2006



Mary Taylor, CPA
Auditor of State

Honorable Board of County Commissioners
Metropolitan Sewer District of Greater Cincinnati
1600 Gest Street
Cincinnati, Ohio 45202

We have reviewed the *Independent Auditors' Report* of the Metropolitan Sewer District of Greater Cincinnati, Hamilton County, prepared by Foxx & Company, for the audit period January 1, 2006 through December 31, 2006. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. The Metropolitan Sewer District of Greater Cincinnati is responsible for compliance with these laws and regulations.

Mary Taylor

Mary Taylor, CPA
Auditor of State

August 13, 2007

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THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING
STANDARDS***

The Honorable Board of County Commissioners
Hamilton County, Ohio

We have audited the financial statements of the Metropolitan Sewer District of Greater Cincinnati (MSD), as of and for the year ended December 31, 2006, and have issued our report thereon dated June 22, 2007. The financial statements present only the financial position of MSD and are not intended to present fairly the financial position of Hamilton County, and the results of its operations and cash flows of its proprietary fund types in conformity with generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the MSD's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the MSD's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the MSD's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the MSD's financial statements that is more than inconsequential will not be prevented or detected by the MSD's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the MSD's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the MSD's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the Ohio Auditor of State and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

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Cincinnati, Ohio
June 22, 2007



**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH
MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

The Honorable Board of County Commissioners
Hamilton County, Ohio

Compliance

We have audited the compliance of the the Metropolitan Sewer District of Greater Cincinnati (MSD), with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2006. MSD's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of MSD's management. Our responsibility is to express an opinion on MSD's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about MSD's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on MSD's compliance with those requirements.

In our opinion, MSD complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2006.

Internal Control Over Compliance

The management of MSD is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered MSD's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of MSD, as of and for the year ended December 31, 2006 and have issued our report thereon dated June 22, 2007. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of management, the Ohio Auditor of State, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

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Cincinnati, Ohio
June 22, 2007

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

for the year ended December 31, 2006

Federal Grantor/Pass-Through Grantor/Program Title	<u>CFDA Number</u>	<u>Grant Number</u>	<u>Federal Disbursements</u>
U.S. Environmental Protection Agency			
<i>Pass-through programs from Ohio Water Development Authority (OWDA)</i>			
Capitalization Grants for State Revolving Funds	66.458	CS391860-02	\$ 91,281
Capitalization Grants for State Revolving Funds	66.458	CS392574-02	508,097
Capitalization Grants for State Revolving Funds	66.458	CS391209-02	<u>2,050,342</u>
Total			<u>2,649,720</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u><u>\$ 2,649,720</u></u>

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

for the year ended December 31, 2006

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

This schedule of expenditures of federal awards includes the federal grant/loan activity of MSD and is presented on an accrual basis of accounting in accordance with generally accepted accounting principles. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
SCHEDULE OF FINDINGS AND QUESTIONED COSTS

for the year ended December 31, 2006

1. Summary of Auditors' Results

Type of financial statement opinion	Unqualified
Where there any material control weakness conditions reported at the financial statement level (GAGAS)?	No
Were there any reportable control weakness conditions reported at the financial statement level (GAGAS)?	No
Was there any other reported noncompliance at the financial statement level (GAGAS)?	No
Was there any material internal control weakness conditions reported for major federal programs?	No
Where there any other reported internal control weakness conditions reported for major federal programs?	No
Type of Major Programs' compliance opinion	Unqualified
Are there any reportable findings under § .510?	No
Major programs	Capitalization Grants for State Revolving FundsCFDA #66.458
Dollar threshold for Type A/B programs	Type A: Over \$300,000 Type B: All others
Low risk auditee?	Yes

2. Findings Related to the Financial Statements Required to be Reported in Accordance with GAGAS

None

3. Findings and Questioned Costs for Federal Awards

None

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
SCHEDULE OF PRIOR AUDIT FINDINGS AND QUESTIONED COSTS

for the year ended December 31, 2006

There were no prior audit findings or questioned costs relative to federal awards for the audit of MSD for the year ended December 31, 2005.

**THE METROPOLITAN SEWER DISTRICT
OF GREATER CINCINNATI
CINCINNATI, OHIO**

FINANCIAL STATEMENTS

for the years ended December 31, 2006 and 2005

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
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INDEPENDENT AUDITORS' REPORT

The Honorable Board of County Commissioners
Hamilton County, Ohio

We have audited the accompanying financial statements of the Metropolitan Sewer District of Greater Cincinnati (MSD), an enterprise fund of the County of Hamilton, Ohio, as of and for the years ended December 31, 2006 and 2005 as listed in the table of contents. These financial statements are the responsibility of MSD's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Metropolitan Sewer District of Greater Cincinnati, at December 31, 2006 and 2005 and the changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements for MSD present only the financial position of MSD, an enterprise fund of the County of Hamilton, Ohio; and are not intended to present fairly the financial position of Hamilton County, Ohio, and the changes in financial position and cash flows of its proprietary fund types in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 22, 2007 on our consideration of MSD's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the

internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Management's Discussion and Analysis on pages three to eight, is presented for purposes of additional analysis and is not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Fox & Company". The signature is written in a cursive, flowing style.

Cincinnati, Ohio
June 22, 2007

MANAGEMENT’S DISCUSSION AND ANALYSIS

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District’s basic financial statements. The District’s basic financial statements are comprised of two components: 1) the financial statements and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

Required Financial Statements

The financial statements of the District report information about the District using accounting methods similar to those used by private-sector companies. These statements provide both long-term and short-term information about the District’s overall financial status.

The Statement of Net Assets presents information on all of the District’s assets and liabilities, with the difference between the two reported as net assets. This statement provides information about the nature and the amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It provides one way to measure the financial health of the District by providing the basis for evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. However, there are several outside nonfinancial factors that need to be considered. Factors such as changing economic conditions, population and customer growth, and new or changed rules and regulations.

All of the current year’s revenue and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the District’s operations over the past year and can be used to determine whether the District has successfully recovered all its cost through its user fees.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. This statement provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Financial Analysis of the District

As previously noted, net assets may serve over time as a useful indicator of an entity’s financial position. In the case of the District, assets exceeded liabilities by \$513,190,000 at the close of the most recent fiscal year. As can be seen in Table A , on the next page, the largest portion of the District’s net assets (59%) reflect its investment in capital assets (e.g., sewers, buildings, machinery and equipment), less any related debt used to acquire those assets that is still outstanding. These capital assets are used primarily in the collection and treatment of wastewater throughout the District’s service area. The related debt will be repaid with resources provided by system users through rates and fees.

Table A
Condensed Summary of Net Assets
(In Thousands)

	<u>2006</u>	Percentage Increase (Decrease) over 2006	<u>2005</u>	Percentage Increase (Decrease) over 2005	<u>2004</u>
Current and other assets	\$ 361,019	20.3%	\$ 300,112	27.5%	\$ 235,430
Capital assets	<u>827,402</u>	5.1%	<u>787,583</u>	5.2%	<u>748,727</u>
Total assets	<u>\$ 1,188,421</u>	9.3%	<u>\$ 1,087,695</u>	10.5%	<u>\$ 984,157</u>
Long-term debt	\$ 648,779	10.9%	\$ 585,207	14.1%	\$ 512,744
Other liabilities	<u>26,452</u>	23.5%	<u>21,416</u>	11.2%	<u>19,265</u>
Total liabilities	<u>\$ 675,231</u>	11.3%	<u>\$ 606,623</u>	14.0%	<u>\$ 532,009</u>
Invested in capital assets					
Net of related debt	\$ 303,621	8.8%	\$ 279,131	(7.7%)	\$ 302,580
Restricted	4,581	0.8%	5,301	28.4%	4,128
Unrestricted	<u>204,988</u>	3.8%	<u>196,640</u>	35.2%	<u>145,440</u>
Total net assets	<u>\$ 513,190</u>	6.7%	<u>\$ 481,072</u>	6.4%	<u>\$ 452,148</u>

Net assets increased \$32.1 million in 2006 and \$28.9 million in 2005. The increases are a combination of income before contributions and contributions in the form of connection fees, assessments, and developer contributions.

Table B
Condensed Summary of Revenues,
Expenses and Changes in Net Assets
(In Thousands)

	2006	Percentage Increase (Decrease) over 2006	2005	Percentage Increase (Decrease) over 2005	2004
Operating revenues	\$ 163,647	6.1%	\$ 154,171	6.1%	\$ 145,291
nonoperating revenues	11,842	97.4%	5,999	47.1%	4,077
Total revenues	<u>175,489</u>	9.6%	<u>160,170</u>	7.2%	<u>149,368</u>
Depreciation expense	30,552	4.3%	29,295	6.8%	27,434
Other operating expense	97,006	10.1%	88,115	0.5%	87,670
Nonoperating expense	24,090	10.8%	21,746	(23.5%)	28,443
Total expenses	<u>151,648</u>	9.0%	<u>139,156</u>	(3.1%)	<u>143,547</u>
Income before capital contributions	23,841	13.5%	21,014	261.0%	5,821
Capital contributions	<u>8,277</u>	4.6%	<u>7,910</u>	6.5%	<u>7,429</u>
Change in net assets	32,118	11.0%	28,924	118.3%	13,250
Beginning net assets	481,072	6.4%	452,148	3.0%	438,898
Ending net assets	<u>\$ 513,190</u>	6.7%	<u>\$ 481,072</u>	6.4%	<u>\$ 452,148</u>

While the Summary of Net Assets (Table A) shows the change in financial position of net assets, the Summary of Revenues, Expenses, and Changes In Net Assets provides details as to the nature and source of these changes. Table B shows that during 2006 total revenues increased 9.6 percent or \$15.3 million and expenses increased 9.0 percent or \$12.5 million. During 2005 total revenues increased 7.2 percent or \$10.8 million and expenses decreased 3.1 percent or \$4.4 million. The major factors which contributed to these results include:

- Operating revenues reflect a 4 percent rate increase implemented January 9, 2006 and a 12 percent rate increase implemented March 31, 2005.
- Nonoperating revenues increased in 2006 and 2005 due to an increase in interest rates.
- Operating expenses increased 10.1 percent or \$8.9 million in 2006. Increases in fringe benefits costs, and repair/upgrade costs were major factors in the increase. Operating expenses increased 0.5 percent or \$0.4 million in 2005. The slight increase in operating costs is an offset of 2004's one time Consent Decree fine and reduced head count coupled with increases in sewer repairs, utilities, plant maintenance and health care.

- Nonoperating expense for 2006 increased 10.8 percent or \$2.3 million due to an increase in interest expense. Nonoperating expense for 2005 decreased 23.5 percent or \$6.7 million due to the decrease in the retirement of fixed assets.
- Capital contributions will fluctuate depending on building activity and assessment projects completed.

BUDGETARY HIGHLIGHTS

The District has an annual operating budget that is approved by the Hamilton County Board of County Commissioners. Capital budgets are approved on a project basis, however; annually a current year and a five year plan is presented to the Board. The 2006 expenses were 4.0 percent under the approved budget and the 2005 expenses were 6.3 percent under the approved budget. The principal areas of savings in both years were reduced Water-In-Basement costs and reduced debt service due to later debt issuance than budgeted.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of December 31, the District's investment in capital assets amounted to \$827 million and \$788 million (net of accumulated depreciation) as shown in Table C for 2006 and 2005, respectively. In 2006, the District spent about \$58 million on capital improvement projects and received about \$8 million in capital contributions. In 2005, the District spent about \$55 million on capital improvement projects and received about \$8 million in capital contributions.

Sewer replacement and improvement projects were in about two-thirds of the program in 2006 and three-fourths of the program in 2005.

Table C
Capital Assets
(In Thousands)

	2006	Percentage Increase (Decrease) over 2006	2005	Percentage Increase (Decrease) over 2005	2004
Land	\$ 4,977	0.0%	\$ 4,977	0.0%	\$ 4,977
Buildings & structures	789,603	5.0%	752,249	5.2%	715,039
Processing systems	266,033	3.0%	258,388	7.0%	241,429
Office & service equipment	36,010	6.0%	33,977	6.3%	31,972
Construction in progress	<u>227,777</u>	10.6%	<u>205,943</u>	5.3%	<u>195,564</u>
Subtotal	1,324,400	5.5%	1,255,534	5.6%	1,188,981
Less accumulated depreciation	<u>496,998</u>	6.2%	<u>467,951</u>	6.3%	<u>440,254</u>
Net capital assets	<u>\$ 827,402</u>	5.1%	<u>\$ 787,583</u>	5.2%	<u>\$ 748,727</u>

Debt Administration

The District finances its construction program primarily through the issuance of revenue bonds. In addition, the District will utilize low interest loan programs through the State of Ohio where appropriate.

The District's revenue bond ratings are:

Moody's Investors Services	Aa3
Standard & Poor's Corporation	AA

Additional information on the District's long-term debt can be found in Note 6 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The service area of the District is best described as mature. The District is not in a growth situation but one in which the system, generally, is being upgraded and replaced to comply with increasing regulatory requirements. The operating budget for 2007 is \$172,228,180 which is \$11.4 million more than the 2006 budget. The increase of the 2007 operating budget reflects increases in debt service, and fringe benefits. Rate increases of 8.6 and 4 percent were approved effective January 9, 2007 and January 9, 2006, respectively.

The capital plan was submitted and accepted for the years 2007 through 2011. The plan contemplates issuing an average of about \$110 million in debt each year to finance the capital improvement program. Each project must be individually approved before proceeding.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENTS OF NET ASSETS
December 31, 2006 and 2005
(all amounts expressed in thousands)

ASSETS	<u>2006</u>	<u>2005</u>
Current assets:		
Cash, cash equivalents and pooled investments held by the City of Cincinnati	\$ 15,823	\$ 14,156
Accounts receivable (Note 3)	29,774	27,648
Prepaid expenses and other	<u>5,090</u>	<u>3,392</u>
Total current assets	<u>50,687</u>	<u>45,196</u>
Noncurrent assets:		
Restricted assets:		
Cash, cash equivalents, and pooled investments held by the City of Cincinnati:		
Construction account	6,965	10,909
Amount to be transferred to surplus account	18,099	22,482
Held by trustee:		
Cash and cash equivalents (Note 2)	33,058	26,803
Investments - Held to maturity (Note 2)	<u>245,545</u>	<u>188,588</u>
Total restricted assets	<u>303,667</u>	<u>248,782</u>
Other assets:		
Unamortized financing costs	5,710	5,101
Other	<u>955</u>	<u>1,033</u>
Total other assets	<u>6,665</u>	<u>6,134</u>
Capital assets: (Note 5)		
Land	4,977	4,977
Buildings and structures	789,603	752,249
Processing systems	266,033	258,388
Office and service equipment	36,010	33,977
Construction in progress	<u>227,777</u>	<u>205,943</u>
	1,324,400	1,255,534
Less accumulated depreciation	<u>(496,998)</u>	<u>(467,951)</u>
Net capital assets	<u>827,402</u>	<u>787,583</u>
Total noncurrent assets	<u>1,137,734</u>	<u>1,042,499</u>
Total assets	<u>\$ 1,188,421</u>	<u>\$ 1,087,695</u>

The notes to the financial statements are an integral part of the financial statements

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENTS OF NET ASSETS
December 31, 2006 and 2005
(all amounts expressed in thousands)

LIABILITIES

	2006	2005
Current liabilities:		
Payable from current assets:		
Current portion of long-term debt (Note 6)	\$ 27,938	\$ 24,861
Accounts payable	7,210	5,770
Accrued payroll expenses	1,583	1,511
Total current liabilities payable from current assets	36,731	32,142
Payable from restricted assets:		
Construction accounts payable	7,873	4,985
Accrued interest payable	2,810	2,569
Total current liabilities payable from restricted assets	10,683	7,554
Total current liabilities	47,414	39,696
Noncurrent liabilities:		
Accrued compensated absences (Note 6)	6,976	6,581
Long-term debt (Note 6)	620,841	560,346
Total noncurrent liabilities	627,817	566,927
Total liabilities	675,231	606,623
Net assets:		
Invested in capital assets, net of related debt	303,621	279,131
Restricted	4,581	5,301
Unrestricted	204,988	196,640
Total net assets	\$ 513,190	\$ 481,072

The notes to the financial statements are an integral part of the financial statements

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENTS OF REVENUES, EXPENSES
AND CHANGES IN NET ASSETS
for the years ended December 31, 2006 and 2005
(all amounts expressed in thousands)

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Sewerage service charges	\$ 143,509	\$ 135,376
Sewer surcharges	17,235	15,275
All other revenues	<u>2,903</u>	<u>3,520</u>
Total operating revenues	<u>163,647</u>	<u>154,171</u>
Operating expenses:		
Personnel services	38,264	35,718
Purchased services	28,901	25,235
Utilities, fuel and supplies	20,785	19,715
Depreciation	30,552	29,295
Other expenses	<u>9,056</u>	<u>7,447</u>
Total operating expenses	<u>127,558</u>	<u>117,410</u>
Operating income	<u>36,089</u>	<u>36,761</u>
Nonoperating revenues (expenses):		
Interest income	11,842	5,999
Change in fair value of investments	619	881
Interest expense	(24,786)	(22,703)
Retirement of fixed assets	<u>77</u>	<u>76</u>
Total nonoperating revenues (expenses)	<u>(12,248)</u>	<u>(15,747)</u>
Income from operations	23,841	21,014
Capital contributions	<u>8,277</u>	<u>7,910</u>
Change in net assets	32,118	28,924
Total net assets, beginning	<u>481,072</u>	<u>452,148</u>
Total net assets, ending	<u>\$ 513,190</u>	<u>\$ 481,072</u>

The notes to the financial statements are an integral part of the financial statements

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENTS OF CASH FLOWS
for the years ended December 31, 2006 and 2005
(all amounts expressed in thousands)

	2006	2005
Cash Flows from Operating Activities		
Cash received from customers	\$ 162,870	\$ 149,082
Cash payments for goods and services	(53,803)	(49,504)
Cash payments for personnel costs	(38,059)	(35,474)
Other operating revenues	2,903	3,633
Net Cash Provided by Operating Activities	73,911	67,737
 Cash Flows from Capital and Related Financing Activities		
Principal and interest payments on long-term debt	(52,570)	(139,242)
Acquisition and construction of capital assets	(70,075)	(67,552)
Loan proceeds	2,816	6,585
Revenue bond proceeds	86,909	181,608
Revenue bond issuance costs	(906)	(1,809)
Tap-in fees	4,677	5,967
Gain/loss from sale of property, plant and equipment	77	76
Net Cash (Used) by Capital and Related Financing Activities	(29,072)	(14,367)
 Cash Flows from Investing Activities		
Purchase of government securities	(319,002)	(299,729)
Maturity of redemption of government securities	262,479	266,759
Net increase in fair value of pooled cash and investments held by City of Cincinnati	186	(82)
Interest earned on investments	11,093	6,611
Net Cash Provided (Used) by Investing Activities	(45,244)	(26,441)
Net Increase (Decrease) in Cash and Cash Equivalents	(405)	26,929
Cash and Cash Equivalents at January 1	74,350	47,421
Cash and Cash Equivalents at December 31	\$ 73,945	\$ 74,350
 Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Income from operations	\$ 36,089	\$ 36,761
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	30,552	29,295
Changes in assets and liabilities:		
Net change in customer accounts receivable	2,126	(1,549)
Net change in other assets	1,726	1,605
Net change in operating accounts payable	2,951	1,380
Net change in accrued payroll and related expenses	467	245
Net Cash Provided by Operating Activities	\$ 73,911	\$ 67,737
 Non-cash Transactions:		
Structures donated as contributed capital in aid of construction	\$ 2,246	\$ 1,644

The notes to the financial statements are an integral part of the financial statements

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NOTE 1 - ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the accompanying financial statements follows:

Organization

The Metropolitan Sewer District of Greater Cincinnati (MSD), an enterprise fund of the County of Hamilton, Ohio, collects and treats industrial and residential wastewater for municipalities and unincorporated areas of Hamilton County. MSD was formed on April 10, 1968, pursuant to resolutions of the Board of County Commissioners of Hamilton County and Ordinances of the City of Cincinnati, providing for a consolidation of the City Sewer Department and the County Sewer District. Under a contract with the City of Cincinnati, the Board designated the City as its agent for the maintenance and operation of MSD. The annual budget, prepared on the cash basis of accounting, is approved by the Board and administered by the City. Budgetary control is exercised at the divisional level, and between personnel and all other costs. The County issues a separate Comprehensive Annual Financial Report which includes MSD as a separate enterprise fund of the County.

Basis of Accounting

The accompanying financial statements were prepared on the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

Enterprise Fund Activity Accounting and Financial Reporting

In accordance with GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Government, the District applies all GASB pronouncements and only FASB Statements and Interpretations, Accounting Principles Board of Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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Statement of Cash Flows

For purposes of the Statements of Cash Flows, all highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents. Pooled cash and investments held by the City of Cincinnati are considered cash equivalents by MSD.

Investments

MSD is required by Ohio law to invest in only United States obligations; federal agency securities; Ohio bonds and other obligations or such obligations of political subdivisions of the state, provided that the subdivisions are located within Hamilton County; time certificates of deposit or deposit accounts in an eligible institution; and no load money market mutual funds consisting only of investments mentioned above. Investments are required to mature within five years from the date of settlement, unless the investment is matched to a specific obligation or debt of MSD.

Investment securities are stated at fair value in accordance with GASB Statement No. 31.

Inventory

Supplies and materials are stated at the lower cost or market on a first-in, first-out (FIFO) basis.

Capital Assets

Capital assets are stated at historical cost for assets acquired after MSD's inception in 1968. Assets which were acquired prior to 1968 and not identifiable with specific historical costs are not included in the capital assets balance. Assets acquired by MSD through contributions, such as contributions from land developers and federal and state grants, are capitalized and recorded in the plant records at the contributors' reported cost. Construction costs include interest capitalized on debt during the period of construction and the cost of in-force labor.

Depreciation expense is computed on the straight-line method over the estimated useful lives of the respective assets. The estimated lives are as follows:

Building and structures	40 years
Processing systems	25 years
Office and service equipment	5-15 years

Any gain or loss arising from the disposal of capital assets has been credited or charged to income.

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Unamortized Financing Costs

The unamortized financing costs include insurance, consulting and attorney fees incurred in connection with the revenue bond obligations. These amounts are being amortized on the straight-line method over the lives of the revenue bonds. Bond premiums and discounts are being amortized on the interest method over the lives of the revenue bonds.

Pension Plans

Employees participate in either the City of Cincinnati's Retirement System or the Public Employees Retirement System administered by the State of Ohio. Pension costs reflect a percentage of employees' gross pay, as defined by the terms of pension plans in which employees participate. MSD's policy is to fund pension costs accrued.

Compensated Absences

Compensated absences are accrued in accordance with GASB Statement No. 16. Components of the liability include accrued vacation time, sick leave, compensatory time and other related payments.

Net Assets

Net assets are the difference between assets and liabilities. Net assets invested in capital asset, net of related debt are capital assets less accumulated depreciation and any outstanding long-term debt related to the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are legal limitations that are imposed on their use by county legislation or external restrictions by other governments, creditors or grantors.

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary fund. For the District, these revenues are charges for services for wastewater treatment. Operating expenses are necessary costs incurred to provide the service that is the primary activity of the fund.

The implementation of GASB Statement No. 40 and GASB Statement No. 42 did not have an effect on the financial statements of MSD, however additional note disclosure can be found in Note 2.

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NOTE 2 - DEPOSITS AND INVESTMENTS

Deposits

State statutes classify monies held by the District into three categories.

Active deposits are public deposits necessary to meet current demands on the treasury. Such monies must be maintained either as cash in the District's Treasury, in commercial accounts payable or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts, or in money market deposit accounts.

Inactive deposits are public deposits that the District has identified as not required for use within the current two year period of designation of depositories. Inactive deposits must either be evidenced by certificates of deposit maturing not later than the end of the current period of designation of depositories, or by savings or deposit accounts including, but not limited to, passbook accounts.

Interim deposits are deposits of interim monies. Interim monies are those monies which are not needed for immediate use but which will be needed before the end of the current period of designation of depositories. Interim deposits must be evidenced by time certificates of deposit maturing not more than one year from the date of deposit or by savings or deposit accounts including passbook accounts.

Protection of the District's deposits is provided by the Federal Deposit Insurance Corporation (FDIC), by eligible securities pledged by financial institution as security for repayment, by surety company bonds deposited with the finance director by the financial institution or by a single collateral pool established by the financial institution to secure the repayment of all public monies deposited with the institution.

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The District's policy for deposits is collateral is required for demand deposits and certificates of deposit at 105 percent of all deposits not covered by federal deposit insurance. Obligations that may be pledged as collateral are obligations of the United States and its agencies and obligations of the State and its municipalities, school districts, and district corporations. Obligations pledged to secure deposits must be delivered to a bank other than the institution in which the deposit is made. Written custodial agreements are required. The District is required to categorize deposits and investments according to GASB Statement No. 3 *Deposits with Financial Institutions, Investments, and Reverse Purchase Agreements*. The carrying value of the District's deposits was \$40,887,000 and \$47,454,000 at December 31, 2006 and 2005, respectively.

Amounts held by the City of Cincinnati are invested on MSD's behalf in accordance with the Cincinnati Municipal Code. Amounts held by the City are collateralized as part of the City's cash and investment balances. For GASB 40 disclosure requirements, refer to the financial statements as of December 31, 2006 for the City of Cincinnati.

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Although the pledging bank has an investment and securities pool used to collateralize all public deposits, which held in the financial institution's name, noncompliance with federal requirements could potentially subject the District to a successful claim by the FDIC. The deposits not covered by federal depository insurance are considered uninsured and uncollateralized under the provisions of Statement No. 3 and subject to custodial credit risk.

Investments

State Statute and board Resolutions authorize the district to invest in obligations of U. S. Treasury, agencies and instrumentalities, certificates of deposit, repurchase agreements, money market deposit accounts, municipal depository funds, super NOW accounts, sweep accounts, separate trading of registered interest and principal of securities, mutual funds, bonds and other obligations of this State, and the State Treasurer's investment pool. Repurchase agreements are limited to 30 days and the market value of the securities must exceed the principal value of the agreement by at least 2 percent and be marked to market daily. Investments in stripped principal or interest obligations reverse repurchase agreements and derivatives are prohibited. The issuance of taxable notes for the purpose of arbitrage, the use of leverage and short selling are also prohibited. An investment must mature within five years from the date of purchase unless matched to a specific obligation or debt of the District, and must be purchased with the expectation that it will be held to maturity. Investments may only be made through specified dealers and institutions. Payment for investments may be made only upon delivery of the securities representing the investments to the finance director or, if the securities are not represented by a certificate, upon receipt of confirmation of transfer from the custodian. The District has no investment policy that addresses interest rate risk.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty the district will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Federal National Mortgage Association Notes, Federal Home Loan Mortgage Corporation Notes, and the Federal Home Loan Bank Notes are exposed to custodial credit risk in that they are uninsured, unregistered, and held by the counterparty's trust department or agent but not in the District's name. The District has no investment policy dealing with investment custodial risk beyond the requirement in state statute that prohibits payment for investments prior to the delivery of the securities representing such investments to the Treasurer or qualified trustee.

Funds held by trustees are eligible investments as defined by the Trust Agreement and are in the name of the trustee for the benefit of MSD.

Investments made by MSD are summarized below. Trustee account investments are categorized according to credit risk into the following categories: (1) insured or registered, or securities held by MSD's or its agent (bank trust department) in the MSD's name; or (2) uninsured and unregistered, with securities held by the counterparty's trust department or agent in the MSD's name; or (3) uninsured, unregistered securities held by the counterparty, or its trust department or agent but not in MSD's name. Money market funds are unclassified investments since they are

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not evidenced by securities that exist in physical or book entry form. As stated in GASB Statement No. 40, obligations of the U. S. government or obligations explicitly guaranteed by the U. S. government are not considered to have credit risk and do not require disclosure of credit quality.

The money market funds are invested in a treasury obligation fund with a Moody's credit rating of Aaa.

Concentration of Credit Risk: The Metropolitan Sewer District uses the City of Cincinnati's Investment Policy which addresses concentration of credit risk by requiring investments to be diversified to reduce risk of loss resulting from over concentration of assets in a specific issue or class of security. The following table includes the percentage of each investment type held by MSD at December 31, 2006.

<u>Investment Type</u>	<u>Fair Value</u>	<u>% of Total</u>
Investments held by the City of Cincinnati	\$ 40,887	12.79
U. S. Government Security	245,545	76.86
Money Market Funds	<u>33,058</u>	<u>10.35</u>
	<u>\$ 319,490</u>	100.00

The classification of cash and cash equivalents and investments on the financial statements is based on criteria set forth in GASB Statement No. 9. A reconciliation between the classifications of cash and investments on the financial statements and the classification per GASB Statement No. 3 is as follows:

(all amounts in thousands)

<u>December 31, 2006</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 73,945	\$ 245,545
Money Market Funds	(33,058)	33,058
Total	<u>\$ 40,887</u>	<u>\$ 278,603</u>

(all amounts in thousands)

<u>December 31, 2005</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 74,350	\$ 188,588
Money Market Funds	(26,803)	26,803
Total	<u>\$ 47,547</u>	<u>\$ 215,391</u>

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NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

(all amounts in thousands)

	2006	2005
Sewer charges and surcharges:		
Unbilled amount	\$ 15,479	\$ 14,870
Billed amount	17,535	15,367
Less allowance for doubtful accounts	(4,500)	(3,500)
Other	1,260	911
Total	\$ 29,774	\$ 27,648

NOTE 4 - RESTRICTED ASSETS

Land acquired for MSD's use is titled to either the City of Cincinnati or Hamilton County. The cost of this land has been recorded on the books of MSD since it has the full benefit of the land as an economical resource.

The Trust Agreement for the Series A Revenue Bonds (see Long-Term Debt Note) requires the establishment of certain trust accounts including a Bond Account, Bond Reserve Account, Replacement and Improvement Account, and a Surplus Account to be held by the Trustee. The Bond Account will be used to accumulate periodic principal and interest payments. The Bond Reserve Account will be funded in an amount equal to the highest annual future debt service requirement. The Replacement and Improvement Account is to be maintained with a balance of \$5,000,000. The Surplus Account is available to be used for any other Sewer System purpose. The Trust Agreement also requires the creation of a Construction Account to be held by the City to pay for project costs. At December 31, 2006 and 2005 the following balances (at fair value) were maintained in the trust accounts:

(all amounts in thousands)

	2006	2005
Held by trustee:		
Reserve	\$ 56,771	\$ 51,391
Replacement and improvement	5,168	4,992
Bond retirement	5,335	4,543
Surplus	211,329	154,465
Total	\$ 278,603	\$ 215,391

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NOTE 5 - CAPITAL ASSETS

The following summarizes the changes in capital assets during 2006:

	(all amounts in thousands)			
<u>December 31, 2006</u>	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets not being depreciated:				
Land	\$ 4,977	\$ -	\$ -	\$ 4,977
Construction in progress	<u>205,943</u>	<u>70,000</u>	<u>(48,166)</u>	<u>227,777</u>
	210,920	70,000	(48,166)	232,754
Capital assets being depreciated:				
Buildings and structures	752,249	37,354	-	789,603
Processing systems	258,388	8,233	(588)	266,033
Office and service equipment	<u>33,977</u>	<u>2,654</u>	<u>(621)</u>	<u>36,010</u>
	1,044,614	48,241	(1,209)	1,091,646
Total Capital Assets	1,255,534	118,241	(49,375)	1,324,400
Less accumulated depreciation	<u>467,951</u>	<u>29,668</u>	<u>(621)</u>	<u>496,998</u>
Net capital assets	<u>\$ 787,583</u>	<u>\$ 88,573</u>	<u>\$ (48,754)</u>	<u>\$ 827,402</u>

The following summarizes the changes in capital assets during 2005:

	(all amounts in thousands)			
<u>December 31, 2005</u>	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
Capital assets not being depreciated:				
Land	\$ 4,977	\$ -	\$ -	\$ 4,977
Construction in progress	<u>195,564</u>	<u>63,179</u>	<u>(52,800)</u>	<u>205,943</u>
	200,541	63,179	(52,800)	210,920
Capital assets being depreciated:				
Buildings and structures	715,039	37,210	-	752,249
Processing systems	241,429	17,731	(772)	258,388
Office and service equipment	<u>31,972</u>	<u>2,552</u>	<u>(547)</u>	<u>33,977</u>
	988,440	57,493	(1,319)	1,044,614
Total Capital Assets	1,188,981	120,672	(54,119)	1,255,534
Less accumulated depreciation	<u>440,254</u>	<u>28,242</u>	<u>(545)</u>	<u>467,951</u>
Net capital assets	<u>748,727</u>	<u>92,430</u>	<u>(53,574)</u>	<u>787,583</u>

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NOTE 6 - LONG-TERM DEBT

Long-term debt consisted of the following:

	<u>Issue</u>	<u>Rate %</u>	<u>Maturity</u>	<u>2006</u>	<u>2005</u>
Revenue Bonds					
2006 (a)	\$ 83,045	4.00-5.00	2031	\$ 83,045	\$ -
2005 (b)	170,560	2.50-5.00	2030	168,680	170,560
2004 (c)	46,385	2.00-5.00	2017	44,135	46,260
2003 (d)	215,575	1.50-5.25	2028	207,515	208,935
2001 (e)	76,000	2.30-5.25	2026	34,030	35,510
2000 (f)	40,085	4.50-5.75	2025	7,440	8,480
1997 (g)	105,245	3.85-5.13	2017	16,525	21,245
1993 (h)	171,790	2.45-5.60	2016	34,880	45,345
				<u>596,250</u>	<u>536,335</u>
Ohio Water Development Authority Contracts	41,830	2.00-7.49	2016	857	963
Ohio Water and Sewer Rotary Commission	-	-	-	50	50
Ohio Public Works Commission	-	3.54-4.80	2017	3,769	4,041
Water Pollution Control Loan Fund	-	0.00-3.00	2018	24,668	23,449
Total obligations				625,594	564,838
Bond discounts				(201)	(317)
Bond premiums				32,208	31,163
Deferred loss on defeasance				(8,822)	(10,477)
Current maturities				(27,938)	(24,861)
Long-term portion				<u>\$ 620,841</u>	<u>\$ 560,346</u>

Principal and interest payments on long-term debt for the next five years and thereafter are as follows:

(all amounts in thousands except percents)

Year	Revenue Bonds		OWDA		OPWC		WPCLF*	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2007	\$ 26,065	\$ 29,119	\$ 110	\$ 31	\$ 277	\$ 75	\$ 1,486	\$ 1,014
2008	27,210	27,657	114	27	283	69	1,544	956
2009	28,475	26,398	118	23	288	64	1,604	895
2010	30,025	25,138	122	19	294	58	1,666	833
2011	31,425	23,742	126	15	300	52	1,731	768
2012-2016	180,260	94,006	267	15	1,478	168	8,677	2,805
2017-2021	105,900	54,246	-	-	776	47	6,758	1,329
2022-2026	100,465	31,720	-	-	73	3	3,642	249
2027-2030	66,425	8,080	-	-	-	-	-	-
	<u>\$ 596,250</u>	<u>\$ 320,106</u>	<u>\$ 857</u>	<u>\$ 130</u>	<u>\$ 3,769</u>	<u>\$ 536</u>	<u>\$ 27,108</u>	<u>\$ 8,849</u>

* This amount represents the total amount of the loans, some of which have not been fully drawdown or finalized.

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Bond discount, premium, loss on defeasance activity for the year:

<u>December 31, 2006</u>	<u>Beginning Balance</u>	<u>Amortized</u>	<u>Refunded</u>	<u>Issued</u>	<u>Ending Balance</u>
Bond discount	\$ (317)	\$ 116	\$ -	\$ -	\$ (201)
Bond premium	31,163	(2,668)	-	3,713	32,208
Loss on defeasance	(10,477)	1,655	-	-	(8,822)
Total	<u>\$ 20,369</u>	<u>\$ (897)</u>	<u>\$ -</u>	<u>\$ 3,713</u>	<u>\$ 23,185</u>

<u>December 31, 2005</u>	<u>Beginning Balance</u>	<u>Amortized</u>	<u>Refunded</u>	<u>Issued</u>	<u>Ending Balance</u>
Bond discount	\$ (631)	\$ 178	\$ 136	\$ -	\$ (317)
Bond premium	24,916	(2,439)	(454)	9,140	31,163
Loss on defeasance	(8,376)	3,110	(5,211)	-	(10,477)
Total	<u>\$ 15,909</u>	<u>\$ 849</u>	<u>\$ (5,529)</u>	<u>\$ 9,140</u>	<u>\$ 20,369</u>

Long-term debt activity for the year:

<u>December 31, 2006</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 536,335	\$ 83,045	\$ 23,130	\$ 596,250
Ohio Water Development Authority	963	-	106	857
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	4,041	-	272	3,769
Water Pollution Control Loan Fund	23,449	2,650	1,430	24,669
Total	<u>\$ 564,838</u>	<u>\$ 85,695</u>	<u>\$ 24,938</u>	<u>\$ 625,595</u>

<u>December 31, 2005</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 472,985	\$ 170,560	\$ 107,210	\$ 536,335
Ohio Water Development Authority	1,062	-	99	963
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	4,398	-	357	4,041
Water Pollution Control Loan Fund	18,340	6,275	1,166	23,449
Total	<u>\$ 496,835</u>	<u>\$ 176,835</u>	<u>\$ 108,832</u>	<u>\$ 564,838</u>

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Revenue Bonds

- a) Effective November 15, 2006, MSD issued \$83,045,000 Series A Sewer System Improvement Revenue Bonds dated November 1, 2006. The proceeds from the 2005 Series B bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2006 Series A bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B, 2004, 2005A and 2005B bonds, secures equally and ratably under the Trust Agreement.
- b) Effective March 30, 2005, MSD issued \$86,960,000 Series A, Sewer System Refunding Revenue Bonds dated March 1, 2005. The proceeds from the 2005 bonds were used to defease portions of the 1997, 2000 and 2001 revenue bonds and pay for the cost of issuance. The 2005A bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B and 2004 bonds, secured equally and ratably under the Trust Agreement.

A portion of the proceeds was used to purchase U.S. Government Securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service to refund \$46,980,000 of outstanding 1997 Series A Bonds, \$20,665,000 of outstanding 2000 Series A Bonds and \$19,280,000 of outstanding 2001 Series A Bonds. As a result, these bonds are considered defeased and the liability for those bonds removed from the balance sheet.

Although the refunding resulted in the recognition of an accounting loss of \$5,211,000 in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$5,201,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$3,748,000.

Effective November 9, 2005, MSD issued \$83,600,000 Series B Sewer System Improvement Revenue Bonds dated November 1, 2005. The proceeds from the 2005 Series B bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2005 Series B bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B, 2004 and 2005A bonds, secures equally and ratably under the Trust Agreement.

- c) Effective October 5, 2004, MSD issued \$46,385,000 Series A, Sewer System Refunding Revenue Bonds dated September 1, 2004. The proceeds from the 2004 bonds were used to defease portions of the 1995, 1997 and 2000 revenue bonds and pay for the cost of issuance. The 2004 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1993, 1995, 1997, 2000,

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2001, and 2003 Series A and 2003 Series B bonds, secured equally and ratably under the Trust Agreement.

A portion of the proceeds was used to purchase U.S. Government Securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service to refund \$34,215,000 of outstanding 1995 Series A Bonds, \$6,280,000 of outstanding 1997 Series A Bonds, and \$6,400,000 of outstanding 2000 Series A Bonds. As a result, these bonds are considered defeased and the liability for those bonds removed from the balance sheet.

Although the advance refunding resulted in the recognition of an accounting loss of \$3,163,000 to be amortized over future periods in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$3,850,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$3,001,000.

- d) Effective July 9, 2003 and September 4, 2003, MSD issued \$160,065,000 Series A, dated June 1, 2003 and \$55,510,000 Series B, dated September 1, 2003, respectively, County of Hamilton, Ohio Sewer System Improvement and Refunding Revenue Bonds. The proceeds from the 2003 bonds were used to permanently fund certain previous capital expenditures, defease portions of the 1993 and 1995 Series A bond issues, provide funds for new projects, fund the new bond reserve requirement and pay for the cost of issuance. The 2003 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1993, 1995, 1997, 2000, and 2001 Series A bonds, secured equally and ratably under the Trust Agreement.

A portion of the proceeds was used to purchase U.S. Government Securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service to refund \$111,430,000 of outstanding 1993 Series A Bonds and \$17,125,000 of outstanding 1995 Series A Bonds. As a result, these bonds are considered defeased and the liability for those bonds removed from the balance sheet.

Although the advance refunding resulted in the recognition of an accounting loss of \$7,154,000 to be amortized over future periods in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$19,250,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$14,719,000.

- e) Effective November 14, 2001, MSD issued \$76,000,000 County of Hamilton, Ohio 2001 Series A Sewer System Improvement and Refunding Revenue bonds dated November 1, 2001. The proceeds from the 2001 bonds were used to permanently fund certain previous capital expenditures, defease a portion of the 1991 Series A bond issue, fund the new bond reserve requirement and pay for the cost of issuance. The 2001 bonds are special obligations of the District, payable solely from the net revenues of the District and were

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for the years ended December 31, 2006 and 2005

issued on a parity with the 1993, 1995, 1997 and 2000 Series A bonds, secured equally and ratably under the Trust Agreement.

- f) Effective June 29, 2000, MSD issued \$40,085,000 County of Hamilton, Ohio 2000 Series A Sewer System Improvement Revenue bonds dated June 1, 2000. The proceeds from the 2000 bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirement and pay the cost of issuance. The 2000 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995 and 1997 Series A bonds, secured equally and ratably under the Trust Agreement.
- g) Effective October 22, 1997, MSD issued \$105,245,000 County of Hamilton, Ohio 1997 Series A Sewer System Improvement Revenue bonds dated October 1, 1997. The proceeds from the 1997 bonds were used to permanently fund certain previous expenditures, fund the new bond reserve requirement and pay the cost of issuance. The 1997 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993 and 1995 Series A bonds, secured equally and ratably under the Trust Agreement.
- h) Effective August 31, 1995, MSD issued \$85,800,000 County of Hamilton, Ohio 1995 Series A Sewer System Improvement and Refunding Revenue bonds dated August 15, 1995. The proceeds from the 1995 bonds were used to permanently fund certain previous capital expenditures, provide funds for new projects, defease a portion of the 1986 and 1991 Series A bond issues, fund the new bond reserve requirement and pay the cost of issuance. The 1995 bonds are special obligations of the District payable solely from the net revenues of the District and were issued on parity with the 1993 Series A bonds, secured equally and ratably under the Trust Agreement.
- i) Effective May 4, 1993, MSD issued \$171,790,000 County of Hamilton, Ohio 1993 Series A Sewer System Improvement and Refunding Revenue bonds dated April 15, 1993. The proceeds from the 1993 Bonds were used to permanently fund certain previous capital expenditures, provide funds for new projects, defease a portion of the 1986 and 1991 Series A bond issues, fund the new bond reserve requirement, and pay the cost of issuance. The 1993 bonds are special obligations of the District payable solely from the net revenues of the District, secured equally and ratably under the Trust Agreement.

The 2006, 2005, 2004, 2003, 2001, 2000, 1997 and 1993 Bonds may be redeemed prior to their maturities in accordance with provisions of the bond resolutions. The redemption process for the bonds includes declining premiums up to 2 percent of principal.

For both December 31, 2006 and December 31, 2005 the amount of defeased debt outstanding was \$99,605,000.

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Maturities for bonds over the next five years and thereafter are shown below:

(all amounts in thousands except percents)

Year	2006 Bonds	2005 Bonds	2004 Bonds	2003 Bonds	2001 Bonds	2000 Bonds	1997 Bonds	1993 Bonds
2007	\$ 1,710	\$ 2,180	\$ 2,260	\$ 1,340	\$ 1,525	\$ 1,095	\$ 4,930	11,025
2008	1,955	7,235	2,200	1,475	1,585	1,145	-	11,615
2009	2,035	7,575	2,260	1,500	1,660	1,205	-	12,240
2010	2,115	2,355	-	16,910	1,740	1,265	5,640	-
2011	2,200	2,445	-	17,690	1,805	1,330	5,955	-
2012-2016	12,410	47,360	15,495	99,200	4,395	1,400	-	-
2017-2021	15,615	47,600	21,920	19,060	1,705	-	-	-
2022-2026	19,785	31,125	-	29,940	19,615	-	-	-
2027-2031	25,220	20,805	-	20,400	-	-	-	-
	<u>\$ 83,045</u>	<u>\$ 168,680</u>	<u>\$ 44,135</u>	<u>\$ 207,515</u>	<u>\$ 34,030</u>	<u>\$ 7,440</u>	<u>\$ 16,525</u>	<u>34,880</u>

Under the terms of the amended revenue bond trust indenture, MSD has agreed to certain covenants, among other things, to restrict additional borrowing, maintain rates sufficient to meet debt service requirements, and maintain specified fund balances under trust agreements.

The Revenue bond issues as discussed above contain covenants which require the MSD to maintain a level of debt service coverage. The following calculation reflects MSD's debt service coverage.

(all amounts in thousands)

	<u>2006</u>	<u>2005</u>
Revenues:		
Total operating revenues	\$ 163,647	\$ 154,171
Interest income	11,842	5,999
Capitalized interest income	1,001	612
Tap-in/connection fees	<u>4,677</u>	<u>5,967</u>
Total pledged revenue	181,167	166,749
Total operating and maintenance expenses less depreciation and amortization	(97,005)	(88,115)
Half of pledged revenues transferred to surplus account	<u>9,049</u>	<u>11,241</u>
Net income available for debt service (a)	<u>\$ 93,211</u>	<u>\$ 89,875</u>
Principal and interest requirement on revenue bonds (b)	<u>49,348</u>	<u>\$ 43,223</u>
Principal and interest requirements on obligations (c)	<u>52,340</u>	<u>\$ 45,792</u>
Debt service coverage		
Revenue bonds (a) divided by (b)	<u>189%</u>	<u>208%</u>
All obligations (a) divided (c)	<u>178%</u>	<u>196%</u>
Maximum debt service coverage required on revenue bonds	<u>125%</u>	<u>125%</u>

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Ohio Water Development Authority Contracts

All contracts between the Ohio Water Development Authority (OWDA) and the Metropolitan Sewer District require MSD to prescribe and charge such rates for sewer usage which are sufficient (after expenses of operation and maintenance) to pay principal and interest on OWDA contracts. The principal is repayable in equal semi-annual installments to maturity.

Ohio Water and Sewer Rotary Commission

Advances from Ohio Water and Sewer Rotary Commission represent tap-in fees and acreage assessments to be forwarded to the Commission upon collection from customers. Such advances do not bear interest unless they are determined to be in default.

Ohio Public Works Commission

The MSD has entered into agreements with the Ohio Public Works Commission (OPWC) for financing of certain qualified capital projects. As the projects progress the commitments are drawn down as funds are paid by OPWC directly to the contractors. The principal is repayable in semi-annual installments to the date of maturity for each project.

Water Pollution Control Loan Fund

The MSD has received low interest loan commitments from the Ohio Water Pollution Control Loan fund for certain qualified projects. As the projects progress the commitments are drawn down. The principal is repayable in semi-annual installments to the date of maturity for each project.

Interest on Long-Term Obligations

The following interest costs were incurred and expensed or capitalized as part of the cost of MSD's additions to capital assets.

(all amounts in thousands)

	2006	2005
Interest incurred	\$ 26,823	\$ 25,021
Less Interest capitalization	(2,037)	(2,318)
Interest expense	\$ 24,786	\$ 22,703

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Compensated Absences

Compensated absences consist of vacation time, sick pay and compensatory time. The following is a summary of activity for 2006 and 2005.

(all amounts in thousands)

	Beginning Balance	Increase	Decrease	Ending Balance
2006	6,581	3,820	3,425	6,976
2005	6,346	3,755	3,520	6,581

NOTE 7 - PENSION AND RETIREMENT

City of Cincinnati Retirement System

The majority of MSD full-time employees participate in the Retirement System of the City of Cincinnati (CRS). CRS is a cost-sharing, multiple-employer, defined benefit, public employee retirement system. The plan provides retirement, disability and death benefits to plan members and beneficiaries. CRS also provides health care benefits to vested retirees. Benefits provided under the plan are established by the Cincinnati Municipal Code. CRS issues a separate, publicly available financial report that includes financial statements and required supplementary information. That report may be obtained from the City of Cincinnati Retirement System, 801 Plum Street, Cincinnati, Ohio 45202 or by calling (513) 352-3227.

The Cincinnati Municipal Code provides statutory authority for employee and employer contribution rates. For 2006 and 2005, the required, determined contribution rates were 17 percent for MSD and 11 percent for employees. MSD's contributions to CRS for the years ending December 31, 2006, 2005 and 2004 were \$4,584,000 and \$2,898,000, \$2,908,000, respectively, equal to the required contribution for each year.

Public Employees' Retirement System

A limited number of MSD employees participate in the Public Employee' Retirement System administrated by the State of Ohio. PERS is not material to the financial statements of MSD and additional disclosures concerning PERS, including other post-employment benefit information, can be found in the plan's annual financial statements. Interested parties may obtain a copy by written request to 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 466-2085.

Other Postemployment Benefit Information

CRS provides hospital and surgical insurance to retired members who have earned fifteen years credited service at the time of termination or terminate after age sixty with five years credited

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service. Those who are receiving survivor benefits of eligible members are entitled to have their hospital and surgical insurance premiums paid by the CRS. When benefits would be reduced by reason of the retired member's eligibility for hospital and medical benefits under federal social security laws, CRS will pay whatever additional fees are required for the Federal medical coverage.

The health care coverage provided by the CRS is advance-funded on an actuarial determined basis as a portion of the employer contribution requirement to the System. The Cincinnati Municipal Code provides authority for employer contributions.

The actuarial assumptions used for the December 31, 2006 valuation included an assumption for hospital and surgical benefits recognizing adjusted premiums, based on experience from recent years, adjusted to current year by assumed annual increases in premium costs. The cost of coverage is recognized as an expense as claims are paid. CRS has 4,826 active contributing participants of which 540 are MSD employees. For 2006, MSD's contribution was 16 percent of the total employers' contribution.

NOTE 8 - RELATED PARTY TRANSACTIONS

Cincinnati Water Works provides billing and collection services on customers' accounts for MSD. Fees for these services for 2006 and 2005 were \$4,791,000 and \$4,305,000 respectively. Fees are also paid to other municipalities and villages within Hamilton County for collection of sewerage bills.

The City of Cincinnati provides "overhead" services to MSD, such as check disbursement, investment and legal services, etc. The fees for these services for 2006 and 2005 were \$2,080,000 and \$2,122,000 respectively. In addition, the City's Municipal Garage provides gasoline and repairs vehicles for MSD. Fees for these services were \$1,518,000 and \$1,404,000 for 2006 and 2005, respectively.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

The City of Cincinnati and the Board of County Commissioners of Hamilton County, Ohio are parties to an Interim Partial Consent Decree on Sanitary Sewer Overflows, which was lodged on February 15, 2002, with the U.S. District Court for the Southern District of Ohio, Western Division. This Decree provides for, among other things, the scheduled elimination of sixteen "highly active" sanitary sewer overflows. On December 4, 2003, a Global Consent Decree was lodged with the U.S. District Court for the Southern District of Ohio, Western Division. This decree focuses on combined sewer overflows, the implementation of the Sanitary Sewer Overflow Correction plan established in the Interim Partial Consent Decree, and other wet weather issues. The court approved the decrees on June 9, 2004. It is estimated that the program, still to be approved, would cost about \$1.5 billion through 2022 and \$.49 billion thereafter, measured in 2006 dollars. The consent decree documents are posted on the MSD web site, msdgc.org, under consent decree.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
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As part of MSD's capital improvement program, MSD has entered into a number of contracts for construction, design, and other services. Commitments under these contracts aggregate approximately \$58 million as of December 31, 2006.

NOTE 10 - RISK MANAGEMENT

MSD is part of the City of Cincinnati Risk Management Program. The City purchases commercial insurance to cover losses due to: theft of, damage to, or destruction of assets and purchases general liability insurance for specific operations and professional liability insurance for certain operations. All other risks of loss are self-insured. Separately, MSD carries property insurance pursuant to an all-risk policy on MSD's buildings and equipment per the revenue bond trust agreement. There has been no reduction in insurance coverage from coverage in 2003. Insurance settlements for claims resulting from risks covered by commercial insurance have not exceeded the insurance coverage in any of the past three years.

NOTE 11 - SUBSEQUENT EVENTS

The Hamilton County Board of Commissioners have approved a 8.6 percent sewerage rate increase effective January 9, 2007.



Mary Taylor, CPA
Auditor of State

METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI

HAMILTON COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
NOVEMBER 8, 2007**