

**THE METROPOLITAN SEWER DISTRICT
OF GREATER CINCINNATI**

SINGLE AUDIT REPORTS

for the year ended December 31, 2005



**Auditor of State
Betty Montgomery**

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, 2005 through December 31, 2005. 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.

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BETTY MONTGOMERY
Auditor of State

September 8, 2006

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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, 2005, and have issued our report thereon dated April 28, 2006. As described in Note 1 of the financial statements, MSD has adopted the provisions of Governmental Accounting Standards Board (GASB) *Statement No. 40 Deposit and Investment Risk Disclosures*, *GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. 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 MSD's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting 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 misstatements caused by error or fraud in amounts that would be material in relation to the financial statements 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 financial reporting and its operation that we consider to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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
April 28, 2006



**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, 2005. 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, 2005.

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, 2005 and have issued our report thereon dated April 28, 2006. 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.

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

Cincinnati, Ohio
April 28, 2006

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

for the year ended December 31, 2005

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	\$ 2,041,259
Capitalization Grants for State Revolving Funds	66.458	CS392574-02	<u>4,233,780</u>
Total			<u>6,275,039</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS			<u>\$ 6,275,039</u>

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

for the year ended December 31, 2005

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, 2005

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 Funds CFDA #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, 2005

There were no prior audit findings or questioned costs relative to federal awards for the audit of MSD for the year ended December 31, 2004.

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

FINANCIAL STATEMENTS

for the years ended December 31, 2005 and 2004

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, 2005 and 2004 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, 2005 and 2004 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 April 28, 2006 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.

Fox & Company

Cincinnati, Ohio
April 28, 2006

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 \$481,072,000 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 (58%) 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)

	2005	Percentage Increase (Decrease) over 2004	2004	Percentage Increase (Decrease) over 2003	2003
Current and other assets	\$ 300,112	27.5%	\$ 235,430	(13.6%)	\$ 272,560
Capital assets	<u>787,583</u>	5.2%	<u>748,727</u>	5.3%	<u>711,245</u>
Total assets	<u>\$ 1,087,695</u>	10.5%	<u>\$ 984,157</u>	0.0%	<u>\$ 983,805</u>
Long-term debt	\$ 585,207	14.1%	\$ 512,744	(2.1%)	\$ 523,916
Other liabilities	<u>21,416</u>	11.2%	<u>19,265</u>	(8.2%)	<u>20,991</u>
Total liabilities	<u>\$ 606,623</u>	14.0%	<u>\$ 532,009</u>	(2.4%)	<u>\$ 544,907</u>
Invested in capital assets					
Net of related debt	\$ 279,131	(7.7%)	\$ 302,580	19.9%	252,441
Restricted	4,543	10.1%	4,128	(26.1%)	5,589
Unrestricted	<u>197,398</u>	35.7%	<u>145,440</u>	(19.6%)	<u>180,868</u>
Total net assets	<u>\$ 481,072</u>	6.4%	<u>\$ 452,148</u>	3.0%	<u>\$ 438,898</u>

Net assets increased \$28.924 million in 2005 and \$13.250 million in 2004. 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)

	2005	Percentage Increase (Decrease) over 2004	2004	Percentage Increase (Decrease) over 2003	2003
Operating revenues	\$ 154,171	6.1%	\$ 145,291	13.0%	\$ 128,579
nonoperating revenues	<u>5,999</u>	47.1%	<u>4,077</u>	(13.5%)	<u>4,711</u>
Total revenues	<u>160,170</u>	7.2%	<u>149,368</u>	12.1%	<u>133,290</u>
Depreciation expense	29,295	6.8%	27,434	(1.5%)	27,864
Other operating expense	88,115	0.5%	87,670	9.6%	79,996
Nonoperating expense	<u>21,746</u>	(23.5%)	<u>28,443</u>	18.6%	<u>23,984</u>
Total expenses	<u>139,156</u>	(3.1%)	<u>143,547</u>	8.9%	<u>131,844</u>
Income before capital contributions	21,014	261.0%	5,821	302.6%	1,446
Capital contributions	<u>7,910</u>	6.5%	<u>7,429</u>	5.2%	<u>7,060</u>
Change in net assets	28,924	118.3%	13,250	55.8%	8,506
Beginning net assets	<u>452,148</u>	3.0%	<u>438,898</u>	2.0%	<u>430,392</u>
Ending net assets	<u>\$ 481,072</u>	6.4%	<u>\$ 452,148</u>	3.0%	<u>\$ 438,898</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 2005 total revenues increased 7.2 percent or \$10.8 million and expenses decreased 3.1 percent or \$4.4 million. During 2004 total revenues increased 12.1 percent or \$16 million and expenses increased 8.9 percent or \$11.7 million. The major factors which contributed to these results include:

- Operating revenues reflect a 12 percent rate increase implemented March 31, 2005 and a 14 percent rate increase implemented January 9, 2004.
- Nonoperating revenues increased in 2005 due to an increase in interest rates. Nonoperating revenues decreased in 2004 due to lower interest rates and less funds available for investment.
- Operating expenses increased 0.5 percent or \$0.4 million in 2005. The slight increase in operating costs is an offset of last years one time Consent Decree fine and reduced head count coupled with increases in sewer repairs, utilities, plant maintenance and health care. Operating expenses increased 9.6 percent or \$7.7

million in 2004. The increase included a \$1.2 million fine paid under the Consent Decree and the Consent Decree mandated the implementation of Water-in-Basement program, \$2.4 million. Increases in fringe benefits costs, utility costs, and repair/upgrade costs were major factors in the remaining increase.

- Nonoperating expense for 2005 decreased 23.5 percent or \$6.7 million due to the decrease in the retirement of fixed assets. Nonoperating expense for 2004 increased 18.6 percent or \$4.5 million due to an increase in interest expense, \$880 thousand offset by an increase in fair value of investments, \$2.2 million and a loss on retirement of assets of \$5.8 million. The District replaced its belt filter press equipment and process with a centrifuge system. The loss on retirement of assets reflects the remaining net book value of the assets replaced.
- 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 2005 expenses were 6.3 percent under the approved budget. The principal areas of savings were reduced Water-In-Basement costs and reduced debt service due to later debt issuance than budgeted. The 2004 expenses were 3.8 percent under the approved budget. About half of the savings was in reduced Water-In-Basement activity attributable to mild weather with reduced debt, due to refundings, and fewer equipment purchases making up the difference.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of December 31, the District's investment in capital assets amounted to \$788 million and \$749 million (net of accumulated depreciation) as shown in Table C for 2005 and 2004, respectively. In 2005, the District spent about \$55 million on capital improvement projects and received about \$8 million in capital contributions. In 2004, the District spent about \$69 million on capital improvement projects and received about \$7 million in capital contributions.

Sewer replacement and improvement projects were in about three-fourths of the program in 2005 and two-thirds of the program in 2004. The upgrade and replacement of the belt filter presses and process resulted in a reduction in processing systems of \$16.9 million and \$11.1 million in related accumulated depreciation during 2004.

Table C
Capital Assets
(In Thousands)

	2005	Percentage Increase (Decrease) over 2005	2004	Percentage Increase (Decrease) over 2004	2003
Land	\$ 4,977	0.0%	\$ 4,977	0.0%	\$ 4,977
Buildings & structures	752,249	5.2%	715,039	5.8%	676,033
Processing systems	258,388	7.0%	241,429	(6.7%)	258,841
Office & service equipment	33,977	6.3%	31,972	3.3%	30,937
Construction in progress	<u>205,943</u>	5.3%	<u>195,564</u>	17.7%	<u>166,127</u>
Subtotal	1,255,534	5.6%	1,188,981	4.6%	1,136,915
Less accumulated depreciation	<u>467,951</u>	6.3%	<u>440,254</u>	3.4%	<u>425,670</u>
Net capital assets	<u>\$ 787,583</u>	5.2%	<u>\$ 748,727</u>	5.3%	<u>\$ 711,245</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 2006 is \$160,805,002 which is \$9.3 million more than the 2005 budget. The increase of the 2006 operating budget reflects increases in debt service, fringe benefits and utilities. Rate increases of 4 and 12 percent were approved effective January 6, 2006 and March 31, 2005, respectively.

The capital plan was submitted and accepted for the years 2006 through 2010. The plan contemplates issuing an average of about \$100 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, 2005 and 2004
(all amounts expressed in thousands)

ASSETS

	<u>2005</u>	<u>2004</u>
Current assets:		
Cash, cash equivalents and pooled investments held by the City of Cincinnati	\$ 14,156	\$ 14,164
Accounts receivable (Note 3)	27,648	26,099
Prepaid expenses and other	<u>3,392</u>	<u>1,880</u>
Total current assets	<u>45,196</u>	<u>42,143</u>
Noncurrent assets:		
Restricted assets:		
Cash, cash equivalents, and pooled investments held by the City of Cincinnati:		
Construction account	10,909	5,850
Amount to be transferred to surplus account	22,482	17,421
Held by trustee:		
Cash and cash equivalents (Note 2)	26,803	9,986
Investments - Held to maturity (Note 2)	<u>188,588</u>	<u>154,655</u>
Total restricted assets	<u>248,782</u>	<u>187,912</u>
Other assets:		
Unamortized financing costs	5,101	4,228
Other	<u>1,033</u>	<u>1,147</u>
Total other assets	<u>6,134</u>	<u>5,375</u>
Capital assets: (Note 5)		
Land	4,977	4,977
Buildings and structures	752,249	715,039
Processing systems	258,388	241,429
Office and service equipment	33,977	31,972
Construction in progress	<u>205,943</u>	<u>195,564</u>
	1,255,534	1,188,981
Less accumulated depreciation	<u>(467,951)</u>	<u>(440,254)</u>
Net capital assets	<u>787,583</u>	<u>748,727</u>
Total noncurrent assets	<u>1,042,499</u>	<u>942,014</u>
Total assets	<u>\$ 1,087,695</u>	<u>\$ 984,157</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, 2005 and 2004
(all amounts expressed in thousands)

LIABILITIES

	<u>2005</u>	<u>2004</u>
Current liabilities:		
Payable from current assets:		
Current portion of long-term debt (Note 6)	\$ 24,861	\$ 21,828
Accounts payable	5,770	4,390
Accrued payroll expenses	<u>1,511</u>	<u>1,501</u>
Total current liabilities payable from current assets	<u>32,142</u>	<u>27,719</u>
Payable from restricted assets:		
Construction accounts payable	4,985	4,766
Accrued interest payable	<u>2,569</u>	<u>2,262</u>
Total current liabilities payable from restricted assets	<u>7,554</u>	<u>7,028</u>
Total current liabilities	<u>39,696</u>	<u>34,747</u>
Noncurrent liabilities:		
Accrued compensated absences (Note 6)	6,581	6,346
Long-term debt (Note 6)	<u>560,346</u>	<u>490,916</u>
Total noncurrent liabilities	<u>566,927</u>	<u>497,262</u>
Total liabilities	<u>606,623</u>	<u>532,009</u>
Net assets:		
Invested in capital assets, net of related debt	279,131	302,580
Restricted	4,543	4,128
Unrestricted	<u>197,398</u>	<u>145,440</u>
Total net assets	<u>\$ 481,072</u>	<u>\$ 452,148</u>

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, 2005 and 2004
(all amounts expressed in thousands)

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Sewerage service charges	\$ 135,376	\$ 125,992
Sewer surcharges	15,275	16,858
All other revenues	<u>3,520</u>	<u>2,441</u>
Total operating revenues	<u>154,171</u>	<u>145,291</u>
Operating expenses:		
Personnel services	35,718	36,871
Purchased services	25,235	25,174
Utilities, fuel and supplies	19,715	17,393
Depreciation	29,295	27,434
Other expenses	<u>7,447</u>	<u>8,232</u>
Total operating expenses	<u>117,410</u>	<u>115,104</u>
Operating income	<u>36,761</u>	<u>30,187</u>
Nonoperating revenues (expenses):		
Interest income	5,999	4,077
Change in fair value of investments	881	135
Interest expense	(22,703)	(22,785)
Retirement of fixed assets	<u>76</u>	<u>(5,793)</u>
Total nonoperating revenues (expenses)	<u>(15,747)</u>	<u>(24,366)</u>
Income from operations	21,014	5,821
Capital contributions	<u>7,910</u>	<u>7,429</u>
Change in net assets	28,924	13,250
Total net assets, beginning	<u>452,148</u>	<u>438,898</u>
Total net assets, ending	<u>\$ 481,072</u>	<u>\$ 452,148</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, 2005 and 2004
(all amounts expressed in thousands)

	<u>2005</u>	<u>2004</u>
Cash Flows from Operating Activities		
Cash received from customers	\$ 149,082	\$ 137,533
Cash payments for goods and services	(49,504)	(51,679)
Cash payments for personnel costs	(35,474)	(36,127)
Other operating revenues	<u>3,633</u>	<u>2,558</u>
Net Cash Provided by Operating Activities	67,737	52,285
Cash Flows from Capital and Related Financing Activities		
Principal and interest payments on long-term debt	(139,242)	(86,583)
Acquisition and construction of capital assets	(67,552)	(62,334)
Loan proceeds	6,585	7,245
Revenue bond proceeds	181,608	46,385
Revenue bond issuance costs	(1,809)	(1,683)
Tap-in fees	5,967	4,696
Gain/loss from sale of property, plant and equipment	<u>76</u>	<u>(5,793)</u>
Net Cash (Used) by Capital and Related Financing Activities	(14,367)	(98,067)
Cash Flows from Investing Activities		
Purchase of government securities	(299,729)	(178,977)
Maturity of redemption of government securities	266,759	219,971
Net increase in fair value of pooled cash and investments held by City of Cincinnati	(82)	572
Interest earned on investments	<u>6,611</u>	<u>4,901</u>
Net Cash Provided (Used) by Investing Activities	(26,441)	46,467
Net Increase (Decrease) in Cash and Cash Equivalents	26,929	685
Cash and Cash Equivalents at January 1	<u>47,421</u>	<u>46,736</u>
Cash and Cash Equivalents at December 31	<u>\$ 74,350</u>	<u>\$ 47,421</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Income from operations	\$ 36,761	\$ 30,188
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	29,295	27,434
Changes in assets and liabilities:		
Net change in customer accounts receivable	(1,549)	(5,317)
Net change in other assets	1,605	311
Net change in operating accounts payable	1,380	(1,074)
Net change in accrued payroll and related expenses	<u>245</u>	<u>743</u>
Net Cash Provided by Operating Activities	<u>\$ 67,737</u>	<u>\$ 52,285</u>
Non-cash Transactions:		
Structures donated as contributed capital in aid of construction	<u>\$ 1,644</u>	<u>\$ 1,819</u>

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

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
NOTES TO THE FINANCIAL STATEMENTS
for the years ended December 31, 2005 and 2004

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.

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

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.

Change in Accounting Principles

MSD has implemented *GASB Statement No. 40, Deposit and Investment Risk Disclosures* and *GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

GASB Statement No. 40 establishes and modified disclosure requirements related to investment risks: credit risk (including custodial credit risk and concentrations of credit risk) and interest rate risk. This statement also establishes and modified disclosure requirements for custodial credit risk on deposits.

GASB Statement No. 42 amends GASB Statement No. 3 and establishes accounting and financial reporting standards for impairment of capital assets and accounting requirements for insurance recoveries. The implementation 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.

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.

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it.

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. The carrying value of the District's deposits was \$47,547,000 and \$37,435,000 at December 31, 2005 and 2004, respectively. For GASB 40 disclosure requirements, refer to the financial statements as of December 31, 2005 for the City of Cincinnati.

Investments

State statutes and the Trust Agreement authorize the District to invest in obligations of the 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% 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. 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.

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. 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: MSD uses an Investment Policy that is approved by the State of Ohio and discussed in Note 1 of this report under Investments. This investment policy reduces the risk of loss because the assets are invested in government securities. The following table includes the percentage of each investment type held by MSD at December 31, 2005.

Investment Type	Fair Value	% of Total
Deposits held by the City of Cincinnati	\$ 47,547	18.08
U. S. Government Securities	188,588	71.72
Money Market Funds	26,803	10.20
	<u>\$ 262,938</u>	<u>100.00</u>

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, 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>

(all amounts in thousands)

<u>December 31, 2004</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 47,421	\$ 154,655
Money Market Funds	(9,986)	9,986
Total	<u>\$ 37,435</u>	<u>\$ 164,641</u>

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

(all amounts in thousands)

	<u>2005</u>	<u>2004</u>
Sewer charges and surcharges:		
Unbilled amount	\$ 14,870	\$ 13,279
Billed amount	15,367	14,802
Less allowance for doubtful accounts	(3,500)	(2,500)
Other	911	518
Total	<u>\$ 27,648</u>	<u>\$ 26,099</u>

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.

In August 1985, the Federal District Court entered a consent order in an action with MSD and others. In complying with the consent order, MSD was required to maintain amounts on deposit in an environmental security account. The balance of this account was \$1,177,000 at December 31, 2003. The new Global Consent Decree (See Note 9) specified that this account be part of the funding for the Water-In-Basement program and was liquidated in 2004.

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, 2005 and 2004 the following balances (at fair value) were maintained in the trust accounts:

	(all amounts in thousands)	
	<u>2005</u>	<u>2004</u>
Held by trustee:		
Reserve	\$ 51,391	\$ 45,795
Replacement and improvement	4,992	4,894
Bond retirement	4,543	4,129
Surplus	154,465	109,824
Total	<u>\$ 215,391</u>	<u>\$ 164,642</u>

NOTE 5 - CAPITAL ASSETS

The following summarizes the changes in capital assets during 2005:

(all amounts in thousands)

<u>December 31, 2005</u>	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land	\$ 4,977	\$ -	\$ -	\$ 4,977
Construction in progress	195,564	63,179	(52,800)	205,943
	<u>200,541</u>	<u>63,179</u>	<u>(52,800)</u>	<u>210,920</u>
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	31,972	2,552	(547)	33,977
	<u>988,440</u>	<u>57,493</u>	<u>(1,319)</u>	<u>1,044,614</u>
				-
Total Capital Assets	1,188,981	120,672	(54,119)	1,255,534
				-
Less accumulated depreciation	440,254	28,242	(545)	467,951
Net capital assets	<u>\$ 748,727</u>	<u>\$ 92,430</u>	<u>\$ (53,574)</u>	<u>\$ 787,583</u>

The following summarizes the changes in capital assets during 2004:

(all amounts in thousands)

<u>December 31, 2004</u>	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land	\$ 4,977	\$ -	\$ -	\$ 4,977
Construction in progress	166,127	66,931	(37,494)	195,564
	<u>171,104</u>	<u>66,931</u>	<u>(37,494)</u>	<u>200,541</u>
Capital assets being depreciated:				
Buildings and structures	676,033	39,381	(375)	715,039
Processing systems	258,841	82	(17,494)	241,429
Office and service equipment	30,937	1,656	(621)	31,972
	<u>965,811</u>	<u>41,119</u>	<u>(18,490)</u>	<u>988,440</u>
				-
Total Capital Assets	1,136,915	108,050	(55,984)	1,188,981
				-
Less accumulated depreciation	425,670	26,610	(12,026)	440,254
Net capital assets	<u>\$ 711,245</u>	<u>\$ 81,440</u>	<u>\$ (43,958)</u>	<u>\$ 748,727</u>

NOTE 6 - LONG-TERM DEBT

Long-term debt consisted of the following:

(all amounts in thousands except percents)

	<u>Principal Issue</u>	<u>Interest Rate %</u>	<u>Year of Maturity</u>	<u>2005</u>	<u>2004</u>
Revenue Bonds					
2005 (a)	\$ 170,560	2.50-5.00	2030	\$ 170,560	\$ -
2004 (b)	46,385	2.00-5.00	2017	46,260	46,385
2003 (c)	215,575	1.50-5.25	2028	208,935	213,205
2001 (d)	76,000	2.30-5.25	2026	35,510	60,510
2000 (e)	40,085	4.50-5.75	2025	8,480	30,140
1997 (f)	105,245	3.85-5.13	2017	21,245	72,720
1995 (g)	85,800	3.70-6.05	2017	-	4,680
1993 (h)	171,790	2.45-5.60	2016	45,345	45,345
				<u>536,335</u>	<u>472,985</u>
Ohio Water Development					
Authority Contracts	41,830	2.00-7.49	2016	963	1,062
Ohio Water and Sewer					
Rotary Commission	-	-	-	50	50
Ohio Public Works Commssion	-	3.54-4.80	2017	4,041	4,398
Water Pollution Control Loan Fund	-	0.00-3.00	2018	23,449	18,340
				<u>564,838</u>	<u>496,835</u>
Total obligations					
				564,838	496,835
Bond discounts					
				(317)	(631)
Bond premiums					
				31,163	24,916
Deferred loss on defeasance					
				(10,477)	(8,376)
Current maturities					
				(24,861)	(21,828)
Long-term portion					
				<u>\$ 560,346</u>	<u>\$ 490,916</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
2006	23,130	26,218	106	35	272	80	1,353	998
2007	24,355	24,905	110	31	278	74	1,406	944
2008	25,255	23,836	114	27	283	69	1,461	889
2009	26,440	22,654	118	23	288	64	1,518	832
2010	27,910	21,476	122	19	294	58	1,578	772
2011-2015	160,260	85,503	393	30	1,540	199	8,345	2,888
2016-2020	113,215	46,269	-	-	951	65	6,395	1,421
2021-2025	76,755	26,075	-	-	135	7	4,412	353
2026-2030	59,015	7,083	-	-	-	-	-	-
	<u>\$ 536,335</u>	<u>\$ 284,019</u>	<u>\$ 963</u>	<u>\$ 165</u>	<u>\$ 4,041</u>	<u>\$ 616</u>	<u>\$ 26,468</u>	<u>\$ 9,097</u>

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

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

<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>

<u>December 31, 2004</u>	<u>Beginning Balance</u>	<u>Amortized</u>	<u>Refunded</u>	<u>Issued</u>	<u>Ending Balance</u>
Bond discount	\$ (1,157)	\$ 191	\$ 335	\$ -	\$ (631)
Bond premium	23,057	(1,807)	-	3,666	24,916
Loss on defeasance	(6,694)	1,333	(3,015)	-	(8,376)
Total	<u>\$ 15,206</u>	<u>\$ (283)</u>	<u>\$ (2,680)</u>	<u>\$ 3,666</u>	<u>\$ 15,909</u>

Long-term debt activity for the year:

<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>

<u>December 31, 2004</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 490,975	\$ 46,385	\$ 64,375	\$ 472,985
Ohio Water Development Authority	1,161	-	99	1,062
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	4,199	453	254	4,398
Water Pollution Control Loan Fund	12,325	6,790	775	18,340
Total	<u>\$ 508,710</u>	<u>\$ 53,628</u>	<u>\$ 65,503</u>	<u>\$ 496,835</u>

Revenue Bonds

- a) 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, secured equally and ratably under the Trust Agreement.

- b) 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, 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.

- c) 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.

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

- f) 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.
- g) 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 a parity with the 1993 Series A bonds, secured equally and ratably under the Trust Agreement.
- h) 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 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.

At December 31, 2005 and 2004 the amount of defeased debt outstanding was \$99,605,000 and \$64,020,000, respectively.

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

(all amounts in thousands except percents)

Year	2005 Bonds	2004 Bonds	2003 Bonds	2001 Bonds	2000 Bonds	1997 Bonds	1993 Bonds
2006	\$ 1,880	\$ 2,125	\$ 1,420	\$ 1,480	\$ 1,040	\$ 4,720	\$ 10,465
2007	2,180	2,260	1,340	1,525	1,095	4,930	11,025
2008	7,235	2,200	1,475	1,585	1,145	-	11,615
2009	7,575	2,260	1,500	1,660	1,205	-	12,240
2010	2,355	-	16,910	1,740	1,265	5,640	-
2011-2015	37,145	10,440	97,790	6,200	2,730	5,955	-
2016-2020	52,450	26,975	33,480	310	-	-	-
2021-2025	34,320	-	25,720	16,715	-	-	-
2026-2030	25,420	-	29,300	4,295	-	-	-
	<u>\$ 170,560</u>	<u>\$ 46,260</u>	<u>\$ 208,935</u>	<u>\$ 35,510</u>	<u>\$ 8,480</u>	<u>\$ 21,245</u>	<u>\$ 45,345</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>2005</u>	<u>2004</u>
Revenues:		
Total operating revenues	\$ 154,171	\$ 145,291
Interest income	5,999	4,077
Capitalized interest income	612	376
Tap-in/connection fees	5,967	4,696
Total pledged revenue	<u>166,749</u>	<u>154,440</u>
Total operating and maintenance expenses less depreciation and amortization	(88,115)	(87,670)
Half of pledged revenues transferred to surplus account	<u>11,241</u>	<u>8,710</u>
Net income available for debt service (a)	<u>\$ 89,875</u>	<u>\$ 75,480</u>
Principal and interest requirement on revenue bonds (b)	<u>\$ 43,223</u>	<u>\$ 42,011</u>
Principal and interest requirements on obligations (c)	<u>\$ 45,792</u>	<u>\$ 43,857</u>
Debt service coverage		
Revenue bonds (a) divided by (b)	<u>208%</u>	<u>180%</u>
All obligations (a) divided (c)	<u>196%</u>	<u>172%</u>
Maximum debt service coverage required on revenue bonds	<u>125%</u>	<u>125%</u>

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)

	<u>2005</u>	<u>2004</u>
Interest incurred	\$ 25,021	\$ 24,918
Less Interest capitalization	<u>(2,318)</u>	<u>(2,133)</u>
Interest expense	<u>\$ 22,703</u>	<u>\$ 22,785</u>

Compensated Absences

Compensated absences consist of vacation time, sick pay and compensatory time. The following is a summary of activity for 2005 and 2004.

(all amounts in thousands)

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Balance</u>
2005	\$ 6,346	\$ 3,755	\$ 3,520	\$ 6,581
2004	\$ 5,891	\$ 4,471	\$ 4,016	\$ 6,346

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 2005 and 2004, the required, determined contribution rates were 11

percent for MSD and 7 percent for employees. MSD's contributions to CRS for the years ending December 31, 2005, 2004 and 2003 were \$2,898,000 and \$2,908,000, \$1,898,000, 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 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, 2005 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 5,013 active contributing participants of which 541 are MSD employees. For 2005, 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 2005 and 2004 were \$4,305,000 and \$4,600,000 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 2005 and 2004 were \$2,122,000 and \$1,896,000 respectively. In addition, the City's Municipal Garage provides gasoline and repairs vehicles for MSD. Fees for these services were \$1,404,000 and \$1,257,000 for 2005 and 2004, 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.

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, 2005.

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 4 percent sewerage rate increase effective January 9, 2006.



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**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
SEPTEMBER 19, 2006**