

**The Metropolitan Sewer District of Greater Cincinnati**  
**Basic Financial Statements**



**For the Years Ended  
December 31, 2011 and 2010**

**INDEPENDENT AUDITOR'S REPORT**

Board of County Commissioners, Hamilton County, Ohio  
Owner of the County Sewer District known as the  
Metropolitan Sewer District of Greater Cincinnati

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, 2011 and 2010. These financial statements are the responsibility of the 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

As discussed in Note 1, the financial statements for the 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 29, 2012, on our consideration of the MSD's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. 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 considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Plattenburg & Associates, Inc.*

Plattenburg & Associates, Inc.  
June 29, 2012

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**(UNAUDITED)**

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**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 results 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 \$726,539,000 at the close of the most recent fiscal year. As can be seen in Table A, on the next page, 60% of the District's net assets reflect its investment in capital assets (e.g., buildings and structures, processing systems, and office and service 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.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)**

**Table A  
Condensed Summary of Net Assets  
(In Thousands)**

	<b>2011</b>	<b>Percentage Increase (Decrease) over 2010</b>	<b>2010</b>	<b>Percentage Increase (Decrease) over 2009</b>	<b>2009</b>
Current and other assets	\$ 449,334	-7.7%	\$ 486,942	12.6%	\$ 432,594
Capital assets, net	<u>1,274,620</u>	9.2%	<u>1,167,641</u>	11.0%	<u>1,052,321</u>
Total assets	<u>\$ 1,723,954</u>	4.2%	<u>\$ 1,654,583</u>	11.4%	<u>\$ 1,484,915</u>
Noncurrent liabilities	\$ 926,245	0.8%	\$ 918,828	16.5%	\$ 788,448
Current liabilities	<u>71,170</u>	15.5%	<u>61,642</u>	3.9%	<u>59,326</u>
Total liabilities	<u>\$ 997,415</u>	1.7%	<u>\$ 980,470</u>	15.7%	<u>\$ 847,774</u>
Invested in capital assets					
Net of related debt	\$ 438,780	32.7%	\$ 330,623	0.7%	\$ 328,398
Restricted	8,008	-4.8%	8,408	30.2%	6,460
Unrestricted	<u>279,751</u>	-16.5%	<u>335,082</u>	10.9%	<u>302,283</u>
Total net assets	<u>\$ 726,539</u>	7.8%	<u>\$ 674,113</u>	5.8%	<u>\$ 637,141</u>

Net assets increased \$52.4 million in 2011 and \$37.0 million in 2010. The increases are a combination of income before contributions and contributions in the form of connection fees, assessments, and developer contributions.

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**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)**

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

	<b>2011</b>	<b>Percentage Increase (Decrease) over 2010</b>	<b>2010</b>	<b>Percentage Increase (Decrease) over 2009</b>	<b>2009</b>
Operating revenues	\$ 239,425	8.2%	\$ 221,287	9.9%	\$ 201,273
Nonoperating revenues	4,922	-25.5%	6,605	36.7%	4,830
Total revenues	<u>244,347</u>	7.2%	<u>227,892</u>	10.6%	<u>206,103</u>
Depreciation and amortization expense	49,222	10.2%	44,674	15.7%	38,623
Other operating expenses	111,823	-7.1%	120,368	15.9%	103,825
Nonoperating expenses	34,212	14.4%	29,905	-2.0%	30,527
Total expenses	<u>195,257</u>	0.2%	<u>194,947</u>	12.7%	<u>172,975</u>
Income from operations	49,090	49.0%	32,945	-0.6%	33,128
Capital contributions	<u>3,336</u>	-17.2%	<u>4,027</u>	-35.4%	<u>6,230</u>
Change in net assets	52,426	41.8%	36,972	-6.1%	39,358
Beginning net assets	<u>674,113</u>	5.8%	<u>637,141</u>	6.6%	<u>597,783</u>
Ending net assets	<u>\$ 726,539</u>	7.8%	<u>\$ 674,113</u>	5.8%	<u>\$ 637,141</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 2011 total revenues increased 7.2 percent or \$16.5 million and expenses increased 0.2 percent or \$0.3 million. During 2010 total revenues increased 10.6 percent or \$21.8 million and expenses increased 12.7 percent or \$22.0 million. The major factors which contributed to these results include:

- Operating revenues reflect an 8 percent rate increase implemented January 9, 2011 and an 11 percent rate increase implemented January 9, 2010.
- Nonoperating revenues decreased in 2011 and increased in 2010 related to the change in fair value of investments.
- Operating expenses decreased 7.1 percent or \$8.5 million in 2011 primarily because the increase in accrued pension liability for 2011 was significantly lower than the increase for 2010. A significant increase in health care costs in 2011 was more than offset by this decrease related to the pension accrual. Operating expenses increased 15.9 percent or \$16.5 million in 2010 mainly due to the significant increase in accrued pension liability.
- Depreciation expense increased 10.2 percent or \$4.5 million in 2011 and 15.7 percent or \$6.1 million in 2010 due to a significant number of large dollar capital assets being placed in service during each of these years.
- Nonoperating expense for 2011 increased 14.4 percent or \$4.3 million due to an increase in interest expense related to the growing capital program.
- Capital contributions will fluctuate depending on building activity and assessment projects completed.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)**

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**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 2011 operating expenses and certifications were 4.4 percent under the approved budget. The principal areas of savings in 2011 were reduced personnel costs and reduced debt service due to savings from the increased use of low interest loans made available from the state. The 2010 operating expenses and certifications were 6.9 percent under the approved budget. The principal areas of savings in 2010 were reduced personnel costs and reduced debt service due to savings from the increased use of low interest loans made available from the state.

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

As of December 31, the District's investment in capital assets (net of accumulated depreciation) amounted to \$1,275 million and \$1,168 million as shown in Table C for 2011 and 2010, respectively. In 2011, the District spent about \$147 million on capital improvement projects and equipment replacement and received about \$3.3 million in capital contributions. In 2010, the District spent about \$139 million on capital improvement projects and equipment replacement and received about \$4.0 million in capital contributions.

Sewer replacement and improvement projects were about three-fourths of the program in 2011 and in 2010. Additional information on the District's capital assets can be found in Note 5 to the financial statements.

**Table C  
Capital Assets  
(In Thousands)**

	<b>2011</b>	<b>Percentage Increase (Decrease) over 2010</b>	<b>2010</b>	<b>Percentage Increase (Decrease) over 2009</b>	<b>2009</b>
Land	\$ 4,977	0.0%	\$ 4,977	0.0%	\$ 4,977
Construction in progress	310,358	16.4%	266,674	-6.7%	285,769
Buildings and structures	1,196,753	7.3%	1,115,330	16.6%	956,572
Processing systems	384,890	6.5%	361,254	2.7%	351,791
Office and service equipment	49,920	1.9%	49,002	11.5%	43,929
Subtotal	1,946,898	8.3%	1,797,237	9.4%	1,643,038
Less accumulated depreciation	672,278	6.8%	629,596	6.6%	590,717
Net capital assets	<u>\$ 1,274,620</u>	9.2%	<u>\$ 1,167,641</u>	11.0%	<u>\$ 1,052,321</u>

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)**

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**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	Aa2
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 2012 is \$179,389,610 which is \$17.5 million less than the 2011 budget. The decrease of the 2012 operating budget reflects a nearly 17% cut in the operations portion (debt service not included) of the budget compared to 2011. A rate increase of 8 percent was approved effective January 9, 2012.

The capital plan was submitted and accepted for the years 2012 through 2016. The plan contemplates issuing an average of about \$280 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, 2011 and 2010**  
**(all amounts expressed in thousands)**

	2011	2010
<b>ASSETS</b>		
Current assets:		
Cash, cash equivalents and pooled investments held by the City of Cincinnati (Note 2)	\$19,118	\$20,113
Accounts receivable (Note 3)	38,493	38,786
Prepaid expenses and other	710	2,710
<b>Total current assets</b>	<b>58,321</b>	<b>61,609</b>
Noncurrent assets:		
Restricted assets:		
Cash, cash equivalents, and pooled investments held by the City of Cincinnati:		
Construction account (Note 2)	40,200	40,185
Amount to be transferred to surplus account (Note 2)	62,180	36,835
Held by trustee: (Note 4)		
Cash and cash equivalents (Note 2)	132,809	90,008
Investments - Held to maturity (Note 2)	148,052	250,028
<b>Total restricted assets</b>	<b>383,241</b>	<b>417,056</b>
Other assets:		
Unamortized financing costs	7,409	7,806
Other	363	471
<b>Total other assets</b>	<b>7,772</b>	<b>8,277</b>
Capital assets: (Note 5)		
Land	4,977	4,977
Buildings and structures	1,196,753	1,115,330
Processing systems	384,890	361,254
Office and service equipment	49,920	49,002
Construction in progress	310,358	266,674
<b>Total capital assets</b>	<b>1,946,898</b>	<b>1,797,237</b>
Less:		
Accumulated depreciation	(672,278)	(629,596)
<b>Net capital assets</b>	<b>1,274,620</b>	<b>1,167,641</b>
<b>Total noncurrent assets</b>	<b>1,665,633</b>	<b>1,592,974</b>
<b>Total assets</b>	<b>\$1,723,954</b>	<b>\$1,654,583</b>

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, 2011 and 2010**  
**(all amounts expressed in thousands)**

	2011	2010
<b>LIABILITIES</b>		
Current liabilities:		
Payable from current assets:		
Current portion of long-term debt (Note 6)	\$41,749	\$38,712
Current portion of compensated absences (Note 8)	3,701	3,739
Accounts payable	5,590	3,765
Accrued payroll expenses	2,816	2,886
Total current liabilities payable from current assets	53,856	49,102
Payable from restricted assets:		
Construction accounts payable	14,100	9,113
Accrued interest payable	3,214	3,427
Total current liabilities payable from restricted assets	17,314	12,540
Total current liabilities	71,170	61,642
Noncurrent liabilities:		
Accrued compensated absences (Note 8)	5,250	4,700
Long-term debt (Note 6)	879,381	880,329
Net Pension Obligation	29,417	24,957
Net Other Post Employment Benefit Obligation	12,197	8,842
Total noncurrent liabilities	926,245	918,828
Total liabilities	997,415	980,470
Net assets:		
Invested in capital assets, net of related debt	438,780	330,623
Restricted	8,008	8,408
Unrestricted	279,751	335,082
Total net assets	\$726,539	\$674,113

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**

December 31, 2011 and 2010

(all amounts expressed in thousands)

	2011	2010
REVENUES		
Operating revenues:		
Sewerage service charges	\$213,435	\$198,435
Sewer surcharges	21,470	19,480
All other revenues	4,520	3,372
Total operating revenues	239,425	221,287
EXPENSES		
Operating expenses:		
Personnel services	54,758	62,198
Purchased services	24,367	23,952
Utilities, fuel and supplies	22,181	24,030
Depreciation and amortization	49,222	44,674
Other expenses	10,517	10,188
Total operating expenses	161,045	165,042
Operating income	78,380	56,245
NONOPERATING		
Nonoperating revenues (expenses):		
Interest income	2,484	3,045
Change in fair value of investments	2,221	3,434
Interest expense	(34,212)	(29,905)
Retirement of capital assets	217	126
Total nonoperating revenues	(29,290)	(23,300)
Income from operations	49,090	32,945
Capital contributions	3,336	4,027
Change in net assets	52,426	36,972
Total net assets, beginning	674,113	637,141
Total net assets, ending	\$726,539	\$674,113

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, 2011 and 2010**  
**(all amounts expressed in thousands)**

	2011	2010
Cash Flows from Operating Activities:		
Cash received from customers	\$235,384	\$217,449
Cash payments for goods and services	(53,240)	(59,375)
Cash payments for personnel costs	(47,051)	(43,941)
Other operating revenues	4,334	2,407
Net Cash Provided by Operating Activities	<u>139,427</u>	<u>116,540</u>
Cash Flows from Capital and Related Financing Activities:		
Principal and interest payments on long-term debt	(77,652)	(75,035)
Acquisition and construction of capital assets	(119,759)	(116,924)
Loan proceeds	16,034	30,438
Transfer into construction account from trustee investment account	100,000	108,348
Transfer from operating cash account to trustee investment account	(36,835)	(36,201)
Revenue bond proceeds	0	137,004
Revenue bond issuance costs	0	(1,240)
Tap-in fees	2,105	2,027
Gain/loss from sale of property, plant and equipment	247	126
Net Cash (Used) by Capital and Related Financing Activities	<u>(115,860)</u>	<u>48,543</u>
Cash Flows from Investing Activities:		
Purchase of government securities	38,453	(96,015)
Net increase in fair value of pooled cash and investments held by City of Cincinnati	430	300
Interest earned on investments	4,716	2,925
Net Cash Provided (Used) by Investing Activities	<u>43,599</u>	<u>(92,790)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	67,166	72,293
Cash and Cash Equivalents at January 1	<u>187,141</u>	<u>114,848</u>
Cash and Cash Equivalents at December 31	<u>\$254,307</u>	<u>\$187,141</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Income from operations	78,380	56,245
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	49,222	44,674
Changes in assets and liabilities:		
Net change in customer accounts receivable	293	(2,914)
Net change in other assets	2,000	923
Net change in operating accounts payable	1,825	(1,116)
Net change in accrued payroll and related expenses	(108)	896
Net Pension Obligation	4,460	14,087
Net Other Post Employment Benefit Obligation	3,355	3,745
Net Cash Provided by Operating Activities	<u>\$139,427</u>	<u>\$116,540</u>
Non-cash Transactions:		
Structures donated as contributed capital in aid of construction	\$847	\$1,517
Acquisition and construction of capital assets paid directly by WPCLF loan proceeds	28,879	23,544
Construction accounts payable related to acquisition of capital assets	<u>14,100</u>	<u>9,113</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, 2011 and 2010**

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**NOTE 1 - ACCOUNTING POLICIES**

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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 a non-GAAP budgetary 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 after 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.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**for the years ended December 31, 2011 and 2010**

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**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, which is based on the quoted market prices or current share prices.

**Prepays**

Payments made for services that will benefit periods beyond December 31, 2011, are recorded as prepaids using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expense is reported in the year in which services are consumed.

**Inventory**

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

**Capital Assets**

Capital assets include land, construction in progress, buildings and structures, processing systems and office and service equipment. Capital assets are defined as assets with an initial, individual cost of more than \$5,000.

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. See note 5 for more information on capital 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.

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

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**for the years ended December 31, 2011 and 2010**

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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. While MSD's policy is to fund pension costs accrued, this did not occur in 2010 or 2011. See Note 9.

**Compensated Absences**

Compensated absences include accrued vacation time, sick leave, compensatory time and other related payments. Compensatory time and vacation time are paid out in full upon termination and are expensed in the year earned. Sick leave is paid out at various levels. The liability for sick leave is computed with the Termination Payment Method using an historical average of total years worked and total amount paid. The current amounts are an average of the annual expenditures. The entire compensated absence liability is reported on the financial statements.

**Net Assets**

Net assets are the difference between assets and liabilities. Net assets invested in capital assets, 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. Restricted net assets of the MSD relate to debt service.

MSD applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. MSD did not have net assets restricted by enabling legislation.

**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 METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**for the years ended December 31, 2011 and 2010**

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**Contributions of Capital**

Contributions of capital arise from outside contributions of capital assets or outside contributions of resources restricted to capital acquisition and construction.

**NOTE 2 - DEPOSITS AND INVESTMENTS**

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**Deposits**

State statues 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 \$121,498,000 and \$97,133,000 at December 31, 2011 and 2010, respectively.



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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, 2011 for the City of Cincinnati.

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 and subject to custodial credit risk.

### **Investments**

State Statute, board of county commissioners resolutions, and the 1985 Trust Indenture as amended 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 the trustee are eligible investments as defined by the Trust Agreement and are in the name of the trustee for the benefit of MSD.

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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 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, 2011.

<u>Investment Type</u>	<u>Fair Value</u>	<u>% of Total</u>
Investments held by the City of Cincinnati	\$ 121,498	30.20
U. S. Government Security	148,052	36.80
Money Market Funds	132,809	33.00
	<u>\$ 402,359</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, 2011</u>	<u>Cash and Cash</u>	
	<u>Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 254,307	\$ 148,052
Money Market Funds	(132,809)	132,809
Total	<u>\$ 121,498</u>	<u>\$ 280,861</u>

(all amounts in thousands)

<u>December 31, 2010</u>	<u>Cash and Cash</u>	
	<u>Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 187,141	\$ 250,028
Money Market Funds	(90,008)	90,008
Total	<u>\$ 97,133</u>	<u>\$ 340,036</u>

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**NOTE 3 - ACCOUNTS RECEIVABLE**

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Accounts receivable consist of the following:

(all amounts in thousands)

	<b>2011</b>	<b>2010</b>
Sewer charges and surcharges:		
Unbilled amount	\$ 19,978	\$ 19,466
Billed amount	25,191	24,359
Less allowance for doubtful accounts	(8,500)	(8,000)
Other	1,824	2,961
Total	\$ 38,493	\$ 38,786

**NOTE 4 - RESTRICTED ASSETS**

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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, 2011 and 2010 the following balances (at fair value) were maintained in the trust accounts:

(all amounts in thousands)

	<b>2011</b>	<b>2010</b>
Held by trustee:		
Reserve	\$ 79,674	\$ 76,408
Replacement and improvement	5,616	5,611
Bond retirement	8,008	8,408
Surplus	187,563	249,609
Total	\$ 280,861	\$ 340,036

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**NOTE 5 - CAPITAL ASSETS**

The following summarizes the changes in capital assets during 2011:

(all amounts in thousands)

<u>December 31, 2011</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	266,674	151,655	(107,971)	310,358
	<u>271,651</u>	<u>151,655</u>	<u>(107,971)</u>	<u>315,335</u>
Capital Assets, being depreciated:				
Buildings and structures	1,115,330	81,423	-	1,196,753
Processing systems	361,254	28,381	(4,745)	384,890
Office and service equipment	49,002	2,316	(1,398)	49,920
	<u>1,525,586</u>	<u>112,120</u>	<u>(6,143)</u>	<u>1,631,563</u>
Total Capital Assets	1,797,237	263,775	(114,114)	1,946,898
Less accumulated depreciation:				
Buildings and structures	399,967	27,264	-	427,231
Processing systems	192,450	13,257	-	205,707
Office and service equipment	37,179	3,560	(1,399)	39,340
Total Accumulated Depreciation	<u>629,596</u>	<u>44,081</u>	<u>(1,399)</u>	<u>672,278</u>
Net Capital Assets	<u>\$ 1,167,641</u>	<u>\$ 219,694</u>	<u>\$ (112,715)</u>	<u>\$ 1,274,620</u>

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The following summarizes the changes in capital assets during 2010:

(all amounts in thousands)

<u>December 31, 2010</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	285,769	135,306	(154,401)	266,674
	290,746	135,306	(154,401)	271,651
Capital Assets, being depreciated:				
Buildings and structures	956,572	158,758	-	1,115,330
Processing systems	351,791	13,929	(4,466)	361,254
Office and service equipment	43,929	6,053	(980)	49,002
	1,352,292	178,740	(5,446)	1,525,586
Total Capital Assets	1,643,038	314,046	(159,847)	1,797,237
Less accumulated depreciation:				
Buildings and structures	375,684	24,283	-	399,967
Processing systems	180,087	12,363	-	192,450
Office and service equipment	34,946	3,212	(979)	37,179
Total Accumulated Depreciation	590,717	39,858	(979)	629,596
Net Capital Assets	<u>\$ 1,052,321</u>	<u>\$ 274,188</u>	<u>\$ (158,868)</u>	<u>\$ 1,167,641</u>

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**NOTE 6 - LONG-TERM DEBT**

Long-term debt consisted of the following:

(all amounts in thousands except percents)

	<b>Principal Issue</b>	<b>Interest Rate %</b>	<b>Year of Maturity</b>	<b>2011</b>	<b>2010</b>
Revenue Bonds					
2010 (a)	\$ 130,675	2.00-5.37	2035	\$ 129,135	\$ 130,675
2009 (b)	149,815	4.00-6.50	2034	149,815	149,815
2007 (c)	72,385	3.50-5.25	2032	65,305	67,190
2006 (d)	83,045	4.00-5.00	2031	73,030	75,230
2005 (e)	170,560	2.50-5.00	2030	146,890	149,335
2004 (f)	46,385	2.00-5.00	2017	37,415	37,415
2003 (g)	215,575	1.50-5.25	2028	151,565	169,255
2001 (h)	76,000	2.30-5.25	2026	425	2,230
1997 (i)	105,245	3.85-5.13	2017	-	5,955
				<u>753,580</u>	<u>787,100</u>
Ohio Water Development Authority Contracts	41,830	2.00-7.49	2016	267	393
Ohio Water and Sewer Rotary Commission	-	-	-	50	50
Ohio Public Works Commission	-	0.00-3.00	2041	2,639	2,626
Water Pollution Control Loan Fund	-	2.50-3.50	2037	128,590	90,748
Capital Lease Payable	15,000	2.00-5.00	2029	<u>13,900</u>	<u>14,460</u>
Total obligations				899,026	895,377
Bond discounts				-	(4)
Bond premiums				26,775	29,991
Deferred loss on defeasance				(4,671)	(6,323)
Current maturities				<u>(41,749)</u>	<u>(38,712)</u>
Long-term portion				<u>\$ 879,381</u>	<u>\$ 880,329</u>

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Principal and interest payments on long-term debt for the next five years and thereafter are as follows:  
(all amounts in thousands)

Year	Revenue Bonds		WPCLF*		OPWC		Capital Lease	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2012	\$ 35,250	\$ 26,148	\$ 6,233	\$ 3,370	\$ 311	\$ 46	\$ 575	\$ 536
2013	36,645	24,846	10,380	6,527	317	40	590	525
2014	38,325	23,456	11,959	6,728	324	34	600	512
2015	40,260	22,024	17,046	7,273	330	27	620	495
2016	42,060	20,519	16,905	6,699	248	21	635	480
2017-2021	161,435	85,647	74,033	25,808	828	47	3,485	2,081
2022-2026	177,285	59,702	61,374	15,499	125	3	4,330	1,240
2027-2031	160,415	27,538	56,746	6,182	52	-	3,065	277
2032-2036	61,905	5,475	10,162	343	52	-	-	-
2037-2041	-	-	119	2	52	-	-	-
	<u>\$ 753,580</u>	<u>\$ 295,355</u>	<u>\$ 264,957</u>	<u>\$ 78,431</u>	<u>\$ 2,639</u>	<u>\$ 218</u>	<u>\$ 13,900</u>	<u>\$ 6,146</u>

\* - This amount represents the total amount of the loans, some of which have not been fully drawdown or finalized and includes OWDA Loans.

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

<u>December 31, 2011</u>	<u>Beginning Balance</u>	<u>Amortized</u>	<u>Refunded</u>	<u>Issued</u>	<u>Ending Balance</u>
Bond discount	\$ (4)	\$ 4	\$ -	\$ -	\$ -
Bond premium	29,991	(3,216)	-	-	26,775
Loss on defeasance	(6,323)	1,652	-	-	(4,671)
Total	<u>\$ 23,664</u>	<u>\$ (1,560)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 22,104</u>

  

<u>December 31, 2010</u>	<u>Beginning Balance</u>	<u>Amortized</u>	<u>Refunded</u>	<u>Issued</u>	<u>Ending Balance</u>
Bond discount	\$ (12)	\$ 8	\$ -	\$ -	\$ (4)
Bond premium	28,355	(4,693)	-	6,329	29,991
Loss on defeasance	(4,051)	1,107	-	(3,379)	(6,323)
Total	<u>\$ 24,292</u>	<u>\$ (3,578)</u>	<u>\$ -</u>	<u>\$ 2,950</u>	<u>\$ 23,664</u>

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Long-term debt activity for the year:

(all amounts in thousands)

<u>December 31, 2011</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 787,100	\$ -	\$ 33,520	\$ 753,580
Ohio Water Development Authority	393	-	126	267
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	2,626	313	300	2,639
Water Pollution Control Loan Fund	90,748	42,315	4,473	128,590
Capital Lease Payable	14,460	-	560	13,900
Total	<u>\$ 895,377</u>	<u>\$ 42,628</u>	<u>\$ 38,979</u>	<u>\$ 899,026</u>

  

<u>December 31, 2010</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 733,325	\$ 130,675	\$ 76,900	\$ 787,100
Ohio Water Development Authority	574	-	181	393
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	3,065	-	439	2,626
Water Pollution Control Loan Fund	41,029	53,982	4,263	90,748
Capital Lease Payable	-	15,000	540	14,460
Total	<u>\$ 778,043</u>	<u>\$ 199,657</u>	<u>\$ 82,323</u>	<u>\$ 895,377</u>

**Revenue Bonds**

- a) Effective November 3, 2010, MSD issued \$43,595,000 Series A, Sewer System Refunding Revenue Bonds dated November 3, 2010. The proceeds from the 2010 Series A Bonds were used to defease portions of the 2000, 2001, and 2003 revenue bonds and pay for the cost of issuance. The 2010A bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1997, 2000, 2001, 2003A, 2003B 2004 2005A, 2005B, 2006, 2007 2009A, and 2009B 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 \$2,730,000 of outstanding 2000 Series A Bonds, \$25,290,000 of outstanding 2001 Series A Bonds, and \$17,035,000 of outstanding 2003 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 \$3,379,000 in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$8,824,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$5,304,000.

Effective November 3, 2010, MSD issued \$87,080,000 Series B Sewer System Improvement Revenue Bonds (Build America Bonds) dated November 3, 2010. The



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proceeds from the 2010 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 2010 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 1997, 2000, 2001, 2003A, 2003B, 2004, 2005A, 2005B, 2006, 2007, 2009A, and 2009B bonds, secured equally and ratably under the Trust Agreement.

- b) Effective August 25, 2009, MSD issued \$19,515,000 Series A Sewer System Improvement Revenue Bonds dated August 11, 2009, and \$130,300,000 Series B Sewer System Improvement Revenue Bonds (Build America Bonds) dated August 11, 2009. The proceeds from the 2009 Series A bonds and 2009 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 2009 Series A bonds and 2009 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, 2005A, 2005B, 2006 and 2007 bonds, secured equally and ratably under the Trust Agreement.
- c) Effective December 20, 2007, MSD issued \$72,385,000 Series A Sewer System Improvement Revenue Bonds dated December 1, 2007. The proceeds from the 2007 Series A bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2007 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, 2005B and 2006 bonds, secured equally and ratably under the Trust Agreement.
- d) 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, secured equally and ratably under the Trust Agreement.
- e) 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,

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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.

- f) 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.

- g) 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.

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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.

- h) 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.
- i) 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.
- j) 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.

The 2010, 2009, 2007, 2006, 2005, 2004, 2003, 2001, and 1997 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, 2011 and December 31, 2010, the amount of defeased debt outstanding was \$17,035,000 and \$61,605,000, respectively.

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

Year	(all amounts in thousands)								
	2010 Bonds	2009 Bonds	2007 Bonds	2006 Bonds	2005 Bonds	2004 Bonds	2003 Bonds	2001 Bonds	Total
2012	\$ 3,275	\$ -	\$ 1,950	\$ 2,290	\$ 2,560	\$ 6,165	\$ 18,585	\$ 425	\$ 35,250
2013	2,310	-	2,020	2,380	9,065	1,360	19,510	-	36,645
2014	860	-	2,090	2,475	10,985	1,420	20,495	-	38,325
2015	425	-	2,165	2,575	12,090	1,495	21,510	-	40,260
2016	3,440	-	2,245	2,690	12,660	5,055	15,970	-	42,060
2017-2021	31,745	26,650	12,750	15,615	47,600	21,920	5,155	-	161,435
2022-2026	40,280	39,855	16,300	19,785	31,125	-	29,940	-	177,285
2027-2031	24,240	48,805	20,945	25,220	20,805	-	20,400	-	160,415
2032-2035	22,560	34,505	4,840	-	-	-	-	-	61,905
	<u>\$ 129,135</u>	<u>\$ 149,815</u>	<u>\$ 65,305</u>	<u>\$ 73,030</u>	<u>\$ 146,890</u>	<u>\$ 37,415</u>	<u>\$ 151,565</u>	<u>\$ 425</u>	<u>\$ 753,580</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.

	2011	2010
Revenues:		
Total operating revenues	\$ 239,425	\$ 221,287
Interest income	2,484	3,045
Capitalized interest income	226	681
Tap-in/connection fees	<u>2,119</u>	<u>2,027</u>
Total pledged revenue	244,254	227,040
Total operating and maintenance expenses less depreciation and amortization	(111,823)	(120,368)
Half of pledged revenues transferred to surplus account	<u>31,090</u>	<u>18,418</u>
Net income available for debt service (a)	<u>\$ 163,521</u>	<u>\$ 125,090</u>
Principal and interest requirement on revenue bonds (b)	<u>\$ 74,155</u>	<u>\$ 69,391</u>
Principal and interest requirements on obligations (c)	<u>\$ 82,624</u>	<u>\$ 77,127</u>
Debt service coverage		
Revenue bonds (a) divided by (b)	<u>221%</u>	<u>180%</u>
All obligations (a) divided (c)	<u>198%</u>	<u>162%</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)

	<u>2011</u>	<u>2010</u>
Interest incurred	\$ 37,317	\$ 36,471
Less Interest capitalization	<u>(3,105)</u>	<u>(6,566)</u>
Interest expense	<u>\$ 34,212</u>	<u>\$ 29,905</u>

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**NOTE 7 – CAPITAL LEASE**

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The District issued a capital lease for a new engineering building in FY2010. The District's lease obligation meets the criteria of a capital lease as defined by FASB Guidance. The leased assets have been capitalized for the amount of the present value of the minimum lease payments at the inception of the lease.

The following is a schedule of the future minimum lease payments required under the capital lease and the present value of the minimum lease payments as of fiscal year end.

(all amounts in thousands)

Fiscal Year Ending December 31,	Long-Term Debt
2012	\$ 1,111
2013	1,115
2014	1,112
2015	1,115
2016	1,115
2017-2021	5,566
2022-2026	5,570
2027-2029	3,342
Total Minimum Lease Payments	20,046
Less: Amount Representing Interest	(6,146)
Present Value of Minimum Lease Payments	\$ 13,900

Capital assets acquired under capital leases in accordance with FASB Guidance are as follows:

Buildings and structures	\$15,000,000
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**NOTE 8 – COMPENSATED ABSENCES**

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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 2011 and 2010. \$3,701 is considered due within one year for compensated absences as of December 31, 2011.

(all amounts in thousands)

	<b>Beginning Balance</b>	<b>Increase</b>	<b>Decrease</b>	<b>Ending Balance</b>
2011	\$ 8,439	\$ 5,005	\$ 4,493	\$ 8,951
2010	\$ 8,493	\$ 4,127	\$ 4,181	\$ 8,439

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**NOTE 9 - PENSION AND RETIREMENT**

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**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 2011, the required contribution rates were 17.00 percent for MSD and 8.0 percent for employees. For 2010, the required contribution rates were 17.00 percent for MSD and 7.5 percent for employees. MSD's contributions to CRS for the years ending December 31, 2011, 2010 and 2009 were \$6,150,000, \$6,005,000, and \$4,941,000, respectively. The full amount has been contributed for 2010 and 2009 and 94% of the required contributions for 2011. The City's (and MSD's) contribution rate for 2011, 2010 and 2009 was not equal to the required contribution rate based on the City's actuarial report.

**Ohio Public Employees' Retirement System**

A limited number of MSD employees participate in the Ohio Public Employee' Retirement System administrated by the State of Ohio. OPERS is not material to the financial statements of MSD and additional disclosures concerning OPERS, 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.

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The actuarial assumptions used for the December 31, 2011 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 3,077 active contributing participants of which 561 are MSD employees. For 2011, MSD's contribution was 19.7 percent of the total employers' contribution.

**NOTE 10 - RELATED PARTY TRANSACTIONS**

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Cincinnati Water Works provides billing and collection services on customers' accounts for MSD. Fees for these services for 2011 and 2010 were \$5,100,000 and \$5,056,000 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 2011 and 2010 were \$2,311,000 and \$2,471,000 respectively. In addition, the City's Municipal Garage provides gasoline and repairs vehicles for MSD. Fees for these services were \$1,534,000 and \$1,372,000 for 2011 and 2010, respectively.

**NOTE 11 - COMMITMENTS AND CONTINGENCIES**

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The City of Cincinnati and the Board of County Commissioners of Hamilton County, Ohio are parties to a Global Consent Decree, which was lodged, in 2003, 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. In August 2010, MSD's Revised Wet Weather Improvement Plan was approved by the federal government. The Plan commits MSD to complete a Phase 1 group of projects totaling \$1.145 billion (in 2006 dollars and including \$450 million that MSD has already spent on projects) by 2018 before scheduling future work (Phase 2). The consent decree documents are posted on the MSD web site, [msdgc.org](http://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 \$155 million as of December 31, 2011.



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**NOTE 12 - RISK MANAGEMENT**

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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 13 - SUBSEQUENT EVENTS**

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The Hamilton County Board of Commissioners has approved an 8 percent sewerage rate increase effective January 9, 2012.

On October 26, 2011, Cincinnati City Council approved joint administrative management of the Greater Cincinnati Water Works, Metropolitan Sewer District of Greater Cincinnati and Stormwater Management Utility. This followed an April 27, 2011 motion requesting a review of the feasibility of such a structure and the submittal of a report, "Feasibility Study for the Integration of the Departments of Water, Sewers and Stormwater Utility."

The three utilities will continue to be independent legal entities with separate enterprise funds. The joint administration would be focused primarily on the support services that are similar for all three utilities, such as accounting, human resources, information technology, and customer service.

A 100 day plan was launched in May 2012 to assess certain functional areas to determine the degree of integration possible, start certain joint utility efforts, and build some early momentum for future joint utility integrations.