



**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Basic Financial Statements  
and Required Supplementary Information

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

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## **Independent Auditors' Report**

The Board of Water Commissioners,  
the Honorable Mayor, and  
Members of the City Council  
City of Detroit, Michigan:

We have audited the accompanying basic financial statements of the Sewage Disposal Fund (the Fund), an enterprise fund of the City of Detroit, Michigan (the City), as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These basic financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits 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 basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting of the Fund. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to above present only the Sewage Disposal Fund of the City and are not intended to present fairly the financial position of the City as of June 30, 2006 and 2005, and the changes in its financial position, and, where applicable, cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Sewage Disposal Fund of the City as of June 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we also audited the financial statements of the City, as described above in this report on the Fund's financial statements. This report does not include the results of our testing of internal control over financial reporting and on our tests of the City's compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters that are reported on separately by us for the City. 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.

The Fund has not presented Management's Discussion and Analysis, which U.S. generally accepted accounting principles have determined is necessary to supplement, although not required to be part of, the basic financial statements.

The schedule of funding progress on page 30 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Detroit, Michigan  
August 20, 2007

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Statements of Net Assets

June 30, 2006 and 2005

| Assets  | <u>2006</u>             | <u>2005</u>          |
|---|-------------------------|----------------------|
| Current assets:   |                         |                      |
| Cash and cash equivalents   | \$ 5,418,283            | —                    |
| Investments   | 47,205,044              | 47,948,538           |
| Due from other funds  | 52,798,669              | 66,388,078           |
| Accounts receivable (including \$50,156,538 and \$41,695,332 for unbilled sewage services and net of allowance for doubtful accounts of \$85,033,590 and \$64,482,340 for June 30, 2006 and 2005, respectively) | 101,428,204             | 88,501,230           |
| Rate adjustments receivable from customers  | 46,062,009              | 12,174,737           |
| Prepaid expenses  | 5,423,804               | 381,847              |
| Inventories   | 10,456,963              | 11,173,380           |
| Restricted cash and cash equivalents  | 39,168,566              | 21,666,661           |
| Restricted investments  | 312,884,409             | 266,046,651          |
| Restricted due from other funds   | 5,541,786               | 37,638,549           |
| Total current assets  | <u>626,387,737</u>      | <u>551,919,671</u>   |
| Noncurrent assets:  |                         |                      |
| Restricted long-term investments  | 111,020,313             | 308,770,507          |
| Net pension asset   | 8,371,380               | 7,850,281            |
| Noncurrent rate adjustments receivable from customers   | 30,820,615              | 44,946,430           |
| Issuance costs – pension obligation certificates of participation   | 509,674                 | 286,646              |
| Unamortized bond issuance costs   | 33,720,782              | 35,433,200           |
| Capital assets:   |                         |                      |
| Land  | 13,834,957              | 13,876,751           |
| Structures  | 1,703,001,142           | 1,143,914,922        |
| Interceptors, regulators, and improvements  | 474,689,271             | 542,769,689          |
| Equipment   | 1,385,071,312           | 708,031,859          |
| Construction work in progress   | 310,502,398             | 1,219,986,063        |
| Total capital assets  | 3,887,099,080           | 3,628,579,284        |
| Less accumulated depreciation   | <u>(750,972,844)</u>    | <u>(681,127,715)</u> |
| Net capital assets  | <u>3,136,126,236</u>    | <u>2,947,451,569</u> |
| Total noncurrent assets   | <u>3,320,569,000</u>    | <u>3,344,738,633</u> |
| Total assets  | <u>\$ 3,946,956,737</u> | <u>3,896,658,304</u> |

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Statements of Net Assets

June 30, 2006 and 2005

| <b>Liabilities and Net Assets</b>                        | <b>2006</b>      | <b>2005</b>   |
|--|------------------|---------------|
|  |                  |               |
| Current liabilities:                                     |                  |               |
| Current liabilities payable from current assets:         |                  |               |
| Book cash overdraft                                      | \$ —             | 758,762       |
| Accounts and contracts payable                           | 13,303,914       | 7,683,870     |
| Due to other funds                                       | 57,747,466       | 53,133,721    |
| Accrued salaries and wages                               | 1,246,496        | 1,629,152     |
| Rate adjustments payable to customers                    | 7,054,465        | 4,938,657     |
| Accrued workers' compensation                            | 811,538          | 895,155       |
| Accrued compensated absences                             | 2,281,068        | 5,556,011     |
| Other current accrued liabilities                        | 958,353          | 754,691       |
| Total current liabilities payable from current assets    | 83,403,300       | 75,350,019    |
| Current liabilities payable from restricted assets:      |                  |               |
| Revenue bonds and revolving loan payable within one year | 53,205,000       | 50,035,000    |
| Accrued bond interest payable                            | 41,115,497       | 38,654,433    |
| Other liabilities  | —                | 89,017        |
| Accounts and contracts payable                           | 35,307,217       | 62,465,874    |
| Due to other funds                                       | 10,262,102       | 11,074,002    |
| Total current liabilities payable from restricted assets | 139,889,816      | 162,318,326   |
| Total current liabilities                                | 223,293,116      | 237,668,345   |
| Long-term liabilities:                                   |                  |               |
| Revenue bonds and revolving loan payable                 | 2,611,323,633    | 2,609,004,255 |
| Pension obligation certificates of participation payable | 9,031,280        | 8,760,811     |
| Deferred swap termination fees                           | 2,504,243        | 2,286,256     |
| Rate adjustments payable to customers                    | 2,610,365        | 7,054,465     |
| Accrued workers' compensation                            | 4,321,980        | 3,832,814     |
| Accrued compensated absences                             | 11,618,703       | 8,361,795     |
| Total long-term liabilities                              | 2,641,410,204    | 2,639,300,396 |
| Total liabilities  | 2,864,703,320    | 2,876,968,741 |
| Net assets:  |                  |               |
| Invested in capital assets, net of related debt          | 532,734,469      | 646,808,681   |
| Restricted   | 303,465,827      | 166,369,102   |
| Unrestricted   | 246,053,121      | 206,511,780   |
| Total net assets   | 1,082,253,417    | 1,019,689,563 |
| Total liabilities and net assets                         | \$ 3,946,956,737 | 3,896,658,304 |

See accompanying notes to basic financial statements.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Statements of Revenues, Expenses, and Changes in Fund Net Assets

Years ended June 30, 2006 and 2005

|   | <b>2006</b>      | <b>2005</b>   |
|---|------------------|---------------|
| Operating revenues:                           |                  |               |
| General customers                             | \$ 160,510,586   | 146,456,155   |
| Suburban customers                            | 188,762,961      | 158,120,913   |
| City departments                              | 530,845          | 281,062       |
| Sewage surcharge                              | 774,798          | 5,914,639     |
| Miscellaneous                                 | 3,876,014        | 2,815,506     |
| Total operating revenues, net                 | 354,455,204      | 313,588,275   |
| Operating expenses before depreciation:       |                  |               |
| Sewage treatment plant                        | 123,392,482      | 103,536,940   |
| Interceptors and regulators                   | 1,237,752        | 740,870       |
| Sewer pumping stations                        | 2,963,775        | 3,122,298     |
| Sewer maintenance and engineering             | 15,775,123       | 12,348,658    |
| Combined sewage overflow control basins       | 1,697,068        | 511,252       |
| Commercial                                    | 5,870,839        | 5,698,629     |
| Administrative and general                    | 46,666,958       | 37,441,707    |
| Total operating expenses before depreciation  | 197,603,997      | 163,400,354   |
| Operating income before depreciation          | 156,851,207      | 150,187,921   |
| Depreciation                                  | 69,951,016       | 44,053,316    |
| Total operating income                        | 86,900,191       | 106,134,605   |
| Nonoperating revenues (expenses):             |                  |               |
| Earnings on investments                       | 18,920,649       | 14,930,952    |
| Interest expense, net of capitalized interest | (43,912,587)     | (44,205,957)  |
| Miscellaneous                                 | 655,601          | (7,038)       |
| Total nonoperating expenses                   | (24,336,337)     | (29,282,043)  |
| Increase in net assets                        | 62,563,854       | 76,852,562    |
| Net assets – beginning of year                | 1,019,689,563    | 942,837,001   |
| Net assets – end of year                      | \$ 1,082,253,417 | 1,019,689,563 |

See accompanying notes to basic financial statements.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Statements of Cash Flows

Years ended June 30, 2006 and 2005

|  | <u>2006</u>           | <u>2005</u>          |
|--|-----------------------|----------------------|
| Cash flows from operationing activities:   |                       |                      |
| Receipts from customers  | \$ 320,864,453        | 326,617,651          |
| Internal activity – Payments to other funds  | 49,488,016            | (18,598,461)         |
| Payments to suppliers  | (156,302,328)         | (124,774,098)        |
| Payments to the General Retirement System in excess of<br>annual required contributions                  | —                     | (7,850,281)          |
| Payments to employees  | (69,072,910)          | (68,354,091)         |
| Net cash provided by operating activities  | <u>144,977,231</u>    | <u>107,040,720</u>   |
| Cash flows from non–capital and related financing activities:  |                       |                      |
| Proceeds from issuance of personal obligation certificates of participator                               | —                     | 8,760,811            |
| Issuance costs–pension obligation certificates of participation  | 170,460               | (286,646)            |
| Bank overdraft   | —                     | 758,762              |
| Net cash provided by non–capital and related financing activities  | <u>170,460</u>        | <u>9,232,927</u>     |
| Cash provided by capital and related financing activities:   |                       |                      |
| Contributions received from customers  | 655,600               | —                    |
| Acquisition and construction of capital assets, net  | (204,612,868)         | (364,680,084)        |
| Principal paid on revenue bond maturities and revolving loar   | (27,840,000)          | (32,590,000)         |
| Interest paid on revenue bonds   | (95,464,337)          | (82,010,501)         |
| Principal paid on refunded debt  | —                     | (108,765,000)        |
| Proceeds from bond issuance and increase in revolving note payable, ne                                   | 31,459,549            | 426,848,891          |
| Swap termination fee   | —                     | (11,750,000)         |
| Unamortized discount and bond issuance cost  | 3,756,736             | 2,542,333            |
| Net cash used in capital and related financing activities  | <u>(292,045,320)</u>  | <u>(170,404,361)</u> |
| Cash flows from investing activities:  |                       |                      |
| Proceeds from sales and maturities of investments  | 622,765,697           | 651,726,904          |
| Purchase of investments  | (471,109,766)         | (623,524,459)        |
| Interest received on investments   | 18,920,649            | 14,930,952           |
| Net cash provided by investing activities  | <u>170,576,580</u>    | <u>43,133,397</u>    |
| Net increase in cash   | 23,678,951            | (10,997,317)         |
| Cash at beginning of year  | 20,907,898            | 31,905,215           |
| Cash at end of year  | <u>\$ 44,586,849</u>  | <u>20,907,898</u>    |
| Reconciliation of operating income to net cash provided by operating activities:                         |                       |                      |
| Operating income   | \$ 86,900,191         | 106,134,605          |
| Adjustments to reconcile operating income to net cash provided by operating activities:                  |                       |                      |
| Depreciation   | 69,951,016            | 44,053,316           |
| Provision for uncollectible accounts   | 20,551,250            | 21,580,685           |
| Changes in certain assets and liabilities:   |                       |                      |
| (Increase) decrease in accounts receivable   | (33,478,223)          | 2,510,949            |
| (Increase) in rate refund receivable from customers  | (19,761,457)          | (21,982,296)         |
| (Increase) in prepaid expenses   | (5,041,957)           | (375,967)            |
| (Increase) decrease in inventories   | 716,417               | (282,877)            |
| (Increase) in Net Pension Asset  | (521,099)             | (7,850,281)          |
| (Decrease) in accounts and contracts payable   | (21,538,613)          | (22,701,285)         |
| Increase (decrease) in accrued salaries and wages  | (382,656)             | 173,323              |
| Increase (decrease) in rate refund payable to customers  | (2,328,292)           | 2,615,338            |
| Increase in other accrued liabilities and accrued compensated absences and accrued workers' compensation | 422,638               | 1,763,672            |
| Net change in due from (to) other funds  | 49,488,016            | (18,598,462)         |
| Net cash provided by operating activities  | <u>\$ 144,977,231</u> | <u>107,040,720</u>   |

See accompanying notes to basic financial statements.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

**(1) Summary of Significant Accounting Policies**

The City of Detroit (the City) Charter established the Water and Sewerage Department (the Department) in the year 1836 to supply water, drainage, and sewage service within and outside the City under the administration of the Board of Water Commissioners. The Sewage Disposal Fund (the Fund), an enterprise fund, separately accounts for the Sewage Disposal System (the System), as is required by bond ordinances of the City. The following is a summary of the more significant accounting policies followed in the preparation of the Fund's basic financial statements. These policies conform to U.S. generally accepted accounting principles.

The basic financial statements of the Fund have been included in the City of Detroit's Comprehensive Annual Financial Report and reported as an Enterprise fund. Copies of these reports, along with other financial information, can be obtained at the Fund's administrative office located at 735 Randolph, Detroit, Michigan, 48226.

**(a) Basis of Accounting**

The accounting policies of the Fund conform to U.S. generally accepted accounting principles (GAAP) as applicable to governmental entities. The accounts of the Fund, which are organized as an enterprise fund, are used to account for the Fund's activities, which are financed and operated in a manner similar to a private business enterprise. Accordingly, the Fund maintains its records on the accrual basis of accounting. Revenues from operations, investments, and other sources are recorded when earned. Expenses (including depreciation and amortization) of providing services to the public are accrued when incurred.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Fund applies all applicable GASB pronouncements, as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Fund also has the option of following FASB guidance issued after November 30, 1989, but has elected not to do so.

**(b) Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

**(c) Investments**

Investments are stated at fair value based on quoted market price.

**(d) Inventories**

Inventories consist of operating and maintenance and repair parts for sewage lines and are valued at the lower of cost or market, with cost being determined on an average cost method.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

**(e) Capital Assets**

Capital assets are recorded at historical cost, together with interest capitalized during construction. Depreciation is computed using the straight-line method over the estimated useful lives of the related assets as follows:

|                             |              |
|-----------------------------|--------------|
| Improvements to land        | 67 years     |
| Structures                  | 40 years     |
| Interceptors and regulators | 100 years    |
| Equipment                   | 3 – 20 years |

**(f) Workers' Compensation**

The Fund has no insurance coverage for workers' compensation claims. Workers' compensation expenses are recorded when the occurrence of the liability is probable and the amount is reasonably estimable. The amounts recorded as of June 30, 2006 and 2005 are based on compensation expected to be paid, along with estimated medical costs, for all claims known as of the balance sheet date, and historical data are used in computing the liability for estimated incurred but unknown claims as of the balance sheet date.

|   | <b>June 30</b> |             |             |
|---|----------------|-------------|-------------|
|   | <b>2006</b>    | <b>2005</b> | <b>2004</b> |
| Balance at beginning of year                    | \$ 4,727,969   | 5,206,684   | 4,844,529   |
| Current year claims and changes<br>in estimates | 964,548        | 475,827     | 1,543,501   |
| Claims payments                                 | (558,999)      | (954,542)   | (1,181,346) |
| Balance at end of year                          | \$ 5,133,518   | 4,727,969   | 5,206,684   |

**(g) Capitalized Interest**

The Fund capitalizes qualifying net interest costs of the System on bonds issued for capital construction in accordance with Statement of Financial Accounting Standards Statement No. 34 *Capitalization of Interest Cost* and Statement No. 62 *Capitalization of Interest Cost in situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants an Amendment of FASB Statement No. 34*. Accordingly, capitalized interest for the years ended June 30, 2006 and 2005 was \$54,012,814 and \$50,767,951, respectively.

**(h) Taxes and City Services**

The Fund pays no direct federal, state, or local taxes, except local taxes on excess property and federal Social Security taxes. The Fund reimburses the City for most of the direct services furnished by other City departments, including general staff services. Charges are billed for all sewage services provided to City departments.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

(i) ***Shared Costs***

Costs related to shared facilities and personnel are allocated to the Fund on a basis that relates costs incurred to the Fund benefited.

(j) ***Compensated Absences***

The Fund records as a liability estimated vested vacation, sick pay, and banked overtime in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. Unused vacation pay accumulates until termination of employment, while there is no vesting of sick pay until an employee reaches age 60 or completes 25 years of service.

(k) ***Accrued Revenue***

The Fund records unbilled revenues for services provided prior to year-end by accruing actual revenues billed in the subsequent month.

(l) ***Net Assets***

Net assets are categorized as follows:

**Invested in capital assets:** This consists of capital assets, net of accumulated depreciation and related debt.

**Restricted:** This consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the Fund's policy to use restricted resources first, and then unrestricted resources when they are needed.

**Unrestricted:** This consists of net assets that do not meet the definition of "restricted" or "invested in capital assets."

(m) ***Classification of Revenues***

The Fund has classified its revenues as either operating or nonoperating revenues according to the following criteria:

**Operating revenues:** Operating revenues include activities that have the characteristics of exchange transactions, such as revenue from charges for sewage service.

**Nonoperating revenues:** Nonoperating revenues include activities that have the characteristics of nonexchange transactions, which are defined as nonoperating revenues by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Government Entities That Use Proprietary Fund Accounting*, and GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, such as investment income and interest expense.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

**(n) Use of Estimates**

The preparation of financial statements in conformity with U.S. 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.

**(o) New Accounting Pronouncements**

The Fund adopted GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets. The Fund implemented Statement No. 42 with the year ended June 30, 2006.

The Fund adopted GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation – an amendment of GASB Statement No. 34*. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government – such as citizens, public interest groups, or the judiciary – can compel a government to honor. This statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing legislation or if legal enforceability is reevaluated. The Fund implemented Statement No. 46 with the year ended June 30, 2006.

In July 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes accounting and financial reporting standards for employers that participate in a defined-benefit “other postemployment benefit” (OPEB) plan. The Fund will implement Statement No. 45 beginning with the year ended June 30, 2007. The Fund is currently evaluating the impact of adopting Statement No. 45.

**(2) Deposits and Investments**

The following is a complete listing of deposits and investments held by the Fund at June 30, 2006:

|                                |                              |
|--------------------------------|------------------------------|
| Deposits                       | \$ 8,833,849                 |
| Investments                    | <u>506,862,766</u>           |
| Total deposits and investments | <u><u>\$ 515,696,615</u></u> |

**CITY OF DETROIT**  
**SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

The deposits and investments of the Fund at June 30, 2006 are reflected in the basic financial statements as follows:

|                            |    |                           |
|----------------------------|----|---------------------------|
| Unrestricted:              |    |                           |
| Deposits                   | \$ | 1,418,283                 |
| Investments                |    | 51,205,044                |
| Restricted:                |    |                           |
| Deposits                   |    | 7,415,566                 |
| Investments – current      |    | 344,637,409               |
| Investments – noncurrent   |    | <u>111,020,313</u>        |
| Total cash and investments | \$ | <u><u>515,696,615</u></u> |

State law authorizes the Fund to make deposits in the accounts of federally insured financial institutions. Cash held by fiscal agents or by trustees is secured in accordance with the requirements of the agency or trust agreement.

The Fund is authorized to invest in obligations of the U.S. government or its agencies, certificates of deposit, savings and depository accounts of insured institutions, commercial paper of certain investment quality, repurchase agreements, banker's acceptances, mutual funds of certain investment quality, and investment pools as authorized by state law.

***Custodial Credit Risk of Bank Deposits***

Custodial credit risk is the risk that in the event of bank failure, the Fund's deposits may not be returned by the bank. The Fund does not have a deposit policy for custodial credit risk. At June 30, 2006 and 2005, the Fund had deposits of \$8,436,281 and \$12,918,713, respectively, that were exposed to custodial credit risk, as they were uninsured and uncollateralized.

***Custodial Credit Risk of Investments***

Custodial credit risk is the risk that in the event of failure of the counterparty, the Fund will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Fund does not have a policy for custodial credit risk. As of June 30, 2006 and 2005, the Fund had no investments subject to custodial credit risk.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

***Interest Rate Risk***

Interest rate risk is the risk that, over time, the value of investments will decrease as a result of a rise in interest rates. The Fund's investment policy does not specifically restrict investment maturities other than commercial paper, which can only be purchased with a 270-day maturity. The Fund's policy minimizes interest rate risk by requiring that the Fund attempt to match its investments with anticipated cash flow requirements. Unless related to a specific cash flow, the Fund is generally not permitted to directly invest in securities maturing more than 10 years from the original date of purchase.

| <u>Investment</u>                 | <u>Fair value</u>     | <u>Investment maturities in years</u> |                          |
|-----------------------------------|-----------------------|---------------------------------------|--------------------------|
|                                   |                       | <u>Less than one year</u>             | <u>one to five years</u> |
| U.S. government agency securities | \$ 257,920,511        | 161,876,955                           | 96,043,556               |
| Certificate of deposit            | 23,421,649            | 23,421,649                            | —                        |
| Commercial paper                  | 34,981,735            | 34,981,735                            | —                        |
| Repurchase agreements             | 19,985,604            | 5,008,847                             | 14,976,757               |
| Money market                      | 170,553,267           | 170,553,267                           | —                        |
| Total investments                 | <u>\$ 506,862,766</u> | <u>395,842,453</u>                    | <u>111,020,313</u>       |

***Credit Risk***

The Fund's investment policy complies with state law. The Fund limits its investments in commercial paper, mutual funds, and external investment pools that purchase commercial paper to the top two rating classifications issued by two nationally recognized statistical rating organizations (NRSROs).

As of June 30, 2006, the Fund had the following investments, maturities, and credit quality ratings of debt securities:

| <u>Investment</u>                 | <u>Fair value</u>     | <u>Rating</u> | <u>Rating organization</u> |
|-----------------------------------|-----------------------|---------------|----------------------------|
| U.S. government agency securities | \$ 161,876,955        | AAA, Aaa      | S & P and Moody's          |
| U.S. government agency securities | 96,043,556            | AAA, Aaa      | S & P and Moody's          |
| Repurchase agreements             | 14,976,757            | AAA, Aaa      | S & P and Moody's          |
| Repurchase agreements             | 5,008,847             | AAA, Aaa      | S & P and Moody's          |
| Money market                      | 60,160,500            | Aaa           | Moody's                    |
| Money market                      | 21,834,727            | Not rated     | N/A                        |
| Money market                      | 88,558,040            | AAAm, Aaa     | S & P and Moody's          |
| Certificates of Deposit           | 23,421,649            | Not rated     | N/A                        |
| Commercial paper                  | 34,981,735            | Not rated     | N/A                        |
| Total investments                 | <u>\$ 506,862,766</u> |               |                            |

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

***Concentration of Credit Risk***

Concentration of credit risk is the risk of loss attributed to the magnitude of the Fund's investment in a single issuer. The Fund's policy specifies a number of limitations to minimize concentration of credit risk, including prohibiting investing more than 5% of the portfolio in securities (other than U.S. government, mutual funds, external investment pools, and other pooled investments) of any one issuer.

More than 5% of the Fund's investments are in Federal Home Loan Bank and Federal National Mortgage Association securities. These investments are 28% and 22%, respectively, of the Fund's total investments.

**(3) Restricted Assets**

Restricted assets, principally cash and investments, are available for debt service on revenue bonds and to provide funds for improvements, enlargements, extensions, and construction. In certain instances, minimum levels of assets are required by bond ordinance provisions or by Board of Water Commissioners' decree. These assets are maintained as follows: (1) With respect to the Bond and Interest Redemption Fund, after provision has been made for expenses of operation and maintenance of the System, a sum proportionately sufficient to provide for payment, when due, of the current principal and interest is set aside. The Bond Reserve Account is part of the Bond and Interest Redemption Fund, and the amounts credited to this account are to be used only to pay principal and interest on the bonds when current revenues are not sufficient. (2) With respect to the Extraordinary Repair and Replacement Reserve Fund, after meeting the requirements of the foregoing funds, monthly deposits in an amount equal to one twelfth of 3% of the budgeted operation and maintenance expense of the System for the fiscal year must be set aside until the aggregate amount funded totals at least 15% of that year's budgeted operating and maintenance costs. These deposits are to be used for major unanticipated repairs and replacement to the System with actual or anticipated cost exceeding \$1 million. Once this fund is fully funded, deposits required are amounts needed to maintain fully funded status. Borrowings of up to 50% of the balance in this fund on the first day of the related fiscal year are allowed for transfer to and use from the Improvement and Extension Fund. Any such borrowings must be repaid prior to any deposits being made to the Improvement and Extension Fund. (3) After the aforementioned deposits have been made, excess amounts may be deposited in the Improvement and Extension Fund, established for the payment of improvements, enlargements, repairs, extensions, or betterment to the System. (4) With respect to the Construction Fund, the portion of the proceeds of the sale of bonds for building or improving the System is deposited in this fund. A separate depository account is required for each series of bonds. Proceeds for construction purposes received from federal and state grants and other sources that restrict the use of such proceeds are also deposited into this account.

When both restricted and unrestricted resources are available for use, generally it is the Fund's policy to use restricted resources first, and then unrestricted resources when they are needed.

The Fund's statement of net assets reports \$303,996,408 of restricted net assets, of which \$299,071,259 is restricted by enabling legislation.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

**(4) Capital Assets**

Capital asset activity for the fiscal years ended June 30, 2006 and 2005 is as follows:

|  | <u>Balance,<br/>June 30,<br/>2005</u> | <u>Additions</u>     | <u>Disposals</u>       | <u>Balance,<br/>June 30,<br/>2006</u> |
|--|---------------------------------------|----------------------|------------------------|---------------------------------------|
| Nondepreciable assets:                             |                                       |                      |                        |                                       |
| Land   | \$ 13,876,751                         | —                    | (41,794)               | 13,834,957                            |
| Construction in progress                           | 1,219,986,063                         | 284,368,969          | (1,193,852,634)        | 310,502,398                           |
|  | <u>1,233,862,814</u>                  | <u>284,368,969</u>   | <u>(1,193,894,428)</u> | <u>324,337,355</u>                    |
| Depreciable assets:                                |                                       |                      |                        |                                       |
| Interceptors, regulators,<br>and land improvements | 542,769,689                           | 106,574,102          | (174,654,520)          | 474,689,271                           |
| Structures   | 1,143,914,922                         | 964,622,796          | (405,536,576)          | 1,703,001,142                         |
| Equipment  | 708,031,859                           | 910,940,701          | (233,901,249)          | 1,385,071,311                         |
| Accumulated depreciation                           | <u>(681,127,715)</u>                  | <u>(69,951,016)</u>  | <u>105,887</u>         | <u>(750,972,844)</u>                  |
|  | <u>1,713,588,755</u>                  | <u>1,912,186,583</u> | <u>(813,986,458)</u>   | <u>2,811,788,880</u>                  |
| Total  | <u>\$ 2,947,451,569</u>               | <u>2,196,555,552</u> | <u>(2,007,880,886)</u> | <u>3,136,126,235</u>                  |
|  |                                       |                      |                        |                                       |
|  | <u>Balance,<br/>June 30,<br/>2004</u> | <u>Additions</u>     | <u>Disposals</u>       | <u>Balance,<br/>June 30,<br/>2005</u> |
| Nondepreciable assets:                             |                                       |                      |                        |                                       |
| Land   | \$ 13,876,751                         | —                    | —                      | 13,876,751                            |
| Construction in progress                           | 1,203,738,078                         | 439,665,001          | (423,417,016)          | 1,219,986,063                         |
|  | <u>1,217,614,829</u>                  | <u>439,665,001</u>   | <u>(423,417,016)</u>   | <u>1,233,862,814</u>                  |
| Depreciable assets:                                |                                       |                      |                        |                                       |
| Interceptors, regulators,<br>and land improvements | 532,455,750                           | 10,313,939           |                        | 542,769,689                           |
| Structures   | 891,488,855                           | 252,665,492          | (239,425)              | 1,143,914,922                         |
| Equipment  | 572,095,371                           | 136,220,745          | (284,257)              | 708,031,859                           |
| Accumulated depreciation                           | <u>(637,571,035)</u>                  | <u>(44,053,316)</u>  | <u>496,636</u>         | <u>(681,127,715)</u>                  |
|  | <u>1,358,468,941</u>                  | <u>355,146,860</u>   | <u>(27,046)</u>        | <u>1,713,588,755</u>                  |
| Total  | <u>\$ 2,576,083,770</u>               | <u>794,811,861</u>   | <u>(423,444,062)</u>   | <u>2,947,451,569</u>                  |

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

**(5) Impaired Capital Assets**

Beginning fiscal year ended June 30, 2006, the Fund implemented GASB Statement No. 42-*Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. As of June 30 2006, the Fund did not have any impaired assets reportable under Statement No. 42.

**(6) Revenue Bonds**

The outstanding indebtedness of the Fund was \$2,657,446,122 and \$2,653,826,572 at June 30, 2006 and 2005, respectively. The interest rates on the outstanding bonds range from 4.2% to 6.5%. Net revenues of the Fund are pledged to repayment of bonds.

Future debt service requirements at June 30, 2006 are as follows:

|                      | <u>Principal</u>        | <u>Bond<br/>interest</u> | <u>Swap<br/>interest</u> | <u>Total<br/>requirements</u> |
|----------------------|-------------------------|--------------------------|--------------------------|-------------------------------|
| Year ending June 30: |                         |                          |                          |                               |
| 2007                 | \$ 53,205,000           | 98,382,197               | 32,993,250               | 184,580,447                   |
| 2008                 | 53,704,128              | 100,782,453              | 33,554,365               | 188,040,946                   |
| 2009                 | 56,925,000              | 107,542,236              | 32,780,631               | 197,247,867                   |
| 2010                 | 59,795,000              | 105,879,518              | 33,307,497               | 198,982,015                   |
| 2011                 | 62,270,000              | 102,905,996              | 32,646,118               | 197,822,114                   |
| 2012 – 2016          | 330,454,096             | 515,844,103              | 178,428,909              | 1,024,727,108                 |
| 2017 – 2021          | 375,230,225             | 490,294,825              | 198,035,091              | 1,063,560,141                 |
| 2022 – 2026          | 431,147,673             | 417,634,980              | 205,211,098              | 1,053,993,751                 |
| 2027 – 2031          | 614,335,000             | 222,394,897              | 97,112,842               | 933,842,739                   |
| 2032 – 2036          | 620,380,000             | 68,643,718               | 19,553,665               | 708,577,383                   |
|                      | <u>\$ 2,657,446,122</u> | <u>2,230,304,923</u>     | <u>863,623,466</u>       | <u>5,751,374,511</u>          |

In fiscal 2005, the Fund issued \$273,355,000 of City of Detroit, Michigan, Sewage Disposal System Revenue Second Lien Bonds, Series 2005-A; \$40,215,000 of City of Detroit, Michigan Sewage Disposal System Revenue Refunding Second Lien Bonds, Series 2005-B; and \$63,160,000 of City of Detroit, Michigan Sewage Disposal System Revenue Refunding Second Lien Bonds, Series 2005-C. The net proceeds were used to refund a portion of the City's outstanding Sewage Disposal System Revenue Bonds and Revenue Refunding Bonds and to pay costs of issuance associated with the 2005 bonds.

The net proceeds of the Sewage Disposal System Revenue Second Lien Bonds, Series 2005-A, will be used (a) to deposit into the Construction Fund and (b) for the payment of the related costs of issuance, including the premium for the municipal bond insurance.

**CITY OF DETROIT**  
**SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

The net proceeds of the Sewage Disposal System Revenue Refunding Second Lien Bonds, Series 2005-B, will be used (a) to advance-refund the \$22,355,000 principal amount of the City's Sewage Disposal System Senior Lien Bonds, Series 1997-A, comprising serial bonds maturing in the year 2022 (the Advance Refunded 1997-A Bonds), with an average interest rate of 5%, (b) to advance-refund \$115,000 of 1999-A Sewage Disposal System Senior Lien Bonds, maturing in 2011, and \$3,425,000 1999-B Sewage Disposal System Senior Lien Bonds, maturing in 2012 (the Advance Refunded 1999-A Bonds), with an average interest rate of 5.20% and 5.25%, respectively, (c) to advance-refund \$8,215,000 of 2003-A Sewage Disposal System Senior Lien Bonds, maturing in 2014, and \$8,470,000 Sewage Disposal System Senior Lien Bonds, maturing in 2015 (the Advance Refunded 2003-A Bonds), with an average interest rate of 5.0%, and (d) the payment of the related costs of issuance, including the premium for the municipal bond insurance.

The proceeds of the Sewage Disposal System Revenue Refunding Second Lien Bonds, Series 2005-C, will be used (a) to currently refund \$6,770,000 principal amount of the City's Sewage Disposal System Senior Lien Bonds, Series 1995-A bonds, maturing in the year 2025, with an average interest rate of 5%, (b) to currently refund the following amounts of the City's Sewage Disposal System Senior Lien Bonds, Series 1995-B bonds, \$2,400,000 principal amount maturing in the year 2008, with an average interest rate of 5.25%, \$20,410,000 principal amount of term bonds maturing in the year 2015, with an average interest rate of 5.25%, and \$36,605,000 principal amount of term bonds, maturing in the year 2021, with an average interest rate of 5.25% (together with the "Currently Refunded 1995-A/B Bonds"), and (c) for the payment of the related costs of issuance, including the premium for the municipal bond insurance.

Proceeds of the Refunding Bonds were deposited into an irrevocable trust with an escrow agent to provide for all future principal and interest payments on the Currently Refunded 1995-A/B Bonds when due to and including July 1, 2005 at 100% and 101%; the Advance Refunded 1997-A Bonds when due to and including July 1, 2007 at 101%; the Advance Refunded 1999-A Bonds when due to and including July 1, 2010 at 101%; and the Advance Refunded 2003-A Bonds when due to and including July 1, 2013 at 100%.

The advance refunding resulted in a difference between the reacquisition price and net carrying amount of the old debt of \$8,987,394. This difference, reported in the basic financial statements as a deduction from bonds payable, is being charged to operations through the year 2024 using the straight-line method. The fund completed the advance refunding to reduce its total debt service payments over the next 20 years and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$6,143,299.

In prior years, the Fund defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and liabilities for the defeased bonds are not included in the Fund's financial statements. Similarly, the interest expense related to the defeased bonds and the related interest income earned on the escrow fund investments have not been recognized in the statements of revenues, expenses, and changes in fund net assets. As of June 30, 2006 and 2005, approximately \$400,800,000 and \$593,330,000 of bonds outstanding are considered defeased.

Bonds outstanding at June 30, 2006 include \$2,439,587,743 of bonds callable at various dates after June 30, 2006. These bonds are callable at varying premiums, depending on the issue and length of time to maturity.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

**(7) Pension Obligation Certificates of Participation (POC's)**

***2005 Issuance***

In June 2005, the Detroit Retirement Systems Funding Trust issued \$1,440,000,000 (\$640 million of fixed rate, Series A, and \$800 million of floating rate, Series B) of taxable Pension Obligation Certificates of Participation (COPs). The Trust was created by the General Retirement System Service Corporation (GRSSC) and the Police and Fire Retirement System Service Corporation (PFRSSC), both blended component units of the City. The City entered into service contracts with the GRSSC and PFRSSC to facilitate the transaction.

The POC's were issued for the purpose of funding certain unfunded accrued actuarial liabilities (UAAL) of the two retirement systems of the City, which include the General Retirement System (GRS) and the Police & Fire Retirement System (PFRS), and a portion of the then current year normal contribution. The GRS includes employees and retirees of certain governmental funds, proprietary funds (Transportation Fund, Sewage Disposal Fund and Water Fund) and the Detroit Public Library, a discretely presented component unit.

A proportionate amount of the liability was recorded on the books of the City's Governmental Activities, Transportation Fund, Sewage Disposal Fund and Water Fund, based on each fund's portion of the overall UAAL liquidated by the use of the 2005 POC net proceeds. In connection with the 2005 transactions, the Service Corporations entered into interest rate exchange agreements (swap agreements) to hedge the variable rate interest exposure associated with the issuance of the 2005 Series-B Certificates.

The original Series A and Series B certificates were not specifically related to either of the Service Corporations. The amount of proceeds from the 2005 issuance recorded on each Service Corporation's books was based on the respective proportion of UAAL funding required for the corresponding Pension System.

***Fiscal Year 2006 Events***

Michigan law entitles each Retirement System to have its UAAL funded over a specified period (Amortization Period), which may be duly changed up to a 30-year maximum. Each 2005 Service Contract required the City to make 2005 COP service payments over a period that was limited to the PFRS or GRS Amortization Period (13 years for PFRS and 20 years for the GRS). The funding Ordinance anticipated the possible future extension of the PFRS and GRS Amortization Periods and authorized the Service Corporations, in that event, to assist the City in gaining the financial benefits of making its 2005 COP Service payments over a similarly lengthened period.

On February 8, 2006, the governing board of the GRS extended the Amortization Period for GRS UAAL from 20 to 30 years. On March 30, 2006, the governing board of the PFRS UAAL extended the amortization period for PFRS UAAL from 13 to 30 years. Accordingly, the Detroit Retirement Systems Funding Trust 2006 issued \$948,540,000 of taxable Certificates of Participation Series 2006. The City also terminated the Swap agreements entered into in the 2005 transaction and received \$48,932,455 as a result of the swap termination.

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

The Taxable Certificates of Participation Series 2006 were issued to enable the City to replace certain scheduled payment obligations that it incurred to provide funding for the 2005 Subject UAAL with new scheduled payment obligations payable over the extended 30-year periods under the 2006 Service Contracts. This will enable the City to achieve financial benefits from the lengthened payment periods compared to the payment period included within the 2005 Series A and B payment schedules.

The 2006 Certificates were issued to fund the optional redemption \$104,055,000 aggregate principal amount of Series 2005-A COPs of certain maturities and the purchase and cancellation of \$800,000,000 aggregate principal amount of Series 2005-B COPs of certain maturities.

The City did not pay off the \$104,055,000 of optionally redeemed Series A 2005 COPs until July 13, 2006. At June 30, 2006 the portion of the 2006 COP proceeds to pay the \$104,055,000 COPs were in irrevocable trust investment accounts and on July 13, 2006 were disbursed to pay the COP service obligation and accrued interest from June 15, 2006 (the last interest payment date) to July 13, 2006. For financial reporting purposes, this disbursement was treated as if it had occurred on June 30, 2006.

In economic substance, the City paid off \$904,055,000 of 2005 Series Certificates with the net proceeds from the \$948,540,000 received from the issuance of Certificates of Participation Series 2006. The net effect of this on the City's balance sheet is to add on additional \$44,485,000 of Certificates of Participation obligations to the government-wide balance sheet. The refunding resulted in an increase of approximately \$992 million in required aggregate future cash outflows for debt service. This resulted in an economic loss (difference between the present values of the old and new debt service requirements) of \$89,265,111.

Certain maturities of the Series 2005-A COPs still remain outstanding concurrently with the 2006 Certificates. The 2005 COPs and the 2006 Certificates are wholly independent of each other.

The redemption dates and a summary of the aggregate principal and interest amounts for the remaining 2005 POC's are as follows:

| Maturity<br>(June 15) | Primary Government<br>Principal |                          |                        |               | Totals         |
|-----------------------|---------------------------------|--------------------------|------------------------|---------------|----------------|
|                       | Governmental<br>Activities      | Business-type Activities |                        |               |                |
|                       |                                 | Sewer Disposal<br>Fund   | Transportation<br>Fund | Water<br>Fund |                |
| 2007                  | -                               | -                        | -                      | -             | -              |
| 2008                  | -                               | -                        | -                      | -             | -              |
| 2009                  | -                               | -                        | -                      | -             | -              |
| 2010                  | 3,861,370                       | 28,880                   | 340,053                | 519,698       | 4,750,000      |
| 2011                  | 8,905,539                       | 66,606                   | 784,268                | 1,198,587     | 10,955,000     |
| 2012-2016             | 113,686,862                     | 850,288                  | 10,011,862             | 15,300,989    | 139,850,000    |
| 2017-2021             | 153,857,304                     | 1,150,731                | 13,549,481             | 20,707,484    | 189,265,000    |
| 2022-2025             | 155,369,335                     | 1,162,040                | 13,682,639             | 20,910,986    | 191,125,000    |
| Total                 | \$ 435,680,409                  | \$ 3,258,546             | \$ 38,368,303          | \$ 58,637,742 | \$ 535,945,000 |

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

| <b>Primary Government</b>       |                                    |                                |                                |                       |                       |
|---------------------------------|------------------------------------|--------------------------------|--------------------------------|-----------------------|-----------------------|
| <b>Interest</b>                 |                                    |                                |                                |                       |                       |
| <b>Business Type Activities</b> |                                    |                                |                                |                       |                       |
| <b>Maturity<br/>(June 15)</b>   | <b>Governmental<br/>Activities</b> | <b>Sewer Disposal<br/>Fund</b> | <b>Transportation<br/>Fund</b> | <b>Water<br/>Fund</b> | <b>Totals</b>         |
| 2007                            | 20,942,804                         | 156,636                        | 1,844,333                      | 2,818,669             | \$ 25,762,441         |
| 2008                            | 20,942,804                         | 156,636                        | 1,844,333                      | 2,818,669             | 25,762,441            |
| 2009                            | 20,942,804                         | 156,636                        | 1,844,333                      | 2,818,669             | 25,762,441            |
| 2010                            | 20,942,804                         | 156,636                        | 1,844,333                      | 2,818,669             | 25,762,441            |
| 2011                            | 20,776,224                         | 155,390                        | 1,829,663                      | 2,796,249             | 25,557,526            |
| 2012-2016                       | 93,492,246                         | 699,248                        | 8,233,418                      | 12,583,018            | 115,007,929           |
| 2017-2021                       | 60,177,138                         | 450,077                        | 5,299,514                      | 8,099,174             | 74,025,904            |
| 2022-2025                       | 20,083,887                         | 150,212                        | 1,768,692                      | 2,703,068             | 24,705,859            |
| Total                           | <u>\$ 278,300,709</u>              | <u>\$ 2,081,470</u>            | <u>\$ 24,508,620</u>           | <u>\$ 37,456,183</u>  | <u>\$ 342,346,982</u> |

The redemption dates and a summary of the aggregate principal and interest amounts for Series 2006 Pension Obligation Certificates are as follows:

| <b>Primary Government</b>       |                                    |                                |                                |                       |                       |
|---------------------------------|------------------------------------|--------------------------------|--------------------------------|-----------------------|-----------------------|
| <b>Principal</b>                |                                    |                                |                                |                       |                       |
| <b>Business-type Activities</b> |                                    |                                |                                |                       |                       |
| <b>Maturity<br/>(June 15)</b>   | <b>Governmental<br/>Activities</b> | <b>Sewer Disposal<br/>Fund</b> | <b>Transportation<br/>Fund</b> | <b>Water<br/>Fund</b> | <b>Totals</b>         |
| 2007                            | \$ -                               | \$ -                           | \$ -                           | \$ -                  | \$ -                  |
| 2008                            | -                                  | -                              | -                              | -                     | -                     |
| 2009                            | -                                  | -                              | -                              | -                     | -                     |
| 2010                            | -                                  | -                              | -                              | -                     | -                     |
| 2011                            | -                                  | -                              | -                              | -                     | -                     |
| 2012-2016                       | -                                  | -                              | -                              | -                     | -                     |
| 2017-2021                       | 33,557,338                         | 250,982                        | 2,955,235                      | 4,516,445             | 41,280,000            |
| 2022-2026                       | 84,689,193                         | 633,408                        | 7,458,175                      | 11,398,224            | 104,179,000           |
| 2027-2031                       | 318,531,321                        | 2,382,363                      | 28,051,539                     | 42,870,777            | 391,836,000           |
| 2032-2035                       | 334,309,285                        | 2,500,370                      | 29,441,030                     | 44,994,315            | 411,245,000           |
| Total                           | <u>\$ 771,087,137</u>              | <u>\$ 5,767,123</u>            | <u>\$ 67,905,979</u>           | <u>\$ 103,779,761</u> | <u>\$ 948,540,000</u> |

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Notes to Basic Financial Statements

June 30, 2006 and 2005

| <b>Maturity<br/>(June 15)</b> | <b>Primary Government<br/>Interest<br/>Business Type Activities</b> |                                |                                |                       |                         | <b>Totals</b> |
|-------------------------------|---|--------------------------------|--------------------------------|-----------------------|-------------------------|---------------|
|                               | <b>Governmental<br/>Activities</b>                                  | <b>Sewer Disposal<br/>Fund</b> | <b>Transportation<br/>Fund</b> | <b>Water<br/>Fund</b> |                         |               |
|                               |   | \$                             | \$                             | \$                    | \$                      |               |
| 2007                          | \$ 40,020,806   | \$ 299,324                     | \$ 3,524,442                   | \$ 5,386,356          | \$ 49,230,928           |               |
| 2008                          | 44,079,824  | 329,682                        | 3,881,901                      | 5,932,655             | 54,224,061              |               |
| 2009                          | 47,826,551  | 357,705                        | 4,211,857                      | 6,436,922             | 58,833,035              |               |
| 2010                          | 47,826,551  | 357,705                        | 4,211,857                      | 6,436,922             | 58,833,035              |               |
| 2011                          | 47,826,551  | 357,705                        | 4,211,857                      | 6,436,922             | 58,833,035              |               |
| 2012-2016                     | 239,132,754   | 1,788,524                      | 21,059,285                     | 32,184,612            | 294,165,175             |               |
| 2017-2021                     | 236,954,334   | 1,772,231                      | 20,867,442                     | 31,891,421            | 291,485,428             |               |
| 2022-2026                     | 223,400,997   | 1,670,863                      | 19,673,864                     | 30,067,292            | 274,813,016             |               |
| 2027-2031                     | 165,038,717   | 1,234,359                      | 14,534,175                     | 22,212,378            | 203,019,629             |               |
| 2032-2035                     | 52,643,635  | 393,733                        | 4,636,075                      | 7,085,248             | 64,758,691              |               |
| Total                         | <u>\$ 1,144,750,722</u>   | <u>\$ 8,561,832</u>            | <u>\$ 100,812,754</u>          | <u>\$ 154,070,728</u> | <u>\$ 1,408,196,036</u> |               |

**(8) Deferred Swap Termination Proceeds and Payments**

During the year ended June 30, 2004, the Fund and its counterparty terminated a forward starting swap agreement related to the future issuance of debt in fiscal year 2005. The Fund received a termination payment in the amount of \$14,056,137 that has been deferred to offset future debt service. The proceeds will be recognized over the life of the debt using the straight-line method.

During the year ended June 30, 2005, the Fund and its counterparty terminated a forward starting swap agreement related to the issuance of debt in fiscal year 2005. The Fund paid a termination payment in the amount of \$11.75 million that has been reserved to offset future debt service. The expense will be recognized over the life of the debt that was issued in fiscal year 2005 using straight-line method.

During the year ended June 30, 2006, The City terminated the Swap agreements entered into in the 2005 transaction and received \$48,932,455. The Fund's allocated share is \$297,509. The proceeds will be recognized over the life of the debt using the straight-line method.

During fiscal year ended June 30, 2006, the amount of amortization expense was \$79,522. The remaining balance of the Sewer Swap Termination Fee as of June 30, 2006 and 2005 is \$2,504,243 and 2,286,256, respectively.

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Notes to Basic Financial Statements

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**(9) Long-Term Liabilities**

Long-term liability activity for the years ended June 30, 2006 and 2005 is as follows:

|   | <u>Balance,<br/>June 30, 2005</u> | <u>Increase</u>   | <u>Decrease</u>     | <u>Balance,<br/>June 30, 2006</u> | <u>Amount<br/>due within<br/>one year</u> |
|---|-----------------------------------|-------------------|---------------------|-----------------------------------|---|
| Revenue bonds payable                   | \$ 2,653,826,572                  | 53,654,550        | (50,035,000)        | 2,657,446,122                     | 53,205,000                                |
| Total revenue bond payable              | 2,653,826,572                     | 53,654,550        | (50,035,000)        | 2,657,446,122                     | 53,205,000                                |
| Add:                                    |                                   |                   |                     |                                   |   |
| Unamortized premium                     | 83,676,956                        | —                 | (5,128,099)         | 78,548,857                        | —   |
| Less:                                   |                                   |                   |                     |                                   |   |
| Deferred charges on refunding           | 63,094,656                        | 10,013,373        | (3,707,707)         | 69,400,322                        | —   |
| Discount                                | 15,369,617                        | —                 | (13,303,593)        | 2,066,024                         | —   |
| Net revenue                             |                                   |                   |                     |                                   |   |
| bonds payable                           | <u>2,659,039,255</u>              | <u>43,641,177</u> | <u>(38,151,799)</u> | <u>2,664,528,633</u>              | <u>53,205,000</u>                         |
| Pension obligation certificates payable | <u>8,760,811</u>                  | <u>270,469</u>    | <u>—</u>            | <u>9,031,280</u>                  | <u>—</u>                                  |
| Other liabilities:                      |                                   |                   |                     |                                   |   |
| Accrued workers' compensation           | 4,727,969                         | 964,548           | (558,999)           | 5,133,518                         | 811,538                                   |
| Accrued compensated absences            | 13,917,806                        | 3,256,908         | (3,274,943)         | 13,899,771                        | 2,281,068                                 |
| Deferred swap termination               | <u>2,286,256</u>                  | <u>297,509</u>    | <u>(79,522)</u>     | <u>2,504,243</u>                  | <u>—</u>                                  |
| Total other liabilities                 | <u>20,932,031</u>                 | <u>4,518,965</u>  | <u>(3,913,464)</u>  | <u>21,537,532</u>                 | <u>3,092,606</u>                          |
| Total                                   | <u>\$ 2,688,732,097</u>           | <u>48,430,611</u> | <u>(42,065,263)</u> | <u>2,695,097,445</u>              | <u>56,297,606</u>                         |

**CITY OF DETROIT  
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|   | <u>Balance,<br/>June 30, 2004</u> | <u>Increase</u>    | <u>Decrease</u>      | <u>Balance,<br/>June 30, 2005</u> | <u>Amount<br/>due within<br/>one year</u> |
|---|-----------------------------------|--------------------|----------------------|-----------------------------------|---|
| Revenue bonds payable                   | \$ 2,375,152,600                  | 420,028,972        | (141,355,000)        | 2,653,826,572                     | 50,035,000                                |
| Add:                                    |                                   |                    |                      |                                   |   |
| Unamortized premium                     | 70,051,130                        | 17,150,459         | (3,524,633)          | 83,676,956                        | —   |
| Less:                                   |                                   |                    |                      |                                   |   |
| Deferred charges on refunding           | 62,230,146                        | 4,456,953          | (3,592,443)          | 63,094,656                        | —   |
| Discount                                | 16,297,959                        | —                  | (928,342)            | 15,369,617                        | —   |
| Net revenue                             |                                   |                    |                      |                                   |   |
| bonds payable                           | <u>2,366,675,625</u>              | <u>432,722,478</u> | <u>(140,358,848)</u> | <u>2,659,039,255</u>              | <u>50,035,000</u>                         |
| Pension obligation certificates payable | <u>—</u>                          | <u>8,760,811</u>   | <u>—</u>             | <u>8,760,811</u>                  | <u>—</u>                                  |
| Other liabilities:                      |                                   |                    |                      |                                   |   |
| Accrued workers' compensation           | 5,206,684                         | 475,827            | (954,542)            | 4,727,969                         | 895,155                                   |
| Accrued compensated absences            | 12,158,263                        | 2,255,075          | (495,532)            | 13,917,806                        | 5,556,011                                 |
| Deferred swap termination               | <u>14,056,137</u>                 | <u>—</u>           | <u>(11,769,881)</u>  | <u>2,286,256</u>                  | <u>—</u>                                  |
| Total other liabilities                 | <u>31,421,084</u>                 | <u>2,730,902</u>   | <u>(13,219,955)</u>  | <u>20,932,031</u>                 | <u>6,451,166</u>                          |
| Total                                   | <u>\$ 2,398,096,709</u>           | <u>444,214,191</u> | <u>(153,578,803)</u> | <u>2,688,732,097</u>              | <u>56,486,166</u>                         |

**(10) Derivatives Not Reported at Fair Value**

The Fund is party to derivative financial instruments consisting of interest rate swaps that are intended to effectively convert variable-rate financings to fixed-rate financings. These are not reported at fair value on the statement of net assets at June 30, 2006.

**Objective of the swaps.** In order to better manage its interest rate exposure and to reduce the overall costs of its financings, the Fund has entered into nine separate fixed-payor interest rate swaps. The Fund is also a party in the City's POC's related to the GRS. The City has entered into two separate fixed-payor interest rate swaps related to the POC's and the GRS.

**Market access risk.** The City is exposed to market access risk on its hedge swaps or forward starting swaps in the event that it will not be able to enter credit markets or in the event that credit will become more costly.

**Terms, fair values, and credit risk.** Certain key terms, fair market values, and counterparty credit ratings relating to the outstanding swaps as of June 30, 2006 are presented below. The notional amounts of the swaps, except those with effective dates of September 1, 2006 and March 1, 2007, match the principal amounts of the outstanding financings. The swaps with effective dates of September 1, 2006 and March 1, 2007, were entered into to hedge future interest rate risk and will be associated with financings expected to be issued prior to the effective dates. Except as discussed under rollover risk, the Fund's swap agreements

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contain scheduled reductions to outstanding notional amounts that match scheduled or anticipated amortization of associated financings.

| <u>Associated financing issue</u>     | <u>Notional amounts (1)</u> | <u>Effective date</u> | <u>Fixed rate paid</u> | <u>Variable rate received</u> | <u>Fair values</u> | <u>Sweep termination date</u> | <u>Final maturity of bonds</u> | <u>Counterparty credit rating</u> |
|---------------------------------------|-----------------------------|-----------------------|------------------------|-------------------------------|--------------------|-------------------------------|--------------------------------|-----------------------------------|
| Sewage 1998-A                         | \$ 68,000,000               | 12/10/1998            | 4.51%                  | BMA (2)                       | \$ (3,258,018)     | 7/1/2023                      | 7/1/2023                       | Aa2/AA-/NR                        |
| Sewage 1998-B                         | 67,900,000                  | 12/10/1998            | 4.51                   | BMA                           | (3,260,270)        | 7/1/2023                      | 7/1/2023                       | Aa2/AA-/NR                        |
| Sewage 1999-A                         | 27,900,000                  | 10/22/1999            | 7.48                   | IMT+.28%                      | (9,227,590)        | 7/1/2029                      | 7/1/2029                       | Aa1/AA-/AA+                       |
| Sewage 2001 C-1                       | 156,500,000                 | 10/23/2001            | 4.43                   | BMA                           | (7,116,931)        | 7/1/2027                      | 7/1/2027                       | Aa2/AA+/AAA                       |
| Sewage 2001 C-2                       | 124,500,000                 | 10/23/2001            | 4.47                   | BMA                           | (6,565,848)        | 7/1/2029                      | 7/1/2029                       | Aa2/AA+/AAA                       |
| Sewage 2003-B                         | 150,000,000                 | 5/22/2003             | 4.14                   | BMA                           | 1,924,401          | 7/1/2033                      | 7/1/2033                       | Aa2/AA+/AAA                       |
| Sewage Hedge Swap                     | 125,000,000                 | 9/1/2006              | 4.96                   | BMA                           | 7,867,616          | 7/1/2036                      | N/A                            | Aa2/AA+/AAA                       |
| Sewage Hedge Swap                     | 56,250,000                  | 3/1/2010              | 4.93                   | BMA                           | 1,320,373          | 7/2/2039                      | N/A                            | Aa3/A+/AA-                        |
| Sewage Hedge Swap                     | 168,750,000                 | 3/1/2010              | 4.93                   | BMA                           | (4,141,786)        | 7/3/2039                      | N/A                            | Aa3/A+/AA-                        |
| Pension Obligation Certificates - GRS | 99,621,000                  | 6/7/2006              | 4.99                   | 3 MTH LIBOR + .34%            | (183,936)          | 6/15/2034                     | 6/15/2034                      | Aa3/A+/AA-                        |
| Pension Obligation Certificates - GRS | 42,252,000                  | 6/7/2006              | 4.99                   | 3 MTH LIBOR + .30%            | (84,084)           | 6/15/2029                     | 6/15/2029                      | Aa3/A+/AA-                        |

(1) Notional amount balance as of July 1, 2006

(2) The Bond Market Association Municipal Swap Index™

(3) Denotes the the swap termination date does not match the final maturity of the financings

**Fair value.** Because interest rates have generally declined since the time the swaps were negotiated, most of the Fund's swaps have a negative fair value as of June 30, 2006. The negative fair values may be countered by lower total interest payments required under the variable-rate financings, creating lower synthetic interest rates.

**Credit risk.** As of June 30, 2006, the Fund was not significantly exposed to net credit risk, as the majority of the swaps had net negative fair values. However, should interest rates change and fair values of the swaps become positive, the Fund would be exposed to credit risk in the amount of the derivatives' positive fair value.

The swap agreements contain varying collateral agreements with the counterparties. The swaps require full collateralization of the fair value of the swap should the counterparty's credit rating fall below certain rating levels by Fitch Ratings, Standard & Poor's, and/or Moody's Investors Service. Collateral on all swaps is to be in the form of U.S. government securities held by a third-party custodian.

**Basis risk.** The Fund is not exposed to significant basis risk on its swaps because most of the variable payments received are based on the Bond Market Association (BMA) index. The Consumer Price Index (CPI) indexed swaps are associated with CPI indexed financings and thus create no basis risk. The London Interbank Offered Rate (LIBOR)-based swap has basis risk on \$28.3 million of swaps.

**Termination risk.** The Fund or counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. In such cases, the Fund may owe or be due a termination payment, depending on the value of the swap at that time. In addition, the Fund is exposed to termination risk, but not termination payments, on certain of the Fund's swaps related to Sewer Series 1998-A, Sewer Series 1998-B, Sewer Series 1999-A, Sewer Series 2001-C-1, Sewer Series 2001-C-2, and Sewer Series 2003-B. These

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swaps provide the counterparty with the option to terminate the swap agreement beginning on January 1, 2010, July 2, 2011, July 1, 2008, July 1, 2008, January 1, 2010, January 1, 2010, and July 1, 2013, respectively, upon the passing of certain BMA thresholds. If any of these swaps were terminated, the associated variable-rate financings would no longer carry synthetic interest rates, but there would be no termination payment.

***Rollover risk.*** The Fund is exposed to rollover risk on swaps that mature or may be terminated prior to the maturity of the associated financings. When these swaps terminate or, in the case of the termination option, if the counterparty exercises its option, the Fund will not realize the synthetic rate offered by the swaps on the underlying issues.

**(11) Employee Benefit Plan**

Substantially all City employees, including the Sewage Disposal Fund employees, are covered by a single-employer plan composed of a defined benefit with an optional employee-contributed annuity through the General Retirement System (GRS). The GRS pays a monthly pension to qualified individuals upon retirement. The amount is based upon a combination of years of service and annual salary.

***Plan Description***

The GRS is administered in accordance with the City of Detroit Charter and union contracts, which assign the authority to establish and amend contributions and benefit provisions to the Retirement System's board of trustees. The GRS issues separate, stand-alone financial statements annually. Copies of these financial statements can be obtained at the Coleman A. Young Municipal Center, 2 Woodward Ave., Rm. 908, Detroit, Michigan 48226.

***Funding Policy***

The GRS funding policy provides for periodic employer contributions at actuarially determined rates that, expressed as percentages of annual covered payroll, are sufficient to accumulate sufficient assets to pay benefits when due. The contribution requirements are established and may be amended by the GRS's board of trustees based on information provided by the GRS's consulting actuary. The City's contribution is set by the City Council in conjunction with its approval of the City's annual budget based on information provided by the GRS's consulting actuary.

The recommended contribution rate is determined by the GRS's consulting actuary using the entry age normal actuarial cost funding method. Significant actuarial assumptions used to compute contribution requirements are the same as those used to compute the actuarial accrued liability.

Based upon the June 30, 2005 actuarial valuation, which was the most recent actuarial data available when the budget was developed for the year ended June 30, 2006, the actuary recommended the Sewage Disposal Fund contribution rate of 2.04%. Contributions for the Sewage Fund totaled \$4,185,887.

Employees may elect to contribute 3%, 5%, or 7% of the first \$87,900 of annual compensation and 5% or 7% of any excess over \$87,900 for annuity savings. Contributions are voluntary for all union and nonunion

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employees. Contributions received from Sewer Fund employees during the year ended June 30, 2006 amounted to \$2,638,158.

The contribution requirements of plan members and the City are established and may be amended by the Board of Trustees in accordance with the City Charter, union contracts, and plan provisions. Members may retire with full benefits after attaining 30 years of service; age 55 with 30 years of service if hired after January 1, 1996; age 60 with 10 years of service; or age 65 with 8 years of service. Employees may retire after 25 years of service and collect an actuarially reduced retirement benefit. Monthly pension benefits, which are subject to certain minimum and maximum amounts, are determined according to fixed rates per year of credited service. Members of the General Retirement System who separated prior to July 1, 1981, met the age and service requirements, and who did not withdraw their accumulated annuity contributions are generally eligible for a pension at the time they would have been eligible had they continued in City employment. Members who separate after July 1, 1981 are not required to leave their accumulated annuity contributions in the System. Pension benefits for all members of the GRS are increased annually by 2.25% of the original pension.

**(a) Administrative Expenses**

Actuarial investment management and bank trustee fees and expenses are included in the GRS plan's administrative expenses when incurred. In addition, the GRS plan's administrative salary, rent, accounting services, duplicating, telecommunications, and travel expenses are included in the GRS plan's administrative expenses when incurred.

|                           | <u>Fiscal year<br/>ended</u> | <u>Annual<br/>pension<br/>cost (APC)</u> | <u>Percentage<br/>of APC<br/>contributed</u> | <u>Net<br/>pension<br/>asset</u> |
|---------------------------|------------------------------|--|--|----------------------------------|
| General Retirement System | June 30, 2004                | \$ 2,559,591                             | 100%   | \$ —                             |
|                           | June 30, 2005                | 6,359,722                                | 223%   | 7,850,281                        |
|                           | June 30, 2006                | 3,795,979                                | —  | 8,240,189                        |

The annual pension cost and net pension asset as of June 30, 2006 are as follows:

|  |                     |
|--|---------------------|
| Annual required contributions              | \$ 3,975,424        |
| Interest on net pension asset              | (620,172)           |
| Adjustment to annual required contribution | 440,727             |
|  | <hr/>               |
| Annual pension cost                        | 3,795,979           |
| Contributions made—employer                | 4,185,887           |
|  | <hr/>               |
| Changes in net pension asset               | 389,908             |
| Net pension asset, beginning of year       | 7,850,281           |
|  | <hr/>               |
| Net pension asset, end of year             | <u>\$ 8,240,189</u> |

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The actuarial methods and significant assumptions used to determine the annual required contributions for June 30, 2006 were as follows:

|  |                           |
|--|---------------------------|
| Valuation date   | June 30, 2005             |
| Actuarial cost method  | Entry age                 |
| Amortization method  | Level percent             |
| Remaining amortization period for unfunded accrued liabilities | 30 years                  |
| Asset valuation method   | 3-year<br>smoothed market |
| <br>   |                           |
| Actuarial assumptions:   |                           |
| Investment rate of return                                      | 7.9%                      |
| Projected salary increases*                                    | 4% – 9.5%                 |
| Cost-of-living adjustments*                                    | 2.25%                     |

\*Includes inflation rate of 4%

**(12) Other Post-employment Benefits**

In addition to the pension benefits described above, the City provides post-retirement benefits to its retirees, which include hospitalization, dental care, eye care, and life insurance. The number of City retirees at June 30, 2006 is 22451. Costs are accounted for in accordance with GASB Statement No. 12, Disclosure of Information on Post-retirement Benefits Other Than Pension Benefits by State and Local Governmental Employers. The benefits are provided in accordance with the City Charter and union contracts. The costs of benefits, which are financed on a pay-as-you-go basis, for the year ended June 30, 2006, are as follows:

| Benefits        | City<br>cost   | Retiree<br>cost | Total<br>cost |
|-----------------|----------------|-----------------|---------------|
| Hospitalization | \$ 139,306,757 | 14,933,508      | 154,240,265   |
| Dental          | 6,160,524      | —               | 6,160,524     |
| Eye care        | 1,969,690      | —               | 1,969,690     |
| Life insurance  | 143,579        | 26,740          | 170,319       |
|                 | \$ 147,580,550 | 14,960,248      | 162,540,798   |

**CITY OF DETROIT  
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Notes to Basic Financial Statements

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**(13) Due from (to) Other Funds**

During the course of operations, numerous transactions occur between individual funds and other City of Detroit funds for goods provided or services rendered. Related receivables and payables are classified as “due from other funds” or “due to other funds” on the balance sheets and are summarized as follows:

|   | <u>2006</u>          | <u>2005</u>       |
|---|----------------------|-------------------|
| Due from other funds (unrestricted):      |                      |                   |
| General                                   | \$ 30,513            | 11,887,394        |
| Water                                     | <u>52,768,156</u>    | <u>54,500,684</u> |
| Total due from other funds (unrestricted) | <u>\$ 52,798,669</u> | <u>66,388,078</u> |
| Due from other funds (restricted):        |                      |                   |
| General                                   | \$ 33,067            | 37,355,552        |
| Water                                     | <u>5,508,719</u>     | <u>282,997</u>    |
| Total due from other funds (restricted)   | <u>\$ 5,541,786</u>  | <u>37,638,549</u> |
| Due to other funds (unrestricted):        |                      |                   |
| General                                   | \$ 5,824,511         | 4,921,074         |
| General Fiduciary                         | 411,500              |                   |
| Water                                     | <u>51,511,455</u>    | <u>48,212,647</u> |
| Total due to other funds (unrestricted)   | <u>\$ 57,747,466</u> | <u>53,133,721</u> |
| Due to other funds (restricted):          |                      |                   |
| General                                   | \$ 30,605            | 48,509            |
| Water                                     | <u>10,231,497</u>    | <u>11,025,493</u> |
| Total due to other funds (restricted)     | <u>\$ 10,262,102</u> | <u>11,074,002</u> |

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Notes to Basic Financial Statements

June 30, 2006 and 2005

**(14) Capital Improvement Programs**

The Fund is engaged in a variety of projects that are a part of its five-year Capital Improvement Program (the Program). The total cost of this Program is anticipated to be approximately \$1.81 billion through fiscal year 2011. The Program is being financed primarily from revenues of the Fund and proceeds from the issuance of revenue bonds.

The total amount of construction contract commitments outstanding at June 30, 2006 and 2005 was approximately \$356 million and \$453 million, respectively.

**(15) Rate Adjustments**

The U.S. Environmental Protection Agency (EPA), in attempting to ensure that user charges are proportional in effect as well as in their design, requires grantees to compare budgeted wastewater contributions, revenues from users, and user classes to actual results and make appropriate rate adjustments in the second succeeding year. The accompanying financial statements reflect management's estimates of the current and noncurrent amounts receivable from and refundable to customers in accordance with the regulations. Although subsequent adjustments to these amounts may occur, management does not believe the impact would be material to the Fund's financial position or results of operations.

**(16) Contingencies**

The operation of the Fund's Waste Water Treatment Plant (WWTP) is subject to extensive regulation pursuant to the Federal Water Pollution Control Act, as amended by the Clean Water Act of 1977 and the Water Quality Act of 1987 (collectively, the Clean Water Act). Included in the regulatory framework established by the Clean Water Act is the National Pollutant Discharge Elimination System (NPDES) permit program, which requires operation of wastewater treatment facilities according to discharge limitations and other requirements as set forth in permits issued to each facility. The U.S. EPA has authorized the State of Michigan Department of Environmental Quality (MDEQ) to implement and enforce the federal NPDES permit program.

The Fund and the City's Legal Department operate the WWTP pursuant to an NPDES permit that took effect on January 1, 2004 and which is due to expire on October 1, 2007.

The Fund is also a defendant in numerous other alleged claims and lawsuits. The Fund and its legal counsel have estimated a reserve for the potential outcome of such claims or the amount of potential damages in the event of an unfavorable outcome for each of the above contingencies, which is included in the accompanying financial statements. The Fund's management and the City's Legal Department estimate that any differences in reserved amounts, and other potential claims against the Fund not covered by the Fund's insurance, resulting from such litigation will not materially impact the Fund's financial position or results of operations.

The City holds various commercial insurance policies to cover potential loss exposures.

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**SEWAGE DISPOSAL FUND**

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**(17) Subsequent Events**

On August 4, 2006, the Fund issued \$401,560,000 of bonds that comprised: (1) Sewage Disposal System Revenue Second Lien Bond Series 2006-A (Variable Rate Demand) of \$125,000,000, (2) Sewage Disposal System Revenue Second Lien Bond Series 2006-B for \$250,000,000 and, (3) Sewage Disposal System Refunding Senior Lien Bonds, Series 2006-C for \$26,560,000. The bonds begin to mature July 1, 2009 and will be fully matured in the year 2036.

The proceeds (includes offering premium less cost of issued) of the Sewage Disposal System Refunding Senior Lien Bonds, Series 2006-C is used to refund Sewage Disposal System Senior Lien Bond, Series 2003-A of various maturities with aggregate principal of \$27,470,000 plus defeasement cost.

In September 2005, several customers of the Fund challenged the method of allocating costs associated with the 800 MHz project. In early 2007, the court issued a preliminary ruling acknowledging that the Fund had been overcharged, but is yet to issued a final ruling. In management's opinion, the final resolution will not have a material effect on the Fund's financial statements.

**REQUIRED SUPPLEMENTARY INFORMATION**

**CITY OF DETROIT  
SEWAGE DISPOSAL FUND**

Required Supplementary Information (Unaudited)

June 30, 2006

Schedule of Funding Progress (in thousands) for the General Retirement System (unaudited):

| <b>Actuarial<br/>valuation<br/>date,<br/>June 30</b> |    | <b>Actuarial<br/>value of<br/>assets</b> | <b>Actuarial<br/>accrued<br/>liability<br/>(AAL)</b> | <b>Funded<br/>ratio</b> |    | <b>Unfunded<br/>AAL<br/>(UAAL)</b> | <b>Covered<br/>payroll</b> | <b>UAAL<br/>as a<br/>percentage<br/>of payroll</b> |
|--|----|--|--|-------------------------|----|------------------------------------|----------------------------|--|
| 2004   | \$ | 190,985                                  | 174,546  | 109.42%                 | \$ | (16,442)                           | —                          | —  |
| 2005   |    | 220,900                                  | 167,291  | 132.05%                 |    | (53,609)                           | —                          | —  |
| 2006   |    | 239,972                                  | 181,684  | 132.08                  |    | (58,288)                           | —                          | —  |

See accompanying independent auditors' report.