KPMG

CITY OF DETROIT
WATER FUND

Basic Financial Statements
and Required Supplementary Information

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

CITY OF DETROIT
WATER FUND

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KPMG LLP
Suite 1200
150 West Jefferson
Detroit, MI 48226-4429

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 Water 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 Water 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 Water 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 31 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
March 20, 2008

CITY OF DETROIT
WATER FUND

Statements of Net Assets

June 30, 2006 and 2005

Assets		2006	2005
Current assets:			
Cash and cash equivalents	$	3,997,111	870,259
Investments		22,345,923	7,520,716
Due from other funds		56,884,330	53,149,298
Accounts receivable (including $28,558,437 and $29,934,243, respectively, for unbilled water services and net of allowance for doubtful accounts of $39,119,680 and $36,887,901 for June 30, 2006 and 2005, respectively)		63,789,759	68,971,401
Inventories		8,967,419	6,330,165
Prepaid expenses		5,930,718	568,211
Restricted cash and cash equivalents		34,465,603	25,052,140
Restricted investments		362,605,066	412,158,969
Restricted due from other funds		6,021,460	40,475,299
Total current assets		565,007,389	615,096,458
Noncurrent assets:			
Restricted long-term investments		10,717,537	30,072,332
Net pension asset		148,590,274	150,452,508
Issuance costs – pension obligation certificates of participation		8,910,507	5,154,834
Unamortized bond issuance costs		30,603,648	32,088,822
Capital assets:			
Land and land rights		6,529,308	6,527,438
Structures		825,649,528	707,846,651
Mains		763,588,390	714,856,603
Services, meters, and improvements to land		106,085,312	103,323,777
Equipment		864,457,966	630,635,010
Construction work in progress		140,815,156	418,027,160
Total capital assets		2,707,125,660	2,581,216,639
Less accumulated depreciation		(743,068,280)	(688,863,364)
Net capital assets		1,964,057,380	1,892,353,275
Total noncurrent assets		2,162,879,346	2,110,121,771
Total assets	$	2,727,886,735	2,725,218,229

(Continued)

CITY OF DETROIT
WATER FUND

Statements of Net Assets

June 30, 2006 and 2005

Liabilities and Net Assets	2006	2005
Current liabilities:		
Accounts and contracts payable	$ 22,718,139	16,543,893
Accrued salaries and wages	1,706,286	2,171,724
Accrued workers' compensation	2,913,177	3,470,751
Accrued compensated absences	3,715,980	8,604,763
Due to other funds	53,873,011	65,882,639
Other current accrued liabilities	8,142,609	3,053,509
Total current liabilities payable from current assets	93,069,202	99,727,279
Current liabilities payable from restricted assets:		
Revenue bonds payable within one year	25,535,000	24,595,000
Accrued bond interest payable	38,626,382	38,521,332
Accounts and contracts payable	20,501,071	20,117,305
Other current accrued liabilities	459,722	629,346
Due to other funds	10,982,590	6,515,574
Total current liabilities payable from restricted assets	96,104,765	90,378,557
Total current liabilities	189,173,967	190,105,836
Long-term liabilities:		
Revenue bonds payable, net	1,900,402,692	1,915,294,379
Pension obligation certificates of participation payable, net	159,017,458	157,548,214
Accrued workers' compensation	15,198,239	15,240,595
Accrued compensated absences	14,912,321	9,808,909
Deferred swap termination fees	16,213,524	16,797,795
Total long-term liabilities	2,105,744,234	2,114,689,892
Total liabilities	2,294,918,201	2,304,795,728
Net assets:		
Invested in capital assets, net of related debt	217,225,377	204,520,234
Restricted for capital acquisitions and bond payments	81,914,130	121,409,825
Unrestricted	133,829,027	94,492,442
Total net assets	432,968,534	420,422,501
Total net assets and liabilities	$ 2,727,886,735	2,725,218,229

See accompanying notes to basic financial statements.

CITY OF DETROIT
WATER FUND

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

Years ended June 30, 2006 and 2005

	2006	2005
Operating revenues:		
Water sales – Detroit	$ 68,736,614	58,921,494
Water sales – suburban	205,581,302	200,050,339
Miscellaneous	1,912,850	1,641,252
Total operating revenues, net	276,230,766	260,613,085
Operating expenses before depreciation:		
Source of supply	2,856,385	2,244,535
Low-lift pumping	8,258,270	6,081,177
Purification	18,441,764	18,983,784
High-lift pumping	15,306,817	19,338,389
Water quality operations	1,705,680	1,876,012
Transmission and distribution	35,101,901	45,417,478
Services and meters	5,939,668	5,645,086
Hydrant division	1,199,902	1,386,783
Commercial	5,084,493	7,227,323
Administrative and general	52,320,068	48,753,131
Total operating expenses before depreciation	146,214,948	156,953,698
Operating income before depreciation	130,015,818	103,659,387
Depreciation	54,628,100	41,529,608
Operating income	75,387,718	62,129,779
Nonoperating revenue (expense):		
Earnings on investments	18,843,877	7,175,672
Interest expense, net of capitalized interest	(83,963,811)	(63,260,449)
Miscellaneous	2,278,249	(62,246)
Total nonoperating expense	(62,841,685)	(56,147,023)
Contributed capital	—	6,938,882
Increase in net assets	12,546,033	12,921,638
Net assets – beginning of year	420,422,501	407,500,863
Net assets – end of year	$ 432,968,534	420,422,501

See accompanying notes to basic financial statements.

CITY OF DETROIT
WATER FUND

Statements of Cash Flows

Years ended June 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Receipts from customers	$ 283,573,844	260,740,367
Loans to other funds	23,176,195	(28,698,398)
Payments to suppliers	(86,907,411)	(115,305,031)
Payments to the General Retirement System in excess of annual required contribution	—	(150,452,508)
Payments to employees	(57,564,022)	(53,688,328)
Net cash provided by (used in) operating activities	162,278,606	(87,403,898)
Cash flow from noncapital and related financing activities:		
Proceeds from issuance of Personal Obligation Certificates of Participation	—	157,548,214
Issuance costs – Pension Obligation Certificates of Participation	(2,286,429)	(5,154,834)
Net cash (used in) provided by noncapital and related financing activities	(2,286,429)	152,393,380
Cash flows from capital and related financing activities:		
Contributions received from customers	2,278,249	6,938,882
Acquisition and construction of capital assets, net	(107,519,457)	(134,448,175)
Principal paid on revenue bond maturities	(24,595,000)	(22,440,000)
Interest paid on revenue bonds	(102,671,509)	(85,928,089)
Principal paid on refunded debt	—	(125,985,000)
Proceeds from bond issuance and increase in revolving note payable, net	4,723,954	424,791,474
Unamortized discount and bond issuance cost	7,404,533	5,175,110
Net cash (used in) provided by capital and related financing activities	(220,379,230)	68,104,202
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	449,752,017	309,876,577
Purchase of investments	(395,668,526)	(449,752,017)
Interest received on investments	18,843,877	7,175,672
Net cash provided by (used in) investing activities	72,927,368	(132,699,768)
Net increase in cash	12,540,315	393,916
Cash at beginning of year	25,922,399	25,528,483
Cash at end of year	$ 38,462,714	25,922,399
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 75,387,718	62,129,779
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	54,628,100	41,529,608
Provision for uncollectible accounts	2,231,779	6,650,637
Changes in certain assets and liabilities:		
(Increase) decrease in accounts receivable	2,949,862	(10,919,185)
(Increase) decrease in inventories	(2,637,254)	501,841
(Increase) in prepaid expenses	(5,362,507)	(461,392)
Increase (decrease) in accounts and contracts payable	6,558,012	(13,787,881)
Increase (decrease) in accrued salaries and wages	(465,438)	354,027
Increase (decrease) in Issuance cost POC	1,862,234	(150,452,508)
Increase in other accrued liabilities, compensated absences, and workers' compensation	3,949,904	5,749,574
Net change in due to (from) other funds	23,176,196	(28,698,398)
Net cash provided by (used in) operating activities	$ 162,278,606	(87,403,898)

Noncash capital financing activities:
Capital assets of $2,278,249 were acquired through contributions from developers.

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

The City of Detroit (the City) Charter established the Water Department (the Department) in the year 1836 to supply water within and outside the City under the administration of the Board of Water Commissioners. The Water Fund (the Fund), an Enterprise fund, separately accounts for the Water Supply 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 financial statements. These policies conform to U.S. generally accepted accounting principles.

The financial statements of the Water Fund have been included in the City of Detroit's Comprehensive Annual Financial Report (CAFR) 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 reported at fair value based on quoted market price.

(d) Inventories

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

(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
Mains	67 years
Services	67 years
Meters and 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.

	June 30		
	2006	**2005**	**2004**
Balance at beginning of year	$ 18,711,345	15,778,254	13,778,575
Current year claims and changes in estimates	4,356,803	7,345,178	6,756,198
Claims payments	(4,956,732)	(4,412,087)	(4,756,519)
Balance at end of year	$ 18,111,416	18,711,345	15,778,254

(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 (SFAS) 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 $18,812,748 and $28,942,595, 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 water services provided to City departments.

(Continued)

(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 City'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 water 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 Governmental 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.

(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 GASB 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 GASB 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 GASB Statement No. 45 beginning with the year ended June 30, 2008. 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	$	12,237,801
Investments		421,893,439
Total deposits and investments	$	434,131,240

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

Unrestricted:		
Cash and cash equivalents	$	3,997,111
Investments		22,345,923
Restricted:		
Cash and cash equivalents		34,465,603
Investments – current		362,605,066
Investments – noncurrent		10,717,537
Total cash and investments	$	434,131,240

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 $6,739,465 and $27,464,345, respectively, which 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.

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.

		Investment maturities in years	
	Fair value	**Less than one year**	**one to five years**
Investment:			
U.S. government agency securities	$ 118,632,147	107,914,610	10,717,537
Certificate of deposit	8,860,656	8,860,656	—
Commercial paper	52,283,902	52,283,902	—
Money market	242,116,734	242,116,734	—
Total investments	$ 421,893,439	411,175,902	10,717,537

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:

	Fair value	**Rating**	**Rating organization**
Investment:			
U.S. government agency securities	$ 46,790,138	AAA, Aaa	S & P and Moody's
U.S. government agency securities	61,124,472	A-1+	S & P
U.S. government agency securities	10,717,537	AAA, Aaa	S & P and Moody's
Money market	14,058,155	Aaa	Moody's
Money market	97,792,234	AAAm, Aaa	S & P and Moody's
Money market	130,266,345	N/A	N/A
Certificate of deposit	8,860,656	N/A	N/A
Commercial paper	52,283,902	N/A	N/A
Total investments	$ 421,893,439		

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, Federal Home Loan Mortgage, and Federal National Mortgage Association securities. These investments are 7%, 13%, and 7%, 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 above 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 $81,914,130 of restricted net assets, of which $71,543,172 is restricted by enabling legislation.

(Continued)

(4) Capital Assets

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

	Balance, June 30, 2005	Additions	Disposals	Balance, June 30, 2006
Nondepreciated capital assets:				
Land and land rights	$ 6,527,438	1,870	—	6,529,308
Construction in progress	418,027,160	132,675,454	(409,887,458)	140,815,156
	424,554,598	132,677,324	(409,887,458)	147,344,464
Depreciated capital assets:				
Services, meters, and improvements to land	103,323,777	2,823,010	(61,475)	106,085,312
Structures	707,846,651	477,053,519	(359,250,642)	825,649,528
Mains	714,856,603	151,730,672	(102,998,885)	763,588,390
Equipment	630,635,010	446,020,895	(212,197,939)	864,457,966
Accumulated depreciation	(688,863,364)	(54,628,100)	423,184	(743,068,280)
	1,467,798,677	1,022,999,996	(674,085,757)	1,816,712,916
Total	$ 1,892,353,275	1,155,677,320	(1,083,973,215)	1,964,057,380

	Balance, June 30, 2004	Additions	Disposals	Balance, June 30, 2005
Nondepreciated capital assets:				
Land and land rights	$ 6,527,438	—	—	6,527,438
Construction in progress	679,745,387	171,715,631	(433,433,858)	418,027,160
	686,272,825	171,715,631	(433,433,858)	424,554,598
Depreciated capital assets:				
Services, meters, and improvements to land	96,834,157	6,489,620	—	103,323,777
Structures	453,406,152	254,440,499	—	707,846,651
Mains	689,057,547	25,799,056	—	714,856,603
Equipment	492,782,490	138,004,268	(151,748)	630,635,010
Accumulated depreciation	(647,652,745)	(41,529,608)	318,989	(688,863,364)
	1,084,427,601	383,203,835	167,241	1,467,798,677
Total	$ 1,770,700,426	554,919,466	(433,266,617)	1,892,353,275

(Continued)

(5) Impaired Capital Assets

Beginning fiscal year ended June 30, 2006, the Fund implemented GASB Statement No. 42. As of June 30, 2006, the Fund did not have impaired assets reportable under GASB Statement No. 42.

(6) Long-Term Obligations

The outstanding indebtedness of the Fund for revenue bonds was approximately $1,971,743,954 and $1,991,615.00 at June 30, 2006 and 2005, respectively. The interest rates on the outstanding fixed-rate revenue bonds range from 4.30% to 6.38%. Net revenues of the Fund are pledged to repayment of bonds.

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

	Principal	Bond interest	Swap interest	Total requirements
Year ending June 30:				
2007	$ 25,535,000	93,995,842	25,260,767	144,791,609
2008	27,025,000	93,168,039	25,540,372	145,733,411
2009	36,145,000	91,782,661	25,499,099	153,426,760
2010	35,755,000	90,148,553	25,453,115	151,356,668
2011	37,625,000	88,720,191	25,364,700	151,709,891
2012 – 2016	222,743,954	413,440,268	123,130,238	759,314,460
2017 – 2021	275,225,000	358,333,894	118,104,233	751,663,127
2022 – 2026	325,090,000	288,434,928	100,020,618	713,545,546
2027 – 2031	456,620,000	193,380,804	66,156,762	716,157,566
2032 – 2036	529,980,000	69,464,886	35,724,841	635,169,727
	$ 1,971,743,954	1,780,870,066	570,254,745	4,322,868,765

In fiscal 2005, the Fund issued $105,000,000 of City of Detroit, Michigan Water Supply System Revenue Senior Lien Bonds, Series 2005-A, $195,000,000 of City of Detroit, Michigan, Water Supply System Revenue refunding Second Lien Bonds (Variable Rate Demand), and Series 2005-B, $126,605,000 of City of Detroit, Michigan, Water Supply System Revenue Refunding Senior Lien Bonds, Series 2005-C. The net proceeds were used to refund a portion of the City’s outstanding Water Supply Systems Revenue Bonds and Revenue Refunding Bonds and to pay cost of issuance associated with the 2005 Bonds.

The proceeds of the Revenue Refunding Senior Lien Bonds, Series 2005-C will be used to (a) to advance-refund $69,285,000 principal amount of the City’s Water Supply Revenue Senior Lien Bonds, Series 1997-A comprised of serial bonds maturing in the years 2010, 2016 and 2017: the 2018 through 2021 mandatory redemption payment for serial 1997-A term bonds maturing July 1, 2027 (Refunded 1997-A Bonds) with an average interest rate of 5.5% (b) to refund $56,700,000 principal amount of the City’s Water Supply System Revenue Senior Lien Bonds, Series 1999-A bonds maturing in the years 2011 through 2018 with interest rate of 7.48% (Refunded 1999-A bonds and collectively with the Refunded 1997-A Bonds, and the Refunded bonds) and (c) for payment of the related costs of issuance, including the premium for the municipal bond insurance.

(Continued)

Those refunded securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Refunded 1999-A Bonds when due to including July 1, 2010 and redeem the Refunded 1997-A Bonds on July 1, 2007 at 101%.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $4,938,589. This difference, reported in the 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 $4,567,184.

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 the liability for the defeased bonds are not included in the Fund's financial statements. Similarly, the interest expenses 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 $666,845,000 and $511,265,000 respectively, of bonds outstanding are considered defeased.

Bonds outstanding at June 30, 2006 include $1,718,013,954 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.

(7) Pension Obligation Certificates (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 (POCs). 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 POC 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 POC 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. 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.

Accordingly, the Detroit Retirement Systems Funding Trust 2006 issued $948,540,000 ($148,540,000 of fixed rate Series A, and $800 million of floating rate Series B) of taxable 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.

The City did not pay off the $104,055,000 of optionally redeemed Series A 2005 POC's until July 13, 2006. At June 30, 2006 the portion of the 2006 POC's proceeds to pay the $104,055,000 POC's were in irrevocable trust investment accounts.

Retirement Trust 2006 account statements reflect that, on July 13, 2006 approximately $104,404,000 of funds were disbursed to pay the POC's service obligation and accrued interest from June 15, 2006 (the last interest payment date) to July 13, 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 the 2006 POC. The net effect of this on the City's balance sheet is to add on additional $44,485,000 of POC obligations to the governmentwide balance sheet.

(Continued)

The present value of the net economic loss from refunding of the COP's Series 2005 by the COP's Series 2006 is $89,265,111.

		Certificates of Participation Series 2006 $948,540,000
Cash flow requirements to service Series 2005 COP's	$	2,267,195,204
Less cash flow requirements for new COP's		2,356,736,036
Net loss from refunding actually realized in years 2026 to 2035	$	(89,540,832)
Economic loss (annually)	$	(89,265,111)

Certain maturities of the Series 2005-A POCs still remain outstanding concurrently with the 2006 Certificates. The 2005 POCs 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:

Primary Government Principal

Maturity (June 15)		Governmental activities	Business-type activities: Sewer Disposal Fund	Business-type activities: Transportation Fund	Business-type activities: Water Fund	Totals
2007	$	—	—	—	—	—
2008		—	—	—	—	—
2009		—	—	—	—	—
2010		3,861,370	28,880	340,053	519,698	4,750,001
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	139,850,001
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	$	435,680,410	3,258,545	38,368,303	58,637,744	535,945,002

Primary Government Interest

Maturity (June 15)		Governmental activities	Business-type activities: Sewer Disposal Fund	Business-type activities: Transportation Fund	Business-type activities: Water Fund	Totals
2007	$	20,942,804	156,636	1,844,333	2,818,669	25,762,442
2008		20,942,804	156,636	1,844,333	2,818,669	25,762,442
2009		20,942,804	156,636	1,844,333	2,818,669	25,762,442
2010		20,942,804	156,636	1,844,333	2,818,669	25,762,442
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	115,007,930
2017 – 2021		60,177,138	450,077	5,299,514	8,099,174	74,025,903
2022 – 2025		20,083,887	150,212	1,768,692	2,703,068	24,705,859
Total	$	278,300,711	2,081,471	24,508,619	37,456,185	342,346,986

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

Primary Government Principal

Maturity (June 15)		Governmental activities	Business-type activities: Sewer Disposal Fund	Business-type activities: Transportation Fund	Business-type activities: Water Fund	Totals
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
2031 – 2035		334,309,285	2,500,370	29,441,030	44,994,315	411,245,000
Total	$	771,087,137	5,767,123	67,905,979	103,779,761	948,540,000

Primary Government Interest

Maturity (June 15)	Governmental activities	Business-type activities: Sewer Disposal Fund	Business-type activities: Transportation Fund	Business-type activities: Water Fund	Totals
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	54,224,062
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
2031 – 2035	52,643,635	393,733	4,636,075	7,085,248	64,758,691
Total	$ 1,144,750,720	8,561,831	100,812,755	154,070,728	1,408,196,034

(8) Deferred Amount on Refunding

The following shows the calculation of the total deferred amount on refunding and the effect on the Pension Obligation Payable by each fund. The total Deferred Amount on Refunding is comprised of the amount transferred from Series 2005 issuance costs of $27,651,925 plus tender and redemption premiums paid of $3,404,274, or a total of $31,056,197. It will be amortized over the remaining life of the old POC's Series 2005 (19 years), which is shorter than the life of the new POC's Series 2006 (29 years).

	Governmental activities	Transportation Fund	Water Fund	Sewage Disposal Fund	Library
POC payable – 2005 Series	$ 435,683,032	38,362,255	58,635,556	3,264,157	—
POC payable – 2006 Series	771,087,136	67,905,979	103,779,761	5,767,123	—
Advance payable Primary Government	—	—	—	—	24,554,826
Deferred amount on refunding	(24,733,155)	(2,223,313)	(3,397,859)	(188,822)	(513,048)
Net POC Payable	$ 1,182,037,013	104,044,921	159,017,458	8,842,458	24,041,778
Net advance payable to Primary Government	$ —	—	—	—	20,041,778

(9) Long-Term Liabilities

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

	Balance, June 30, 2005	Increase	Decrease	Balance, June 30, 2006	Amount due within one year
Revenue bonds payable	$ 1,991,615,000	—	(24,595,000)	1,967,020,000	25,535,000
State revolving loan	—	4,723,954	—	4,723,954	—
Total revenue bonds payable	1,991,615,000	4,723,954	(24,595,000)	1,971,743,954	25,535,000
Add unamortized premium	17,976,690	—	(1,078,078)	16,898,612	—
Less:					
Deferred charges on refunding	49,223,977	6,221,498	—	55,445,475	—
Discount	20,478,334	—	(13,218,935)	7,259,399	—
Net revenue bonds	1,939,889,379	(1,497,544)	(12,454,143)	1,925,937,692	25,535,000
Pension obligation certificates payable 2005 series	157,548,214	—	(98,912,658)	58,635,556	—
Pension obligation certificates payable 2006 series	—	103,779,761	—	103,779,761	—
Less deferred defeasance cost	—	3,397,859	—	3,397,859	—
Net pension obligation certificate payable	157,548,214	100,381,902	(98,912,658)	159,017,458	—
Other liabilities:					
Accrued workers' compensation	18,711,346	4,356,803	(4,956,733)	18,111,416	2,913,177
Accrued compensated absences	18,413,672	5,103,411	(4,888,782)	18,628,301	3,715,980
Deferred swap termination	16,797,795	—	(584,271)	16,213,524	—
Total other liabilities	53,922,813	9,460,214	(10,429,786)	52,953,241	6,629,157
Total	$ 2,151,360,406	108,344,572	(121,796,587)	2,137,908,391	32,164,157

	Balance, June 30, 2004	Increase	Decrease	Balance, June 30, 2005	Amount due within one year
Revenue bonds payable	$ 1,713,435,000	426,605,000	(148,425,000)	1,991,615,000	24,595,000
Add unamortized premium	6,257,305	12,302,729	(583,344)	17,976,690	—
Less:					
Deferred charges on refunding	44,223,565	8,298,346	(3,297,934)	49,223,977	—
Discount	21,604,144	—	(1,125,810)	20,478,334	—
Net revenue bonds	1,653,864,596	430,609,383	(144,584,600)	1,939,889,379	24,595,000
Pension obligation certificates payable	—	157,548,214	—	157,548,214	—
Other liabilities:					
Accrued workers' compensation	15,778,254	7,345,178	(4,412,086)	18,711,346	3,470,751
Accrued compensated absences	15,589,521	4,203,964	(1,379,813)	18,413,672	8,604,763
Deferred swap termination	16,943,863	—	(146,068)	16,797,795	—
Total other liabilities	48,311,638	11,549,142	(5,937,967)	53,922,813	12,075,514
Total	$ 1,702,176,234	599,706,739	(150,522,567)	2,151,360,406	36,670,514

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

Associated financing issue	Notional amounts (1)	Effective date	Fixed rate paid	Variable rate received	Fair values	Sweep termination date	Final maturity of bonds	Counterparty credit rating
Water 2001-C (3)	$ 47,723,000	6/7/2001	4.07%	BMA	$ —	1/1/2006	7/1/2029 (3)	Aaa/AA+NR
Water 2001-C (3)	29,972,000	6/7/2001	4.70	BMA	(1,214,171)	7/1/2011	7/1/2029 (3)	Aaa/AA+NR
Water 2001-C (3)	47,628,000	1/1/2006	5.42	BMA	(3,490,184)	7/1/2011	7/1/2029 (3)	Aaa/AA+NR
Water 2001-C	114,150,000	6/7/2001	4.90	BMA	(10,802,162)	7/1/2026	7/1/2026	Aa3/A+/AA
Water 2003-B	1,980,000	1/30/2003	3.02	CPI + 1.01%	57,777	7/1/2009	7/1/2009	Aa3/A+/AA
Water 2003-B	2,290,000	1/30/2003	3.31	CPI + 1.12%	67,167	7/1/2010	7/1/2010	Aa3/A+/AA
Water 2003-B	2,500,000	1/30/2003	3.55	CPI + 1.25%	74,359	7/1/2011	7/1/2011	Aa3/A+/AA
Water 2003-B	2,175,000	1/30/2003	3.74	CPI + 1.33%	59,662	7/1/2012	7/1/2012	Aa3/A+/AA
Water 2003-B	2,800,000	1/30/2003	3.87	CPI + 1.34%	66,848	7/1/2013	7/1/2013	Aa3/A+/AA
Water 2003-B	2,505,000	1/30/2003	4.00	CPI + 1.36%	47,560	7/1/2014	7/1/2014	Aa3/A+/AA
Water 2003-C	2,005,000	1/30/2003	3.87	CPI + 1.34%	47,885	7/1/2013	7/1/2013	Aa3/A+/AA
Water 2003-C	2,330,000	1/30/2003	4.00	CPI + 1.36%	44,237	7/1/2014	7/1/2014	Aa3/A+/AA
Water 2003-D	150,545,000	2/6/2003	4.06	BMA	(3,674,234)	7/1/2033	7/1/2033	Aa2/AA-/NR
Water 2004-A	77,010,000	5/13/2004	3.94	BMA	(903,397)	7/1/2025	7/1/2025	Aa2/AA-/NR
Water 2004-B	163,590,000	5/13/2004	3.85	BMA	(856,979)	7/1/2023	7/1/2023	Aa2/AA-/NR
Water 2005-B	195,000,000	4/1/2005	4.71	BMA	(6,703,870)	7/2/2035	7/2/2035	Aa3/A+/AA-
Water Forward Starting Swap	120,000,000	3/1/2007	5.00	BMA	(7,616,810)	7/3/2036	7/3/2036	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 June 30, 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.

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 Water Series 2001-C, Water Series 2003-D, Water Series 2004-A, and Water Series 2004-B. These swaps provide the counterparty with the option to terminate the swap agreement beginning on January 1, 2010, July 2, 2011, July 1, 2008, and July 1, 2008, 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. The Fund has this risk for the three (3) Water Series 2001-C financing issues.

(11) Employee Benefit Plan

Substantially all City employees, including the Water Fund employees, are covered by a single-employer plan composed of a defined benefit with an optional employee-contributed annuity through the 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 a Water Fund contribution rate of 20.84%. Contributions for the Water Fund totaled $5,156,381.

Employees may elect to contribute 3%, 5%, or 7% of the first $90,000 of annual compensation and 5% or 7% of any excess over $90,000 for annuity savings. Contributions are voluntary for all union and nonunion employees. Contributions received from Water Fund employees during the year ended June 30, 2006 amounted to $3,032,044.

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 GRS 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.

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.

	Fiscal year ended	Annual pension cost (APC)	Percentage of APC contributed	Net pension asset
General Retirement System	June 30, 2004	$ 16,814,426	100	$ —
	June 30, 2005	17,571,543	956	150,452,508
	June 30, 2006	7,018,615	100	148,590,274

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

Annual required contributions	$ 10,457,713
Interest on net pension asset	(11,885,748)
Adjustment to annual required contribution	8,446,650
Annual pension cost	7,018,615
Contributions made (employer)	5,156,381
Changes in net pension asset	(1,862,234)
Net pension asset, beginning of year	150,452,508
Net pension asset, end of year	$ 148,590,274

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

Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period for unfunded accrued liabilities**	30 years
Asset valuation method	3-year smoothed market
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%

**Amortization period was changed in FY 2006, see note 7.

(12) Other Post-Employment Benefits

In addition to the pension benefits described above, the City provides postretirement benefits to its retirees, which include hospitalization, dental care, eye care, and life insurance, The number of City retirees at June 30, 2006 is 22,451. Costs are accounted for in accordance with GASB Statement No. 12, *Disclosure of Information on Postemployment 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 cost	Retiree cost	Total 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

(13) Due to (from) 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:

		2006	2005
Due from other funds (unrestricted):			
General Fund	$	804,919	757,819
Sewage Disposal Fund		56,079,411	52,391,479
Total due from other funds	$	56,884,330	53,149,298
Due from other funds (restricted):			
General Fund	$	357,919	33,628,639
Sewage Disposal Fund		5,663,541	6,846,660
Total due from other funds	$	6,021,460	40,475,299
Due to other funds (unrestricted):			
General Fund	$	6,038,572	17,324,357
General Fiduciary		506,181	
Sewage Disposal Fund		47,328,259	48,558,282
Total due to other funds	$	53,873,012	65,882,639
Due to other funds (restricted):			
General Fund	$	33,963	290,175
Sewage Disposal Fund		10,948,627	6,225,399
Total due to other funds	$	10,982,590	6,515,574

(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 $1.68 billion through fiscal year 2010. The Program is being primarily financed 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 June 30, 2005 was approximately $156 million and $101 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 Fund is also a defendant in numerous alleged claims, lawsuits, billing disputes, and other stated and pending demands. The Fund and the City's Legal Department have estimated a reserve, which is included in the accompanying financial statements, 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. The Fund's management and the City's Legal Department believe that any differences in reserved amounts and final settlement, after consideration of claims covered by 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.

(17) Subsequent Events

On August 14, 2006 the Water Supply System issued $1,136,585,000 of Series 2006 bonds to finance a portion of the costs of the Water Supply System capital improvement program, refund certain prior outstanding bonds, fund reserve requirements and pay cost of issuance of the 2006 Bonds. These were comprised of: (1.) $767,235,000 of new issued bonds ($280,000,000 Revenue Senior Lien Bonds-Series 2006(A), $120,000,000 System Revenue Second Lien Bonds (Variable Rate Demand), Series 2006 (B), $220,645,000 Revenue Refunding Second Lien Bonds, Series 2006 (C), and, $146,590,000 Revenue Refunding Senior Lien Bonds, Series 2006 (D)). The Series (A) bonds begin to mature July 1, 2007 and will fully mature in the year 2018. The Series (B) bonds mature July 1, 2036. The Series 2006 (C) and (D) both begin to mature July 1, 2007 and will fully mature in the years 2012 and 2013, respectively. (2.) $142,755,000 of refunded fixed rate Revenue Senior Lien Bonds Series 2003(D). These were remarketed/converted on September 1, 2006 and begin maturing January 1, 2007. (3.) $226,595,000 of Refunded Revenue Senior Lien Bonds, Series 2004(A) and (B). ($72,765,000 Refunding Second Lien Bonds fixed rate Series 2004(A) and $153,830,000 Refunding Senior Lien Bonds fixed rate Series 2004(B)). Both of the Series 2004 Bonds have a remarketing date of August 16, 2006.

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 issue a final ruling. In management's opinion, the final resolution will not have a material effect on the Fund's financial statements.

The Fund issued Revenue Refunding bonds that are insured with bond insurance coverage purchased through rated bond insurers. The bond insurance helps the Fund to obtain a lower cost of borrowing. As of February 20, 2008 the major rating agencies downgraded one of the Fund’s bond insurers. The rating of the Fund’s bonds that are insured by the downgraded bond insurer has not been affected.

REQUIRED SUPPLEMENTARY INFORMATION

CITY OF DETROIT
WATER FUND

Required Supplementary Information (Unaudited)

June 30, 2006

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

Actuarial valuation date, June 30	Actuarial value of assets	Actuarial accrued liability (AAL)	Funded ratio	Unfunded AAL (UAAL)	Covered payroll
2001 (a) (b)	$ 2,912.1	3,179.6	91.6%	$ 267.5	439.6
2002	2,761.2	3,276.6	84.3	515.4	440.7
2003	2,537.7	3,270.6	77.6	733.0	448.6
2004	2,470.2	3,383.9	73.0	913.7	444.6
2005	3,222.4	3,347.4	96.3	125.0	390.6

(a) After changes in actuarial assumptions.

(b) Plan amended.

See accompanying independent auditors' report.