CITY OF DETROIT
WATER FUND

Basic Financial Statements

June 30, 2009

(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 Dave Bing,
and the Honorable 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 year ended June 30, 2009, 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 financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Fund's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 audit provides a reasonable basis for our opinion.

As discussed in note 1 to the basic financial statements, 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, 2009, the changes in its financial position, or, where applicable, its cash flows for the year 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 as of June 30, 2009, and the changes in its financial position and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in note (1)(o) to the basic financial statements, the Fund adopted the provisions of Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, as of July 1, 2008.

The Fund has not presented a management's discussion and analysis, schedule of employer contributions, and schedule of funding progress that U.S. generally accepted accounting principles require to supplement, although not be a part of, the basic financial statements.

KPMG LLP

Detroit, Michigan
May 28, 2010

CITY OF DETROIT
WATER FUND

Statement of Fund Net Assets

June 30, 2009

Current assets:	
Cash and cash equivalents	$ 80,194
Investments	44,013,126
Accounts receivable:	
Billed accounts receivable	70,619,839
Unbilled accounts receivable	24,551,149
Allowance for doubtful accounts	(41,327,531)
Total accounts receivable, net	53,843,457
Due from other funds	67,887,115
Inventories	5,554,349
Prepaid expenses	1,211,910
Restricted:	
Cash and cash equivalents	27,303,429
Investments	84,743,357
Due from other funds	6,610,671
Total current assets	291,247,608
Noncurrent assets:	
Restricted:	
Cash and cash equivalents	15,461,872
Investments	338,514,873
Net pension asset	81,680,247
Deferred charges	42,545,292
Capital assets:	
Land and land rights	7,267,873
Land improvements	15,086,525
Buildings and structures	919,168,569
Mains	908,448,970
Services and meters	96,016,857
Machinery, equipment, and fixtures	865,004,376
Construction in progress	238,605,814
Total capital assets	3,049,598,984
Less accumulated depreciation	(917,873,210)
Total capital assets, net	2,131,725,774
Total noncurrent assets	2,609,928,058
Total assets	$ 2,901,175,666

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CITY OF DETROIT
WATER FUND

Statement of Fund Net Assets

June 30, 2009

Current liabilities:		
Current liabilities payable from unrestricted assets:		
Accounts and contracts payable	$	13,975,714
Accrued salaries and wages		2,418,786
Due to other funds		51,493,183
Due to fiduciary funds		3,226,516
Other accrued liabilities		5,160,432
State revolving loans		402,500
Pension obligation certificates of participation		257,831
Capital leases		894,020
Accrued compensated absences		7,091,446
Accrued workers' compensation		2,087,000
Claims and judgments		6,000
Pollution remediation obligation		20,992
Total current liabilities payable from unrestricted assets		87,034,420
Current liabilities payable from restricted assets:		
Revenue bonds and state revolving loans		34,767,500
Accrued interest		57,500,394
Accounts and contracts payable		18,625,592
Due to other funds		7,315,910
Other current accrued liabilities		451,905
Total current liabilities payable from restricted assets		118,661,301
Total current liabilities		205,695,721
Long-term liabilities:		
Revenue bonds and state revolving loans, net		2,263,338,649
Pension obligation certificates of participation, net		81,072,429
Capital leases		657,430
OPEB obligation		16,611,769
Accrued compensated absences		11,919,904
Accrued workers' compensation		8,608,000
Claims and judgments		8,410,200
Total long-term liabilities		2,390,618,381
Total liabilities	$	2,596,314,102
Fund net assets:		
Invested in capital assets, net of related debt	$	98,352,666
Restricted:		
Restricted for capital acquisitions		87,293,229
Restricted for debt service		78,420,017
Unrestricted		40,795,652
Total fund net assets	$	304,861,564

See accompanying notes to basic financial statements.

CITY OF DETROIT
WATER FUND

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

Year ended June 30, 2009

Operating revenues:	
Water sales – Detroit	$ 65,360,449
Water sales – suburban	206,282,285
Miscellaneous	2,452,729
Total operating revenues	274,095,463
Operating expenses:	
Source of supply	1,435,307
Low-lift pumping	6,136,788
High-lift pumping	22,052,260
Purification	19,062,007
Water quality operations	1,111,392
Transmission and distribution	43,536,055
Services and meters	5,812,986
Hydrant division	3,489
Commercial	7,046,284
Operations and maintenance	33,709,777
Central city staff services	5,664,954
Administrative and general	20,172,634
Total operating expenses before depreciation	165,743,933
Depreciation	71,084,673
Total operating expenses	236,828,606
Operating income	37,266,857
Nonoperating revenues (expenses):	
Investment earnings	13,749,381
Interest expense, net of capitalized interest	(112,905,999)
Miscellaneous expense	(7,920,379)
Total nonoperating expenses, net	(107,076,997)
Decrease in net assets before capital contributions	(69,810,140)
Capital contributions	340,076
Decrease in fund net assets	(69,470,064)
Fund Net assets – beginning of year	374,331,628
Fund Net assets – end of year	$ 304,861,564

See accompanying notes to basic financial statements.

CITY OF DETROIT
WATER FUND

Statement of Cash Flows

Year ended June 30, 2009

Cash flows from operating activities:	
Receipts from customers	$ 272,032,894
Loans to other funds	(7,736,285)
Payments to suppliers	(92,030,008)
Payments to employees	(57,576,898)
Net cash provided by operating activities	114,689,703
Cash flows from noncapital financing activities:	
Interest paid on pension obligation certificates of participation	(4,919,726)
Miscellaneous nonoperating income	60,979
Net cash used in noncapital financing activities	(4,858,747)
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(146,225,915)
Proceeds from sale of capital assets	187,420
Principal paid on revenue bonds and state revolving loans	(33,705,963)
Interest paid on revenue bonds and state revolving loans	(112,883,789)
Payment to agent for remarketed bonds	(120,000,000)
Proceeds from issuance of revenue bonds and state revolving loans	123,514,289
Net cash used in capital and related financing activities	(289,113,958)
Cash flows from investing activities:	
Proceeds from sales and maturities of investments	924,129,725
Purchase of investments	(787,772,569)
Interest received on investments	1,495,158
Net cash provided by investing activities	137,852,314
Net decrease in cash and cash equivalents	(41,430,688)
Cash and cash equivalents at beginning of year	84,276,183
Cash and cash equivalents at end of year	$ 42,845,495
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 37,266,857
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	71,084,673
Write-off of construction in progress	2,858,318
Loss on disposal of capital assets	4,029,145
Changes in assets and liabilities:	
Accounts receivable	(2,062,569)
Due from other funds	67,273,864
Inventories	1,796,305
Prepaid expenses	286,316
Net pension asset	(4,037,937)
Accounts and contracts payable	(2,669,110)
Accrued salaries and wages	(696,148)
Due to other funds	(75,010,149)
Due to fiduciary funds	1,599,156
Other accrued liabilities, compensated absences, and workers’ compensation	3,074,891
OPEB obligation	8,997,599
Claims and judgments payable	877,500
Pollution remediation obligations	20,992
Net cash provided by operating activities	$ 114,689,703

See accompanying notes to basic financial statements.

(1) Summary of Significant Accounting Policies

The City of Detroit (the City) Charter established the Water 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 (GAAP).

The 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 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.

Nonexchange transactions, in which the Fund receives value without directly giving equal value in return, include contributions and grants. On an accrual basis, revenue from contributions and grants is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements and expenditure requirements. Timing requirements specify the year when the resources are required to be used or the fiscal year when use is first permitted. Expenditure requirements specify the year in which the resources are provided to the Fund on a reimbursement basis.

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 prices.

(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:

Land improvements	67 years
Building and structures	40 years
Mains	67 years
Services and meters	67 years
Machinery, equipment, and fixtures	3 – 20 years

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*, as amended. Accordingly, capitalized interest for the year ended June 30, 2009 was $15,140,602.

(f) 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.

(g) 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.

(h) Compensated Absences

The liability for compensated absences reported in the financial statements consists of unpaid, accumulated vacation, and sick leave balances. Unused vacation pay and banked overtime accumulate up to a maximum level until termination of employment, while there is no vesting of sick pay until an employee reaches age 60 or completes 25 years of service. The liability for compensated absences has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary-related costs (e.g., social security and Medicare tax).

(i) Bond Premiums, Discounts, Issuance Costs, and Deferred Amounts on Refundings

Bond premiums, discounts, issuance costs, and deferred amounts on refundings are deferred and amortized over the life of the bonds. Bond premiums and discounts are amortized using the effective-interest method, and bond issuance costs and deferred amounts on refunding are amortized using the straight-line method. Bonds payable are reported net of the applicable bond premium, discounts, and deferred amounts on refundings. Bond issuance costs are reported as deferred charges.

(j) 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."

(k) Unbilled Revenue

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

(l) Interest Expense

Interest expense in the statement of revenues, expenses, and changes in fund net assets includes amounts paid on interest rate swaps, as well as the amortization of premiums, discounts, issuance costs, and deferred amounts on refunding. Interest expense is reported net of capitalized interest of $15,140,602 for the year ended June 30, 2009.

(m) Classification of Revenues and Expenses

The Fund classifies its revenues and expenses as either operating or nonoperating.

Operating revenues include activities that have the characteristics of exchange transactions, such as revenue from charges for water service. Nonoperating revenue includes activities that have the characteristics of nonexchange transactions, such as contributions and investment income.

Operating expenses include the costs of operating the water utility, administrative expenses, and depreciation on capital assets. All expenses not meeting this definition, including interest expense, are reported as nonoperating expenses.

(n) Use of Estimates

The preparation of financial statements in conformity with GAAP 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

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (Statement No. 49). This statement establishes accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and clean-ups. The standard excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care. The Fund implemented Statement No. 49 as of July 1, 2008. As a result, the Fund recorded an estimated pollution remediation obligation of $20,992 as a current year expense in the statement of fund net assets.

The Fund's pollution remediation obligation is the result of projects that have been budgeted to improve the City's water system infrastructure. These projects include clean-up of contaminated soil and removal of other environmental pollution (e.g., lead paint and asbestos) identified at the individual sites. The estimated liability is calculated using the expected cash flow technique. The pollution remediation obligation is an estimate and subject to changes resulting from price increases or reductions, technology, or changes in applicable laws and regulations.

The provisions of Statement No. 49 require the measurement of pollution remediation liabilities at July 1, 2008. As of July 1, 2008, the Fund had no material pollution remediation liabilities, and therefore, beginning fund net assets have not been restated. The adoption of Statement No. 49 is now reflected in the Fund's long-term obligations, which can be seen in note 5.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement establishes accounting and financial reporting requirements for intangible assets. All intangible assets not specifically excluded by the scope of this statement should be classified as capital assets. This statement requires that an intangible asset be recognized in the statement of fund net assets only if it is considered identifiable. Additionally, this statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated. Effectively, outlays associated with the development of such assets should not begin to be capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria should be expensed as incurred. This statement also provides guidance on recognizing internally generated computer software as an intangible asset. The Fund is currently evaluating the impact this standard

(Continued)

will have on the financial statements when adopted. The City, including the Fund, will implement GASB Statement No. 51 beginning with the fiscal year ending June 30, 2010.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments. Specifically, it requires that derivative instruments be reported at fair value. The changes in fair value of derivative instruments that are used for investment purposes or that are reported as investment derivative instruments because of ineffectiveness are reported within the investment revenue classification. Alternatively, the changes in fair value of derivative instruments that are classified as hedging derivative instruments are reported in the statement of fund net assets as deferrals. The Fund is currently evaluating the impact this standard will have on the financial statements when adopted. The City, including the Fund, will implement GASB Statement No. 53 beginning with the fiscal year ending June 30, 2010.

(2) Deposits and Investments

The deposits and investments of the Fund at June 30, 2009 are reported in the financial statements as follows:

		Cash and cash equivalents	Investments
Current unrestricted assets	$	80,194	44,013,126
Current restricted assets		27,303,429	84,743,357
Noncurrent restricted assets		15,461,872	338,514,873
Total cash and investments	$	42,845,495	467,271,356

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.

(a) 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, 2009, the Fund had deposits of $14,202,981, which were exposed to custodial credit risk, as they were uninsured and uncollateralized.

(b) 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, 2009, the Fund had no investments subject to custodial credit risk.

(c) Interest Rate Risk

Interest rate risk is the risk that, over time, the value of investments will decrease as a result of an increase 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. As of June 30, 2009, the maturities for the Fund's fixed income investments are as follows:

		Investment maturities in years	
	Fair value	**Less than one year**	**One to five years**
Investment:			
U.S. government agency securities	$ 212,401,152	47,796,934	164,604,218
Commercial paper	52,120,000	52,120,000	—
Money market	202,750,204	202,750,204	—
Total investments	$ 467,271,356	302,667,138	164,604,218

(d) Credit Risk

Credit risk is the risk that the Fund will not recover its investments due to the inability of the counterparty to fulfill its obligation. 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, 2009, the credit quality ratings for the Fund's fixed income investments are as follows:

		Ratings	
Investment	**Fair value**	**S&P**	**Moody's**
U.S. government agency securities	$ 149,242,062	AAA	Aaa
U.S. government agency securities	55,094,174	AAAe	Aaa
U.S. government agency securities	3,052,500	AAAm	Aaa
U.S. government agency securities	5,012,416	AAA	WR
Commercial paper	28,670,000	AA+	Aa2
Commercial paper	23,450,000	NR	NR
Money market	33,886,697	AAAm	AAAm
Money market	34,437,481	NR	Aaa
Money market	5,521,761	NR	NR
Money market	128,904,265	AAAm	Aaa
Total investments	$ 467,271,356		

(e) 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 Farm Credit, Federal Home Loan Mortgage, Federal National Mortgage Association securities, and GE Capital Commercial Paper. These investments represent 10%, 12%, 12%, 11%, and 6% respectively, of the Fund's total investments as of June 30, 2009.

(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.

(4) Capital Assets

Capital asset activity for the year ended June 30, 2009 was as follows:

	Balance, June 30, 2008	Additions	Disposals	Balance, June 30, 2009
Nondepreciated capital assets:				
Land and land rights	$ 7,265,164	2,709	—	7,267,873
Construction in progress	255,431,184	97,551,004	(114,376,374)	238,605,814
Total nondepreciable assets	262,696,348	97,553,713	(114,376,374)	245,873,687
Depreciated capital assets:				
Land improvements	15,086,454	71	—	15,086,525
Buildings and structures	926,550,410	22,641,069	(30,022,910)	919,168,569
Mains	800,068,944	108,863,889	(483,863)	908,448,970
Services	48,378,507	807,163	(486,783)	48,698,887
Meters	46,676,709	641,261	—	47,317,970
Machinery, equipment, and fixtures	818,369,131	52,957,221	(6,321,976)	865,004,376
Total depreciable assets	2,655,130,155	185,910,674	(37,315,532)	2,803,725,297
Less accumulated depreciation:				
Land improvements	(6,576,732)	(156,447)	—	(6,733,179)
Buildings and structures	(235,853,306)	(19,771,635)	22,177,297	(233,447,644)
Mains	(285,652,261)	(11,222,037)	390,659	(296,483,639)
Services	(24,907,553)	(605,282)	—	(25,512,835)
Meters	(32,087,100)	(1,287,296)	—	(33,374,396)
Machinery, equipment, and fixtures	(286,829,194)	(38,041,976)	2,549,653	(322,321,517)
Total accumulated depreciation	(871,906,146)	(71,084,673)	25,117,609	(917,873,210)
Net capital assets	$ 2,045,920,357	212,379,714	(126,574,297)	2,131,725,774

(Continued)

(5) Long-Term Obligations

Changes in long-term obligations for the year ended June 30, 2009 were as follows:

	Balance June 30, 2008	Increase	Decrease	Balance June 30, 2009	Amount due within one year
Revenue bonds	$ 2,295,735,000	120,000,000	(151,565,000)	2,264,170,000	33,560,000
State revolving loans	19,946,336	3,047,440	(1,325,000)	21,668,776	1,610,000
Total revenue bonds	2,315,681,336	123,047,440	(152,890,000)	2,285,838,776	35,170,000
Add unamortized premiums	64,470,399	1,658,809	(2,839,816)	63,289,392	—
Less:					
Unamortized discounts	(4,457,921)	—	225,506	(4,232,415)	—
Deferred amounts on refunding	(47,567,792)	(1,581,633)	2,762,321	(46,387,104)	—
Total revenue bonds, net	2,328,126,022	123,124,616	(152,741,989)	2,298,508,649	35,170,000
Pension obligation certificates 2005 series	28,862,049	—	—	28,862,049	257,831
Pension obligation certificates 2006 series	51,506,122	—	—	51,506,122	—
Less deferred amounts on refunding	964,954	—	(2,865)	962,089	—
Total pension obligation certificates, net	81,333,125	—	(2,865)	81,330,260	257,831
Other long-term liabilities:					
Capital lease payable	2,367,413	—	(815,963)	1,551,450	894,020
OPEB obligation	7,614,170	8,999,726	(2,127)	16,611,769	—
Accrued compensated absences	15,909,044	3,378,376	(276,070)	19,011,350	7,091,446
Accrued workers' compensation	11,128,000	2,476,973	(2,909,973)	10,695,000	2,087,000
Claims and judgments	7,538,700	1,245,700	(368,200)	8,416,200	6,000
Pollution remediation obligation	—	20,992	—	20,992	20,992
Total other long-term liabilities	44,557,327	16,121,767	(4,372,333)	56,306,761	10,099,458
Total	$ 2,454,016,474	139,246,383	(157,117,187)	2,436,145,670	45,527,289

(6) Revenue Bonds Payable (Including State Revolving Loans)

Revenue bonds payable were $2,285,838,776 at June 30, 2009. Net revenues of the Fund are pledged to repayment of bonds. The following is a schedule of the revenue bonds payable at June 30, 2009:

Issue	Bond date	Amount issued	Range of interest rates (%)	Maturity date	Outstanding balance at June 30, 2009	
Series 1993	10/15/93	$ 38,225,000	6.50	7/1/14-15	$ 24,725,000	
Series 1995-A	10/15/95	102,100,000	5.20 to 5.55	7/1/09-12	13,590,000	
Series 1995-B	10/15/95	60,485,000	5.20 to 5.55	7/1/09-12	36,415,000	
Series 1997-A	8/1/97	29,080,000	5.75 to 6.00	7/1/11-15	29,160,000	
Series 1997-A	8/1/97	186,220,000	4.80 to 5.25	7/1/09-27	74,575,000	c
Series 1999-A	11/1/99	18,000,000	5.00 to 5.25	7/1/09-09	4,000,000	
Series 2001-A	5/1/01	1,320,000	4.50	7/1/11	1,320,000	
Series 2001-A	5/1/01	301,165,000	5.00	7/1/29-30	73,790,000	c
Series 2001-C	5/14/08	4,055,000	3.00 to 4.25	7/1/09-18	4,055,000	
Series 2001-C	5/14/08	186,350,000	4.50 to 5.75	7/1/09-29	186,350,000	c
Series 2003-A	1/30/03	234,805,000	4.50 to 5.00	7/1/19-34	181,835,000	c
Series 2003-B	1/30/03	14,250,000	Variable (*)	7/1/09-14	14,250,000	
Series 2003-B	1/30/03	172,945,000	5.00	7/1/34	41,770,000	c
Series 2003-C	1/30/03	16,695,000	2.50 to 5.00	7/1/09-11	355,000	
Series 2003-C	1/30/03	4,335,000	Variable (*)	7/1/13-14	4,335,000	
Series 2003-C	1/30/03	25,325,000	4.25 to 5.25	7/1/15-22	25,325,000	c
Series 2003-D	9/1/06	3,180,000	4.00 to 4.20	7/1/09-16	2,465,000	
Series 2003-D	9/1/06	139,575,000	4.25 to 5.00	7/1/17-33	139,575,000	c
Series 2004-A	9/1/06	17,600,000	3.75 to 5.25	7/1/12-16	17,580,000	
Series 2004-A	9/1/06	55,165,000	4.50 to 5.25	7/1/17-25	55,165,000	c
Series 2004-B	9/1/06	52,840,000	4.00 to 5.00	7/1/09-16	46,510,000	
Series 2004-B	9/1/06	100,990,000	4.25 to 5.00	7/1/17-23	100,990,000	c
Series 2005-A	3/23/05	20,965,000	3.00 to 5.00	7/1/09-15	17,200,000	
Series 2005-A	3/23/05	84,035,000	3.90 to 5.00	7/1/16-35	84,035,000	c
Series 2005-B	5/14/08	19,070,000	4.00 to 5.50	7/1/10-18	19,070,000	
Series 2005-B	5/14/08	175,830,000	4.75 to 5.50	7/1/19-35	175,830,000	c
Series 2005-C	3/23/05	36,405,000	3.00 to 5.00	7/1/09-15	34,915,000	
Series 2005-C	3/23/05	90,200,000	5.00	7/1/16-22	90,200,000	c
Series 2006-A	8/14/06	42,795,000	5.00	7/1/11-16	42,795,000	
Series 2006-A	8/14/06	237,205,000	5.00	7/1/17-34	237,205,000	c
Series 2006-C	8/14/06	12,585,000	4.00 to 5.00	7/1/09-19	11,040,000	
Series 2006-C	8/14/06	208,060,000	5.00	7/1/19-33	208,060,000	c
Series 2006-D	8/14/06	4,430,000	4.00 to 5.00	7/1/09-16	3,525,000	
Series 2006-D	8/14/06	142,160,000	4.25 to 5.00	7/1/17-32	142,160,000	c
Bonds remarketed in March 17, 2009:						
Series 2006-B	4/1/09	900,000	2.60 to 5.00	7/1/11-19	900,000	
Series 2006-B	4/1/09	119,100,000	5.50 to 7.00	7/1/23-36	119,100,000	c
Total revenue bonds payable					$ 2,264,170,000	

* Interest rates are reset periodically at the stated current market interest rate.

c Indicates bonds are callable under terms specified in the indenture; all other bonds are noncallable.

The following is a schedule of the state revolving loans payable at June 30, 2009:

Issue	Bond date		Amount issued	Range of interest rates percentage	Maturity date		Outstanding balance at June 30, 2009
Series 2005 SRF-1	9/22/05	$	10,914,772	2.125	10/1/09-26	$	9,664,772
Series 2005 SRF-2	9/22/05		7,923,139	2.125	10/1/09-26		7,043,139
Series 2006 SRF-1	9/21/06		4,440,074	2.125	10/1/09-26		3,945,074
Series 2008 SRF-1	9/29/08		7,515,791	2.500	10/1/09-28		1,015,791
Total state revolving loans payable						$	21,668,776

Stated Principal amount of State Revolving Fund Bonds issued as part of the State of Michigan's Revolving Fund Loan Program. As the System draws additional amount from time to time hereafter, the outstanding principal amounts of such bonds will correspondingly increase. All loans are callable under terms specified in the loan agreements.

Future debt service requirements as of June 30, 2009 are as follows:

		Principal	Bond interest	Swap interest	Total requirements
Year ending June 30:					
2010	$	35,170,000	117,134,966	3,655,373	155,960,339
2011		36,760,000	116,255,297	3,695,072	156,710,369
2012		45,090,000	114,366,315	3,665,192	163,121,507
2013		47,270,791	112,212,843	4,306,196	163,789,830
2014		49,340,000	109,975,712	4,290,150	163,605,862
2015 – 2019		286,610,000	509,266,454	20,996,480	816,872,934
2020 – 2024		363,812,985	426,609,874	20,667,196	811,090,055
2025 – 2029		461,415,000	321,067,058	15,186,521	797,668,579
2030 – 2034		585,655,000	190,424,223	8,305,615	784,384,838
2035 – 2039		374,715,000	42,526,981	5,692,474	422,934,455
	$	2,285,838,776	2,059,839,723	90,460,269	4,436,138,768

Bonds outstanding at June 30, 2009 include $1.9 billion of bonds and loans callable at various dates after June 30, 2009. These bonds are callable at varying premiums, depending on the issue and length of time to maturity.

(a) Issuance of Revenue Bonds and Current Refunding of Debt

Fiscal Year 2009 Activity

The City received loans from the State of Michigan Drinking Water Revolving Loan Fund totaling $3,047,440 during the year ended June 30, 2009. The proceeds of the loans were used to pay costs of acquiring, contracting extensions, and making certain repairs and improvements to the Water Supply System.

On April 1, 2009, the City elected to change the interest rate mode for $120,000,000 of variable rate demand bonds from a variable rate "weekly mode" to a "fixed rate mode" for $120,000,000 of Water Supply System Revenue Second Lien Bond Series 2006-B.

The bonds were initially issued by the City in the weekly mode and currently bear interest at a weekly rate. Pursuant to the original offering documents and bond indentures, the bonds could be outstanding in any one of six interest rate modes, including the daily mode, the weekly mode, the commercial paper rate mode, the auction rate mode, the term rate modes, and the fixed rate mode. After issuance of the bonds, the City could elect to change the mode of any of the bonds from the weekly mode to any other of the six modes. Upon election of a rate change, the bonds are subject to mandatory tender for purchase by the City and subsequent remarketing by the transfer agent. Additionally, if the mode of any of the bonds is changed to the fixed rate mode, such bonds will remain in the fixed rate mode until maturity and may not be changed subsequently to any other mode.

For financial reporting purposes, the subsequent remarketing/conversion of the Series 2006-B revenue bond was accounted for as a current refunding (extinguishment of the variable rate demand bonds and issuance of the fixed rate bonds). The fund completed the current refunding due to increase in interest rates resulting from the downgrading of the bond insurer. The current refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $1,581,633. This difference, reported in the financial statements as a deferred amount on refunding, is being amortized as an adjustment to interest expense through the year 2036 using the straight-line method.

(b) Defeased Debt

In prior years, the Fund defeased certain revenue bonds by placing the proceeds of new revenue 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. At June 30, 2009, $732,620,000 of bonds outstanding are considered defeased.

(c) Capital Leases

The Fund has entered into a lease agreement as lessee for financing the purchase of certain computer equipment. This lease agreement qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments as of the inception date. The future minimum lease obligations and the net present value are as follows:

Year ending June 30:		
2010	$	894,020
2011		663,649
2012		30,598
Total minimum lease payments		1,588,267
Less amount representing interest		(36,817)
Present value of minimum lease payments	$	1,551,450

(d) Pledges of Future Revenue

The Fund has pledged substantially all revenue of the water fund, net of operating expenses to repay the above water revenue bonds and state revolving loans. Proceeds from the bonds provided financing for the construction and maintenance of the water supply system. The bonds are payable solely from the net revenues of the water system. The remaining principal and interest to be paid on the bonds is $4,436,138,768. During the current year, net revenues of the system were $122,440,987 compared with the amount pledged for annual debt requirements of $155,960,339. In addition, the Fund has approximately $92 million in bond and interest reserves on hand at June 30, 2009.

(7) Pension Obligation Certificates (POCs)

The Detroit Retirement Systems Funding Trust issued POCs 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 and Fire Retirement System (PFRS). 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 of the City.

A 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 POCs were allocated to the governmental activities and the Transportation, Sewage Disposal, and Water Funds based on those funds portion of the overall UAAL liquidated by the use of the POCs net proceeds. Since the Detroit Public Library is a discretely presented component unit of the City, its prorated portion of the POCs liability assumed was included in the balance of the POCs obligation recorded in the governmental activities.

The Fund's portion of future principal and interest amounts for the POCs as of June 30, 2009 is as follows:

	Principal	Bond interest	Swap interest	Total
2010	$ 257,165	1,876,411	2,703,696	4,837,272
2011	593,104	1,865,317	2,744,975	5,203,396
2012	913,613	1,839,197	2,746,900	5,499,710
2013	1,250,905	1,798,514	2,746,900	5,796,319
2014	1,604,980	1,742,185	2,746,900	6,094,065
2015 – 2019	10,942,994	7,392,036	13,734,500	32,069,530
2020 – 2024	14,447,368	4,915,497	13,046,504	32,409,369
2025 – 2029	18,832,057	2,553,827	10,991,423	32,377,307
2030 – 2034	25,448,722	2,408,164	4,423,233	32,280,119
2035	6,077,263	364,078	—	6,441,341
Total	$ 80,368,171	26,755,226	55,885,031	163,008,428

(8) Risk Management

The Fund is exposed to various types of risk of loss including torts; theft of, damage to, or destruction of assets; errors or omissions; job-related illnesses or injuries to employees; natural disasters; and environmental occurrences. The Fund is self-insured for losses such as workers' compensation, legal, disability benefits, and vehicular liabilities. Also included is the risk of loss associated with providing health, dental, and life insurance benefits to employees and retirees.

The Fund, through the City, provides health and dental insurance benefits to employees and retirees through self-insured health plans that are administered by third-party administrators. The Fund does not purchase excess or stop-loss insurance for its self-insured health plans.

The Fund purchases public official liability insurance, property insurance for certain properties, and general liability insurance for accidents occurring at certain properties. The Fund assumes a $250,000 self-insured retention for any one loss or occurrence under its self-insured public official liability program. The Fund purchases excess liability insurance for its general liability for certain properties that provides per occurrence and aggregate protection. The Fund is fully self-insured for environmental-related liabilities and purchases no excess environmental liability insurance.

There were no significant changes in the insurance coverage from coverage provided in the prior year for any of the above-described risks.

A liability for claims is reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Claim liabilities are calculated considering the effects of recent claim settlement trends including frequency and amount of payouts and other economic and social factors. The claim liabilities also include estimated costs for claim administration fees and outside legal and medical assistance costs.

Changes in the balance of claim liabilities for the years ended June 30, 2009 and 2008 are as follows:

		2009	2008
Balance at beginning of year	$	18,666,700	23,348,079
Current year claims and changes in estimates		3,722,673	2,290,812
Claims payments		(3,278,173)	(6,972,191)
Balance at end of year	$	19,111,200	18,666,700

(9) Derivatives not Reported at Fair Value

(a) Interest Rate Swaps

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 fund net assets at June 30, 2009.

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 14 separate pay-fixed, receive-variable interest rate swaps. The Fund is also allocated a portion of the City's four separate pay-fixed, receive-variable interest rate swaps related to the POCs and the GRS. The fund also has pay-variable, receive-fixed interest rate swaps in order to avoid termination on existing related swaps.

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 values, and counterparty credit ratings relating to the outstanding swaps as of June 30, 2009 are presented below. The notional amounts of the swaps, except those with effective dates of March 1, 2010 and July 1, 2011, match the principal amounts of the outstanding financings. The swaps with effective dates of March 1, 2010 and July 1, 2011 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	Rate paid	Rate received	Fair values	Swap termination date	Final maturity of bonds	Counterparty credit rating
Water 2001-C	$ 113,070,000	6/7/01	4.90	SIFMA (2) + 0.0%	$ (24,506,149)	7/1/26	7/126	A2/A/A
Water 2001-C Offsetting Swap (5)	113,070,000	5/14/08	SIFMA (2)	3.498%	2,073,894	7/1/26	7/126	A2/A/A
Water 2003-B	1,980,000	1/1/03	3.02	CPI + 1.01%	(29,898)	7/1/09	7/1/09	A2/A/A
Water 2003-B	2,290,000	1/30/03	3.31	CPI + 1.12%	(61,581)	7/1/10	7/1/10	A2/A/A
Water 2003-B	2,500,000	1/30/03	3.55	CPI + 1.25%	(86,835)	7/1/11	7/1/11	A2/A/A
Water 2003-B	2,175,000	1/30/03	3.74	CPI + 1.33%	(84,815)	7/1/12	7/1/12	A2/A/A
Water 2003-B	2,800,000	1/30/03	3.87	CPI + 1.34%	(116,795)	7/1/13	7/1/13	A2/A/A
Water 2003-B	2,505,000	1/30/03	4.00	CPI + 1.36%	(109,253)	7/1/14	7/1/14	A2/A/A
Water 2003-C	2,005,000	1/30/03	3.87	CPI + 1.34%	(83,631)	7/1/13	7/1/13	A2/A/A
Water 2003-C	2,330,000	1/30/03	4.00	CPI + 1.36%	(101,620)	7/1/14	7/1/14	A2/A/A
Water 2005-B	195,000,000	4/1/05	4.71	SIFMA (2)	(31,470,734)	7/1/35	7/1/35	A2/A/A
Water 2005-offsetting swap (5)	195,000,000	5/6/08	SIFMA (2)	3.652%	2,221,915	7/1/35	7/1/35	A2/A/A
Water 2006-B	120,000,000	3/1/07	5.00	SIFMA (2)	(26,532,153)	7/1/36	7/1/36	A2/A/A
Water 2006-B-offsetting swap (5)	120,000,000	4/1/09	SIFMA (2)	3.652%	(7,922,144)	7/1/36	7/1/36	A2/A/A
Water Hedge Swap (3)	150,000,000	3/1/10	4.93	SIFMA (2)	(27,102,584)	7/1/39	N/A	A2/A/A
Water Hedge Swap (3)	50,000,000	3/1/10	4.93	SIFMA (2)	(9,765,378)	7/1/39	N/A	A1/A+/A+
Water Hedge Swap (3)	76,510,000	7/1/11	4.87	SIFMA (2)	(7,435,597)	7/1/29	N/A	A1/A+/A+
Water Hedge Swap (3) Offsetting Swap (5)	76,510,000	7/1/11	SIFMA (2)	3.998%	(67,752)	7/1/29	N/A	A1/A+/A+
Pension Obligation Certificates – GRS (4)	14,792,275	6/12/06	6.26	3 MTH LIBOR + .34%	(4,282,889)	6/15/34	6/15/34	A1/A+/A+
Pension Obligation Certificates – GRS (4)	6,927,894	6/12/06	6.22	3 MTH LIBOR + .30%	(1,868,776)	6/15/29	6/15/29	A1/A+/A+
Pension Obligation Certificates – GRS (4)	14,792,275	6/12/06	6.26	3 MTH LIBOR + .34%	(4,212,204)	6/15/34	6/15/34	Aa2/A+/A+
Pension Obligation Certificates – GRS (4)	6,927,894	6/12/06	6.22	3 MTH LIBOR + .30%	(1,780,542)	6/15/29	6/15/29	Aa2/A+/A+

(1) Notional amount balance as of June 30, 2009.

(2) The Securities Industry and Financial Markets Association Municipal Swap Index™.

(3) Denotes that the associated bond issue has not been issued as of the balance sheet date; these swaps are issued in anticipation of a

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, 2009. The fair value was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

Credit Risk. When the fair value of any swap has a positive value, then the Fund is exposed to the risk that the counterparty will not fulfill its obligations. As of June 30, 2009, the Fund was exposed to $4,295,809 of credit risk (without regard to collateral or other security arrangements). The previous table shows the credit quality ratings of the counterparties to each swap. The Fund uses three different counterparties as a way of diversifying its credit risk. In addition, 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 exposed to basis risk when the variable interest received on a swap is based on a different index than the variable interest rate to be paid on the associated variable rate debt obligation. At June 30, 2009, the associated debt used the same index for all Securities Industry and Financial Markets Association Municipal Swap Index (SIFMA) and Consumer Price Index (CPI) referenced swaps, as well as the POCs (based on LIBOR) in the previous table. As a result, there is no significant exposure to basis risk at June 30, 2009.

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 fair value of the swap at that time. If any of these swaps were terminated, the associated variable-rate financings would no longer carry synthetic interest rates. Additionally, for the swaps associated with the Water 2001-C, 2001-C Offsetting (mirror), and 2005-B Offsetting (mirror) issuances, the Fund pays a lower fixed rate in exchange for granting the counterparty a special termination option. Under this option, the counterparty can terminate the swap without payment if the SIFMA averages 7% or higher for a consecutive 180-day period. The termination provision for the swap associated with Water 2001-C is effective after January 1, 2010, while the others are currently effective. The termination of any of the above-mentioned swaps requires simultaneous termination of the related mirror or original swap.

In light recent debt rating declines of the City, in concert with falling ratings of the City's Swap Agreement Insurers, a risk of a Swap Agreement Termination exists related to the Swap Agreements issued in conjunction with the issuance of the General, Police, and Fire Retirement Systems Trusts' POCs. As of June 30, 2009, the City had eight such interest rate exchange agreements (the Swap Agreements) in effect.

With the Swap Agreements, the City maintains a potential payable to the Swap Agreement's Counterparty should certain termination events occur. Potential termination events in the original Swap Agreements included cases where the POCs ratings were withdrawn, suspended, or downgraded below "Baa3" (or equivalent) or if the Swap Insurers' ratings fell below an "A3" (or equivalent) rating.

On January 8, 2009, the City received formal notice from the Swap Counterparty to four of the eight Swap Agreements stating that an event had occurred, which, if not cured by the City, would constitute an Additional Termination Event. On January 14, 2009, the City also received formal notice from the Swap Counterparty to the four remaining Swap Agreements, stating that the applicable Swap Insurers had been downgraded below the thresholds set forth in the Swap

Agreements. Under the Swap Agreements, such Swap Insurer downgrades, coupled with the downgrades of the POCs, if not cured by the City, constitute an Additional Termination Event. In June 2009, the City and the Counterparties agreed to an amendment to the Swap Agreements, and thereby eliminating the Additional Termination Event and the potential for an immediate demand for payment to the Swap Counterparties.

As part of the amended Swap Agreements, the Counterparties waived their right to termination payments. Additionally, the City now directs its Wagering Tax revenues to a Trust as collateral for the quarterly payment to the Counterparties, increased the swap rate by 10 basis points effective July 1, 2010, and agreed to other new termination events. The termination events under the amended Swap Agreement includes a provision for the Counterparties to terminate the amended Swap Agreement if certain coverage levels of the Wagering Taxes over the required quarterly payment are not met or if POCs ratings are withdrawn, suspended, or downgraded below “Ba3” (or equivalent). Should such Termination Events occur in connection with these Swap Agreements, and not be cured, the City’s obligations to the Counterparties could increase significantly and there is some risk that the City may not be able to meet the cash demands under the terms of the amended Swap Agreements.

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 is exposed to rollover risk on GRS swaps if they are terminated prior to the maturity of the associated financings (POCs).

(b) Swaptions

Objective of the Swaptions – In addition to the interest rate swaps described above, the Fund entered into three swaptions in conjunction with the termination of three previous interest rate swaps. Specifically, the Fund entered into one interest rate swap in February 2003 and two interest rate swaps in April 2004 related to the issuance of variable rate water bonds. Those interest rate swap agreements included provisions that allowed for the counterparty to put the Fund into a swaption arrangement upon termination. Upon the restructuring of those variable rate bonds in August 2006 to fixed-rate bonds, the interest rate swaps were terminated, and the counterparty executed the swaptions. The swaptions give the counterparty the option to make the Fund enter into a pay-variable, receive-fixed interest rate swap. If the option is exercised, the Fund may consider the potential to issue variable rate refunding bonds and terminate the swaption, but it is not committed to doing so.

Terms, Fair Values, and Credit Risk – The counterparty may exercise its option to enter into the underlying interest rate swap agreements anytime in which the SIFMA index has averaged 7.00% or higher for a consecutive 180-day period. Certain other key terms, fair values, and counterparty credit ratings relating to the outstanding swaptions as of June 30, 2009 are presented below. If the options are exercised by the counterparty, the underlying swap agreements contain scheduled reductions to outstanding notional amounts that match scheduled or anticipated amortization of associated financings.

Associated financing issue	Notional amounts(1)	Option effective date	Rate paid	Rate received	Fair values	Swap termination date	Counterparty credit rating
Water 2003-D	$ 149,185,000	7/02/2011	SIFMA (2)	4.06%	$ (13,038,455)	07/01/33	Aa1/AA-/AA-
Water 2004-A	77,010,000	7/01/2005	SIFMA (2)	3.94	(3,247,555)	07/01/25	Aa1/AA-/AA-
Water 2004-B	155,175,000	7/01/2005	SIFMA (2)	3.85	(4,957,731)	07/01/23	Aa1/AA-/AA-

(1) Notional amount balance as of June 30, 2009.

(2) The Securities Industry and Financial Markets Association Municipal Swap Index.

Fair Value – Fair value was estimated using an option pricing model that considers the likelihood of exercise, interest rate volatility, and other risks and market factors.

Market Access Risk – If the options to enter into interest rate swap agreements are exercised by the counterparty and variable rate refunding bonds are not issued by the City, the Fund would make net swap payments as required by the terms of the contracts–that is, making a variable payment of the SIFMA index rate (unadjusted) to the counterparty for the term of the respective swap and receiving a fixed payment.

(10) Employee Benefit Plan

Substantially all City employees, including 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.

(a) 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 GRS 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, MI, 48226.

(b) Funding Policy and Annual Pension Cost

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' board of trustees based on information provided by the GRS' 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' consulting actuary.

The recommended contribution rate is determined by the GRS' 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 2007 actuarial valuation, the actuarial required contribution rate for the Fund was 10.71% of covered payroll for the year ended June 30, 2009. Contributions for the Fund were $6,439,286 for the year ended June 30, 2009.

Employees may also elect to contribute (a) 3% of annual compensation up to the Social Security wage base and 5% of any excess over that, (b) 5%, or (c) 7% toward annuity savings. Contributions received from Fund employees were $2,680,636 during the year ended June 30, 2009.

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.

The annual pension cost and the changes in net pension asset allocated to the Fund for the year ended June 30, 2009 are as follows:

Annual required contributions	$	4,176,125
Interest on net pension asset		(6,133,742)
Adjustment to annual required contribution		4,358,966
Annual pension cost		2,401,349
Contributions made (employer)		6,439,286
Changes in net pension asset		4,037,937
Net pension asset, beginning of year		77,642,310
Net pension asset, end of year	$	81,680,247

The actuarial methods and significant assumptions used to determine the annual required contributions (ARCs) for the year ended June 30, 2009 were as follows:

Valuation date	June 30, 2007
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%.

(c) Three-Year Trend Information

	Fiscal year ended		Annual pension cost (APC)	Percentage of APC contributed		Net pension asset
General Retirement System	June 30, 2007	$	9,020,943	72%	$	146,055,288
	June 30, 2008		4,332,093	151		77,642,310
	June 30, 2009		2,401,349	269		81,680,247

(d) 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.

(e) Funded Status and Funding Progress

As of June 30, 2008, the most recent actuarial valuation date, the GRS plan was 101% funded. The actuarial accrued liability for benefits to all City employees participating in GRS was $3,609,558,628 and the actuarial value of assets was $3,641,197,523, resulting in an UAAL of $(31,638,895). Of this amount, it was estimated that 12% is attributable to the Fund. The covered payroll (annual payroll of all City employees covered by the plan) was $368,470,990 and the ratio of the UAAL to covered payroll was (8.6%). The covered payroll for employees of the fund was $44,904,000.

A schedule of funding progress, which presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits, is included in the City's comprehensive annual financial report.

(11) Other Postemployment Benefits

(a) Plan Description

The employees of the Fund participate in the Employee Health and Life Insurance Benefit Plan (Benefit Plan), which is a single-employer defined benefit plan administered by the City and the City's retirement systems. The Benefit Plan provides hospitalization, dental care, eye care, and life insurance to all officers and employees of the City who were employed on the day preceding the effective date of the Benefit Plan and who continue in the employ of the City on and after the effective date of the Benefit Plan. Retirees are allowed to enroll in any of the group plans offered by the City to active employees. The City provides healthcare coverage for substantially all retirees in accordance with terms set forth in union contracts or provisions found in Section 13, Article 8 of the Code of Ordinances.

The healthcare benefit eligibility conditions for Fund employees hired before 1995 are 30 years of creditable service or age 60 and 10 years of creditable service or age 65 and 8 years of creditable service. The healthcare benefit eligibility conditions for Fund employees hired after 1995 are age 55 and 30 years of creditable services, or age 60 and 10 years of creditable service, or age 65 and 8 years of creditable service. The City provides full healthcare coverage to Fund employees who retired prior to January 1, 1984, except for the Master Medical benefit that was added on to the coverage after that date. The Fund pays up to 90% of healthcare coverage if retired after January 1, 1984; however, for Fund employees who retired between January 1, 1984 and June 30, 1994, the retiree share has been reduced by 50% by appropriations from City Council. The Fund also pays health coverage for the spouse, under the same formulas noted above, as long as the spouse continues to receive a pension. The Fund does not pay health coverage for a new non-City retiree spouse. Dental and vision coverage is provided for the retiree and the spouse.

(Continued)

The City does provide healthcare coverage to Fund employees that opt for early retirement. For employees hired before 1995, the healthcare benefit eligibility conditions are 25 years of creditable service and employees hired after 1995 is age 55 and 25 years of creditable service. The coverage begins when the retiree would have been eligible for normal retirement. The Fund pays up to 90% of healthcare coverage for the retiree and the spouse. Dental and vision coverage is provided for the retiree and the spouse.

The City also provides healthcare coverage to Fund employees who meet certain healthcare benefit eligibility conditions at reduced rates for those that retire under the Deferred Retirement Benefits (Vested), the Death-in-Service Retirement Benefits Duty and Non-Duty Related, and the Disability Retirement Benefits Duty and Non-Duty Related. Complementary healthcare coverage is provided by the City for those Fund retirees that are Medicare-Eligible. For those Fund retirees who opt out of the retiree healthcare coverage may obtain coverage at a later date.

In addition to healthcare coverage, the City allows Fund retirees to continue life insurance coverage under the Group Insurance Protection Plan offered to active employees in accordance with Section 13, Article 9 of the Code of Ordinances. The basic life insurance coverage for Fund employees is based on the employee's basic annual earnings to the next higher thousand dollars. The life insurance benefit amounts range from $3,750 to $12,500.

The Employee Supplemental Death Benefit Plan (Supplemental Plan) is prefunded single-employer defined benefit plan administered by the Employee Benefits Board of Trustees. The money is held in the City of Detroit Employee Benefit Trust and the City uses the trust fund to account for the Supplemental Plan. In accordance with Section 13, Article 8 of the Code of Ordinances, effective July 1, 1999 and prior to the member's retirement from the City, a death benefit of $10,000 will be paid. After retirement of the member from the City, the amount of death benefits paid is based upon the retiree's years of City service ranging from $1,860 (for ten (10) or less years of service) to $3,720 (for thirty (30) years of service). For years of service beyond (30) years, ninety-three dollars ($93.00) will be added per year for each additional year of service.

There were 1,463 retirees eligible for benefits, as of July 1, 2007, the date of the most recent actuarial valuation. These plans do not issue separate financial statements.

(b) Funding Policy

Health and Life Insurance Benefit Plan – The cost of benefits for the Benefit Plan, which are financed on a pay-as-you-go basis for the year ended June 30, 2009, for the Fund retiree's are as follows:

Benefits		Fund cost	Fund retiree cost	Total cost
Hospitalization	$	7,242,697	1,750,871	8,993,568
Dental		318,145	—	318,145
Eye care		63,972	—	63,972
Life insurance		5,056	5,495	10,551
	$	7,629,870	1,756,366	9,386,236

Supplemental Death Benefit Plan – The cost of benefits for the Supplemental Plan, which are a prefunded plan and the funds are held in the City of Detroit Employee Benefit Trust, for the year ended June 30, 2009 for the Fund retiree's are as follows:

Benefit		Fund cost	Fund retiree cost	Total cost
Supplemental Death Benefit Plan	$	13,385	1,361	14,746
Total	$	13,385	1,361	14,746

The City of Detroit Employee Benefit Trust paid death benefits in the amount of $103,137 for Fund retirees for the year ended June 30, 2009.

(c) Annual OPEB Costs and Net OPEB Obligation

The Fund's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the Fund's annual OPEB cost for the year ended June 30, 2009, the amount actually contributed to the plans, and changes in the Fund's OPEB obligation for the retirees of the Fund:

		Health and Life Insurance Benefit Plan	Supplemental Death Benefit Plan	Total
Annual required contribution (ARC)	$	16,325,120	11,258	16,336,378
Interest on net OPEB obligation		304,476	—	304,476
Annual OPEB cost (expense)		16,629,596	11,258	16,640,854
Contributions made (employer)		(7,629,870)	(13,385)	(7,643,255)
Changes in OPEB obligation		8,999,726	(2,127)	8,997,599
OPEB obligation, beginning of year		7,611,909	2,261	7,614,170
OPEB obligation, end of year	$	16,611,635	134	16,611,769

The annual OPEB cost, the percentage of annual OPEB cost contributed to each plan, and the OPEB obligation for the years ended June 30, 2009 and 2008 for the retirees employees of the Fund were as follows:

	Year ended June 30,		Annual OPEB cost	Actual contributions	Percentage of annual OPEB cost contributed		Net OPEB obligation
Health and Life Ins.	2009	$	16,629,596	7,629,870	45.9%	$	16,611,635
Benefit Plan	2008		15,920,197	8,308,288	52.2		7,611,909
Supplemental Death	2009		11,258	13,385	118.9		134
Benefit Plan	2008		14,865	12,604	84.8		2,261

(d) Funding Status and Funding Progress

Health and Life Insurance Benefit Plan (Benefit Plan) – As of June 30, 2007, the most recent actuarial valuation date for the Benefit Plan, the actuarial accrued liability for benefits related to all City employees was $4,823,562,208, and the actuarial value of assets was $0, resulting in an unfunded actuarial accrued liability (UAAL) of $4,823,562,208. The covered payroll (annual payroll of all active City employees covered by the plan) was $608,689,066 and the ratio of the UAAL to the covered payroll was 792%. The funded status related to the retirees of the Fund was not available.

Supplemental Death Benefit Plan (Supplemental Plan) – As of June 30, 2007, the most recent actuarial valuation date for the Supplemental Plan, the actuarial accrued liability for benefits related to all City employees was $29,050,860 and the actuarial value of assets was $27,457,460, resulting in an unfunded actuarial accrued liability (UAAL) of $1,593,400. The covered payroll (annual payroll of all active City employees covered by the plan) was $608,689,066 and the ratio of the UAAL to the covered payroll was less than 0.3%. The funded status related to the retirees of the Fund was not available.

Actuarial valuations of the ongoing plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

(e) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The actuarial methods and significant assumptions used to determine the annual required contributions for the year ended June 30, 2009 were as follows:

	Health Benefit Plan	**Death Benefit Plan**
Valuation date	June 30, 2007	June 30, 2007
Actuarial cost method	Entry age	Entry age
Amortization method	Level percent	Level percent
Remaining amortization period for unfunded accrued liabilities	30 years	30 years
Asset valuation method	N/A	5-year smoothed market
Actuarial assumptions:		
Investment rate of return	4.0%	7.0%
Projected salary increases*	4.0%	N/A
Healthcare cost trend rate	9.0% for 2008, grading down to 4.0% in 2017 and beyond	N/A

* Includes inflation rate of 4%.

(Continued)

In the June 30, 2007, actuarial valuation for the Supplemental Death Benefit Plan, the City's plan used the 1983 Group Annuity Mortality Table in evaluating death benefits to be paid. The City's plan used an annual rate of retirement for males and females of 25% and 30%, initially, reduced to an ultimate rate of 25% for males and 20% for females after age 67.

(12) Due to (from) Other Funds

During the course of operations, numerous transactions occur between individual funds and other City 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 statement of fund net assets and are summarized as follows as of June 30, 2009:

Due from other funds (unrestricted):		
General Fund	$	8,460,740
General Retirement System Service Corporation		40,536
Sewage Disposal Fund		59,385,839
Total due from other funds	$	67,887,115
Due from other funds (restricted):		
General Fund	$	324,853
Sewage Disposal Fund		6,285,818
Total due from other funds	$	6,610,671
Due to other funds (unrestricted):		
General Fund	$	8,247,932
Other Governmental Funds		193,287
Fiduciary funds		3,226,516
Sewage Disposal Fund		43,051,964
Total due to other funds	$	54,719,699
Due to other funds (restricted):		
General Fund	$	40,004
Sewage Disposal Fund		7,275,906
Total due to other funds	$	7,315,910

(13) 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 $1.85 billion through fiscal year 2014. 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, 2009 was approximately $92 million.

(14) 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 other potential loss exposures.

(15) Compliance with Finance-Related Legal and Contractual Provisions

The Fund has not implemented the necessary procedures to ensure compliance with the arbitrage rebate rules of Section 148(f) of the Internal Revenue Code of 1986 applicable to the City's outstanding tax-exempt obligations. The Fund is engaged in discussions with the Internal Revenue Service to establish such procedures. The potential impact to the Fund is indeterminable at this time.

The Treasurer of the State of Michigan requires that the financial statements of local governments must be submitted to the Treasurer no later than six months after year-end. The City (including the Fund) is in violation of this requirement. The Secretary of State of the State of Michigan has the authority to suspend the City's certificate of motor vehicle self-insurance when a financial statement with application is not submitted 30 days prior to the desired effective date of the certificate. Failure to adhere to the requirement may result in the cancellation of the certificate of motor vehicle self-insurance. The Fund's motor vehicles are covered under the City's certificate of motor vehicle self-insurance. However, the Secretary of State of Michigan has extended the City's certificate of motor vehicle self-insurance.

Bond ordinances require amounts be held on deposit in a Bond and Interest Redemption Fund such that the aggregate balance is sufficient to provide for payment, when due, of the current principal and interest. During the fiscal year ended June 30, 2009, the balance in the Bond and Interest Redemption Fund was not in compliance with these ordinances. However, the Fund transferred the required amounts on July 1, 2009 and made the principal and interest payments on a timely basis.

During the fiscal year ended June 30, 2009, the fund identified certain expenditures that potentially should not have been funded by bond proceeds. The City is currently unable to determine whether there were any legal violations or implications as to the tax-exempt nature of the bonds as a result of this potential noncompliance. The City does not believe the outcome of this matter will have a material impact on the accompanying financial statements.

(16) Subsequent Events

(a) Subsequent Economic Events

Subsequent to the fiscal year ended June 30, 2009, there has been some improvement in the local economy, but the economic conditions remain recessionary. The City's unemployment rate of 25.3% for March 2010 (27.2% in June 2009) continues to be higher than the rest of the State and Nation, which if not lowered will result in little improvement in collection of personal income taxes. The large number of resident home foreclosures, delinquent property tax levels, and declining home taxable values will contribute to decreasing property tax revenues. The State cut distributable state aid (i.e., revenue sharing) to the City for the City's fiscal year 2009–2010 by $33.6 million.

Conditions in the municipal debt markets have improved since the general liquidity shortages experienced late in 2008. Notwithstanding this general improvement, imbalances in supply and demand and illiquidity problems remain in certain segments of the market in 2009. These issues are particularly applicable to lower rated debt issues.

The federal government to date, through the American Reinvestment and Recovery Act (ARRA), has allocated stimulus funds totaling $249.6 million to the City to spur economic recovery. ARRA funding includes $33.6 million for Weatherization of City homes, $40.8 million for Neighborhood stabilization programs, $11.1 million for Cops Hiring, $23.5 million for road improvements, and $37.6 million for new buses. The stimulus funding is expected to increase local employment and creation of new small businesses and result in higher income and property tax collections.

The City and local private and public leaders are working together to build a light rail system in the City on Woodward Avenue from downtown to the Michigan State Fairgrounds near Eight Mile. The estimated cost to build 9.3 miles of the Light Rail system is $394 million. Funding for the system will come from private and public sources. The system is expected to significantly improve the local economy with new construction and transit jobs. Also, studies have shown that new rail systems generate economic development in the surrounding area. Based on Michigan Department of Transportation studies, the Woodward Light Rail System would generate an estimated $933 million in economic development after opening. In February 2010, the federal government announced that the Woodward Light Rail System would receive a $25 million Transportation Investment Generating Economic Recovery (TIGER) grant.

As a result of the current economic conditions and other factors, including the reported accumulated deficit in the accompanying General Fund financial statements, the City's financial challenges are expected to remain in the near term. However, the City is cautiously optimistic that the ARRA funded projects and proposed Woodward Light Rail System will spur economic recovery and development in the City and contribute to the improvement of the City's financial condition.

(Continued)

(b) Debt Ratings

In August 2009, Moody's downgraded Detroit's Unlimited Tax General Obligation Bonds rating from "Ba2" to "Ba3", Limited Tax General Obligation Bonds rating from "Ba3" to "B1," and Detroit Retirement Systems Funding Trust Series 2005-A, 2006-A, B from "Ba2" to "Ba3." Concurrently, Moody's downgraded the Global Scale Rating assigned to the outstanding POCs from "Baa3" to "Ba1."

The City's General Obligation, Water Supply System Revenue, and Sewage Disposal System Revenue Bonds are also insured with bond insurance coverage purchased to obtain a lower cost of borrowing through rated bond insurers. The ratings of several of the City's bonds that are insured by the downgraded bond insurers have been affected.