CITY OF DETROIT
WATER FUND

Basic Financial Statements

June 30, 2011

(With Independent Auditors' Report Thereon)

CITY OF DETROIT
WATER FUND

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KPMG LLP
Suite 1900
150 West Jefferson
Detroit, MI 48226

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, 2011, 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 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 also 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 basic financial statements referred to above present only the Fund of the City and are not intended to present fairly the financial position of the City as of June 30, 2011, 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, 2011, 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.

The Fund has not presented a management's discussion and analysis, schedules of employer contributions, and schedules 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
December 22, 2011

CITY OF DETROIT
WATER FUND

Statement of Fund Net Assets

June 30, 2011

Current assets:		
Cash and cash equivalents	$	7,357,748
Investments		84,018,134
Accounts receivable:		
Billed accounts receivable		72,914,205
Unbilled accounts receivable		30,350,253
Other accounts receivable		3,757,139
Allowance for doubtful accounts		(25,387,639)
Total accounts receivable, net		81,633,958
Due from other funds		66,690,098
Inventories		5,939,985
Prepaid expenses		1,510,001
Restricted:		
Cash and cash equivalents		8,870,389
Investments		134,715,746
Due from other funds		4,045,774
Total current assets		394,781,833
Noncurrent assets:		
Restricted:		
Cash and cash equivalents		3,810,114
Investments		45,032,315
Net pension asset		88,474,553
Deferred charges		37,990,918
Fair value of derivatives		27,693,455
Capital assets:		
Land and land rights		6,062,803
Land improvements		101,851,813
Buildings and structures		887,692,615
Mains		984,494,019
Services and meters		170,265,759
Machinery, equipment, and fixtures		895,442,206
Construction in progress		197,274,741
Total capital assets		3,243,083,956
Less accumulated depreciation		(1,070,762,411)
Total capital assets, net		2,172,321,545
Deferred outflows of resources		1,927,019
Total noncurrent assets and deferred outflows		2,377,249,919
Total assets and deferred outflows		2,772,031,752

See accompanying notes to basic financial statements.

(Continued)

CITY OF DETROIT
WATER FUND

Statement of Fund Net Assets

June 30, 2011

Current liabilities:		
Current liabilities payable from unrestricted assets:		
Accounts and contracts payable	$	20,723,955
Accrued salaries and wages		922,524
Due to other funds		22,792,696
Due to fiduciary funds		8,549,055
Other accrued liabilities		18,295,619
State revolving loans		418,750
Pension obligation certificates of participation		913,613
Capital lease		30,534
Accrued compensated absences		6,427,622
Accrued workers' compensation		1,868,000
Claims and judgments		3,531,000
Total current liabilities payable from unrestricted assets		84,473,368
Current liabilities payable from restricted assets:		
Revenue bonds and state revolving loans		44,671,250
Accrued interest		57,839,797
Accounts and contracts payable		8,227,900
Due to other funds		13,411,537
Total current liabilities payable from restricted assets		124,150,484
Total current liabilities		208,623,852
Long-term liabilities:		
Revenue bonds and state revolving loans, net		2,114,741,662
Pension obligation certificates of participation, net		79,560,644
OPEB obligation		40,578,926
Accrued compensated absences		4,453,598
Accrued workers' compensation		8,469,000
Claims and judgments		243,000
Derivative instruments – swap liability		191,883,006
Total long-term liabilities		2,439,929,836
Total liabilities		2,648,553,688
Fund net assets:		
Invested in capital assets, net of related debt		62,141,704
Restricted:		
Restricted for capital acquisitions		22,648,822
Restricted for debt service		101,862,800
Unrestricted (deficit)		(63,175,262)
Total fund net assets	$	123,478,064

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, 2011

Operating revenues:	
Water sales – Detroit	$ 74,810,362
Water sales – suburban	237,099,865
Miscellaneous	4,091,974
Total operating revenues	316,002,201
Operating expenses:	
Source of supply	5,683,036
Low-lift pumping	8,269,998
High-lift pumping	19,581,883
Purification	17,681,131
Water quality operations	787,600
Pumping stations	16,741,756
Transmission	16,607,563
Distribution	11,988,970
Services	8,634,858
Hydrant division	697,442
Meters	4,600,757
Commercial	6,129,979
Administrative and general	29,475,444
Other items	14,638,350
Total operating expenses before depreciation	161,518,767
Depreciation	71,995,060
Total operating expenses	233,513,827
Operating income	82,488,374
Nonoperating revenues (expenses):	
Investment earnings (losses):	
Losses on investment activity	(6,736,536)
Changes in fair value of derivatives	21,216,407
Interest expense, net of capitalized interest	(111,666,753)
Miscellaneous revenues	1,588,987
Total nonoperating expenses, net	(95,597,895)
Decrease in net assets before capital contributions	(13,109,521)
Capital contributions	211,745
Decrease in fund net assets	(12,897,776)
Fund net assets – beginning of year	136,375,840
Fund net assets – end of year	$ 123,478,064

See accompanying notes to basic financial statements.

CITY OF DETROIT
WATER FUND

Statement of Cash Flows

Year ended June 30, 2011

Cash flows from operating activities:	
Receipts from customers	$ 300,205,708
Loans to other funds	(19,023,134)
Payments to suppliers	(65,256,267)
Payments to employees	(61,370,167)
Net cash provided by operating activities	154,556,140
Cash flows from noncapital financing activities:	
Interest paid on pension obligation certificates of participation	(4,979,284)
Principal paid on pension obligation certificates	(593,104)
Miscellaneous nonoperating income	1,681,275
Net cash used in noncapital financing activities	(3,891,113)
Cash flows from capital and related financing activities:	
Acquisition and construction of capital assets	(96,605,117)
Proceeds from sales of capital assets	135,042
Principal paid on capital lease	(655,538)
Principal paid on revenue bonds and state revolving loans	(36,760,000)
Interest paid on revenue bonds and state revolving loans	(110,265,513)
Proceeds from issuance of revenue bonds and state revolving loans	3,136,725
Net cash used in capital and related financing activities	(241,014,401)
Cash flows from investing activities:	
Proceeds from sales and maturities of investments	855,939,057
Purchases of investments	(757,271,383)
Derivative settlement payments	(6,736,536)
Loss on investments	(12,875,784)
Net cash provided by investing activities	79,055,354
Net decrease in cash and cash equivalents	(11,294,020)
Cash and cash equivalents at beginning of year	31,332,271
Cash and cash equivalents at end of year	$ 20,038,251
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 82,488,374
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	71,995,060
Bad debt expense	8,836,391
Write-off of capital assets, including construction in progress	12,057,904
Changes in assets and liabilities:	
Accounts receivable	(24,632,884)
Due from other funds	51,979,962
Inventories	1,311,857
Prepaid expenses	(236,812)
Net pension asset	(2,948,695)
Accounts and contracts payable	5,672,355
Accrued salaries and wages	(1,596,818)
Due to other funds	(71,003,096)
Due to fiduciary funds	3,492,096
Other current accrued liabilities, accrued compensated absences, and accrued workers' compensation	
OPEB obligation	12,634,490
Claims and judgments	(775,000)
Pollution remediation obligations	(80,000)
Accrued compensated absences	(257,276)
Accrued workers' compensation	(616,000)
Other current accrued liabilities	6,234,232
Net cash provided by operating activities	$ 154,556,140
Noncash activities:	
Fair value of derivatives	$ (24,332,773)
Deferred outflows of resources – hedging derivatives	2,573,360

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 basic financial statements. These policies conform to U.S. generally accepted accounting principles (GAAP).

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

(a) Basis of Accounting

The accounting policies of the Fund conform to 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) 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.

(Continued)

(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 assets and are valued at the lower of cost or market, with cost being determined on an average cost method. Inventory is recorded as expenditures when consumed rather than when purchased.

(e) Capital Assets

Capital assets are recorded at historical cost, together with interest capitalized during construction. The Fund's capitalization levels are $5,000 on tangible personal property and for improvements other than buildings, and $50,000 on infrastructure, including water mains. All acquisitions of land and land improvements are capitalized regardless of cost. 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	20 – 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, 2011 was $7,997,888.

(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 basic 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 Refunding

Bond premiums, discounts, issuance costs, and deferred amounts on refunding 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 refunding. 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 $7,997,888 for the year ended June 30, 2011.

(Continued)

(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. Such revenue has been shown net of allowances of $8,836,391. 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 basic 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 basic financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(o) Reclassification

Certain changes have been made to the classifications of operating expense amounts for the year ended June 30, 2011 to more accurately reflect the operations of the Fund.

(2) Deposits and Investments

The deposits and investments of the Fund at June 30, 2011 are reported in the basic financial statements as follows:

		Cash and cash equivalents	Investments
Current unrestricted assets	$	7,357,748	84,018,134
Current restricted assets		8,870,389	134,715,746
Noncurrent restricted assets		3,810,114	45,032,315
Total cash and investments	$	20,038,251	263,766,195

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, 2011, the Fund had no deposits, which were exposed to custodial credit risk, as they were insured and collateralized.

(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, 2011, 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 flows requirements. Unless related to a specific cash flows, 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, 2011, 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	$	95,534,937	—	95,534,937
Commercial paper		23,442,000	23,442,000	—
Money market		144,789,258	144,789,258	—
Total investments	$	263,766,195	168,231,258	95,534,937

(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).

(Continued)

As of June 30, 2011, the credit quality ratings for the Fund's fixed income investments are as follows:

Investment		Fair value	Ratings S&P	Ratings Moody's
U.S. government agency securities	$	45,600,285	AAA	Aaa
U.S. government agency securities		30,010,368	AAAe	Aaa
U.S. government agency securities		17,939,062	AAA	NR
U.S. government agency securities		1,985,222	AAAe	NR
Commercial paper		23,442,000	A-1	P-1
Money market		140,622,848	AAAm	Aaa-mf
Money market		3,352,738	AAAm	NR
Money market		813,672	NR	NR
Total investments	$	263,766,195		

(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 Home Loan Mortgage, Federal National Mortgage Association securities, and Silver Tower Commercial Paper. These investments represent 24%, 7%, 5%, and 9%, respectively, of the Fund's total investments as of June 30, 2011.

(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, 2011 was as follows:

		Balance, June 30, 2010	Additions	Disposals	Balance, June 30, 2011
Nondepreciated capital assets:					
Land and land rights	$	6,062,803	—	—	6,062,803
Construction in progress		160,010,296	66,564,768	(29,300,323)	197,274,741
Total nondepreciable assets		166,073,099	66,564,768	(29,300,323)	203,337,544
Depreciated capital assets:					
Land improvements		101,488,494	372,303	(8,984)	101,851,813
Buildings and structures		881,760,913	8,629,712	(2,698,010)	887,692,615
Mains		975,196,514	9,963,519	(666,014)	984,494,019
Services		48,796,664	184,745	—	48,981,409
Meters		116,389,794	4,894,556	—	121,284,350
Machinery, equipment, and fixtures		874,452,577	24,436,812	(3,447,183)	895,442,206
Total depreciable assets		2,998,084,956	48,481,647	(6,820,191)	3,039,746,412
Less accumulated depreciation:					
Land improvements		(14,122,737)	(1,003,580)	—	(15,126,317)
Buildings and structures		(238,019,206)	(30,270,095)	—	(268,289,301)
Mains		(309,490,370)	(13,995,276)	—	(323,485,646)
Services		(26,114,109)	(596,740)	—	(26,710,849)
Meters		(34,674,885)	(4,984,534)	—	(39,659,419)
Machinery, equipment, and fixtures		(376,875,022)	(21,144,835)	528,978	(397,490,879)
Total accumulated depreciation		(999,296,329)	(71,995,060)	528,978	(1,070,762,411)
Net capital assets	$	2,164,861,726	43,051,355	(35,591,536)	2,172,321,545

Certain beginning balances have been reclassified as a result of changes in asset classifications to reflect a more accurate presentation.

(Continued)

(5) Long-Term Obligations

Changes in long-term obligations for the year ended June 30, 2011 were as follows:

	Balance, June 30, 2010	Increase	Decrease	Balance, June 30, 2011	Amount due within one year
Revenue bonds	$ 2,230,610,000	—	(35,115,000)	2,195,495,000	43,415,000
State revolving loans	22,087,520	3,136,725	(1,645,000)	23,579,245	1,675,000
Total revenue bonds	2,252,697,520	3,136,725	(36,760,000)	2,219,074,245	45,090,000
Add: Unamortized premiums	60,110,321	—	(2,993,866)	57,116,455	—
Less:					
Unamortized discounts	(4,013,085)	—	212,489	(3,800,596)	—
Deferred amounts on refunding	(118,655,137)	—	6,096,695	(112,558,442)	—
Total revenue bonds, net	2,190,139,619	3,136,725	(33,444,682)	2,159,831,662	45,090,000
Pension obligation certificates 2005 series	28,604,884	—	(593,104)	28,011,780	913,613
Pension obligation certificates 2006 series	51,506,122	—	—	51,506,122	—
Less deferred amounts on refunding	959,222	—	(2,867)	956,355	—
Total pension obligation certificates, net	81,070,228	—	(595,971)	80,474,257	913,613
Other long-term liabilities:					
Capital lease payable	686,072	—	(655,538)	30,534	30,534
OPEB obligation	27,944,436	22,014,706	(9,380,216)	40,578,926	—
Accrued compensated absences	11,138,496	6,170,346	(6,427,622)	10,881,220	6,427,622
Accrued workers' compensation	10,953,000	4,576,180	(5,192,180)	10,337,000	1,868,000
Claims and judgments	4,549,000	5,205,500	(5,980,500)	3,774,000	3,531,000
Pollution remediation obligations	80,000	8,700	(88,700)	—	—
Total other long-term liabilities	55,351,004	37,975,432	(27,724,756)	65,601,680	11,857,156
Total	$ 2,326,560,851	41,112,157	(61,765,409)	2,305,907,599	57,860,769

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

Revenue bonds payable and state revolving loans amounted to $2,219,074,245 at June 30, 2011. Net revenues of the Fund are pledged to repayment of bonds. The following is a schedule of the revenue bonds payable at June 30, 2011:

Issue	Bond date	Amount issued	Range of interest rates	Maturity date	Outstanding balance at June 30, 2011	
Series 1993	10/15/93	$ 38,225,000	6.50%	7/01/14-15	$ 24,725,000	
Series 1995-A	10/15/95	102,100,000	5.40 to 5.55	7/01/11-12	7,150,000	
Series 1995-B	10/15/95	60,485,000	5.40 to 5.55	7/01/11-12	16,535,000	
Series 1997-A	8/01/97	29,080,000	5.75 to 6.00	7/01/11-15	20,215,000	
Series 1997-A	8/01/97	186,220,000	5.00	7/01/11-27	74,575,000	c
Series 2001-A	5/01/01	1,320,000	4.50	7/01/11	1,320,000	
Series 2001-A	5/01/01	301,165,000	5.00	7/01/29-30	73,790,000	c
Series 2001-C	5/08/08	4,055,000	3.00 to 4.25	7/01/11-18	3,080,000	
Series 2001-C	5/08/08	186,350,000	4.50 to 5.75	7/01/19-29	186,350,000	c
Series 2003-A	1/28/03	234,805,000	4.50 to 5.00	7/01/19-34	181,835,000	c
Series 2003-B	1/28/03	131,175,000	Variable (*)	7/01/11-14	9,980,000	
Series 2003-B	1/28/03	41,770,000	5.00	7/01/34	41,770,000	c
Series 2003-C	1/28/03	16,695,000	3.60	7/01/11	180,000	
Series 2003-C	1/28/03	4,335,000	Variable (*)	7/01/13-14	4,335,000	
Series 2003-C	1/28/03	25,325,000	4.25 to 5.25	7/01/15-22	25,325,000	c
Series 2003-D	8/14/06	3,180,000	4.00 to 4.20	7/01/11-16	1,915,000	
Series 2003-D	8/14/06	139,575,000	4.25 to 5.00	7/01/17-33	139,575,000	c
Series 2004-A	8/14/06	17,600,000	3.75 to 5.25	7/01/12-16	17,580,000	
Series 2004-A	8/14/06	55,165,000	4.50 to 5.25	7/01/17-25	55,165,000	c
Series 2004-B	8/14/06	52,840,000	4.00 to 5.00	7/01/11-16	41,070,000	
Series 2004-B	8/14/06	100,990,000	4.25 to 5.00	7/01/17-23	100,990,000	c
Series 2005-A	3/11/05	20,965,000	3.25 to 5.00	7/01/11-15	10,900,000	
Series 2005-A	3/11/05	84,035,000	3.90 to 5.00	7/01/16-35	84,035,000	c
Series 2005-B	5/08/08	19,070,000	4.00 to 5.50	7/01/11-18	17,320,000	
Series 2005-B	5/08/08	175,830,000	4.75 to 5.50	7/01/19-35	175,830,000	c
Series 2005-C	3/11/05	36,405,000	5.00	7/01/11-15	25,260,000	
Series 2005-C	3/11/05	90,200,000	5.00	7/01/16-22	90,200,000	c
Series 2006-A	8/14/06	42,795,000	5.00	7/01/11-16	42,795,000	
Series 2006-A	8/14/06	237,205,000	5.00	7/01/17-34	237,205,000	c
Series 2006-C	8/14/06	12,585,000	4.00 to 5.00	7/01/11-16	10,785,000	
Series 2006-C	8/14/06	208,060,000	5.00	7/01/17-33	208,060,000	c
Series 2006-D	8/14/06	4,430,000	4.00 to 5.00	7/01/11-16	3,485,000	
Series 2006-D	8/14/06	142,160,000	4.25 to 5.00	7/01/17-32	142,160,000	c
Bonds remarketed in 2009:						
Series 2006-B	4/01/09	900,000	2.60 to 5.00	7/01/11-19	900,000	
Series 2006-B	4/01/09	119,100,000	5.50 to 7.00	7/01/20-36	119,100,000	c
Total revenue bonds payable					$ 2,195,495,000	

* 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 at June 30, 2011:

Issue	Bond date	Amount issued	Range of interest rates	Maturity date	Outstanding balance at June 30, 2011
Series 2005 SRF-1	9/22/05	$ 13,673,159	2.125%	10/01/11-26	$ 11,118,159
Series 2005 SRF-2	9/22/05	8,014,219	2.125	10/01/11-26	6,214,219
Series 2006 SRF-1	9/21/06	5,180,926	2.125	10/01/11-26	4,170,926
Series 2008 SRF-1	9/29/08	2,590,941	2.500	10/01/11-26	2,075,941
Total state revolving loans					$ 23,579,245

The state revolving loans are 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.

As of June 30, 2011, aggregate debt service requirements of the Fund's debt (fixed rate and variable rate) and net receipts/payments on associated hedging derivative instruments are as follows. These amounts assume that current interest rates on variable rate bonds and the current reference rates of hedging derivative instruments will remain the same for their term. As these rates vary, interest payments on variable rate bonds and net receipts/payments on the hedging derivative instruments will vary. Refer to note 9 for information on derivative instruments.

	Principal	Interest	Hedging derivatives, net	Total requirements
Year ending June 30:				
2012	$ 45,090,000	113,677,934	(496,082)	158,271,852
2013	47,310,000	111,420,123	(397,730)	158,332,393
2014	49,620,000	109,094,696	(317,466)	158,397,230
2015	51,990,000	106,738,550	(154,121)	158,574,429
2016	54,720,000	104,062,475	—	158,782,475
2017 – 2021	316,875,941	476,095,631	—	792,971,572
2022 – 2026	402,273,304	387,388,641	—	789,661,945
2027 – 2031	508,460,000	274,394,502	—	782,854,502
2032 – 2036	625,235,000	135,232,996	—	760,467,996
2037	117,500,000	7,763,750	—	125,263,750
	$ 2,219,074,245	1,825,869,298	(1,365,399)	4,043,578,144

Bonds outstanding at June 30, 2011 include approximately $2.0 billion of bonds and loans callable at various dates after June 30, 2011. These bonds are callable at varying premiums, depending on the issue and length of time to maturity.

(a) Issuance of Revenue Bonds

The City received loans from the State of Michigan Revolving Fund Loan Program totaling $3,136,725 during the year ended June 30, 2011. The proceeds of the loans were used to pay costs of acquiring, contracting extensions, and making certain repairs and improvements to the System. At June 30, 2011, $9,050,755 in bonds was authorized and unissued.

(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 basic financial statements. At June 30, 2011, $496,925,000 of bonds outstanding is considered defeased.

(c) Capital Lease

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:		
2012	$	30,598
Total minimum lease payments		30,598
Less amount representing interest		(64)
Present value of minimum lease payments	$	30,534

(d) Pledges of Future Revenue

The Fund has pledged substantially all revenue of the 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 of the System. The bonds are payable solely from the net revenues of the System. The remaining principal and interest to be paid on the bonds is $4,043,578,144. During the current year, net revenues of the System were $169,121,782 compared with the amount pledged for annual debt requirements of $157,701,794. In addition, the Fund has approximately $103 million in bond and interest reserves on hand at June 30, 2011.

(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, 2011 is as follows:

	Principal	Interest	Hedging derivatives, net	Total
2012	$ 913,613	2,090,224	2,495,873	5,499,710
2013	1,250,905	2,049,541	2,495,873	5,796,319
2014	1,604,980	1,993,212	2,495,873	6,094,065
2015	1,801,509	1,919,977	2,495,873	6,217,359
2016	2,000,473	1,836,873	2,495,873	6,333,219
2017 – 2021	12,481,707	7,662,526	12,340,486	32,484,719
2022 – 2026	15,987,758	4,907,532	11,508,144	32,403,434
2027 – 2031	21,214,001	3,219,269	7,909,533	32,342,803
2032 – 2035	22,262,956	1,790,343	1,562,832	25,616,131
Total	$ 79,517,902	27,469,497	45,800,360	152,787,759

(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, 2011 and 2010 are as follows:

		2011	2010
Balance at beginning of year	$	15,502,000	19,111,200
Current year claims and changes in estimates		9,781,680	5,938,447
Claims payments		(11,172,680)	(9,547,647)
Balance at end of year	$	14,111,000	15,502,000

(9) Derivative Instruments

The table below summarizes derivative instrument activity during the reporting period and balances at the end of the period:

	Changes in fair value		Fair value at June 30, 2011		Notional
	Classification	Amount	Classification	Amount	amount
Cash flow hedges:					
Pay-fixed interest rate swaps					
Negative fair values	Deferred outflow	$ 2,603,476	Long-term liabilities	$ (13,028,290)	$ 43,440,338
Positive fair values	Deferred outflow	512,539	Long-term assets	170,402	14,315,000
Investment derivatives:					
Pay-fixed interest rate swaps					
Negative fair values	Interest and investment earnings	21,913,739	Long-term liabilities	(176,314,716)	1,075,020,000
Investment derivatives:					
Pay-floating interest rate swaps					
Negative fair values	Interest and investment earnings	(1,235,907)	Long-term liabilities	(2,540,000)	120,000,000
Positive fair values	Interest and investment earnings	538,575	Long-term assets	27,523,053	382,155,000

(Continued)

The fair values of the interest rate swaps were 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 swaps.

(a) Objectives

In order to better manage its interest rate exposure and to reduce the overall costs of its financings, the Fund has entered into six 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.

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.

(b) *Terms*

Certain key terms and fair values relating to the outstanding hedging and investment derivative instruments are presented below:

Associated financing issue		Notional amount (1)	Effective date	Rate paid	Rate received		Fair value	Swap termination date	Final maturity of bonds
Hedging derivatives:									
Cash flow hedges,									
pay-fixed interest									
rate swaps:									
Water 2003-B	$	2,500,000	1/30/2003	3.55%	CPI + 1.25%	$	41,934	7/1/2011	7/1/2011
Water 2003-B		2,175,000	1/30/2003	3.74	CPI + 1.33%		29,434	7/1/2012	7/1/2012
Water 2003-B		2,800,000	1/30/2003	3.87	CPI + 1.34%		32,518	7/1/2013	7/1/2013
Water 2003-B		2,505,000	1/30/2003	4.00	CPI + 1.36%		22,398	7/1/2014	7/1/2014
Water 2003-C		2,005,000	1/30/2003	3.87	CPI + 1.34%		23,285	7/1/2013	7/1/2013
Water 2003-C		2,330,000	1/30/2003	4.00	CPI + 1.36%		20,833	7/1/2014	7/1/2014
Total	$	14,315,000				$	170,402		
Pension obligation certificates:									
Taxable certificate of									
participation SBSFPC-0009 (3)	$	14,792,275	6/12/2006	6.36%	3-MTH LIBOR +0.34%	$	(4,551,711)	6/15/2034	6/15/2034
Taxable certificate of									
participation SBSFPC-0012 (3)		6,927,894	6/12/2006	6.32	3-MTH LIBOR +0.30%		(1,961,683)	6/15/2029	6/15/2029
Taxable certificate of									
participation 37380341 (3)		14,792,275	6/12/2006	6.36	3-MTH LIBOR +0.34%		(4,552,971)	6/15/2034	6/15/2034
Taxable certificate of									
participation 37380351 (3)		6,927,894	6/12/2006	6.32	3-MTH LIBOR +0.30%		(1,961,925)	6/15/2029	6/15/2029
Total	$	43,440,338				$	(13,028,290)		
Investment derivatives:									
Pay-fixed interest									
rate swaps:									
Water 2001-C	$	112,445,000	6/7/2001	4.90%	SIFMA (2) + 0.0%	$	(27,223,347)	7/1/2026	7/1/2026
Water 2005-B		193,200,000	4/1/2005	4.71	SIFMA (2)		(39,130,951)	7/1/2035	7/1/2035
Water 2006-B		120,000,000	3/1/2007	5.00	SIFMA (2)		(31,549,334)	7/1/2036	7/1/2036
Water hedge swap		150,000,000	7/2/2012	5.07	SIFMA (2)		(34,096,264)	7/1/2039	N/A
Water hedge swap		50,000,000	7/1/2012	4.93	SIFMA (2)		(12,412,989)	7/1/2039	N/A
Water hedge swap		76,510,000	7/1/2011	4.87	SIFMA (2)		(16,121,327)	7/1/2029	N/A
Water 2003-D		148,185,000	7/2/2011	SIFMA (2)	4.06		(11,523,259)	7/1/2033	N/A
Water 2004-A		77,010,000	7/1/2005	SIFMA (2)	3.94		(1,838,511)	7/1/2025	N/A
Water 2004-B		147,670,000	7/1/2005	SIFMA (2)	3.85		(2,418,734)	7/1/2023	N/A
Total	$	1,075,020,000				$	(176,314,716)		

Associated financing issue	Notional amount (1)	Effective date	Rate paid	Rate received	Fair value	Swap termination date	Final maturity of bonds
Pay-floating interest rate swaps:							
Water 2006-B offsetting swap	$ 120,000,000	4/1/2009	SIFMA (2)	3.26%	$ (2,540,000)	7/1/2036	7/1/2036
Water 2001-C offsetting swap	112,445,000	5/14/2008	SIFMA (2)	3.50	8,449,532	7/1/2026	7/1/2026
Water 2005-B offsetting swap	193,200,000	5/6/2008	SIFMA (2)	3.65	10,804,365	7/1/2035	7/1/2035
Water hedge swap offsetting swap	76,510,000	7/1/2011	SIFMA (2)	4.00	8,269,156	7/1/2029	N/A
Total	$ 502,155,000				$ 24,983,053		

(1) Notional amount balance as of June 30, 2011.
(2) The Securities Industry and Financial Markets Association Municipal Swap Index™.
(3) Denotes the System's allocation of the associated notional amount.

(c) Credit Risk

Credit risk can be measured by actual market value exposure or theoretical exposure. When the fair value of any swap has a positive market value, then the Fund is exposed to the actual risk that the counterparty will not fulfill its obligations. As of June 30, 2011, the Fund had no net exposure to actual credit risk on its hedging derivatives or its investment derivatives (without regard to collateral or other security arrangements) for any of its counterparties. The table below shows the credit quality ratings of the counterparties to each swap. The Fund uses six different counterparties, as one 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 (S&P), and/or Moody's Investors Service (Moody's). Collateral on all swaps is to be in the form of cash or U.S. government securities held by a third-party custodian. The Fund has not calculated theoretical credit exposure.

Counterparty	S&P	Moody's
Citigroup Financial Products, Inc.:		
Guaranteed by Citigroup Global Markets Holdings, Inc.	A+	A3
JP Morgan Chase Bank, NA	AA-	Aa1
Loop Financial Products:		
Credit Support provided by Deutsche Bank AG	A+	Aa3
Morgan Stanley Capital Services, Inc.	A	A2
SBS Financial Products Company, LLC:		
Credit Support provided by Merrill Lynch Capital Services, Inc. and guaranteed by Merrill Lynch & Co.	A	A2
UBS, AG	A+	Aa3

(d) Interest Rate Risk

All hedging derivatives are pay-fixed, receive-variable, cash flow hedges, hedging a portion of the Fund's variable rate debt. The Fund believes it has significantly reduced interest rate risk attributable to the principal amount being hedged by entering into interest rate swaps.

There are thirteen investment derivatives in the portfolio. Four of the investment derivatives that are pay-fixed, receiving-floating swaps have offsetting receive-fixed, pay-floating swaps that serve to remove the interest rate risk of the change in the floating rate index. Five of the investment derivatives are pay-fixed, receive-floating swaps, and are subject to changing cash flows as the variable index changes; however, these five derivatives are not effective as of June 30, 2011.

(e) 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, 2011, the associated debt used the same index for all Consumer Price Index (CPI) referenced swaps, as well as the POCs (based on LIBOR) in the table above. As a result, there is no significant exposure to basis risk as of June 30, 2011.

(f) 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. The termination payment due to a counterparty may not be equal to the fair value. If any of the swaps were terminated, the associated variable rate financings would no longer carry synthetic interest rates.

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 SIFMA averages 7% or higher for a consecutive 180-day period. All special termination provisions are currently effective. The termination of any of the above-mentioned swaps requires simultaneous termination of the related mirror or original swap.

In light of 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' Pension Obligation Certificates. As of June 30, 2011, 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 Agreements' 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 include 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.

(g) 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 the GRS swaps should they be terminated prior to the maturity of the associated financings (POCs).

(h) Foreign Currency Risk

All derivatives are denominated in U.S. dollars, and therefore, the Fund is not exposed to foreign currency risk.

(i) Market Access Risk

The Fund is exposed to market access risk on swaps in the event it will not be able to enter credit markets or in the event the credit will become more costly.

(10) Employee Benefit Plan

Substantially all employees of the City, including employees of the Fund, 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.

(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. A copy of these financial statements can be obtained at the Coleman A. Young Municipal Center, 2 Woodward Ave., Rm. 908, Detroit, Michigan, 48226.

(b) Funding Policy and Annual Pension Cost (APC)

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 2009 actuarial valuation, the actuarial required contribution rate for the Fund was 19.63% of covered payroll for the year ended June 30, 2011. Contributions for the Fund were $12,030,953 for the year ended June 30, 2011.

Employees may also elect to contribute (a) 0%, (b) 3% of annual compensation up to the Social Security wage base and 5% of any excess over that, (c) 5%, or (d) 7% toward annuity savings. Contributions are voluntary for all union and nonunion employees. Contributions received from employees of the Fund were $2,632,136 during the year ended June 30, 2011.

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

(Continued)

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 APC and the change in net pension asset allocated to the Fund for the year ended June 30, 2011 are as follows:

Annual required contributions	$	10,775,433
Interest on net pension asset		(6,756,543)
Adjustment to annual required contribution		5,063,368
Annual pension cost		9,082,258
Contributions made (employer)		12,030,953
Change in net pension asset		2,948,695
Net pension asset, beginning of year		85,525,858
Net pension asset, end of year	$	88,474,553

The actuarial methods and significant assumptions used to determine the annual required contributions (ARCs) for the year ended June 30, 2011 were as follows:

Valuation date	June 30, 2009
Actuarial cost method	Entry age
Amortization method	Level percent
Remaining amortization period for unfunded accrued liabilities	30 years
Asset valuation method	5-year smoothed market
Actuarial assumptions:	
Investment rate of return	7.9%
Projected salary increases*	4.0% – 8.9%
Cost-of-living adjustments	2.25%

* Includes inflation rate of 4%.

(c) Three-Year Trend Information

	Fiscal year ended		APC	Percentage of APC contributed		Net pension asset
General Retirement System	June 30, 2011	$	9,082,258	132%	$	88,474,553
	June 30, 2010		3,064,858	225		85,525,858
	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, 2010, the most recent actuarial valuation date, the GRS plan was 87% funded. The actuarial accrued liability for benefits to all employees of the City participating in GRS was $3,719,586,762 and the actuarial value of assets was $3,238,130,553, resulting in an UAAL of $481,456,209. Of this amount, it was estimated that 12% is attributable to the Fund. The covered payroll (annual payroll of all employees of the City covered by the plan) was $334,343,506 and the ratio of the UAAL to covered payroll was 144%. The covered payroll for employees of the Fund was $49,898,124.

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, vision 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 employees of the Fund 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 employees of the Fund hired on after 1995 are age 55 and 30 years of creditable service, 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 employees of the Fund 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 employees of the Fund 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 healthcare 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 healthcare coverage for a new non-City retiree spouse. Dental and vision coverage are provided for the retiree and the spouse.

(Continued)

The City does provide healthcare coverage to employees of the Fund 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. The Fund pays up to 90% of healthcare coverage for the spouse as long as the spouse continues to receive a pension. The City does not pay for healthcare coverage for a new non-City retiree spouse. Dental and vision coverage are provided for the retiree and the spouse.

The City also provides healthcare coverage to employees of the Fund 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 NonDuty Related, and the Disability Retirement Benefits Duty and NonDuty Related. Complementary healthcare coverage is provided by the City for those fund retirees that are Medicare-Eligible. 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 employees of the Fund is based on the employees' basic annual earnings to the next higher thousand dollars. The life insurance benefit amounts range from $3,750 to $12,500.

The Supplemental Death Benefit Plan (Supplemental Plan) is a 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 benefit 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 thirty (30) years, ninety-three dollars ($93) will be added per year for each additional year of service.

There were 1,564 retirees eligible for benefits as of June 30, 2010, the date of the most recent actuarial valuation. These plans do not issue separate financial statements.

(b) Funding Policy

Employee Health and Life Insurance Benefit Plan – The cost of benefits for the Benefit Plan, which is financed on a pay-as-you-go basis for the year ended June 30, 2011, for the retirees of the Fund are as follows:

Benefits		City cost	Retiree cost	Total cost
Hospitalization	$	8,819,703	1,856,263	10,675,966
Dental		461,800	—	461,800
Vision		72,858	—	72,858
Life insurance		13,691	5,226	18,917
	$	9,368,052	1,861,489	11,229,541

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, 2011, for the retirees of the Fund are as follows:

Benefit		City cost	Retiree cost	Total cost
Supplemental Death Benefit Plan	$	12,164	1,464	13,628
Total	$	12,164	1,464	13,628

The City of Detroit Employee Benefit Trust paid death benefits in the amount of $96,654 for retirees of the Fund for the year ended June 30, 2011.

(c) Annual OPEB Costs and Net OPEB Obligation

The Fund's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the ARC, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. 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 thirty years.

The following table shows the components of the Fund's annual OPEB cost for the year ended June 30, 2011, the amount actually contributed to the plans, and changes in the Fund's OPEB obligation for the retirees of the Fund:

		Employee Health and Life Insurance Benefit Plan	Supplemental Death Benefit Plan	Total
ARC	$	21,739,184	88,900	21,828,084
Interest on net OPEB obligation		1,116,471	1,633	1,118,104
Adjustment to ARC		(930,393)	(1,089)	(931,482)
Annual OPEB cost		21,925,262	89,444	22,014,706
Contributions made		(9,368,052)	(12,164)	(9,380,216)
Changes in net OPEB obligation		12,557,210	77,280	12,634,490
Net OPEB obligation, beginning of year		27,911,776	32,660	27,944,436
Net OPEB obligation, end of year	$	40,468,986	109,940	40,578,926

The annual OPEB cost, the percentage of annual OPEB cost contributed to each plan, and the OPEB obligation for the three most recent fiscal years ended June 30 for the retirees of the Fund were as follows:

	Year ended	Annual OPEB cost	Actual contributions	Percentage of annual OPEB cost contributed	Net OPEB obligation
Employee Health and Life Insurance Benefit Plan	June 30, 2011	$ 21,925,262	$ 9,368,052	42.7%	$ 40,468,986
	June 30, 2010	19,304,818	8,004,677	41.5	27,911,776
	June 30, 2009	16,629,596	7,629,870	45.9	16,611,635
Supplemental Death Benefit Plan	June 30, 2011	$ 89,444	$ 12,164	13.6%	$ 109,940
	June 30, 2010	44,437	11,911	26.8	32,660
	June 30, 2009	11,258	13,385	118.9	134

(d) Funded Status and Funding Progress

Employee Health and Life Insurance Benefit Plan (Benefit Plan) – As of June 30, 2009, the most recent actuarial valuation date for the Benefit Plan, the actuarial accrued liability for benefits related to all employees of the City was $4,971,236,281, and the actuarial value of assets was zero, resulting in an UAAL of $4,971,236,281. The covered payroll (annual payroll of all active employees of the

City covered by the plan) was $591,242,616 and the ratio of the UAAL to the covered payroll was 841%. The funded status related to the retirees of the Fund was not available.

Supplemental Death Benefit Plan (Supplemental Plan) – As of June 30, 2010, the most recent actuarial valuation date for the Supplemental Plan, the actuarial accrued liability for benefits related to all employees of the City was $35,186,590 and the actuarial value of assets was $24,067,628, resulting in an UAAL of $11,118,962. The covered payroll (annual payroll of all active employees of the City covered by the plan) was $567,288,051 and the ratio of the UAAL to the covered payroll was 1.9%. 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 ARCs 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 ARCs for the year ended June 30, 2011 were as follows:

	Employee Health and Life Insurance Benefit Plan	**Supplemental Death Benefit Plan**
Valuation date	June 30, 2009	June 30, 2010
Actuarial cost method	Individual entry age	Individual entry age
Amortization method	Level percent	Level percent
Amortization period for unfunded actuarial accrued liabilities	30 years, open basis	30 years, open basis
Asset valuation method	N/A	4-year smoothed market
Actuarial assumptions:		
Investment rate of return	4.0%	5.0%
Projected salary increases*	4.0%	N/A
Healthcare cost trend rate	9.0% for 2010, grading down to 4.0% in 2019 and beyond	N/A

* Includes inflation rate of 4%.

In the June 30, 2010 actuarial valuation for the Supplemental Plan, the mortality tables used by the City's plan to evaluate death benefits to be paid for retirees of the Fund was 120% of the RP 2000 Combined Male and 120% of the RP 2000 Combined Female table setback 2 years. The City's plan used an annual rate of retirement of 50%, initially, reduced to an ultimate rate of 20% after age 70 for General City.

(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,” respectively, on the statement of fund net assets, will be settled within one year, and are summarized as follows as of June 30, 2011:

Due from other funds (unrestricted):		
General Fund	$	5,492,080
Other governmental funds		2,091,660
General Retirement System Service Corporation		33,907
Sewage Disposal Fund		59,072,451
Total due from other funds	$	66,690,098
Due from other funds (restricted):		
Sewage Disposal Fund	$	4,045,774
Due to other funds (unrestricted):		
General Fund	$	6,771,616
Other governmental funds		229,197
Other enterprise funds		11,788
Fiduciary funds		8,549,055
Sewage Disposal Fund		15,780,095
Total due to other funds	$	31,341,751
Due to other funds (restricted):		
Sewage Disposal Fund	$	13,411,537

(13) Capital Improvement Program

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 $723 million through fiscal year 2016. 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, 2011 was approximately $47 million.

(14) Contingencies

The City is subject to various governmental environmental laws and regulations. GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, established 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 cleanups. 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 determined that there was no estimated pollution remediation obligation to be recorded at June 30, 2011.

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 basic 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 fully 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 Fund's outstanding tax-exempt obligations. The City settled selected bond issues with the Internal Revenue Service (IRS) in August 2010 and September 2011 and is currently engaged in discussions with the IRS to settle the remaining bond issues. The potential impact to the Fund is undeterminable at this time.

(16) Subsequent Events

(a) Legal Matters

On November 4, 2011, the U.S. District Court (the Court) issued an order that will modify several aspects of the Fund's management processes. The order incorporated recommendations of a committee established by the Court to identify and implement strategies to ensure sustainable environmental compliance of the Fund. The principal recommendations of the Root Cause Committee report, and the provisions of the November 4, 2011 order are designed to produce more autonomous operations of the Fund and include:

- The Fund will continue to remain an enterprise Fund of the City, and all assets of the water and wastewater systems will remain property of the City;
- The Fund's labor relations will no longer be governed by the Collective Bargaining Agreements (CBA) that are applicable to all other City funds. It is envisioned that separate agreements and provisions will be established that are specific to the Fund's needs. The order strikes and enjoins all other provisions that are deemed to threaten compliance;
- The Fund will be exempted from the City's procurement ordinance and will establish procurement policies that will facilitate efficiency and long-term compliance;

- The Fund will establish and distinct (from the City) resources for provision of the finance, procurement, law, human resource, and information technology services that are currently being provided by the City;
- Rates for suburban customers will no longer be subject to approval by the Detroit City Council;
- Future Directors will continue to be appointed by the Mayor, but will be engaged with advice from a search committee that includes representation from a suburban board member and the Detroit City Council. Removal of future Directors will require a super majority of either the board or the City Council.

The stated intent of the order and the Plan of Action was to institute policies and procedures that provide management of the Fund with more flexibility for achieving environmental compliance. While the Fund has successfully utilized existing policies to meet its obligations for the System, the Root Cause Committee concluded that these policies were not well designed for the unique challenges of managing a large, regional municipal utility serving a significant population outside its jurisdictional limits. The new human resources and procurement policies resulting from the order are designed and intended to enhance the implementation of the Fund's ability to implement its strategic planning initiatives. The Court also directed other implementation steps, and set forth a revised time frame upon which the Fund may file a motion seeking to dismiss the case.

(b) Sale of Bonds

On December 22, 2011, the Fund issued $500,675,000 in bonds that comprised: (1) Water Supply System Revenue Senior Lien Bonds, Series 2011-A of $379,590,000, (2) Water Supply System Revenue Senior Lien Bonds, Series 2011-B (Federally Taxable) of $17,195,000 and, (3) Water Supply System Revenue Refunding Senior Lien Bonds, Series 2011-C of $103,890,000. The bonds begin to mature July 1, 2012 and will be fully mature in the year 2041.

The proceeds of the bonds will be used to finance a portion of the costs of the Water Supply System capital improvement program, to terminate all outstanding swaps, and to refund Water Supply System Senior Lien Bonds, Series 1997-A, Series 2003-A, and Series 2006-A, and Water Supply System Second Lien Bonds, Series 1995-A, and Series 2003-B. The total fair value termination amount on the swaps on the date of issuance was negative $221,921,429 compared to negative $151,161,261 at June 30, 2011.