

The Metropolitan Sewer District of Greater Cincinnati

Basic Financial Statements



**For the Years Ended
December 31, 2012 and 2011**

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Metropolitan Sewer District of Greater Cincinnati, (MSD) an enterprise fund of the County of Hamilton, Ohio, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the MSD's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the MSD, as of December 31, 2012, and the respective changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements for the MSD present only the financial position of MSD, an enterprise fund of the County of Hamilton, Ohio; and are not intended to present fairly the financial position of Hamilton County, Ohio, and the changes in financial position and cash flows of its proprietary fund types in conformity with generally accepted accounting principles.

As described in Note 13 to the financial statements, in 2012, the MSD adopted new accounting guidance, GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* and GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 – 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 14, 2013, on our consideration of the MSD's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the MSD's internal control over financial reporting and compliance.

Plattenburg & Associates, Inc.

Cincinnati, Ohio
June 14, 2013

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

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of two components: 1) the financial statements and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

Required Financial Statements

The financial statements of the District report information about the District using accounting methods similar to those used by private-sector companies. These statements provide both long-term and short-term information about the District's overall financial status.

The Statement of Net Position presents information on all of the District's assets and liabilities, with the difference between the two reported as net position. This statement provides information about the nature and the amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It provides one way to measure the financial health of the District by providing the basis for evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. However, there are several outside nonfinancial factors that need to be considered. Factors such as changing economic conditions, population and customer growth, and new or changed rules and regulations.

All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position. This statement measures the results of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its cost through its user fees.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. This statement provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Financial Analysis of the District

As previously noted, net position may serve overtime as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by \$799,422,000 at the close of the most recent fiscal year. As can be seen in Table A, on the next page, 62% of the District's net position reflect its investment in capital assets (e.g., buildings and structures, processing systems, and office and service equipment), less any related debt used to acquire those assets that is still outstanding. These capital assets are used primarily in the collection and treatment of wastewater throughout the District's service area. The related debt will be repaid with resources provided by system users through rates and fees.

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

Table A
Condensed Summary of Net Position
(In Thousands)

	2012	Percentage Increase (Decrease) over 2011	2011	Percentage Increase (Decrease) over 2010	2010
Current and other assets	\$ 457,197	1.7%	\$ 449,334	-7.7%	\$ 486,942
Capital assets, net	<u>1,371,640</u>	7.6%	<u>1,274,620</u>	9.2%	<u>1,167,641</u>
Total assets	<u>\$ 1,828,837</u>	6.1%	<u>\$ 1,723,954</u>	4.2%	<u>\$ 1,654,583</u>
Noncurrent liabilities	\$ 958,124	3.4%	\$ 926,245	0.8%	\$ 918,828
Current liabilities	<u>71,291</u>	0.2%	<u>71,170</u>	15.5%	<u>61,642</u>
Total liabilities	<u>\$ 1,029,415</u>	3.2%	<u>\$ 997,415</u>	1.7%	<u>\$ 980,470</u>
Net Investment in capital assets	\$ 495,513	12.9%	\$ 438,780	32.7%	\$ 330,623
Restricted	7,994	-0.2%	8,008	-4.8%	8,408
Unrestricted	<u>295,915</u>	5.8%	<u>279,751</u>	-16.5%	<u>335,082</u>
Total net position	<u>\$ 799,422</u>	10.0%	<u>\$ 726,539</u>	7.8%	<u>\$ 674,113</u>

Net position increased \$72.9 million in 2012 and \$52.4 million in 2011. The increases are a combination of income before contributions and contributions in the form of connection fees, assessments, and developer contributions.

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

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

	2012	Percentage Increase (Decrease) over 2011	2011	Percentage Increase (Decrease) over 2010	2010
Operating revenues	\$ 249,156	4.1%	\$ 239,425	8.2%	\$ 221,287
Nonoperating revenues	8,741	77.6%	4,922	-25.5%	6,605
Total revenues	<u>257,897</u>	5.5%	<u>244,347</u>	7.2%	<u>227,892</u>
Depreciation and amortization expense	54,823	11.4%	49,222	10.2%	44,674
Other operating expenses	101,418	-9.3%	111,823	-7.1%	120,368
Nonoperating expenses	35,067	2.5%	34,212	14.4%	29,905
Total expenses	<u>191,308</u>	-2.0%	<u>195,257</u>	0.2%	<u>194,947</u>
Income from operations	66,589	35.6%	49,090	49.0%	32,945
Capital contributions	<u>6,294</u>	88.7%	<u>3,336</u>	-17.2%	<u>4,027</u>
Change in net position	72,883	39.0%	52,426	41.8%	36,972
Total net position, beginning	<u>726,539</u>	7.8%	<u>674,113</u>	5.8%	<u>637,141</u>
Total net position, ending	<u>\$ 799,422</u>	10.0%	<u>\$ 726,539</u>	7.8%	<u>\$ 674,113</u>

While the Summary of Net Position (Table A) shows the change in financial position of the District's net position, the Summary of Revenues, Expenses, and Changes in Net Position provides details as to the nature and source of these changes. Table B shows that during 2012 total revenues increased 5.5 percent or \$13.6 million and expenses decreased 2.0 percent or \$3.9 million. During 2011 total revenues increased 7.2 percent or \$16.5 million and expenses increased 0.2 percent or \$0.3 million. The major factors which contributed to these results include:

- Operating revenues reflect an 8 percent rate increase implemented January 9, 2012 and an 8 percent rate increase implemented January 9, 2011.
- Nonoperating revenues increased in 2012 related to the change in interest income and decreased in 2011 related to the change in fair value of investments.
- Operating expenses decreased 9.3 percent or \$10.4 million in 2012 primarily because the increase in accrued pension liability for 2012 was significantly lower than the increase for 2011. A significant increase in health care costs in 2012 was more than offset by this decrease related to the pension accrual. Operating expenses decreased 7.1 percent or \$8.5 million in 2011 primarily because the increase in accrued pension liability for 2011 was significantly lower than the increase for 2010. A significant increase in health care costs in 2011 was more than offset by this decrease related to the pension accrual.

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

- Depreciation expense increased 11.4 percent or \$5.6 million in 2012 and 10.2 percent or \$4.5 million in 2011 due to a significant number of large dollar capital assets being placed in service during each of these years.
- Nonoperating expense for 2012 increased 2.5 percent or \$0.8 million due mainly to the change in fair value of investments.
- Capital contributions will fluctuate depending on building activity and assessment projects completed.

BUDGETARY HIGHLIGHTS

The District has an annual operating budget that is approved by the Hamilton County Board of County Commissioners. Capital budgets are approved on a project basis, however; annually a current year and a five year plan is presented to the Board. The 2012 operating expenses and certifications were 4.1 percent under the approved budget. The principal areas of savings in 2012 were reduced debt service due to savings from the increased use of low interest loans made available from the state. The 2011 operating expenses and certifications were 4.4 percent under the approved budget. The principal areas of savings in 2011 were reduced personnel costs and reduced debt service due to savings from the increased use of low interest loans made available from the state.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of December 31, the District's investment in capital assets (net of accumulated depreciation) amounted to \$1,372 million and \$1,275 million as shown in Table C for 2012 and 2011, respectively. In 2012, the District spent about \$152 million on capital improvement projects and equipment replacement and received about \$6.3 million in capital contributions. In 2011, the District spent about \$147 million on capital improvement projects and equipment replacement and received about \$3.3 million in capital contributions.

Sewer replacement and improvement projects were about three-fourths of the program in 2012 and in 2011. Additional information on the District's capital assets can be found in Note 5 to the financial statements.

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

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

	2012	Percentage Increase (Decrease) over 2011	2011	Percentage Increase (Decrease) over 2010	2010
Land	\$ 6,364	27.9%	\$ 4,977	0.0%	\$ 4,977
Construction in progress	320,353	3.2%	310,358	-6.7%	266,674
Buildings and structures	1,294,889	8.2%	1,196,753	16.6%	1,115,330
Processing systems	417,342	8.4%	384,890	2.7%	361,254
Office and service equipment	51,239	2.6%	49,920	11.5%	49,002
Subtotal	2,090,187	7.4%	1,946,898	9.4%	1,797,237
Less accumulated depreciation	718,547	6.9%	672,278	6.6%	629,596
Net capital assets	<u>\$ 1,371,640</u>	7.6%	<u>\$ 1,274,620</u>	11.0%	<u>\$ 1,167,641</u>

Debt Administration

The District finances its construction program primarily through the issuance of revenue bonds. In addition, the District will utilize low interest loan programs through the State of Ohio where appropriate.

The District's revenue bond ratings are:

Moody's Investors Services	Aa2
Standard & Poor's Corporation	AA+

Additional information on the District's long-term debt can be found in Note 6 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The service area of the District is best described as mature. The District is not in a growth situation but one in which the system, generally, is being upgraded and replaced to comply with increasing regulatory requirements. The operating budget for 2013 is \$214,761,270 which is \$31.4 million more than the 2012 budget. The increase of the 2013 operating budget reflects a nearly 22% increase in the operations portion (debt service not included) of the budget compared to 2012. A rate increase of 5 percent was approved effective January 9, 2013.

The capital plan was submitted and accepted for the years 2013 through 2017. The plan contemplates issuing an average of about \$200 million in debt each year to finance the capital improvement program. Each project must be individually approved before proceeding.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENT OF NET POSITION
December 31, 2012 and 2011
(all amounts expressed in thousands)

	2012	2011
ASSETS		
Current assets:		
Cash, cash equivalents and pooled investments held by the City of Cincinnati (Note 2)	\$17,306	\$19,118
Accounts receivable (Note 3)	44,833	38,493
Prepaid expenses and other	1,352	710
Total current assets	63,491	58,321
Noncurrent assets:		
Restricted assets:		
Cash, cash equivalents, and pooled investments held by the City of Cincinnati:		
Construction account (Note 2)	71,026	40,200
Amount to be transferred to surplus account (Note 2)	73,070	62,180
Held by trustee: (Note 4)		
Cash and cash equivalents (Note 2)	127	132,809
Investments - Held to maturity (Note 2)	242,213	148,052
Total restricted assets	386,436	383,241
Other assets:		
Unamortized financing costs	7,012	7,409
Other	258	363
Total other assets	7,270	7,772
Capital assets: (Note 5)		
Land	6,364	4,977
Buildings and structures	1,294,889	1,196,753
Processing systems	417,342	384,890
Office and service equipment	51,239	49,920
Construction in progress	320,353	310,358
Total capital assets	2,090,187	1,946,898
Less:		
Accumulated depreciation	(718,547)	(672,278)
Net capital assets	1,371,640	1,274,620
Total noncurrent assets	1,765,346	1,665,633
Total assets	\$1,828,837	\$1,723,954

The notes to the financial statements are an integral part of the financial statements

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENT OF NET POSITION
December 31, 2012 and 2011
(all amounts expressed in thousands)

	2012	2011
LIABILITIES		
Current liabilities:		
Payable from current assets:		
Current portion of long-term debt (Note 6)	\$47,935	\$41,749
Current portion of compensated absences (Note 8)	3,796	3,701
Accounts payable	3,465	5,590
Accrued payroll expenses	1,256	2,816
Total current liabilities payable from current assets	56,452	53,856
Payable from restricted assets:		
Construction accounts payable	11,759	14,100
Accrued interest payable	3,080	3,214
Total current liabilities payable from restricted assets	14,839	17,314
Total current liabilities	71,291	71,170
Noncurrent liabilities:		
Accrued compensated absences (Note 8)	5,384	5,250
Long-term debt (Note 6)	908,542	879,381
Net Pension Obligation	32,463	29,417
Net Other Post Employment Benefit Obligation	11,735	12,197
Total noncurrent liabilities	958,124	926,245
Total liabilities	1,029,415	997,415
Net position:		
Net Investment in capital assets	495,513	438,780
Restricted	7,994	8,008
Unrestricted	295,915	279,751
Total net position	\$799,422	\$726,539

The notes to the financial statements are an integral part of the financial statements

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
December 31, 2012 and 2011
(all amounts expressed in thousands)

	2012	2011
REVENUES		
Operating revenues:		
Sewerage service charges	\$224,160	\$213,435
Sewer surcharges	21,454	21,470
All other revenues	3,542	4,520
Total operating revenues	249,156	239,425
EXPENSES		
Operating expenses:		
Personnel services	47,704	54,758
Purchased services	25,428	24,367
Utilities, fuel and supplies	19,481	22,181
Depreciation and amortization	54,823	49,222
Other expenses	8,805	10,517
Total operating expenses	156,241	161,045
Operating income	92,915	78,380
NONOPERATING		
Nonoperating revenues (expenses):		
Interest income	8,560	2,484
Change in fair value of investments	(905)	2,221
Interest expense	(34,162)	(34,212)
Retirement of capital assets	181	217
Total nonoperating revenues	(26,326)	(29,290)
Income from operations	66,589	49,090
Capital contributions	6,294	3,336
Change in net position	72,883	52,426
Total net position, beginning	726,539	674,113
Total net position, ending	\$799,422	\$726,539

The notes to the financial statements are an integral part of the financial statements

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
STATEMENT OF CASH FLOWS
For the years ended December 31, 2012 and 2011
(all amounts expressed in thousands)

	2012	2011
Cash Flows from Operating Activities:		
Cash received from customers	\$239,921	\$235,384
Cash payments for goods and services	(51,852)	(53,240)
Cash payments for personnel costs	(46,395)	(47,051)
Other operating revenues	3,069	4,334
Net Cash Provided by Operating Activities	144,743	139,427
Cash Flows from Capital and Related Financing Activities:		
Principal and interest payments on long-term debt	(80,597)	(77,652)
Acquisition and construction of capital assets	(116,825)	(119,759)
Loan proceeds	48,428	16,034
Transfer into construction account from trustee investment account	102,180	100,000
Transfer from operating cash account to trustee investment account	(62,180)	(36,835)
Tap-in fees	2,618	2,105
Gain/loss from sale of property, plant and equipment	181	247
Net Cash (Used) by Capital and Related Financing Activities	(106,195)	(115,860)
Cash Flows from Investing Activities:		
Purchase of government securities	(132,682)	38,453
Net increase in fair value of pooled cash and investments held by City of Cincinnati	(78)	430
Interest earned on investments	1,434	4,716
Net Cash Provided (Used) by Investing Activities	(131,326)	43,599
Net Increase (Decrease) in Cash and Cash Equivalents	(92,778)	67,166
Cash and Cash Equivalents at January 1	254,307	187,141
Cash and Cash Equivalents at December 31	\$161,529	\$254,307
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Income from operations	92,915	78,380
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	54,823	49,222
Changes in assets and liabilities:		
Net change in customer accounts receivable	(2,655)	293
Net change in other assets	(642)	2,000
Net change in operating accounts payable	(2,125)	1,825
Net change in accrued payroll and related expenses	(1,331)	(108)
Net Pension Obligation	3,045	4,460
Net Other Post Employment Benefit Obligation	(461)	3,355
Construction in Progress Reconciliation	1,174	0
Net Cash Provided by Operating Activities	\$144,743	\$139,427
Non-cash Transactions:		
Structures donated as contributed capital in aid of construction	\$2,363	\$847
Acquisition and construction of capital assets paid directly by WPCLF loan proceeds	30,720	28,879
Construction accounts payable related to acquisition of capital assets	11,759	14,100

The notes to the financial statements are an integral part of the financial statements

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
NOTES TO THE FINANCIAL STATEMENTS
for the years ended December 31, 2012 and 2011

NOTE 1 - ACCOUNTING POLICIES

A summary of the significant accounting policies applied in the accompanying financial statements follows:

Organization

The Metropolitan Sewer District of Greater Cincinnati (MSD), an enterprise fund of the County of Hamilton, Ohio, collects and treats industrial and residential wastewater for municipalities and unincorporated areas of Hamilton County. MSD was formed on April 10, 1968, pursuant to resolutions of the Board of County Commissioners of Hamilton County and Ordinances of the City of Cincinnati, providing for a consolidation of the City Sewer Department and the County Sewer District. Under a contract with the City of Cincinnati, the Board designated the City as its agent for the maintenance and operation of MSD. The annual budget, prepared on a non-GAAP budgetary basis of accounting, is approved by the Board and administered by the City. Budgetary control is exercised at the divisional level, and between personnel and all other costs. The County issues a separate Comprehensive Annual Financial Report which includes MSD as a separate enterprise fund of the County.

Basis of Accounting

The accompanying financial statements were prepared on the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Statement of Cash Flows

For purposes of the Statements of Cash Flows, all highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents. Pooled cash and investments held by the City of Cincinnati are considered cash equivalents by MSD.

Investments

MSD is required by Ohio law to invest in only United States obligations; federal agency securities; Ohio bonds and other obligations or such obligations of political subdivisions of the state, provided that the subdivisions are located within Hamilton County; time certificates of deposit or deposit accounts in an eligible institution; and no load money market mutual funds consisting only of investments mentioned above. Investments are required to mature within five years from the date of settlement, unless the investment is matched to a specific obligation or debt of MSD.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
NOTES TO THE FINANCIAL STATEMENTS
for the years ended December 31, 2012 and 2011

Investment securities are stated at fair value, which is based on the quoted market prices or current share prices.

Prepays

Payments made for services that will benefit periods beyond December 31, 2012, are recorded as prepaids using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expense is reported in the year in which services are consumed.

Inventory

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

Capital Assets

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

Capital assets are stated at historical cost for assets acquired after MSD's inception in 1968. Assets which were acquired prior to 1968 and not identifiable with specific historical costs are not included in the capital assets balance. Assets acquired by MSD through contributions, such as contributions from land developers and federal and state grants, are capitalized and recorded in the plant records at the contributors' reported cost. Construction costs include interest capitalized on debt during the period of construction and the cost of in-force labor. See note 5 for more information on capital assets.

Land acquired for MSD's use is titled to either the City of Cincinnati or Hamilton County. The cost of this land has been recorded on the books of MSD since it has the full benefit of the land as an economical resource.

Depreciation expense is computed on the straight-line method over the estimated useful lives of the respective assets. The estimated lives are as follows:

Building and structures	40 years
Processing systems	25 years
Office and service equipment	5-15 years

Any gain or loss arising from the disposal of capital assets has been credited or charged to income.

Unamortized Financing Costs

The unamortized financing costs include insurance, consulting and attorney fees incurred in connection with the revenue bond obligations. These amounts are being amortized on the straight-line method over the lives of the revenue bonds. Bond premiums and discounts are being amortized on the interest method over the lives of the revenue bonds.

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
NOTES TO THE FINANCIAL STATEMENTS
for the years ended December 31, 2012 and 2011

Pension Plans

Employees participate in either the City of Cincinnati's Retirement System or the Public Employees Retirement System administered by the State of Ohio. Pension costs reflect a percentage of employees' gross pay, as defined by the terms of pension plans in which employees participate. While MSD's policy is to fund pension costs accrued, this did not occur in 2011 or 2012. See Note 9.

Compensated Absences

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

Net Position

Net positions are the difference between assets and liabilities. Net investment in capital assets are capital assets less accumulated depreciation and any outstanding long-term debt related to the acquisition, construction or improvement of those assets. Net positions are reported as restricted when there are legal limitations that are imposed on their use by county legislation or external restrictions by other governments, creditors or grantors. Restricted net positions of the MSD relate to debt service.

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

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary fund. For the District, these revenues are charges for services for wastewater treatment. Operating expenses are necessary costs incurred to provide the service that is the primary activity of the fund.

Contributions of Capital

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

THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI
NOTES TO THE FINANCIAL STATEMENTS
for the years ended December 31, 2012 and 2011

NOTE 2 - DEPOSITS AND INVESTMENTS

Deposits

State statutes classify monies held by the District into three categories.

Active deposits are public deposits necessary to meet current demands on the treasury. Such monies must be maintained either as cash in the District's Treasury, in commercial accounts payable or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts, or in money market deposit accounts.

Inactive deposits are public deposits that the District has identified as not required for use within the current two year period of designation of depositories. Inactive deposits must either be evidenced by certificates of deposit maturing not later than the end of the current period of designation of depositories, or by savings or deposit accounts including, but not limited to, passbook accounts.

Interim deposits are deposits of interim monies. Interim monies are those monies which are not needed for immediate use but which will be needed before the end of the current period of designation of depositories. Interim deposits must be evidenced by time certificates of deposit maturing not more than one year from the date of deposit or by savings or deposit accounts including passbook accounts.

Protection of the District's deposits is provided by the Federal Deposit Insurance Corporation (FDIC), by eligible securities pledged by financial institution as security for repayment, by surety company bonds deposited with the finance director by the financial institution or by a single collateral pool established by the financial institution to secure the repayment of all public monies deposited with the institution.

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The District's policy for deposits is collateral is required for demand deposits and certificates of deposit at 105 percent of all deposits not covered by federal deposit insurance. Obligations that may be pledged as collateral are obligations of the United States and its agencies and obligations of the State and its municipalities, school districts, and district corporations. Obligations pledged to secure deposits must be delivered to a bank other than the institution in which the deposit is made. Written custodial agreements are required. The District is required to categorize deposits and investments according to GASB Statement No. 3 *Deposits with Financial Institutions, Investments, and Reverse Purchase Agreements*. The carrying value of the District's deposits was \$161,401,000 and \$121,498,000 at December 31, 2012 and 2011, respectively.

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Amounts held by the City of Cincinnati are invested on MSD's behalf in accordance with the Cincinnati Municipal Code. Amounts held by the City are collateralized as part of the City's cash and investment balances. For GASB 40 disclosure requirements, refer to the financial statements as of December 31, 2012 for the City of Cincinnati.

Although the pledging bank has an investment and securities pool used to collateralize all public deposits, which held in the financial institution's name, noncompliance with federal requirements could potentially subject the District to a successful claim by the FDIC. The deposits not covered by federal depository insurance are considered uninsured and uncollateralized and subject to custodial credit risk.

Investments

State Statute, board of county commissioners resolutions, and the 1985 Trust Indenture as amended authorize the District to invest in obligations of U. S. Treasury, agencies and instrumentalities, certificates of deposit, repurchase agreements, money market deposit accounts, municipal depository funds, super NOW accounts, sweep accounts, separate trading of registered interest and principal of securities, mutual funds, bonds and other obligations of this State, and the State Treasurer's investment pool. Repurchase agreements are limited to 30 days and the market value of the securities must exceed the principal value of the agreement by at least 2 percent and be marked to market daily. Investments in stripped principal or interest obligations reverse repurchase agreements and derivatives are prohibited. The issuance of taxable notes for the purpose of arbitrage, the use of leverage and short selling are also prohibited. An investment must mature within five years from the date of purchase unless matched to a specific obligation or debt of the District, and must be purchased with the expectation that it will be held to maturity. Investments may only be made through specified dealers and institutions. Payment for investments may be made only upon delivery of the securities representing the investments to the finance director or, if the securities are not represented by a certificate, upon receipt of confirmation of transfer from the custodian. The District has no investment policy that addresses interest rate risk.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Federal National Mortgage Association Notes, Federal Home Loan Mortgage Corporation Notes, and the Federal Home Loan Bank Notes are exposed to custodial credit risk in that they are uninsured, unregistered, and held by the counterparty's trust department or agent but not in the District's name. The District has no investment policy dealing with investment custodial risk beyond the requirement in state statute that prohibits payment for investments prior to the delivery of the securities representing such investments to the Treasurer or qualified trustee.

Funds held by the trustee are eligible investments as defined by the Trust Agreement and are in the name of the trustee for the benefit of MSD.

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Investments made by MSD are summarized below. Trustee account investments are categorized according to credit risk into the following categories: (1) insured or registered, or securities held by MSD's or its agent (bank trust department) in the MSD's name; or (2) uninsured and unregistered, with securities held by the counterparty's trust department or agent in the MSD's name; or (3) uninsured, unregistered securities held by the counterparty, or its trust department or agent but not in MSD's name. Money market funds are unclassified investments since they are not evidenced by securities that exist in physical or book entry form. As stated in GASB Statement No. 40, obligations of the U. S. government or obligations explicitly guaranteed by the U. S. government are not considered to have credit risk and do not require disclosure of credit quality.

The money market funds are invested in a treasury obligation fund with a Moody's credit rating of Aaa.

Concentration of Credit Risk: The Metropolitan Sewer District uses the City of Cincinnati's Investment Policy which addresses concentration of credit risk by requiring investments to be diversified to reduce risk of loss resulting from over concentration of assets in a specific issue or class of security. The following table includes the percentage of each investment type held by MSD at December 31, 2012.

<u>Investment Type</u>	<u>Fair Value</u>	<u>% of Total</u>
Investments held by the City of Cincinnati	\$ 161,401	39.98
U. S. Government Security	242,213	59.99
Money Market Funds	127	0.03
	<u>\$ 403,741</u>	<u>100.00</u>

The classification of cash and cash equivalents and investments on the financial statements is based on criteria set forth in GASB Statement No. 9. A reconciliation between the classifications of cash and investments on the financial statements and the classification per GASB Statement No. 3 is as follows:

(all amounts in thousands)

<u>December 31, 2012</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 161,528	\$ 242,213
Money Market Funds	(127)	127
Total	<u>\$ 161,401</u>	<u>\$ 242,340</u>

(all amounts in thousands)

<u>December 31, 2011</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 254,307	\$ 148,052
Money Market Funds	(132,809)	132,809
Total	<u>\$ 121,498</u>	<u>\$ 280,861</u>

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NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

	(all amounts in thousands)	
	<u>2012</u>	<u>2011</u>
Sewer charges and surcharges:		
Unbilled amount	\$ 22,566	\$ 19,978
Billed amount	25,613	25,191
Less allowance for doubtful accounts	(8,500)	(8,500)
Other	5,154	1,824
Total	<u>\$ 44,833</u>	<u>\$ 38,493</u>

NOTE 4 - RESTRICTED ASSETS

The Trust Agreement for the Series A Revenue Bonds (see Long-Term Debt Note) requires the establishment of certain trust accounts including a Bond Account, Bond Reserve Account, Replacement and Improvement Account, and a Surplus Account to be held by the Trustee. The Bond Account will be used to accumulate periodic principal and interest payments. The Bond Reserve Account will be funded in an amount equal to the highest annual future debt service requirement. The Replacement and Improvement Account is to be maintained with a balance of \$5,000,000. The Surplus Account is available to be used for any other Sewer System purpose. The Trust Agreement also requires the creation of a Construction Account to be held by the City to pay for project costs. At December 31, 2012 and 2011 the following balances (at fair value) were maintained in the trust accounts:

	(all amounts in thousands)	
	<u>2012</u>	<u>2011</u>
Held by trustee:		
Reserve	\$ 74,701	\$ 79,674
Replacement and improvement	5,649	5,616
Bond retirement	7,994	8,008
Surplus	153,996	187,563
Total	<u>\$ 242,340</u>	<u>\$ 280,861</u>

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NOTE 5 - CAPITAL ASSETS

The following summarizes the changes in capital assets during 2012:

(all amounts in thousands)

December 31, 2012	Beginning Balance	Increase	Decrease	Ending Balance
Capital Assets, not being depreciated:				
Land	\$4,977	\$ 1,387	\$ -	\$6,364
Construction in progress	<u>310,358</u>	<u>156,012</u>	<u>(146,017)</u>	<u>320,353</u>
	315,335	157,399	(146,017)	326,717
Capital Assets, being depreciated:				
Buildings and structures	1,196,753	98,136	-	1,294,889
Processing systems	384,890	39,609	(7,157)	417,342
Office and service equipment	<u>49,920</u>	<u>2,325</u>	<u>(1,006)</u>	<u>51,239</u>
	1,631,563	140,070	(8,163)	1,763,470
Total Capital Assets	1,946,898	297,469	(154,180)	2,090,187
Less accumulated depreciation:				
Buildings and structures	427,231	29,483	-	456,714
Processing systems	205,707	14,331	-	220,038
Office and service equipment	<u>39,340</u>	<u>3,454</u>	<u>(999)</u>	<u>41,795</u>
Total Accumulated Depreciation	<u>672,278</u>	<u>47,268</u>	<u>(999)</u>	<u>718,547</u>
Net Capital Assets	<u>\$ 1,274,620</u>	<u>\$ 250,201</u>	<u>\$ (153,181)</u>	<u>\$ 1,371,640</u>

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The following summarizes the changes in capital assets during 2011:

(all amounts in thousands)

December 31, 2011	Beginning Balance	Increase	Decrease	Ending Balance
Capital Assets, not being depreciated:				
Land	\$4,977	\$ -	\$ -	\$4,977
Construction in progress	266,674	151,655	(107,971)	310,358
	271,651	151,655	(107,971)	315,335
Capital Assets, being depreciated:				
Buildings and structures	1,115,330	81,423	-	1,196,753
Processing systems	361,254	28,381	(4,745)	384,890
Office and service equipment	49,002	2,316	(1,398)	49,920
	1,525,586	112,120	(6,143)	1,631,563
Total Capital Assets	1,797,237	263,775	(114,114)	1,946,898
Less accumulated depreciation:				
Buildings and structures	399,967	27,264	-	427,231
Processing systems	192,450	13,257	-	205,707
Office and service equipment	37,179	3,560	(1,399)	39,340
Total Accumulated Depreciation	629,596	44,081	(1,399)	672,278
Net Capital Assets	\$ 1,167,641	\$ 219,694	\$ (112,715)	\$ 1,274,620

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NOTE 6 - LONG-TERM DEBT

Long-term debt consisted of the following:

(all amounts in thousands except percents)					
	Principal Issue	Interest Rate %	Year of Maturity	2012	2011
Revenue Bonds					
2010 (a)	\$ 130,675	2.00-5.37	2035	\$ 125,860	\$ 129,135
2009 (b)	149,815	4.00-6.50	2034	149,815	149,815
2007 (c)	72,385	3.50-5.25	2032	63,355	65,305
2006 (d)	83,045	4.00-5.00	2031	70,740	73,030
2005 (e)	170,560	2.50-5.00	2030	144,330	146,890
2004 (f)	46,385	2.00-5.00	2017	31,250	37,415
2003 (g)	215,575	1.50-5.25	2028	132,980	151,565
2001 (h)	76,000	2.30-5.25	2026	-	425
				<u>718,330</u>	<u>753,580</u>
Ohio Water Development Authority Contracts	41,830	2.00-7.49	2016	136	267
Ohio Water and Sewer Rotary Commission	-	-	-	50	50
Ohio Public Works Commission	-	0.00-3.00	2041	2,328	2,639
Water Pollution Control Loan Fund	-	2.50-3.50	2037	201,526	128,590
Capital Lease Payable	15,000	2.00-5.00	2029	<u>13,325</u>	<u>13,900</u>
Total obligations				935,695	899,026
Bond premiums				23,801	26,775
Deferred loss on defeasance				(3,019)	(4,671)
Current maturities				<u>(47,935)</u>	<u>(41,749)</u>
Long-term portion				<u>\$ 908,542</u>	<u>\$ 879,381</u>

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Principal and interest payments on long-term debt for the next five years and thereafter are as follows:

(all amounts in thousands)

Year	Revenue Bonds		WPCLF*		OPWC		Capital Lease	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2013	\$ 36,645	\$ 36,956	\$ 10,383	\$ 6,529	\$ 317	\$ 40	\$ 590	\$ 525
2014	38,325	35,225	12,301	6,935	324	34	600	512
2015	40,260	33,401	17,033	7,403	330	27	620	495
2016	42,060	31,470	16,886	6,833	248	21	635	480
2017	44,135	29,482	16,848	6,330	252	17	650	462
2018-2022	149,840	123,075	70,235	24,210	615	32	3,630	1,940
2023-2027	181,385	81,950	64,300	14,109	96	1	4,515	1,054
2028-2032	145,000	34,734	54,865	4,707	52	-	2,085	142
2033-2037	40,680	4,173	2,572	107	52	-	-	-
2038-2041	-	-	-	-	42	-	-	-
	<u>\$ 718,330</u>	<u>\$ 410,466</u>	<u>\$ 265,423</u>	<u>\$ 77,163</u>	<u>\$ 2,328</u>	<u>\$ 172</u>	<u>\$ 13,325</u>	<u>\$ 5,610</u>

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

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

December 31, 2012	Beginning Balance	Amortized	Refunded	Issued	Ending Balance
Bond premium	\$ 26,775	\$ (2,974)	\$ -	\$ -	\$ 23,801
Loss on defeasance	(4,671)	1,652	-	-	(3,019)
Total	<u>\$ 22,104</u>	<u>\$ (1,322)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,782</u>
December 31, 2011	Beginning Balance	Amortized	Refunded	Issued	Ending Balance
Bond discount	\$ (4)	\$ 4	\$ -	\$ -	\$ -
Bond premium	29,991	(3,216)	-	-	26,775
Loss on defeasance	(6,323)	1,652	-	-	(4,671)
Total	<u>\$ 23,664</u>	<u>\$ (1,560)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 22,104</u>

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Long-term debt activity for the year:

(all amounts in thousands)

<u>December 31, 2012</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 753,580	\$ -	\$ 35,250	\$ 718,330
Ohio Water Development Authority	267	-	131	136
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	2,639	-	311	2,328
Water Pollution Control Loan Fund	128,590	79,148	6,212	201,526
Capital Lease Payable	13,900	-	575	13,325
Total	<u>\$ 899,026</u>	<u>\$ 79,148</u>	<u>\$ 42,479</u>	<u>\$ 935,695</u>
<u>December 31, 2011</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 787,100	\$ -	\$ 33,520	\$ 753,580
Ohio Water Development Authority	393	-	126	267
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	2,626	313	300	2,639
Water Pollution Control Loan Fund	90,748	42,315	4,473	128,590
Capital Lease Payable	14,460	-	560	13,900
Total	<u>\$ 895,377</u>	<u>\$ 42,628</u>	<u>\$ 38,979</u>	<u>\$ 899,026</u>

Revenue Bonds

- a) Effective November 3, 2010, MSD issued \$43,595,000 Series A, Sewer System Refunding Revenue Bonds dated November 3, 2010. The proceeds from the 2010 Series A Bonds were used to defease portions of the 2000, 2001, and 2003 revenue bonds and pay for the cost of issuance. The 2010A bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1997, 2000, 2001, 2003A, 2003B 2004 2005A, 2005B, 2006, 2007 2009A, and 2009B bonds, secured equally and ratably under the Trust Agreement.

A portion of the proceeds was used to purchase U.S. Government Securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service to refund \$2,730,000 of outstanding 2000 Series A Bonds, \$25,290,000 of outstanding 2001 Series A Bonds, and \$17,035,000 of outstanding 2003 Series A Bonds. As a result, these bonds are considered defeased and the liability for those bonds removed from the balance sheet.

Although the refunding resulted in the recognition of an accounting loss of \$3,379,000 in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$8,824,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$5,304,000.

Effective November 3, 2010, MSD issued \$87,080,000 Series B Sewer System Improvement Revenue Bonds (Build America Bonds) dated November 3, 2010. The proceeds from the 2010 Series B bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2010 Series B bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on

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a parity with the 1997, 2000, 2001, 2003A, 2003B, 2004, 2005A, 2005B, 2006, 2007, 2009A, and 2009B bonds, secured equally and ratably under the Trust Agreement.

- b) Effective August 25, 2009, MSD issued \$19,515,000 Series A Sewer System Improvement Revenue Bonds dated August 11, 2009, and \$130,300,000 Series B Sewer System Improvement Revenue Bonds (Build America Bonds) dated August 11, 2009. The proceeds from the 2009 Series A bonds and 2009 Series B bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2009 Series A bonds and 2009 Series B bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B, 2004, 2005A, 2005B, 2006 and 2007 bonds, secured equally and ratably under the Trust Agreement.
- c) Effective December 20, 2007, MSD issued \$72,385,000 Series A Sewer System Improvement Revenue Bonds dated December 1, 2007. The proceeds from the 2007 Series A bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2007 Series A bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B, 2004, 2005A, 2005B and 2006 bonds, secured equally and ratably under the Trust Agreement.
- d) Effective November 15, 2006, MSD issued \$83,045,000 Series A Sewer System Improvement Revenue Bonds dated November 1, 2006. The proceeds from the 2005 Series B bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2006 Series A bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B, 2004, 2005A and 2005B bonds, secured equally and ratably under the Trust Agreement.
- e) Effective March 30, 2005, MSD issued \$86,960,000 Series A, Sewer System Refunding Revenue Bonds dated March 1, 2005. The proceeds from the 2005 bonds were used to defease portions of the 1997, 2000 and 2001 revenue bonds and pay for the cost of issuance. The 2005A bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B and 2004 bonds, secured equally and ratably under the Trust Agreement.

A portion of the proceeds was used to purchase U.S. Government Securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service to refund \$46,980,000 of outstanding 1997 Series A Bonds, \$20,665,000 of outstanding 2000 Series A Bonds and \$19,280,000 of outstanding 2001 Series A Bonds. As a result, these bonds are considered defeased and the liability for those bonds removed from the balance sheet.

Although the refunding resulted in the recognition of an accounting loss of \$5,211,000 in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$5,201,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$3,748,000.

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Effective November 9, 2005, MSD issued \$83,600,000 Series B Sewer System Improvement Revenue Bonds dated November 1, 2005. The proceeds from the 2005 Series B bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirements and pay the cost of issuance. The 2005 Series B bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997, 2000, 2001, 2003A, 2003B, 2004 and 2005A bonds, secured equally and ratably under the Trust Agreement.

- f) Effective October 5, 2004, MSD issued \$46,385,000 Series A, Sewer System Refunding Revenue Bonds dated September 1, 2004. The proceeds from the 2004 bonds were used to defease portions of the 1995, 1997 and 2000 revenue bonds and pay for the cost of issuance. The 2004 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1993, 1995, 1997, 2000, 2001, and 2003 Series A and 2003 Series B bonds, secured equally and ratably under the Trust Agreement.

A portion of the proceeds was used to purchase U.S. Government Securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service to refund \$34,215,000 of outstanding 1995 Series A Bonds, \$6,280,000 of outstanding 1997 Series A Bonds, and \$6,400,000 of outstanding 2000 Series A Bonds. As a result, these bonds are considered defeased and the liability for those bonds removed from the balance sheet.

Although the advance refunding resulted in the recognition of an accounting loss of \$3,163,000 to be amortized over future periods in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$3,850,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$3,001,000.

- g) Effective July 9, 2003 and September 4, 2003, MSD issued \$160,065,000 Series A, dated June 1, 2003 and \$55,510,000 Series B, dated September 1, 2003, respectively, County of Hamilton, Ohio Sewer System Improvement and Refunding Revenue Bonds. The proceeds from the 2003 bonds were used to permanently fund certain previous capital expenditures, defease portions of the 1993 and 1995 Series A bond issues, provide funds for new projects, fund the new bond reserve requirement and pay for the cost of issuance. The 2003 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on parity with the 1993, 1995, 1997, 2000, and 2001 Series A bonds, secured equally and ratably under the Trust Agreement.

A portion of the proceeds was used to purchase U.S. Government Securities which were deposited in an irrevocable trust with an escrow agent to provide for all future debt service to refund \$111,430,000 of outstanding 1993 Series A Bonds and \$17,125,000 of outstanding 1995 Series A Bonds. As a result, these bonds are considered defeased and the liability for those bonds removed from the balance sheet.

Although the advance refunding resulted in the recognition of an accounting loss of \$7,154,000 to be amortized over future periods in accordance with GASB 23, the District in effect reduced its aggregate debt service payments by \$19,250,000 and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$14,719,000.

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- h) Effective November 14, 2001, MSD issued \$76,000,000 County of Hamilton, Ohio 2001 Series A Sewer System Improvement and Refunding Revenue bonds dated November 1, 2001. The proceeds from the 2001 bonds were used to permanently fund certain previous capital expenditures, defease a portion of the 1991 Series A bond issue, fund the new bond reserve requirement and pay for the cost of issuance. The 2001 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997 and 2000 Series A bonds, secured equally and ratably under the Trust Agreement.

The 2010, 2009, 2007, 2006, 2005, 2004, 2003, and 2001 Bonds may be redeemed prior to their maturities in accordance with provisions of the bond resolutions. The redemption process for the bonds includes declining premiums up to 2 percent of principal.

At December 31, 2012 and December 31, 2011, the amount of defeased debt outstanding was \$17,035,000 and \$17,035,000, respectively.

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

(all amounts in thousands)								
Year	2010 Bonds	2009 Bonds	2007 Bonds	2006 Bonds	2005 Bonds	2004 Bonds	2003 Bonds	Total
2013	\$ 2,310	\$ -	\$ 2,020	\$ 2,380	\$ 9,065	\$ 1,360	\$ 19,510	\$ 36,645
2014	860	-	2,090	2,475	10,985	1,420	20,495	38,325
2015	425	-	2,165	2,575	12,090	1,495	21,510	40,260
2016	3,440	-	2,245	2,690	12,660	5,055	15,970	42,060
2017	1,935	-	2,330	2,850	15,100	21,920	-	44,135
2018-2022	37,400	34,035	13,355	16,345	38,650	-	10,055	149,840
2023-2027	37,220	41,440	17,150	20,765	29,820	-	34,990	181,385
2028-2032	25,065	50,865	22,000	20,660	15,960	-	10,450	145,000
2033-2035	17,205	23,475	-	-	-	-	-	40,680
	<u>\$ 125,860</u>	<u>\$ 149,815</u>	<u>\$ 63,355</u>	<u>\$ 70,740</u>	<u>\$ 144,330</u>	<u>\$ 31,250</u>	<u>\$ 132,980</u>	<u>\$ 718,330</u>

Under the terms of the amended revenue bond trust indenture, MSD has agreed to certain covenants, among other things, to restrict additional borrowing, maintain rates sufficient to meet debt service requirements, and maintain specified fund balances under trust agreements.

The Revenue bond issues as discussed above contain covenants which require the MSD to maintain a level of debt service coverage. The following calculation reflects MSD's debt service coverage.

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for the years ended December 31, 2012 and 2011

(all amounts in thousands)

	2012	2011
Revenues:		
Total operating revenues	\$ 249,156	\$ 239,425
Interest income	8,560	2,484
Capitalized interest income	507	226
Tap-in/connection fees	<u>2,165</u>	<u>2,119</u>
Total pledged revenue	260,388	244,254
 Total operating and maintenance expenses less depreciation and amortization	 (101,418)	 (111,823)
 Half of pledged revenues transferred to surplus account	 <u>36,535</u>	 <u>31,090</u>
 Net income available for debt service (a)	 <u>\$ 195,505</u>	 <u>\$ 163,521</u>
 Principal and interest requirement on revenue bonds (b)	 <u>\$ 73,803</u>	 <u>\$ 74,155</u>
 Principal and interest requirements on obligations (c)	 <u>\$ 85,062</u>	 <u>\$ 82,624</u>
 Debt service coverage		
Revenue bonds (a) divided by (b)	<u>265%</u>	<u>221%</u>
All obligations (a) divided (c)	<u>230%</u>	<u>198%</u>
Maximum debt service coverage required on revenue bonds	<u>125%</u>	<u>125%</u>

Ohio Water Development Authority Contracts

All contracts between the Ohio Water Development Authority (OWDA) and the Metropolitan Sewer District require MSD to prescribe and charge such rates for sewer usage which are sufficient (after expenses of operation and maintenance) to pay principal and interest on OWDA contracts. The principal is repayable in equal semi-annual installments to maturity.

Ohio Water and Sewer Rotary Commission

Advances from Ohio Water and Sewer Rotary Commission represent tap-in fees and acreage assessments to be forwarded to the Commission upon collection from customers. Such advances do not bear interest unless they are determined to be in default.

Ohio Public Works Commission

The MSD has entered into agreements with the Ohio Public Works Commission (OPWC) for financing of certain qualified capital projects. As the projects progress the commitments are drawn down as funds are paid by OPWC directly to the contractors. The principal is repayable in semi-annual installments to the date of maturity for each project.

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Water Pollution Control Loan Fund

The MSD has received low interest loan commitments from the Ohio Water Pollution Control Loan fund for certain qualified projects. As the projects progress the commitments are drawn down. The principal is repayable in semi-annual installments to the date of maturity for each project.

Interest on Long-Term Obligations

The following interest costs were incurred and expensed or capitalized as part of the cost of MSD's additions to capital assets.

(all amounts in thousands)

	<u>2012</u>	<u>2011</u>
Interest incurred	\$ 41,127	\$ 37,317
Less Interest capitalization	<u>(6,965)</u>	<u>(3,105)</u>
Interest expense	<u>\$ 34,162</u>	<u>\$ 34,212</u>

NOTE 7 – CAPITAL LEASE

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

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

(all amounts in thousands)

Fiscal Year Ending December 31,	Long-Term Debt
2013	\$ 1,115
2014	1,112
2015	1,115
2016	1,115
2017	1,112
2018-2022	5,570
2023-2027	5,569
2028-2029	<u>2,227</u>
Total Minimum Lease Payments	18,935
Less: Amount Representing Interest	<u>(5,610)</u>
Present Value of Minimum Lease Payments	<u>\$ 13,325</u>

Capital assets acquired under capital leases are as follows:

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

Compensated Absences

Compensated absences consist of vacation time, sick pay and compensatory time. The following is a summary of activity for 2012 and 2011. \$3,796 is considered due within one year for compensated absences as of December 31, 2012.

(all amounts in thousands)					
	<u>Beginning</u>				<u>Ending</u>
	<u>Balance</u>	<u>Increase</u>	<u>Decrease</u>		<u>Balance</u>
2012	\$ 8,951	\$ 4,122	\$ 3,893	\$	9,180
2011	\$ 8,439	\$ 5,005	\$ 4,493	\$	8,951

NOTE 9 - PENSION AND RETIREMENT

City of Cincinnati Retirement System

The majority of MSD full-time employees participate in the Retirement System of the City of Cincinnati (CRS). CRS is a cost-sharing, multiple-employer, defined benefit, public employee retirement system. The plan provides retirement, disability and death benefits to plan members and beneficiaries. CRS also provides health care benefits to vested retirees. Benefits provided under the plan are established by the Cincinnati Municipal Code. CRS issues a separate, publicly available financial report that includes financial statements and required supplementary information. That report may be obtained from the City of Cincinnati Retirement System, 801 Plum Street, Cincinnati, Ohio 45202 or by calling (513) 352-3227.

The Cincinnati Municipal Code provides statutory authority for employee and employer contribution rates. For 2012, the required contribution rates were 18.00 percent for MSD and 8.5 percent for employees. For 2011, the required contribution rates were 17.00 percent for MSD and 8.0 percent for employees. MSD's contributions to CRS for the years ending December 31, 2012, 2011 and 2010 were \$6,893,000, \$6,150,000, and \$6,005,000, respectively. The full amount has been contributed for 2011 and 2010 and 98% of the required contributions for 2012. The City's (and MSD's) contribution rate for 2012, 2011 and 2010 was not equal to the required contribution rate based on the City's actuarial report.

Ohio Public Employees' Retirement System

A limited number of MSD employees participate in the Ohio Public Employee' Retirement System administrated by the State of Ohio. OPERS is not material to the financial statements of MSD and additional disclosures concerning OPERS, including other post-employment benefit information, can be found in the plan's annual financial statements. Interested parties may obtain a copy by written request to 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 466-2085.

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Other Postemployment Benefit Information

CRS provides hospital and surgical insurance to retired members who have earned fifteen years credited service at the time of termination or terminate after age sixty with five years credited service. Those who are receiving survivor benefits of eligible members are entitled to have their hospital and surgical insurance premiums paid by the CRS. When benefits would be reduced by reason of the retired member's eligibility for hospital and medical benefits under federal social security laws, CRS will pay whatever additional fees are required for the Federal medical coverage.

The health care coverage provided by the CRS is advance-funded on an actuarial determined basis as a portion of the employer contribution requirement to the System. The Cincinnati Municipal Code provides authority for employer contributions.

The actuarial assumptions used for the December 31, 2012 valuation included an assumption for hospital and surgical benefits recognizing adjusted premiums, based on experience from recent years, adjusted to current year by assumed annual increases in premium costs. The cost of coverage is recognized as an expense as claims are paid. CRS has 3,343 active contributing participants of which 556 are MSD employees. For 2012, MSD's contribution was 20.3 percent of the total employers' contribution.

NOTE 10 - RELATED PARTY TRANSACTIONS

Cincinnati Water Works provides billing and collection services on customers' accounts for MSD. Fees for these services for 2012 and 2011 were \$5,206,000 and \$5,100,000 respectively. Fees are also paid to other municipalities and villages within Hamilton County for collection of sewerage bills.

The City of Cincinnati provides "overhead" services to MSD, such as check disbursement, investment and legal services, etc. The fees for these services for 2012 and 2011 were \$2,075,000 and \$2,311,000 respectively. In addition, the City's Municipal Garage provides gasoline and repairs vehicles for MSD. Fees for these services were \$1,622,000 and \$1,534,000 for 2012 and 2011, respectively.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

The City of Cincinnati and the Board of County Commissioners of Hamilton County, Ohio are parties to a Global Consent Decree, which was lodged, in 2003, with the U.S. District Court for the Southern District of Ohio, Western Division. This decree focuses on combined sewer overflows, the implementation of the Sanitary Sewer Overflow Correction plan established in the Interim Partial Consent Decree, and other wet weather issues. The court approved the decrees on June 9, 2004. In August 2010, MSD's Revised Wet Weather Improvement Plan was approved by the federal government. The Plan commits MSD to complete a Phase 1 group of projects totaling \$1.145 billion (in 2006 dollars and including \$526 million that MSD has already spent on projects) by 2018 before scheduling future work (Phase 2). The consent decree documents are posted on the MSD web site, msdgc.org, under consent decree.

As part of MSD's capital improvement program, MSD has entered into a number of contracts for construction, design, and other services. Commitments under these contracts aggregate approximately \$126 million as of December 31, 2012.

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NOTE 12 - RISK MANAGEMENT

MSD is part of the City of Cincinnati Risk Management Program. The City purchases commercial insurance to cover losses due to: theft of, damage to, or destruction of assets and purchases general liability insurance for specific operations and professional liability insurance for certain operations. All other risks of loss are self-insured. Separately, MSD carries property insurance pursuant to an all-risk policy on MSD's buildings and equipment per the revenue bond trust agreement. There has been no reduction in insurance coverage from coverage in 2003. Insurance settlements for claims resulting from risks covered by commercial insurance have not exceeded the insurance coverage in any of the past three years.

NOTE 13 – CHANGE IN ACCOUNTING PRINCIPLES

MSD adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements and GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position. GASB Statement No. 62 incorporates Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants' (AICPA) accounting and financial reporting guidance issued on or before November 30, 1989 into GASB authoritative literature. GASB Statement No. 63 provides financial reporting guidance for deferred outflows and inflows of resources and net position.

NOTE 14 - SUBSEQUENT EVENTS

The Hamilton County Board of Commissioners has approved an 5 percent sewerage rate increase effective January 9, 2013.