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Financial Report (Audited), 2006

Metropolitan St. Louis Sewer District

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CLAIRE C. McCASKILL
Missouri State Auditor

November 6, 2006

Janice M. Zimmerman, Director of Finance
Metropolitan St. Louis Sewer District
2350 Market Street
St. Louis, MO 63103-2555

Fiscal Period: One Year Ended June 30, 2006 ✓

Dear Ms. Zimmerman:

In accordance with Section 105.145, RSMo, we acknowledge receipt of the financial report of your political subdivision for the above-described fiscal period.

Thank you for your cooperation in sending this information.

Sincerely,

CLAIRE C. McCASKILL
STATE AUDITOR

A handwritten signature in black ink that reads "Judy Buerky".

Judy Buerky
Local Government Analyst



Metropolitan
St. Louis Sewer
District

2350 Market Street
St. Louis, MO 63103-2555
(314) 768-6200

CERTIFIED MAIL

October 25, 2006



Claire C. McCaskill
Missouri State Auditor
224 State Capitol
Jefferson City, MO 65101

Dear Ms. McCaskill:

Enclosed are Audited Financial Statements for the year ended June 30, 2006, for the Metropolitan St. Louis Sewer District presented on the "Enterprise" Basis of Accounting, in accordance with generally accepted accounting principles.

I have also enclosed a copy of our Unaudited Summary Trial Balance by Fund for the same period along with a list of fund names with corresponding number that will enable you to understand the attached report.

Sincerely,

Janice M. Zimmerman
Director of Finance

Enclosures



Hochschild, Bloom & Company LLP
Certified Public Accountants
Consultants and Advisors

**THE METROPOLITAN ST. LOUIS
SEWER DISTRICT**

FINANCIAL REPORT
(Audited)

Year Ended June 30, 2006

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

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Hochschild, Bloom & Company LLP
Certified Public Accountants
Consultants and Advisors

INDEPENDENT AUDITORS' REPORT

September 15, 2006

Board of Trustees
THE METROPOLITAN ST. LOUIS SEWER DISTRICT

We have audited the basic financial statements of **THE METROPOLITAN ST. LOUIS SEWER DISTRICT** (the District) as of and for the year then ended June 30, 2006, as listed in the accompanying table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of the District as of June 30, 2005 were audited by other auditors whose report dated September 2, 2005, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with U.S. generally accepted auditing standards 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 audits 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 District'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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2006, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2006 on our consideration of the District's internal control over financial reporting and on 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Hochschild Bloom & Company LLP
CERTIFIED PUBLIC ACCOUNTANTS

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

The annual report of The Metropolitan St. Louis Sewer District (the District) includes the independent auditors' report, management's discussion and analysis (MD&A), and the financial statements accompanied by notes essential to the user's understanding of the financial statements.

Management of the District has provided this MD&A to be used in combination with the District's financial statements. This narrative is intended to provide the reader with more insight into management's knowledge of the transactions, events, and conditions reflected in the accompanying financial statements and the fiscal policies that govern the District's operations.

2006 Financial Highlights

- Net capital assets increased by \$143.8 million due to continued high levels of spending related to the regulatory required Capital Improvement and Replacement Program (CIRP).
 - Collection and pumping plant \$ 92.1 million
 - Construction in progress (CIP) \$ 90.0 million
 - Treatment and disposal plant and equipment \$ 2.9 million
 - General plant and equipment \$ 1.0 million
 - Land \$ 0.1 million
 - Less: Change in accumulated depreciation \$ 42.3 million
- Cash and cash equivalents balances increased by \$36.5 million, while investment balances decreased by \$41.1 million, from fiscal year 2005 to fiscal year 2006. The shift from longer-term investments to cash and cash equivalents occurred as a result of the current interest rate environment in which an inverted yield curve makes short-term investments more attractive than long-term investments and to provide sufficient liquid assets to fund the CIRP.
- Bonds and notes payable balances, net of unamortized premium and issue costs, increased by \$37.6 million in most part due to the issuance of Series 2006A bonds in the amount of \$42.7 million. Retirements of \$5.5 million and changes in the unamortized premium balance and the balance of bond issuance costs netting to \$0.4 million combine for the remaining \$5.1 million in change.
- Capital contributions increased by \$36.7 million due to the transfer of assets related to 293 developments in fiscal year 2006 versus 194 in fiscal year 2005.
- Operating revenues increased by \$17.8 million or 9.4% as a result of the rate increase that took effect in July 2005.

2005 Financial Highlights

- Cash and cash equivalents balances decreased by \$158.0 million, while investment balances increased by \$111.5 million, from fiscal year 2004 to fiscal year 2005 due to bond proceeds held as cash in 2004 being invested in 2005.
- Net capital assets increased by \$116.5 million due to increased levels of spending related to the CIRP.
 - Construction in progress (CIP) \$ 83.8 million
 - Collection and pumping plant \$ 77.0 million
 - Treatment and disposal plant and equipment \$ (0.1) million
 - General plant and equipment \$ 1.9 million

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

- Land \$ (3.0) million
- Less: Change in accumulated depreciation \$ 43.1 million
- Operating revenues increased \$31.0 million or 19.6% as a result of the rate increase that took affect in July 2004. The increased revenue is the driving force behind the \$26.6 million operating income achieved in fiscal year 2005, which was a significant improvement over the \$7.4 million operating income in fiscal year 2004.
- Clean water capital improvement surcharge refund payable increased from zero in fiscal year 2004 to \$5.7 million in fiscal year 2005 reflecting the refund to customers scheduled to be issued in November 2005.

Required Financial Statements

The financial statements presented by the management of the District include a Statement of Net Assets; Statement of Revenues, Expenses, and Changes in Net Assets; and Statement of Cash Flows. These statements are prepared using the accrual basis of accounting. This method of accounting recognizes revenues at the time they are earned and expenses when the related liability occurs. As a result of using this method of accounting, the District's performance over the time period being reported is more easily determinable.

The Statement of Net Assets provides a report of the District's current, restricted, and other noncurrent assets such as cash, investments, receivables, and property. Also, the Statement of Net Assets provides a summary of the District's current, restricted, and noncurrent liabilities, including contracts and accounts payable, deposits and accrued expenses, and bond and notes payable. The final section of the Statement of Net Assets, the net assets section, contains earnings retained for use by the District. Increases or decreases in the net assets section may be indicative of an improving or declining financial position. This statement provides the basis for computing rate of return, evaluating the capital structure of the District, and assessing the liquidity and financial flexibility of the District.

The Statement of Revenues, Expenses, and Changes in Net Assets summarizes all of the year's revenues and expenses. This statement indicates how successful the District was at maintaining expenses below the level of revenues earned.

The Statement of Cash Flows accounts for the net change in cash and cash equivalents by summarizing cash receipts and cash disbursements resulting from operating activities, noncapital financing activities, capital and related financing activities, and investing activities. This statement assists the user in determining the sources of cash coming into the District, the items for which cash was expended, and the beginning and ending cash balance.

Financial Analysis

The overall financial condition of the District is strong as indicated by the increase in net assets over the past year. The District had income before capital contributions of \$60.6 million in fiscal year 2006, compared to \$43.6 million in 2005 and \$35.3 million in 2004. Plans for maintaining the District's ability to meet future spending needs are discussed in greater detail in the section of the MD&A entitled "Decisions Impacting the Future."

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

Condensed Financial Statements and Analysis

The Metropolitan St. Louis Sewer District Condensed Statement of Net Assets (000s)

	2006	2005	Increase (Decrease) 2006-2005	2004	Increase (Decrease) 2005-2004
Current, Restricted, and Other Assets	\$ 523,948	\$ 523,666	\$ 282	\$ 562,503	\$ (38,837)
Capital Assets (net of accumulated depreciation)	1,886,435	1,742,683	143,752	1,626,139	116,544
Total assets	2,410,383	2,266,349	144,034	2,188,642	77,707
Current Liabilities	52,685	57,115	(4,430)	41,606	15,509
Noncurrent Liabilities	381,333	345,006	36,327	341,237	3,769
Total liabilities	434,018	402,121	31,897	382,843	19,278
Net Assets					
Invested in capital assets, net of related debt	1,652,348	1,625,673	26,675	1,589,612	36,061
Restricted	273,062	193,803	79,259	163,592	30,211
Unrestricted	50,955	44,752	6,203	52,595	(7,843)
Total Net Assets	\$ 1,976,365	\$ 1,864,228	\$ 112,137	\$ 1,805,799	\$ 58,429

2006 Analysis

Total net assets increased \$112.1 million, or 6.0%, over prior year. This change is the result of an increase in total assets of \$144.0 million and an increase in liabilities of \$31.9 million.

Net capital assets increased by \$143.8 million in fiscal year 2006 from fiscal year 2005 accounting for the overwhelming majority of the change in total assets. Current, restricted, and other assets account for the other \$0.2 million of the \$144.0 million dollar increase. The change in net capital assets can be attributed to an increase in collection and pumping plant of \$92.1 million and an increase in construction in progress of \$90.0 million with an offsetting increase in accumulated depreciation of \$42.3 million. The remaining increase of \$4.0 million is a combination of treatment and disposal plant and equipment, general plant and equipment, and land.

The change in total liabilities of \$31.9 million is representative of an increase in noncurrent liabilities of \$36.3 million and a decrease of current liabilities of \$4.4 million. Noncurrent liabilities increased by \$36.3 million almost exclusively due to the issuance of Series 2006A bonds through the state revolving fund (SRF) in the amount of \$42.7 million. The retirement of bonds totaling \$5.5 million, less a net change in unamortized premium and accretion of bond issuance costs of \$0.4 million, and a \$1.7 million change in the current portion of bonds payable combine to offset the \$42.7 million and account for the change in noncurrent bonds and notes payable. An increase in deposits and accrued expenses of \$0.4 million rounds out the variance in noncurrent liabilities from fiscal year 2005 to fiscal year 2006.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Management's Discussion and Analysis
for the year ended June 30, 2006**

2005 Analysis

Total net assets increased \$58.4 million, or 3.2%, over prior year. This change is the result of an increase in total assets of \$77.7 million and an increase in liabilities of only \$19.3 million.

Current, restricted, and other assets decreased by \$38.8 million from prior year. Most of this decrease is attributable to restricted assets. Restricted assets decreased \$33.1 million below prior year as a result of CIRP spending. The restricted assets affected were cash and cash equivalents, which decreased \$152.0 million, investments increased \$118.5 million, and accrued income on investments increased \$1.2 million. In addition to the decreases caused by CIRP, grants receivable fell by \$0.8 million.

Net capital assets increased by \$116.5 million due to increased levels of spending for CIRP. Contributing factors include an increase in CIP of \$83.8 million, an increase in collection and pumping plant assets of \$77.0 million, an increase in general plant and equipment of \$1.9 million, a decrease in land of \$3.0 million, a decrease in treatment and disposal plant equipment of \$0.1 million, and an increase in accumulated depreciation of \$43.1 million.

The \$19.3 million increase in liabilities represents a 5% change over the prior year. One factor to consider is the \$5.7 million clean water capital improvement surcharge refund payable that did not exist in the prior year. This refund, planned for payment in November 2005, represents the unused clean water capital improvement surcharge revenues. Bonds and notes payable increased \$6.1 million. Contracts and accounts payable increased by \$5.7 million over prior year. Retainage payable increased by \$2.9 million due to the increased level of CIRP projects, and deposits and accrued expenses decreased a total of \$1.1 million.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

The Metropolitan St. Louis Sewer District Statements of Revenues, Expenses, and Changes in Net Assets (000s)

	2006	2005	Increase (Decrease) 2006-2005	2004	Increase (Decrease) 2005-2004
Operating Revenues:					
Sewer service charges	\$ 203,880	\$ 183,513	\$ 20,367	\$ 150,519	\$ 32,994
Recovery of (provision for) doubtful service charge accounts	(3,161)	(1,546)	(1,615)	385	(1,931)
Licenses, permits, and other fees	5,210	6,549	(1,339)	6,297	252
Other	873	478	395	770	(292)
Total operating revenues	<u>206,802</u>	<u>188,994</u>	<u>17,808</u>	<u>157,971</u>	<u>31,023</u>
Nonoperating Revenues:					
Property taxes levied by the District	23,211	22,016	1,195	21,744	272
Investment income	7,610	5,502	2,108	2,060	3,442
Recovery of doubtful clean water capital improvement surcharge accounts	--	--	--	116	(116)
Grant revenue	1,425	1,553	(128)	7,787	(6,234)
Other	1,027	1,038	(11)	1,010	28
Total nonoperating revenues	<u>33,273</u>	<u>30,109</u>	<u>3,164</u>	<u>32,717</u>	<u>(2,608)</u>
Total revenues	<u>240,075</u>	<u>219,103</u>	<u>20,972</u>	<u>190,688</u>	<u>28,415</u>
Operating Expenses:					
Pumping and treatment	38,316	35,514	2,802	30,788	4,726
Collection system maintenance	27,792	25,225	2,567	23,408	1,817
Engineering	8,737	6,851	1,886	6,728	123
General and administrative	37,055	37,047	8	40,199	(3,152)
Depreciation	43,980	44,443	(463)	42,592	1,851
Other	20,009	13,294	6,715	6,878	6,416
Total operating expenses	<u>175,889</u>	<u>162,374</u>	<u>13,515</u>	<u>150,593</u>	<u>11,781</u>
Nonoperating Expenses:					
Capital improvement surcharge refund	95	5,667	(5,572)	--	5,667
Net loss on disposal and sale of utility plant	95	3,139	(3,044)	548	2,591
Nonrecurring projects and studies	3,375	4,292	(917)	4,027	265
Other	--	--	--	184	(184)
Total nonoperating expenses	<u>3,565</u>	<u>13,098</u>	<u>(9,533)</u>	<u>4,759</u>	<u>8,339</u>
Total expenses	<u>179,454</u>	<u>175,472</u>	<u>3,982</u>	<u>155,352</u>	<u>20,120</u>
Income before capital contributions	60,621	43,631	16,990	35,336	8,295
Capital contributions	<u>51,516</u>	<u>14,798</u>	<u>36,718</u>	<u>28,643</u>	<u>(13,845)</u>
Change in net assets	112,137	58,429	53,708	63,979	(5,550)
Net assets-beginning of year	<u>1,864,228</u>	<u>1,805,799</u>	<u>58,429</u>	<u>1,741,820</u>	<u>63,979</u>
Net Assets-End of Year	<u>\$1,976,365</u>	<u>\$1,864,228</u>	<u>\$ 112,137</u>	<u>\$1,805,799</u>	<u>\$ 58,429</u>

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

2006 Analysis

Net assets increased \$112.1 million which was \$53.7 million over 2005. The largest contributing factor in the increase in net assets is the increased level of capital contributions. In fiscal year 2006, capital contributions totaled \$51.5 million while in fiscal year 2005 they were \$14.8 million. This change accounts for \$36.7 million of the total change in net assets, and is a result of a larger number of developments being gifted to the District.

Another significant factor in the \$53.7 million increase in net assets over 2005 was the increase in sewer service charge revenues totaling \$20.4 million as a result of the rate increase that took effect in July of 2005.

Operating expenses increased by \$13.5 million or 8.3% over prior year. The largest increase in operating expenses occurred in other operating expenses in the amount of \$6.7 million. This increase is a result of greater spending on infrastructure repair and data collection projects. Additionally, pumping and treatment, collection system maintenance, and engineering expenses increased by \$2.8 million, \$2.6 million, and \$1.9 million, respectively, while depreciation expense decreased by \$0.5 million.

Nonoperating expenses decreased by \$9.5 million or 72.8% over prior year. The decrease can be attributed to the capital improvement surcharge refund. \$5.7 million of the refund was expensed in fiscal year 2005, while only \$0.1 million was charged in fiscal year 2006. The other major contributing factor to the \$9.5 million decrease is a drop in the net loss on disposal and sale of utility plant in the amount of \$3.0 million. In fiscal year 2005, land valued at over \$3.0 million was gifted to the City of Maplewood.

2005 Analysis

Operating revenues increased \$31.0 million from 2004 to 2005. A rate increase in July 2004 caused the change. During the fiscal year, the District's operating expenses increased \$11.8 million to \$162.4 million primarily due to a \$6.4 million rise in other operating expenses. Other operating expenses increased due to an increased level of infrastructure repair and data collection projects. Pumping and treatment expenses experienced an increase of \$4.7 million, collection system maintenance expenses increased \$1.8 million, depreciation increased \$1.9 million, and general and administrative expenses decreased \$3.2 million. The final result was an operating income of \$26.6 million in 2005. This was an increase of \$19.2 million or 261% over the operating income of \$7.4 million that was recorded in 2004.

Net income from nonoperating activities fell \$10.9 million from prior year levels due to several factors. Grant revenue declined \$6.2 million as the grant funding for the Meramec treatment plant was fully utilized and the availability of state stormwater grant money ended. A refund of approximately \$5.7 million of the unused clean water capital improvement surcharge is scheduled for November of 2005, and investment income increased by \$3.4 million as a result of higher investment balances and improving market conditions. The major reason for an increase in the net loss on disposal and sale of utility plant of \$2.6 million is due to the gifting of land costing \$3.0 million to the City of Maplewood to be used as a park. The land was purchased as part of a flood mitigation project.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

The Metropolitan St. Louis Sewer District Condensed Statement of Cash Flows (000s)

	2006	2005	Increase (Decrease) 2006-2005	2004	Increase (Decrease) 2005-2004
Cash flows from operating activities	\$ 69,033	\$ 71,563	\$ (2,530)	\$ 45,189	\$ 26,374
Cash flows from noncapital financing activities	23,211	22,016	1,195	21,744	272
Cash flows from capital and related financing activities	(105,123)	(145,635)	40,512	261,115	(406,750)
Cash flows from investing activities	49,380	(105,948)	155,328	(144,063)	38,115
Net increase (decrease) in cash and cash equivalents	36,501	(158,004)	194,505	183,985	(341,989)
Cash and cash equivalents at beginning of year	66,588	224,592	(158,004)	40,607	183,985
Cash and Cash Equivalents at End of Year	\$ 103,089	\$ 66,588	\$ 36,501	\$ 224,592	\$(158,004)

2006 Analysis

The net increase in cash and cash equivalents experienced a \$194.5 million increase in relation to fiscal year 2005. The most significant reason for that increase is the cash flow from investing activities. In fiscal year 2006, cash flow from investing activities was a positive \$49.4 million while in fiscal year 2005 the District had a negative cash flow from investing activities of \$105.9 million. Bond proceeds originally converted to long-term investments have been converted to cash to cover CIRP expenses and to take advantage of better interest rates on short-term investments.

Cash outflows from capital and related financing activities increased by \$40.5 million in fiscal year 2006. In fiscal year 2006, the District's proceeds from issuance of debt increased by \$35.6 million. Payments for capital improvements decreased by \$14.8 million, principal and interest and fees paid on debt increased by a combined \$3.7 million, cash refunded for the clean water capital improvement surcharge increased by \$5.8 million, and proceeds from capital grants and sale of utility plant declined by a net of \$0.4 million.

2005 Analysis

Cash flows from operating activities increased \$26.4 million during fiscal year 2005. The rate change effective in July 2004 increased funds received from customers by \$32.7 million, which was partially offset by a \$6.6 million increase in payments for goods and services. Payments to employees for services decreased by \$0.2 million.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

Cash flows from capital and related financing activities decreased by \$406.8 million from fiscal year 2004 to fiscal year 2005. Proceeds from the issuance of debt declined by \$400.8 million, or 98%, while payments for capital improvements increased by \$51.5 million, reflecting the higher level of CIRP spending compared to the prior year.

Cash flows from investing activities were a negative \$105.9 million in fiscal year 2005 and a negative \$144.1 million in fiscal year 2004. In both years, the cash outflow for the purchase of investments exceeded inflows from the sale and maturity of investments. The net outflow was greater in fiscal year 2004 than in fiscal year 2005 as a result of the large amount of bond proceeds that were received and invested in fiscal year 2004.

Capital Assets

The Metropolitan St. Louis Sewer District

Capital Assets

Net of Depreciation (000s)

	<u>2006</u>	<u>2005</u>	<u>Increase (Decrease) 2006-2005</u>	<u>2004</u>	<u>Increase (Decrease) 2005-2004</u>
Land	\$ 26,976	\$ 26,912	\$ 64	\$ 29,888	\$ (2,976)
Construction in progress	365,628	275,615	90,013	191,769	83,846
Treatment and disposal plant and equipment	278,200	290,262	(12,062)	305,977	(15,715)
Collection and pumping plant	1,200,494	1,134,222	66,272	1,081,597	52,625
General plant and equipment	15,137	15,671	(534)	16,908	(1,237)
Total	<u>\$ 1,886,435</u>	<u>\$ 1,742,682</u>	<u>\$ 143,753</u>	<u>\$ 1,626,139</u>	<u>\$ 116,543</u>

2006 Analysis

Total capital asset, net of depreciation, increased \$143.8 million over prior year. The most significant increase was to construction in progress, which rose by \$90.0 million. Collection and pumping plant also increased by a significant amount of \$66.3 million in large part due to the increase in contributed assets. Treatment and disposal plant and equipment decreased by \$12.1 million as depreciation outpaced additions in this asset category. Finally, general plant and equipment decreased by \$0.5 million in relation to the prior year, and land increased by less than \$0.1 million.

2005 Analysis

The District's total capital assets, net of depreciation, increased \$116.5 million over the prior year. The most significant change was an increase in construction in progress of \$83.8 million. Another significant change was an increase in collection and pumping plant assets of \$52.6 million, net of depreciation. Additions to collection and pumping plant consisted of \$62.1 million in constructed assets, \$14.8 million in contributed assets, and \$0.2 million in purchased assets, while disposals and depreciation totaled \$0.1 million and \$24.4 million, respectively. A decrease in land of \$3.0 million is a result of gifting land purchased for flood mitigation purposes to the City of Maplewood for use as a park. Treatment and disposal plant and equipment assets fell \$15.7 million due to \$0.1 million in additions, \$0.2 million in disposals, and net depreciation of \$15.6 million.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

General plant and equipment assets fell \$1.2 million resulting from additions of \$3.0 million, disposals of \$1.1 million, and net depreciation of \$3.1 million.

For additional information related to the District's capital assets, see Note 4 to the financial statements.

Long-term Debt

The Metropolitan St. Louis Sewer District Long-term Debt (000s)

	2006	2005	Increase (Decrease) 2006-2005	2004	Increase (Decrease) 2005-2004
Revenue Bonds:					
Series 2004A	\$ 173,500	\$ 175,000	\$ (1,500)	\$ 175,000	\$ --
Series 2004B	156,245	160,152	(3,907)	161,280	(1,128)
Series 2005A	6,800	6,800	--	--	6,800
Series 2006A	42,715	--	42,715	--	--
West Watson and Nanell	486	536	(50)	--	536
Ozark and Tablerock	116	147	(31)	375	(228)
Energy Loan Program	79	89	(10)	98	(9)
	<u>\$ 379,941</u>	<u>\$ 342,724</u>	<u>\$ 37,217</u>	<u>\$ 336,753</u>	<u>\$ 5,971</u>

2006 Analysis

The District ended fiscal year 2006 with \$379.9 million in long-term debt outstanding, consisting mainly of revenue bonds. The increase of \$37.2 million is a result of new issues in the amount of \$42.7 million and retirements of \$5.5 million.

2005 Analysis

At the end of 2005, the District had \$342.7 million of long-term debt outstanding, consisting mainly of revenue bonds. The increase of \$6.0 million is due to new issuances of \$7.3 million and retirements of \$1.3 million.

The issuance of 2006 and 2005 debt helped to fund the first phase of the District's CIRP.

For additional information related to the District's long-term debt, see Note 5 to the financial statements.

Decisions Impacting the Future

In the upcoming fiscal year, the District intends to issue the remaining \$114.2 million in bonds previously approved by the voters in February 2004. These bonds will continue to fund the first of four phases of a 20-year wastewater capital improvement program projected to total \$3.7 billion in expenditures. The remaining phases are expected to be funded through a combination of additional bonds, if approved by the voters, and additional rate increases.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Management's Discussion and Analysis for the year ended June 30, 2006

The District also plans to address the current lack of funding to adequately support the operation and maintenance of the St. Louis Region's existing stormwater infrastructure. The District intends to recommend a change in stormwater funding by modifying the current monthly 24¢ per customer fixed charge to a variable charge based on impervious area. A combined rate proposal addressing both the wastewater and stormwater funding issues will be subject to review by the District's Board of Trustees and Rate Commission. The District anticipates submitting a formal funding proposal for consideration by the third quarter of fiscal year 2007.

In addition to these major funding initiatives, the District will also be embarking on the implementation of the first year of a multi-year strategic technology plan. This comprehensive plan is based on a year long review of all District technology systems and business processes during the past fiscal year and is designed to dramatically improve connectivity and interaction between District Departments, increase overall District efficiency, and enhance customer service for all District ratepayers.

Requests for Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

The Metropolitan St. Louis Sewer District
Director of Finance
2350 Market Street
St. Louis, MO 63103-2555



THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Statements of Net Assets June 30, 2006 and 2005

ASSETS	2006	2005
Current Assets:		
Cash and cash equivalents	\$ 11,919,000	\$ 10,624,709
Investments	8,701,028	5,844,714
Sewer service charges receivable, less allowance of \$2,906,000 in 2006 and \$2,451,000 in 2005	27,151,790	23,835,183
Unbilled sewer service charges receivable, less allowance of \$326,000 in 2006 and \$305,000 in 2005	15,961,693	14,323,829
Accrued income on investments	241,174	182,936
Grants receivable	10,434	410,662
Other receivables, less allowance of \$6,934 in 2006 and \$32,473 in 2005	1,945,845	946,812
Supplies inventory	7,972,849	8,039,067
	73,903,813	64,207,912
Noncurrent Assets:		
Restricted Assets:		
Cash and cash equivalents	91,169,876	55,963,332
Investments	346,775,935	387,428,934
Accrued income on investments	2,721,930	2,471,441
Grants receivable	530,602	1,492,997
Other receivables	54,161	53,754
	441,252,504	447,410,458
Other Assets:		
Long-term investments	8,792,859	12,047,814
Capital Assets:		
Depreciable:		
Treatment and disposal plant and equipment	569,721,790	566,802,423
Collection and pumping plant	1,606,656,767	1,514,563,636
General plant and equipment	53,194,761	52,201,691
	2,229,573,318	2,133,567,750
Less: Accumulated depreciation	735,742,465	693,412,288
	1,493,830,853	1,440,155,462
Nondepreciable:		
Land	26,976,107	26,911,933
Construction in progress	365,627,566	275,615,002
	392,603,673	299,999,935
Net capital assets	1,886,434,526	1,742,682,397
Total noncurrent assets	2,336,479,889	2,202,140,669
Total Assets	2,410,383,702	2,266,348,581

See the accompanying notes to the financial statements.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

LIABILITIES

	2006	2005
Current Liabilities:		
Contracts and accounts payable	\$ 8,623,266	\$ 9,665,837
Deposits and accrued expenses	16,518,268	16,481,847
Retainage payable	33,970	197,572
	25,175,504	26,345,256
Current Liabilities--Payable From Restricted Assets:		
Contracts and accounts payable	15,685,704	14,899,449
Deposits and accrued expenses	2,411,785	1,392,523
Retainage payable	5,052,722	6,108,025
Clean Water Capital Improvement Surcharge refund	--	5,667,330
Current portion of bonds and notes payable	4,359,578	2,702,568
	27,509,789	30,769,895
Total current liabilities	52,685,293	57,115,151
Noncurrent Liabilities:		
Deposits and accrued expenses	4,154,065	3,765,893
Bonds and notes payable	377,178,944	341,239,433
	381,333,009	345,005,326
Total Liabilities	434,018,302	402,120,477

NET ASSETS

Invested in capital assets, net of related debt	1,652,348,133	1,625,672,653
Restricted for:		
Debt service	20,198,822	15,493,176
Real property purchase and improvement	2,544,713	2,774,628
Subdistrict construction and improvement	46,774,026	43,735,215
Construction	203,544,388	131,800,378
Unrestricted	50,955,318	44,752,054
	50,955,318	44,752,054
Total Net Assets	\$ 1,976,365,400	\$ 1,864,228,104

See the accompanying notes to the financial statements.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Statements of Revenues, Expenses, and Changes in Net Assets for the years ended June 30, 2006 and 2005

	2006	2005
Operating Revenues:		
Sewer service charges	\$ 203,880,320	\$ 183,512,398
Recovery of (provision for) doubtful sewer service charge accounts	(3,160,972)	(1,545,971)
Licenses, permits, and other fees	5,210,321	6,549,221
Other	873,353	478,025
Total operating revenues	<u>206,803,022</u>	<u>188,993,673</u>
Operating Expenses:		
Pumping and treatment	38,316,092	35,514,218
Collection system maintenance	27,791,675	25,225,163
Engineering	8,737,413	6,850,679
General and administrative	37,055,565	37,046,813
Depreciation	43,979,819	44,442,903
Other	20,008,972	13,294,119
Total operating expenses	<u>175,889,536</u>	<u>162,373,895</u>
Operating Income	<u>30,913,486</u>	<u>26,619,778</u>
Nonoperating Revenues:		
Property taxes levied by the District	23,210,982	22,015,870
Investment income	7,610,461	5,501,708
Grant revenue	1,424,920	1,552,839
Other	1,026,547	1,038,074
Total nonoperating revenues	<u>33,272,910</u>	<u>30,108,491</u>
Nonoperating Expenses:		
Capital improvement surcharge refund	95,372	5,667,330
Net loss on disposal and sale of utility plant	95,064	3,138,531
Nonrecurring projects and studies	3,375,189	4,291,874
Total nonoperating expenses	<u>3,565,625</u>	<u>13,097,735</u>
Income before capital contributions	60,620,771	43,630,534
Capital Contributions	<u>51,516,525</u>	<u>14,798,951</u>
Change in Net Assets	112,137,296	58,429,485
Net Assets-Beginning of Year	<u>1,864,228,104</u>	<u>1,805,798,619</u>
Net Assets-End of Year	<u>\$ 1,976,365,400</u>	<u>\$ 1,864,228,104</u>

See the accompanying notes to the financial statements.



THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Statements of Cash Flows for the years ended June 30, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Received from customers	\$ 201,059,008	\$ 184,049,092
Paid to employees for services	(58,033,022)	(54,002,673)
Paid to suppliers for goods and services	(73,992,802)	(58,483,089)
Net cash provided by operating activities	69,033,184	71,563,330
Cash flows provided by noncapital financing activities:		
Taxes levied	23,210,982	22,015,870
Cash flows from capital and related financing activities:		
Proceeds from capital grants	2,142,401	2,829,296
Clean Water Capital Improvement Surcharge refunded	(5,762,702)	--
Proceeds from sale of utility plant	223,313	35,618
Proceeds from issuance of debt	43,193,659	7,567,844
Principal paid on debt	(5,498,061)	(1,365,276)
Interest and fees paid on debt	(13,848,925)	(14,299,185)
Payments for capital improvements	(125,572,530)	(140,402,733)
Net cash used in capital and related financing activities	(105,122,845)	(145,634,436)
Cash flows from investing activities:		
Purchase of investments	(224,477,577)	(366,502,840)
Proceeds from sale and maturity of investments	263,696,471	253,728,335
Investment income	9,134,073	5,788,168
Proceeds from rents	1,026,547	1,038,074
Net cash provided by (used in) investing activities	49,379,514	(105,948,263)
Net increase (decrease) in cash and cash equivalents	36,500,835	(158,003,499)
Cash and cash equivalents at beginning of year	66,588,041	224,591,540
Cash and Cash Equivalents at End of Year	\$ 103,088,876	\$ 66,588,041
Noncash capital and investing activities:		
Utility plant contributed by other governments and developers	\$ 51,516,525	\$ 14,798,951
Fair value investment adjustment	\$ (1,549,223)	\$ (1,220,574)

See the accompanying notes to the financial statements.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

	<u>2006</u>	<u>2005</u>
Reconciliation of operating income to net cash flows from operating activities:		
Operating income	\$ 30,913,486	\$ 26,619,778
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	43,979,819	44,442,903
Change in operating assets and liabilities:		
(Increase) decrease in billed and unbilled sewer service charges receivable	(4,954,471)	(4,874,855)
(Increase) decrease in other receivables	(999,033)	(600,129)
(Increase) decrease in supplies inventory	66,218	(1,689,505)
Increase (decrease) in contracts and accounts payable	(1,416,690)	8,859,975
Increase (decrease) in deposits and accrued expenses	1,443,855	(1,194,837)
Net Cash Provided by Operating Activities	<u>\$ 69,033,184</u>	<u>\$ 71,563,330</u>

See the accompanying notes to the financial statements.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Notes to Financial Statements
June 30, 2006 and 2005**

1. Organization and Summary of Significant Accounting Policies

Organization

The Metropolitan St. Louis Sewer District (the District) was authorized by the voters, established and chartered under the provisions of the Constitution of Missouri, as a municipal corporation and a political subdivision of the State. Upon creation in 1954, the District assumed responsibilities to provide for the construction, operation, and maintenance of the sewer facilities within its defined boundaries. The District's service area now comprises all of the City of St. Louis and most of St. Louis County. Subdistricts within the District's total service area represent separate geographic areas within which specific taxes are levied for the retirement of indebtedness issued to finance construction of sanitary or stormwater facilities within the area or to operate, maintain, or construct improvements within the subdistrict. The District also maintains all of the publicly owned stormwater sewers within its original boundaries and is continuing to accept maintenance of the stormwater sewers in the remainder of its service area.

Pursuant to provisions of its charter and subject to limitations imposed by the Constitution of Missouri, all powers of the District are vested in a six-member Board of Trustees (the Board), three of whom are appointed by the Mayor of the City of St. Louis and three of whom are appointed by the County Executive of St. Louis County.

Reporting Entity

The District defines its financial reporting entity to include all component units for which the District's governing body is financially accountable. To be considered financially accountable, the organization must be fiscally dependent on the District and the District must either 1) be able to impose its will on the organization or 2) the relationship must have the potential for creating a financial benefit or imposing a financial burden on the District.

Based on the foregoing, the District's financial statements include all funds that are established under the authority of the District's charter. There are no agencies, boards, commissions, or authorities that are controlled by or dependent on the District.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Throughout the year, the District maintains its detailed accounting records on the modified accrual basis of accounting. In order to account for the transactions related to certain subdistricts and restricted resources, separate fund accounting records are maintained. For financial reporting purposes, the District reports its operations as a single enterprise fund. Accordingly, the accounting records are converted to the accrual basis of accounting and all interfund transactions are eliminated. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when the related liability is incurred. The District's measurement focus is on the flow of economic resources, since income determi-

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

1. Organization and Summary of Significant Accounting Policies (continued)

Measurement Focus, Basis of Accounting, and Financial Statement Presentation (continued)

nation and capital maintenance are critical. Unbilled sewer service charge revenues are accrued by the District based on estimated billings for services provided through the end of the current fiscal year.

Revenues and expenses are divided into operating and nonoperating items. Operating revenues generally result from providing services in connection with the District's principal ongoing operations. The principal operating revenues of the District are user fees, licenses, and permits for wastewater treatment services. Operating expenses include the costs associated with the conveyance and treatment of wastewater, stormwater, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting these definitions are reported as nonoperating revenues and expenses.

The District follows GASB Statement No. 33, *Accounting and Financial Reporting for Non-Exchange Transactions* (GASB 33), which establishes accounting and financial reporting standards for non-exchange transactions involving financial or capital resources.

GASB 33 groups nonexchange transactions into the following four classes, based upon their principal characteristics: derived tax revenues, imposed nonexchange revenues, government mandated non-exchange transactions, and voluntary nonexchange transactions. For the District, the following non-exchange transactions are applicable.

The District recognizes assets from imposed nonexchange revenue transactions in the period when an enforceable legal claim to the assets arises or when the resources are received, whichever occurs first. Revenues are recognized in the period when the resources are required to be used or the first period that use is permitted. The District recognizes revenues from property taxes, net of estimated refunds and estimated uncollectible amounts, in the period for which the taxes are levied. Imposed nonexchange revenues also include licenses, permits, and other fees.

Intergovernmental revenues, representing grants and assistance received from other governmental units, are generally recognized as revenues in the period when all eligibility requirements, as defined by GASB 33, have been met. Any resources received before eligibility requirements are met are reported as deferred revenues.

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

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

1. Organization and Summary of Significant Accounting Policies (continued)

Measurement Focus, Basis of Accounting, and Financial Statement Presentation (continued)

During 2005, the District adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures, an Amendment of GASB Statement No. 3* (GASB 40). The adoption of GASB 40 modifies certain financial statement disclosures requirements. The new standard enhances the deposit and investment risk disclosures by updating the custodial credit risk disclosure requirements of GASB 3 and addressing other common risks, including concentrations of credit risk, interest rate risk, and foreign currency risk. The implementation of GASB 40 had no effect on financial statement amounts.

The District follows all Governmental Accounting Standards Board (GASB) pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principle Board Opinions, and Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. In addition, the District also applies all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents and Investments

The District's "cash and cash equivalents" consist of all highly liquid investments (including restricted assets) with maturity dates of 89 days or less from the date acquired by the District. "Investments" consist of those investments with maturity dates 90 days or greater at the time of purchase by the District. Investments are stated at fair value based upon quoted market prices.

Clean Water Capital Improvement Surcharge

In connection with the Consent Decree, on August 2, 1988, the voters within the District approved a schedule of capital improvement surcharges to be added to each customer's user charge.

The collections from the surcharges, as well as investment income and proceeds from various grants, are financing upgrades to certain sewage treatment facilities and other capital improvements required by the Federal Clean Water Act and the Missouri Clean Water Law (required projects). The ballot proposition stated that all surcharges, investment income, and grant proceeds collected were to be deposited in a Clean Water Capital Improvement Trust Fund (the Trust Fund). All funds of the Trust Fund are included in the financial statements of the District. The District issues a publicly available financial report on the Trust Fund that includes financial statements and supplementary information. That report may be obtained by writing: The Metropolitan St. Louis Sewer District, 2350 Market Street, St. Louis, MO 63103-2555.

The District was entitled to levy and collect the surcharges until one of the following three events occurred: 1) the cumulative collections totaled \$436,000,000; 2) the intended construction and improvements were complete; or 3) until December 31, 1995, regardless of whether the construction was complete or whether the cumulative collections totaled \$436,000,000. The surcharge was eliminated in April 1995. This was made possible

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

1. Organization and Summary of Significant Accounting Policies (continued)

Clean Water Capital Improvement Surcharge (continued)

by favorable construction bids, higher than expected investment earnings, and increased federal and state grant participation. In January 1997, the District refunded approximately \$25 million to its customers. In 1998, the District determined that approximately \$9.2 million would also be available for refund to customers.

In 1999, the District identified additional projects to be completed reducing the amount available for refund. In 2005, the District identified all remaining allowable projects to be completed. The District refunded \$5,762,702 from the Trust Fund to its customers during 2006.

Capital Assets

Capital assets are valued at historical cost or estimated historical cost based in part upon a study performed in 1981. Interest cost is capitalized as part of the historical cost of acquiring certain assets when the effect of such capitalization is material to the financial statements. Interest is not capitalized on assets constructed with contributions from other governmental sources. Depreciation is calculated on a straight-line basis over the following estimated useful lives:

Treatment and disposal plant and equipment	10 to 50 years
Collection and pumping plant	10 to 100 years
General plant and equipment	3 to 50 years

When designing user charge rates, the District includes funding for replacement cost of assets, which may differ from depreciation expense recorded for financial reporting purposes.

Normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Betterments are capitalized and depreciated over the remaining useful lives of the related assets, as applicable. The District defines capital assets as assets with an initial, individual cost of more than \$1,000 and an estimated useful life in excess of three years.

Capitalization of Interest

Interest costs are capitalized as part of the costs of capital assets during the period of construction based on the related weighted average net borrowing costs incurred. Interest earned on temporary investments acquired with the proceeds of such borrowed funds from the date of the borrowing until the assets are ready for their intended use is used to reduce the interest costs capitalized on the constructed assets. Interest is not capitalized for outlays financed by capital grants (or other outside parties) externally restricted for the acquisition of specified assets. In 2006 and 2005, the District capitalized \$8,182,438 and \$8,358,236 of net interest expense, respectively.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

1. Organization and Summary of Significant Accounting Policies (continued)

Supplies Inventory

Supplies inventory consists of parts and supplies to be used to operate and maintain treatment facilities and various treatment-related equipment at the District. This inventory is stated at the lower of cost or market, determined on the average cost method. Expenses are recognized when the inventory is consumed.

Net Assets

Invested in capital assets, net of related debt: This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding debt that is attributable to the acquisition, construction, or improvement of those assets.

Restricted: This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors, grantors, contributors, laws, or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. Restricted net assets represent those portions of equity set aside for specific purposes. Proceeds from the sale of real property no longer necessary in the operation of the District and rental income from District-owned properties have been restricted for the purchase and improvement of real property and expenses related to the use of 2350 Market Street. Property taxes levied by the various subdistricts and other revenues received for construction in those subdistricts have also been restricted for that use. Clean water capital improvement surcharges, sewer extension and connection fees, grants, and other revenues received for construction within certain subdistricts have been restricted for that use. In addition, a portion of sanitary sewer charges have been restricted for the payment of principal and interest on certain debt of the District.

Unrestricted net assets: This component of net assets consists of net assets that do not meet the definition of restricted or invested in capital assets, net of related debt.

Capital Contributions

Capital contributions to the District represent government grants and other aid used to fund capital projects. In accordance with GASB 33, capital contributions are recognized as revenue when the expenditure is made and the amount becomes subject to claim for reimbursement.

Bond Issuance Costs/Bond Premiums and Discounts

Bond issuance costs incurred, as well as bond premiums and discounts, and paid from the proceeds of revenue bond issues are deferred and amortized using the straight-line method over the term of the bonds.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

1. Organization and Summary of Significant Accounting Policies (continued)

Compensated Absences

Vacation

Under the terms of the District's personnel policies, employees are allowed to carry a maximum of 30 to 45 days of vacation (depending on length of service) from one calendar year to the next. Since vacation accrued at year-end is expected to be used by the employee during the following fiscal year, the accrual is reported as a component of current deposits and accrued expenses payable.

Sick Leave

Employees earn sick pay benefits at accrual rates ranging from 10 days per year to 12 days per year (depending on length of service). Unused sick leave can be carried over at year-end without limitation. An employee retiring from the District with five or more years of service, who has unused accrued sick leave remaining, will be compensated for that portion of unused accrued sick leave at the rate of 1-1/4% for each year of District service. The District has recorded a liability, which has been actuarially determined to be equal to the accumulated expense charge that will amortize the employees' benefits over their period of District service. The liability, included in current deposits and accrued expenses payable, includes vested accumulated rights to receive sick leave benefits estimated to be paid within one year. The portion of sick leave expected to be paid after one year is recorded as a component of noncurrent deposits and accrued expenses payable.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements. Actual results could differ from those estimates.

Reclassification of Prior Year

The financial statements for the year ended June 30, 2005, contain a reclassification of landfill closure and postclosure costs from a current liability to a long-term liability, allowance for uncollectible sewer service charges, and a portion of invested capital assets, net of related debt to restricted net assets for comparability purposes. These reclassifications had no effect on the total net assets of the District.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

2. Deposits and Investments

With the approval of the District's Board of Trustees, the Secretary-Treasurer is authorized to invest excess cash in any investment authorized by the District's charter. The District's investment policy conforms to the investment policy guidelines for the State of Missouri. The District's investment policy authorizes the District to invest in the following instruments: U.S. Treasury notes, certificates of deposit, obligations of any agency or instrumentality of the U.S., repurchase agreements, banker's acceptances, and commercial paper rated in the three highest classifications, for terms specified in the policy. At June 30, 2006 and 2005, all of the District's investments were in compliance with the District's investment policy and charter.

In accordance with the District's investment policy, the District also invests in mortgage-backed securities such as collateralized mortgage obligations. These securities are reported at fair value and are based on the cash flows from interest payments by the underlying mortgages. As a result, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. For example, if interest rates decline and homeowners refinance mortgages, thereby prepaying the mortgages underlying these securities, the cash flow from interest payments is reduced and the value of these securities declines. Likewise, if homeowners pay on mortgages longer than anticipated, the cash flows are greater and the return on the initial investment would be higher than anticipated.

A summary of deposits and investments as of June 30, 2006 and 2005, is as follows:

	2006		2005	
	Cost	Fair Value	Cost	Fair Value
Deposits	\$ 60,784,313	\$ 60,784,313	\$ 13,217,342	\$ 13,217,342
Repurchase agreements (collateralized)	9,074,525	9,074,525	17,923,038	17,923,038
U.S. Treasury and Agency obligations	370,388,893	366,358,187	396,743,935	395,119,629
Commercial paper	31,023,546	31,141,673	45,574,411	45,649,494
	<u>\$ 471,271,277</u>	<u>\$ 467,358,698</u>	<u>\$ 473,458,726</u>	<u>\$ 471,909,503</u>

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

2. Deposits and Investments (continued)

Interest Rate Risk

As of June 30, 2006, the District had the following investments and maturities:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Maturity (years)</u>
Repurchase agreements (collateralized)	\$ 9,074,525	0.00
Certificates of deposit	11,200,000	0.33
U.S. Treasuries	116,409,742	0.24
U.S. Agencies	249,948,445	1.37
Commercial paper	31,141,673	0.11
Total	\$ 417,774,385	.93

The District will minimize the risk that the fair value of debt securities in the portfolio will fall due to increases in general interest rates by:

1. Structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities on the open market prior to maturity, and
2. Investing operating funds primarily in short-term securities.
3. State law limits the maximum stated maturities to five years on any investment from the date of purchase.

Custodial/Credit Risk

The District will minimize credit risk, the risk of loss due to failure of the security issuer or backer, by:

1. Prequalifying the financial institutions, broker/dealers, intermediaries, and advisors with which the District will do business; and
2. Diversifying the portfolio so that potential losses on individual securities will be minimized.

In accordance with its investment policy, the District limits its investments in these investment types to the top rating issued by NRSROs. As of June 30, 2006, the District's investments in commercial paper were rated A1 by Standard & Poor's, F-1 by Fitch ratings, and P-1 by Moody's Investors Service. The District's investments in U.S. Agencies and repurchase agreements all carry the explicit guarantee of the U.S. Government. All cash deposits of the District were fully collateralized with securities held by a third party financial institution in the District's name.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

2. Deposits and Investments (continued)

Concentration of Credit Risk

The District places no limit on the amount the District may invest in any one issuer with respect to U.S. Treasury Securities and collateralized time and demand deposits. U.S. Government agencies and government-sponsored enterprises are limited to 60% of the portfolio; and collateralized repurchase agreements are limited to 50% of the portfolio. U.S. Government agency callable securities, commercial paper, and bankers' acceptances are limited to 30% of the portfolio, each. The following table lists investments in issuers that represent 5% or more of total investments at June 30, 2006:

<u>Issuer</u>	<u>Percent of Total Investments</u>
Federal Home Loan Bank	24.1%
Federal Home Loan Mortgage Corporation	7.3%
Federal National Mortgage Association	18.8%

3. Property Tax

On or before May 1 of each year, the District levies ad valorem taxes on all taxable tangible property, real and personal, within its boundaries based on assessed valuations established by the City of St. Louis and St. Louis County assessors. Tax rates vary by subdistrict and purpose. Taxes levied are used for operations and stormwater maintenance, debt service, and construction. Taxes are recorded as nonoperating revenues. Property tax bills are mailed in October. They become delinquent and represent a lien on the related property if not paid by December 31. All property taxes are billed and collected by the City of St. Louis and St. Louis County Collectors of Revenue and are distributed to the District monthly.

4. Change in Capital Assets

The following is a summary of capital assets changes for the fiscal years ended June 30, 2006 and June 30, 2005:

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

4. Change in Capital Assets (continued)

	Balance June 30, 2005	Additions	Deletions	Balance June 30, 2006
Capital assets not being depreciated:				
Land	\$ 26,911,933	\$ 64,174	\$ --	\$ 26,976,107
Construction in progress	275,615,002	134,326,899	44,314,335	365,627,566
Total capital assets not being depreciated	302,526,935	134,391,073	44,314,335	392,603,673
Capital assets being depreciated:				
Treatment and disposal plant and equipment	566,802,423	3,490,424	571,057	569,721,790
Collection and pumping plant	1,514,563,636	92,156,109	62,978	1,606,656,767
General plant and equipment	52,201,691	2,327,055	1,333,985	53,194,761
Total capital assets being depreciated	2,133,567,750	97,973,588	1,968,020	2,229,573,318
Less: Accumulated depreciation:				
Treatment and disposal plant and equipment	(276,540,194)	(15,309,480)	(328,365)	(291,521,309)
Collection and pumping plant	(380,341,905)	(25,882,705)	(61,202)	(406,163,408)
General plant and equipment	(36,530,189)	(2,787,635)	(1,260,076)	(38,057,748)
Total accumulated depreciation	(693,412,288)	(43,979,820)	(1,649,643)	(735,742,465)
Total capital assets being depreciated, net	1,440,155,462	53,993,768	318,377	1,493,830,853
Total Capital Assets	\$ 1,742,682,397	\$ 188,384,841	\$ 44,632,712	\$ 1,886,434,526
	Balance	Additions	Deletions	Balance
	June 30, 2004			June 30, 2005
Capital assets not being depreciated:				
Land	\$ 29,887,872	\$ 97,282	\$ 3,073,221	\$ 26,911,933
Construction in progress	191,769,427	147,322,627	63,477,052	275,615,002
Total capital assets not being depreciated	221,657,299	147,419,909	66,550,273	302,526,935
Capital assets being depreciated:				
Treatment and disposal plant and equipment	566,876,959	110,851	185,387	566,802,423
Collection and pumping plant	1,437,525,264	77,141,920	103,548	1,514,563,636
General plant and equipment	50,295,189	2,964,373	1,057,871	52,201,691
Total capital assets being depreciated	2,054,697,412	80,217,144	1,346,806	2,133,567,750
Less: Accumulated depreciation:				
Treatment and disposal plant and equipment	(260,899,518)	(15,824,532)	(183,856)	(276,540,194)
Collection and pumping plant	(355,928,728)	(24,439,479)	(26,302)	(380,341,905)
General plant and equipment	(33,387,017)	(4,178,892)	(1,035,720)	(36,530,189)
Total accumulated depreciation	(650,215,263)	(44,442,903)	(1,245,878)	(693,412,288)
Total capital assets being depreciated, net	1,404,482,149	35,774,241	100,928	1,440,155,462
Total Capital Assets	\$ 1,626,139,448	\$ 183,194,150	\$ 66,651,201	\$ 1,742,682,397

5. Long-term Liabilities

The following is a summary of changes in the District's long-term liabilities for the year ended June 30, 2006:

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Notes to Financial Statements
June 30, 2006 and 2005**

5. Long-term Liabilities (continued)

	<u>Original Issuance Amounts</u>	<u>Balance July 1, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2006</u>	<u>Current Portion</u>
Bonds and notes payable:						
Revenue bonds:						
Series 2004A	\$ 175,000,000	\$ 175,000,000	\$ --	\$ 1,500,000	\$ 173,500,000	\$ 1,505,000
Series 2004B	161,280,000	160,152,500	--	3,907,500	156,245,000	2,780,000
Series 2005A	6,800,000	6,800,000	--	--	6,800,000	--
Series 2006A	42,715,000	--	42,715,000	--	42,715,000	--
Missouri Department of Natural Resources:						
Ozark and Table						
Rock	374,680	146,787	--	30,693	116,094	13,700
Energy Loan Program	98,595	88,712	--	9,768	78,944	10,078
West Watson and Nanell	535,600	535,600	--	50,100	485,500	50,800
	<u>\$ 386,803,875</u>	<u>\$ 342,723,599</u>	<u>\$ 42,715,000</u>	<u>\$ 5,498,061</u>	379,940,538	<u>\$ 4,359,578</u>
Add: Unamortized premium, net					7,090,569	
Less: Bond issue costs, net					<u>(5,492,585)</u>	
					<u>\$ 381,538,522</u>	
Deposits and accrued expenses:						
Landfill closure and postclosure costs		\$ 470,256	\$ 28,165	\$ --	\$ 498,421	\$ --
Compensated absences		4,119,547	782,904	332,896	4,569,555	913,911
		<u>\$ 4,589,803</u>	<u>\$ 811,069</u>	<u>\$ 332,896</u>	<u>\$ 5,067,976</u>	<u>\$ 913,911</u>

Wastewater System Revenue Bonds Payable

In May 2004, the District authorized and issued \$175,000,000 of Wastewater System Revenue Bonds Series 2004A (Series 2004A) for the purpose of providing funds to finance the initial phase of its capital improvements and replacement program, including constructing, repairing, and replacing new wastewater facilities. These senior bonds have interest rates ranging from 2% to 5% and are payable in semiannual installments at varying amounts through 2034. The revenue bonds do not constitute a legal debt or liability for the District, the State of Missouri, or for any political subdivision thereof and do not constitute indebtedness within the meaning of any constitutional or statutory debt limitation or restriction. The issuance of the revenue bonds does not obligate the District to levy any form of taxation therefore or to make

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

5. Long-term Liabilities (continued)

Wastewater System Revenue Bonds Payable (continued)

any appropriation for their payments in any fiscal year. The principal and interest on the bonds are expected to be paid from future wastewater revenues. The scheduled payment of the principal of and interest on the Series 2004A Bonds maturing on May 1 when due are guaranteed under a financial guaranty insurance policy.

Water Pollution Control and Drinking Water Revenue Bonds Payable

In May 2006, the State Environmental Improvement and Energy Resources Authority (the Authority) authorized and issued \$87,505,000 of Water Pollution Control and Drinking Water Revenue Bonds (State Revolving Funds Programs) Series 2006A (Series 2006A). The Series 2006A bonds provided funds to make loans to 13 Missouri political subdivisions that will be used to finance water pollution control and drinking water projects. A portion of the proceeds of the Series 2006A bonds issued by the Authority were used to purchase subordinate Participant Revenue Bonds (Participant Bonds) authorized and issued by the District in the aggregate principal amount of \$42,715,000, the proceeds of which will be used for constructing, repairing, and equipping new and existing wastewater facilities. The District's Participant Bonds have interest rates ranging from 3.5% to 4.5% and are payable in semiannual installments at varying amounts through 2025.

In May 2005, the Authority authorized and issued \$53,060,000 of Water Pollution Control and Drinking Water Revenue Bonds (State Revolving Funds Programs) Series 2005A (Series 2005A). The Series 2005A bonds provided funds to make loans to ten Missouri political subdivisions and one Missouri non-profit corporation that will be used to finance water pollution control and drinking water projects. A portion of the proceeds of the Series 2005A bonds issued by the Authority were used to purchase Participant Bonds authorized and issued by the District in the aggregate principal amount of \$6,800,000, the proceeds of which will be used for constructing, repairing, and equipping new and existing wastewater facilities. The District's Participant Bonds have interest rates ranging from 3% to 5% and are payable in semiannual installments at varying amounts through 2026.

In May 2004, the Authority authorized and issued \$179,780,000 of Water Pollution Control and Drinking Water Revenue Bonds (State Revolving Funds Programs) Series 2004B (Series 2004B). The Series 2004B bonds provided funds to make loans to seven Missouri political subdivisions that will be used to finance water pollution control projects. A portion of the proceeds of the Series 2004B bonds issued by the Authority were used to purchase Participant Bonds authorized and issued by the District in the aggregate principal amount of \$161,280,000, the proceeds of which will be used to finance the District's three water pollution control construction projects outlined in the agreement. The District's Participant Bonds have interest rates ranging from 2% to 5.25% and are payable in semiannual installments at varying amounts through 2027.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

5. Long-term Liabilities (continued)

Water Pollution Control and Drinking Water Revenue Bonds Payable (continued)

The Series 2004B, 2005A, and 2006A bonds do not constitute a legal debt or liability for the District, the State of Missouri, or for any political subdivision thereof and do not constitute indebtedness within the meaning of any constitutional or statutory debt limitation or restriction. The issuance of the Series 2004B, 2005A, and 2006A bonds does not obligate the District to levy any form of taxation therefore or to make any appropriation for their payments in any fiscal year. The principal and interest on the bonds are expected to be paid from future wastewater revenues.

In connection with the District's issuance of the Participant Bonds, which were purchased with the proceeds of the Series 2004B, Series 2005A, and 2006A bonds issued by the Authority, the District participates in the State Revolving Loan Program established by the Missouri Department of Natural Resources (DNR). Monies from federal capitalization grants and state matching funds are used to fund a reserve account for each participant. As the District incurs approved capital expenses, the DNR reimburses the District for the expenses from the bond proceeds account and deposits in a bond reserve fund in the District's name an additional 60% of the expenditure amount for the Series 2004B bonds or 70% for the Series 2005A and Series 2006A bonds. Interest earned from this reserve fund can be used by the District to fund interest payments on the bonds. On the date of each payment of the principal amount of the District's Participant Bonds, the trustee transfers from this reserve account to the master trustee an amount equal to 60% of the principal payment for the Series 2004B bonds or 70% for the Series 2005A and Series 2006A bonds. The costs of operation and maintenance of the wastewater treatment and sewerage facilities and the debt service is payable from wastewater revenues.

In accordance with the Series 2006A, Series 2005A, Series 2004A, and Series 2004B bond issuances, the District's annual net operating revenues from wastewater activities, as defined in the agreement, coupled with investments earnings must be at least 125% of the current portion of principal and interest due on all senior bonds and at least 115% of the current portion of principal and interest due on all bonds. At June 30, 2006 and 2005, the District was in compliance with this covenant.

Principal and Interest Requirements on Revenue Bonds Payable

The annual principal and interest requirements to maturity on revenue bonds payable outstanding as of June 30, 2006 are as follows:

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Notes to Financial Statements
June 30, 2006 and 2005**

5. Long-term Liabilities (continued)

Principal and Interest Requirements on Revenue Bonds Payable (Continued)

Wastewater System Revenue Bonds Payable/ Water Pollution Control and Drinking Water Revenue Bonds Payable			
<u>Years ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 4,285,000	\$ 17,619,860	\$ 21,904,860
2008	8,195,000	17,965,355	26,160,355
2009	9,095,000	17,639,655	26,734,655
2010	10,255,000	17,226,599	27,481,599
2011	11,160,000	16,793,806	27,953,806
2012-2016	60,925,000	76,203,129	137,128,129
2017-2021	75,445,000	60,292,900	135,737,900
2022-2026	93,345,000	39,808,819	133,153,819
2027-2031	63,005,000	20,052,869	83,057,869
2032-2034	43,550,000	4,425,750	47,975,750
Total	<u>\$ 379,260,000</u>	<u>\$ 288,028,742</u>	<u>\$ 667,288,742</u>

West Watson and Nanell Loan Agreement

During fiscal year 2005, the Department of Natural Resources loaned \$535,600 to the District. The West Watson and Nanell Loan bears interest at a rate of 1.5% and is payable through November 1, 2014. The purpose of this note is to finance the planning, acquisition, construction, improvement, repair, rehabilitation, and extension of the sewer system of a certain regional subdistrict. This note is classified as special assessment debt by the District; therefore, the principal and interest on this note will be repaid from additional tax assessments on property values within the subdistrict. The additional assessment to be paid by the property owners is 54.78 cents per square foot over the next ten years, with interest accruing at a rate of 2.5% per annum.

Ozark and Table Rock Loan Agreement

During fiscal year 2004, the Department of Natural Resources loaned \$374,680 to the District. The Ozark and Table Rock Loan bears interest at a rate of 1.5% and is payable through November 1, 2013. The purpose of this note is to finance the planning, acquisition, construction, improvement, repair, rehabilitation, and extension of the sewer system of a certain regional subdistrict. This note is classified as special assessment debt by the District; therefore, the principal and interest on this note will be repaid from additional tax assessments on property values within the subdistrict. The additional assessment to be

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Notes to Financial Statements
June 30, 2006 and 2005**

5. Long-term Liabilities (continued)

Ozark and Table Rock Loan Agreement (continued)

paid by the property owners is 61.2 cents per square foot over the next ten years, with interest accruing at a rate of 2.5% per annum.

Principal and Interest Requirements on Ozark and Table Rock and West Watson and Nanell Loan Agreements

The annual principal and interest requirements to maturity on the Ozark and Table Rock Loan Agreement and the West Watson and Nanell Loan Agreement outstanding as of June 30, 2006 are as follows:

<u>Special Assessment Loan Agreements</u>			
<u>Years ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 64,500	\$ 8,540	\$ 73,040
2008	65,600	7,564	73,164
2009	66,500	6,574	73,074
2010	67,500	5,569	73,069
2011	68,500	4,549	73,049
2012-2015	268,994	7,801	276,795
Total	\$601,594	\$40,597	\$642,191

Energy Efficiency Leveraged Note Payable

In April 2004, the Department of Natural Resources loaned \$98,595 to the District. The Energy Efficiency Leveraged Note Payable bears interest at a rate of 3.15% per annum and is payable through August 1, 2013. The purpose of this note is to finance the design, acquisition, installation, and implementation of energy conservation measures. The principal and interest on this note will be repaid from wastewater revenues.

Principal and Interest on Energy Efficiency Leveraged Note Payable

The annual principal and interest requirements to maturity on the Energy Efficiency Leveraged Note Payable outstanding as of June 30, 2006 are as follows:

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

5. Long-term Liabilities (continued)

Principal and Interest on Energy Efficiency Leveraged Note Payable (continued)

<u>Energy Efficiency Leveraged Note Payable</u>			
<u>Years ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 10,078	\$ 2,408	\$ 12,486
2008	10,398	2,088	12,486
2009	10,728	1,758	12,486
2010	11,069	1,417	12,486
2011	11,420	1,066	12,486
2012-2014	25,251	1,053	26,304
Total	\$78,944	\$9,790	\$88,734

Restricted Cash and Investments

The following trustee held accounts have been established in accordance with bond ordinances and financing agreements that require receipts generated from operations be segregated and certain reserve accounts be established:

Revenue Fund

The Revenue Fund will be used for the purpose of depositing wastewater operating revenues, providing funds to pay for expenses related to the operation and maintenance of the District, and fulfilling Sinking Fund requirements in accordance with the bond ordinances.

Sinking/Repayment Funds

The bond ordinances provide for deposits to and the use of monies in the Sinking Fund to be used for the sole purpose of principal and interest payments on the bonds. Sufficient monies shall be paid in periodic installments from the Revenue Funds.

Debt Service Fund

The Debt Service Fund shall be used by the Trustee for the sole purpose of paying the principal of and interest on the bonds, as and when the same become due.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Notes to Financial Statements
June 30, 2006 and 2005**

5. Long-term Liabilities (continued)

Restricted Cash and Investments (continued)

Debt Service Reserve Fund

After initial deposit of the amount required pursuant to the bond ordinances and financing agreements of the Series 2004A bonds, monies in the Debt Service Reserve Fund shall be disbursed and expensed by the District solely for the payment of the principal and interest on the bonds and notes to the extent of any deficiency in the Debt Service Fund for such purpose. The District may disburse and expend monies from the Debt Service Reserve Fund for such purpose immediately. At June 30, 2006 and 2005, cash and investments in the Debt Service Reserve Fund totaled \$20,101,437 and \$15,415,733, respectively.

Special Participant Bond Reserve Account

For the Series 2004B, Series 2005A, and Series 2006A bonds, the District shall deposit into the Special Participant Bond Reserve Account amounts in accordance with the bond ordinance, if any, which shall be disbursed and expensed by the District solely for the payment of the principal and interest on the Participant Bonds to the extent of any deficiency in the Repayment Fund for such purpose. At June 30, 2006 and 2005, cash and investments in the Special Participant Bond Reserve Account held on behalf of the District totaled \$80,982,438 and \$45,769,030, respectively. Monies in this account are not considered to be District funds. However, interest earnings on this account may be used by the District to reduce interest payments on the bonds outstanding.

Renewal and Extension Fund

All sums accumulated and retained in the Renewal And Extension Fund shall be first used to prevent default in the payment of interest on or principal of the bonds when due and shall then be applied by the District from time to time, as and when the District shall determine, for purposes pursuant to the trust Indenture. No monies have been deposited into this account at June 30, 2006 and 2005.

Project Funds

The Project Funds for all bond issuances outstanding will be used for the purpose of providing monies to pay project costs. The proceeds from the bonds and notes, after a deposit into the Debt Service Reserve Fund for the amounts required pursuant to the bond ordinances and note agreements of just the Series 2004A bonds, shall be deposited into the Project Fund. At June 30, 2006 and 2005, cash and investments in the Project Funds total \$170,405,547 and \$230,779,983, respectively.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

5. Long-term Liabilities (continued)

Restricted Cash and Investments (continued)

Rebate Funds

The bond ordinances provide for the creation of a Rebate Fund into which shall be deposited such amounts as are required to be deposited therein pursuant to the arbitrage instructions regarding the calculation and payment of rebate amounts due. The District does not have any rights in or claims to such money; provided, however, any funds remaining in the Rebate Fund after redemption and payment of all bonds and payment of any rebatable arbitrage amount, or provision having been made therefore, shall be remitted to the District. At June 30, 2006, cash and investments in the Rebate Funds total \$502,675. No monies were deposited into these accounts at June 30, 2005.

Administrative Fee Funds

The Administrative Fee Fund will be used for the payment of the Trustee's fees and other administrative fees pursuant to the note agreement. The Trustee shall immediately withdraw the fee amounts when due. Monies held in this account shall not be invested.

Fair Value of Financial Instruments

The value of the District's long-term debt is estimated based on the current rates offered to the District for debt of the same remaining maturities. The carrying amount and estimated fair value of the District's long-term debt as of June 30, 2006 were \$381,538,522 and \$388,317,214, respectively. The carrying amount and estimated fair value of the District's long-term debt as of June 30, 2005 were \$343,942,001 and \$357,579,126, respectively.

6. Changes in Restricted Net Assets

Details of changes in restricted net assets for the fiscal years ended June 30, 2006 and 2005, are:

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

6. Changes in Restricted Net Assets (continued)

	Restricted by Enabling Legislation				Total
	Debt Service	Real Property Purchase and Improvement	Subdistrict Construction and Improvement	Construction	
Balances, June 30, 2004	\$ 15,116,114	\$ 2,664,238	\$ 40,035,096	\$ 105,776,289	\$ 163,591,737
Additions:					
Proceeds from bonds and loans	--	--	--	7,032,244	7,032,244
Unspent prior year bond proceeds	--	--	--	301,309,136	301,309,136
Property taxes levied by the					
District	17,875	--	10,218,924	--	10,236,799
Investment income	377,062	96,994	1,145,065	9,322,438	10,941,559
Grant revenue	--	--	79,681	492,266	571,947
Connection fees	--	--	--	431,648	431,648
Transfers from other accounts	15,551,069	--	--	73,458,690	89,009,759
Other	--	1,038,074	--	--	1,038,074
Total additions	<u>15,946,006</u>	<u>1,135,068</u>	<u>11,443,670</u>	<u>392,046,422</u>	<u>420,571,166</u>
Deductions:					
Unused bond proceeds	--	--	--	226,932,257	226,932,257
Principal payments on long-term debt	1,127,500	--	--	--	1,127,500
Interest payments	14,423,569	--	--	--	14,423,569
Capital asset additions	--	--	7,411,253	118,704,329	126,115,582
Other contractual expenses	--	1,024,678	332,298	11,752,348	13,109,324
Clean Water Capital Improvement Refund	--	--	--	5,667,330	5,667,330
Transfers to other accounts	17,875	--	--	2,966,069	2,983,944
Total deductions	<u>15,568,944</u>	<u>1,024,678</u>	<u>7,743,551</u>	<u>366,022,333</u>	<u>390,359,506</u>
Balances, June 30, 2005	<u>15,493,176</u>	<u>2,774,628</u>	<u>43,735,215</u>	<u>131,800,378</u>	<u>193,803,397</u>
Additions:					
Proceeds from bonds and loans	--	--	--	43,193,659	43,193,659
Unspent prior year bond proceeds	--	--	--	226,932,257	226,932,257
Property taxes levied by the					
District	5,111	--	10,793,675	--	10,798,786
Investment income	375,740	86,043	1,475,114	11,375,498	13,312,395
Grant revenue	--	--	33,765	396,777	430,542
Connection fees	--	--	--	402,187	402,187
Transfers from other accounts	23,572,172	--	--	63,264,585	86,836,757
Other	--	1,026,547	--	--	1,026,547
Total additions	<u>23,953,023</u>	<u>1,112,590</u>	<u>12,302,554</u>	<u>345,564,963</u>	<u>382,933,130</u>
Deductions:					
Unused bond proceeds	--	--	--	147,452,130	147,452,130
Principal payments on long-term debt	5,407,500	--	--	--	5,407,500
Interest payments	13,834,766	--	--	--	13,834,766
Capital asset additions	--	--	8,492,063	110,564,678	119,056,741
Other contractual expenses	--	1,342,505	771,680	15,708,773	17,822,958
Clean Water Capital Improvement Refund	--	--	--	95,372	95,372
Transfers to other accounts	5,111	--	--	--	5,111
Total deductions	<u>19,247,377</u>	<u>1,342,505</u>	<u>9,263,743</u>	<u>273,820,953</u>	<u>303,674,578</u>
Balances, June 30, 2006	<u><u>\$ 20,198,822</u></u>	<u><u>\$ 2,544,713</u></u>	<u><u>\$ 46,774,026</u></u>	<u><u>\$ 203,544,388</u></u>	<u><u>\$ 273,061,949</u></u>

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

7. Defined Benefit Pension Plan

Plan Description

The Metropolitan St. Louis Sewer District Employees' Pension Plan (the Plan) is a noncontributory single employer defined benefit plan providing retirement benefits as well as death and disability benefits to members. As a condition of employment, all full-time employees of the District are covered by the Plan. The financial statements for the Plan are produced using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when the related liability is incurred. The Plan issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing: The Metropolitan St. Louis Sewer District, 2350 Market Street, St. Louis, MO 63103-2555.

The Plan, established on November 1, 1967, is amended from time to time by the District's Board of Trustees, primarily to improve benefits to members. A Pension Committee consisting of two members of the District's Board of Trustees, two elected employee members, and four members of the District's management staff administer the Plan. A committee of the District's Board of Trustees, with the aid of an investment advisor, reviews and evaluates the Plan's investments and the related rates of return on a periodic basis. The Plan is exempt from the requirements of the Employee Retirement Income Security Act of 1974 and, as such, is not subject to the Act's reporting requirements.

All benefits vest after five years of credited service. Members retiring at or after age 65 with five or more years credited service are entitled to a pension benefit. The Plan permits early retirement with reduced benefits beginning at age 55 if the member has completed 60 months of employment. A member whose combined age and term of service is equal to 75 may retire early with unreduced benefits.

The annual benefit accrued by a member is equal to 1.45% of final average earnings plus 0.40% of final average earnings that are in excess of covered earnings multiplied by the period of years and months of credited service not to exceed thirty-five years. A survivor's benefit for vested members who have not yet reached their normal retirement date or earned 75 points is provided for. The survivor's benefit is equal to the greater of 50% of the member's monthly-accrued retirement benefit as of the date of death, or 15% of the monthly earnings and the member's monthly-accrued retirement benefit actuarially reduced under the 100% joint and survivor annuity option. Members are also able to select a Contingent Annuity Pop-Up option. This option allows the member to elect a survivor annuity for life, with the provision that if the beneficiary should predecease the member, the benefit shall increase to the amount payable had the survivor option not been selected.

Ordinance Number 10872, effective January 1, 2001, further amended the Plan to extend the cost of living increases for retirees from a maximum of 30% to 45% of the original benefit.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Notes to Financial Statements
June 30, 2006 and 2005**

7. Defined Benefit Pension Plan (continued)

Plan Description (continued)

Effective August 1, 2004, Ordinance No. 11781 amended the plan to change the benefit formula to 1.70% of final average earnings plus 0.40% of final average earnings that are in excess of covered earnings multiplied by the period of years and months of credited service not to exceed thirty-five years without including accrued sick leave. A member who retires between August 1, 2004 and July 1, 2007 is entitled to select the greater of the above or the benefit calculated under the 1.45%/1.85% benefit formula including accrued sick leave. Sick leave is paid out at 1.25% per year of service times the amount of leave accrued. Also, the Plan was amended to provide the retiring member with a 10% partial lump sum payment option. The balance of the distribution will be paid in accordance with anyone of the other payment options available under the Plan.

The retirement benefit payable to a member who retires after his or her normal retirement date is the greater of a) the benefit that would have been payable on the normal retirement date plus a special annual retirement benefit provided by the accumulated value, at 4% per annum interest, of the monthly benefit that would have been received prior to the postponed retirement date or b) the benefit determined as of the postponed retirement date under the normal formula.

Funding Policy

The District's employees do not contribute to the Plan. Ordinances establishing the Plan provide for actuarially determined annual contributions, paid solely by the District, that are sufficient to pay benefits when due. The Entry Age Normal actuarial funding method is used to determine contributions.

Annual Pension Cost

Contributions of \$7,184,531 and \$6,775,520, excluding certain professional fees paid by the District, were made to the Plan during the Plan's calendar years ended December 31, 2005 and 2004, respectively. These contributions were made in accordance with actuarially determined contribution requirements based on actuarial valuations performed at January 1, 2005 and 2004, respectively, and for 2005 consisted of a) \$4,576,505 normal cost plus b) \$2,106,780 amortization of the actuarial accrued assets in excess of the actuarial accrued liability and prior changes c) multiplied by an inflation factor of 1.075.

The District provides certain professional fees, office space, utilities, and other services to the Plan at no cost. Other costs of administering the Plan are financed from plan net assets.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

7. Defined Benefit Pension Plan (continued)

Significant actuarial assumptions used in the valuations are as follows:

Latest valuation date	January 1, 2006
Actuarial cost method	Entry Age Normal
Amortization method	Level dollar closed
Amortization period	20-year period
Asset valuation method	Three-year average of adjusted market values
Post-retirement benefit increases	3.0% of current benefit, or \$50, if less
Investment rate of return	7.5% per annum (1)
Projected salary increases	5.5% per annum (1)
Social Security wage base	4.5% per annum increase (1)

(1) Includes inflation component of 4.0%

Three-Year Trend Information

Historical trend information about the District's participation in the Plan is presented below to help readers assess the Plan's funding status on a going-concern basis and assess progress being made in accumulating assets to pay benefits when due.

Calendar Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2005	\$ 6,980,026	100%	--
2004	6,384,774	100	--
2003	5,385,572	100	--

Required Supplementary Information (unaudited)

Schedule of Funding Progress (dollars in thousands)

Actuarial Valuation Date	Actuarial Value of Assets (1)	Entry Age Actuarial Liability (2)	(Unfunded)	Funded Ratio (1)/(2)	Annual Covered Payroll (3)	(UAAL) as a Percentage of Covered Payroll (1-2)/(3)
			Actuarial Accrued Liability (UAAL) (1)-(2)			
01/01/06	\$ 158,321	\$ 177,630	\$ (19,309)	89.1%	\$ 40,144	(48.1)%
01/01/05	142,986	168,237	(25,251)	85.0	39,382	(64.1)
01/01/04	133,966	159,444	(25,478)	84.0	37,637	(67.7)

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

**Notes to Financial Statements
June 30, 2006 and 2005**

8. Deferred Compensation Plan

The District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The deferred compensation plan, available to all District employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, disability, or due to financial hardship as defined by the Plan.

The Deferred Compensation Plan was amended and restated to comply with the Economic Growth and Tax Relief Reconciliation Act of 2001 (the Act). The Act made significant changes to Section 457(b) of the Internal Revenue Code of 1986, as previously amended. Plan assets are held in trust for the exclusive benefit of participants and their beneficiaries under Section 1448 of the Small Business Job Protection Act of 1996. As a result, the assets and liabilities of the Deferred Compensation Plan are not included in the accompanying financial statements.

The Deferred Compensation Plan issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing: The Metropolitan St. Louis Sewer District, 2350 Market Street, St. Louis, MO 63103-2555.

9. Post-Employment Health Care Benefits

In addition to providing pension benefits, the District provides post-employment health care benefits, in accordance with District policy, to employees who elect early retirement from the District or who retire from the District on or after attaining age 62. As of June 30, 2006 and 2005, 109 and 105 retirees, respectively, met the eligibility requirements. The District pays the monthly group health insurance premium for the individual until the retiree becomes eligible for Medicare at age 65. During fiscal 2006 and 2005, expenses of \$444,648 and \$363,249, respectively, were recognized for post-retirement health care premiums as those premiums were paid.

10. Self-Insurance Programs

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District has established a risk management program and retains the risk related to officers', directors', and general liability; to its obligation to provide workers' compensation and medical and hospitalization benefits to its employees; and to pay water backup claims to its customers. The estimated liabilities for payment of incurred (both reported and unreported) but unpaid claims relating to these matters are included as a component of current deposits and accrued expenses, and as such are expected to be paid within one year of the date of the statement of net assets. At June 30, 2006 and 2005, these liabilities amounted to \$2,733,584 and \$3,050,225, respectively.

The claims liabilities reported are based on the requirements of GASB Statement No. 10, which requires that a liability for claims be reported if information obtained prior to the issuance of the financial statements indicates it is probable that a liability has been incurred and the amount of the liability can be rea-

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

10. Self-Insurance Programs (continued)

sonably estimated. Changes in the balance of claims liabilities during fiscal 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Liability, beginning of year	\$ 3,050,225	\$ 3,227,973
Current year claims and changes in estimates	10,959,988	15,383,529
Claim payments	<u>(11,276,629)</u>	<u>(15,561,277)</u>
Liability, End of Year	<u><u>\$ 2,733,584</u></u>	<u><u>\$ 3,050,225</u></u>

The District obtains periodic funding valuations from the third-party administrators managing the self-insurance programs and adjusts the charges as required to maintain the appropriate level of estimated claims liability. The District also maintains excess liability insurance coverage for workers' compensation and medical and hospitalization claims; general liability; and water backup damage to customers' property.

The District purchases commercial insurance for all other risks of loss. Settled claims have not exceeded this commercial coverage in any of the past three years.

11. Closure and Postclosure Care Costs

State and federal laws and regulations require the District to place a final cover on its Prospect Hill Reclamation Project landfill site when it stops accepting waste and to perform certain maintenance and monitoring functions at the site for 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that the landfill stops accepting waste, the District reports a portion of these closure and postclosure care costs as an operating expense in each period based on landfill capacity used as of the end of the fiscal year. The \$498,421 and \$470,256 reported as landfill closure and postclosure care liabilities at June 30, 2006 and 2005, respectively, represent the cumulative amounts reported at fiscal year-end based on the use of 75% and 75% of the estimated capacity of the landfill for fiscal years ended 2006 and 2005, respectively. The District will recognize the remaining estimated cost of closure and postclosure care of \$168,984 at June 30, 2006 as the remaining estimated capacity is filled. These amounts are based on what it would cost to perform all closure and postclosure care in 2006. The District expects to close the landfill in the year 2012. Actual cost may be higher due to inflation, changes in technology, or changes in regulations.

The District is required to demonstrate that it has the financial capability to close the landfill to the State of Missouri through the use of a financial test as specified in 10 CSR 80-2.030(4)(D)6 of the Missouri Solid Waste Management Rules. The District has complied with the State's requirement. The District recognizes that estimates of closure costs may change as a result of inflation, deflation, and/or changes in technology and applicable laws and regulations. If closure cost estimates change, the liability currently reported on the balance sheet will be adjusted accordingly.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

12. Commitments and Contingencies

On or about July 29, 2002, the District entered into a Settlement Agreement with Missouri Department of Natural Resources (MDNR), the Missouri Clean Water Commission (Commission), and the Missouri Attorney General regarding the Baumgartner Sewage Treatment Facility (Baumgartner).

Previously, the State filed the case of State of Missouri ex rel. William L. Webster, et al. v. The Metropolitan St. Louis Sewer District, No. 864-00250, against the District with respect to certain alleged past and continuing violations of the Federal Water Pollution Control Act, 33 U.S.C. §§1251 et seq., the Missouri Clean Water Law §644.006, et seq., RSMo, and Missouri State Operating Permits issued to various sewage treatment facilities and other facilities owned and operated by the District. An Amended Consent Judgment was entered by the Circuit Court on January 20, 1989.

Paragraph XXIV of the Amended Consent Judgment further provided, in pertinent part, that the Amended Consent Judgment shall terminate when the District has achieved substantial compliance with the final effluent limitations for the Bissell Point Facility and Baumgartner for a period of one year. One of the purposes of the Amended Consent Judgment was for the District to achieve and then continue to achieve compliance with its Missouri State Operating Permit effluent limitations at Baumgartner.

Under said settlement agreement the District agreed to take certain measures to achieve temporary compliance with fecal coliform permit limits at Baumgartner. Ultimately, the District is to take the Baumgartner lagoon off-line on or before December 31, 2006. This will be done by connecting the sewage flow going to Baumgartner to a new Meramec Wastewater Treatment Facility. Furthermore, the parties agreed that the District will complete closure of the Baumgartner lagoon pursuant to 10 CSR 20-6.010(12) within 24 months of taking the Baumgartner lagoon offline. As of May 31, 2003, a moratorium on further sewer connects to Baumgartner will be enacted should the District be unable to meet identified effluent limits.

In addition, should the District fail to meet any of the deadlines set out in the Settlement Agreement or violate any of the terms contained therein, the penalties for each missed deadline could reach a maximum of \$10,000 per day, per violation.

The District is the current owner of a piece of property located adjacent to the Great Lakes Container Corporation Superfund Site and the Bissell Facility. As part of the Great Lakes Container Corporation Superfund clean up, the Environmental Protection Agency (EPA) removed approximately 800 buried drums from the District's property. The total cost of the site clean up was \$9,127,244, distributed among several responsible parties. As the current owner of the property, the District's assigned share of the total was \$365,090. On August 14, 2002 the U.S. Department of Justice confirmed an agreement in principle with the District.

Under this agreement in principle, the District was to pay \$230,000 in exchange for contribution protection under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and a covenant not to sue for past response costs. Appropriate monies were set aside from the fiscal year 2002 budget to pay said fine. The consent decree was reviewed by DOJ, EPA-Region 7, and MDNR, and timely placed in the Federal Register for comments.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

12. Commitments and Contingencies (continued)

On November 19, 2003, the proposed consent decree was filed with the U.S. District Court for the Eastern District for Missouri. Subsequently, on March 30, 2004, co-defendant Mallinckrodt, Inc. intervened in the case arguing primarily that the District's settlement was not fair and reasonable under the totality of the facts presented.

On August 11, 2004, DOJ's and the District's Motion to Support the consent decree was heard by the Court. The Court granted said Motion on September 9, 2004. Based upon entry of the Consent Decree, the District wired a payment to DOJ for \$230,000 on October 8, 2004.

On October 7, 2004 co-defendant Mallinckrodt, Inc. filed a Motion to Alter the Judgment Based on Newly Discovered Evidence. This Motion was denied by the Court on December 22, 2004. On January 25, 2005 Mallinckrodt Inc. filed a Rule 60(b)(3) Motion for Relief from Judgment. On February 1, 2005 the Court denied this Motion. On February 17, 2005 Mallinckrodt, Inc. appealed to the U.S. Court of Appeals. The District, DOJ, and Mallinckrodt, Inc. submitted briefs on June 13, 2005. On March 6, 2006 the U.S. Court of Appeals affirmed the District Court's ruling to deny Mallinckrodt, Inc.'s motion.

EPA and MDNR are considering initiating legal action against the District on the grounds that alleged, unpermitted discharges of untreated wastewater from combined sewer overflows (CSO's) and sanitary sewer overflows (SSO's) constitute violations of the Clean Water Act 33 U.S.C. § 1311. At this time the District's senior staff and Office of General Counsel are in preliminary discussions with EPA and MDNR and have presented the District's Capital Improvement Plan to both organizations for their review and consideration. By statute each day of an unlawful discharge represents a day of violation, and the Missouri Clean Water Law provides for a civil penalty with a maximum of \$10,000 per day, per violation. Currently, no lawsuits have been filed in this matter. Since July 22, 2003, the District has met a number of times with EPA, DOJ, and DOJ's technical consultant. On August 20, 2004, the District received a Section 308 letter from EPA Region VII, which is an official request for information and documentation. On January 19, 2005 the District provided an initial response to the Section 308 letter. The District continues to submit deliverables required by the Section 308 letter in a timely manner.

The District has been named as a defendant in several other lawsuits, some of which seek substantial damages. In the opinion of District management, none of these lawsuits will have a material impact on the financial position of the District.

The District has entered into construction and other contracts amounting to approximately \$215,070,115 and \$169,691,000 at June 30, 2006 and 2005, respectively. Grants to be received from various governmental agencies and entities to partially offset the cost of the contract commitments amounted to approximately \$772,000 and \$2,990,000 at June 30, 2006 and 2005, respectively.

At June 30, 2006, the District had \$114,205,000 bonds authorized, but unissued. These bonds will continue to fund the first of four phases of a 20-year wastewater capital improvement program.

THE METROPOLITAN ST. LOUIS SEWER DISTRICT

Notes to Financial Statements June 30, 2006 and 2005

13. Future Accounting Pronouncements

GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans* (GASB 43), and GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension Plans* (GASB 45), establish accounting and financial reporting standards for postemployment benefits other than pensions. As part of a total compensation package, many governments offer postemployment benefit plans other than pensions such as healthcare, life insurance, and so forth. GASB 43 establishes uniform financial reporting standards for other postemployment benefit (OPEB) plans and applies to OPEB trust funds included in the financial reports of plan sponsors or employers, as well as in stand-alone financial reports. GASB 45 establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local government employers. GASB 43 will be effective for the District for the fiscal year ending June 30, 2007, and GASB 45 will be effective for the District for the fiscal year ending June 30, 2008. Management of the District has not yet completed its assessment of the statement.