

FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY
INFORMATION

Suffolk County Water Authority
Years Ended May 31, 2007 and 2006
With Report of Independent Auditors

Suffolk County Water Authority
Financial Statements and
Required Supplementary Information

Years ended May 31, 2007 and 2006

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Report of Independent Auditors

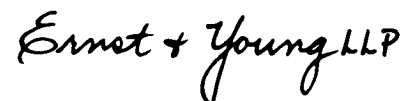
To the Members of
Suffolk County Water Authority

We have audited the accompanying balance sheets of the Suffolk County Water Authority (the “Authority”) as of May 31, 2007 and 2006, and the related statements of revenues, expenses and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in 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. We were not engaged to perform an audit of the Authority’s internal control over financial reporting. Our audit included 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 Authority’s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Authority as of May 31, 2007 and 2006, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

Management’s Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this required supplementary information. However, we did not audit the information and express no opinion on it.



August 21, 2007

Suffolk County Water Authority

Management's Discussion and Analysis

The primary purpose of the Suffolk County Water Authority (the "Authority") is to establish a single, integrated public water supply and distribution system providing pure water at a reasonable cost to serve Suffolk County.

The Financial Statements include:

The Balance Sheets provide information about the nature and amounts of investments in resources (assets) and the obligations to the Authority's creditors (liabilities), with the difference between the two reported as net assets.

The Statements of Revenues, Expenses and Changes in Fund Net Assets report how the Authority's net assets changed during each year. The statement accounts for all of the year's revenues and expenses, measures the financial results of the Authority's operations for the year and can be used to determine how the Authority has funded its costs.

The Statements of Cash Flows provide information about the Authority's cash receipts, cash payments and net changes in cash resulting from operations, investing activities and capital and related financing activities.

The notes to the financial statements contain information that is essential to understanding the financial statements, such as the Authority's accounting methods and policies.

Management provides the following discussion and analysis ("MD&A") of the Authority's financial activities and financial statements. This overview is provided for the fiscal years ended May 31, 2007, 2006 and 2005. The reader should use the information contained in this analysis in conjunction with the information contained in the audited financial statements, all of which follow this narrative on the subsequent pages.

Suffolk County Water Authority's Changes in Net Assets

	2007	2006	2005
	<i>(in thousands of dollars)</i>		
Operating revenues			
Water service	\$ 119,610	\$ 120,262	\$ 105,491
Other	10,540	12,381	8,693
Total operating revenues	130,150	132,643	114,184
Operating expenses			
Operations and maintenance	84,591	81,088	75,933
Depreciation and amortization	32,030	30,996	29,753
Total operating expenses	116,621	112,084	105,686
Operating income	13,529	20,559	8,498
Non-operating revenues and expenses			
Interest expense, net	(14,888)	(15,533)	(15,791)
Capital reimbursement fees	10,029	12,550	11,475
Unrealized loss on investments	1,076	(1,079)	240
Total non-operating revenues and expenses	(3,783)	(4,062)	(4,076)
Increase in net assets	9,746	16,497	4,422
Net assets—beginning of year	545,815	529,318	524,896
Net assets—end of year	\$ 555,561	\$ 545,815	\$ 529,318

Operating Revenues

Water service revenues decreased \$.7 million or .6% during the current year from \$120.3 million for the 2006 fiscal year to \$119.6 million for the 2007 fiscal year. The decrease was a result of a reduced demand on the system as compared to the prior year, offset by customer growth of below 1%, and an average rate increase of 4% effective April 1, 2007.

Water service revenues increased \$14.8 million or 14.0% during the prior fiscal year from \$105.5 million for the 2005 fiscal year to \$120.3 million for the 2006 fiscal year. The increase was a result of a higher than average demand on the system as compared to the prior year, customer growth of slightly under 1%, and average rate increases of 3% effective August 1, 2005 and April 1, 2006.

Other operating revenues decreased \$1.9 million or 15.3% from \$12.4 million for the 2006 fiscal year to \$10.5 million for the 2007 fiscal year. Other operating revenues remained stable with the exception of the legal settlement against the County of Suffolk, which occurred in fiscal year ending May 31, 2006.

Other operating revenues increased \$3.7 million or 42.5% from \$8.7 million for the 2005 fiscal year to \$12.4 million for the 2006 fiscal year. The increase is primarily attributable to a legal settlement against the County of Suffolk and increases from the cost of living adjustments in antennae leases, additional antennae lease sites, and miscellaneous customer related fees.

Operating Expenses

Operations and maintenance expense increased \$3.6 million or 4.4% from \$81.0 million for the 2006 fiscal year to \$84.6 million for the 2007 fiscal year. The \$3.6 million increase was mainly attributable to workers' compensation costs and general insurance (\$.5 million), health insurance (\$1.2 million), water treatment (\$.3 million), system maintenance (\$1.7 million), meter reading/collecting (\$.4 million), system operations (\$.8 million) offset by decreased power (\$.9 million), damage claims (\$.2 million), and retirement costs (\$.2 million).

Operations and maintenance expense increased \$5.1 million or 6.7% from \$75.9 million for the 2005 fiscal year to \$81.0 million for the 2006 fiscal year. The \$5.1 million increase was mainly attributable to increased power (\$4.3 million), workers' compensation costs and general insurance costs (\$1.1 million), offset by decreased costs incurred for water treatment (\$.1 million), and system maintenance cost (\$.2 million).

Depreciation and amortization expenses were \$32.0 million during fiscal 2007 as compared to \$31.0 million during fiscal 2006, an increase of \$1.0 million or 3.2%. The increase is attributable to additional capital assets placed in service during fiscal year 2007 along with goodwill related amortization.

Depreciation and amortization expenses were \$31.0 million during fiscal 2006 as compared to \$29.8 million during fiscal 2005, an increase of \$1.2 million or 4.0%. The increase is attributable to additional capital assets placed in service during fiscal year 2006 along with goodwill related amortization.

During fiscal year 2006, deferred losses of approximately \$3.8 million were recorded in connection with the defeasance of Suffolk County Water Authority Water Revenue Senior Lien Bonds—Series 1993, 1994, 1997, 1997A, 2001A, 2003, and Subordinate Lien Bonds— Series 1993 (see long term debt). In accordance with accounting principles generally accepted in the United States, the deferred loss is being amortized over the life of the refunded debt, which is shorter than the life of the new debt (between 8 and 12 years) resulting in current year amortization of \$.211 million.

Total amortization is \$.625 million and \$.422 million for fiscal years 2007 and 2006 respectively.

Non-operating Revenues and Expenses

Capital reimbursement fees were \$10.0 million during fiscal 2007 as compared to \$12.6 million during fiscal 2006, a decrease of \$2.6 million or 20.6% during the current year. The decrease is a result of the amount of developer main installations completed and placed in service (\$2.2 million) and a net reduction in tapping fees and surcharges billed (\$.4 million) during the fiscal year.

Capital reimbursement fees were \$12.6 million during fiscal 2006 as compared to \$11.5 million during fiscal 2005, an increase of \$1.1 million or 9.6% during the current year. The increase is a result of the amount of main and service installation completed and placed in service during the fiscal year.

Interest expense was \$23.2 million during fiscal 2007 as compared to \$22.7 million during fiscal 2006, an increase of \$.5 million. This is attributable to the annual payments of principal portions of certain outstanding long term bonds and interest rate changes on Suffolk County Water Authority Variable Rate Water Revenue Bonds 2006A and Variable Rate Bond Anticipation Notes 2003 and 2004 (see Long-Term Debt section).

Interest expense was \$22.7 million during fiscal 2006 as compared to \$20.8 million during fiscal 2005, an increase of \$1.9 million. This is attributable to the issuance of \$208.9 million long-term debt reduced by the defeasance of \$100.7 long-term debt and the partial payoff of variable rate Bond Anticipation Notes from 2001 and 2003 (see Long-Term Debt section).

Interest income was \$9.4 million during fiscal year 2007 as compared to \$6.1 million during fiscal year 2006, an increase of \$3.3 million. A higher interest rate environment is the main reason for this increase.

Interest income was \$6.1 million during fiscal year 2006 as compared to \$5.2 million during fiscal year 2005, an increase of \$.9 million. The increase is the result of continued good cash management as well as a higher interest rate environment.

Suffolk County Water Authority's Net Assets

	2007	2006	2005
	<i>(in thousands of dollars)</i>		
Assets			
Capital assets, net of accumulated depreciation	\$ 951,024	\$ 925,002	\$ 894,508
Other assets:			
Current	143,579	131,362	145,895
Noncurrent	84,849	194,998	106,364
Total assets	1,179,452	1,251,362	1,146,767
Liabilities			
Current liabilities	44,843	47,084	46,401
Other long-term liabilities	4,437	4,955	6,947
Long term debt	574,611	653,508	564,101
Total liabilities	623,891	705,547	617,449
Net assets			
Invested in capital, net of related debt	389,386	393,868	369,707
Restricted for debt service	33,923	33,426	31,927
Unrestricted	132,252	118,521	127,684
Total net assets	555,561	545,815	529,318
Total liabilities and net assets	\$ 1,179,452	\$ 1,251,362	\$ 1,146,767

Capital Assets, Net of Accumulated Depreciation (Water Plant)

There was a net increase in water plant in fiscal 2007 of \$26.0 million comprised of an increase of \$49.8 million in gross water plant (including construction in progress) reduced by an increase in accumulated depreciation of \$23.8 million.

There was a net increase in water plant in fiscal 2006 of \$30.5 million comprised of an increase of \$59.8 million in gross water plant (including construction in progress) reduced by an increase in accumulated depreciation of \$29.3 million.

Current Assets

	2007	2006
	<i>(in thousands of dollars)</i>	
Increases (Decreases)		
Cash and cash equivalents	\$ 706	\$ (668)
Current portion of investments	10,837	(17,096)
Accounts receivable, net	(764)	(470)
Accrued water services and fire protection	1,655	1,840
Materials and supplies	654	63
Prepayments and other current assets	(153)	967
Interest and other receivables	(718)	831
Net increase (decrease) in current assets	<u>\$ 12,217</u>	<u>\$ (14,533)</u>

Total investments, including cash and cash equivalents, were \$177.3 million at May 31, 2007, representing a net decrease of \$98.3 million. This is a result of additional cash provided by operating, financing and investing activities, reduced by the payoff of Suffolk County Water Authority Variable Rate Bond Anticipation Notes 2001 and 2003 and capital expenditures paid from unrestricted available funds.

Total investments, including cash and cash equivalents, were \$275.6 million at May 31, 2006, representing a net increase of \$67.2 million. This is a result of additional cash provided by operating, financing and investing activities. On May 15, 2006, \$70 million SCWA Water System Variable Rate Revenue Bonds were issued for the purpose of paying off outstanding Suffolk County Water Authority Variable Rate Bond Anticipation Notes 2001 and 2003. These notes are paid off subsequent to May 31, 2006 (see long term debt). Accordingly, these funds are included on the books and records of the Authority at May 31, 2006.

Accrued water services and fire protection reflects accrued revenue corresponding to pumpage which has not been billed as of May 31st. Water pumped in April and May 2007 was approximately 6.0% higher than 2006, which combined with a rate increase of approximately 4.0% (April 1, 2007) results in an increase of approximately \$1.7 million.

Accrued water services and fire protection reflects accrued revenue corresponding to pumpage which has not been billed as of May 31st. Water pumpage in April and May 2006 was approximately 12.5% higher than 2005 resulting in an increase of approximately \$1.8 million.

Inventory at May 31, 2007 is valued at \$6.3 million, an increase of \$.7 million compared to May 31, 2006. The increase is a result of excess purchases over stock issues and incremental inflationary increases.

Non-current Assets

The value of non-current assets decreased by approximately \$84.1 million, which is comprised of a \$26.0 increase in net capital assets, \$109.8 million decrease in investments held for construction, \$.1 million decrease in goodwill and a \$.2 million decrease in deferred charges and other assets.

Monies held for construction are internally designated to the costs of acquiring, constructing and replacing current water systems. The decrease in investments held for construction is a result of holding proceeds from previous financings designated for construction projects and the payoff of certain bond anticipation notes. Refer to Long-term Debt discussions for detailed information.

Investments

The Authority's investment policy complies with the NYS Comptroller's guidelines for investments. The investment policy permits investments in, among others, obligations of the U.S. Treasury, its agencies, and repurchase agreements backed by such obligations. Investments are reported at fair value.

The Authority's unrestricted investments increased 10.8 million or 11.5% from 93.9 million as of May 31, 2006 to \$104.7 million as of May 31, 2007. The increase in investments of unrestricted assets overall is attributable to the addition of monies available from revenues after the payment of debt service reduced by the use of funds to pay for water system capital improvements.

The Authority's unrestricted investments decreased \$17.1 million or 15% from \$111 million as of May 31, 2005 to \$93.9 million as of May 31, 2006. The decrease in investments of unrestricted assets overall is attributable to the use of funds to defease \$29 million of outstanding Suffolk County Water Authority Water Revenue Bonds. This decrease was mitigated by the addition of monies available from revenues after the payment of debt service.

Current Liabilities

The \$2.2 million decrease in current liabilities from 2006 to 2007 consists of increases in current maturities of water revenue bonds (\$.4 million), customer deposits (\$.4 million) and other accrued liabilities (\$.1 million). These increases are offset by decreases in accounts payable (\$1.4 million), accrued interest (\$.9 million), and accrued employee welfare costs (\$.8 million).

The \$.7 million increase in current liabilities from 2005 to 2006 consists of decreases in current maturities of water revenue bonds (\$.5 million) and other accrued liabilities (\$.4 million). These decreases are offset by increases in accrued interest (\$1 million) and accrued employee welfare costs (\$.6 million).

Accrued retirement contributions continue to be stable (less than \$.1 million) between 2006 and 2007. This is attributable to a slightly lower contribution payment made in December 2006 based on rates established by the New York State Retirement System. Based on estimated payroll for the water authority combined with rates, which have been established by the New York State Retirement System, the regular pension costs for the period April 1, 2007 through March 31, 2008 are estimated to be an average of 9.2% of payroll.

Accrued retirement contributions have remained relatively stable (less than \$.1 million) between 2005 and 2006. This is attributable to slightly reduced contribution rates as established by the New York State Retirement System mitigated by increased payroll costs. The Authority has been advised by the New York State Retirement System that regular pension costs for the period April 1, 2006 through March 31, 2007 are estimated to be an average of 9.6% of payroll.

The \$1.4 million decrease experienced in accounts payable from 2006 to 2007 is attributable principally to a decrease in outstanding invoices related to capital, and operating and maintenance expenses.

The increase in customer deposits of \$.4 million is attributable to overpayments made by customers resulting in additional customers with credit balances.

The decrease in accrued interest of \$.9 million is primarily attributable to the reduction of outstanding debt with the Environmental Facilities Corporation in the course of making normally scheduled payments in accordance with debt service schedules.

The decrease of \$.4 million in other accrued liabilities from 2005 and 2006 is primarily attributable to the reduction in liability for potential workers' compensation claims.

Long-term Debt

The Authority's long-term debt (including current maturities and exclusive of unamortized discounts) decreased from fiscal 2006 to fiscal 2007 by \$10.2 million resulting from the scheduled maturities during the fiscal year.

Water System Revenue and Environmental Facilities
Corporation Revenue Bonds

	2007	2006	2005
	<i>(in thousands of dollars)</i>		
New issues:			
EFC 2005A	\$ —	\$ 7,047	\$ —
SCWA 2005	—	71,905	—
SCWA 2005C	—	60,000	—
SCWA 2006A	—	70,000	—
EFC 2004	—	—	6,605
SCWA 2003	—	—	—
EFC 2003	—	—	—
	—	208,952	6,605
Maturities, retirements and defeasances:			
SCWA	(6,795)	(108,351)	(7,035)
EFC	(3,437)	(3,220)	(2,845)
	(10,232)	(111,571)	(9,880)
Net change in long-term debt	\$ (10,232)	\$ 97,381	\$ (3,275)

As a result of legislation initiated by New York State and enacted by the U.S. Congress a Drinking Water State Revolving Fund (“DWSRF”) was created to provide financial incentive for public and private water systems to finance drinking water infrastructure improvements in the form of subsidized low interest rate loans and grants for qualified projects. The Environment Facilities Corporation (“EFC”) administers the financial aspects of the DWSRF. The Authority has participated in this program since 1998. The Authority has determined it advisable and financially advantageous to continue to participate in this program. During the fiscal year ending May 31, 2007 the Authority did not issue any Water Revenue Bonds directly or through the EFC.

During the fiscal year ending May 31, 2006 (July 2005) the Authority issued \$7,047,361 of Senior Lien Bonds to provide for the retirement of \$1 million principal amount of the Authority’s outstanding Variable Rate Bond Anticipation Notes, 2001 and retirement of \$4.6 million principal amount of the Authority’s outstanding Variable Rate Bond Anticipation Notes, 2003, to fund a reserve account for these Senior Lien Bonds in the amount of \$704,736, and to finance additional costs of the approved projects.

Short-term debt

The Authority has, from time to time, issued Bond Anticipation Notes to finance improvements and additions to the Water System. During the fiscal year ended May 31, 2007 the Authority did not issue any new Bond Anticipation Notes. As indicated in the subsequent paragraph the Authority in May 2006 issued \$70 million in long term debt for the purpose of refunding all outstanding Variable Rate Bond Anticipation Notes, 2001 in the amount of \$47.9 million due June 1, 2006 and a partial refunding of Variable Rate Bond Anticipation Notes, 2003 in the amount of \$21 million. These notes were paid August 2, 2006.

During the fiscal year ended May 31, 2006 the Authority did not issue any new Bond Anticipation Notes. The Authority determined it financially advisable to refund certain outstanding Variable Rate Bond Anticipation Notes (Bans 2001 and 2003—\$1 million and \$4.6 million, respectively) through the issuance of long term debt as described elsewhere in this management discussion analysis. Additionally, in May 2006 the Authority issued \$70 million in long term debt for the purpose of refunding all outstanding Variable Rate Bond Anticipation Notes, 2001 in the amount of \$47.9 million due June 1, 2006 and a partial refunding of Variable Rate Bond Anticipation Notes, 2003 in the amount of \$21 million, paid August 2, 2006.

Net Assets Invested in Capital, Net of Related Debt

Invested in capital, net of related debt, represents the Authority's total investment in capital assets less related long-term debt.

The decrease of \$4.5 million from 2006 to 2007 results from an increase of \$25.8 million in net water plant reduced by a decrease in related debt of \$30.3 million.

Net Assets Restricted

Net assets, restricted, increased as a result of the unspent bond proceeds.

Net Assets Unrestricted

Net assets, unrestricted, increased as a result of operations and the decrease in the invested in capital balance.

Budget vs. Actual

Water sales are predicted based on average historical usage and the determination of the typical customer using 160,000 gallons of water annually. The past year's pumpage, 9% lower than the previous fiscal year, a slightly below 1% growth in customers, and water rate increases implemented on April 1, 2006 and April 1, 2007 correlates to actual water and hydrant revenues of \$.04 million above budget.

Other revenues include (1) charges to customers for late charges, reconnection fees, returned check fees, collection fees, initiation fees, (2) water district management fees, (3) antennae space rental fees, and (4) capital reimbursement fees. Other revenues, excluding capital reimbursement fees were below the corresponding budgeted amount of \$10.7 million by \$.2 million. Capital reimbursement fees were below the budgeted amount of \$10.3 million by \$.3 million, resulting from lower than anticipated customer growth.

Operating and maintenance expenses were budgeted at \$84.8 million, and actual expenses were \$84.6 million, \$.2 million under budget. Power costs were \$1.3 million over budget. Maintenance of facilities and equipment were \$1.2 million over budget. Lower than budgeted increases in treatment, testing, and remediation (\$.2 million), risk management (\$.4 million), customer service (\$.5 million), general & administrative (\$.3 million) and benefits (health, retirement, etc.) (\$1.3 million) offset the aforementioned increase in power costs and maintenance.

Actual debt service costs equaled budgeted costs of \$32.8 million.

Suffolk County Water Authority

Balance Sheets

	May 31	
	2007	2006
	<i>(in thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,662	\$ 2,956
Investments	104,786	93,949
Accounts receivable, less allowance for doubtful accounts of \$1,056 and \$1,079 in 2007 and 2006, respectively	8,836	9,600
Accrued water services and fire protection revenues	16,668	15,013
Interest and other receivables	1,407	2,125
Materials and supplies, at average cost	6,284	5,630
Prepayments and other current assets	1,936	2,089
Total current assets	<u>143,579</u>	131,362
Restricted investments	68,899	178,682
Goodwill	4,085	4,236
Deferred charges and other assets	11,865	12,080
Capital assets, net	951,024	925,002
	<u>1,038,873</u>	1,120,000
Total assets	<u>\$ 1,179,452</u>	<u>\$ 1,251,362</u>
Liabilities and net assets		
Current liabilities:		
Current maturities of bonds payable	\$ 10,652	\$ 10,232
Accounts payable	6,544	7,984
Accrued interest	8,916	9,899
Accrued employee welfare costs	6,151	6,939
Other accrued liabilities	4,471	4,358
Customer deposits	8,109	7,672
Total current liabilities	<u>44,843</u>	47,084
Bond anticipation notes payable	101,900	170,800
Bonds payable, less current portion	472,711	482,708
Advances for construction	4,437	4,955
Total liabilities	<u>623,891</u>	705,547
Commitments and contingencies		
Net assets:		
Invested in capital, net of related debt	389,386	393,868
Restricted for debt service	33,923	33,426
Unrestricted	132,252	118,521
Total net assets	<u>555,561</u>	545,815
Total liabilities and net assets	<u>\$ 1,179,452</u>	<u>\$ 1,251,362</u>

See accompanying notes.

Suffolk County Water Authority

Statements of Revenues, Expenses and Changes in
Fund Net Assets

	Year ended May 31	
	2007	2006
	<i>(in thousands)</i>	
Operating revenues:		
Water service	\$ 119,610	\$120,262
Other	10,540	12,381
Total operating revenues	130,150	132,643
Operating expenses:		
Operations	64,293	62,927
Maintenance	20,298	18,161
Depreciation and amortization	32,030	30,996
Total operating expenses	116,621	112,084
Operating income	13,529	20,559
Non-operating revenues and expenses:		
Interest expense	(23,237)	(22,745)
Income from investments	9,425	6,133
Capital reimbursement fees	10,029	12,550
Total non-operating revenues and expenses	(3,783)	(4,062)
Increase in net assets	9,746	16,497
Net assets:		
Beginning of year	545,815	529,318
End of year	\$ 555,561	\$545,815

See accompanying notes.

Suffolk County Water Authority

Statements of Cash Flows

	Year ended May 31	
	2007	2006
	<i>(in thousands)</i>	
Cash flows from operating activities		
Cash receipts from customers	\$ 118,719	\$ 118,892
Other operating cash receipts	11,910	11,574
Cash payments to suppliers of goods and services	(57,688)	(57,705)
Cash payments to employees for services	(29,519)	(28,070)
Net cash provided by operating activities	43,422	44,691
Cash flows from investing activities		
Purchase of investments	(90,858)	(7,000)
Proceeds from sales and maturities of investments	80,021	24,096
Interest received	8,349	7,212
Net cash (used in) provided by investing activities	(2,488)	24,308
Cash flows from capital and related financing activities		
Defeasance of bonds payable	–	(74,151)
Additions to water plant, net of retirements	(57,901)	(61,340)
Disbursements from (designations to) designated investments	110,859	(86,080)
Proceeds from issuance of long-term debt	–	208,952
Repayment of notes payable	(68,900)	(5,600)
Repayment of current maturities of bonds payable	(9,577)	(40,257)
Interest paid	(24,220)	(21,749)
Proceeds from advances for construction, net of refunds	9,511	10,558
Net cash used in capital and related financing activities	(40,228)	(69,667)
Net increase (decrease) in cash and cash equivalents	706	(668)
Cash and cash equivalents at beginning of year	2,956	3,624
Cash and cash equivalents at end of year	\$ 3,662	\$ 2,956
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 13,529	\$ 20,559
Depreciation and amortization expense	32,030	30,996
(Increase) decrease in operating assets:		
Accounts receivable	764	470
Accrued water service and fire protection	(1,655)	(1,840)
Materials and supplies and prepayments	(501)	(1,030)
Other assets	933	(4,614)
(Decrease) increase in operating liabilities:		
Accounts payable	(1,440)	32
Accrued employee welfare	(788)	618
Other accrued liabilities	113	(524)
Customer deposits	437	24
Net cash provided by operating activities	\$ 43,422	\$ 44,691
Non-cash investing activities		
Increase (decrease) in the fair value of investments	\$ 1,076	\$ (644)

See accompanying notes.

Suffolk County Water Authority

Notes to Financial Statements

May 31, 2007

1. Summary of Significant Accounting Policies

Suffolk County Water Authority (the “Authority”) is a public benefit corporation, created by resolution of the Suffolk County Board of Supervisors in 1937, with a two-fold purpose. The first was to acquire, construct, maintain and operate a public water supply for Suffolk County. The second was to develop a single, integrated public water supply and distribution system to serve all of Suffolk County. The accounts of the Authority are maintained generally in accordance with the Uniform System of Accounts prescribed by the New York State Public Service Commission (“PSC”), although the Authority is not subject to PSC rules and regulations. The rates established by the Authority do not require PSC or Suffolk County Legislative approval.

Basis of Presentation

In its accounting and financial reporting, the Authority follows the pronouncements of the Governmental Accounting Standards Board (“GASB”). In addition, the Authority follows the pronouncements of only applicable Financial Accounting Standards Board (“FASB”) Statements and Interpretations, issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements.

In accordance with GASB standards, the accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. As required by GASB standards, the transactions of the Authority are accounted for on a flow of economic resources measurement focus and accrual basis of accounting.

Water Plant

Water plant is recorded at original cost. The capitalized cost of additions to water plant include charges for ancillary construction costs such as construction period interest, engineering, supervision, payroll taxes and pension benefits. The original cost of property replaced, retired or otherwise disposed of in ordinary retirements is deducted from plant accounts and together with costs to remove, less any salvage, is charged to accumulated depreciation. The costs of repairs, minor betterments and renewals are charged to maintenance expense as incurred.

Depreciation

Water plant depreciation is provided on the straight-line basis using a composite annual rate of 2.84%, which is based on the average service lives and net salvage values of properties.

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Capitalized Interest

The Authority capitalizes interest on constructed assets during the period of construction. The amount of interest cost capitalized on qualifying assets acquired with proceeds of tax exempt borrowings that are externally restricted to finance acquisition of specified assets is all interest cost of the borrowings less any interest earned on related interest-bearing investments acquired with such unexpended proceeds from the date of the borrowings until the assets are substantially complete and are ready for their intended use. Interest cost capitalized during the years ended May 31, 2007 and 2006 was approximately \$1,413,000 and \$539,000, respectively.

Cash and Cash Equivalents

Investments with original maturity dates of 90 days or less are considered cash equivalents.

Investments

All investments with maturities longer than 90 days are reported as investments and are carried at fair value, except for investment agreements and certificates of deposit. Investment agreements, which can take the form of open time deposits or fixed repurchase agreements, are reported at an amount equal to principal and accrued interest. Certificates of deposit are valued at cost.

Investments Held for Debt Service

In accordance with the 1988 General Bond Resolution, as amended (the "Resolution"), the Authority maintains a debt service reserve (or bond insurance, as described in Note 5). This reserve is held by a Fiscal Agent.

Investments held for debt service are used solely for the purpose of paying the principal and interest on the bonds, and for retiring the bonds prior to maturity. Amounts in the bond fund are invested in U.S. Treasury Notes and U.S. government securities.

Investments Held for Construction

In accordance with the Resolution, monies held for construction are internally designated for the costs of acquiring, constructing and replacing the water system.

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Goodwill

Goodwill was derived from the Authority's acquisition of various private water purveyors. The Authority amortizes goodwill over a 40 year period.

Advances for Construction and Capital Reimbursement Fees

Under current standard construction contracts with residential real estate developers and others, the developer advances to the Authority the cost of new main installations based on a flat cost per foot. Upon completion of construction, the monies are recognized as capital reimbursement fees in the statements of revenues, expenses and changes in fund net assets. Provisions exist, and are infrequently exercised, whereby the developer may receive reimbursement if the actual footage of the main installed was less than 95% of the original estimate. These refunds are made from the construction advance account.

There exist certain construction contracts with residential real estate developers and others, whereby the developer advances the Authority the cost of new main installations based on actual costs. Upon completion of construction, the developer is either billed (not to exceed 10% of original estimate) or refunded the difference between the advance and actual cost. The monies paid by the developer are recognized as capital reimbursement fees in the statements of revenues, expenses and changes in fund net assets when the construction is completed.

Capital reimbursement fees also include the original cost of systems paid to the Authority by municipalities and others as well as service, tapping and other fees.

Water District Contracts

The Authority has entered into a number of contracts with various municipalities throughout Suffolk County for the purpose of installing water mains within the related municipality's created water district. Under the terms of these contracts, the municipality agrees to pay for the installation of the water main, plus interest over a 38 year period. The Authority agrees to provide a credit against the gross payments due under the contract equal to 40% of the water revenues collected from customers within the designated water supply district. The amount of the credit cannot exceed the gross payments due.

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

As of May 31, 2007, the Authority had 19 active contracts where the credit did not equal the gross amount due. Annual gross payments for these contracts range from \$1,500 to \$357,000 with final maturity dates between 2012 and 2035. The cumulative gross payments due for all of these water district contracts through their respective maturity dates amount to approximately \$24,007,000. The Authority has elected not to record the value of these contracts as an asset and liability at May 31, 2007.

The cost of these installations has been paid for and capitalized through the Authority's capital budget.

Debt Issuance Costs, Bond Discount and Other Bond Related Costs

Debt issuance costs and bond discount and premium are amortized over the life of the related bond issues using the effective interest method. Premiums paid in connection with interest rate cap agreements are amortized and reported as interest expense over the life of the respective agreements. Deferred bond refunding costs are amortized to expense over the shorter of the life of the refunding bonds or the refunded bonds.

Customer Deposits

As security for the payment of bills, the Authority generally requires a deposit from commercial customers and high volume water users. No interest is paid on such deposits.

Accrued Employee Welfare Costs

The Authority accrues the expected value of all vacation and sick leave benefits earned by employees to date.

Revenues

The Authority distinguishes operating revenues and expenses from non-operating items in the preparation of its financial statements. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. Water service revenues are recognized based on actual customer water usage, including estimates for unbilled periods. Other operating revenues are recognized when service has been rendered and collection is reasonably assured. The Authority's operating expenses include operations and maintenance expenses. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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

Use of Resources

Pursuant to the Resolution, revenues received are used as follows: (1) payment of operations and maintenance expenses, (2) payment of debt service, and (3) to be used for any lawful purpose of the Authority, including use by the construction fund. The payment of capital expenditures is generally paid for by restricted bond proceeds, other restricted resources, and by funds previously transferred to the general fund.

Income Taxes

As a public benefit corporation of the State of New York, the Authority is exempt from federal, state and local income taxes.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, as well as disclosures within the financial statements. Actual results could differ from those estimates.

Significant estimates relate to accounts receivable, accrued water services and fire protection revenues, water plant, accrued employee welfare costs and workers' compensation.

Recent Accounting Pronouncement

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The Statement establishes guidance for the financial reporting of other postemployment benefits ("OPEB") cost over a period that approximates employees' years of service and providing information about actuarially calculated liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. This Statement is effective for financial statements for periods beginning after December 15, 2006.

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Under GASB 45, based on an actuarial valuation, an annual required contribution (“ARC”) will be determined by the Authority. The ARC is the sum of (a) the normal cost for the year (the present value of future benefits being earned by current employees) plus (b) amortization of the unfunded accrued liability (benefits already earned by current and former employees but not yet provided for), using an amortization period of not more than 30 years. If the Authority contributes an amount less than the ARC, a net incremental OPEB obligation will result, which is required to be recorded as a liability on its financial statements.

GASB 45 does not require that the unfunded liability actually be funded, only that the Authority account for unfunded accrued liability and compliance in meeting the ARC. Actuarial valuations will be required every two years for most government employers, including the Authority.

The Authority engaged a consultant in fiscal year 2006 to assist in estimating its actuarial unfunded OPEB liabilities based on existing plan benefits and certain assumptions. While the initial analysis is preliminary and is still being reviewed by the Authority, the report estimates an actuarial OPEB liability of approximately \$205 million and annual ARC of approximately \$7.5 million. This initial analysis is subject to further review and adjustment based in part on further examination of the relevant assumptions, measures which the Authority may consider to manage plan benefits, ongoing changes in health care costs and the delivery of health care services. The reporting of OPEB liabilities will be done in accordance with GASB 45 regulations for fiscal year ending May 31, 2008.

Reclassifications

Certain fiscal 2006 balances have been reclassified in order to conform with the current fiscal year presentation.

Suffolk County Water Authority

Notes to Financial Statements (continued)

2. Water Plant

	May 31, 2006	Additions/ Reclassifications	Deletions/ Reclassifications	May 31, 2007
	<i>(in thousands of dollars)</i>			
Land and land rights	\$ 21,098	\$ 269	\$ (10)	\$ 21,357
Distribution systems	701,730	24,351	(637)	725,444
Wells, reservoirs and structures	190,868	14,885	(395)	205,358
Pumping and purification equipment	85,308	10,473	(640)	95,141
Other	113,057	7,892	(5,682)	115,267
Water plant in service	1,112,061	57,870	(7,364)	1,162,567
Less accumulated depreciation	(323,242)	(31,818)	8,050	(347,010)
Net water plant in service	788,819	26,052	686	815,557
Construction in progress	136,183	55,757	(56,473)	135,467
Water plant	\$ 925,002	\$ 81,809	\$ (55,787)	\$ 951,024

	May 31, 2005	Additions/ Reclassifications	Deletions/ Reclassifications	May 31, 2006
	<i>(in thousands of dollars)</i>			
Land and land rights	\$ 19,938	\$ 1,160	\$ -	\$ 21,098
Distribution systems	674,907	27,781	(958)	701,730
Wells, reservoirs and structures	187,209	3,802	(143)	190,868
Pumping and purification equipment	83,000	2,429	(121)	85,308
Other	108,545	4,624	(112)	113,057
Water plant in service	1,073,599	39,796	(1,334)	1,112,061
Less accumulated depreciation	(293,950)	(30,662)	1,370	(323,242)
Net water plant in service	779,649	9,134	36	788,819
Construction in progress	114,859	61,120	(39,796)	136,183
Water plant	\$ 894,508	\$ 70,254	\$ (39,760)	\$ 925,002

Depreciation expense amounted to approximately \$31,377,000 and \$30,205,000 for the years ended May 31, 2007 and 2006, respectively, based on a composite annual rate of 2.84%.

Suffolk County Water Authority

Notes to Financial Statements (continued)

3. Cash and Cash Equivalents and Investments

Cash and Cash Equivalents

Cash consists of insured (FDIC) or collateralized deposits which have carrying values of approximately \$3,662,000 and \$2,956,000 and bank balances of approximately \$5,821,000 and \$4,964,000 at May 31, 2007 and 2006, respectively. Collateral for deposits is held by the bank in the name of the Authority.

Investments

Investments consist of the following:

	Fair Value		Investment Maturities at May 31, 2007 in Years		
	2007	2006	Less than 1	1 to 5	5 to 10
	<i>(in thousands of dollars)</i>				
Certificates of deposit	\$ 13,400	\$ 36,750	\$ 13,400	\$ -	\$ -
U.S. Treasury bills (a)	477	190	477	-	-
U.S. Treasury notes (a)	2,980	2,970	997	1,983	-
U.S. Treasury bonds (a)	8,794	8,817	-	-	8,794
FNMA's (a)	56,239	46,106	45,082	11,157	-
FHLB Notes (a)	51,454	136,652	16,552	34,902	-
FHLMC Notes	4,890	11,978	-	4,890	-
FRMC Notes	3,974	8,826	3,974	-	-
FFCB Notes	6,461	-	-	6,461	-
Money market (a)	224	546	224	-	-
Guaranteed investment contracts (a)	569	589	569	-	-
Repurchase agreements	24,223	19,207	24,223	-	-
Total investments	\$ 173,685	\$ 272,631	\$105,498	\$ 59,393	\$8,794

	2007	2006
	<i>(in thousands of dollars)</i>	
Investment breakdown:		
Restricted for:		
Debt service	\$ 33,923	\$ 33,426
Construction	34,976	145,256
Unrestricted	104,786	93,949
Total investments	\$ 173,685	\$ 272,631

(a) Includes approximately \$53,742,000 and \$121,887,000 of investments held by Fiscal Agent in the Authority's name at May 31, 2007 and 2006, respectively.

Suffolk County Water Authority

Notes to Financial Statements (continued)

3. Cash and Cash Equivalents and Investments (continued)

Accrued interest on investments is included in interest and other receivables on the balance sheets. Investments bear interest rates that range from 2.75% to 6.75%.

The Authority's investment policy states that securities underlying repurchase agreements must have a market value at least equal to the cost of the investment. All investments are either insured or registered and held by the Authority or its agent in the Authority's name.

Investments include U.S. Treasury obligations, its agencies, certificates of deposit, guaranteed investment contract and repurchase agreements backed by such obligations. Investments are reported at fair value.

In addition, the Authority invests in an external investment pool called New York CLASS. The pool invests in obligations permissible under the Authority's investment policies. The fair value of the position of the pool is equal to the value of the pool shares. The value of this investment is reported as repurchase agreements in the table above.

Interest Rate Risk: The Authority does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk: It is the Authority's policy to limit its investments in debt securities to those rated in the highest rating category by at least two nationally recognized bond rating agencies. As of May 31, 2007, the Authority's investments in Federal National Mortgage Association, Federal Home Loan Bank and the Federal Home Loan Mortgage Corporation were rated Aaa by Moody's Investors Service and AAA by Standard & Poor's and Fitch Ratings.

Concentration of Credit Risk: The Authority places no limit on the amount the Authority may invest in any one issuer. More than 5% of the Authority's investments are in Federal National Mortgage Association and Federal Home Loan Bank. These investments are 32% and 30%, respectively, of the Authority's total investments.

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable

Outstanding bonds are summarized as follows:

Series	Interest Rate	Final Maturity Date	May 31, 2006	Issued	Matured/Refunded	May 31, 2007	Due within one Year
<i>(in thousands of dollars)</i>							
Water System Revenue Bonds							
(a) 1993 Senior Lien	4.80-5.10%	2013	\$ 26,495	\$ -	\$ (4,825)	\$ 21,670	\$ 6,520
(a) 1993 Subordinate Lien	4.80-5.10%	2013	14,040	-	(55)	13,985	60
(a) 1994 Subordinate Lien	4.13-6.00%	2017	6,265	-	(1,355)	4,910	-
(a) 1997 Senior Lien	4.10-5.25%	2012	2,840	-	-	2,840	-
(a) 1997A Senior Lien	4.00-5.00%	2022	11,230	-	-	11,230	-
(b) 2001A Senior Lien	4.13-5.25%	2023	21,925	-	-	21,925	-
(b) 2003 Senior Lien	2.00-4.50%	2017	58,340	-	(560)	57,780	570
(b) 2003C Senior Lien	4.00-4.50%	2026	80,000	-	-	80,000	-
(b) 2005C Senior Lien	4.50-5.00%	2029	60,000	-	-	60,000	-
(b) 2005 Subordinate Lien	4.37-4.55%	2027	71,905	-	-	71,905	-
(b) 2006A Senior Lien	Variable	2031	70,000	-	-	70,000	-
Environmental Facilities Corporation Revenue Bonds							
(b) 1998B	3.65-5.20%	2017	4,255	-	(275)	3,980	285
(b) 1999A	2.77-4.91%	2018	4,120	-	(230)	3,890	235
(b) 2000A	3.80-5.96%	2019	685	-	(35)	650	35
(b) 2000B	4.31-5.74%	2020	4,475	-	(195)	4,280	205
(b) 2001A	3.48-5.17%	2021	8,545	-	(425)	8,120	430
(b) 2001B	2.62-5.15%	2021	14,445	-	(670)	13,775	685
(b) 2002A	1.36-5.00%	2022	9,145	-	(430)	8,715	445
(b) 2002B	1.33-5.12%	2022	7,450	-	(335)	7,115	335
(b) 2003B	0.72-4.50%	2023	8,025	-	(360)	7,665	370
(b) 2004A	1.20-4.96%	2024	6,270	-	(227)	6,043	218
(b) 2005B	2.08-4.02%	2026	6,852	-	(255)	6,597	259
Total bonds outstanding			497,307	\$ -	\$ (10,232)	487,075	\$ 10,652
Less: Unamortized discount (premium)			(1,707)			(1,737)	
Deferred amount			6,074			5,449	
Current maturities payable			10,232			10,652	
			<u>\$482,708</u>			<u>\$472,711</u>	

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable (continued)

Series	Interest Rate	Final Maturity Date	May 31, 2005	Issued	Matured	May 31, 2006	Due within one Year
<i>(in thousands of dollars)</i>							
Water System Revenue Bonds							
(a) 1993 Senior Lien	4.80-5.10%	2013	\$ 36,570	\$ -	\$ (10,075)	\$ 26,495	\$ 4,825
(a) 1993 Subordinate Lien	4.80-5.10%	2013	15,295	-	(1,255)	14,040	55
(a) 1994 Subordinate Lien	4.13-6.00%	2017	29,396	-	(23,131)	6,265	1,355
(a) 1997 Senior Lien	4.10-5.25%	2012	27,495	-	(24,655)	2,840	-
(a) 1997A Senior Lien	4.00-5.00%	2022	35,135	-	(23,905)	11,230	-
(b) 2001A Senior Lien	4.13-5.25%	2023	38,200	-	(16,275)	21,925	-
(a) 2003 Senior Lien	2.00-4.50%	2017	67,395	-	(9,055)	58,340	560
(a) 2003C Senior Lien	4.00-4.50%	2026	80,000	-	-	80,000	-
(b) 2005C Senior Lien	4.50-5.00%	2029	-	60,000	-	60,000	-
(a) 2005 Subordinate Lien	4.37-4.55%	2027	-	71,905	-	71,905	-
(a) 2006A Senior Lien	Variable	2031	-	70,000	-	70,000	-
Environmental Facilities Corporation Revenue Bonds							
(b) 1998B	3.65-5.20%	2017	4,520	-	(265)	4,255	275
(b) 1999A	2.77-4.91%	2018	4,340	-	(220)	4,120	230
(b) 2000A	3.80-5.96%	2019	720	-	(35)	685	35
(b) 2000B	4.31-5.74%	2020	4,665	-	(190)	4,475	195
(b) 2001A	3.48-5.17%	2021	8,955	-	(410)	8,545	425
(b) 2001B	2.62-5.15%	2021	15,100	-	(655)	14,445	670
(b) 2002A	1.36-5.00%	2022	9,538	-	(393)	9,145	430
(b) 2002B	1.33-5.12%	2022	7,761	-	(311)	7,450	335
(b) 2003B	0.72-4.50%	2023	8,351	-	(326)	8,025	360
(b) 2004A	1.20-4.96%	2024	6,490	-	(220)	6,270	227
(b) 2005B	2.08-4.02%	2026	-	7,047	(195)	6,852	255
Total bonds outstanding			399,926	\$208,952	\$ (111,571)	497,307	\$ 10,232
Less: Unamortized discount (premium)			(998)			(1,707)	
Deferred amount			2,528			6,074	
Current maturities payable			10,695			10,232	
			\$387,701			\$ 482,708	

- (a) The payment of principal and interest is insured by a municipal bond insurance policy issued by MBIA Corporation or AMBAC Indemnity Corporation.
- (b) The payment of principal and interest is assured by a minimum debt service fund balance maintained by the Authority.

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable (continued)

Water System Revenue Bonds

The Water System Revenue Bonds are issued to finance the cost of acquisition and construction of improvements and additions to the water system. The Water System Senior Lien Revenue Bonds are payable solely from net revenues of the Authority's water system. The Water System Subordinate Revenue Bonds are payable solely from net revenues available after payment of debt service on Senior Lien Revenue Bonds issued by the Authority.

Suffolk County Water Authority did not issue any additional Water System Revenue Bonds during the fiscal year ending May 31, 2007.

During fiscal year ending May 31, 2006 Suffolk County Water Authority entered into the following bond transactions.

In December 2005, the Authority issued \$60,000,000 Senior Lien Water System Revenue Bonds, Series 2005C and \$71,905,000 Water System Revenue Bonds, Series 2005 Subordinate Lien Refunding Bonds. The Series 2005C Bonds were used to finance the cost of acquisition and construction of improvements and additions to the water system. The Series 2005 Subordinate Lien Refunding Bonds were issued in part to provide sufficient money to advance refund various issues of the Authority. The Series 2005C bonds bear interest at rates ranging from 4.5% to 5.0% and have a final maturity date of June 1, 2029. The Series 2005 bonds bear interest at rates ranging from 4.375% to 4.55% and have a final maturity date of June 1, 2027.

In May 2006, the Authority issued \$70,000,000 of Senior Lien Bonds, Variable Rate Water System Revenue Bonds, Series 2006A for the purpose of refunding all outstanding Variable Rate Bond Anticipation Notes, 2001 in the amount of \$47,900,000 due June 1, 2006 and a partial refunding of Variable Rate Bond Anticipation Notes, 2003 in the amount of \$21,000,000, paid August 1, 2006. These bonds are initially issued for a special auction period beginning on date of delivery to and including October 9, 2006 at the annual interest rate of 3.70% per annum, payable on October 10, 2006. Commencing on October 10, 2006, the Auction Period for this issue will convert to a seven-day Auction Period at the applicable annual interest rate determined by an auction to be conducted on October 6, 2006 pursuant to auction procedures. These bonds have a final maturity date of June 1, 2031.

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable (continued)

Environmental Facilities Corporation Revenue Bonds (“EFC Revenue Bonds”)

The State of New York has established a State Drinking Water Program, which includes a State drinking water revolving fund (the “Revolving Fund”) to be used for purposes of the Safe Drinking Water Act. The New York State Environmental Facilities Corporation (the “Corporation”) is responsible for administering the Revolving Fund and to provide financial assistance from the Revolving Fund. The Corporation issues bonds to provide loans from the Revolving Fund to private water companies, political subdivisions and public benefit corporations of the State of New York. The Authority has been issued a portion of the total bond proceeds in the amounts stated in the table above to finance safe drinking water projects.

Suffolk County Water Authority did not issue additional Water System Revenue Bonds through the Environmental Facilities Corporation during the fiscal year ending May 31, 2007.

During the fiscal year ending May 31, 2006 Suffolk County Water Authority issued the following Water System Revenue Bonds through the Environmental Facilities Corporation.

In July 2005, the Authority received bond proceeds in the amount of \$7,047,361 from the Environmental Facilities Corporation’s 2005B Revenue Bond Offering. The bonds have a final maturity date of April 1, 2026 and bear interest at rates ranging from 2.08% to 4.02%. The interest cost of these bonds is subsidized by the State of New York drinking water revolving fund.

The debt refundings during 2006 resulted in an economic loss of approximately \$3,756,000 and an increase in future debt service cash flow of approximately \$134,500,000. The economic loss is defined as the present value of the increase in future debt service cash flows.

In prior years, the Authority defeased certain debt obligations by placing the proceeds of new bonds and its own funds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Authority’s financial statements. At May 31, 2007, the amount of defeased debt obligation outstanding amounts to \$214,735,000.

Interest expense on the bonds outstanding during the fiscal year was \$19,450,000 and \$17,956,000 for the years ended May 31, 2007 and 2006, respectively.

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable (continued)

Bond maturities payable, including mandatory sinking fund redemptions, over the next five fiscal years and thereafter are as follows:

	Principal	Interest	Total
	<i>(in thousands of dollars)</i>		
Fiscal year ending:			
2008	\$ 10,652	\$ 22,219	\$ 32,871
2009	10,968	21,874	32,842
2010	9,755	21,442	31,197
2011	11,525	20,916	32,441
2012	11,630	20,380	32,010
2013-2017	74,015	93,081	167,096
2018-2022	92,170	73,525	165,695
2023-2027	117,835	48,031	165,866
2028-2032	148,525	15,870	164,395
	\$487,075	\$337,338	\$824,413

5. Debt Service Requirements

As prescribed in the Authority's Resolution, a minimum debt service reserve balance is to be maintained, which is the lesser of 10% of the proceeds of the Water System Revenue Bonds Series 1992B-2003D plus the EFC Revenue Bonds Series 1998B-2002A or the average of the annual installments of debt service with respect to Water System Revenue Bonds Series 1992B-2003C plus the EFC Revenue Bonds Series 1998B-2002G outstanding for the current and all future fiscal years. The Authority may purchase bond insurance in lieu of the debt service reserve requirement. The Authority has elected to maintain bond insurance on the Water System Revenue Bonds Series 1992B-2003D for the payment of principal and interest on stated maturity and sinking fund installment dates and in the event of default by the Authority. For the Water System Revenue Bonds Series 2001A, 2005C and EFC Revenue Bonds Series 1998B, 1999A, 2000A, 2000B, 2001A, 2001B, 2002A, 2002G, 2003B, 2004A and 2005B Bonds, the Authority elected to maintain a minimum debt service balance of 10% of the proceeds. At May 31, 2007, the debt service reserve held amounted to approximately \$18,809,000.

Revenue before interest expense and depreciation and amortization was equivalent to 1.98 times (2.11 in 2006) the debt service requirement, for the year ended May 31, 2007. The minimum debt service requirement on all bonds is 1.10.

Suffolk County Water Authority

Notes to Financial Statements (continued)

6. Notes Payable

Outstanding bond anticipation notes (“BANS”) payable are summarized as follows:

Series	Final Maturity Date	Balance at May 31, 2006	Issued	Redeemed	Balance at May 31, 2007	Due within one Year
<i>(in thousands of dollars)</i>						
2001	06/01/06	\$ 47,900	\$ –	\$ (47,900)	\$ –	\$ –
2003	01/01/08	62,900	–	(21,000)	41,900	41,900
2004	12/01/09	60,000	–	–	60,000	–
Total notes outstanding		\$ 170,800	\$ –	\$ (68,900)	\$ 101,900	\$ 41,900

Series	Final Maturity Date	Balance at May 31, 2005	Issued	Redeemed	Balance at May 31, 2006	Due within one Year
<i>(in thousands of dollars)</i>						
2001	06/01/06	\$ 48,900	\$ –	\$ (1,000)	\$ 47,900	\$ 47,900
2003	01/01/08	67,500	–	(4,600)	62,900	–
2004	12/01/09	60,000	–	–	60,000	–
Total notes outstanding		\$ 176,400	\$ –	\$ (5,600)	\$ 170,800	\$ 47,900

These notes are issued in anticipation of the issuance of long-term revenue bonds or replacement BANS, the proceeds of which will be used to repay the notes payable. The notes were issued to fund construction activities.

These notes are periodically remarketed and, therefore, interest on these notes is based on the minimum interest rate that, under prevailing financial market conditions, enables the notes to be sold at par, subject to the applicable effective interest rate period. The effective interest rate period may be daily, weekly, monthly, or semi-annually. Interest is payable periodically, based upon the effective interest rate period, through January 1, 2008, and December 1, 2009, the date of principal maturity, for the 2003 and 2004 notes, respectively.

For the years ended May 31, 2007 and 2006, the effective interest rate was 2.78% and 2.81%, respectively.

Interest expense on the BANS was approximately \$3,787,000 and \$4,789,000 for the years ended May 31, 2007 and 2006, respectively.

Suffolk County Water Authority

Notes to Financial Statements (continued)

7. Pension Plan

The Authority's employees are eligible to participate in the New York State and Local Employees' Retirement System, which is a cost-sharing, multi-employer, public employee retirement system. The benefits provided to members of this retirement system are established by New York State law and may be amended only by the State Legislature. The New York State and Local Employees' Retirement System issues a publicly available financial report. The report may be obtained from the New York State and Local Retirement System, Gov. Smith State Office Building, Albany, New York 12244. Benefit provisions vary as follows:

The Employees' Retirement System is subdivided into the following four classes:

Tier I	members who last joined prior to July 1, 1973.
Tier II	members who last joined on or after July 1, 1973 and prior to July 27, 1976.
Tier III	members who last joined on or after July 27, 1976 and prior to September 1, 1983.
Tier IV	members who joined on or after September 1, 1983.

Tier I members are eligible for retirement at age 55. If members retire with 20 or more years of total service, the service retirement benefit is 2% of the final average salary for each year of service. If members retire with less than 20 years of total service, the service retirement benefit is 1.66% of the final average salary for each year of service.

Tier II members are eligible to retire with full benefits at age 62, and with reduced benefits for retirement between ages 55 and 62. Retirement benefits are equivalent to Tier I members.

Tier III members with five or more years of credited service after July 1, 1973 are eligible to retire with full benefits at age 62 or at age 55 with 30 years of service and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Benefits are integrated with Social Security beginning at age 62. If members retire at age 62 and have 25 or more years of credited service, the service retirement benefit will be two percent of final average salary for each year of service (not to exceed 30 years), plus 1.5 percent of the final average salary for each year of credited service beyond 30 years. If members retire at age 62 with fewer than 25 years of credited service, the service retirement benefit will be 1.66% of the final average salary for each year of service.

Suffolk County Water Authority

Notes to Financial Statements (continued)

7. Pension Plan (continued)

Tier IV members with five or more years of credited service are eligible to retire with full benefits at age 62 or at age 55 with 30 years of service and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Benefits are equivalent to Tier III members.

Retirement benefits vest after five years of credited service and are payable at age 55 or greater. The Employees' Retirement System also provides death and disability benefits.

Tier I and II members are eligible to receive one month service credit for each year of service at retirement, with a maximum of 24 months.

Tier II, III and IV members will be able to purchase previous service credit (continuous service rules no longer apply) with member, having at least two years of service to have previous service creditable.

Tier III and IV members are required by law to contribute 3% of their annual salary to the Employees' Retirement System (3% contribution ceases after ten years of membership or ten years of credited service) and eligible Tier I and II members may make contributions under certain conditions. The Authority is required by the same statute to contribute the remaining amounts necessary to pay benefits when due.

After five years in the retirement system, veterans will be able to purchase up to three years of military service credit, at a cost of 3% of their last year's salary, for each year of credit acquired. A member is required to have been on active duty for at least one day during the following eligible periods:

World War II	(12/7/41 – 12/31/46)
Korean War	(6/27/50 – 1/31/55)
Vietnam Era	(2/28/61 – 5/7/75)

Pension expense contractually required by New York State and recorded in the Authority's accounts was \$2,493,415 and \$2,664,762 for the years ended May 31, 2007 and 2006, respectively. The Authority has recorded an accrued retirement contribution liability for certain pensions costs of employees related to construction work in progress which have been capitalized to water plant. The Authority capitalized \$1,066,946 and \$1,129,663 for the years ended May 31, 2007 and 2006, respectively.

Suffolk County Water Authority

Notes to Financial Statements (continued)

8. Deferred Compensation

All Authority employees may participate in a deferred compensation program designated as an Internal Revenue Code Section 457 plan. This program enables employees to contribute a portion of their salary, on a tax deferred basis, to group variable annuity contracts. The assets and related liabilities of the plan are recorded at the assets' market values and are excluded from the Authority's balance sheets. The Authority has no obligation to make contributions to the deferred compensation program. The Authority remits deferred compensation amounts withheld from employees' salaries to an outside fiduciary agent who administers the program and invests program assets as instructed by each of the participants. Assets in such program amounted to approximately \$26,798,000 and \$22,385,000 at May 31, 2007 and 2006, respectively.

9. Postretirement Benefits

The Authority's employees participate in the New York State Health Insurance Plan, a multi-employer plan, which provides certain health insurance benefits for retired employees. Substantially all the Authority's employees may become eligible for these benefits if they reach normal retirement age while working for the Authority. The cost of retiree health care benefits is recognized as an expense as costs are incurred. The cost amounted to approximately \$2,576,000 and \$2,408,000 for the years ended May 31, 2007 and 2006, respectively. During 2007, there were 898 participants that were eligible to receive benefits. See Note 1, "Recent Accounting Pronouncement".

10. Commitments and Contingencies

Operating Leases

As of May 31, 2007, the Authority is obligated under several operating leases with various lease terms through 2012, for telephone, copiers and mail machine:

	<i>(in thousands of dollars)</i>
Year ending May 31:	
2008	\$288
2009	250
2010	240
2011	231
2012	219

Rental expense for operating leases was approximately \$421,080 and \$427,000 for the years ended May 31, 2007 and 2006, respectively.

Suffolk County Water Authority

Notes to Financial Statements (continued)

10. Commitments and Contingencies (continued)

Legal

The Authority is involved in various litigation resulting from the ordinary course of business. In the opinion of management, and based on advice of legal counsel, the ultimate liability, if any, to the Authority will not have a material effect on the Authority's financial position and changes in net assets.

Risk Management

The Authority is exposed to various risks of loss related to automobiles and general liability. The Authority is partially self-insured for up to a maximum of \$500,000 for each general liability claim and \$500,000 for each automobile claim. The Authority purchases commercial insurance for claims in excess of coverage provided by the Authority to cover various other risks of loss. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years. The Authority is covered through the New York State Plan for workers' compensation; however, the Authority has recorded a liability related to workers' compensation for the period of time that the Authority did not have commercial insurance.

The Authority has established a liability based on actuarial estimates of the amounts needed to pay prior year and current year claims and to establish a reserve for catastrophic losses. That liability which is for workers compensation, general and automobile claims was \$3,013,255 and \$3,406,577 at May 31, 2007 and 2006, respectively, and is based on the requirements of Governmental Accounting Standards Board Statement No. 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

Changes in the Authority's workers' compensation claims liability amount in fiscal 2007 and 2006 were:

	Year ended May 31	
	2007	2006
Unpaid claims, beginning of fiscal year	\$ 1,457,776	\$ 2,054,502
Changes in the estimate for claims of all years	122,723	(509,055)
Retroactive payments	(754,191)	(87,671)
Unpaid claims, end of fiscal year	\$ 826,308	\$ 1,457,776

Suffolk County Water Authority

Notes to Financial Statements (continued)

10. Commitments and Contingencies (continued)

Changes in the Authority’s general and automobile claims liability amount in fiscal 2007 and 2006 were:

	Year ended May 31	
	2007	2006
Unpaid claims, beginning of fiscal year	\$ 1,948,801	\$ 1,220,764
Changes in the estimate for claims of all years	467,994	1,083,988
Claim payments	(229,848)	(355,951)
Unpaid claims, end of fiscal year	<u>\$ 2,186,947</u>	<u>\$ 1,948,801</u>

The Authority has included the above amounts under the caption, “Other accrued liabilities” in the balance sheets.

11. Net Assets

The Authority’s net assets represent the excess of assets over liabilities and are categorized as follows:

- *Invested in Capital Assets* are the amounts expended by the Authority for the acquisition of capital assets, net of accumulated depreciation.
- *Restricted Net Assets* are the net assets that have been restricted as in use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- *Unrestricted Net Assets* are the remaining net assets, which can be further categorized as designated or undesignated. Designated assets are not governed by statute or contract but are committed for specific purposes pursuant to Authority policy and/or Board directives. Designated assets include funds and assets committed to working capital.

Suffolk County Water Authority

Notes to Financial Statements (continued)

11. Net Assets (continued)

Changes in Net Assets

The changes in net assets are as follows:

	Invested in Capital Assets	Unrestricted	Restricted	Total
Net assets at May 31, 2005	\$ 369,707	\$ 127,684	\$ 31,927	\$ 529,318
Income	–	16,497	–	16,497
Transfers	24,161	(25,660)	1,499	–
Net assets at May 31, 2006	393,868	118,521	33,426	545,815
Income	–	9,746	–	9,746
Transfers	(4,482)	3,985	497	–
Net assets at May 31, 2007	\$ 389,386	\$ 132,252	\$ 33,923	\$ 555,561