SUFFOLK COUNTY WATER AUTHORITY

Financial Statements and
Required Supplementary Information

May 31, 2010 and 2009

(With Independent Auditors' Reports Thereon)

SUFFOLK COUNTY WATER AUTHORITY

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Independent Auditors' Report

The Members
Suffolk County Water Authority:

We have audited the accompanying balance sheet of the Suffolk County Water Authority (the Authority) as of May 31, 2010, and the related statements of revenues, expenses, and changes in fund net assets, and cash flows for the year 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 audit. The accompanying financial statements of the Authority as of May 31, 2009, were audited by other auditors whose report thereon dated August 31, 2009, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 Authority'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 net assets of the Suffolk County Water Authority as of May 31, 2010, and the changes in its net assets and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 31, 2010 on our consideration of the Authority'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 audit.

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The management's discussion and analysis and the schedule of funding progress for the retiree healthcare plan, on pages 3 to 12 and page 37, respectively, are not a required part of the financial statements but are supplementary information required by the U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of this required supplemental information. However, we did not audit the information and express no opinion on it.

KPMG LLP

August 31, 2010

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. Board Members are appointed by the Suffolk County Legislature for five-year overlapping terms. Vacancies, other than by expiration of term, are filled by the Suffolk County Legislature by appointment for the unexpired term. The Chairman of the Authority is also appointed by the Suffolk County Legislature. The rates established by the Authority do not require PSC or Suffolk County Legislative approval.

The Financial Statements

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 statements account for all of the years' revenues and expenses, measure the financial results of the Authority's operations for the years, 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 operating activities, 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, 2010 and 2009. 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. Management provides the following MD&A of the Authority's financial activities and financial statements.

(Continued)

Changes in Net Assets

		Year ended May 31	
	2010	**2009**	**2008**
		(In thousands)	
Operating revenues:			
Water service	$ 114,579	119,241	127,686
Other	14,663	14,306	12,277
Total operating revenues	129,242	133,547	139,963
Operating expenses:			
Operations and maintenance	97,071	103,476	97,554
Depreciation and amortization	37,768	36,200	34,845
Total operating expenses	134,839	139,676	132,399
Operating (loss) income	(5,597)	(6,129)	7,564
Nonoperating revenues and expenses:			
Interest expense, net	(21,538)	(17,352)	(14,654)
Costs to be recovered from future revenues	12,409	12,322	11,972
Capital reimbursement fees	8,381	8,629	10,283
Legal settlement	—	78,533	—
Total nonoperating revenues and expenses	(748)	82,132	7,601
Change in net assets	(6,345)	76,003	15,165
Net assets, beginning of year	646,729	570,726	555,561
Net assets, end of year	$ 640,384	646,729	570,726

Operating Revenues

Water service revenues decreased $4.6 million or 3.9% during the current fiscal year from $119.2 million for the 2009 fiscal year to $114.6 million for the 2010 fiscal year. The decrease was a result of reduced demand of 6.3% on the system as compared to the prior year, offset by other small variances.

Water service revenues decreased $8.5 million or 6.6% during the previous year from $127.7 million for the 2008 fiscal year to $119.2 million for the 2009 fiscal year. The decrease was a result of a reduced demand of 7.3% on the system as compared to the prior year, offset by other small variances.

Other operating revenues increased $0.4 million or 2.5% from $14.3 million for the 2009 fiscal year to $14.7 million for the 2010 fiscal year. The increase is primarily attributable to increases from the cost of living adjustments in antennae leases, antennae site enhancement fees, and additional antennae lease sites.

Other operating revenues increased $2.0 million or 16.3% from $12.3 million for the 2008 fiscal year to $14.3 million for the 2009 fiscal year. The increase is primarily attributable to increases from the cost of living adjustments in antennae leases, antennae site enhancement fees, and additional antennae lease sites.

Operating Expenses

Operations and maintenance expense decreased $6.4 million or 6.2% from $103.5 million for the 2009 fiscal year to $97.1 million for the 2010 fiscal year. The $6.4 million decrease was attributable principally to the reduced power cost $(3.8 million), and reduced system maintenance related costs of $(1.1 million). The reduction in power costs is attributable to the reduced consumption and related pumpage of water as well as improved management operation of the pump stations and related infrastructure, which is estimated at approximately $1 million in savings.

Operations and maintenance expense increased $5.9 million or 6.0% from $97.6 million for the 2008 fiscal year to $103.5 million for the 2009 fiscal year. The $5.9 million increase was mainly attributable to increases in operations and maintenance of wells and pump stations ($0.2 million), power costs ($1.9 million), transmission and distribution costs ($3.0 million), and treatment costs ($0.8 million).

Depreciation and amortization expenses were $37.8 million during fiscal 2010 as compared to $36.2 million during fiscal 2009, an increase of $1.6 million or 4.4%. The increase is attributable to additional capital assets placed in service, during fiscal year 2010 along with goodwill-related amortization.

Depreciation and amortization expenses were $36.2 million during fiscal 2009 as compared to $34.8 million during fiscal 2008, an increase of $1.4 million or 4.0%. The increase is attributable to additional capital assets placed in service during fiscal year 2009 along with goodwill-related amortization.

Nonoperating Revenues and Expenses

Capital reimbursement fees were $8.4 million during fiscal 2010 as compared to $8.6 million during fiscal 2009, a decrease of $0.2 million or 2.3% during the current year. The decrease is a result of reduced developer main installations completed and placed in service.

Capital reimbursement fees were $8.6 million during fiscal 2009 as compared to $10.3 million during fiscal 2008, a decrease of $1.7 million or 16.5% during the current year. The decrease is a result of reduced developer main installations completed and placed in service.

Interest expense – gross was $25.5 million during fiscal 2010 as compared to $24.2 million during fiscal 2009, an increase of $0.7 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 Bond Anticipation Notes 2004 and 2008 (see Long-Term Debt section).

Interest expense – gross was $24.2 million during fiscal 2009 as compared to $23.7 million during fiscal 2008, an increase of $0.5 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 Bond Anticipation Notes 2004 and 2008 (see Long-Term Debt section).

Interest income – gross was $3.0 million during fiscal year 2010 as compared to $6.8 million during fiscal year 2009, a decrease of $3.8 million. An increased availability of funds negated by an unprecedented lower interest rate environment is the main reason for this decrease.

Interest income – gross was $6.8 million during fiscal year 2009 as compared to $9.0 million during fiscal year 2008, a decrease of $2.2 million. An increased availability of funds negated by an unprecedented lower interest rate environment is the main reason for this decrease.

Costs to be recovered from future revenues of $12.4 million represent the difference between the Authority's annual required contributions for postemployment benefits other than pensions as required by Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB 45), and the amount paid out for such benefits by the Authority during fiscal 2010. In accordance with Financial Accounting Standards Board Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, the Authority has deferred the excess of the annual other post employment benefits (OPEB) costs over the amount paid during the fiscal year. The deferred costs will be recovered through future revenues.

Balance Sheets

		May 31	
	2010	**2009**	**2008**
		(In thousands)	
Assets:			
Capital assets (water plant), net of accumulated depreciation	$ 1,031,273	997,654	975,258
Current assets	208,676	267,043	167,270
Other noncurrent assets	216,559	87,590	129,569
Total assets	$ 1,456,508	1,352,287	1,272,097
Liabilities:			
Current liabilities	$ 50,474	110,018	48,478
Other long-term liabilities	39,655	28,172	16,262
Long-term debt, net of current portion	725,995	567,368	636,631
Total liabilities	816,124	705,558	701,371
Net assets:			
Invested in capital, net of related debt	367,305	361,791	380,565
Restricted for debt service	98,177	36,152	36,694
Unrestricted	174,902	248,786	153,467
Total net assets	640,384	646,729	570,726
Total liabilities and net assets	$ 1,456,508	1,352,287	1,272,097

Capital Assets, Net of Accumulated Depreciation (Water Plant)

		May 31, 2009	Additions/ reclassifications	Deletions/ reclassifications	May 31, 2010
			(In thousands)		
Water plant in service	$	1,284,793	53,069	(8,272)	1,329,590
Less accumulated depreciation		(407,978)	(36,768)	7,088	(437,658)
Net water plant in service		876,815	16,301	(1,184)	891,932
Construction in progress		120,839	71,621	(53,119)	139,341
Water plant	$	997,654	87,922	(54,303)	1,031,273

		May 31, 2008	Additions/ reclassifications	Deletions/ reclassifications	May 31, 2009
			(In thousands)		
Water plant in service	$	1,257,916	62,106	(35,229)	1,284,793
Less accumulated depreciation		(377,011)	(36,552)	5,585	(407,978)
Net water plant in service		880,905	25,554	(29,644)	876,815
Construction in progress		94,353	79,542	(53,056)	120,839
Water plant	$	975,258	105,096	(82,700)	997,654

There was a net increase in water plant in fiscal 2010 of $33.6 million comprising an increase of $63.3 million in gross water plant (including construction in progress) reduced by an increase in accumulated depreciation of $29.7 million.

There was a net increase in water plant in fiscal 2009 of $22.4 million comprising an increase of $58.4 million in gross water plant (including construction in progress) reduced by an increase in accumulated depreciation of $36.0 million.

Current Assets

		May 31	
		2010	2009
		(In thousands)	
Increases (decreases):			
Cash and cash equivalents	$	26,656	25,565
Unrestricted investments		(89,601)	73,009
Accounts receivable, net		(309)	1,255
Accrued water services and fire protection revenues		1,797	(764)
Materials and supplies		461	1,215
Prepayments and other current assets		(866)	(279)
Interest and other receivables		3,495	(228)
Net increase in current assets	$	(58,367)	99,773

Current Assets

The Authority's investment policy complies with the New York State 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. Authority investments are reported at fair value.

The Authority's unrestricted investments, including cash and cash equivalents, decreased $62.9 million or 27.3% from $230.8 million as of May 31, 2009 to $167.9 million as of May 31, 2010. The decrease in investments of unrestricted assets overall is attributable principally to the funding of debt service reserve accounts for certain previously issued outstanding bonds which resulted in the increase in restricted investments. The total decreased attributable for funding debt service and transferred to restricted investments was approximately $117.8 million. These decreases were offset by $41.2 million of cash provided by operating activities.

The Authority's unrestricted investments, including cash and cash equivalents increased $98.6 million or 74.5% from $132.3 million as of May 31, 2008 to $230.8 million as of May 31, 2009. The increase in investments of unrestricted assets overall is attributable to the addition of monies available from the legal settlement from oil companies and other operating revenues, after the payment of debt service reduced by the use of funds to pay for water system capital improvements, which was paid for from revenues available after payment of debt service and proceeds of previous financing.

Accrued water services and fire protection revenues reflect accrued revenue corresponding to pumpage, which has not been billed as of May 31. Water pumped in April and May 2010 was approximately 13.8% higher than 2009 as a result of Suffolk County experiencing drought-like conditions particular to the months of April and May providing for the increase of $1.8 million.

Water pumped in April and May 2009 was approximately 7.3% lower than 2008, which results in a decrease of approximately $0.8 million.

Interest and other receivables increased $3.5 million or 2.9% as a result of the receivable from a balance of $1.2 million at May 31, 2010 to $4.7 million at May 31, 2010. The primary source of this increase was the award of $3.8 million in funds to the Authority under the American Recovery and Reinvestment Act of 2009 (ARRA). These funds were awarded for purposes of constructing 17,763 feet of water main to existing residential customers that currently rely on point of use treatment systems for water service.

Other Noncurrent Assets

Other noncurrent assets increased by $129.0 million from a balance of $87.6 million to $216.6 million as of May 31, 2010. This increase was the direct result of a transfer from investments available for sale to restricted investments for purposes of meeting debt service requirements. The amount transferred approximated $117.8 million. This increase was supplemented by an additional costs deferred to the balance sheet in the amount of $12.4 million for costs associated with postemployment benefits.

Liabilities

Current Liabilities

		May 31 2010	May 31 2009
		(In thousands)	
Increase (decrease):			
Current maturities of bond anticipation notes payable	$	(60,000)	60,000
Current maturities of bonds payable		(3,230)	(1,213)
Accounts payable		(1,452)	1,785
Accrued interest		4,363	768
Accrued employee welfare costs		1,361	423
Other accrued liabilities		465	(550)
Customer deposits		(1,051)	327
Net change in current liabilities	$	(59,544)	61,540

Current Liabilities

The primary fluctuation between 2008 and 2009 of an approximately $60.0 million increase and 2009 to 2010 of $60.0 million decrease is the direct result of the bond anticipation notes becoming due and classified as short-term at May 31, 2009, and then subsequently paid at May 31, 2010.

The $1.5 million decrease experienced in accounts payable from 2009 to 2010 is attributable principally to a reduction in outstanding invoices related to capital and operating and maintenance expenses processed subsequent to May 31, 2010, where as the increase over the balance of May 31, 2008 was due to a slight increase in expenditures.

The increase in accrued interest of $4.4 million is attributable to the issuance of additional long-term debt issued during the current fiscal year, and the timing of interest payments on related debt.

The reduction in customer deposits of $1.1 million is attributable to the Water Authority's effort to refund excess payments made by customers resulting in additional customers with credit balances, and a reduction in construction related easement deposits.

Other Postemployment Benefits Other than Pensions (OPEBs)

Other long-term liabilities increased by $11.5 million from $28.2 million at May 31, 2009 to a balance of $39.7 million at May 31, 2010. This is a direct result of the increase in OPEB costs approximating $12.4 million in additional costs deferred to the balance sheet in the current year. GASB 45 establishes guidance for the financial reporting of OPEB cost over a period that approximates employees' years of service. Under GASB 45, based on an actuarial valuation, an annual required contribution (ARC) is 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. To the extent that 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 the unfunded accrued liability. The financial statements at May 31, 2010 include a liability in the amount of $36.7 million that represents the Authority's unfunded liability. The unfunded liability at May 31, 2009 was $24.3 million.

Long-Term Debt

The Authority's long-term debt (including current maturities, unamortized discounts and deferred amounts) increased from fiscal 2009 to 2010 by $151.0 million resulting from new bond issuances offset by the scheduled maturities during the fiscal year.

Water System Revenue and Environmental Facilities Corporation Revenue Bonds

		May 31		
		2010	**2009**	**2008**
			(In thousands)	
Balance, beginning	$	510,455	521,423	487,075
New issues:				
SCWA 2007		—	—	45,000
SCWA 20099B BAB's		100,000	—	—
SCWA 2009A		66,395	—	—
SCWA 2009 Refunding		13,415	—	—
		179,810	—	45,000
Maturities, retirements, and defeasances:				
SCWA		(25,145)	(7,385)	(7,150)
EFC		(3,680)	(3,583)	(3,502)
		(28,825)	(10,968)	(10,652)
Net changes in long-term debt		150,985	(10,968)	34,348
Balance, ending	$	661,440	510,455	521,423

Investment ratings on debt issued by the Authority by Standard and Poor's Rating Services (S&P) and Fitch Ratings (Fitch), were as follows at May 31, 2010:

	Investment Ratings	
	S&P	**Fitch**
Long Term Debt	AA+	AAA

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 fiscal years ending May 31, 2010 and 2009, the Authority did not issue any long-term debt through the DWSRF.

During the fiscal year ended May 31, 2010, the Authority issued $66.4 million Suffolk County Water Authority Senior Lien Water System Revenue Bonds for the purpose of retiring $60.0 million principal amount of the Authority's Variable Rate Bond Anticipation Notes, 2004. The Authority also issued, $13.4 million Suffolk County Water Authority Senior Lien Water System Revenue Bonds for the purpose of retiring of $2.8 million 1997 Suffolk County Water Authority Senior Lien Water System Revenue Bonds and $11.2 million 1997A Senior Lien Water System Revenue Bonds. The Authority also issued $100.0 million Suffolk County Water Authority Senior Lien Water System Revenue Bonds under the Build America Bonds program. These funds will be used to finance the cost of acquisition and construction of improvements and additions to the Water System.

(Continued)

During the fiscal year ended May 31, 2009, the Authority did not issue any Senior Lien Water System Revenue Bonds.

Short-Term Debt

The Authority has, from time to time, issued Bond Anticipation Notes to finance improvements and additions to the water system. In February 2010, the Authority issued $3.8 million Suffolk County Water Authority Variable Rate Bond Anticipation Notes, 2010 (EFC Series). Additionally, in November 2009, the Authority issued $66.4 million in long-term debt for the purpose of refunding all outstanding Variable Rate Bond Anticipation Notes, 2004 in the amount of $60 million due December 1, 2009.

During the fiscal year ended May 31, 2009, the Authority did not issue any new Bond Anticipation Notes.

Net Assets Invested in Capital, Net of Related Debt and Net Assets Restricted for Debt Service

Invested in capital, net of related debt represents the Authority's total investment in capital assets less related long-term debt. The decrease of $5.2 million over the May 31, 2009 balance is the result of an increase in water plant expenditures, offset by the net increase in debt balances.

Restricted for debt service increased by $62.0 million over the May 31, 2009 balance as with the bankruptcy of AMBAC, the guarantor of principal and debt payments, the Authority was required to collateralize the principal debt service payments in accordance with existing debt covenants.

Invested in capital net of related debt had decreased $18.8 million over May 31, 2008 balances as the result $22.4 million in water plant expenditures and amortization net of related debt of $11.5 million. These increases were offset by a reduction in restricted investments of $52.7 million.

Net Assets – Unrestricted

In 2010, net assets – unrestricted, decreased over the May 31, 2009 balance as noted above, the Authority to stay compliant with previously existing debt covenants was required to increase restricted investment to service debt payments.

In 2009, net assets – unrestricted had increased over the May 31, 2008 balance due to the receipt of nonoperating income of $78.5 million (net of legal expenses) due to a legal from the oil companies.

Contacting the Authority's Financial Management

This financial report is designed to provide the customers, clients, and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the resources at its disposal. If you have any questions about this report or need additional financial information, contact the Public Information Officer, Suffolk County Water Authority, 4060 Sunrise Highway, Oakdale, NY 11769.

SUFFOLK COUNTY WATER AUTHORITY

Balance Sheets

May 31, 2010 and 2009

Assets		**2010**	**2009**
		(In thousands)	
Current assets:			
Cash and cash equivalents	$	54,722	28,066
Investments		113,175	202,776
Accounts receivable, less allowance for doubtful accounts of $1,233 and $1,182 in 2010 and 2009, respectively		10,806	11,115
Accrued water services and fire protection revenues		15,709	13,912
Interest and other receivables		4,688	1,193
Materials and supplies		8,764	8,303
Prepayments and other current assets		812	1,678
Total current assets		208,676	267,043
Restricted investments		165,892	48,082
Goodwill		3,632	3,783
Costs to be recovered from future revenues		36,702	24,293
Deferred charges and other assets		10,333	11,432
Water plant (capital assets), net		1,031,273	997,654
		1,247,832	1,085,244
Total assets	$	1,456,508	1,352,287

Liabilities and Net Assets

Liabilities and net assets:			
Current maturities of bond anticipation notes payable	$	—	60,000
Current maturities of bonds payable		6,525	9,755
Accounts payable		7,924	9,376
Accrued interest		15,093	10,730
Accrued employee welfare costs		8,165	6,804
Other accrued liabilities		4,936	4,471
Customer deposits		7,831	8,882
Total current liabilities		50,474	110,018
Bond anticipation notes payable, less current portion		73,844	70,000
Bonds payable, less current portion		652,151	497,368
Postemployment benefits other than pension		36,702	24,293
Advances for construction		2,953	3,879
Total liabilities		816,124	705,558
Commitments and contingencies			
Net assets:			
Invested in capital, net of related debt		367,305	372,461
Restricted for debt service		98,177	36,152
Unrestricted		174,902	238,116
Total net assets		640,384	646,729
Total liabilities and net assets	$	1,456,508	1,352,287

See accompanying notes to financial statements.

SUFFOLK COUNTY WATER AUTHORITY

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

May 31, 2010 and 2009

		2010	2009
		(In thousands)	
Operating revenues:			
Water service	$	114,579	119,241
Other		14,663	14,306
Total operating revenues		129,242	133,547
Operating expenses:			
Operations		76,654	83,579
Maintenance		20,417	19,897
Depreciation and amortization		37,768	36,200
Total operating expenses		134,839	139,676
Operating loss		(5,597)	(6,129)
Nonoperating revenues (expenses):			
Interest expense		(25,484)	(24,184)
Income from investments		3,946	6,832
Costs to be recovered from future revenues		12,409	12,322
Capital reimbursement fees		8,381	8,629
Legal settlement		—	78,533
Total nonoperating revenues (expenses)		(748)	82,132
(Decrease) increase in net assets		(6,345)	76,003
Net assets:			
Beginning of year		646,729	570,726
End of year	$	640,384	646,729

See accompanying notes to financial statements.

SUFFOLK COUNTY WATER AUTHORITY

Statements of Cash Flows

May 31, 2010 and 2009

		2010	2009
		(In thousands)	
Cash flows from operating activities:			
Cash receipts from customers	$	114,193	119,625
Other operating cash receipts		13,612	14,633
Cash payments to suppliers of goods and services		(42,417)	(42,284)
Cash payments to employees for services and fringe benefits		(41,129)	(48,149)
Net cash provided by operating activities		44,259	43,825
Cash flows from noncapital financing activity:			
Receipts from legal settlements		—	78,533
Net cash provided by noncapital financing activity		—	78,533
Cash flows from investing activities:			
Purchase of investments		(365,629)	(349,866)
Proceeds from sales and maturities of investments		337,894	330,632
Interest received		3,821	6,560
Net cash used in investing activities		(23,914)	(12,674)
Cash flows from capital and related financing activities:			
Additions to water plant, net of retirements		(71,572)	(58,445)
Proceeds from issuance of notes payable		3,844	—
Proceeds from issuance of long-term debt		179,810	—
Repayment of notes payable		(60,000)	—
Repayment of current maturities of bonds payable		(28,825)	(10,968)
Interest paid		(20,553)	(22,924)
Capital Grant included in other receivables		(3,844)	—
Proceeds from advances for construction, net of refunds		7,451	8,218
Net cash provided by (used in) capital and related financing activities		6,311	(84,119)
Net increase in cash and cash equivalents		26,656	25,565
Cash and cash equivalents at beginning of year		28,066	2,501
Cash and cash equivalents at end of year	$	54,722	28,066
Reconciliation of operating loss to net cash provided by operating activities:			
Operating loss	$	(5,597)	(6,129)
Depreciation and amortization expense		37,768	36,200
Loss on disposal		336	—
(Increase) decrease in operating assets:			
Accounts receivable		309	(1,255)
Accrued water services and fire protection revenues		(1,797)	764
Materials and supplies and prepayments		405	(936)
Other assets		1,102	874
Costs to be recovered from future revenues		12,409	12,321
Increase (decrease) in operating liabilities:			
Accounts payable		(1,451)	1,785
Accrued employee welfare costs		1,361	423
Other accrued liabilities		465	(550)
Customer deposits		(1,051)	328
Net cash provided by operating activities	$	44,259	43,825
Noncash investing activities:			
Increase in fair value of investments	$	474	$ 500

See accompanying notes to financial statements.

(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.

(a) 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.

(b) Water Plant (Capital Assets)

Water plant is recorded at original cost. The capitalized cost of additions to water plant includes 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.

Property and equipment represents land, leasehold improvement, office equipment, furniture, and fixtures of the Authority.

(c) Depreciation

The provisions for depreciation for water plant result from the application of straight-line rates by groups of depreciable properties in service. The rates are determined by age-life studies performed on depreciable properties. The average composite depreciation rate is 2.84% for May 31, 2010 and 2009.

(d) 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, 2010 and 2009 was approximately $1.6 million and $1.0 million, respectively.

(e) Cash and Cash Equivalents and Investments

Funds held by the Authority are administered in accordance with the Authority's investment guidelines pursuant to Section 2925 of the New York State Public Authorities Law. These guidelines comply with the New York State Comptroller's investment guidelines for public authorities. Certain investments and cash and cash equivalents have been designated by the Authority's Board of Trustees to be used for specific purposes, including rate stabilization, debt service, and capital expenditures. Investments' carrying values are reported at fair market value. See note 3 for a further discussion.

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

All investments with original maturities of 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, which approximates fair value.

(f) Investments Held for Debt Service

In accordance with the 1988 General Bond Resolution, as amended (the Resolution), the Authority maintains a debt service reserve. This reserve is held by a Fiscal Agent.

Investments held for debt service reserve and bond funds are used solely for the purpose of paying the principal and interest on the bonds, and for retiring the bonds prior to maturity and are reported as restricted investments in the accompanying balance sheets. Amounts in the debt service and bond funds are invested in U.S. Treasury Notes and U.S. government securities.

(g) Investments Held for Construction

In accordance with the Resolution, investments held for construction in the construction fund are internally designated for the costs of acquiring, constructing, and replacing the water system and are reported as restricted investments in the accompanying balance sheets.

(h) Goodwill

Goodwill was derived from the Authority's acquisition of various private water purveyors where the purchase price paid exceeded the net assets acquired. The Authority amortizes goodwill over a 40-year period.

(i) 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 to 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.

(j) 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.

As of May 31, 2010, 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 at May 31, 2010 and 2009 amount to approximately $19.9 million and $21.7 million, respectively. The Authority has determined that as the asset and liability created from these contracts have the right of offset, these amounts are not reflected on the balance sheets as May 31, 2010 and 2009.

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

(k) Debt Issuance Costs, Bond Discount and Premiums, and Other Bond Related Costs

Debt issuance costs and bond discount and premium are amortized over the life of the related bond issues. 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. Debt issuance costs, bond discount and premiums, and other related bond issuance costs are reported as deferred changes of $6.7 million and $6.8 million at May 31, 2010 in the accompanying balance sheets.

(l) 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.

(m) Accrued Employee Welfare Costs

The Authority permits employees to accumulate a limited amount of earned but unused leave benefits which will be paid to employees upon separation from service. Unpaid compensated absences are recorded as a liability in accordance with GASB Statement No. 16, *Accounting for Compensated Absences.*

(n) Revenues

The Authority distinguishes operating revenues and expenses from nonoperating 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 nonoperating revenues and expenses.

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.

(o) Costs to Be Recovered from Future Revenues

The Authority's cost recovery rate model used to establish rates, fees, and charges includes an amount for postemployment benefits other than pensions that are expected to be paid out during the fiscal year, but not for the amount of the annual required contribution as calculated under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. In accordance with FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, the Authority has deferred the excess of current annual required contribution over the amount paid during the 2010 fiscal year. The deferred costs will be recovered through future revenues in accordance with the Authority's rate model. The deferred amount for the years ended May 31, 2010 and 2009 was $36.7 million and $24.3 million, respectively.

(p) Legal Settlement

In August 2002, the Authority and the County of Suffolk commenced legal action against most major petroleum companies for contaminating Suffolk County water supplies with the gasoline additive methyl tertiary butyl ether. During the fiscal year ending May 31, 2009, the Authority reached a settlement with all of the defendants, except one minor defendant, and received $78.5 million in net settlement proceeds reflected as nonoperating revenues.

(q) 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.

(r) Income Taxes

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

(s) 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 of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of capital assets; allowances for doubtful accounts and inventory, the valuation of financial instruments other than cash, accrued water services and fire protection revenues, accrued employee welfare costs, workers' compensation and postemployment benefits, and other uncertainties and other contingencies. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

(t) Reclassifications

Certain prior year amounts have been reclassified in the financial statements to conform to the current year presentation.

(2) Water Plant, Property, and Equipment

		May 31, 2009	Additions/ reclassifications	Deletions/ reclassifications	May 31, 2010
			(In thousands)		
Land and land rights	$	21,608	1,424	—	23,032
Distribution systems		789,732	27,234	(1,349)	815,617
Wells, reservoirs, and structures		221,483	6,012	(5)	227,490
Pumping and purification equipment		103,019	6,266	(43)	109,242
Other		148,951	12,133	(6,875)	154,209
Water plant in service		1,284,793	53,069	(8,272)	1,329,590
Less accumulated depreciation		(407,978)	(36,768)	7,088	(437,658)
Net water plant in service		876,815	16,301	(1,184)	891,932
Construction in progress		120,839	71,621	(53,119)	139,341
Water plant	$	997,654	87,922	(54,303)	1,031,273

		May 31, 2008	Additions/ reclassifications	Deletions/ reclassifications	May 31, 2009
			(In thousands)		
Land and land rights	$	21,582	26	—	21,608
Distribution systems		771,256	19,639	(1,163)	789,732
Wells, reservoirs, and structures		217,039	4,505	(61)	221,483
Pumping and purification equipment		101,695	1,377	(53)	103,019
Other		146,344	36,559	(33,952)	148,951
Water plant in service		1,257,916	62,106	(35,229)	1,284,793
Less accumulated depreciation		(377,011)	(36,552)	5,585	(407,978)
Net water plant in service		880,905	25,554	(29,644)	876,815
Construction in progress		94,353	79,542	(53,056)	120,839
Water plant	$	975,258	105,096	(82,700)	997,654

Depreciation expense amounted to approximately $37.8 million and $36.7 million for the years ended May 31, 2010 and 2009, respectively, based on a composite annual rate of 2.84%.

(3) Cash and Cash Equivalents and Investments

(a) Cash and Cash Equivalents

Cash consists of insured (FDIC) or collateralized deposits that have carrying values of approximately $54.8 million and $28.1 million and bank balances of approximately $57.8 million and $28.1 million at May 31, 2010 and 2009, respectively. Collateral for deposits is held by the bank in the name of the Authority.

(b) Investments

Investments, including restricted investments, at May 31, 2010 and 2009 consist of the following:

	Fair value		Investment maturities at May 31, 2010 (in years)		
	2010	**2009**	**Less than 1**	**1 to 5**	**Greater than 5**
			(In thousands)		
Certificates of deposit	$ —	128,300	—	—	—
U.S. Treasury notes (1)	501	510	—	501	—
U.S. Treasury bonds (1)	8,794	8,794	—	—	8,794
FNMAs (1)	69,060	20,064	35,893	28,112	5,055
FHLB Notes (1)	55,578	27,419	15,456	35,097	5,025
FHLMC Notes	67,362	12,332	53,327	9,017	5,018
FDIC Insured Notes	5,210	5,194	—	5,210	—
FFCB Notes	7,599	28,614	2,030	5,569	—
Money market (1)	41,873	507	41,873	—	—
Guaranteed investment contracts (1)	62	241	62	—	—
Repurchase agreements	23,028	18,883	23,028	—	—
Total investments	$ 279,067	250,858	171,669	83,506	23,892

(1) Includes approximately $165.9 million and $48.1 million of investments held by Fiscal Agent in the Authority's name at May 31, 2010 and 2009, respectively.

	2010	**2009**
	(In thousands)	
Investment breakdown:		
Restricted for:		
Debt service	$ 98,177	36,152
Construction	67,715	11,930
Unrestricted	113,175	202,776
Total investments	$ 279,067	250,858

Accrued interest on investments other than investment agreements is included in interest and other receivables on the balance sheets. Investments bear interest rates that range from 1.00% to 5.00%.

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 contracts, and repurchase agreements backed by such obligations. Investments are reported 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.

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's investment policy does not include limits on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Custodial 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, 2010, the Authority's investments in Federal National Mortgage Association, Federal Home Loan Bank, FDIC Guaranteed Bonds, FFCB Notes, 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 anyone issuer. More than 5% of the Authority's investments are in Federal National Mortgage Association, Federal Home Loan Bank, and Federal Home Loan Mortgage Corporation. These investments are 25%: $(69.1 million), 20%: $(55.6 million) and 25%: $(67.4 million), respectively, of the Authority's total investments.

(4) Bonds Payable

Outstanding bonds are summarized as follows:

	Series		Interest rate	Final maturity date	May 31, 2009	Issued	Matured/ refunded	May 31, 2010	Due within one year
							(In thousands)		
Water System Revenue Bonds:									
(a & b)	1993	Senior Lien	4.80 – 5.10%	2013	$ 8,410	—	(8,410)	—	—
(a & b)	1993	Subordinate Lien	4.80 – 5.10%	2013	13,865	—	(2,065)	11,800	2,155
(a & b)	1994	Subordinate Lien	4.13 – 6.00%	2017	4,910	—	—	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	—
(a & b)	2003	Senior Lien	2.00 – 4.50%	2017	56,625	—	(600)	56,025	615
(a & b)	2003C	Senior Lien	4.00 – 4.50%	2026	80,000	—	—	80,000	—
(a & 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	—
(a & b)	2006A	Senior Lien	3.59 – 4.95%	2031	70,000	—	—	70,000	—
(a & b)	2007A	Senior Lien	4.00 – 4.50%	2032	45,000	—	—	45,000	—
(b)	2009	Senior Lien	2.00 – 5.00%	2022	—	13,415	—	13,415	—
(b)	2009A	Senior Lien	4.00 – 5.00%	2035	—	66,395	—	66,395	—
(b)	2009B	Senior Lien	5.50%	2035	—	100,000	—	100,000	—
Environmental Facilities Corporation Revenue Bonds:									
(b)	1998B		3.65 – 5.20%	2017	3,405	—	(295)	3,110	300
(b)	1999A		2.77 – 4.91%	2018	3,415	—	(245)	3,170	255
(b)	2000A		3.80 – 5.96%	2019	580	—	(35)	545	40
(b)	2000B		4.31 – 5.74%	2020	3,865	—	(220)	3,645	230
(b)	2001A		3.48 – 5.17%	2021	7,255	—	(455)	6,800	460
(b)	2001B		2.62 – 5.15%	2021	12,380	—	(730)	11,650	750
(b)	2002A		1.36 – 5.00%	2022	7,825	—	(455)	7,370	455
(b)	2002B		1.33 – 5.12%	2022	6,440	—	(350)	6,090	355
(b)	2003B		0.72 – 4.50%	2023	6,925	—	(370)	6,555	375
(b)	2004A		1.20 – 4.96%	2024	5,575	—	(250)	5,325	255
(b)	2005B		2.08 – 4.02%	2026	6,080	—	(275)	5,805	280
		Total bonds outstanding			510,455	$ 179,810	(28,825)	661,440	6,525
Less:									
Unamortized discount (premium)					(899)			(837)	
Deferred amount					4,231			3,601	
Current maturities payable					9,755			6,525	
					$ 497,368			652,151	

	Series		Interest rate	Final maturity date	May 31, 2008	Issued	Matured/ refunded	May 31, 2009	Due within one year
							(In thousands)		
Water System Revenue Bonds:									
(a)	1993	Senior Lien	4.80 – 5.10%	2013	$ 15,150	—	(6,740)	8,410	5,410
(a)	1993	Subordinate Lien	4.80 – 5.10%	2013	13,925	—	(60)	13,865	65
(a)	1994	Subordinate Lien	4.13 – 6.00%	2017	4,910	—	—	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	—
(a)	2001A	Senior Lien	4.13 – 5.25%	2023	21,925	—	—	21,925	—
(a)	2003	Senior Lien	2.00 – 4.50%	2017	57,210	—	(585)	56,625	600
(a)	2003C	Senior Lien	4.00 – 4.50%	2026	80,000	—	—	80,000	—
(a)	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	3.59 – 4.95%	2031	70,000	—	—	70,000	—
(a)	2007A	Senior Lien	4.00 – 4.50%	2032	45,000	—	—	45,000	—
Environmental Facilities Corporation Revenue Bonds:									
(b)	1998B		3.65 – 5.20%	2017	3,695	—	(290)	3,405	295
(b)	1999A		2.77 – 4.91%	2018	3,655	—	(240)	3,415	245
(b)	2000A		3.80 – 5.96%	2019	615	—	(35)	580	35
(b)	2000B		4.31 – 5.74%	2020	4,075	—	(210)	3,865	220
(b)	2001A		3.48 – 5.17%	2021	7,690	—	(435)	7,255	455
(b)	2001B		2.62 – 5.15%	2021	13,090	—	(710)	12,380	730
(b)	2002A		1.36 – 5.00%	2022	8,270	—	(445)	7,825	455
(b)	2002B		1.33 – 5.12%	2022	6,780	—	(340)	6,440	350
(b)	2003B		0.72 – 4.50%	2023	7,295	—	(370)	6,925	370
(b)	2004A		1.20 – 4.96%	2024	5,825	—	(250)	5,575	250
(b)	2005B		2.08 – 4.02%	2026	6,338	—	(258)	6,080	275
		Total bonds outstanding			521,423	$ —	(10,968)	510,455	9,755
Less:									
Unamortized discount (premium)					(1,003)			(899)	
Deferred amount					4,827			4,231	
Current maturities payable					10,968			9,755	
					$ 506,631			497,368	

(a) The payment of principal and interest for the year ended May 31, 2009 was insured by a municipal bond insurance policy issued by MBIA Corporation or AMBAC Indemnity Corporation. For the year ended May 31, 2010, the principal and interest was funded by the Authority.

(b) The payment of principal and interest is assured by a minimum debt service fund balance maintained by the Authority.

In satisfaction of the Reserve Account requirements of each Water Revenue Bond Issue, the Authority may provide a letter of credit, surety agreement, insurance agreement, or other type of agreement with any entity whose obligations are rated in one of the two (2) highest rating categories by Standard & Poor’s Ratings Services or Moody’s Investors Service. If, at any time the rating issued by Standard & Poor’s Rating Services or Moody’s Investors Service falls below such two (2) highest ratings, then within twelve (12) months thereafter, the Authority shall use its best efforts to either, at its option, replace such a credit agreement with an entity whose obligations are rated with such two (2) highest ratings or deposit into the

Reserve Account sufficient monies in accordance with the respective bond resolution to replace such Credit Agreement.

The Authority was advised the rating of MBIA Corporation and AMBAC Indemnity Corporation had fallen below the aforementioned two (2) highest ratings. Consequently, in November 2009, the Authority provided $41.5 million to fund Debt Service Reserve Accounts for the Suffolk County Water Revenue Bonds, Series 1993 Sr., Series 1993Jr., 1994Jr., 2003, 2003c, 2005 Subordinate, 2006A, and 2007A. These Reserve Accounts are held in trust by the designated trustee, Bank of New York Mellon.

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 Senior Lien Water System 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.

During fiscal year ended May 31, 2010, the Authority entered into the following bond transactions:

$66.4 million Senior Lien Water System Revenue Bonds, Series 2009A to refund all outstanding Variable Rate Bond Anticipation Notes, 2004 in the amount of $60.0 million due December 1, 2009. The Series 2009A bonds bear interest at rates ranging from 4.0% to 5.0% and have a final maturity date of June 1, 2035. The proceeds of which were used to redeem $60.0 million of the 2004 Variable Rate Bond Anticipation Notes. The remaining funds were used to fund the reserve account for $5.7 million and to pay bond issuance costs of $0.3 million. The refunding produced an approximate $1.2 million net present value savings.

$13.4 million Senior Lien Water System Revenue Bonds, 2009 to retire $2.8 million of Suffolk County Water Authority Senior Lien Water System Revenue Bonds, Series 1997 and retire $11.2 million of Suffolk County Water Authority Senior Lien Water System Revenue Bonds, Series 1997A. The Series 2009 bonds bear interest at rates ranging from 2.0% to 5.0% and have a final maturity of June 1, 2022. The proceeds were used to redeem $13.4 million of the 1997 and 1997A Senior Lien Outstanding Debt. The remaining funds were used to fund the reserve account for $1.1 million and to pay bond issuance costs of $0.1 million.

$100.0 million Senior Lien Water System Revenue Bonds – Build America Bonds, Series 2009B to fund the cost of acquisition, construction of improvements, and additions to the Water System of $86.9 million. The Series 2009B bonds bear an interest rate of 5.5%. Under the Build America Bond Program the Authority is entitled a 35% rebate on all interest cost. The remaining proceeds were used to fund the reserve account of $9.2 million and to pay the bond issuance costs of $1.1 million.

The Authority did not issue any Water System Revenue Bonds during the fiscal year ended May 31, 2009.

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 providing financial assistance from the Revolving Fund. The Corporation issues bonds, the proceeds of which are used to fund the Revolving Fund, which then provides loans to the 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.

The Authority did not issue Water System Revenue Bonds through the Corporation during the fiscal year ended May 31, 2009.

Interest expense on the bonds outstanding was approximately $25.3 million and $22.6 million for the years ended May 31, 2010 and 2009, respectively.

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, 2010, the amount of defeased debt obligation outstanding was approximately $122 million.

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

	Principal	Interest	Total
		(In thousands)	
Fiscal years ending:			
2011	$ 6,525	31,199	37,724
2012	15,105	30,490	45,595
2013	15,845	29,849	45,694
2014	16,345	29,169	45,514
2015	17,020	28,421	45,441
2016 and thereafter	590,600	343,535	934,135
	$ 661,440	492,663	1,154,103

As the final bond maturity of $107.9 million is due June 1, 2036, there is no interest expense that will be paid on this bond.

(5) Debt Service Requirements

As prescribed in the Authority's Resolution, the Authority is required to maintain a Reserve Account for each Series of Bonds to be held in the custody of the Bond Fund Trustee in an amount equal to the lesser of (1) 10% of the proceeds of the particular bond issue, (2) the maximum debt service due on the particular bond issue, or (3) 125% of the average of the annual installments of Debt Service with respect to all current and future years of the particular bond issue. The resolution permits the Authority to deposit a letter of credit, surety agreement, insurance agreement, or other type of agreement or arrangement with an entity whose obligations are rated in one of the two highest rating categories by Standard and Poor's Ratings Services or Moody's Investors Service in order to satisfy the Reserve Account requirements. The Authority has elected to maintain bond insurance and reserve accounts on the Senior Lien Water System Revenue Bonds Series 1993, 1997, 1997A, 2003, 2003C, 2005C, 2006A, and 2007A and Subordinate Lien Water System Revenue Bonds Series 1993 and 1994 for the payment of principal and interest on stated maturity and sinking fund installment dates and in the event of default by the Authority. If, at any time the rating issued by Standard & Poor's Rating Services or Moody's Investors Service falls below such two (2) highest ratings, then within twelve (12) months thereafter the Authority shall use it best efforts to either, at its option, replace such a credit agreement with an entity whose obligations are rated with such two (2) highest ratings or deposit into the Reserve Account sufficient monies in accordance with the respective bond resolution to replace such Credit Agreement. The Authority was advised that the rating of MBIA Corporation and AMBAC Indemnity Corporation had fallen below the aforementioned two (2) highest ratings. Consequently, in November 2009, and as discussed in note 4, the Authority provided $41.5 million to fund Debt Service Reserve Accounts for the Suffolk County Water Revenue Bonds, Series 1993Sr., Series 1993Jr., 1994Jr., 2003, 2003c, 2005 Subordinate, 2006A, and 2007A. These Reserve Accounts are held in trust by the designated trustee, Bank of New York Mellon. For the Senior Lien Water System Revenue Bonds Series 2001A, 2005 Refunding and EFC Revenue Bonds Series 1998B, 1999A, 2000A, 2000B, 2001A, 2001B, 2002A, 2002B, 2003B, 2004A, 2005B, 2009, 2009A, and 2009B Bonds, the Authority elected to maintain a minimum debt service balance of 10% of the proceeds. At May 31, 2010, the debt service reserve funds were approximately $77.4 million.

Revenue before interest expense and depreciation and amortization was equivalent to 1.64 times (3.95 in 2009) the debt service requirement on all outstanding debt. The minimum debt service requirement on all bonds is 1.10.

(6) Notes Payable

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

Series	Final maturity date	Balance at May 31, 2009	Issued	Redeemed	Balance at May 31, 2010	Due within one year
			(In thousands)			
2004	December 1, 2009	$ 60,000	—	(60,000)	—	—
2008	January 15, 2013	70,000	—	—	70,000	—
2010 (EFC)	February 1, 2013	—	3,844	—	3,844	—
Total notes outstanding		$ 130,000	3,844	(60,000)	73,844	—

Series	Final maturity date	Balance at May 31, 2008	Issued	Redeemed	Balance at May 31, 2009	Due within one year
			(In thousands)			
2004	December 1, 2009	$ 60,000	—	—	60,000	60,000
2008	January 15, 2013	70,000	—	—	70,000	—
Total notes outstanding		$ 130,000	—	—	130,000	60,000

These notes are issued in anticipation of the issuance of long-term revenue bonds, 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 semiannually. Interest is payable periodically, based upon the effective interest rate period, through January 15, 2013, the date of principal maturity, for 2008 notes.

Environmental Facility Corporation Bond Anticipation Notes (EFC Series)

In February 2010, the Authority and the New York State Environmental Facility Corporation entered into a Project Finance Agreement as part of the American Recovery and Reinvestment Act (ARRA). This project specific financing is associated with the installation of approximately 17,763 feet of water main to existing residential customers that currently rely on point of use treatment systems for water service. The total estimated cost as well as the maximum amount of financing for this project is \$3.8 million. Progress reimbursements to SCWA shall be made upon presentation of applicable documentation as prescribed within the Project Financing Agreement. The short-term financing for this project will be at an interest rate of 0%. Upon completion of the project, SCWA will receive a 50% subsidy from the federal government through the ARRA in an amount not to exceed \$1.9 million. Coinciding with the receipt of the subsidy, SCWA will repay to the NYS Environmental Facilities Corporation 100% of the costs of the project previously reimbursed to the Authority in full satisfaction of the Project Financing Agreement. In connection with this agreement, the Authority issued Bond Anticipation Notes, 2010 with the Environmental Facilities Corporation in the amount of \$3.8 million. These, unlike regular Bond Anticipation Notes, have an effective interest rate of 0% and mature on February 1, 2013.

For the years ended May 31, 2010 and 2009, the effective interest rate was 0.19% and 1.01%, respectively.

Interest expense on the BANS was approximately \$0.2 million and \$1.6 million for the years ended May 31, 2010 and 2009, respectively.

(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, multiemployer, 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, NY 12244. Benefit provisions vary as follows:

The Employees' Retirement System is subdivided into the following five 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 and prior to January 1, 2010
Tier V	Members who last joined on or after January 1, 2010

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 2% of final average salary for each year of service (not to exceed 30 years), plus 1.5% of the final average salary for each year of credited service beyond 30 years. If members retire at age 62 with fewer than 20 years of credited service, the service retirement benefit will be 1.66% of the final average salary for each year of service.

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 V members must have 10 years of service credit to be vested and eligible for retirement benefits. Retirement benefits of members retiring between age 55 and 62 will be reduced for early retirement, even if they have 30 years of service credit. Members must contribute 3% of their salary to the Employees' Retirement System for all their years of service. Overtime pay in excess of an annual cap is not included in the definition of wages. This overtime cap for 2010 is $15,000.

(Continued)

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 $2.4 million, $2.1 million, and $2.5 million for the years ended May 31, 2010, 2009, and 2008, respectively, which is equal to 100% of its annual required contribution. 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 $1.0 million, $0.9 million, and $1.1 million for the years ended May 31, 2010, 2009, and 2008, respectively.

(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 $29.8 million and $25.8 million at May 31, 2010 and 2009, respectively.

(9) Postemployment Benefits Other Than Pensions

The Authority's employees participate in the New York State Health Insurance Plan, a single multi-employer health-care plan that provides postemployment medical and dental benefits for eligible retirees and their spouses. The Authority sponsors a single employer dental and optical plan and provides dental and optical benefits for eligible retirees and their spouses. Substantially all of the Authority's employees may become eligible for these benefits if they reach normal retirement age while working for the Authority. The Authority does not issue a publicly available financial report for the plan.

(Continued)

Benefit provisions for the plan are established and amended through the Authority's Board of Directors, and there is no statutory requirement for the Authority to continue this plan for future Authority employees. The health, dental, and optical plans are noncontributory for active employees, with all payments for plan benefits being funded by the Authority. Upon retirement, the cost of the dental and optical plans is partially funded by the Authority and the balance by the retiree. During 2010, there were 922 participants (590 active and 332 inactive) that were eligible to receive benefits.

GASB 45 establishes guidance for the financial reporting of 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. The Authority adopted this new standard effective with the May 31, 2008 year-end.

In accordance with this standard, the Authority's annual OPEB cost for the plan is calculated based on the Annual Required Contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. GASB 45 does not require that the employer actually fund its ARC, but allows for the financing of these benefits on a pay-as-you-go basis. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the Authority's annual OPEB cost for the year, the amount contributed to the plan, and changes in the Authority's net OPEB obligation for the years ended May 31, 2010 and 2009 (in thousands):

		2010	2009
Annual required contribution	$	16,478	15,204
Interest on net OPEB obligation		972	479
NOO amortization adjustments to the ARC		(1,405)	—
Annual OPEB cost (expense)		16,045	15,683
Contributions made		(3,636)	(3,362)
Increase in net OPEB obligation		12,409	12,321
Net OPEB obligation, beginning of year		24,293	11,972
Net OPEB obligation, end of year	$	36,702	24,293

(Continued)

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows (dollars in thousands):

Fiscal year ended		Annual OPEB cost	Percentage of annual OPEB cost contributed		Net OPEB obligation
May 31, 2010	$	16,045	22.1%	$	37,124
May 31, 2009		15,683	22.4		24,293

As of May 31, 2010 and 2009, the actuarial accrued liability for benefits was $170.3 million and $166.5 million, respectively, all of which was unfunded. As of May 31, 2010 and 2009, the covered payroll (annual payroll of active employees covered by the plan) was $38.9 million and $36.0 million, respectively, 438% and 462% for each respective year, and the ratio of the unfunded actuarial accrued liability to the covered payroll was 462%.

The actuarial valuation date is as of May 31, 2010. Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Amounts determined regarding the funded status of the plan and the ARCs of the employer are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress presented as required supplemental information provides multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits in force at the valuation date and the pattern of sharing benefit costs between the Authority and the plan members to that point. Actuarial calculations reflect a long-term perspective and employ methods and assumptions that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

For the May 31, 2010 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4% discount rate for the unfunded portion, and an annual health care cost trend rate of 10% grading down to 5% for medical, dental 5.0% grading down to 4%, and optical 3%. The unfunded actuarial accrued liability is being amortized over 30 years as a level percentage of projected payroll on an open basis.

(10) Commitments and Contingencies

(a) Wireless Cell Rental Income

Assorted wireless cell carriers desire to use the Authority owned premises for the construction, installation, maintenance, and operation of radio transmitting and receiving equipment and other associated equipment as approved by the Authority in connection with its wireless communications business. The Authority receives in the form of monthly payments a fee for providing such use. Rental fees range from $3,600 to $4,800 per month and have terms ranging from five (5) to fifteen (15) years, multiple five-year renewals, and 3% annual rental increases. The Authority currently has

202 lease agreements with 5 different wireless carriers. Annual lease income from these agreements for the next five years are expected to be:

2011	$ 9.8 million
2012	10.0 million
2013	10.3 million
2014	10.7 million
2015	11.0 million

Annual lease income that is included in other operating revenue for the fiscal year ending May 31, 2010 and 2009 were $9.8 million and $9.0 million, respectively.

(b) Legal

The Authority is involved in various litigations 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.

As of August 10, 2010, the Authority is awaiting final permit approval from the Town of Southold Trustees. A group of residents from Orient previously filed a legal action to prevent the Authority from proceeding with this water main installation. This case was dismissed by the Supreme Court, Suffolk County in July 2010. The group has approximately six months (January 20, 2011) to file legal briefs appealing the dismissal. Following approval of the Town of Southold Trustee permit, the Authority intends to proceed with this project.

(c) 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 $5 million for each general liability claim and $5 million for each automobile claim subject to a stop-loss aggregate of $1.5 million. The Authority purchases commercial insurance for claims in excess of this self-insured retention limit 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 when the Authority purchased loss sensitive insurance policies. A loss sensitive policy requires the insured to pay that portion of the premium that is in excess of a minimum premium. It is also subject to a maximum premium.

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 approximately $2.8 million at May 31, 2010 and 2009 and is based on the requirements of GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, 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 2010 and 2009 were:

		Year ended May 31	
		2010	**2009**
		(In thousands)	
Unpaid claims, beginning of fiscal year	$	464	1,060
Changes in the estimate for claims of all years		104	(325)
Claim payments		—	(271)
Unpaid claims, end of fiscal year	$	568	464

Changes in the Authority's general and automobile claims liability amount in fiscal 2010 and 2009 were:

		Year ended May 31	
		2010	**2009**
		(In thousands)	
Unpaid claims, beginning of fiscal year	$	2,286	2,381
Changes in the estimate for claims of all years		182	182
Claim payments		(270)	(277)
Unpaid claims, end of fiscal year	$	2,198	2,286

(Continued)

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 and related debt.
- *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.

Changes in Net Assets

The changes in net assets are as follows (in thousands):

	Invested in capital assets	Unrestricted	Restricted	Total
Net assets at May 31, 2008	$ 392,322	141,710	36,694	570,726
Income	—	76,003	—	76,003
Transfers	(19,861)	20,403	(542)	—
Net assets at May 31, 2009	372,461	238,116	36,152	646,729
Loss	—	(6,345)	—	(6,345)
Transfers	(5,156)	(56,869)	62,025	—
Net assets at May 31, 2010	$ 367,305	174,902	98,177	640,384

SUFFOLK COUNTY WATER AUTHORITY

Required Supplementary Information - Schedule of Funding Progress
for the Retiree Healthcare Plan (Unaudited)

May 31, 2010

(In thousands)

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) – level dollar (b)	Unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll (b-a)/c
May 31, 2010	$ —	170,324	170,324	—	38,891	438%

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Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Members
Suffolk County Water Authority:

We have audited the financial statements of the Suffolk County Water Authority (the Authority) as of and for the year ended May 31, 2010, and have issued our report thereon dated August 31, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, Members of the Suffolk County Water Authority, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

August 31, 2010