



*suffolk county* Water Authority



*Annual Report 2004*

## Financial Highlights

	2004	1995	10-Year Growth	Percent Change
Customers .....	375,796	316,067	59,729	19%
Miles of Main .....	5,577	4,684	893	19%
Fire Hydrants .....	34,174	28,886	5,288	18%
Water Pumped (Billion Gallons) ..	59.9	54.7	5	10%
Employees .....	578	601	(23)	(4)%
Gross Revenue .....	\$ 135,348,000	\$ 90,816,000	\$ 42,365,000	47%
Expenses .....	72,515,000	52,841,000	19,674,000	37%
Water Plant at Cost .....	1,138,950,000	675,182,000	463,768,000	69%
Bonded Indebtedness .....	526,112,000	363,495,000	162,617,000	45%
Total Cumulative Earnings .....	309,743,169	146,976,000	162,767,169	111%

## 2003–2004 Highlights

	May 31, 2004	May 31, 2003
Total Revenues .....	\$ 135,348,000	\$ 138,969,000
Operating and Maintenance Expense .....	72,515,000	70,451,000
Interest on Bonds and Notes .....	18,579,000	16,257,000
Depreciation .....	27,303,666	25,897,000
Total Water Plant at Cost .....	1,138,950,000	1,082,517,000
Net Additions to Water Plant .....	56,433,000	53,213,000
Customers (Active Service) .....	375,796	372,237
Miles of Main in Service .....	5,577	5,513
Fire Hydrants in Service .....	34,174	33,724
Water Production (Billion Gallons) .....	59.9	68.7

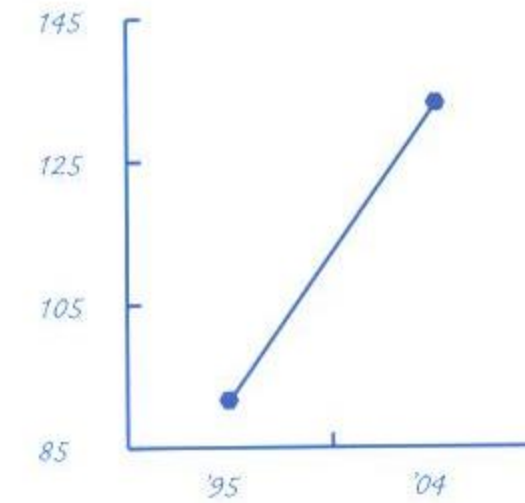
## Authority Profile

The SCWA is a self-supporting, public benefit corporation operating by virtue of the Public Authorities Law of the State of New York. It is without taxing power and operates as a business enterprise. The Authority is neither an agency of New York State nor Suffolk County Government.

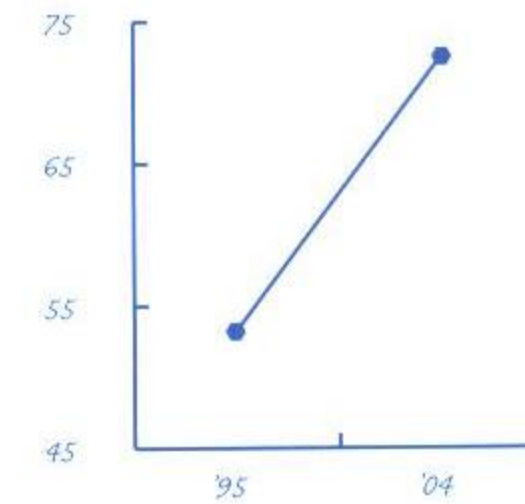
The majority of the revenue the Authority receives is that obtained from the sale of water to its customers. The Authority is non-profit: all revenue received must be used for operating expenses, construction costs, and for paying outstanding debts.

The Suffolk County Water Authority is the largest groundwater supplier in the nation and has been operating for 53 years. Currently, the SCWA serves more than one million Suffolk County residents. The Authority is operated solely for the benefit of the customers it serves.

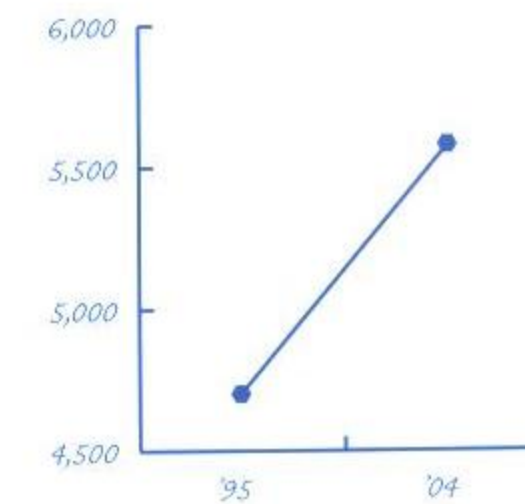
Revenues  
(dollars in millions)



Expenses  
(dollars in millions)



Miles of Main





SCWA

*“...good management, skilled staff, and a desire to succeed...we believe that the Suffolk County Water Authority embodies these fundamental traits...”*

*Hazen and Sawyer, 2004*

*“The organization appears to have developed a ‘do it right—then do it better’ attitude...”*

*Hazen and Sawyer, 2004*

*“In general...we believe that the Suffolk County Water Authority laboratory is one of the finest state-of-the-art laboratories in the U.S.”*

*Hazen and Sawyer, 2004*

*foresight*



## *Chairman's Message:*

On August 14, 2003 at 4:06 p.m. EDT, a large power fluctuation was experienced in an electric power transmission grid in northeast Ohio. In as little as nine seconds, the grid collapsed, and in the ensuing four minutes, as power plants and transmission systems “tripped” off line, the flow of electricity across the Eastern Seaboard ceased. When the cascading effects of this colossal system failure finally ended, an area covering over 24,086 square kilometers was without electricity as our nation experienced the largest blackout in its history, and Long Island was not spared.

In the deep recesses of our state-of-the-art control center, our personnel watched as one red warning light after another flashed across a large wall mounted screen indicating our production wells were shutting down as the blackout rolled across Suffolk County. But almost simultaneously, over 90 of our wells came back to life as sensors detected the loss of electricity, brought Water Authority gas and diesel fired electric generators on line and kept the water flowing to our almost 1.2 million customers. That evening, and into the next day, our extensive backup systems kept water flowing to our customers' homes, to places of business, schools, nursing homes, hospitals and fire hydrants as our state-of-the-art control center continued to closely monitor the situation. There was no electricity, and

many of the basic day-to-day activities of our customers came to a halt, but through leadership, foresight, and planning for just such an emergency, there was water, that life giving necessity that so many take for granted.

Our actions during the blackout were the result of leadership, foresight and the recognition by our employees of our vitally important mission. But our actions that disruptive August day were not atypical of our approach to the business of running the Water Authority.

During the fiscal year, the nationally renowned consulting firm of Hazen and Sawyer conducted an in-depth study of the Authority's operations and properties in compliance with our 1988 Bond Resolution. This study is conducted every five years to ensure the investment community of the strength of the Authority, its facilities, its product, and most importantly, to have continued confidence in its leadership. The results of this study confirmed the success of the course first charted in the early 1990's. Among its findings, Hazen and Sawyer found that “SCWA has developed into an impressive organization that is committed to continual self improvement”; that “SCWA delivers water of exceptionally high quality due to aggressive testing, coupled with diligent maintenance of its production, transmission, and distribution facilities”; that “SCWA addresses its

customer complaints through proactive programs”; that “the distribution system has been found to be very reliable with respect to main break frequency, which appears to be well below the industry average”; that, “The organization appears to have developed a ‘do it right—then do it better’ attitude as it relates to its core business. There is pride in association with SCWA”; and most importantly, “...good management, skilled staff, and a desire or culture to succeed...we believe that the Suffolk County Water Authority embodies these fundamental traits, both organizationally and tangibly...”

The financial community continued to recognize the financial strength of the Water Authority and our leadership among all revenue producing Authorities in New York State. We continued to maintain our “AA” bond rating, the highest category rating of any revenue producing Authority in New York State. This year’s audited report of PricewaterhouseCoopers reflects a coverage of available income over debt service of 2.67 facilitating the borrowing of funds at the lowest possible rates for needed capital construction.

Borrowing from the New York State Drinking Water Revolving Fund has reduced the cost of interest to the Authority by approximately \$500,000 annually for currently outstanding bonds. We took advantage of record low interest rates, our “AA” rating, and the demand for tax-exempt investments in the financial community and refinanced \$66.395 million, to



produce a \$7.5 million savings for our customers. Through such refinancings and their resultant savings, and our conservative fiscal policies, we have been able to maintain water rates that are 40 percent below the national average and negate the need for a rate increase for the third year in a row.

During the fiscal year the Authority expended \$55,900,000 for capital construction that included service installations for an additional 3,559 customers. Operating costs in some critical areas are constantly rising and virtually impossible to avoid such as medical insurance costs, pension benefits and electricity charges. We have successfully addressed these increasing costs through stringent cost management techniques.

The continued improprieties in the corporate and municipal world have initiated a number of governmental regulations and professional guidelines. The Authority has always been independently audited, and responsive to the financial community, rating agencies, legislative inquiries and customer inquiries.

During the year, the Board voted, in accordance with the recommendations of the Sarbanes-Oxley Act, to create an audit committee to increase Board financial oversight and open lines of communication to external auditors.

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Our water quality laboratory continued its leadership and record of excellence when it, once again, received a perfect score in its New York State Proficiency test. Our laboratory, which is state certified and also has the distinction of being federally certified through the National Environmental Laboratory Accreditation Program, is at the cornerstone of our commitment to provide our customers with the highest quality water possible. In its report to the Authority, Hazen and Sawyer wrote, "In general, from our experience working with large water purveyors, we believe that the Suffolk County Water Authority laboratory is one of the finest state-of-the-art laboratories in the U.S."

We continued to provide environmental leadership in the courts and in the communities we serve. In our continuing efforts to protect our customers from the high costs of removing the gasoline additive MTBE from some of our wells, we advanced our MTBE lawsuit in the New York State Supreme Court when the Court rejected an attempt by petroleum manufacturers to block the Water Authority and County of Suffolk's joint lawsuit to recover millions of dollars of reimbursement associated with the cleanup of this pollutant.

The success of the Water Authority today is the result of the hard work, dedication, and integrity of past and current employees who keenly understand the importance of our mission. Our success is also the result of the leadership, direction, and support provided by our Board over the past dozen years. While we have achieved extraordinary progress in the past decade, we will not rest on our laurels. Our employees are always encouraged to innovate and create new and exciting procedures and processes to continue our program for greater efficiency and effectiveness to benefit our customers.

A handwritten signature in blue ink that reads "Michael A. LoGrande". The signature is fluid and cursive.

Michael A. LoGrande  
Chairman

# Management's Discussion and Analysis May 31, 2004 and 2003

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.

During the fiscal year ended May 31, 2003, the Authority adopted Governmental Accounting Standards Board ("GASB") Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments," as amended by GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus" and GASB Statement No. 38, "Certain Financial Statement Note Disclosures," (collectively, "GASB 34"). GASB 34 establishes accounting and financial reporting standards for general purpose external reporting by state and local governments and requires, among other things, that management's discussion and analysis be included as required supplemental information to the general purpose external financial statements.

## 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 Net Assets show how the Authority's net assets changed during each year. It accounts for all the current year's revenues and expenses, measures the financial results of the Authority's operations over the past 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, capital and related financing and investing activities.

The notes to the financial statements contain information that is essential to understanding the basic 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 statements. This overview is provided for the fiscal years ended May 31, 2004 and 2003. The reader should use the information contained in this analysis in conjunction with the information contained in our audited financial statements, all of which follow this narrative on the subsequent pages.

## Financial Highlights

(in thousands of dollars)

	2004	2003	2002
<b>Operating revenues</b>			
Water service .....	\$ 99,133	\$114,217	\$108,800
Other.....	10,482	9,385	8,193
Total operating revenues.....	109,615	123,602	116,993
<b>Operating expenses</b>			
Operations and maintenance.....	72,515	70,451	64,842
Depreciation and amortization.....	28,399	26,879	19,467
Total operating expenses.....	100,914	97,330	84,309
Operating income.....	8,701	26,272	32,684
<b>Non-operating revenues and expenses</b>			
Interest expense, net.....	(14,556)	(12,057)	(12,325)
Capital reimbursement fees.....	21,710	11,167	15,631
Unrealized loss on investments.....	(2,167)	203	304
Other expense.....	(295)	—	—
Loss on extinguishment of debt.....	—	—	(4,368)
Total non-operating revenues and expenses.....	4,692	(687)	(758)
Increase in net assets .....	\$ 13,393	\$ 25,585	\$ 31,926

## Operating Revenues

Water service revenues decreased \$15.1 million or 13.2% during the current year from \$114.2 million for the 2003 fiscal year to \$99.1 million for the 2004 fiscal year. The decrease was a result of poor weather conditions mitigated by customer growth of 1%.

Water service revenues increased \$5.4 million or 5.0% during the 2003 fiscal year compared to the 2002 fiscal year of \$108.8 million. The increase was a result of customer growth, dry weather conditions, and the increased use of in-ground sprinkler systems.

Other operating revenues increased \$1.1 million or 11.7% from \$9.4 million for the 2003 fiscal year to \$10.5 million for the 2004 fiscal year. The increase is primarily attributable to the settlement of legal proceedings, maintenance fees for main on private property, and cost of living adjustments related to antennae leases.

The increase in other operating revenues of \$1.2 million from fiscal year 2002 to 2003 was primarily attributable to increases in the amount of rent from new antennae leases. Continued growth in the cell phone industry is the reason for additional leases, resulting in communication companies seeking additional space on Authority property for transmission equipment.

## Operating Expenses

Operations and maintenance expense increased \$2.1 million or 2.9% from \$70.5 million for the 2003 fiscal year to \$72.5 million for the 2004 fiscal year. The \$2.1 million increase was mainly attributable to increased health care costs (\$.8 million), workers' compensation costs (\$.6 million), general liability insurance (\$.5 million) and maintenance costs (\$.2 million).

Operations and maintenance expense increased \$5.6 million or 8.7% from \$64.8 million for the 2002 fiscal year to \$70.5 million for the 2003 fiscal year. The increase was attributable to increased health care costs (\$.7 million), workers' compensation costs (\$1.5 million), retirement costs (\$1.8 million), power costs (\$1.1 million) and maintenance costs (\$.5 million).

Depreciation and amortization expenses were \$28.4 million during fiscal 2004 as compared to \$26.9 million during fiscal 2003, an increase of \$1.5 million or 5.7%. Depreciation and amortization expenses increased in 2003 by \$7.4 million or 38.1%. The increase in depreciation and amortization was primarily attributable to an increase in depreciable water plant assets. During the 2003 fiscal year, the Authority engaged outside consultants to perform a depreciation study, yielding an increase in the composite rate of .70 percentage points from 2.14 percent during 2002 to 2.84 percent during fiscal 2003.

In 2004, a deferred loss of \$3.137 million was recorded in connection with the defeasance of the Suffolk County Water Authority Revenue Bonds—Series 1994 Senior by the issuance of Suffolk County Water Authority Revenue Bonds—Series 2003 Refunding. The deferred loss is being amortized over the life of the refunded debt, which is 14 years, resulting in current year amortization of \$.399 million.

## Non-Operating Revenues and Expenses

Capital reimbursement fees were \$21.7 million during fiscal 2004 as compared to \$11.2 million during fiscal 2003, an increase of \$10.5 million or 94.4% during the current year. Capital reimbursement fees decreased \$4.5 million or 28.6% from fiscal 2002 to fiscal 2003. Capital reimbursement fees include developer fees (which are initially recognized as construction advances), tapping fees, and other capital reimbursement surcharges.

As a result of implementing of GASB 34, Contribution in Aid of Construction (including construction advances) are reflected on the Statement of Revenues, Expenses and Changes in Net Assets as Capital Reimbursement Fees. In order to match Capital Reimbursement Fees to the date water service is provided, construction advances are transferred to capital reimbursement fees based on the date water service is provided rather than when all costs are accounted for and transferred to plant.

Prior to the implementation of GASB 34, the Authority recorded monies received to pay for main installations, principally from developers, as a construction advance. Upon transfer of completed costs to water plant, corresponding construction advances were transferred to Contributions in Aid of Construction. There is typically a delay between the date water service is provided and the date that the transfer of monies to Contribution in Aid of Construction occurs.

Interest expense was \$18.6 million during fiscal 2004 as compared to \$16.3 million during fiscal 2003, an increase of \$2.3 million. This is attributable to the issuance of long-term debt reduced by the payoff of variable rate Bond Anticipation Notes from 2000 and 2001 as well as the refunding of certain long-term debt.

Interest expense decreased by \$3.7 million from fiscal 2002 to fiscal 2003, which was attributable to the defeasance of \$72.3 million of Senior Loan Water Revenue Bonds, Series 1992 A&B and Series 1993 in March 2002.

Continued good cash management allowed the Authority to maintain a stable level of interest income for fiscal year 2004 as compared to 2003 despite the reduction in the amount of invested monies and continued low interest rate environment.

Interest income was \$4.2 million during fiscal 2003 as compared to \$8 million during fiscal 2002, a decrease of \$3.8 million, which is attributable to the lower interest yields for invested monies.

## Condensed Financial Information

(in thousands of dollars)

	2004	2003	2002
<b>Assets</b>			
Capital assets, net of accumulated depreciation.....	\$ 871,647	\$ 839,224	\$ 808,613
Other assets			
Current.....	109,133	104,436	103,724
Long-term.....	110,585	143,870	111,441
Total assets.....	1,091,365	1,087,530	1,023,778
<b>Liabilities</b>			
Current liabilities.....	40,542	44,338	70,092
Other long-term liabilities.....	4,776	16,640	19,276
Long-term debt.....	521,151	515,049	448,492
Total liabilities.....	566,469	576,027	537,860
<b>Net assets</b>			
Invested in capital, net of related debt.....	373,087	390,936	339,705
Restricted for debt service.....	21,591	22,912	24,668
Unrestricted.....	130,218	97,655	121,545
Total net assets.....	524,896	511,503	485,918
Total liabilities and net assets.....	\$1,091,365	\$1,087,530	\$1,023,778

## Capital Assets, Net of Accumulated Depreciation (Water Plant)

There was a net increase in water plant in fiscal 2004 of \$32.4 million comprised of an increase in gross water plant (including construction in progress) of \$56.4 million reduced by an increase in accumulated depreciation of \$24.0 million.

The increase in fiscal year 2003 was \$30.6 million, comprised of gross water plant additions of \$53.2 million reduced by an increase in accumulated depreciation of \$22.6 million. Refer to notes to financial statements for further details concerning capital asset activities.



## Current Assets

(in thousands of dollars)

	2004	2003
<b>Increases (Decreases)</b>		
Cash and cash equivalents .....	\$ 452	\$(2,600)
Current portion of investments .....	1,255	4,481
Accounts receivable, net.....	1,697	98
Accrued water services and fire protection.....	529	(1,792)
Materials and supplies.....	1,057	845
Prepayments and other current assets .....	(280)	(424)
Interest and other receivables .....	(13)	104
Net increase in current assets .....	<u>\$4,697</u>	<u>\$ 712</u>

Total investments, including cash and cash equivalents, were \$171 million at May 31, 2004, representing a net reduction of \$35 million. This is a result of cash used in capital activities offset by cash provided by operating and investing activities. The \$1.3 million increase in current investments is attributable to the anticipated expenditure requirements for the next twelve months.

The \$2.6 million decrease in cash and cash equivalents from fiscal 2002 through fiscal 2003 was attributable to cash used in capital related financing activities offset by cash provided by operating activities of \$61.5 million, and cash provided by investing activities of \$10 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 2004 was approximately 4% higher than 2003, resulting in an increase of approximately \$.5 million.

Accrued water services and fire protection from fiscal year 2002 to fiscal year 2003 decreased as a result of high rainfall in April and May of 2003, causing lower pumpage. Consequently, accrued billings decreased by \$1.8 million in comparison to 2002.

## Non-Current Assets

The value of non-current assets decreased by approximately \$33.3 million, which is comprised of a \$39.7 million decrease in investments held for construction, a \$3.4 million increase in deferred charges and other assets and a \$1.3 million decrease in debt service reserve and bonds offset by a \$4.4 million increase in non-current investments.

Non-current assets from fiscal year 2002 to fiscal year 2003 increased by approximately \$32.4 million, which is comprised of \$41.4 million increase in investments held for construction, \$3.2 million increase in deferred charges, a decrease of \$10.3 million in non-current investments and a decrease of \$1.8 million in debt service reserve and bonds.

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 are a result of utilizing proceeds from previous financings designated for construction projects. Refer to Long-Term Debt discussions for detailed information.

The decrease in deferred charges and other assets from fiscal 2003 to fiscal 2004 is due primarily to a decrease of \$3.4 million due to issuance of BANS at a premium thereby decreasing the unamortized costs by approximately \$3.3 million. The increase in deferred charges and other assets from fiscal 2002 to fiscal 2003 is due primarily to an increase of \$3.6 million due from the Town of Islip for the installation of a main in the community of Fair Harbor, Fire Island, New York. The Authority and the Town of Islip have an agreement for the cost to be paid back over a twenty-year period with interest.

## 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 market value.

Investments are classified as both long-term and short-term based upon the dates of maturity on the instruments with consideration given to the Authority's reasonable expectation of those resources to be consumed during a normal operating cycle. The Authority's unrestricted investments increased \$5.6 million or 6% from \$86.9 million as of May 31, 2003 to \$92.5 million as of May 31, 2004. The increase in investments of unrestricted assets overall is attributable to the addition of monies available from revenues after the payment of debt service.

The Authority's investments decreased \$5.9 million or 6.3% from \$92.7 million as of May 31, 2002 to \$86.9 million as of May 31, 2003. The decrease in investments overall is attributable, primarily, to the utilization of the Authority's investments held for general use to pay off \$28.1 million of Bond Anticipation Notes—1997, offset by the addition of monies available from revenues after the payments of debt service.

## Current Liabilities

The \$3.8 million decrease in current liabilities from 2003 to 2004 consists of decreases in current maturities of water revenue bonds (\$3.5 million), other accrued liabilities (\$1.5 million), deferred revenue (\$1.0 million), and accrued retirement contributions (\$1.9 million). These decreases are offset by increases in accounts payable (\$2.2 million) and accrued interest (\$1.4 million).

The \$25.8 million decrease in current liabilities from 2002 to 2003 is primarily the result of repayment of \$32.3 million on the 1997 variable rate Bond Anticipation Notes which came due during 2003, a decrease in accrued interest of \$.3 million, and a decrease in accrued employee welfare of \$.3 million. The decreases were offset by increases in accounts payable (\$1.1 million), other accrued liabilities (\$3 million), accrued retirement contributions (\$2.6 million) and customer deposits (\$.5 million).

# Management's Discussion and Analysis

May 31, 2004 and 2003 (continued)

Accrued retirement contributions have decreased approximately \$1.9 million from 2003 to 2004. This is attributable to the payment made during fiscal year ending May 31, 2004 in the amount of \$3.6 million, which included the cost for the 2003 New York State Retirement Incentive Program in the amount of \$1.9 million. The Authority has been advised by the New York State Retirement System that regular pension costs for the period April 1, 2004 through March 31, 2005 is estimated to be 12.4% of payroll as compared to 4.5% of payroll for the period April 1, 2003 through March 31, 2004.

Accrued retirement contributions from 2002 to 2003 increased approximately \$2.6 million, as a result of the Authority's participation in the 2002 New York State Retirement Incentive Program. The cost to the Authority was \$1.9 million. These positions were evaluated and, where applicable, were not replaced or replaced in the same capacity or in other required positions throughout the Authority. Those positions filled were, in most cases, filled at lower salaries. Savings in excess of \$2 million have been achieved as a result of this program.

The \$2.2 million increase experienced in accounts payable from 2004 to 2003 is attributable principally to an increase in outstanding invoices related to capital (\$.9 million), and operating and maintenance invoices (\$1.6 million) and decreased by a reduction in accounts receivable credits in the amount of \$.3 million.

The \$1.1 million increase experienced in accounts payable from 2003 to 2002 is attributable principally to an increase in outstanding invoices related to construction (\$1.2 million), reduction in outstanding operating and maintenance invoices (\$.4 million) and an increase in accounts receivable credits in the amount of \$.3 million.

The increase of \$1.5 million in other accrued liabilities from 2003 and 2004 is primarily attributable to \$2.2 million in accrued interest on long-term debt due to the issuance of Suffolk County Water Authority Revenue Bonds during the fiscal year. This increase was offset by reductions in insurance reserves for workers' compensation and auto damage claims in the amount of \$.2 million, \$.6 million in capitalized computer lease liability, and a \$.2 million decrease in other accrued liabilities.

The increase of \$3 million in other accrued liabilities from 2002 to 2003 is primarily attributable to a \$2.9 million increase in insurance reserves for workers' compensation and auto damage claims, as a result of establishing an additional reserve for estimated costs for current and past claims.

## Long-Term Debt

The Authority's long-term debt (including current maturities and exclusive of unamortized discounts) increased from fiscal 2003 to fiscal 2004 by \$79.5 million resulting from the issuance of senior lien SCWA Water Revenue Bonds, Series 2003 (\$67.4 million), Series 2003C (\$80 million), and Senior Lien EFC Bonds, Series 2003B (\$8.7 million as of May 31, 2004 and 2003). These increases are reduced by the defeasance of SCWA Water Revenue Bonds, Series 1994 (\$64 million), Series 1997 (\$2.6 million), Series 1997A (\$1.5 million), and scheduled principal payments (\$8.5 million).

The Authority's long-term debt (including current maturities and exclusive of unamortized discounts) increased from fiscal 2002 to fiscal 2003 by \$33.8 million, comprised of a \$50 thousand increase in bonds, and a \$33.7 million increase in variable rate bond anticipation notes ("BANs").

## Water System Revenue and Environmental Facilities Corporation Revenue Bonds

(in thousands of dollars)

	2004	2003
<b>New Issue</b>		
SCWA 2003 .....	\$ 67,395	\$ —
EFC 2003B .....	9,131	8,615
SCWA 2003C .....	80,000	—
	<b>156,526</b>	8,615
1993 Jr. ....	(45)	(540)
1994 Jr. ....	(2,030)	(1,445)
1994 Sr. ....	(64,000)	—
1997 .....	(5,035)	(1,425)
1997A .....	(3,095)	(3,000)
2001A .....	—	—
EFC 1998B .....	(245)	(235)
EFC 1999A .....	(210)	(212)
EFC 2000A .....	(30)	(30)
EFC 2000B .....	(179)	(170)
EFC 2001A .....	(380)	(365)
EFC 2001B .....	(617)	(613)
EFC 2002A .....	(385)	(300)
EFC 2002B .....	—	(230)
EFC 2002G .....	(315)	—
EFC 2003B .....	(435)	—
	<b>(77,001)</b>	(8,565)
Net change in long-term debt .....	<b>\$ 79,525</b>	\$ 50
BANs 1997 .....	—	(32,300)
BANs 2000 .....	(46,000)	(2,100)
BANs 2001 .....	(36,000)	(1,900)
BANs 2003 .....	—	70,000
Net change in variable rate BANs .....	<b>\$(82,000)</b>	\$ 33,700

The Authority has, from time to time, issued bond anticipation notes to finance improvements and additions to the Water System.

In June 2003, the Authority determined it advisable and financially advantageous to issue on June 19, 2003, \$67,395,000 of Senior Lien Bonds, Water System Revenue Bonds, Series 2003 (Refunding) to provide for the refunding, in advance of their maturities, all of the \$64 million of its Water System Revenue Bonds, Series 1994, dated January 1, 1994, \$2,575,000 of its Water System Revenue Bonds, Series 1997, dated March 1, 1997, maturing June 1, 2004, and \$1,550,000 of its Water System Revenue Bonds, Series 1997A, dated November 1, 1997, maturing June 1, 2004. These bonds bear interest at rates ranging from two (2%) to four and one-half (4.5%) percent and have a final maturity date of June 1, 2017.

In July 2003, the Authority determined it advisable and financially advantageous to issue on July 24, 2003, \$80,000,000 of Senior Lien Bond, Water System Revenue Bonds, Series 2003C to provide for the retirement of \$45,900,000 aggregate principal amount of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2000 and \$33,200,000 aggregate principal amount of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2001. These bonds bear interest at rates ranging from four (4%) to four and three-quarter (4.75%) percent and have a final maturity date of June 1, 2026.

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 Environmental 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 borrow from the Environmental Facilities Corporation and in July 2003, issued \$9,130,775 of Senior Lien Bonds to provide for the retirement of \$100,000 principal amount of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2000, retirement of \$2,800,000 principal amount of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2001, to fund a reserve account for these Senior Lien Bonds in the amount of \$913,078, and to finance additional costs of the approved projects.

Subsequent to year end, on July 22, 2004, the Authority issued senior lien Water System Revenue Bonds, EFC Series 2004A in the amount of \$6,605,448 to provide for the retirement of \$3,200,000 principal of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2001, retirement of \$2,500,000 principal 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 \$660,544, and to finance additional costs of the approved projects.

### **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 \$17.9 million from 2003 to 2004 results from an increase of \$32.4 million in net water plant plus a decrease of \$50.3 million in related debt.

### **Restricted**

Net assets, restricted, decreased as the unspent bond proceeds were used.

### **Unrestricted**

Net assets, unrestricted, increased as a result of the operational results 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, resulting from inclement weather during the summer of 2003, negated by a 1% growth in customers, correlates to actual water and hydrant revenues \$6.5 million below budget.

Other revenues includes (1) charges to customers for late charges, reset 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 exceeded the budgeted amount of \$12 million by \$20.2 million. This was a result of the settlement of a lawsuit in the amount of \$5 million and an increase in capital reimbursement fees in the amount of \$18.9 million, maintenance fees of \$2 million, water district management fees of \$3 million, and other miscellaneous items of \$3 million.

Operating and Maintenance Expenses were budgeted at \$71 million, and actual expenses were \$72.5 million, \$1.5 million over budget. Power costs were \$1.2 million over budget. Reduced pumpage resulted in a lower amount of power use, but this reduction was offset by the additional surcharges assessed by LIPA. Other factors causing the remaining \$.3 million over budget include higher insurance premiums and required reserves for potential claims (\$1.8 million), higher benefit costs (\$.4 million), and retirement costs. Original estimates from New York State indicated retirement contributions to be approximately 17% of payroll. As a result of subsequent legislation, this increase has been deferred until 2005/2006 resulting in actual retirement costs to be \$1.8 million under budget.

Debt service was budgeted at \$28.1 million and actual costs were \$21.5 million, or \$4.6 million under budget. This was the result of (1) lower than anticipated short-term interest rates on the Authority's Bond Anticipation Notes, (2) lower than anticipated long-term interest rates on issuance of new long-term debt, and (3) the defeasance of certain higher interest long-term debt.

*Balance sheets* May 31, 2004 and 2003*(in thousands of dollars)*

	2004	2003
<b>Assets</b>		
Water plant, at cost less accumulated depreciation .....	\$ 871,647	\$ 839,224
Current assets		
Cash and cash equivalents .....	2,442	1,990
Short-term investments .....	74,041	72,786
Accounts receivable, less allowance for doubtful accounts of \$1,165 and \$738 in 2004 and 2003, respectively .....	11,108	9,411
Accrued water services and fire protection revenues .....	12,725	12,196
Interest and other receivables .....	952	965
Materials and supplies, at average cost .....	6,452	5,395
Prepayments and other current assets .....	1,413	1,693
Total current assets .....	109,133	104,436
Investments .....	18,431	14,074
Investments held for debt service .....	21,591	22,912
Investments held for construction .....	54,459	94,146
Goodwill .....	4,839	4,839
Deferred charges and other assets .....	11,265	7,899
Total assets .....	\$1,091,365	\$1,087,530
<b>Liabilities</b>		
Current maturities of bonds payable .....	4,961	8,440
Accounts payable .....	9,317	7,139
Accrued interest .....	8,479	7,051
Accrued employee welfare costs .....	5,662	5,383
Other accrued liabilities .....	5,614	7,084
Customer deposits .....	5,464	5,340
Deferred revenue .....	—	1,000
Accrued retirement contributions .....	1,045	2,901
Total current liabilities .....	40,542	44,338
Bond anticipation notes payable .....	122,100	204,100
Bonds payable, less current portion and unamortized discount .....	399,051	310,949
Obligation under capital lease .....	220	425
Advances for construction .....	4,556	16,215
Total liabilities .....	566,469	576,027
Commitments and contingencies		
<b>Net assets</b>		
Invested in capital, net of related debt .....	373,087	390,936
Restricted for debt service .....	21,591	22,912
Unrestricted .....	130,218	97,655
Total net assets .....	524,896	511,503
Total capitalization and liabilities .....	\$1,091,365	\$1,087,530

The accompanying notes are an integral part of these financial statements.

# *Statements of Revenues, Expenses and Changes in Net Assets*

Years Ended May 31, 2004 and 2003

(in thousands of dollars)

	2004	2003
<b>Operating revenues</b>		
Water service.....	\$ 99,133	\$114,217
Other.....	10,482	9,385
Total operating revenues.....	<b>109,615</b>	123,602
<b>Operating expenses</b>		
Operations.....	54,753	54,017
Maintenance.....	17,762	16,434
Depreciation and amortization.....	28,399	26,879
Total operating expenses.....	<b>100,914</b>	97,330
Operating income.....	<b>8,701</b>	26,272
<b>Non-operating revenues and expenses</b>		
Interest expense.....	(18,579)	(16,257)
Interest income.....	4,023	4,200
Capital reimbursement fees.....	21,710	11,167
Unrealized (loss) gain on investments.....	(2,167)	203
Other expense.....	(295)	—
Total non-operating revenues and expenses.....	<b>4,692</b>	(687)
Increase in net assets.....	<b>13,393</b>	25,585
<b>Net assets</b>		
Beginning of year.....	<b>511,503</b>	485,918
End of year.....	<b>\$524,896</b>	\$511,503

The accompanying notes are an integral part of these financial statements.

# Statements of Cash Flows

Years Ended May 31, 2004 and 2003

(in thousands of dollars)

	2004	2003
<b>Cash flows from operating activities</b>		
Cash receipts from customers .....	\$ 96,164	\$115,176
Other operating cash receipts .....	9,534	9,183
Cash payments to suppliers of goods and services .....	(45,061)	(35,863)
Cash payments to employees for services .....	(28,229)	(27,141)
Net cash provided by operating activities .....	32,408	61,355
<b>Cash flows from investing activities</b>		
Net proceeds from sales/(purchases) of investment securities .....	(7,780)	6,072
Interest received .....	4,036	4,097
Net cash (used in) provided by investing activities .....	(3,744)	10,169
<b>Cash flows from capital and related financing activities</b>		
Defeasance of bonds payable .....	(68,125)	—
Additions to water plant, net of retirements .....	(59,727)	(56,509)
Disbursements from (designations to) investments designated for construction .....	39,687	(41,370)
Proceeds from issuance of long-term debt .....	156,526	8,615
Proceeds from issuance of notes payable .....	—	70,000
Repayment of notes payable .....	(82,000)	(36,300)
Repayment of current maturities of Bonds payable .....	(8,876)	(8,564)
Interest paid .....	(17,150)	(16,606)
Repayment of capital lease obligation .....	(206)	(157)
Proceeds from advances for construction, net of refunds .....	10,504	5,827
Payment of bonds and notes payable issuance costs and discount .....	(166)	(815)
Designations of investments for debt service .....	1,321	1,755
Net cash used in capital and related financing activities .....	(28,212)	(74,124)
Net increase (decrease) in cash and cash equivalents .....	452	(2,600)
Cash and cash equivalents at beginning of year .....	1,990	4,590
Cash and cash equivalents at end of year .....	\$ 2,442	\$ 1,990
<b>Reconciliation of operating income to net cash provided by operating activities</b>		
Operating income .....	\$ 8,701	\$ 26,272
Depreciation and amortization expense .....	28,399	26,879
(Increase) decrease in operating assets .....		
Accounts receivable .....	(1,697)	(652)
Accrued water service and fire protection .....	(529)	1,792
Materials and supplies and prepayments .....	(777)	(422)
Other assets .....	53	797
Increase (decrease) in operating liabilities .....		
Accounts payable .....	2,179	1,946
Accrued retirement contribution .....	(1,854)	2,636
Deferred revenue .....	(1,000)	(1,000)
Accrued employee welfare .....	279	(328)
Other accrued liabilities .....	(1,470)	2,983
Customer deposits .....	124	452
Net cash provided by operating activities .....	\$ 32,408	\$ 61,355

The accompanying notes are an integral part of these 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 twofold 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**

The Authority's financial statements are prepared in accordance with all applicable pronouncements of the Governmental Accounting Standards Board ("GASB"). In accordance with GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments" ("GASB 34"), the Authority also prepares its financial statements in accordance with all authoritative pronouncements applicable to non-governmental entities (i.e., Financial Accounting Standards Board ("FASB") statements) that do not conflict with GASB pronouncements.

During fiscal 2003, the Authority adopted GASB 34, as amended by GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus," and GASB Statement No. 38, "Certain Financial Statement Note Disclosures." GASB 34 establishes accounting and financial reporting standards for general purpose external reporting by state and local governments and requires, among other things, that management's discussion and analysis be included as required supplemental information to the general purpose external financial statements. GASB 34 further requires the classification of net assets into three components: invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

*Invested in capital assets, net of related debt*

This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

*Restricted*

This component of net assets consists of constraints placed on net asset 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*

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

In accordance with GASB 34, the accounting and financial reporting treatment applied to the Authority is determined by its measurement focus and 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**

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

**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, 2004 and 2003 was \$357,000 and \$1,096,000, respectively.

**Cash and Cash Equivalents**

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

**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) and monies 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.

**Goodwill**

As a result of the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets," effective June 1, 2003, the Authority is required to conduct an annual review for potential impairment of goodwill. The Authority completed its review and determined that no impairment existed as of May 31, 2004 or 2003.

**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 non-operating revenue in the statement of revenues, expenses, and changes in net assets. Provision exists, and is infrequently exercised, whereby the developer may receive reimbursement if the actual footage of the main installed was less than 95 percent 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 ten percent of original estimate) or refunded the difference between the advance and actual cost. The monies paid by the developer are recognized as non-operating revenue in the statement of revenues, expenses, and changes in net assets.

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.

**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**

Revenues and expenses are distinguished between operating and non-operating items. Operating revenues 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 revenues are recognized when service has been rendered and collection is reasonably assured.

**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 are 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 of America 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.

**Concentration of Credit Risk**

Financial instruments which subject the Authority to credit risk consist principally of residential, commercial and industrial customer receivables. The Authority maintains reserves for potential credit losses from such accounts receivable and actual losses have historically not been materially different from management's estimates.

**Reclassifications**

Certain fiscal 2003 balances have been reclassified in order to conform with the current year presentation.

**Recent Accounting Pronouncements**

In March 2003, the GASB issued GASB Statement No. 40, "Deposit and Investment Risk Disclosure." The deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an



element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement also should be disclosed. The Authority does not expect adoption of this Statement effective June 1, 2005 to have a significant impact on its disclosure pertaining to its financial position, results of operations or cash flows.

In November 2003, the GASB issued Statement No. 42, "Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries." The Statement defines and establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. The Statement is effective for financial statements for periods beginning after December 15, 2004. The adoption of this standard by the Authority is not expected to have a significant impact on its financial position, results of operation, or cash flows.

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. The Authority is currently evaluating the impact of implementing GASB No. 45.

## 2. WATER PLANT

<i>(in thousands of dollars)</i>	May 31, 2003	Additions/ Reclassifications	Deletions/ Reclassifications	May 31, 2004
Land and land rights.....	\$ 19,064	\$ 788	\$ —	\$ 19,852
Distribution systems .....	688,313	24,536	(1,128)	711,721
Wells, reservoirs and structures .....	97,670	7,925	(159)	105,436
Pumping and purification equipment.....	109,439	5,370	(288)	114,521
Other.....	62,115	3,613	(2,820)	62,908
Water plant in service.....	976,601	42,232	(4,395)	1,014,438
Less—accumulated depreciation .....	(243,293)	(27,304)	3,294	(267,303)
Net water plant in service .....	733,308	14,928	(1,101)	747,135
Construction in progress ...	105,916	60,828	(42,232)	124,512
Water plant.....	\$ 839,224	\$ 75,756	\$(43,333)	\$ 871,647

Depreciation expense amounted to \$27,304,000 and \$25,897,000 for the years ended May 31, 2004 and 2003, respectively.

Water plant includes approximately \$1,104,000 of computer equipment recorded under a capital lease at May 31, 2004 and 2003.

## 3. CASH AND CASH EQUIVALENTS AND INVESTMENTS

### *Cash and Cash Equivalents*

Cash consists of insured (FDIC) or collateralized deposits which have carrying values of \$2,442,000 and \$1,990,000 and bank balances of \$4,884,000 and \$1,964,000 at May 31, 2004 and 2003, respectively.

### *Investments*

Investments consist of the following:

<i>(in thousands of dollars)</i>	2004	2003
Certificates of deposit .....	\$ 3,000	\$ 4,000
Investments held for debt service		
U.S. Treasury bills <sup>(a)</sup> .....	418	220
Short-term notes <sup>(a)</sup> .....	13,524	16,030
Long-term notes <sup>(a)</sup> .....	7,429	6,516
Other <sup>(a)</sup> .....	220	145
Investments held for construction		
Certificates of deposit.....	1,100	19,425
U.S. T-bills .....	—	76
Short-term notes <sup>(b)</sup> .....	20,949	15,553
Medium-term notes .....	18,889	25,114
Long-term notes <sup>(b)</sup> .....	—	3,377
Money Market .....	6,730	30,596
Other <sup>(b)</sup> .....	5	5
Investment pool.....	19,740	35,675
Short-term notes.....	—	20,092
Medium-term notes .....	76,518	25,080
Long-term notes .....	—	2,014
Investments* .....	\$168,522	\$203,918

*(a) Investments are held by fiscal agent.*

*(b) Includes \$15,728 and \$15,634 of investments held by fiscal agent at May 31, 2004 and 2003, respectively.*

*\*Includes investments held for construction and debt service.*

Accrued interest on investments is included in interest and other receivables on the balance sheets. Investments bear interest rates that range from .83 percent to 6.75 percent.

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, and repurchase agreements backed by such obligations. Investments are reported at fair market 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.

*Notes to Financial Statements* May 31, 2004 and 2003 (continued)**4. BONDS PAYABLE**

Outstanding bonds are summarized as follows:

Series	Interest Rate	Final Maturity Date	May 31, 2003	Issued	Matured	May 31, 2004
<i>(in thousands of dollars)</i>						
<b>Water System Revenue Bonds</b>						
(a) 1993 Senior Lien.....	4.80-5.10%	2013	\$ 41,445	\$ —	\$ —	<b>\$ 41,445</b>
(a) 1993 Subordinate Lien.....	4.80-5.10%	2013	15,385	—	(45)	<b>15,340</b>
(a) 1994 Senior Lien.....	5.00%	2017	64,000	—	(64,000)	<b>—</b>
(a) 1994 Subordinate Lien.....	4.13-6.00%	2017	33,541	—	(2,030)	<b>31,511</b>
(a) 1997 Senior Lien.....	4.10-5.25%	2012	32,530	—	(5,035)	<b>27,495</b>
(a) 1997A Senior Lien.....	4.00-5.00%	2022	38,230	—	(3,095)	<b>35,135</b>
(b) 2001A Senior Lien.....	4.13-5.25%	2023	38,200	—	—	<b>38,200</b>
(b) 2003 Senior Lien.....	2.00-4.50%	2017	—	67,395	—	<b>67,395</b>
(b) 2003C Senior Lien.....	4.00-4.50%	2026	—	80,000	—	<b>80,000</b>
<b>Environmental Facilities Corporation Revenue Bonds</b>						
(b) 1998B .....	3.65-5.20%	2017	5,020	—	(245)	<b>4,775</b>
(b) 1999A .....	2.77-4.91%	2018	4,765	—	(210)	<b>4,555</b>
(b) 2000A .....	3.80-5.96%	2019	780	—	(30)	<b>750</b>
(b) 2000B .....	4.31-5.74%	2020	5,024	—	(179)	<b>4,845</b>
(b) 2001A .....	3.48-5.17%	2021	9,725	—	(380)	<b>9,345</b>
(b) 2001B .....	2.62-5.15%	2021	16,352	—	(617)	<b>15,735</b>
(b) 2002A .....	1.36-5.00%	2022	10,294	—	(385)	<b>9,909</b>
(b) 2002B .....	1.33-5.12%	2022	8,385	—	(315)	<b>8,070</b>
(b) 2003B .....	0.72-4.50%	2023	—	9,131	(435)	<b>8,696</b>
<b>Total bonds outstanding</b> .....			<u>323,676</u>	<u>\$156,526</u>	<u>\$ (77,001)</u>	<b>403,201</b>
Less: Unamortized discount (premium) .....			4,287			<b>(811)</b>
Current maturities payable.....			8,440			<b>4,961</b>
			<u>\$310,949</u>			<b>\$399,051</b>

(a) The payment of principal and interest is insured by a municipal bond insurance policy issued by MBI 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.

**Water System Revenue Bonds**

The Water System Revenue Bonds were 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.

In June 2003, the Authority issued \$67,395,000 of Senior Lien Bonds, Water System Revenue Bonds, Series 2003 (Refunding) to provide for the refunding, in advance of their maturities, all of the \$64,000,000 of Water System Revenue Bonds, Series 1994, dated January 1, 1994, \$2,575,000 of Water System Revenue Bonds, Series 1997, dated March 1, 1997, maturing June 1, 2004, and \$1,550,000 of Water System Revenue Bonds, Series 1997A, dated November 1, 1997, maturing June 1, 2004. These bonds bear interest at rates ranging from two percent to four and one-half percent and have a final maturity date of June 1, 2017.

In July 2003, the Authority issued \$80,000,000 of Senior Lien Bond, Water System Revenue Bonds, Series 2003C to provide for the retirement of \$45,900,000 aggregate principal amount of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2000 and \$33,200,000 aggregate principal amount of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2001. These bonds bear interest at rates ranging from four percent to four and three-quarter percent and have a final maturity date of June 1, 2026.

*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 in order 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.

In July 2002, the Authority was issued \$8,615,000 of proceeds under the Environmental Facilities Corporation 2002G Revenue Bond Offering. The bonds have a final maturity date of October 15, 2022 and bear interest at rates ranging from 1.33 percent to 5.12 percent. The interest cost of these bonds is subsidized by the State of New York drinking water revolving fund.

In July 2003, the Authority was issued \$9,131,000 of proceeds under the Environmental Facilities Corporation 2003D Revenue Bond Offering. The bonds have a final maturity date of October 15, 2023 and bear interest at rates ranging from 0.72 percent to 4.5 percent. The interest cost of these bonds is subsidized by the State of New York drinking water revolving fund.

Subsequent to year end, on July 22, 2004, the Authority issued senior lien Water System Revenue Bonds, EFC Series 2004A in the amount of \$6,605,448 to provide for the retirement of \$3,200,000 principal amount of the Authority's outstanding Variable Rate Bond Anticipation Notes, 2001, retirement of \$2,500,000 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 \$660,544, and to finance additional costs of the approved projects.

*Water System and Environmental Facilities Corporation Revenue Bonds*

*Bond Refundings*

In accordance with GASB Statement No. 23, "Accounting and Financial Reporting for Refunding of Debt Reported by Proprietary Activities" relating to the refundings, gains or losses resulting from debt refundings have been deferred and will be amortized over the lesser of the remaining life of the old debt or the life of the new debt. The debt refundings resulted in an economic loss of approximately \$3,100,000 and an increase in future debt service cash flow of \$5,200,000. The economic loss is defined as the present value of the increase in future debt service cash flows.

Interest expense on the bonds outstanding during the fiscal year was \$17,082,000 and \$15,279,000 for the years ended May 31, 2004 and 2003, respectively.

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

Fiscal Year Ending	Principal	Interest	Total
<i>(in thousands of dollars)</i>			
2005.....	\$15,268	\$18,786	\$ 34,054
2006.....	15,992	18,098	34,090
2007.....	17,940	17,366	35,306
2008.....	18,735	16,542	35,277
2009.....	19,575	15,633	35,208
	\$87,510	\$86,425	\$173,935

**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 ten percent 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 and EFC Revenue Bonds Series 1998B, 1999A, 2000A, 2000B, 2001A, 2001B, 2002A, 2002G and 2003B Bonds, the Authority elected to maintain a minimum debt service balance of ten percent of the proceeds.

Revenue before interest expense and depreciation and amortization was equivalent to 2.67 times (2.77 in 2003) the debt service requirement, for the year ended May 31, 2004. The minimum debt service requirement on all bonds is 1.10.

## Notes to Financial Statements *May 31, 2004 and 2003 (continued)*

### 6. NOTES PAYABLE

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

Series	Final Maturity Date	Balance at May 31, 2003	Issued	Redeemed	Balance at May 31, 2004
<i>(in thousands of dollars)</i>					
2000.....	05/01/05	\$ 46,000	\$—	\$(46,000)	\$ —
2001.....	06/01/06	88,100	—	(36,000)	52,100
2003.....	01/01/08	70,000	—	—	70,000
Total notes outstanding.....		\$204,100	\$—	\$(82,000)	\$122,100

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.

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 May 1, 2005, June 1, 2006 and January 1, 2008, the date of principal maturity, for the 2000, 2001 and 2003 notes, respectively.

For the years ended May 31, 2004 and 2003, the effective interest rate was 1.10 percent and .95 percent, respectively.

Interest expense on the BANS was \$1,497,000 and \$2,074,000 for the years ended May 31, 2004 and 2003, respectively.

On January 29, 2003, the Authority issued \$70,000,000 of variable rate bond anticipation notes to fund construction activities. The notes mature on January 1, 2008, and are expected to be periodically remarketed to bear interest based on the minimum interest rate that, under prevailing financial conditions, enables the notes to be sold at par, subject to the applicable effective interest rate period.

### 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 Systems, 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 two percent 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 percent 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 percent 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 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 three percent of their annual salary to the Employees' Retirement System (three percent 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 three percent of their last year's salary, for each year of credit acquired. Member is required to have been on active duty for at least one day during the following eligible periods:

- World War 2 (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 \$2,744,000 and \$1,853,000 for the years ended May 31, 2004 and 2003. 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.

### 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 sheet. 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 \$16,750,000 and \$13,749,000 at May 31, 2004 and 2003, 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 \$2,136,000 and \$1,691,000 for the years ended May 31, 2004 and 2003, respectively.

### 10. CAPITAL LEASES

In June 2000, the Authority entered into a capital lease agreement for computer equipment. Future minimum payments under the capital lease obligation are scheduled as follows:

Year Ending May 31,	
<i>(in thousands of dollars)</i>	
2005.....	\$ 216
2006.....	216
Total minimum lease payments.....	432
Less: amounts representing interest.....	(7)
Present value of minimum lease payments.....	425
Less: current portion.....	(205)
Obligation under capital lease.....	\$ 220

### 11. COMMITMENTS AND CONTINGENCIES

#### *Operating Leases*

As of May 31, 2003, the Authority is obligated under several operating leases with various lease terms through 2008, for meter reading, telephone and computer equipment:

Year Ending May 31,	
<i>(in thousands of dollars)</i>	
2005.....	\$ 293
2006.....	96
2007.....	61
2008.....	51
2009.....	10
	\$ 511

Rental expense for operating leases was \$228,000 and \$276,000 for the years ended May 31, 2004 and 2003, respectively.

#### *Legal Proceedings*

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, revenues invested in facilities or cash flows.

# Report of Independent Auditors

To the Members of Suffolk County Water Authority:

In our opinion, the accompanying balance sheets and the related statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of Suffolk County Water Authority ("Authority") at May 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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.

Management's Discussion and Analysis and the supplementary information on pages 1 through 10 is not a required part of the basic financial statements but supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management, regarding the presentation of the supplementary information. However, we did not audit the information, and express no opinion on it.

*PricewaterhouseCoopers LLP*

Melville, New York  
August 6, 2004

## Authority Members



Michael A. LoGrande  
*Chairman*



Melvin M. Fritz, D.O., M.D.  
*Secretary*



Eric J. Russo, Esq.



George Proios



Bernard Brady

## Management Staff

Stephen M. Jones  
*Chief Executive Officer*

Nicolo DiBartolo  
*Chief Financial Officer*

Michael R. Frank  
*Deputy Chief Executive Officer for Customer Service*

Herman J. Miller, P. E.  
*Deputy Chief Executive Officer for Operations*

Michael Stevenson  
*Deputy Chief Executive Officer for Administration*

Timothy J. Hopkins, Esq.  
*General Counsel*

Steven T. Burns, P. E.  
*Director of Distribution*

Michael A. DeBlasi  
*Director of General Services*

Clifford J. Foy  
*Director of Customer Service*

Larry B. Kulick, C.P.A.  
*Director of Finance*

Michael A. Litka  
*Director of Information Technology*

Robert L. Murray  
*Director of Production Control*

Joseph M. Pokorny, P. E.  
*Chief Engineer*

Karen A. Randazzo  
*Director of Laboratory Services*

## Consultants

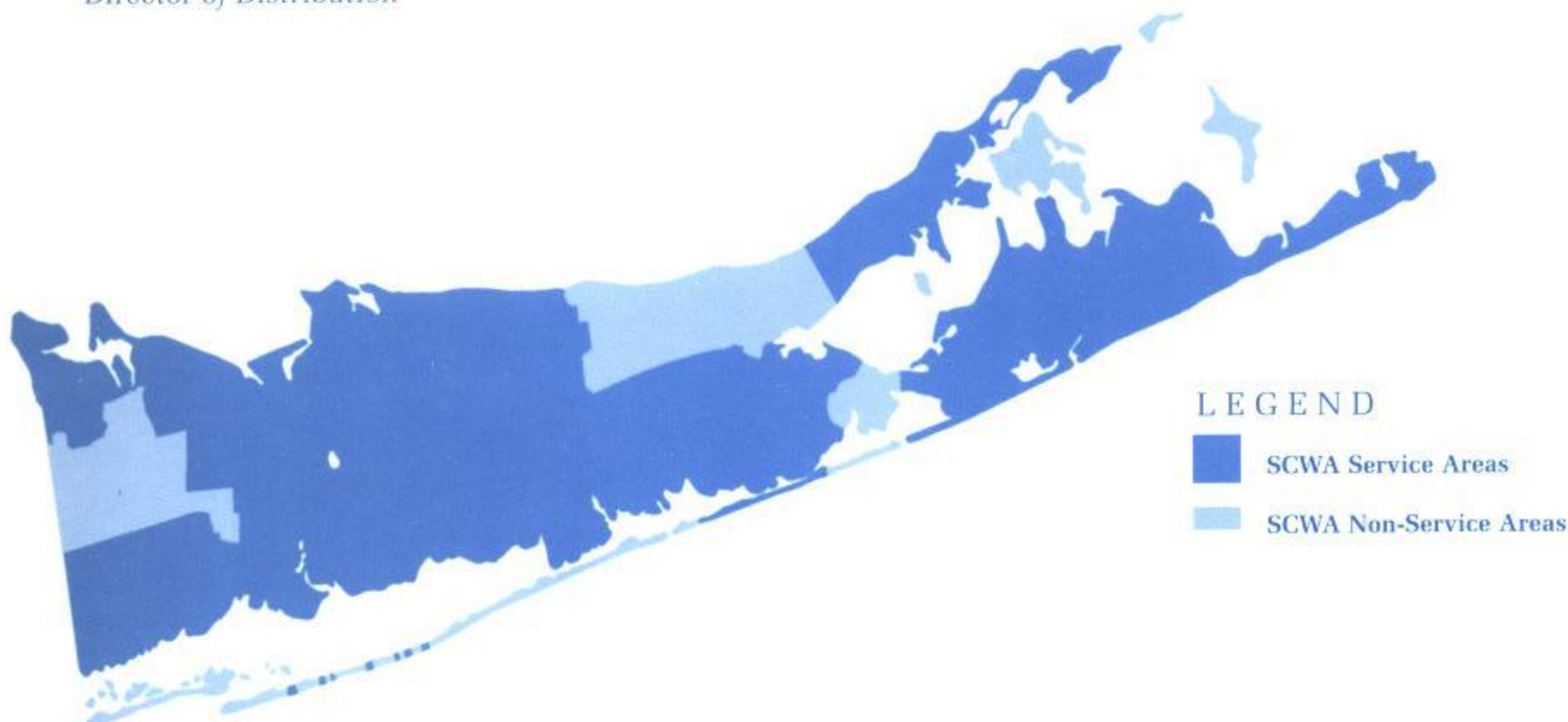
Bank of New York  
*Bond Trustee*

PricewaterhouseCoopers LLP  
*Independent Accountants*

Citigroup Global Markets Inc.  
*Financial Consultant*

Nixon Peabody LLP  
*Bond Counsel*

Leggette, Brashears & Graham, Inc.  
*Consulting Groundwater Geologists*



## Groundwater Guardian Program

We have continued our involvement with the Groundwater Foundation, a non-profit educational organization based in Lincoln, Nebraska.

Suffolk County was originally named as a Groundwater Guardian Community by the group in 1998. This is a renewable designation, and the team meets on a regular basis to reevaluate its primary concerns and develop and coordinate ways to address them. The team's current focus is on public education, pollution prevention, and other environmental concerns that could affect our groundwater.

The Groundwater Guardian designation enables this area to join with Groundwater Guardian communities throughout North America in a unified effort to motivate people to learn more about groundwater and help protect this essential resource.



*Suffolk County Water Authority*

Administration Office  
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