

FINANCIAL STATEMENTS AND REQUIRED
SUPPLEMENTAL INFORMATION

Suffolk County Water Authority
Years Ended May 31, 2009 and 2008
With Report of Independent Auditors

Suffolk County Water Authority
Financial Statements and
Required Supplemental Information
Years Ended May 31, 2009 and 2008

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Report of Independent Auditors

To the Members of
Suffolk County Water Authority

We have audited the accompanying balance sheets of the Suffolk County Water Authority (the “Authority”) as of May 31, 2009 and 2008, and the related statements of revenues, expenses and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Authority as of May 31, 2009 and 2008, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 9, during 2008 the Authority adopted the accounting provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 31, 2009 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.

Management's discussion and analysis and the schedule of funding progress for the retiree healthcare plan, on pages 3 to 12, and page 40, respectively, are not a required part of the financial statements but are supplementary information required by the Governmental Accounting Standards Board. 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.

Ernst + Young LLP

August 31, 2009

Suffolk County Water Authority

Management's Discussion and Analysis

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

The Financial Statements

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 operations, investing activities and capital and related financing activities.

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

Management provides the following discussion and analysis ("MD&A") of the Authority's financial activities and financial statements. This overview is provided for the fiscal years ended May 31, 2009, 2008 and 2007. The reader should use the information contained in this analysis in conjunction with the information contained in the audited financial statements, all of which follow this narrative on the subsequent pages.

Suffolk County Water Authority's Changes in Net Assets

	Year Ended May 31		
	2009	2008	2007
	<i>(In Thousands)</i>		
Operating revenues			
Water service	\$ 119,241	\$ 127,686	\$ 119,610
Other	14,306	12,277	10,540
Total operating revenues	133,547	139,963	130,150
Operating expenses			
Operations and maintenance	103,476	97,554	84,591
Depreciation and amortization	36,200	34,845	32,030
Total operating expenses	139,676	132,399	116,621
Operating (loss) / income	(6,129)	7,564	13,529
Nonoperating revenues and expenses			
Interest expense, net	(17,852)	(16,115)	(14,888)
Costs to be recovered from future revenues	12,322	11,972	–
Capital reimbursement fees	8,629	10,283	10,029
Unrealized gain on investments	500	1,461	1,076
Legal Settlement	78,533	–	–
Total nonoperating revenues and expenses	82,132	7,601	(3,783)
Increase in net assets	76,003	15,165	9,746
Net assets, beginning of year	570,726	555,561	545,815
Net assets, end of year	\$ 646,729	\$ 570,726	\$ 555,561

Operating Revenues

Water service revenues decreased \$8.5 million or 6.6% during the current fiscal 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 reduced demand of 7.3% on the system as compared to the prior year.

Water service revenues increased \$8.1 million or 6.8% during the previous year from \$119.6 million for the 2007 fiscal year to \$127.7 million for the 2008 fiscal year. The increase was a result of an increased demand of 5.4% on the system as compared to the prior year, offset by customer growth of below 1%, and an average rate increase of 4% effective April 1, 2008.

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.

Other operating revenues increased \$1.8 million or 17.1% from \$10.5 million for the 2007 fiscal year to \$12.3 million for the 2008 fiscal year. The increase is primarily attributable to increases from the cost of living adjustments in antennae leases and additional antennae lease sites.

Operating Expenses

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).

Operations and maintenance expense increased \$13.0 million or 15.3% from \$84.6 million for the 2007 fiscal year to \$97.6 million for the 2008 fiscal year. The \$13.0 million increase was mainly attributable to the recording of other postemployment benefits (“OPEB”), in accordance with GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, (\$12.0 million). Other operating and maintenance costs attributable to the remaining \$1.0 million increase are treatment costs (\$1.4 million), workers’ compensation costs (\$0.4 million), laboratory costs (\$0.4 million), uncollectible accounts (\$0.3 million), employee benefits (\$0.6 million), and public relations (\$0.2 million) offset by decreased costs incurred for general insurance costs (\$0.4 million), maintenance of mains (\$0.3 million), hydrants (\$0.4 million) and services (\$0.3 million), and system maintenance (\$0.9 million).

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.

Depreciation and amortization expenses were \$34.8 million during fiscal 2008 as compared to \$32.0 million during fiscal 2007, an increase of \$2.8 million or 8.7%. The increase is attributable to additional capital assets placed in service during fiscal year 2008 along with goodwill-related amortization.

Total amortization is \$0.582 million and \$0.623 million for fiscal years 2009 and 2008, respectively.

Nonoperating Revenues and Expenses

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.

Capital reimbursement fees were \$10.3 million during fiscal 2008 as compared to \$10.0 million during fiscal 2007, an increase of \$0.3 million or 3.0% during the current year. The increase is a result of the amount of main and service installation completed and placed in service during the fiscal year.

Interest expense was \$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 expense was \$23.7 million during fiscal 2008 as compared to \$23.2 million during fiscal 2007, an increase of \$0.5 million. This is attributable to an increase in the interest on long-term water revenue bonds as the result of the issuance of \$45 million Suffolk County Water System Revenue Bonds 2008A and the remarketing of Suffolk County Water System Revenue Bonds 2006A from auction rate to long-term fixed rate bonds mitigated by the reduced interest costs associated with the outstanding Suffolk County Water Authority Variable Rate Bond Anticipation Notes (see Long-Term Debt section).

Interest income 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.

Interest income was \$9.0 million during fiscal year 2008 as compared to \$9.4 million during fiscal year 2007, a decrease of \$0.4 million. The decrease is the result of market conditions, which saw a lower interest rate environment during this past fiscal year, mitigated by the additional funds available from net revenue and financing.

Costs to be recovered from future revenues (\$12.3 million) represent the difference between the Authority's annual required contributions for postemployment benefits other than pensions as required by GASB Statement No. 45 and the amount paid out for such benefits by the Authority during fiscal 2009. In accordance with FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, the Authority has deferred the excess of the annual OPEB costs over the amount paid during the fiscal year. The deferred costs will be recovered through future revenues in accordance with the Authority's rate model.

Suffolk County Water Authority's Net Assets

	2009	May 31 2008	2007
	<i>(In Thousands)</i>		
Assets			
Capital assets, net of accumulated depreciation	\$ 997,654	\$ 975,258	\$ 951,024
Other assets	354,633	296,839	228,428
Total assets	<u>\$ 1,352,287</u>	<u>\$ 1,272,097</u>	<u>\$ 1,179,452</u>
Liabilities			
Current liabilities	\$ 110,018	\$ 48,478	\$ 44,843
Other long-term liabilities	28,172	16,262	4,437
Long-term debt	567,368	636,631	574,611
Total liabilities	<u>705,558</u>	<u>701,371</u>	<u>623,891</u>
Net assets			
Invested in capital assets, net of related debt	361,791	380,565	389,527
Restricted for debt service	36,152	36,694	33,923
Unrestricted	248,786	153,467	132,111
Total net assets	<u>646,729</u>	<u>570,726</u>	<u>555,561</u>
Total liabilities and net assets	<u>\$ 1,352,287</u>	<u>\$ 1,272,097</u>	<u>\$ 1,179,452</u>

Capital Assets, Net of Accumulated Depreciation (Water Plant)

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.

There was a net increase in water plant in fiscal 2008 of \$24.2 million comprising an increase of \$54.2 million in gross water plant (including construction in progress) reduced by an increase in accumulated depreciation of \$30.0 million.

Current Assets

	May 31	
	2009	2008
	<i>(In Thousands)</i>	
Increases (Decreases)		
Cash and cash equivalents	\$ 25,565	\$ (1,161)
Current portion of investments	73,009	24,981
Accounts receivable, net	1,255	1,024
Accrued water services and fire protection revenues	(764)	(1,992)
Materials and supplies	1,215	804
Prepayments and other current assets	(279)	21
Interest and other receivables	(228)	14
Net increase in current assets	<u>\$ 99,773</u>	<u>\$ 23,691</u>

Total investments, including cash and cash equivalents, were \$278.9 million at May 31, 2009, representing a net increase of \$45.3 million as compared to May 31, 2008. This is the result of additional cash provided by operations, (including a legal settlement of \$78.5 million, net of legal fees), financing, and investing activities, reduced by operating and capital expenditures.

Total investments, including cash and cash equivalents, were \$233.6 million at May 31, 2008, representing a net increase of \$56.3 million as compared to May 31, 2007. This is a result of additional cash provided by operating, financing and investing activities. On January 15, 2008, \$70 million Suffolk County Water System Variable Rate Bond Anticipation Notes, 2008 were issued for the purpose of providing monies for the acquisition and construction of improvements and additions to the water system.

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 2009 was approximately 7.3% lower than 2008, which results in a decrease of approximately \$0.8 million.

Water pumped in April and May 2008 was approximately 8.0% lower than 2007, which results in a decrease of approximately \$2.0 million.

Inventory at May 31, 2009 is valued at \$8.3 million, an increase of \$1.2 million compared to May 31, 2008. Management's review and restructuring of the inventory system resulted in reclassifying certain items from nonstock to stock.

Inventory at May 31, 2008 was valued at \$7.1 million, an increase of \$0.8 million compared to May 31, 2007. Management's review and restructuring of the inventory system resulted in reclassifying certain items from nonstock to stock. This change along with excess inventory purchases and incremental inflationary increases resulted in the aforementioned increase.

Noncurrent Assets

The total value of noncurrent assets remained constant at approximately \$1.1 billion. Variances within non-current assets consisted of a \$22.4 million increase in net capital assets, \$53.2 million decrease in investments held for construction and debt service, \$12.3 million increase in costs to be recovered from future revenues, \$0.9 million decrease in deferred charges and other assets, and \$0.2 million decrease in goodwill. The Authority's cost recovery rate model used to establish rates, fees and charges includes an amount for postemployment benefits other than pensions that is expected to be paid out during the fiscal year, but not for the amount of the annual OPEB costs as calculated under GASB Statement No. 45. In accordance with FASB Statement No. 71, the Authority has deferred the excess of current annual required contribution over the amount paid during the fiscal year. The deferred costs will be recovered through future revenues in accordance with the Authority's rate model. The amount deferred as of May 31, 2009 is \$24.3 million.

Investments

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 amounts that approximate fair value.

The Authority's unrestricted investments increased \$73.0 million or 56.3% from \$129.8 million as of May 31, 2008 to \$202.8 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.

The Authority's unrestricted investments increased \$25.0 million or 23.8% from \$104.8 million as of May 31, 2007 to \$129.8 million as of May 31, 2008. The increase in investments of unrestricted assets overall is attributable to the addition of monies available from revenues after the payment of debt service reduced by the use of funds to pay for water system capital improvements, which was paid for principally from proceeds of previous financing.

Current Liabilities

The \$61.5 million increase in current liabilities from 2008 to 2009 consists of increases in accounts payable (\$1.8 million), accrued interest (\$0.7 million), accrued employee welfare costs (\$0.4 million), customer deposits (\$0.3 million) and the Suffolk County Water Authority Variable Rate Bond Anticipation Notes, 2004, which have a final maturity date of December 1, 2009 (\$60.0 million). These increases are offset by decreases in current maturities of water revenue bonds (\$1.2 million), and other accrued liabilities (\$0.5 million).

The \$3.6 million increase in current liabilities from 2007 to 2008 consists of increases in current maturities of water revenue bonds (\$0.3 million), accounts payable (\$1.0 million), accrued interest (\$1.2 million), other accrued liabilities (\$0.4 million), customer deposits (\$0.5 million), and accrued employee welfare costs (\$0.2 million).

Accrued retirement contributions continue to be stable at \$568,000 as of May 31, 2009 as compared to \$576,000 as of May 31, 2008. This is attributable to slightly lower contribution rates negated by increased payroll costs. The Authority, based on the rates set by the New York State Retirement System, has been advised the regular pension costs for the period April 1, 2009 through March 31, 2010 are estimated to be an average of 7.1% of payroll.

Accrued retirement contributions at May 31, 2008 were \$576,000, which is comparable with the \$591,000 accrued at May 31, 2007. This is attributable to slightly reduced contribution rates as established by the New York State Retirement System mitigated by increased payroll costs. The New York State Retirement System billed the Authority regular pension costs for the period April 1, 2008 through March 31, 2009 was \$2.9 million based on an average rate of 7.6% of payroll.

The \$1.8 million increase experienced in accounts payable from 2008 to 2009 is attributable principally to an increase in outstanding invoices related to capital and operating and maintenance expenses processed subsequent to May 31, 2009.

The increase in customer deposits of \$0.3 million is attributable to excess payments made by customers resulting in additional customers with credit balances, additional work order deposits, and a reduction in construction related easement deposits.

The increase in accrued interest of \$0.7 million is attributable to the reduction of outstanding debt in the course of making normally scheduled payments in accordance with debt service schedules.

The decrease of \$0.5 million in other accrued liabilities from 2008 and 2009 is primarily attributable to the reduction in liability for potential workers' compensation claims.

Postemployment Benefits Other than Pensions

GASB Statement No. 45 establishes guidance for the financial reporting of OPEB cost over a period that approximates employees' years of service. Under GASB Statement No. 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 Statement No. 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, 2009 include a liability in the amount of \$24.3 million that represents the Authority's unfunded liability.

Long-Term Debt

The Authority's long-term debt (including current maturities and exclusive of unamortized discounts) decreased from fiscal 2008 to fiscal 2009 by \$11.0 million resulting from the scheduled maturities during the fiscal year.

Water System Revenue and Environmental Facilities Corporation Revenue Bonds

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	<i>(In Thousands)</i>		
New issues:			
SCWA 2007	\$ –	\$ 45,000	\$ –
	–	45,000	–
Maturities, retirements and defeasances:			
SCWA	(7,385)	(7,150)	(6,795)
EFC	(3,583)	(3,502)	(3,437)
	(10,968)	(10,652)	(10,232)
Net change in long-term debt	<u>\$ (10,968)</u>	<u>\$ 34,348</u>	<u>\$ (10,232)</u>

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 participate in this program.

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

Net Assets Invested in Capital Assets, Net of Related Debt

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

The decrease of \$18.8 million from 2008 to 2009 results from an additional \$22.4 million in net water plant and payments and amortization of related debt of \$11.5 million offset by a decrease in restricted investments of \$52.7 million.

Net Assets, Unrestricted

Net assets, unrestricted, increased as a result of operations and a legal settlement. During the year the Authority received net proceeds in the amount \$78.5 million as settlement from legal action commenced against most major petroleum companies for contaminating Suffolk County Water Supplies with the gasoline additive methyl tertiary butyl ether.

Contacting the Authority's Financial Management

This financial report is designed to provide our 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	
	2009	2008
	<i>(In Thousands)</i>	
Assets		
Current assets:		
Cash and cash equivalents	\$ 28,066	\$ 2,501
Investments	202,776	129,767
Accounts receivable, less allowance for doubtful accounts of \$1,182 and \$1,089 in 2009 and 2008, respectively	11,115	9,860
Accrued water services and fire protection revenues	13,912	14,676
Interest and other receivables	1,193	1,421
Materials and supplies	8,303	7,088
Prepayments and other current assets	1,678	1,957
Total current assets	267,043	167,270
Restricted investments	48,082	101,357
Goodwill	3,783	3,934
Costs to be recovered from future revenues	24,293	11,972
Deferred charges and other assets	11,432	12,306
Capital assets, net	997,654	975,258
	1,085,244	1,104,827
Total assets	\$ 1,352,287	\$ 1,272,097
Liabilities and net assets		
Current liabilities:		
Current maturities of bond anticipation notes payable	\$ 60,000	\$ —
Current maturities of bonds payable	9,755	10,968
Accounts payable	9,376	7,591
Accrued interest	10,730	9,962
Accrued employee welfare costs	6,804	6,381
Other accrued liabilities	4,471	5,021
Customer deposits	8,882	8,555
Total current liabilities	110,018	48,478
Bond anticipation notes payable	70,000	130,000
Bonds payable, less current portion	497,368	506,631
Postemployment benefits other than pension	24,293	11,972
Advances for construction	3,879	4,290
Total liabilities	705,558	701,371
Commitments and contingencies		
Net assets:		
Invested in capital assets, net of related debt	361,791	380,565
Restricted for debt service	36,152	36,694
Unrestricted	248,786	153,467
Total net assets	646,729	570,726
Total liabilities and net assets	\$ 1,352,287	\$ 1,272,097

See accompanying notes.

Suffolk County Water Authority

Statements of Revenues, Expenses and Changes in
Fund Net Assets

	Year Ended May 31	
	2009	2008
	<i>(In Thousands)</i>	
Operating revenues:		
Water service	\$ 119,241	\$ 127,686
Other	14,306	12,277
Total operating revenues	133,547	139,963
Operating expenses:		
Operations	83,579	78,888
Maintenance	19,897	18,666
Depreciation and amortization	36,200	34,845
Total operating expenses	139,676	132,399
Operating (loss) income	(6,129)	7,564
Nonoperating revenues and expenses:		
Interest expense	(24,184)	(23,680)
Income from investments	6,832	9,026
Costs to be recovered from future revenues	12,322	11,972
Capital reimbursement fees	8,629	10,283
Legal Settlement	78,533	–
Total nonoperating revenues and expenses	82,132	7,601
Increase in net assets	76,003	15,165
Net assets:		
Beginning of year	570,726	555,561
End of year	\$ 646,729	\$ 570,726

See accompanying notes.

Suffolk County Water Authority

Statements of Cash Flows

	Year Ended May 31	
	2009	2008
	<i>(In Thousands)</i>	
Cash flows from operating activities		
Cash receipts from customers	\$ 118,750	\$ 128,654
Other operating cash receipts	14,392	12,599
Cash payments to suppliers of goods and services	(20,881)	(45,424)
Cash payments to employees for services	(68,436)	(39,623)
Net cash provided by operating activities	<u>43,825</u>	<u>56,206</u>
Cash flows from noncapital financing activities		
Receipts from legal settlements	78,533	-
Net cash provided by noncapital financing activities	<u>78,533</u>	<u>-</u>
Cash flows from investing activities		
Purchase of investments	(78,533)	(173,984)
Proceeds from sales and maturities of investments	59,299	118,006
Interest received	6,560	7,565
Net cash used in investing activities	<u>(12,674)</u>	<u>(48,413)</u>
Cash flows from capital and related financing activities		
Additions to water plant, net of retirements	(58,445)	(58,928)
Proceeds from issuance of notes payable	-	70,000
Proceeds from issuance of long-term debt	-	45,000
Repayment of notes payable	-	(41,900)
Repayment of current maturities of bonds payable	(9,970)	(10,764)
Interest paid	(23,922)	(22,498)
Proceeds from advances for construction, net of refunds	8,218	10,136
Net cash used in capital and related financing activities	<u>(84,119)</u>	<u>(8,954)</u>
Net increase (decrease) in cash and cash equivalents	25,565	(1,161)
Cash and cash equivalents at beginning of year	2,501	3,662
Cash and cash equivalents at end of year	<u>\$ 28,066</u>	<u>\$ 2,501</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating (loss) income	\$ (6,129)	\$ 7,564
Depreciation and amortization expense	36,200	34,845
(Increase) decrease in operating assets:		
Accounts receivable	(1,255)	(1,024)
Accrued water services and fire protection revenues	764	1,992
Materials and supplies and prepayments	(936)	(825)
Other assets	874	(455)
Costs to be recovered from future revenues	12,321	11,972
Increase (decrease) in operating liabilities:		
Accounts payable	1,785	1,047
Accrued employee welfare costs	423	230
Other accrued liabilities	(550)	414
Customer deposits	328	446
Net cash provided by operating activities	<u>\$ 43,825</u>	<u>\$ 56,206</u>
Noncash investing activities		
Increase in the fair value of investments	<u>\$ 500</u>	<u>\$ 1,461</u>

See accompanying notes.

Suffolk County Water Authority

Notes to Financial Statements

May 31, 2009

1. Summary of Significant Accounting Policies

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

Basis of Presentation

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

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

Capital Assets

Capital Assets are recorded at original cost. The capitalized cost of additions capital assets 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 capital accounts and together with costs to remove is charged to accumulated depreciation. The costs of repairs, minor betterments and renewals are charged to maintenance expense as incurred.

Depreciation

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

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Capitalized Interest

The Authority capitalizes interest on constructed assets during the period of construction. The amount of interest cost capitalized on qualifying assets acquired with proceeds of tax-exempt borrowings that are externally restricted to finance acquisition of specified assets is all interest cost of the borrowings less any interest earned on related interest-bearing investments acquired with such unexpended proceeds from the date of the borrowings until the assets are substantially complete and are ready for their intended use. Interest cost capitalized during the years ended May 31, 2009 and 2008 was approximately \$973,925 and \$1,770,000, respectively.

Cash and Cash Equivalents

Investments with original maturities of 90 days or less are considered cash equivalents and carried at amounts that approximate fair value.

Investments

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.

Investments Held for Debt Service

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

Investments held for debt service reserve and bond funds are restricted by the Resolution solely for the purpose of paying the principal and interest on the bonds and for retiring the bonds prior to maturity. Amounts in the debt service reserve and bond funds are invested in U.S. Treasury Notes and U.S. government securities.

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Investments Held for Construction

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

Goodwill

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

Advances for Construction and Capital Reimbursement Fees

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

There exist certain construction contracts with residential real estate developers and others, whereby the developer advances 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.

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

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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, 2009, the Authority had 19 active contracts where the credit did not equal the gross amount due. Annual gross payments for these contracts range from \$1,500 to \$357,000 with final maturity dates between 2012 and 2035. The cumulative gross payments due for all of these water district contracts through their respective maturity dates amount to approximately \$21,660,000. The Authority has elected not to record the value of these contracts as an asset and liability at May 31, 2009.

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

Debt Issuance Costs, Bond Discount and Other Bond Related Costs

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

Customer Deposits

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

Accrued Employee Welfare Costs

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

Revenues

The Authority distinguishes operating revenues and expenses from 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

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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.

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 2009 fiscal year. The deferred costs will be recovered through future revenues in accordance with the Authority's rate model. The deferred amount for the year ended May 31, 2009 and 2008 was determined as follows:

	May 31	
	2009	2008
Costs excluded from rate model:		
Annual OPEB costs recoverable from rate payers	\$ 15,682,886	\$ 15,204,025
Cost included in the rate model:		
Amount of current year payments	(3,361,806)	(3,232,506)
	12,321,080	11,971,519
Balance, beginning of the year	11,971,519	–
Balance, end of the year	\$ 24,292,599	\$ 11,971,519

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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 non-operating revenues.

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 the utilization of funds held in unrestricted net assets.

Income Taxes

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

Use of Estimates

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

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

Suffolk County Water Authority

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. This Statement establishes specific guidance on the measurement and recognition of pollution remediation obligations or responsibilities. The guidance lists what events must occur for a government to be required to calculate and report a pollution remediation liability. The Authority adopted GASB Statement No. 49 in fiscal 2009; it had no effect on the accompanying financial statements.

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures – an amendment of GASB Statements No. 25 and No. 27*. This Statement more closely aligns the GASB’s financial reporting requirements for pensions with those for other postemployment benefits (“OPEB”). The reporting changes required by this Statement amend applicable note disclosures and required supplemental information for pensions. The Authority adopted GASB Statement No. 50 in fiscal 2009; it had no effect on the accompanying financial statements.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This Statement requires that all intangible assets not specifically excluded by the scope provisions be classified as capital assets. The Authority is required to adopt GASB Statement No. 51 for its 2011 financial statements. The implementation of this Statement is not expected to have a significant impact on the financial position of the Authority.

Suffolk County Water Authority

Notes to Financial Statements (continued)

2. Capital Assets

	May 31, 2008	Additions/ Reclassifications	Deletions/ Reclassifications	May 31, 2009
	<i>(In Thousands)</i>			
Capital Assets, not being depreciated				
Land and land rights	\$ 21,582	\$ 26	\$ –	\$ 21,608
Construction in progress	94,353	79,542	(53,056)	120,839
Total Capital Assets, not being depreciated	115,935	79,568	(53,056)	142,447
Capital Assets, being depreciated				
Pumping and Purification				
Equipment	101,695	1,377	(53)	103,019
Distribution Systems	771,256	19,639	(1,163)	789,732
Wells, reservoirs and structures	217,039	4,505	(61)	221,483
Other	146,344	36,559	(33,952)	148,951
Total Capital Assets, being depreciated	1,236,334	62,080	(35,229)	1,263,185
Less accumulated depreciation	(377,011)	(36,552)	5,585	(407,978)
Capital Assets, net	\$ 975,258	\$ 105,096	\$ (82,700)	\$ 997,654

Suffolk County Water Authority

Notes to Financial Statements (continued)

2. Capital Assets (continued)

	May 31, 2007	Additions/ Reclassifications	Deletions/ Reclassifications	May 31, 2008
<i>(In Thousands)</i>				
Capital Assets, not being depreciated				
Land and land rights	\$ 21,357	\$ 731	\$ (506)	\$ 21,582
Construction in progress	135,467	128,935	(170,049)	94,353
Total Capital Assets, not being depreciated	156,824	129,666	(170,555)	115,935
Capital Assets, being depreciated				
Pumping and Purification				
Equipment	95,141	11,532	(4,978)	101,695
Distribution Systems	725,444	85,479	(39,667)	771,256
Wells, reservoirs and structures	205,358	23,386	(11,705)	217,039
Other	115,267	96,031	(64,954)	146,344
Total Capital Assets, being depreciated	1,141,210	216,428	(121,304)	1,236,334
Less accumulated depreciation	(347,010)	(34,732)	4,731	(377,011)
Capital Assets, net	\$ 951,024	\$ 311,362	\$ (287,128)	\$ 975,258

Depreciation expense amounted to approximately \$35,618,000 and \$34,186,000 for the years ended May 31, 2009 and 2008, respectively, based on a composite annual rate of 2.84%.

3. Cash and Cash Equivalents and Investments

Cash and Cash Equivalents

Cash consists of insured (FDIC) or collateralized deposits which have carrying values of approximately \$28,066,000 and \$2,501,000 and bank balances of approximately \$29,724,000 and \$4,159,00 at May 31, 2009 and 2008, respectively. Collateral for deposits is held by the bank in the name of the Authority.

Suffolk County Water Authority

Notes to Financial Statements (continued)

3. Cash and Cash Equivalents and Investments (continued)

Investments

Investments at May 31, 2009 and 2008 consist of the following:

	Fair Value		Investment Maturities at May 31, 2009 in Years		
	2009	2008	Less than 1	1 to 5	Greater Than 5
	<i>(In Thousands)</i>				
Certificates of deposit	\$ 128,300	\$ 75,600	\$ 128,300	\$ -	\$ -
U.S. Treasury bills ^(a)	-	177	-	-	-
U.S. Treasury notes ^(a)	510	2,035	510	-	-
U.S. Treasury bonds ^(a)	8,794	8,794	-	-	8,794
FNMA's ^(a)	20,064	34,380	18,025	2,039	-
FHLB Notes ^(a)	27,419	39,579	24,400	3,019	-
FHLMC Notes	12,332	10,060	1,195	11,137	-
FDIC Insured Notes	5,194	-	-	5,194	-
FFCB Notes	28,614	3,053	507	28,107	-
Money market ^(a)	507	424	507	-	-
Guaranteed investment contracts ^(a)	241	500	241	-	-
Repurchase agreements	18,883	56,522	18,883	-	-
Total investments	<u>\$ 250,858</u>	<u>\$ 231,124</u>	<u>\$ 192,568</u>	<u>\$ 49,496</u>	<u>\$ 8,794</u>

(a) Includes approximately \$48,082,000 and \$54,394,000 of investments held by Fiscal Agent in the Authority's name at May 31, 2009 and 2008, respectively.

	2009	2008
	<i>(In Thousands)</i>	
Investment breakdown:		
Restricted for:		
Debt service	\$ 36,152	\$ 36,694
Construction	11,930	64,663
Unrestricted	202,776	129,767
Total investments	<u>\$ 250,858</u>	<u>\$ 231,124</u>

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%.

Suffolk County Water Authority

Notes to Financial Statements (continued)

3. Cash and Cash Equivalents and Investments (continued)

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 and its agencies, obligations, 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.

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, 2009, the Authority's investments in obligations of the Federal National Mortgage Association, the Federal Home Loan Bank, FDIC insured notes, the Federal Home Loan Mortgage Corporation, and FFCB notes were rated Aaa by Moody's Investors Service and AAA by Standard & Poor's and Fitch Ratings.

Concentration of Credit Risk: The Authority places no limit on the amount the Authority may invest in any one issuer. More than 5% of the Authority's investments are in obligations of the Federal National Mortgage Association, the Federal Home Loan Bank and the Federal Farm Credit Bank. These investments are 8% (\$20,064,000), 11% (\$27,419,000) and 11% (\$28,614,000), respectively, of the Authority's total investments.

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable

Outstanding bonds are summarized as follows:

Series	Interest Rate	Final Maturity Date	May 31, 2008	Issued	Matured/ Refunded	May 31, 2009	Due within one Year
<i>(in thousands of dollars)</i>							
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	–
(b) 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	–
(b) 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	
			<u>\$ 506,631</u>			<u>\$ 497,368</u>	

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable (continued)

Series	Interest Rate	Final Maturity Date	May 31, 2007	Issued	Matured/ Refunded	May 31, 2008	Due within one Year
<i>(in thousands of dollars)</i>							
Water System Revenue Bonds							
(a) 1993 Senior Lien	4.80-5.10%	2013	\$ 21,670	\$ –	\$ (6,520)	\$ 15,150	\$ 6,740
(a) 1993 Subordinate Lien	4.80-5.10%	2013	13,985	–	(60)	13,925	60
(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	–
(b) 2001A Senior Lien	4.13-5.25%	2023	21,925	–	–	21,925	–
(a) 2003 Senior Lien	2.00-4.50%	2017	57,780	–	(570)	57,210	585
(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	–
(b) 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	3,980	–	(285)	3,695	290
(b) 1999A	2.77-4.91%	2018	3,890	–	(235)	3,655	240
(b) 2000A	3.80-5.96%	2019	650	–	(35)	615	35
(b) 2000B	4.31-5.74%	2020	4,280	–	(205)	4,075	210
(b) 2001A	3.48-5.17%	2021	8,120	–	(430)	7,690	435
(b) 2001B	2.62-5.15%	2021	13,775	–	(685)	13,090	710
(b) 2002A	1.36-5.00%	2022	8,715	–	(445)	8,270	445
(b) 2002B	1.33-5.12%	2022	7,115	–	(335)	6,780	340
(b) 2003B	0.72-4.50%	2023	7,665	–	(370)	7,295	370
(b) 2004A	1.20-4.96%	2024	6,043	–	(218)	5,825	250
(b) 2005B	2.08-4.02%	2026	6,597	–	(259)	6,338	258
Total bonds outstanding			487,075	\$ 45,000	\$ (10,652)	521,423	\$ 10,968
Less: Unamortized discount (premium)			(1,737)			(1,003)	
Deferred amount			5,449			4,827	
Current maturities payable			10,652			10,968	
			<u>\$ 472,711</u>			<u>\$ 506,631</u>	

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

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable (continued)

Water System Revenue Bonds

The Water System Revenue Bonds are issued to finance the cost of acquisition and construction of improvements and additions to the water system. The 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.

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

During fiscal year ended May 31, 2008, the Authority entered into the following bond transactions:

In December 2007, the Authority issued \$45,000,000 Senior Lien Water System Revenue Bonds, Series 2007A to refund all outstanding Variable Rate Bond Anticipation Notes, 2003 in the amount of \$41,900,000 due January 1, 2008. The Series 2007A bonds bear interest at rates ranging from 4.0% to 4.5% and have a final maturity date of June 1, 2032.

In January 2008, the Authority issued \$70,000,000 of Variable Rate Bond Anticipation Notes, 2008. The proceeds are to be used to finance the cost of acquisition and construction of improvements and additions to the water system. The notes mature on January 15, 2013, 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.

In March 2008, the Authority remarketed the outstanding \$70,000,000 Senior Lien Water System Variable Rate Revenue Bonds, Series 2006A. This remarketing memorandum was prepared for the purpose of converting the Auction Rate to a Long-Term Interest Rate. The Series 2006A bonds bear interest at a rate of 4.95% and have a final maturity date of June 1, 2031.

Suffolk County Water Authority

Notes to Financial Statements (continued)

4. Bonds Payable (continued)

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

The State of New York has established a State Drinking Water Program, which includes a state drinking water revolving fund (the “Revolving Fund”) to be used for purposes of the Safe Drinking Water Act. The New York State Environmental Facilities Corporation (the “Corporation”) is responsible for administering the Revolving Fund and 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 additional Water System Revenue Bonds through the Corporation during the fiscal years ended May 31, 2009 and 2008.

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, 2009, the amount of defeased debt obligation outstanding amounts to \$140,039,800.

Interest expense on the bonds outstanding was approximately \$22,591,000 and \$20,561,000 for the years ended May 31, 2009 and 2008, respectively.

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

	Principal	Interest	Total
	<i>(In Thousands)</i>		
Fiscal year ending:			
2010	\$ 9,755	\$ 23,221	\$ 32,976
2011	11,525	22,695	34,220
2012	11,630	22,160	33,790
2013	13,275	21,646	34,921
2014	13,795	21,093	34,888
2015-2019	85,515	94,492	180,007
2020-2024	101,730	72,049	173,779
2025-2029	132,170	44,028	176,198
2030-2032	131,060	9,638	140,698
	\$ 510,455	\$ 331,022	\$ 841,477

Suffolk County Water Authority

Notes to Financial Statements (continued)

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 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. 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 and 2005B Bonds, the Authority elected to maintain a minimum debt service balance of 10% of the proceeds. At May 31, 2009, the debt service reserve held funds that amounted to approximately \$19,520,000.

Revenue before interest expense and depreciation and amortization was equivalent to 3.95 times (2.19 in 2008) the debt service requirement for the year ended May 31, 2009. 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, 2008	Issued	Redeemed	Balance at May 31, 2009	Due Within One Year
<i>(In Thousands)</i>						
2004	12/01/09	\$ 60,000	\$ –	\$ –	\$ 60,000	\$ 60,000
2008	01/15/13	70,000	–	–	70,000	–
Total notes outstanding		\$130,000	\$ –	\$ –	\$130,000	\$ 60,000

Suffolk County Water Authority

Notes to Financial Statements (continued)

6. Notes Payable (continued)

Series	Final Maturity Date	Balance at May 31, 2007	Issued	Redeemed	Balance at May 31, 2008	Due Within One Year
<i>(In Thousands)</i>						
2003	01/01/08	\$ 41,900	\$ –	\$ (41,900)	\$ –	\$ –
2004	12/01/09	60,000	–	–	60,000	–
2008	01/15/13	–	70,000	–	70,000	–
Total notes outstanding		<u>\$ 101,900</u>	<u>\$ 70,000</u>	<u>\$ (41,900)</u>	<u>\$ 130,000</u>	<u>\$ –</u>

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

These notes are periodically remarketed and, therefore, interest on these notes is based on the minimum interest rate that, under prevailing financial market conditions, enables the notes to be sold at par, subject to the applicable effective interest rate period. The effective interest rate period may be daily, weekly, monthly, or semiannually. Interest is payable periodically, based upon the effective interest rate period, through December 1, 2009, and January 15, 2013, the date of principal maturity, for the 2004 and 2008 notes, respectively.

For the years ended May 31, 2009 and 2008, the effective interest rate was 1.01% and 2.69%, respectively.

Interest expense on the BANS was approximately \$1,593,000 and \$3,119,000 for the years ended May 31, 2009 and 2008, 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, New York 12244. Benefit provisions vary as follows:

Suffolk County Water Authority

Notes to Financial Statements (continued)

7. Pension Plan (continued)

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

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

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

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

Tier III members with five or more years of credited service after July 1, 1973 are eligible to retire with full benefits at age 62 or at age 55 with 30 years of service and with reduced benefits for retirement between ages 55 and 62 with less than 30 years of service. Benefits are integrated with Social Security beginning at age 62. If members retire at age 62 and have 25 or more years of credited service, the service retirement benefit will be 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 25 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 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.

Suffolk County Water Authority

Notes to Financial Statements (continued)

7. Pension Plan (continued)

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 \$2,052,797, \$2,499,226 and \$2,493,415 for the years ended May 31, 2009, 2008 and 2007, respectively. The Authority has recorded an accrued retirement contribution liability for certain pensions costs of employees related to construction work in progress which have been capitalized to water plant. The Authority capitalized \$879,770, \$1,071,097 and \$1,066,946 for the years ended May 31, 2009, 2008, and 2007 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 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 \$25,768,000 and \$28,522,000 at May 31, 2009 and 2008, respectively.

Suffolk County Water Authority

Notes to Financial Statements (continued)

9. Postemployment Benefits Other Than Pensions

The Authority sponsors a single employer health care plan that provides postemployment medical and dental benefits for eligible retirees and their spouses through the New York State Health Insurance Plan. 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.

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 plan is a noncontributory plan, with all payments for plan benefits being funded by the Authority. During 2009, there were 904 participants that were eligible to receive benefits.

In June 2004, the GASB issued Statement No. 45. The Statement 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 June 1, 2008.

In accordance with this standard, the Authority's annual OPEB cost for the plan is calculated based on the ARC, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. 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, 2009 and 2008 (in thousands):

	2009	2008
Annual required contribution	\$ 15,204	\$ 15,204
Interest on net OPEB obligation	479	–
Annual OPEB cost (expense)	15,683	15,204
Contributions made	(3,362)	(3,232)
Increase in net OPEB obligation	12,321	11,972
Net OPEB obligation, beginning of year	11,972	–
Net OPEB obligation, end of year	\$ 24,293	\$ 11,972

Suffolk County Water Authority

Notes to Financial Statements (continued)

9. Postemployment Benefits Other Than Pensions (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, 2009	\$15,683	21.4%	\$24,293
May 31, 2008	\$15,204	21.3%	\$11,972

As of May 31, 2007, the actuarial accrued liability for benefits was \$166,487,365, all of which was unfunded. As of May 31, 2008, the covered payroll (annual payroll of active employees covered by the plan) was \$36,035,914, and the ratio of the unfunded actuarial accrued liability to the covered payroll was 462%.

The actuarial valuation date is May 31, 2007. 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, 2007 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4% discount rate and an annual health care cost trend rate of 10.5% medical and 6.5% dental and grading down to an ultimate rate of 5%. The unfunded actuarial accrued liability is being amortized over 30 years as a level percentage of projected payroll on an open basis. The remaining amortization period at May 31, 2009 was 28 years.

Suffolk County Water Authority

Notes to Financial Statements (continued)

10. Commitments and Contingencies

Operating Leases

As of May 31, 2009, the Authority is obligated under several operating leases with various lease terms through 2014, for telephone, copiers and mail machine (in thousands):

Year ending May 31:	
2010	\$ 297
2011	286
2012	161
2013	109
2014	14

Rental expense for operating leases was approximately \$374,000 and \$410,000 for the years ended May 31, 2009 and 2008, respectively.

Legal

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

Risk Management

The Authority is exposed to various risks of loss related to automobiles and general liability. The Authority is partially self-insured for up to a maximum of \$500,000 for each general liability claim and \$500,000 for each automobile claim subject to a stop loss aggregate of \$1,507,000. 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.

Suffolk County Water Authority

Notes to Financial Statements (continued)

10. Commitments and Contingencies (continued)

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 \$2,750,139 and \$3,441,533 at May 31, 2009 and 2008, respectively, 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 2009 and 2008 were:

	Year Ended May 31	
	2009	2008
Unpaid claims, beginning of fiscal year	\$ 1,060,270	\$ 826,308
Changes in the estimate for claims of all years	(325,036)	855,169
Retroactive payments	(270,822)	(621,207)
Unpaid claims, end of fiscal year	\$ 464,412	\$ 1,060,270

Changes in the Authority's general and automobile claims liability amount in fiscal 2009 and 2008 were:

	Year Ended May 31	
	2009	2008
Unpaid claims, beginning of fiscal year	\$ 2,381,263	\$ 2,186,947
Changes in the estimate for claims of all years	182,369	632,010
Claim payments	(277,905)	(437,694)
Unpaid claims, end of fiscal year	\$ 2,285,727	\$ 2,381,263

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

Suffolk County Water Authority

Notes to Financial Statements (continued)

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 for 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:

	Invested in Capital Assets	Unrestricted	Restricted	Total
	<i>(In Thousands)</i>			
Net assets at May 31, 2007	\$ 389,527	\$ 132,111	\$ 33,923	\$ 555,561
Income	–	15,165	–	15,165
Transfers	(8,962)	6,191	2,771	–
Net assets at May 31, 2008	380,565	153,467	36,694	570,726
Income	–	76,003	–	76,003
Transfers	(18,774)	19,316	(542)	–
Net assets at May 31, 2009	\$ 361,791	\$ 248,786	\$ 36,152	\$ 646,729

Required Supplemental Information

Suffolk County Water Authority

Schedule of Funding Progress for the
Retiree Healthcare Plan

(Dollars 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, 2007	\$ –	\$166,487	\$166,487	0%	\$36,036	462%

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*

To the Members of
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, 2009, and have issued our report thereon dated August 31, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States 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 control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected by the entity’s internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity’s internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

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.

Ernst + Young LLP

August 31, 2009