



SUFFOLK COUNTY WATER AUTHORITY

Financial Statements and
Required Supplementary Information

May 31, 2012 and 2011

(With Independent Auditors' Report
and Report on Internal Control Thereon)

SUFFOLK COUNTY WATER AUTHORITY

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Independent Auditors' Report

The Members
Suffolk County Water Authority:

We have audited the accompanying balance sheets of the Suffolk County Water Authority (the Authority) as of May 31, 2012 and 2011, and the related statements of revenues, expenses, and changes in 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 of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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 Suffolk County Water Authority as of May 31, 2012 and 2011, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 28, 2012, 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.

U.S. generally accepted accounting principles require that management's discussion and analysis and the schedule of funding progress for the retiree healthcare plan, on pages 3 – 14 and page 40, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic



financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

August 28, 2012

SUFFOLK COUNTY WATER AUTHORITY

Management's Discussion and Analysis

May 31, 2012 and 2011

(Unaudited)

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

The Financial Statements

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

The statements of revenues, expenses, and changes in net assets report how the Authority's net assets changed during each year. The statements account for all of the years' revenues and expenses, measure the financial results of the Authority's operations for the years, and can be used to determine how the Authority has funded its costs.

The statements of cash flows provide information about the Authority's cash receipts, cash payments, and net changes in cash resulting from operating activities, investing activities, and capital and related financing activities.

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

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Management's Discussion and Analysis

May 31, 2012 and 2011

(Unaudited)

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, 2012, 2011, and 2010. The reader should use the information contained in this analysis in conjunction with the information contained in the audited financial statements, of which the 2012 and 2011 financial statements follow this narrative on the subsequent pages. Management provides the following MD&A of the Authority's financial activities and financial statements:

Summary of Revenues, Expenses, and Changes in Net Assets

	Year ended May 31		
	2012	2011	2010
	(In thousands)		
Operating revenues:			
Water service	\$ 131,293	131,860	114,579
Other	18,953	16,800	14,663
Total operating revenues	150,246	148,660	129,242
Operating expenses:			
Operations and maintenance	113,288	102,974	97,071
Depreciation and amortization	39,237	38,413	37,768
Total operating expenses	152,525	141,387	134,839
Operating (loss) income	(2,279)	7,273	(5,597)
Nonoperating revenues and expenses:			
Interest expense, net	(24,619)	(26,981)	(24,853)
Amortization and loss on bond refunding	(579)	(5,773)	(631)
Income from Investments	2,067	2,906	3,946
Costs to be recovered from future	14,629	12,984	12,409
Capital reimbursement fees	10,270	6,169	8,381
Total nonoperating revenues and expenses	1,768	(10,695)	(748)
Change in net assets	(511)	(3,422)	(6,345)
Net assets, beginning of year	636,962	640,384	646,729
Net assets, end of year	\$ 636,451	636,962	640,384

Operating Revenues

Water service revenues decreased \$0.6 million or 0.4% from \$131.9 million in 2011 to \$131.3 million in 2012. The decrease was a result of reduced water demand 71.0 billion and 74.0 billion gallons for fiscal years ended May 31, 2012 and 2011, respectively. The effects of reduced pumpage were mitigated by an increase in water rates by an average of 4.0% effective March 1, 2011 and April 1, 2012.

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(Unaudited)

Water service revenues increased \$17.3 million or 15.1% from \$114.6 million in 2010 to \$131.9 million in 2011. The increase was a result of increased water demand (74.0 billion and 62.0 billion gallons for fiscal years ended May 31, 2011 and 2010, respectively). Also, a factor in the increased revenues is a general increase in water rates, effective March 1, 2011. Annualized, this rate increase will reflect an average increase of 4.0%.

Other operating revenues increased \$2.1 million or 12.82% from \$16.8 million in 2011 to \$18.9 million in 2012. The increase is attributable to the following: 1) a net increase in managed water district revenue of \$1.1 million, primarily from the first full year of managing the East Farmingdale Water District, 2) Grant Money of \$0.6 million from Greater Long Island Clean Cities Coalition, for the conversion to, and purchase of natural gas vehicles, and 3) net increase of various miscellaneous fee totaling \$0.5 million.

Other operating revenues increased \$2.1 million or 14.6% from \$14.7 million in 2010 to \$16.8 million in 2011. The increase is primarily attributable to increases from the cost of living adjustments in antenna leases, antenna site enhancement fees, and additional antenna lease sites.

Operating Expenses

Operations and maintenance expense increased \$10.3 million or 10.0% from \$103 million in 2011 to \$113 million in 2012. The \$10.3 million increase was mainly attributable to increases in maintenance of mains, services, and hydrants (\$3.2 million), laboratory and chemical treatment costs (\$1.4 million) and other treatment related costs (\$0.7 million), increase in postretirement benefits other than pension "OPEB" (\$2.6 million) maintenance of wells and pumping facilities (\$1.2 million), and accounting collecting, legal, and benefit costs (\$1.2 million).

Operations and maintenance expense increased \$6.0 million or 6% from \$97.0 million in 2010 to \$103 million in 2011. The \$6.0 million increase was mainly attributable to increases in operations and maintenance of power costs of \$3.9 million, treatment costs of approximately \$1.0 million, and \$1.1 million for the cost of the retirement incentive program.

Depreciation and amortization expenses were \$39.2 million in 2012 as compared to \$38.4 million in 2011, an increase of \$0.8 million or 2.2%. The increase is attributable to additional capital costs placed in service during fiscal 2012 along with goodwill-related amortization.

Depreciation and amortization expenses were \$38.4 million in 2011 as compared to \$37.8 million in 2010, an increase of \$0.6 million or 1.6%. The increase is attributable to additional capital costs placed in service during fiscal 2011 along with goodwill-related amortization.

Nonoperating Revenues and Expenses

Interest expense was \$24.6 million in 2012 as compared to \$27.0 million in 2011, a decrease of \$2.4 million. The decrease is a result of the refinancing of \$16.6 million of long-term EFC Water System Revenue Bonds and the advance refunding of certain long-term Suffolk County Water Authority Water System Revenue bonds in the amount of \$83.1 million, and reduced by annual payments of principal of \$3.0 million (See Long-Term Debt section).

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(Unaudited)

Interest expense was \$27.0 million in 2011 as compared to \$24.9 million in 2010, an increase of \$2.1 million. The increase is a result of the issuance of \$100 million of Bond Anticipation Notes 2011 and \$24.9 million of long-term refunding bonds reduced by annual payments of principal of certain long-term bonds of \$3.0 million and the advance refunding of certain long-term bonds in the amount of \$92.4 million (See Long-Term Debt section).

In 2011, the Authority advance refunded and or defeased certain bonds with a face value of approximately \$109.2 million. The difference between the face amount of the bonds outstanding, net of accumulated premiums and discounts, and the amounts required to be deposited with the Trustee for the refunding of these bonds of approximately \$5.8 million has been recognized as a loss on bond refunding in the accompanying statement of revenues, expenses, and changes in net assets.

Income from investment was \$2.1 million in 2012 as compared to \$2.9 million in 2011, a decrease of \$0.8 million. The change in investment earnings was a result of a decrease in principal invested and a continued low interest rate environment.

Income from investment was \$2.9 million in 2011 as compared to \$3.9 million in 2010, a decrease of \$1.0 million. The change in investment earnings was a result of a decrease in principal invested and a continued low interest rate environment.

Costs to be recovered from future revenues of \$14.6 million represent the difference between the Authority's annual required contributions for postemployment benefits other than pensions as required by Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* (GASB No. 45), and the amount paid out or accrued for such benefits by the Authority during fiscal 2012. In accordance with Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) 980, *Regulated Operations* (previously FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*), the Authority has deferred the excess of the annual other postemployment benefits (OPEB) costs over the amount paid or accrued during the fiscal year. The deferred costs will be recovered through future revenues.

Capital reimbursement fees were \$10.3 million in 2012 as compared to \$6.1 million in 2011, an increase of \$4.1 million or 66.5% during the current year. The increase is a result of the timing of projects completed and placed into service.

Capital reimbursement fees were \$6.2 million in 2011 as compared to \$8.4 million in 2010, a decrease of \$2.2 million or 26.2% during the current year. The decrease is a result of reduced main installations completed and placed in service.

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Management's Discussion and Analysis

May 31, 2012 and 2011

(Unaudited)

Balance Sheet Summary

	<u>2012</u>	<u>May 31 2011</u>	<u>2010</u>
		(In thousands)	
Assets:			
Capital assets (water plant), net of accumulated depreciation	\$ 1,057,463	1,053,271	1,031,273
Current assets	242,856	193,146	208,676
Other noncurrent assets	186,900	232,042	216,559
Total assets	\$ 1,487,219	1,478,459	1,456,508
Liabilities:			
Current liabilities	\$ 162,908	93,506	50,474
Other long-term liabilities	66,195	53,576	39,655
Long-term debt, net of current portion	621,665	694,415	725,995
Total liabilities	850,768	841,497	816,124
Net assets:			
Invested in capital, net of related debt	349,384	384,929	367,305
Restricted for debt service	80,059	90,497	98,177
Unrestricted	207,008	161,536	174,902
Total net assets	636,451	636,962	640,384
Total liabilities and net assets	\$ 1,487,219	1,478,459	1,456,508

Capital Assets, Net of Accumulated Depreciation (Water Plant)

	<u>May 31, 2011</u>	<u>Additions/ reclassifications</u>	<u>Deletions/ reclassifications</u>	<u>May 31, 2012</u>
		(In thousands)		
Water plant in service	\$ 1,361,149	65,623	(7,821)	1,418,951
Less accumulated depreciation	(468,371)	(39,964)	7,821	(500,514)
Net water plant in service	892,778	25,659	—	918,437
Construction in progress	160,493	44,155	(65,622)	139,026
Water plant	\$ 1,053,271	69,814	(65,622)	1,057,463

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	<u>May 31,</u> <u>2010</u>	<u>Additions/ reclassifications</u>	<u>Deletions/ reclassifications</u>	<u>May 31,</u> <u>2011</u>
	(In thousands)			
Water plant in service	\$ 1,329,590	39,524	(7,965)	1,361,149
Less accumulated depreciation	<u>(437,658)</u>	<u>(38,678)</u>	<u>7,965</u>	<u>(468,371)</u>
Net water plant in service	891,932	846	—	892,778
Construction in progress	<u>139,341</u>	<u>60,702</u>	<u>(39,550)</u>	<u>160,493</u>
Water plant	<u>\$ 1,031,273</u>	<u>61,548</u>	<u>(39,550)</u>	<u>1,053,271</u>

There was a net increase in water plant in fiscal 2012 of \$4.2 million comprising an increase of \$36.3 million in gross water plant (including construction in progress) reduced by an increase on accumulated depreciation of \$32.1 million.

There was a net increase in water plant in fiscal 2011 of \$22.0 million comprising an increase of \$52.7 million in gross water plant (including construction in progress) reduced by an increase on accumulated depreciation of \$30.7 million.

In October 2010, the Town of Babylon, on behalf of the East Farmingdale Water District entered into a forty (40) year lease agreement with Suffolk County Water Authority, whereby the Authority agrees to operate, construct, maintain, and repair, at its own expense, the entire operating plant. The Town, on behalf of the District agreed to lease all of the rights, title, and interest in the entire operations, plant, hydrants, water storage, and distribution system, real property, and office facilities of the District, and all extensions thereto. In consideration, the Authority paid the sum of \$3 million.

Current Assets

	<u>May 31</u>	
	<u>2012</u>	<u>2011</u>
	(In thousands)	
Increases (decreases):		
Cash and cash equivalents	\$ 62,762	(2,261)
Investments	(17,757)	(8,308)
Accounts receivable, net	458	(722)
Accrued water services and fire protection revenues	3,627	(1,171)
Materials and supplies	527	(63)
Prepayments and other current assets	131	1,322
Interest and other receivables	<u>(38)</u>	<u>(4,327)</u>
Net decrease in current assets	<u>\$ 49,710</u>	<u>(15,530)</u>

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(Unaudited)

Current Assets

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

The Authority's investments, including cash and cash equivalents, increased \$45.0 million or 28.6% from \$157.3 million as of May 31, 2011 to \$202.3 million as of May 31, 2012. The increase is attributable to funds generated from excess revenues after paying for accrued operating and maintenance costs, water system capital improvements, and debt.

The Authority's investments, including cash and cash equivalents, decreased \$10.6 million or 6.3% from \$167.9 million as of May 31, 2010 to \$157.3 million as of May 31, 2011. The decrease is attributable to the utilization of funds to pay for the advance refunding of certain outstanding bonds, accrued operating and maintenance costs, and water system capital improvements.

Accrued water services and fire protection revenues reflect revenue corresponding to water consumption, which has not been billed as of May 31, 2012. Water pumped in April and May 2012 was approximately 33% higher than 2011, which results in an increase of approximately \$3.6 million.

Accrued water services and fire protection revenues reflect revenue corresponding to water consumption, which has not been billed as of May 31, 2011. Water pumped in April and May 2011 was approximately 13% lower than 2010, which results in a decrease of approximately \$1.2 million.

Materials and supplies at May 31, 2012 are valued at \$9.2 million, an increase of \$0.5 million from May 31, 2011. The increase is resulting from an increase in Meter inventory necessary to support the ongoing Automatic Meter Reading Project.

Materials and supplies at May 31, 2011 are valued at \$8.6 million, a decrease of \$0.1 million from May 31, 2010. Management's continued effort to minimize increases in its annual budgets from year to year as well improvement in establishing reorder points results in the corresponding level inventory value from year to year.

The increase in prepayments and other current assets from May 31, 2011 to 2012 in the amount of \$0.1 million is due to increased premium in cost of insurance.

The increase in prepayments and other current assets from May 31, 2010 to 2011 in the amount of \$1.3 million is primarily due to a \$1 million NYS health insurance premium payment for June 2011 paid prior to May 31, which is recorded as a prepayment at May 31, 2011.

In 2011, interest and other receivables decreased \$4.3 million or 92.3% as a result of a reversal of recording 3.8 million in funds for the American Recovery and Reinvestment Act of 2009 (ARRA). In February 2010, the Authority issued \$3.8 million Suffolk County Water Authority Variable Rate Bond Anticipation Notes, 2010 (EFC Series). These funds were awarded for the purpose of construction 17,763 feet of water main to existing residential customers that currently rely on point of use treatment systems for water service. In January 2011, the Authority advised the Environmental Facilities Corporation that the intended project was canceled and requested

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termination of the Project Financing Loan Agreement and related Bond Anticipation Notes. The EFC accepted this request and the Bond Anticipation Note were canceled.

Other Noncurrent Assets

Other noncurrent assets decreased by \$45.1 million from a balance of \$232.0 million as of May 31, 2011 to \$186.9 million as of May 31, 2012. This was the result of a decrease in restricted investments of \$58.8 million and the amortization of goodwill and other assets of \$0.9 million, offset by a \$14.6 increase in costs to be recovered from future revenues.

Liabilities

Current Liabilities

	<u>May 31</u>	
	<u>2012</u>	<u>2011</u>
	(In thousands)	
Increase (decrease):		
Current maturities of bond anticipation notes payable	\$ 70,000	50,000
Current maturities of bonds payable	(236)	(3,035)
Accounts payable	441	(190)
Accrued interest	(359)	(2,231)
Accrued employee welfare costs	801	(2,248)
Accrued NYS Retirement	(1,057)	1,877
Other accrued liabilities	(188)	(1,141)
Net change in current liabilities	<u>\$ 69,402</u>	<u>43,032</u>

Current Liabilities

In fiscal year 2012, \$50 million of Bond Anticipation Renewal Notes 2012A were issued, which are due in the next fiscal year.

In fiscal year 2011, \$100 million of additional Bond Anticipation Notes were issued, of which \$50 million of 2011A fixed rate Bond Anticipation Notes are due in the next fiscal year.

The \$0.4 million increase experienced in accounts payable from 2011 to 2012 is attributable principally to the invoice amounts associated with the capital and operating and maintenance expenses completed and not paid as of May 31, 2012.

The \$0.2 million decrease experienced in accounts payable from 2010 to 2011 is attributable principally to a reduction in outstanding invoices related to capital and operating and maintenance expenses.

The decrease in accrued interest of \$0.4 million from 2011 to 2012 is attributable to the defeasance of certain long-term debt negated by the issuance of Bond Anticipation Notes and Water System Revenue Refunding Bonds. (see Long-Term Debt section).

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The decrease in accrued interest of \$2.2 million from 2010 to 2011 is attributable to the defeasance of certain long-term debt negated by the issuance of Bond Anticipation Notes and Water System Revenue Refunding Bonds (see Long-Term Debt section).

Accrued employee welfare represents the expected value of all vacation, sick leave, and other payroll-related benefits earned by employees to date. The increase in accrued employee welfare at May 31, 2012 from 2011 is \$0.8 million and is principally attributable to additional sick and vacation leave earned.

Accrued employee welfare represents the expected value of all vacation, sick leave, and other payroll-related benefits earned by employees to date. The decrease in accrued employee welfare at May 31, 2011 from 2010 is \$2.3 million and is principally attributable to the payout of earned vacation and sick leave to the 38 employees who opted to retire in conjunction with the NYS Retirement Incentive Program as well as the payment of retroactive payroll associated with the settlement of the union contract.

Accrued NYS retirement contributions decreased by \$1.0 million to an amount of \$1.7 million as of May 31, 2012 as compared to \$2.7 million as of May 31, 2011. The decrease is attributable to the costs of the 2010 New York State Retirement Incentive Program, which was accrued in the prior fiscal year. The cost to the Authority was approximately \$1.8 million. The Authority, required to recoup the costs over a two-year period was able to recover the cost in less than twelve months. 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, 2011 through March 31, 2012 are estimated to be an average of 16% of payroll.

Accrued NYS retirement contributions increase by \$1.9 million to an amount of \$2.7 million as of May 31, 2011 as compared to \$0.8 million as of May 31, 2010. During the current year, the Authority participated in the 2010 New York State Retirement Incentive Program. Thirty-eight (38) employees took part in this program retiring by December 31, 2010. The estimated cost to SCWA is \$1.8 million. The Authority anticipates payroll savings in excess of \$3.5 million over a two (2) year period ending December 31, 2012. 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, 2011 through March 31, 2012 are estimated to be an average of 16% of payroll.

Other current liabilities decreased by \$0.2 million between May 31, 2011 and 2012. This is principally the result of a decrease in workers' compensation costs of \$0.14 million.

Other current liabilities decreased by \$1.1 million between May 31, 2010 and 2011. This is principally the result of decreases in reserves for insurance claims, self-insurance, and workers' compensation of \$0.5 million, accrued payroll of \$0.6 million.

Other Long-Term Liabilities

Other long-term liabilities increased by \$12.6 million from \$53.6 million at May 31, 2011 to a balance of \$66.2 million at May 31, 2012. This is a result of the increase in additional OPEB costs deferred to the balance sheet approximating \$15.6 million. This increase was mitigated by the transfer of deposits (\$3.0 million) to capital reimbursement revenues in connection with the financial closing of construction reimbursement contracts.

GASB No. 45 establishes guidance for the financial reporting of OPEB cost over a period that approximates employees' years of service. Under GASB No. 45, based on an actuarial valuation, an annual required

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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 No. 45 does not require that the unfunded liability actually be funded, only that the Authority account for the unfunded accrued liability. However, during 2012, in an effort to mitigate possible future rate impact related to any expected legal legislation, the Authority has established an undedicated reserve for this purpose. As of May 31, 2012, the undedicated reserve is \$1 million. The financial statements at May 31, 2012 and 2011 include a liability in the amount of \$65.3 million and \$49.7 million, respectively.

Long-Term Debt

The Authority's long-term debt (including current maturities, excluding unamortized discounts and deferred amounts) decreased from fiscal 2011 to 2012 by \$8.3 million.

**Water System Revenue and
Environmental Facilities Corporation Revenue Bonds**

	May 31		
	2012	2011	2010
		(In thousands)	
Balance, beginning	\$ 581,318	661,440	510,455
New issues:			
SCWA 2011 Refunding	—	24,930	100,000
SCWA 2012 Refunding	83,635	—	—
EFC 2010C Refunding	—	2,903	66,395
EFC 2011A Refunding	—	7,384	13,415
EFC 2011C Refunding	10,947	—	—
	<u>94,582</u>	<u>35,217</u>	<u>179,810</u>
Maturities, retirements, and defeasances:			
SCWA	(83,150)	(95,250)	(25,145)
EFC	(19,777)	(20,089)	(3,680)
	<u>(102,927)</u>	<u>(115,339)</u>	<u>(28,825)</u>
Net changes in long-term debt	<u>(8,345)</u>	<u>(80,122)</u>	<u>150,985</u>
Balance, ending	<u>\$ 572,973</u>	<u>581,318</u>	<u>661,440</u>

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(Unaudited)

Investment ratings on debt issued by the Authority by Standard and Poor’s Ratings Services (S&P) and Fitch Ratings (Fitch) were reaffirmed and are as follows at May 31, 2012:

	Investment ratings	
	S&P	Fitch
Long-term debt	AA+	AAA

As a result of legislation initiated by New York State and enacted by the U.S. Congress, a Drinking Water State Revolving Fund (DWSRF) was created to provide financial incentive for public and private water systems to finance drinking water infrastructure improvements in the form of subsidized low interest rate loans and grants for qualified projects. The New York State Environment Facilities Corporation (EFC) administers the financial aspects of the DWSRF. The Authority has participated in this program since 1998. The Authority has determined it advisable and financially advantageous to continue to participate in this program. During fiscal years ended May 31, 2011, and 2012, the Authority participated in the New York State Environmental Facilities Corporation (EFC) refinancing of outstanding bonds by refunding existing DWSRF bonds with new DWSRF bonds issued at lower current-market interest rates, thus passing the interest savings onto the Authority. Of the NYS EFC Series 2010C Revenue Bonds, the Authority refinanced \$3.2 million of 1999A Suffolk County Water Authority (EFC Series) Senior Lien Revenue Bonds. Of the NYS EFC Series 2011A Revenue Bonds, the Authority refinanced \$2.8 million of 1998B Suffolk County Water (EFC Series) Revenue Bonds, \$0.5 million of 2000A Suffolk county Water (EFC Series) Revenue Bonds, \$3.4 million of 2000B Suffolk County Water (EFC Series) Revenue Bonds, and \$6.8 million of 2001A Suffolk County Water (EFC Series) Revenue Bonds.

During fiscal year ended May 31, 2012, the NYS EFC issued Series 2011C in the amount of 10.9 million and along with unspent proceeds and debt service reserve funds in the amount of \$5.7 million refinanced \$10.9 million of 2001B Suffolk County Water Authority (EFC Series) Revenue Bonds and \$5.7 million of 2002G Suffolk County Water (EFC Series) Revenue Bonds.

During the fiscal year ended May 31, 2012, the Authority issued \$83.6 million “Suffolk County Water System Revenue Refunding Bonds,” for the purpose of currently refunding the balance of \$10.7 million 2001A Suffolk County Water System Revenue Bonds, and advance refunding \$72.5 million 2003C Suffolk County Water System Revenue Bonds.

During the fiscal year ended May 31, 2011, the Authority issued \$24.9 million “Suffolk County Water System Revenue Refunding Bonds,” for the purpose of retiring \$4.4 million 2001A Suffolk County Water Senior Lien Revenue Bonds, \$7.5 million 2003C Suffolk County Water Senior Lien Revenue Bonds, \$8.7 million 2009A Suffolk County Water Senior Lien Revenue bonds, and \$2.8 million 2009 Suffolk County Water Authority Refunding Bonds. The Authority also provided \$75 million in funds from the proceeds of the 2009 legal settlement for the purpose of retiring \$9.6 million of 1993 Suffolk County Water Subordinate Lien Revenue Bonds, \$4.2 million 1994 Suffolk County Water Subordinate Lien Revenue Bonds, \$6.8 million Suffolk County Water Senior Lien Revenue Bonds, and \$48.4 million 2003 Suffolk County Water Senior Lien Revenue Refunding Bonds.

SUFFOLK COUNTY WATER AUTHORITY

Management's Discussion and Analysis

May 31, 2012 and 2011

(Unaudited)

Short-Term Debt

The Authority has, from time to time, issued Bond Anticipation Notes to finance improvements and additions to the water system.

In March 2012, the Authority issued a total of \$50 million Suffolk County Water Authority Bond Anticipation Renewal Notes 2012A (Fixed Rate) for the purpose of renewing the Authority's 2011A Bond Anticipation Notes that were due April 1, 2012.

In April 2011, the Authority issued a total of \$100 million Suffolk County Water Authority Bond Anticipation Notes, consisting of \$50 million Bond Anticipation Note 2011A (Fixed Rate) and \$50 million Bond Anticipation Note 2011B (Variable SIFMA Rate).

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

Invested in capital, net of related debt represents the Authority's total investment in capital assets plus related long-term debt. The decrease of \$35.5 million over the May 31, 2011 balance is the result of an increase in water plant expenditures and funds available for construction offset by the net increase in debt balances.

Invested in capital, net of related debt represents the Authority's total investment in capital assets plus related long-term debt. The increase of \$17.6 million over the May 31, 2010 balance is the result of an increase in water plant expenditures and funds available for construction offset by the net increase in debt balances.

Net Assets – Unrestricted

In 2012, net assets – unrestricted, increased over the May 31, 2011 balance in the amount of \$45.5 million. During fiscal year 2012, net assets – unrestricted were increased by the investment in capital assets, which includes the net increase in plant, net increase in funds available for construction, and net decrease in debt of \$35.5 million and a decrease in revenues invested in facilities of \$.5 million, and reduced by \$10.4 million representing the reduction of debt service and debt service reserves in accordance with bond covenants.

In 2011, net assets – unrestricted, decreased over the May 31, 2010 balance in the amount of \$13.3 million. During fiscal year 2011, net assets – unrestricted were increased by the investment in capital assets, which includes the net increase in plant, net increase in funds available for construction, and net increase in debt of \$17.6 million and a decrease in revenues invested in facilities of \$3.4 million, and reduced by \$7.7 million representing the reduction of debt service and debt service reserves in accordance with bond covenants.

Contacting the Authority's Financial Management

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

SUFFOLK COUNTY WATER AUTHORITY

Balance Sheets

May 31, 2012 and 2011

Assets	2012	2011
	(In thousands)	
Current assets:		
Cash and cash equivalents	\$ 115,223	52,461
Investments	87,110	104,867
Accounts receivable, less allowance for doubtful accounts of \$1,468 and \$1,395 in 2012 and 2011, respectively	10,542	10,084
Accrued water services and fire protection revenues	18,165	14,538
Interest and other receivables	323	361
Materials and supplies, at average cost	9,228	8,701
Prepayments and other current assets	2,265	2,134
Total current assets	242,856	193,146
Restricted investments	110,716	169,474
Goodwill	3,331	3,481
Costs to be recovered from future revenues	64,315	49,686
Deferred charges and other assets	8,538	9,401
Capital assets, net	1,057,463	1,053,271
Total noncurrent assets	1,244,363	1,285,313
Total assets	\$ 1,487,219	1,478,459
Liabilities and Net Assets		
Current liabilities:		
Current maturities of bonds payable	\$ 3,254	3,490
Current maturities of bond anticipation notes payable	120,000	50,000
Accounts payable	8,175	7,734
Accrued interest	12,503	12,862
Accrued employee welfare costs	6,718	5,917
Accrued NYS retirement contributions	1,668	2,725
Other accrued liabilities	10,590	10,778
Total current liabilities	162,908	93,506
Bond anticipation notes payable	50,000	120,000
Bonds payable, less current portion and unamortized discounts	571,665	574,415
Postemployment benefits other than pension	65,315	49,686
Advances for construction	880	3,890
Total liabilities	850,768	841,497
Commitments and contingencies		
Net assets:		
Invested in capital, net of related debt	349,384	384,929
Restricted for debt service	80,059	90,497
Unrestricted	207,008	161,536
Total net assets	636,451	636,962
Total liabilities and net assets	\$ 1,487,219	1,478,459

See accompanying notes to financial statements.

SUFFOLK COUNTY WATER AUTHORITY

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended May 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
	(In thousands)	
Operating revenues:		
Water service	\$ 131,293	131,860
Other	18,953	16,800
Total operating revenues	<u>150,246</u>	<u>148,660</u>
Operating expenses:		
Operations	89,754	83,228
Maintenance	23,534	19,746
Depreciation and amortization	39,237	38,413
Total operating expenses	<u>152,525</u>	<u>141,387</u>
Operating (loss) income	<u>(2,279)</u>	<u>7,273</u>
Nonoperating revenues and expenses:		
Interest expense, net	(24,619)	(26,981)
Amortization and loss on bond refunding	(579)	(5,773)
Income from investments	2,067	2,906
Costs to be recovered from future revenues	14,629	12,984
Capital reimbursement fees	10,270	6,169
Total nonoperating revenues and expenses	<u>1,768</u>	<u>(10,695)</u>
Change in net assets	(511)	(3,422)
Net assets:		
Beginning of year	<u>636,962</u>	<u>640,384</u>
End of year	\$ <u><u>636,451</u></u>	\$ <u><u>636,962</u></u>

See accompanying notes to financial statements.

SUFFOLK COUNTY WATER AUTHORITY

Statements of Cash Flows

Years ended May 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
	(In thousands)	
Cash flows from operating activities:		
Cash receipts from customers	\$ 128,071	134,685
Other operating cash receipts	18,765	15,659
Cash payments to suppliers of goods and services	(41,878)	(36,514)
Cash payments to employees for services and benefits	(56,104)	(55,145)
	<hr/>	<hr/>
Net cash provided by operating activities	48,854	58,685
	<hr/>	<hr/>
Cash flows from investing activities:		
Purchase of investments	(337,753)	(88,960)
Proceeds from sales and maturities of investments	413,789	93,500
Interest received	2,584	3,575
	<hr/>	<hr/>
Net cash provided by investing activities	78,620	8,115
	<hr/>	<hr/>
Cash flows from capital and related financing activities:		
Additions to water plant, net of retirements	(43,429)	(60,411)
Proceeds from issuance of notes payable	50,000	100,000
Proceeds from issuance of long-term debt	100,747	35,217
Repayment of notes payable	(50,000)	(3,844)
Repayment of current maturities of bonds payable	(102,927)	(115,339)
Interest paid	(25,784)	(29,861)
Amortization and loss on bond refunding	(579)	(5,773)
Capital grant included in other receivables	—	3,844
Proceeds from advances for construction, net of refunds	7,260	7,106
	<hr/>	<hr/>
Net cash used in capital and related financing activities	(64,712)	(69,061)
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	62,762	(2,261)
	<hr/>	<hr/>
Cash and cash equivalents at beginning of year	52,461	54,722
	<hr/>	<hr/>
Cash and cash equivalents at end of year	\$ 115,223	52,461
	<hr/>	<hr/>
Reconciliation of operating (loss) income to net cash provided by operating activities:		
Operating (loss) income	\$ (2,279)	7,273
Depreciation and amortization expense	39,387	38,564
(Increase) decrease in operating assets:		
Accounts receivable	(458)	722
Accrued water services and fire protection revenues	(3,627)	1,171
Materials and supplies and prepayments	(658)	(1,259)
Deferred charges and other assets	863	932
Postemployment benefits other than pension	15,629	12,984
Increase (decrease) in operating liabilities:		
Accounts payable	441	(190)
Accrued employee welfare costs	801	(2,248)
Accrued NYS retirement contributions	(1,057)	1,877
Other accrued liabilities	(188)	(1,141)
	<hr/>	<hr/>
Net cash provided by operating activities	\$ 48,854	58,685
	<hr/>	<hr/>
Noncash investing activities:		
Change in the fair value of investments	\$ (479)	(186)

See accompanying notes to financial statements.

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

(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.

(a) *Basis of Presentation*

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

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

(b) *Water Plant (Capital Assets)*

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

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

(c) *Depreciation*

The provisions for depreciation for water plant result from the application of straight-line rates by groups of depreciable properties in service. The rates are determined by age-life studies performed on depreciable properties. The most recent rate study, done in November 2003, established the composite depreciation rate of 2.84%. The Authority reviews the composition of its fixed assets annually in order to determine the appropriateness of this depreciation rate. The Authority determined that the depreciation rate of 2.84% remained appropriate at May 31, 2012 and 2011.

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

(d) Capitalized Interest

The Authority capitalizes interest on constructed assets during the period of construction. Interest cost capitalized during the years ended May 31, 2012 and 2011 was approximately \$1.2 million and \$1.3 million, respectively.

(e) Cash and Cash Equivalents and Investments

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

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

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

(f) Investments Held for Debt Service

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

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

(g) Investments Held for Construction

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

(h) Goodwill

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

(i) Advances for Construction and Capital Reimbursement Fees

Under current standard construction contracts with residential real estate developers and others, the developer advances to the Authority the cost of new main installations based on a flat cost per foot.

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

Upon completion of construction, the moneys are recognized as capital reimbursement fees in the statements of revenues, expenses, and changes in 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 moneys paid by the developer are recognized as capital reimbursement fees in the statements of revenues, expenses, and changes in net assets when the construction is completed.

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

(j) *Water District Contracts*

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

As of May 31, 2012, the Authority had 16 active contracts where the credit did not equal the gross amount due. Annual gross payments for these contracts range from \$1,800 to \$377,000 with final maturity dates between 2012 and 2030. The cumulative gross payments due for all of these water district contracts through their respective maturity dates at May 31, 2012 and 2011 amount to approximately \$12.5 million and \$13.7 million, respectively. The Authority has determined that as the asset and liability created from these contracts have the right of offset, these amounts are not reflected on the balance sheets as of May 31, 2012 and 2011.

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

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

Debt issuance costs and bond discount and premium are amortized over the life of the related bond issues. Premiums paid in connection with interest rate cap agreements are amortized and reported as interest expense over the life of the respective agreements. Deferred bond refunding costs are amortized to expense over the shorter of the life of the refunding bonds or the refunded bonds. Debt issuance costs, bond discount and premiums, and other related bond issuance costs are reported as deferred charges of \$6.2 million and \$6.8 million at May 31, 2012 and 2011, respectively, in the accompanying balance sheets.

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

(l) Customer Deposits

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

(m) Accrued Employee Welfare Costs

The Authority permits employees to accumulate a limited amount of earned but unused leave benefits, which will be paid to employees upon separation from service. Unpaid compensated absences are recorded as a liability in accordance with GASB Statement No. 16, *Accounting for Compensated Absences*. As of May 31, 2012 and 2011, the amounts of accrued employee welfare costs are \$6.7 million and \$5.9 million, respectively.

(n) Revenues

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

(o) Costs to Be Recovered from Future Revenues

The Authority's cost recovery rate model used to establish rates, fees, and charges includes an amount for postemployment benefits other than pensions that are expected to be paid out during the fiscal year, but not for the amount of the annual required contribution as calculated under GASB Statement No. 45 (GASB No. 45), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. In accordance with FASB ASC 980, *Regulated Operations* (previously, FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*), the Authority has deferred the excess of current annual required contribution over the amount paid during the 2010 fiscal year. The deferred costs will be recovered through future revenues in accordance with the Authority's rate model. The deferred amount as of and for the years ended May 31, 2012 and 2011 was \$64.3 million and \$49.7 million, respectively.

(p) Use of Resources

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

(q) Income Taxes

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

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

(r) Use of Estimates

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

(s) Recent Accounting Pronouncements

In December 2009, GASB issued Statement No. 57 (GASB No. 57), *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. GASB No. 57 addresses issues related to the use of alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer OPEB plans. The statement amends previous GASB statements on OPEB plans, and will improve the consistency of reporting for OPEB plans. This statement is effective for the Authority beginning in fiscal 2013. The Authority does not believe this statement will have a material impact on its financial statements.

In June 2010, GASB issued Statement No. 59 (GASB No. 59), *Financial Instruments Omnibus*. GASB No. 59 addresses topics relating to the reporting and disclosure of certain financial instruments and external investment pools, and includes some clarifications to GASB No. 53. This statement became effective in fiscal 2012, and did not have a material impact on its financial statements.

In December 2010, GASB issued Statement No. 62 (GASB No. 62), *Codification of Accounting and Financial Reporting Guidance Contained in the Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB No. 62 incorporates into GASB's authoritative literature certain accounting and financial reporting guidance issued on or before November 30, 1989 included in: FASB Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the AICPA Committee on Accounting Procedure that do not conflict with or contradict GASB pronouncements. The statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Fund and Other Governmental Entities That Use Proprietary Fund Accounting*, which eliminates the election for business-type activities to apply post November 30, 1989 FASB Statements and Interpretations that do not conflict with GASB pronouncements. This statement becomes effective fiscal 2013. The Authority does not believe this statement will have a material impact on its financial statements.

In June 2011, GASB issued Statement No. 63 (GASB No. 63), *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. GASB No. 63 required that deferred outflows of resources be reported in the balance sheet in a separate section following assets and deferred inflows of resources be reported in a separate section following liabilities. GASB 63 becomes effective fiscal 2013. The Authority does not believe this statement will have a material impact on its financial statements.

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

(2) Capital Assets, Net

	<u>May 31, 2011</u>	<u>Additions/ reclassifications</u>	<u>Deletions/ reclassifications</u>	<u>May 31, 2012</u>
	(In thousands)			
Land and land rights	\$ 23,032	846	—	23,878
Distribution systems	834,248	28,618	(1,401)	861,465
Wells, reservoirs, and structures	233,551	17,872	(356)	251,067
Pumping and purification equipment	110,801	7,452	(96)	118,157
Other	<u>159,517</u>	<u>10,835</u>	<u>(5,968)</u>	<u>164,384</u>
Water plant in service	1,361,149	65,623	(7,821)	1,418,951
Less accumulated depreciation	<u>(468,371)</u>	<u>(39,964)</u>	<u>7,821</u>	<u>(500,514)</u>
Net water plant in service	892,778	25,659	—	918,437
Construction in progress	<u>160,493</u>	<u>44,155</u>	<u>(65,622)</u>	<u>139,026</u>
Water plant	<u>\$ 1,053,271</u>	<u>69,814</u>	<u>(65,622)</u>	<u>1,057,463</u>

	<u>May 31, 2010</u>	<u>Additions/ reclassifications</u>	<u>Deletions/ reclassifications</u>	<u>May 31, 2011</u>
	(In thousands)			
Land and land rights	\$ 23,032	—	—	23,032
Distribution systems	815,617	20,572	(1,941)	834,248
Wells, reservoirs, and structures	227,490	6,068	(7)	233,551
Pumping and purification equipment	109,242	1,646	(87)	110,801
Other	<u>154,209</u>	<u>11,238</u>	<u>(5,930)</u>	<u>159,517</u>
Water plant in service	1,329,590	39,524	(7,965)	1,361,149
Less accumulated depreciation	<u>(437,658)</u>	<u>(38,678)</u>	<u>7,965</u>	<u>(468,371)</u>
Net water plant in service	891,932	846	—	892,778
Construction in progress	<u>139,341</u>	<u>60,702</u>	<u>(39,550)</u>	<u>160,493</u>
Water plant	<u>\$ 1,031,273</u>	<u>61,548</u>	<u>(39,550)</u>	<u>1,053,271</u>

Depreciation expense amounted to approximately \$39.2 million and \$38.4 million for the years ended May 31, 2012 and 2011, respectively, based on a composite annual rate of percentage.

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

(3) Cash and Cash Equivalents and Investments

(a) Cash and Cash Equivalents

Cash consists of insured (FDIC) or collateralized deposits that have carrying values of approximately \$115.2 million and \$52.5 million and bank balances of approximately \$116.7 million and \$54.4 million at May 31, 2012 and 2011, respectively. Collateral for deposits is held by a third-party bank in the name of the Authority.

(b) Investments

Investments, including restricted investments, at May 31, 2012 and 2011 consist of the following:

	Fair value		Investment maturities at May 31, 2012		
			(In years)		
	2012	2011	Less than 1	1 to 5	Greater than 5
			(In thousands)		
U.S. Treasury notes (1)	\$ 2,865	1,004	501	1,511	853
U.S. Treasury bonds (1)	3,541	6,982	—	—	3,541
FNMA's (1)	46,640	30,104	—	33,615	13,025
FHLB notes (1)	96,024	103,086	18,017	70,602	7,405
FHLMC notes	11,047	1,502	—	11,047	—
FDIC – insured notes	5,004	5,153	5,004	—	—
FPCB notes	3,496	13,526	—	3,496	—
Money market (1)	28,554	72,661	28,554	—	—
Guaranteed investment contracts (1)	655	325	655	—	—
Repurchase agreements	—	39,998	—	—	—
Total investments	\$ 197,826	274,341	52,731	120,271	24,824

(1) Includes approximately \$82.2 million and \$96.8 million of investments held by Fiscal Agent in the Authority's name at May 31, 2012 and 2011, respectively.

	2012	2011
	(In thousands)	
Investment breakdown:		
Restricted for:		
Debt service	\$ 80,059	90,497
Construction	30,657	78,977
Unrestricted	87,110	104,867
Total investments	\$ 197,826	274,341

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 0.10% to 4.60%.

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

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

Investments include U.S. Treasury obligations, its agencies, certificates of deposit, guaranteed investment contracts, and repurchase agreements backed by such obligations. Investments are reported at fair value, except for investment agreements and certificates of deposit. Investment agreements, which can take the form of open time deposits or fixed repurchase agreements, are reported at an amount equal to principal and accrued interest. Certificates of deposit are valued at cost.

In addition, the Authority invests in an external investment pool called New York CLASS. The pool invests in obligations permissible under the Authority's investment policies. The fair value of the position of the pool is equal to the value of the pool shares. The value of this investment is reported as repurchase agreements in the table above. The New York Class program was closed and liquidated in June 2011.

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

Custodial Credit Risk: It is part of the Authority's investment policy to safeguard the principal of its investments while obtaining the highest interest rate possible that is consistent with this and other components of its policy. Toward that end, permitted investments include but are not limited to federally backed securities or obligations of any state of the United States of America or any political subdivision rated by at least two nationally recognized bond-rating agencies. As of May 31, 2012, the Authority's investments in Federal National Mortgage Association, Federal Home Loan Bank, FDIC Guaranteed Bonds, Federal Farm Credit Bank Notes, and the Federal Home Loan Mortgage Corporation were rated Aaa by Moody's Investors Service and AAA by Standard & Poor's Ratings Services and Fitch Ratings. There were no investments in obligations of any state of the United States of America or any political subdivision.

Concentration of Credit Risk: The Authority places no limit on the amount the Authority may invest in any one issuer. More than 5% of the Authority's investments are in Federal National Mortgage Association, Federal Home Loan Bank, Federal Home Loan Mortgage Corp., and Money Market Accounts. These investments are 24%: \$(46.6 million), 49%: \$(96.0 million), 6%: \$(11.0 million), and 14%: \$(28.6 million), respectively, of the Authority's total investments.

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(4) Bonds Payable

Outstanding bonds are summarized as follows:

<u>Series</u>	<u>Interest rate</u>	<u>Final maturity date</u>	<u>May 31, 2011</u>	<u>Issued</u>	<u>Matured/ refunded</u> <small>(In thousands)</small>	<u>May 31, 2012</u>	<u>Due within one year</u>
Water System Revenue Bonds:							
1994 Subordinate Lien	4.13 – 6.00	2015	\$ 695	—	—	695	—
2001A Senior Lien	5.00 – 5.25	2026	10,650	—	(10,650)	—	—
2003 Senior Lien	2.00 – 4.50	2017	7,000	—	—	7,000	—
2003C Senior Lien	4.00 – 4.50	2026	72,500	—	(72,500)	—	—
2005C Senior Lien	4.50 – 5.00	2029	60,000	—	—	60,000	—
2005 Subordinate Lien	4.37 – 4.55	2027	71,905	—	—	71,905	—
2006A Senior Lien	3.59 – 4.95	2031	70,000	—	—	70,000	—
2007A Senior Lien	4.00 – 4.50	2032	45,000	—	—	45,000	—
2009 Senior Lien	2.00 – 5.00	2022	10,635	—	—	10,635	—
2009A Senior Lien	4.00 – 5.00	2035	57,740	—	—	57,740	—
2009B Senior Lien	5.50	2035	100,000	—	—	100,000	—
2011 Senior Lien	4.75 – 5.00	2040	24,930	—	—	24,930	—
2012 Senior Lien	3.00 – 5.00	2026	—	83,635	—	83,635	—
Environmental Facilities Corporation Revenue Bonds:							
2001B	2.62 – 5.15	2021	10,900	—	(10,900)	—	—
2002A	1.36 – 5.00	2022	6,915	—	(465)	6,450	480
2002B	1.33 – 5.12	2022	5,735	—	(5,735)	—	—
2003B	0.72 – 4.50	2023	6,180	—	(380)	5,800	395
2004A	1.20 – 4.96	2024	5,070	—	(265)	4,805	290
2005B	2.08 – 4.02	2026	5,525	—	(285)	5,240	290
2010C	0.85 – 3.16	2019	2,648	—	(263)	2,385	270
2011A	0.79 – 3.99	2021	7,290	—	(692)	6,598	709
2011C	0.54 – 3.57	2022	—	10,947	(792)	10,155	820
Total bonds outstanding			581,318	94,582	(102,927)	572,973	3,254
				<u>Additions</u>	<u>Amortization/ payments</u>		
Less:							
Unamortized discount (premium)			398	(10,703)	926	(9,379)	
Deferred amount			3,015	4,997	(579)	7,433	
Current maturities payable			3,490	3,254	(3,490)	3,254	
			<u>\$ 574,415</u>	<u>97,034</u>	<u>(99,784)</u>	<u>571,665</u>	

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<u>Series</u>	<u>Interest rate</u>	<u>Final maturity date</u>	<u>May 31, 2010</u>	<u>Issued</u>	<u>Matured/ refunded</u>	<u>May 31, 2011</u>	<u>Due within one year</u>
			(In thousands)				
Water System Revenue Bonds:							
1993 Subordinate Lien	4.80 – 5.10	2013	\$ 11,800	—	(11,800)	—	—
1994 Subordinate Lien	4.13 – 6.00	2015	4,910	—	(4,215)	695	—
2001A Senior Lien	5.00 – 5.25	2026	21,925	—	(11,275)	10,650	—
2003 Senior Lien	2.00 – 4.50	2017	56,025	—	(49,025)	7,000	—
2003C Senior Lien	4.00 – 4.50	2026	80,000	—	(7,500)	72,500	—
2005C Senior Lien	4.50 – 5.00	2029	60,000	—	—	60,000	—
2005 Subordinate Lien	4.37 – 4.55	2027	71,905	—	—	71,905	—
2006A Senior Lien	3.59 – 4.95	2031	70,000	—	—	70,000	—
2007A Senior Lien	4.00 – 4.50	2032	45,000	—	—	45,000	—
2009 Senior Lien	2.00 – 5.00	2022	13,415	—	(2,780)	10,635	—
2009A Senior Lien	4.00 – 5.00	2035	66,395	—	(8,655)	57,740	—
2009B Senior Lien	5.50	2035	100,000	—	—	100,000	—
2011 Senior Lien	4.75 – 5.00	2040	—	24,930	—	24,930	—
Environmental Facilities Corporation Revenue Bonds:							
1998B	3.65 – 5.20	2017	3,110	—	(3,110)	—	—
1999A	2.77 – 4.91	2018	3,170	—	(3,170)	—	—
2000A	3.80 – 5.96	2019	545	—	(545)	—	—
2000B	4.31 – 5.74	2020	3,645	—	(3,645)	—	—
2001A	3.48 – 5.17	2021	6,800	—	(6,800)	—	—
2001B	2.62 – 5.15	2021	11,650	—	(750)	10,900	775
2002A	1.36 – 5.00	2022	7,370	—	(455)	6,915	465
2002B	1.33 – 5.12	2022	6,090	—	(355)	5,735	365
2003B	0.72 – 4.50	2023	6,555	—	(375)	6,180	380
2004A	1.20 – 4.96	2024	5,325	—	(255)	5,070	265
2005B	2.08 – 4.02	2026	5,805	—	(280)	5,525	285
2010C	0.85 – 3.16	2019	—	2,903	(255)	2,648	263
2011A	0.79 – 3.99	2021	—	7,384	(94)	7,290	692
Total bonds outstanding			661,440	35,217	(115,339)	581,318	3,490
				<u>Additions</u>	<u>Amortization/ payments</u>		
Less:							
Unamortized discount (premium)			(837)	(424)	1,659	398	
Deferred amount			3,601	915	(1,501)	3,015	
Current maturities payable			6,525	3,490	(6,525)	3,490	
			<u>\$ 652,151</u>	<u>31,236</u>	<u>(108,972)</u>	<u>574,415</u>	

In accordance with bond covenants, the Authority is required to guarantee the payment of principal and interest by establishing a reserve fund for each bond issue and funding the reserve account with a portion of the proceeds from the respective bond issue or from the Authority's unrestricted funds.

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

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agreement with an entity whose obligations are rated with such two (2) highest ratings or deposit into the Reserve Account sufficient moneys in accordance with the respective bond resolution to replace such Credit Agreement.

For the fiscal year 2011, the Authority, at its own discretion, has elected to fund the reserve accounts in the amount of \$36.1 million from bond proceeds and \$34.6 million from unrestricted funds. For the fiscal year 2012, the Authority, at its own discretion, has elected to fund the reserve accounts in the amount of \$41.2 million from bond proceeds and \$26.8 million from unrestricted funds.

(a) Water System Revenue Bonds

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

During fiscal year ended May 31, 2012, the Authority entered into the following bond transactions:

In January 2012, the Authority issued \$83.6 million Senior Lien Water System Revenue Bonds, Series 2012 (Refunding) to provide for the current refunding of \$10.7 million Suffolk County Water Authority Senior Lien Water System Revenue Bond Series 2001A and for the advanced refunding of \$72.5 million Suffolk County Water Authority Senior Lien Water System Revenue Bond Series 2003C. The Series 2012 Refunding Bonds bear interest rates ranging from 3.00% to 5.00% and have a final maturity date of June 1, 2026. The proceeds from the Series 2012 Refunding Bonds including existing reserve funds were used to fund the escrow accounts for 88.2 million, to pay bond issuance costs of \$0.5 million and to fund the Reserve account for \$9.3 million.

During fiscal year ended May 31, 2011, the Authority entered into the following bond transactions:

In March 2011, the Authority provided \$75 million in unrestricted funds to cash defease bond principal amounts and interest coming due within the next five to ten years. The funds required for the defeasance are held in Escrow by the Trustee and principal and interest are paid when due. The Authority defeased \$6.84 million Suffolk County Water Authority Senior Lien Water System Revenue Bond Series 2001A, \$9.64 million Suffolk County Water Authority Subordinate Lien Water System Revenue Bond Series 1993, \$4.24 million Suffolk County Water Authority Subordinate Lien Water System Revenue Bond Series 1994, and \$48.4 million Suffolk County Water Authority Senior Lien Water System Revenue Bond, Series 2003. The difference between the face amount of the bonds outstanding and the amount required to be deposited with the Trustee has been recognized as a loss on bond refunding in the accompanying statement of revenues, expenses, and changes in net assets.

In April 2011, the Authority issued \$24.9 million Senior Lien Water System Revenue Bonds, Series 2011 (Refunding) to provide for the advance refunding of \$4.4 million Suffolk County Water System Revenue Bond Series 2001A, \$7.5 million Suffolk County Water Authority Senior Lien Water System Revenue Bond Series 2003C, \$8.7 million Suffolk County Water Authority Senior Lien Water System Revenue Bond Series 2009A, and \$2.8 million Suffolk County Water Authority

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Senior Lien Water System Revenue Bond Series 2009 Refunding. The Series 2011 Refunding Bonds bear interest at rates ranging from 4.75% to 5.00% and have a final maturity date of June 1, 2040. The funds were used to fund the escrow accounts for \$20.9 million, to pay bond issuance costs of \$0.2 million and to provide for future capital improvements in the amount of \$3.8 million.

(b) *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. EFC 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.

Since June 2010, the Authority has participated in the EFC Refunding Program initiated by the New York State Environmental Facilities Corporation on behalf of the municipalities that initially financed projects through the State Clean Water and Drinking Water Revolving Funds as more fully described below. The EFC refunded certain Suffolk County Water Authority EFC Bond Series with new bonds issued at lower current-market interest rates, thus passing the interest savings net of EFC financing costs along to the Authority in the form of reduced Debt Service bills.

During the fiscal year ended May 31, 2012, the Authority entered into the following EFC bond transactions:

In July 2011, the Authority participated in the EFC Series 2011C, which refinanced along with unspent proceeds and debt service reserve funds in the amount of \$5.7 million, \$10.9 million Suffolk County Water Authority Water System Revenue Bond EFC Series 2001B, and \$5.7 million Suffolk County Water Authority Water System Revenue Bond EFC Series 2002G. The 2011C EFC Series bear interest rates ranging from 0.540% to 3.566% with a final maturity date of October 15, 2022. This refunding resulted in a net present value savings from cash flow of an approximate total of \$1.4 million.

Subsequent to year-end, in June 2012, the Authority participated in the EFC Series 2012B refunding \$6.5 million of Suffolk County Water Authority Water System Revenue Bond EFC Series 2002A.

During the fiscal year ended May 31, 2011, the Authority entered into the following EFC bond transactions:

In June 2010, the Authority participated in the EFC 2010C Series refunding of \$3.2 million Suffolk County Water Authority Water System Revenue Bonds EFC Series 1999A. The Series 2010C EFC Bonds bear an interest rate of 0.845% to 3.155% and have a final maturity date of April 15, 2019. This refunding resulted in a net present value of savings from cash flow of approximately \$199,475.

In March 2011, the Authority participated in the EFC 2011A Series refunding of \$2.8 million of the Authorities EFC Series 1998B, \$0.5 million EFC Series 2000A, \$3.4 million EFC Series 2000B, and

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\$6.8 million EFC Series 2001A. The EFC Series 2011A bear an interest rate ranging from 0.789% to 3.989% with a final maturity date of May 15, 2021. This refunding resulted in a net present value savings from cash flow of an approximate total of \$1.3 million.

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, 2012, the amount of defeased debt obligation outstanding was approximately \$177.2 million.

Interest expense on the bonds was \$24.6 million and \$26.9 million for the years ended May 31, 2012 and 2011, respectively.

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

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
		(In thousands)	
Fiscal year ending:			
2013	\$ 3,254	26,438	29,692
2014	3,322	26,363	29,685
2015	5,638	26,178	31,816
2016	6,262	25,946	32,208
2017	7,829	25,647	33,476
2018 and thereafter	546,668	298,263	844,931
	<u>\$ 572,973</u>	<u>428,835</u>	<u>1,001,808</u>

(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 elected to maintain a minimum debt service balance of 10% of the proceeds on all outstanding issues. At May 31, 2012, the debt service reserve funds were approximately \$68 million.

Revenue before interest expense and depreciation and amortization was equivalent to 2.27 times (2.04 in 2011) the debt service requirement on all outstanding debt. The minimum debt service requirement on all bonds is 1.10.

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(6) Notes Payable

Outstanding bond anticipation notes payable are summarized as follows:

<u>Series</u>	<u>Final maturity date</u>	<u>Balance at May 31, 2011</u>	<u>Issued</u>	<u>Redeemed</u>	<u>Balance at May 31, 2012</u>	<u>Due within one year</u>
			(In thousands)			
2008	January 15, 2013	\$ 70,000	—	—	70,000	70,000
2011 A	April 1, 2012	50,000	—	(50,000)	—	—
2011 B	April 1, 2014	50,000	—	—	50,000	—
2012 A	January 15, 2013	—	50,000	—	50,000	50,000
	Total notes outstanding	\$ <u>170,000</u>	<u>50,000</u>	<u>(50,000)</u>	<u>170,000</u>	<u>120,000</u>

<u>Series</u>	<u>Final maturity date</u>	<u>Balance at May 31, 2010</u>	<u>Issued</u>	<u>Redeemed</u>	<u>Balance at May 31, 2011</u>	<u>Due within one year</u>
			(In thousands)			
2008	January 15, 2013	\$ 70,000	—	—	70,000	—
2010 (EFC)	February 1, 2013	3,844	—	(3,844)	—	—
2011 A	April 1, 2012	—	50,000	—	50,000	50,000
2011 B	April 1, 2014	—	50,000	—	50,000	—
	Total notes outstanding	\$ <u>73,844</u>	<u>100,000</u>	<u>(3,844)</u>	<u>170,000</u>	<u>50,000</u>

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

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

During the fiscal year ended May 31, 2012, the Authority entered into the following Bond Anticipation Note transactions:

In March 2012, the Authority issued \$50 million Suffolk County Water Authority Bond Anticipation Renewal Notes, 2012A in renewal of the 2011A Notes, which matured on April 1, 2012 with a fixed rate of 1.50%. The 2012A Renewal Note bears interest at a fixed rate of 2.00% and matures January 15, 2013.

During the fiscal year ended May 31, 2011, the Authority entered into the following Bond Anticipation Note transactions:

In April 2011, the Authority issued an aggregate \$100 million Suffolk County Water Authority 2011 Bond Anticipation Notes consisting of \$50 million Suffolk County Water Authority Bond Anticipation Note

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2011A (fixed rate) and \$50 million Suffolk County Water Authority Bond Anticipation Note 2011B (SIFMA). The 2011A Note bears interest at the fixed rate of 1.50% and matures April 1, 2012. The 2011B Note, maturing April 1, 2014 bears interest at a variable rate equal to the adjusted SIFMA (Securities Industry and Financial Market Association) rate plus the per annum spread of 0.40%.

Environmental Facility Corporation Bond Anticipation Notes (EFC Series)

In February 2010, the Authority and EFC entered into a Project Finance Agreement as part of the American Recovery and Reinvestment Act (ARRA). This project specific financing is associated with the installation of approximately 17,763 feet of water main to existing residential customers that currently rely on point of use treatment systems for water service. The total estimated cost as well as the maximum amount of financing for this project was \$3.8 million. Progress reimbursements to the Authority were to be made upon presentation of applicable documentation as prescribed within the Project Financing Agreement. The short-term financing for this project was to be at an interest rate of 0%. Upon completion of the project, SCWA would have received a 50% subsidy from the federal government through the ARRA in an amount not to exceed \$1.9 million. In connection with this agreement, the Authority issued Bond Anticipation Notes, 2010 with the New York State Environmental Facilities Corporation in the amount of \$3.8 million. These, unlike regular Bond Anticipation Notes, had an effective interest rate of 0%. In January 2011, the aforementioned project associated with the EFC 2010 Bond Anticipation Note was canceled and the Project Financing agreement was terminated at the request of the Authority.

For the years ended May 31, 2012 and 2011, the effective interest rate for the 2008 Bond Anticipation Notes was 0.11% and 0.21%, respectively.

For the years ended May 31, 2012 and 2011, the effective interest rate for the 2011B Bond Anticipation Notes was 0.55% and 0.63%, 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, Governor Smith State Office Building, Albany, New York 12244. Benefit provisions vary as follows:

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

Tier I	Members who last joined prior to July 1, 1973
Tier II	Members who last joined on or after July 1, 1973 and prior to July 27, 1976
Tier III	Members who last joined on or after July 27, 1976 and prior to September 1, 1983
Tier IV	Members who joined on or after September 1, 1983 and prior to January 1, 2010
Tier V	Members who last joined on or after January 1, 2010
Tier VI	Members who joined on or after April 1, 2012

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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 2.00% 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. If members retire at age 62 and have 20 or more years of credited service, the service retirement benefit will be 2.00% of final average salary for each year of service (not to exceed 30 years), plus 1.50% of the final average salary for each year of credited service beyond 30 years. If members retire at age 62 with fewer than 20 years of credited service, the service retirement benefit will be 1.66% of the final average salary for each year of service.

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

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

Tier V members must have 10 years of service credit to be vested and eligible for retirement benefits. Tier V members are eligible to retire with full benefits at age 62 with 10 years of service credit, and with reduced benefits for retirement between ages 55 and 62 (even if they have 30 years of service credit). Members must contribute 3% of their salary to the Employees' Retirement System for all their years of service (maximum 30 years). Overtime pay in excess of an annual cap is not included in the definition of wages. This overtime cap for 2012 is \$15,913.

Tier VI members must have 10 years of service credit to be vested and eligible for retirement benefits. Tier VI members are eligible to retire with full benefits at age 63 with 10 years of service credit, and with reduced benefits for retirement between 55 and 63. Tier VI members contribute 3% of their gross salary toward their retirement benefits. Beginning April 1, 2013, the contribution rate will be based on the employee's annual wage as follows:

\$45,000 or less	3% contribution rate
\$45,000.01 to \$55,000	3.5% contribution rate
\$55,000.01 to \$75,000	4.5% contribution rate
\$75,000.01 to \$100,000	5.75% contribution rate
\$100,000.01 or more	6.0% contribution rate

The overtime cap for Tier VI is \$15,000.

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.

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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.

Pension costs contractually required by New York State and recorded in the Authority's financial books and records were \$6.3 million, \$6.0 million, and \$3.3 million for the years ended May 31, 2012, 2011, and 2010, respectively, which is equal to 100% of its annual required contribution. The Authority has recorded, as part of its operating expenses \$4.4 million, \$4.6 million, and \$2.4 million for the years ended May 31, 2012, 2011, and 2010, respectively. The Authority has capitalized to water plant, a portion of these retirement costs in connection with employees related to construction work in progress. The Authority capitalized \$1.9 million, \$1.4 million, and \$0.9 million for the years ended May 31, 2012, 2011, and 2010, respectively.

(8) Deferred Compensation

All Authority employees may participate in a deferred compensation program designated as an Internal Revenue Code Section 457 plan. This program enables employees to contribute a portion of their salary, on a tax-deferred basis, to group variable annuity contracts. The assets and related liabilities of the plan are recorded at the assets' market values and are excluded from the Authority's balance sheets. The Authority has no obligation to make contributions to the deferred compensation program. The Authority remits deferred compensation amounts withheld from employees' salaries to an outside fiduciary agent who administers the program and invests program assets as instructed by each of the participants. Assets in such program amounted to approximately \$34.0 million at May 31, 2012 and 2011.

(9) Postemployment Benefits Other than Pensions

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

Benefit provisions for the plan are established and amended through the Authority's Board of Directors, and there is no statutory requirement for the Authority to continue this plan for future Authority employees. The health, dental, and optical plans are noncontributory for active employees, with all payments for plan benefits being funded by the Authority. Upon retirement, the cost of the dental and optical plans is partially funded by the Authority and the balance by the retiree. During fiscal year 2012, there were 931 participants (569 active and 362 inactive) that were eligible to receive benefits.

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Notes to Financial Statements

May 31, 2012 and 2011

GASB No. 45 establishes guidance for the financial reporting of OPEB cost over a period that approximates employees' years of service and providing information about actuarially calculated liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan.

In accordance with this standard, the Authority's annual OPEB cost for the plan is calculated based on the Annual Required Contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB No. 45. GASB No. 45 does not require that the employer actually fund its ARC, but allows for the financing of these benefits on a pay-as-you-go basis. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the Authority's annual OPEB cost for the year, the amount contributed to the plan, and changes in the Authority's net OPEB obligation for the years ended May 31, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
	(In thousands)	
Annual required contribution (ARC)	\$ 21,398	17,744
Interest on net OPEB obligation	1,987	1,468
Net OPEB obligation amortization adjustments to the ARC	<u>(2,874)</u>	<u>(2,123)</u>
Annual OPEB cost (expense)	20,511	17,089
Contributions made	<u>(4,882)</u>	<u>(4,105)</u>
Increase in net OPEB obligation	15,629	12,984
Net OPEB obligation, beginning of year	<u>49,686</u>	<u>36,702</u>
Net OPEB obligation, end of year	<u>\$ 65,315</u>	<u>49,686</u>

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):

<u>Fiscal year ended</u>	<u>Annual OPEB cost</u>	<u>Percentage of annual OPEB cost contributed</u>	<u>Net OPEB obligation</u>
May 31, 2012	\$ 20,511	23.8%	\$ 65,315
May 31, 2011	17,089	24.0	49,686

As of May 31, 2012 and 2011, the actuarial accrued liability for benefits was \$213.2 million and \$180.0 million, respectively. Whereas, no legislation has been enacted to establish a dedicated trust for these funds, the aforementioned accrued liability remains unfunded. However, during 2012, in an effort to mitigate possible future rate impact related to any enacted legislation, the Authority has established an undedicated reserve for this purpose. As of May 31, 2012, the undedicated reserve is \$1 million.

SUFFOLK COUNTY WATER AUTHORITY

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As of May 31, 2012 and 2011, the covered payroll (annual payroll of active employees covered by the plan) was \$39.6 million and \$40.3 million, respectively, 538% and 447% for each respective year.

The actuarial valuation date, as updated May 31, 2012, involves 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, 2012 actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions included a 4.0% discount rate for the unfunded portion, and an annual healthcare cost trend rate of 10.0% grading down to 5.0% for medical, dental 5.0% grading down to 4.0%, and optical 3.0%. The unfunded actuarial accrued liability is being amortized over 30 years as a level percentage of projected payrolls on an open basis.

(10) Commitments and Contingencies

(a) Wireless Cell Rental Income

Assorted wireless cell carriers desire to use the Authority owned premises for the construction, installation, maintenance, and operation of radio transmitting and receiving equipment and other associated equipment as approved by the Authority in connection with its wireless communications business. The Authority receives in the form of monthly payments a fee for providing such use. Rental fees range from \$3,000 to \$6,150 per month and have terms ranging from five (5) to fifteen (15) years, multiple five-year renewals, and 3.0% to 3.5% annual rental increases. The Authority currently has 205 lease agreements with 8 different wireless carriers. Annual lease income from these agreements for the next five years is expected to be the following:

2013	\$ 10.8 million
2014	11.1 million
2015	11.5 million
2016	11.8 million
2017	12.2 million

Annual lease income that is included in other operating revenue for the fiscal years ended May 31, 2012 and 2011 was \$10.5 million and \$10.1 million, respectively.

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Notes to Financial Statements

May 31, 2012 and 2011

(b) Legal

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

(c) Risk Management

The Authority is exposed to various risks of loss related to automobiles and general liability. The Authority is partially self-insured in the amount of approximately \$500,000 for each general liability claim and \$500,000 for each automobile claim subject to a stop-loss aggregate of \$1.25 million. The Authority purchases commercial insurance for claims in excess of this self-insured retention limit to cover various other risks of loss. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years. The Authority maintains workers' compensation insurance through Liberty Mutual's guaranteed cost policy. The Authority has recorded a liability related to workers' compensation for the period of time when the Authority purchased loss sensitive insurance policies. A loss sensitive policy requires the insured to pay that portion of the premium that is in excess of a minimum premium. It is also subject to a maximum premium.

The Authority has established a liability based on actuarial estimates of the amounts needed to pay prior year and current year claims and to establish a reserve for catastrophic losses. That liability, which is for workers' compensation, general, and automobile claims was approximately \$1.9 million and \$2.3 million at May 31, 2012 and 2011, 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 2012 and 2011 were as follows:

	Year ended May 31	
	2012	2011
	(In thousands)	
Unpaid claims, beginning of fiscal year	\$ 340	568
Changes in the estimate for claims of all years	(61)	(157)
Claim payments	(79)	(71)
Unpaid claims, end of fiscal year	\$ 200	340

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May 31, 2012 and 2011

Changes in the Authority's general and automobile claims liability amount in fiscal 2012 and 2011 were as follows:

	Year ended May 31	
	2012	2011
	(In thousands)	
Unpaid claims, beginning of fiscal year	\$ 1,928	2,198
Changes in the estimate for claims of all years	161	594
Claim payments	(357)	(864)
Unpaid claims, end of fiscal year	<u>\$ 1,732</u>	<u>1,928</u>

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

(11) Net Assets

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

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

	Invested in capital assets	Restricted	Unrestricted	Total
	(In thousands)			
Net assets at May 31, 2010	\$ 367,305	98,177	174,902	640,384
Loss	—	—	(3,422)	(3,422)
Transfers	17,624	(7,680)	(9,944)	—
Net assets at May 31, 2011	<u>384,929</u>	<u>90,497</u>	<u>161,536</u>	<u>636,962</u>
Loss	—	—	(511)	(511)
Transfers	(35,545)	(10,438)	45,983	—
Net assets at May 31, 2012	<u>\$ 349,384</u>	<u>80,059</u>	<u>207,008</u>	<u>636,451</u>

SUFFOLK COUNTY WATER AUTHORITY

Notes to Financial Statements

May 31, 2012 and 2011

(12) Subsequent Events

The Authority has evaluated subsequent events through August 28, 2012, the date the financial statements were available to be issued, and identified the following additional disclosure:

Effective June 1, 2012, the Town of Brookhaven, on behalf of the Stony Brook Water District, entered into a forty (40) year lease agreement with the Authority, whereby the Authority agrees to operate, construct, maintain, and repair, at its own expense, the entire operating plant. The Town of Brookhaven, on behalf of the District agreed to lease all of the rights, title, and interest in the entire operations, plant, hydrants, and distribution system, real property, of the District, and all extensions thereto. Previously, Stony Brook Water District purchased water from the Authority under the Wholesale Water Rate Category and contracted with the Authority to operate and maintain its water supply system and customers.

SUFFOLK COUNTY WATER AUTHORITY

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

May 31, 2012, 2011, and 2010

(In thousands)

Actuarial valuation date	Actuarial value of assets (a)	Actuarial accrued liability (AAL) – Level dollar (b)	Unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll (b-a)/c
May 31, 2012	\$ —	213,235	213,235	—	39,620	538%
May 31, 2011	—	180,049	180,049	—	40,266	447
May 31, 2010	—	170,324	170,324	—	38,891	438

See accompanying independent auditors' report.



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

The Members
Suffolk County Water Authority:

We have audited the financial statements of the Suffolk County Water Authority (the Authority) as of and for the year ended May 31, 2012, and have issued our report thereon dated August 28, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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



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

KPMG LLP

August 28, 2012