Statement of Investments

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

Suffolk County Water Authority

Statement of Investments

Year Ended May 31, 2007

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Report of Independent Auditors

Suffolk County Water Authority
Oakdale, New York

We have audited, in accordance with auditing standards generally accepted in the United States, the financial statements of the Suffolk County Water Authority (the Authority) for the year ended May 31, 2007, and have issued our report thereon dated August 21 2007. We also have audited the accompanying Statement of Investments of the Authority as of May 31, 2007, and for the year then ended. This statement is the responsibility of the Authority's management. Our responsibility is to express an opinion on this statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Statement of Investments is free of material misstatement. We were not engaged to perform an audit of the Authority's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit 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, and evaluating the overall financial statement presentation. We believe that our audit provide a reasonable basis for our opinion.

In our opinion, the statement referred to above presents fairly, in all material respects, the Statement of Investments of the Authority at May 31, 2007, and for the year then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 21, 2007 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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August 21, 2007

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

Suffolk County Water Authority
Oakdale, New York

We have audited the financial statements of the Suffolk County Water Authority (the Authority), as of and for the year ended May 31, 2007, and have issued our report thereon dated August 21, 2007. We have also audited the Statement of Investments as of and for the year ended May 31, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; the standards for financial and compliance audits contained in the Investment Guidelines for Public Authorities, issued by the Office of the State Comptroller of the State of New York; and the investment guidelines established by the Authority.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record process, or report financial data reliability in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described below to be a significant deficiency in internal control over financial reporting.

Inventory

Criteria: As part of our audit procedures pertaining to inventory, we perform physical inventory test counts to test the completeness, valuation and existence of the inventory.

Statement of Condition: During our audit, we noted a number of differences between our physical inventory test counts and the amounts recorded in the Authority's May 31, 2007 inventory listing that the Authority was unable to reconcile. In addition, there were instances where inventory in the warehouse was not counted and as a result, the inventory records were adjusted to indicate that this inventory did not exist.

We also noted that inventory of the same type is not always stored in the same warehouse location. This condition caused unnecessary difficulty during the physical inventory count when trying to ensure that all inventory of the same type was properly counted.

These conditions create an environment that is conducive to a lack of internal control over the Authority's inventory tracking system, its physical inventory count procedures and its warehouse management process.

Context: The finding was identified during our audit of the Authority's inventory balance as of May 31, 2007.

Cause and Effect: The lack of adequate internal controls over the tracking of inventory, the physical inventory count procedures and the management of the Authority's warehouse could result in the amount of material and supplies reported to be misstated and possibly theft.

Recommendation: The Authority should strengthen its inventory control procedures. Such procedures should include stricter supervision of the inventory counts along with the suspension of all inventory movement during the period in which a physical inventory count takes place. Authority management should also ensure that the warehouse is properly organized and that same type of inventory is stored within the warehouse in one location to the extent possible. All physical inventory count discrepancies should be reconciled timely and to the extent necessary a second count performed to verify any discrepancies and management should review the physical inventory counts before adjusting the inventory system.

Views of Responsible Officials and Planned Corrective Action: The Authority has begun the following to address the recommendations mentioned. The actions include a complete reorganization and standardization of the Oakdale warehouse facility and ancillary facilities in Coram, Bayshore, Westhampton, and East Hampton. This includes, but is not limited to reviewing for obsolete items (and subsequent disposition), improved stock locations (based on frequency of use), and specific tagging of stock items (for ease of identification). Cycle counts have begun to be done on a daily basis and will continue throughout the year. The Internal Audit and Accounting Department will be more actively involved in the review of cycle counts and identification and resolution of any discrepancies. The Water Authority will also be addressing personnel issues to deal with accessibility to and oversight of stock. These actions as well as any other forthcoming will be to ensure the safeguarding of authority assets and the avoidance of potential theft.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more that a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control. Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

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, grant agreements, and investment guidelines, 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 object 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.*

We noted certain matters that we reported to management of the Authority in a separate letter dated August 21, 2007.

This report is intended solely for the information and use of the Audit Committee, management and the Office of the State Comptroller of the State of New York, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

August 21, 2007

Suffolk County Water Authority

Statement of Investments

May 31, 2007

(In thousands of dollars)

Operating, general, and revenue funds		$ 104,786
Construction fund	$ 34,976	
Debt service reserve and bond funds	33,923	
Total restricted funds	68,899	
		$ 173,685

The accompanying notes are an integral part of this statement.

Suffolk County Water Authority

Notes to Statement of Investments

May 31, 2007

1. Organization and Functions of the Authority

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

2. Summary of Significant Accounting Policies for Investments

Cash and Cash Equivalents

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

Investments

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

Investments Held for Debt Service

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

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

2. Summary of Significant Accounting Policies (continued)

Investments Held for Construction

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

3. Cash and Cash Equivalents and Investments

Cash and Cash Equivalents

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

Investments

Investments consist of the following:

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

3. Cash and Cash Equivalents and Investments (continued)

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

(a) Includes approximately $53,742,000 and $121,887,000 of investments held by Fiscal Agent at May 31, 2007 and 2006, respectively.

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

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

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

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

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

3. Cash and Cash Equivalents and Investments (continued)

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

Concentration of Credit Risk: The Authority places a limit of 75% of its funds on the amount the Authority may invest in any one issuer. More than 5% of the Authority's investments are in Federal National Mortgage Association and Federal Home Loan Bank. These investments are 32% and 30%, respectively, of the Authority's total investments.