

# McGladrey & Pullen

Certified Public Accountants

## **CITY OF PROVIDENCE, RHODE ISLAND WATER SUPPLY BOARD**

**FINANCIAL REPORT  
JUNE 30, 2006 and 2005**

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# McGladrey & Pullen

Certified Public Accountants

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Providence Water Supply Board  
Providence, Rhode Island

We have audited the accompanying financial statements of the Providence Water Supply Board (the "Water Supply Board") (an enterprise fund of the City of Providence, Rhode Island) as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Water Supply Board'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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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 financial position of the Water Supply Board as of June 30, 2006 and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management discussion and analysis on pages 2 through 5 is not a required part of the basic financial statements, but is supplementary information required by accounting standards generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with "Government Auditing Standards," we have also issued our report dated November 3, 2006, on our consideration of the Water Supply Board'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 and other matters. 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.

*McGladrey & Pullen, LLP*

New Haven, Connecticut  
November 3, 2006

# **Providence Water Supply Board Management's Discussion and Analysis June 30, 2006**

The management of the Providence Water Supply Board (the Water Supply Board) offers readers of our financial statements the following narrative overview and analysis of our financial activities for the years ended June 30, 2006 and 2005.

## **Financial Statements**

Our financial statements are prepared using proprietary fund (enterprise fund) accounting that uses the same basis of accounting as private-sector business enterprises. Under this method of accounting an economic resources measurement focus and the accrual basis of accounting is used.

Revenue is recorded when earned and expenses are recorded when incurred. The financial statements include statements of net assets, statements of revenues, expenses and changes in net assets, and statements of cash flows. These statements are followed by notes to the financial statements.

The statements of net assets present information on the assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Water Supply Board is improving or deteriorating.

The statements of revenues, expenses, and changes in net assets report the operating and nonoperating revenues and expenses of the Water Supply Board for the fiscal year with the difference – the net income or loss – being combined with any capital contributions to determine the net change in assets for the fiscal year. That change combined with the previous year-end net assets total reconciles to the net assets at the end of the fiscal year.

The statements of cash flows report cash and cash equivalents activity for the fiscal year resulting from operating activities, non-capital financing activities, capital and related financing activities, and investing activities. The net result of these activities added to the beginning of the year cash balance reconciles to the cash and cash equivalents balance at the end of the fiscal year.

**PROVIDENCE WATER SUPPLY BOARD**  
**(An enterprise fund of the City of Providence, Rhode Island)**  
**Management's Discussion and Analysis - Required Supplementary Information**  
**June 30, 2006 and 2005 (000's)**

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**Condensed Financial Information (in thousands)**

Condensed financial information from the statements of net assets and revenues, expenses, and changes in net assets is presented below.

	<u>2006</u>	2005	2004
Current assets	<b>\$ 36,113</b>	\$ 31,809	\$ 35,512
Capital assets, net	<b>176,465</b>	169,558	164,667
<b>Total assets</b>	<b><u>212,578</u></b>	<u>201,367</u>	<u>200,179</u>
Current liabilities	<b>17,307</b>	13,296	16,872
Noncurrent liabilities	<b>14,829</b>	18,573	22,086
<b>Total liabilities</b>	<b><u>32,136</u></b>	<u>31,869</u>	<u>38,958</u>
Net assets:			
Invested in capital assets, net of related debt	<b>157,507</b>	146,421	137,352
Restricted	<b>16,746</b>	15,411	15,860
Unrestricted	<b>6,189</b>	7,666	8,009
<b>Total net assets</b>	<b><u>\$ 180,442</u></b>	<u>\$ 169,498</u>	<u>\$ 161,221</u>
Operating revenues	<b>\$ 52,432</b>	\$ 48,807	\$ 49,168
Operating expenses	<b>32,556</b>	31,097	28,855
Depreciation	<b>9,890</b>	9,774	8,759
<b>Total operating expenses, including depreciation</b>	<b><u>42,446</u></b>	<u>40,871</u>	<u>37,614</u>
<b>Operating income</b>	<b>9,986</b>	7,936	11,554
Nonoperating expense	<b>(351)</b>	(1,123)	(1,163)
Capital grants and contributions	<b>1,309</b>	1,464	1,197
<b>Increase in net assets</b>	<b><u>\$ 10,944</u></b>	<u>\$ 8,277</u>	<u>\$ 11,588</u>

## **Financial Highlights**

The Water Supply Board's net assets totaled \$ 180.4 million at June 30, 2006. Total net assets increased by \$10.9 million, or about 6.5% from June 30, 2005.

During the year, the Water Supply Board had operating revenues that exceeded operating expenses by \$10.0 million. This is primarily due to the large commitment to the replacement of infrastructure included in water rates. In addition, there was an increase in user rates during the year.

At June 30, 2006, the Water Supply Board's net assets totaled \$ 180.4 million. Total assets were \$212.6 million, up \$ 11.2 million from last year's total assets of \$ 201.4 million.

At June 30, 2005, the Water Supply Board's net assets totaled \$ 169.5 million. Total assets were \$201.4 million, up \$ 1.2 million from the prior year's total assets of \$ 200.2 million.

The Water Supply Board's total operating revenues were \$ 52.4 million at June 30, 2006, which increased from \$48.8 million in June 30, 2005. The total cost of operating the water system, including property taxes and depreciation, was \$ 42.4 million. This resulted in an operating income of \$ 10.0 million. Non-operating revenue consists of interest and dividend income. Interest on long-term restricted debt is the largest non-operating expense, followed by miscellaneous and other expenses. Non-operating income for the fiscal year totaled (\$0.4) million, with capital grants of \$ 1.3 million. The total increase in net assets was \$ 10.9 million.

The Water Supply Board's total operating revenues were \$ 48.8 million at June 30, 2005 which slightly decreased from \$49.1 million in June 30, 2004. The total cost of operating the water system, including property taxes and depreciation, was \$ 40.9 million. This resulted in an operating income of \$ 7.9 million. Non-operating revenue consists of interest and dividend income. Interest on long-term restricted debt is the largest non-operating expense, followed by miscellaneous and other expenses. Non-operating income for the fiscal year totaled (\$1.1) million, with capital grants of \$ 1.5 million. The total increase in net assets was \$ 8.3 million.

The increase in expenditures in both 2006 and 2005 were a result of normal inflation, contractual and external factors.

## **Capital Assets and Debt Administration**

### **Capital Assets**

At June 30, 2006, the Water Supply Board had \$ 176.5 million invested in various capital assets, including land, buildings and improvements, transmission and distribution reservoirs, mains, services, hydrants and appurtenances, machinery and equipment and construction work in progress. This amount represents a net increase of \$ 6.9 million, or 4.1%, over last year.

At June 30, 2005, the Water Supply Board had \$ 169.6 million invested in various capital assets, including land, buildings and improvements, transmission and distribution reservoirs, mains, services, hydrants and appurtenances, machinery and equipment and construction work in progress. This amount represents a net increase of \$ 4.9 million, or 3%, over the prior year.

Major project expenditures included (in millions):

- Sludge handling and disposal, \$2.0
- Various distribution improvements, \$0.6
- Replace fire hydrants, \$0.2
- Replace lead services, \$0.4
- Replace meters, \$1.7
- AMR system, \$0.8
- Geographic Info. Systems (GIS), \$0.3
- Rehabilitate chemical transfer systems, \$0.3
- Aqueduct Pump Station, \$1.5
- Neutaconkanut Reservoir, \$1.4
- Replace water mains, \$0.9
- Fire safety improvements, \$1.2
- 102" aqueduct improvements, \$2.3
- Sand Filters, \$0.2
- Clarification Optimization, \$0.1

The Water Supply Board's fiscal 2007 capital budget includes projected expenditures of \$15.5 million for infrastructure and capital projects. The major projects are a new pump station, sludge removal and disposal, pump station rehabilitation, chemical system upgrades, GIS system implementation, meter replacements, distribution system improvements, and transmission main inspection and rehabilitation. Other projects will be funded from bond proceeds available from bonds issued in prior fiscal years and with restricted cash funding from rate revenues. The majority of infrastructure projects are financed on a pay-as-you-go, cash basis. New capital additions, that benefit the ratepayers for many years, are paid for with debt financing on an as needed basis.

## **Debt**

At June 30, 2006, the Water Supply Board had \$ 14.7 million in bonds and notes outstanding versus \$ 17.5 million in the previous year. This represented a decrease of \$ 2.8 million or 16.0%.

No new debt was issued in 2006.

At June 30, 2005, the Water Supply Board had \$ 17.5 million in bonds and notes outstanding versus \$ 20.8 million in the previous year. This represented a decrease of \$ 3.3 million or 15.7%.

Old debt was re-financed in 2005 to take advantage of lower interest rates. The present value of the projected savings was approximately \$1.2 million.

## **Contacting Providence Water's Financial Management**

This financial report is designed to provide our customers, investors and creditors with a general overview of the Water Supply Board's finances and to show the Water Supply Board's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Finance Director at the Providence Water Supply Board, 552 Academy Avenue, Providence, RI 02908.

**PROVIDENCE WATER SUPPLY BOARD**  
(An enterprise fund of the City of Providence, Rhode Island)

**STATEMENTS OF NET ASSETS**  
**June 30, 2006 and 2005 (000's)**

	<u>2006</u>	<u>2005</u>
<b>ASSETS</b>		
Current Unrestricted Assets		
Cash and cash equivalents (Note 3)	\$ 4,200	\$ 115
Accounts receivable, net of allowance for uncollectible accounts of \$2,713 in 2006 and \$2,952 in 2005, respectively	6,670	9,496
Accounts receivable - unbilled	4,338	4,059
Inventory	403	1,158
Other assets	-	77
Due from other funds	41	28
<b>Total unrestricted</b>	<u>15,652</u>	<u>14,933</u>
Current Restricted Assets (Note 2)		
Cash and cash equivalents (Note 3)	18,079	14,701
Investments (Note 3)	1,476	1,333
Accounts receivable	373	319
Accounts receivable - unbilled	533	523
<b>Total restricted</b>	<u>20,461</u>	<u>16,876</u>
<b>Total current assets</b>	<u>36,113</u>	<u>31,809</u>
Capital Assets (Note 10)		
Land	10,289	10,258
Building and improvements	25,600	25,034
Improvements other than buildings	163,976	157,202
Machinery and equipment	24,150	23,255
Assets under capital leases (Note 7)	14,728	14,728
Scituate Reservoir Project	18,682	18,682
Construction in progress	23,150	14,618
	<u>280,575</u>	<u>263,777</u>
Less accumulated depreciation and amortization	104,110	94,219
<b>Capital assets, net</b>	<u>176,465</u>	<u>169,558</u>
<b>Total assets</b>	<u>212,578</u>	<u>201,367</u>

See accompanying notes to financial statements.

	<u>2006</u>	<u>2005</u>
<b>LIABILITIES</b>		
Current Liabilities		
Due to City of Providence General Fund (Note 6)	\$ 2,901	\$ 591
Accounts payable	2,261	2,554
Accrued expenses	2,662	2,566
Unearned revenues	1,639	1,556
Current portion of long-term debt (Note 5)	2,829	2,799
Current portion of obligations under capital lease (Note 7)	915	1,050
Line of credit (Note 8)	385	715
	<u>13,592</u>	<u>11,831</u>
Amounts to be paid from current restricted assets (Note 2)		
Due to Water Resources Board	450	447
Accounts payable	3,265	1,018
	<u>3,715</u>	<u>1,465</u>
<b>Total current liabilities</b>	<u>17,307</u>	<u>13,296</u>
Non-current Liabilities		
General revenue bonds (Note 5)	11,879	14,708
Obligations under capital lease (Note 7)	2,950	3,865
<b>Total non-current liabilities</b>	<u>14,829</u>	<u>18,573</u>
<b>Total liabilities</b>	<u>32,136</u>	<u>31,869</u>
Commitments and contingencies (Note 9)		
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	157,507	146,421
Restricted	16,746	15,411
Unrestricted	6,189	7,666
<b>Total net assets</b>	<u>\$ 180,442</u>	<u>\$ 169,498</u>

**PROVIDENCE WATER SUPPLY BOARD**  
(An enterprise fund of the City of Providence, Rhode Island)

**STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN FUND NET ASSETS**  
For the Years Ended June 30, 2006 and 2005 (000's)

	<u>2006</u>	<u>2005</u>
<b>Operating Revenues</b>		
Charges for services:		
Water sales (Note 1):		
General customers	\$ 35,020	\$ 32,312
Other local water suppliers	12,908	12,590
Fire protection services	1,514	1,392
Maintenance charges and other revenue	2,990	2,513
<b>Total operating revenues</b>	<b>52,432</b>	<b>48,807</b>
<b>Operating Expenses</b>		
Source of supply	1,737	1,488
Pumping operations	724	603
Water treatment	6,202	5,447
Transmission and distribution	3,811	3,690
Charge for services provided by other City departments (Note 6)	730	730
Customer accounts and service	2,215	2,676
Administrative and general	11,106	10,678
Depreciation and amortization	9,891	9,774
Property taxes - other local governments	6,030	5,785
<b>Total operating expenses</b>	<b>42,446</b>	<b>40,871</b>
<b>Operating income</b>	<b>9,986</b>	<b>7,936</b>
<b>Nonoperating Revenues (Expenses)</b>		
Interest income	864	427
Interest expense and other	(1,215)	(1,550)
<b>Net nonoperating expenses</b>	<b>(351)</b>	<b>(1,123)</b>
<b>Capital Grants and Contributions</b>	<b>1,309</b>	<b>1,464</b>
<b>Change in net assets</b>	<b>10,944</b>	<b>8,277</b>
<b>Net Assets, beginning of year</b>	<b>169,498</b>	<b>161,221</b>
<b>Net Assets, end of year</b>	<b>\$ 180,442</b>	<b>\$ 169,498</b>

See accompanying notes to financial statements.

**PROVIDENCE WATER SUPPLY BOARD**  
(An enterprise fund of the City of Providence, Rhode Island)

**STATEMENTS OF CASH FLOWS**  
**For the Years Ended June 30, 2006 and 2005 (000's)**

	Business-Type Activities Enterprise Funds Water Supply Board	
	2006	2005
<b>Cash Flows From Operating Activities</b>		
Cash received from customers	\$ 54,914	\$ 50,443
Cash paid to vendors	(12,963)	(13,967)
Cash paid to employees	(16,622)	(17,669)
<b>Net cash provided by operating activities</b>	<b>25,329</b>	<b>18,807</b>
<b>Cash Flows From Non-Capital and Related Financing Activities</b>		
Due to/from other funds	2,297	(2,042)
<b>Cash Flows From Capital and Related Financing Activities</b>		
Acquisition and construction of capital assets	(16,798)	(14,663)
Interest paid on debt	(1,215)	(1,550)
Proceeds of long-term debt	-	8,101
Proceeds from line of credit	-	714
Repayment to line of credit	(330)	(400)
Repayment of long-term debt and capital leases	(3,849)	(4,829)
Payments to escrow	-	(7,766)
Capital grants	1,309	1,464
<b>Net cash used in capital and related financing activities</b>	<b>(20,883)</b>	<b>(18,929)</b>
<b>Cash Flows From Investing Activities</b>		
Purchase of investment securities	(144)	(98)
Investment income	864	427
<b>Net cash provided by investing activities</b>	<b>720</b>	<b>329</b>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>7,463</b>	<b>(1,835)</b>
<b>Cash and cash equivalents</b>		
Beginning	14,816	16,651
Ending	\$ 22,279	\$ 14,816
Unrestricted cash and cash equivalents	\$ 4,200	\$ 115
Restricted cash and cash equivalents	\$ 18,079	\$ 14,701

See accompanying notes to financial statements.

**PROVIDENCE WATER SUPPLY BOARD**  
 (An enterprise fund of the City of Providence, Rhode Island)

**STATEMENTS OF CASH FLOWS, Continued**  
**For the Years Ended June 30, 2006 and 2005 (000's)**

	Business-Type Activities Enterprise Funds Water Supply Board	
	2006	2005
<b>Reconciliation of Operating Income to</b>		
<b>Net Cash Provided by Operating Activities:</b>		
Operating income	\$ 9,986	\$ 7,936
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	9,891	9,774
Changes in assets and liabilities:		
Accounts receivable	2,482	1,635
Inventories	755	137
Other assets	77	220
Accounts payable	2,055	(992)
Unearned revenue	83	97
<b>Net cash provided by operating activities</b>	<b>\$ 25,329</b>	<b>\$ 18,807</b>

See accompanying notes to financial statements.

**PROVIDENCE WATER SUPPLY BOARD**  
(An enterprise fund of the City of Providence, Rhode Island)

**NOTES TO FINANCIAL STATEMENTS**  
June 30, 2006 and 2005 (000's)

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**Note 1. Nature of Business and Significant Accounting Policies**

Reporting entity

The Providence Water Supply Board, an enterprise fund of the City of Providence, (the "Water Supply Board") was created in 1940 by Chapter 832 of the Public Laws of the State of Rhode Island. Membership of the Water Supply Board is comprised of four persons appointed by the Mayor, who serve for four-year staggered terms and two City Council members elected by the City Council who serve during their four-year City Council term. The Finance Director of the City of Providence also serves as an ex-officio Water Supply Board member.

The Water Supply Board provides water supply services through metered sales in Providence and parts of the surrounding communities of North Providence, Johnston and Cranston. The Water Supply Board also sells water to other local water supply systems on a wholesale basis. The Water Supply Board's source of water supply is the Scituate Reservoir, located in the Town of Scituate, Rhode Island, and five tributary reservoirs.

Significant accounting policies are as follows:

Basis of Presentation

The Water Supply Board is considered an enterprise fund of the City of Providence (the "City"). The operations of the Water Supply Board are accounted for with a separate set of self-balancing accounts organized on a Proprietary Fund type (Enterprise Fund) basis.

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (including depreciation) of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Water Supply Board utilizes the accrual basis of accounting, under which revenues are recognized when earned and expenses are recognized when incurred.

Regulations and Operation

The Water Supply Board is subject, as to rates, and other matters, to the regulatory authority of the State of Rhode Island Public Utilities Commission (PUC).

**PROVIDENCE WATER SUPPLY BOARD**  
**(An enterprise fund of the City of Providence, Rhode Island)**

**NOTES TO FINANCIAL STATEMENTS, Continued**  
**June 30, 2006 and 2005 (000's)**

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Cash equivalents

The Water Supply Board considers all highly liquid debt instruments with an original maturity of three months or less, when purchased, to be cash equivalents.

Investments

The Water Supply Board accounts for investments at fair values which are established by quoted market prices.

Inventory

Inventory, consisting of materials and supplies, is valued at the lower of average cost or market using the first-in, first-out method.

Capital assets, depreciation and amortization

Capital assets owned by the Water Supply Board are stated at cost. They are defined as assets with an initial cost of more than \$3,000 and an estimated useful life in excess of 1 year. Depreciation and amortization is provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Building, source of supply structures, and improvements	5-75 years
Improvements other than buildings	3-75 years
Equipment	3-50 years

Depreciation expense is not reflected for construction in progress until such time as it is placed in service. Assets under capital leases are amortized under the Water Supply Board's normal depreciation policies for similar assets.

Restricted funds for construction of assets

Restricted funds for construction of assets represent unexpended revenue bond proceeds obtained specifically for construction of water facilities. These funds are included in restricted assets.

Capital contributions

Capital contributions consist of property and equipment paid for by customers for water installations. Once the installation is complete, the property and equipment transfers to the Water Supply Board at fair value.

Revenues, operating revenues and expenses

Revenues include amounts billed and unbilled to all customers, including those customers outside the City of Providence, Rhode Island. All billed charges are based on rates approved by the PUC. Revenues for unbilled amounts to general customers are estimated based on billing amounts subsequent to year-end. The Water Supply Board distinguishes operating revenues and expenses from non-operating. Operating

**PROVIDENCE WATER SUPPLY BOARD**  
**(An enterprise fund of the City of Providence, Rhode Island)**

**NOTES TO FINANCIAL STATEMENTS, Continued**  
**June 30, 2006 and 2005 (000's)**

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revenues result from charges to customers for water and related services. Operating expenses include the cost of operations, maintenance, sales and service, administrative expenses and depreciation. All revenues and expenses not meeting this definition are reported as non-operating or capital contributions.

Proprietary fund accounting

The Water Supply Board has implemented Statement No. 20 of the Governmental Accounting Standards Board (GASB), "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting." This Statement provides guidance on the applicability of accounting pronouncements from other standard setting organizations. Under the Board's election, it must apply all GASB pronouncements and the following pronouncements issued before November 30, 1989 unless they contradict GASB pronouncements: Statements and Interpretations of the Financial Accounting Standards Board, Accounting Principles Board Opinions, and Accounting Research Bulletins of the committee on Accounting Procedures.

Concentration of credit risk

The Water Supply Board's financial instruments that are exposed to concentrations of credit risk consist primarily of accounts receivable. Exposure to losses on receivables is principally dependent on each customer's financial condition. Concentration of credit risk with respect to receivables is limited due to the large number of customers. The Water Supply Board monitors its exposure for credit losses and maintains allowances for anticipated losses.

Use of estimates

The preparation of the financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of 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.

Compensated absences

Employees accumulate sick leave hours for subsequent use or for payment upon termination or retirement. Sick leave and vacation vest and may be carried forward, but not to exceed 135 days and 55 days, respectively.

Vested sick leave and accumulated vacation leave are recorded as expenses and liabilities as the benefits accrue to employees.

**Note 2. Restricted Assets**

The State of Rhode Island enacted the Public Drinking Water Protection Act of 1987 (the "Act") that empowers suppliers of public drinking water to levy a surcharge (the "surcharge") on one cent (\$0.01) per hundred gallons of water for all customers. The surcharge has been amended several times since 1987.

**PROVIDENCE WATER SUPPLY BOARD**  
**(An enterprise fund of the City of Providence, Rhode Island)**

**NOTES TO FINANCIAL STATEMENTS, Continued**  
**June 30, 2006 and 2005 (000's)**

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The last increase was on July 1, 2002, when the surcharge increased to \$0.0292 per hundred gallons of water for all customers. In addition to the increase, the Water Supply Board will retain 36.1% of the surcharge in its Water Quality Protection fund, remit 57.0% to the State Water Resources Board and retain 6.9% for general operations. The funds collected in the Water Quality Protection fund are to be expended in the following manner: 1) at a minimum, 55% of the funds are to be spent for the acquisition of land or land rights or physical improvements to acquired land to protect the quality of the raw water of the water supply system; 2) 35% may be used to acquire a fee simple interest or a conservation restriction that directly protects the quality and safety of the public drinking water supply; and 3) 10% may be used by the supplier for any purpose relating to its operations.

The restricted investments are pooled with the cash and cash equivalents and investments of other funds maintained by the City of Providence. The earnings from investments are allocated in proportion to each fund's balance.

**Note 3. Cash and Investments**

The following is a summary of cash and investments:

	<u>Fair Value</u>
Cash and cash equivalents	\$ 4,200
Restricted cash and cash equivalents	18,079
Equity Mutual Funds	<u>1,476</u>
<b>Total</b>	<b><u>\$ 23,755</u></b>

Responsibility for custodial credit risk of deposits and investments and interest rate risk and risk and concentration of investments rests with the City; accordingly separate disclosure is not possible. The City's financial statements should be read to determine the associated risks of the Water Supply Board's deposits and investments.

**Note 4. Pension Plans**

Substantially all employees of the Water Supply Board participate in the Employees' Retirement System of the City of Providence (the "Plan"), a defined-benefit, single-employer plan. Disclosures about this plan, as a whole, are presented in the City of Providence, Rhode Island's basic financial statements. As of June 30, 2006 and 2005, the City recorded a liability for unpaid pension contributions of \$121,000 and \$116,000, respectively. Separate actuarial information related to the Water Supply Board employees is not available. Accordingly, only disclosures about the Water Supply Board's participation in the Plan are presented herein.

All Water Supply Board employees participating in the Plan are eligible to retire at age 55 or at any age after 25 years of service. The total retirement allowance is equal to an annuity, which is the actuarial

**PROVIDENCE WATER SUPPLY BOARD**  
**(An enterprise fund of the City of Providence, Rhode Island)**

**NOTES TO FINANCIAL STATEMENTS, Continued**  
**June 30, 2006 and 2005 (000's)**

equivalent of accumulated contributions at the time of retirement, plus a pension which when added together, equals 1/40 of final compensation for each year of total service up to 20 years and 1/50 of final compensation for each year of service in excess of 20 years. These benefit provisions and all other requirements are established by City ordinance.

The Water Supply Board's allocation of the actuarial required contribution and amount contributed for the year ended June 30, 2006 were \$2,800 and \$2,500, respectively. The Water Supply Board's allocation of the actuarial required contribution and amount contributed for the year ended June 30, 2005 were \$2,700 and \$2,500, respectively. The employer and employees contribution rates are approximately 25% and 23%, respectively, for both 2006 and 2005.

The historical schedules of employer contributions and funding progress for the Plan are included in the City of Providence, Rhode Island's basic financial statements.

**Note 5. Long-Term Debt**

Long-term liability activity for the years ended June 30, 2006 and 2005 were as follows:

	2006				
	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
<b>Bonds payable:</b>					
Revenue bonds	\$ 17,455	\$ -	\$ (2,747)	\$ 14,708	\$ 2,829
Notes payable	52	-	(52)	-	-
<b>Total bonds and notes payable</b>	<b>17,507</b>	<b>-</b>	<b>(2,799)</b>	<b>14,708</b>	<b>2,829</b>
<b>Capital leases</b>	<b>4,915</b>	<b>-</b>	<b>(1,050)</b>	<b>3,865</b>	<b>915</b>
	<b>\$ 22,422</b>	<b>\$ -</b>	<b>\$ (3,849)</b>	<b>\$ 18,573</b>	<b>\$ 3,744</b>

	2005				
	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
<b>Bonds payable:</b>					
Revenue bonds	\$ 20,705	\$ 8,101	\$ (11,351)	\$ 17,455	\$ 2,747
Notes payable	104	-	(52)	52	52
<b>Total bonds and notes payable</b>	<b>20,809</b>	<b>8,101</b>	<b>(11,403)</b>	<b>17,507</b>	<b>2,799</b>
<b>Capital leases</b>	<b>6,105</b>	<b>-</b>	<b>(1,190)</b>	<b>4,915</b>	<b>1,050</b>
<b>Total long-term liabilities</b>	<b>\$ 26,914</b>	<b>\$ 8,101</b>	<b>\$ (12,593)</b>	<b>\$ 22,422</b>	<b>\$ 3,849</b>

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**NOTES TO FINANCIAL STATEMENTS, Continued**  
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The following is a summary of bonds and notes outstanding at June 30, 2006 and 2005 (amounts in thousands):

Description	June 30, 2006	
	Interest Rate	Balance
Revenue bonds:		
Safe Drinking Water Bonds (CWFA FY2001)	3.14%	\$ 1,047
Safe Drinking Water Bonds (CWFA FY2002)	4.81%	2,101
Safe Drinking Water Bonds (CWFA FY2003)	2.59%	820
Scituate Reservoir Project (PPBA I)	7.21%	3,362
Safe Drinking Water Bonds (CWFA FY2005)	2.25%	<u>7,378</u>
		<u>\$ 14,708</u>

Description	June 30, 2005	
	Interest Rate	Balance
Revenue bonds:		
Safe Drinking Water Bonds (CWFA FY2001)	3.1-3.8%	\$ 2,070
Safe Drinking Water Bonds (CWFA FY2002)	4.81%	2,198
Safe Drinking Water Bonds (CWFA FY2003)	1.95%	1,215
Scituate Reservoir Project (PPBA I)	6.0%	3,871
Safe Drinking Water Bonds (CWFA FY2005)	2.22%	8,101
Note Payable City of Cranston	5.6%	<u>52</u>
		<u>\$ 17,507</u>

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**NOTES TO FINANCIAL STATEMENTS, Continued**  
**June 30, 2006 and 2005 (000's)**

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Scheduled principal maturities of long-term debt are as follows:

	Principal	Interest	Balance
Fiscal year ending June 30:			
2007	\$ 2,829	\$ 455	\$ 3,284
2008	1,836	377	2,213
2009	1,471	326	1,797
2010	1,524	271	1,795
2011	1,570	213	1,783
2012-2016	4,554	451	5,005
2017-2021	757	97	854
2022-2026	167	3	170
	\$ 14,708	\$ 2,193	\$ 16,901

In-Substance Defeasance Prior-Years

In prior years, the Water Supply Board has defeased various bond issues by creating separate irrevocable trust funds. New debt has been issued and the proceeds have been used to purchase U.S. government securities that were placed in the trust funds. The investments and fixed earnings from the investments are sufficient to fully service the defeased debt until the debt is called or matures. For financial reporting purposes, the debt has been considered defeased and therefore removed as a liability from the financial statements. As of June 30, 2006, the amount of defeased debt outstanding but removed from the Water Supply Board's statements was \$7,765,000.

**Note 6. Transactions with City of Providence, Rhode Island**

The City of Providence performs various services for the Water Supply Board including certain accounting, personnel and cash management services and working capital support. The total billing to the Water Supply Board for services performed during the years ended June 30, 2006 and 2005, amounted to \$730. This amount is established by the City, approved by the Water Supply Board and ultimately approved by the PUC. The Water Supply Board also provides services to various City funds and departments, the charges for which have been included as revenue in the accompanying financial statements. Included within the accounts payable balance are the related balances due for these services and pension payments which at June 30, 2006 and 2005 totaled \$2,901 and \$591, respectively.

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**Note 7. Leases**

On July 1, 1988, the City of Providence, through its Water Supply Board, entered into a lease agreement with the Rhode Island Water Resources Board. The Water Supply Board has leased the project, which expires on September 15, 2010. At the expiration of the lease term, the Water Supply Board has the option to purchase the facilities for one dollar (\$1.00). This lease has been accounted for as a capital lease.

The assets and liabilities under all capital leases are recorded at the present value of the minimum lease payments. Amortization of these assets charged to expense during the years ended June 30, 2006 and 2005 amounted to \$312 and \$309, respectively. Summary of book value is as follows:

	<u>2006</u>	<u>2005</u>
Cost	\$ 14,728	\$ 14,728
Accumulated amortization	(3,323)	(3,011)
Book value	<u>\$ 11,405</u>	<u>\$ 11,717</u>

Minimum future lease payments under capital leases as of June 30, 2006 are as follows:

	<u>RI Water Resources Board</u>
2007	\$ 1,079
2008	1,070
2009	1,034
2010	990
Total minimum lease payments	<u>4,173</u>
Less amount representing interest	<u>(308)</u>
	<u>\$ 3,865</u>

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**Note 8. Line of Credit**

The Water Supply Board has a \$2,750 line of credit with an outstanding balance of \$385 and \$715 as of June 30, 2006 and 2005. The line of credit bears interest at 5.95% and 2.95%, and matures August 10, 2007.

Line of credit transactions for the year ended June 30, 2006 were as follows:

Outstanding, July 1, 2005	\$ 715
Borrowings	-
Repayments	<u>(330)</u>
Outstanding, June 30, 2006	<u>\$ 385</u>

Line of credit transactions for the year ended June 30, 2005 were as follows:

Outstanding, July 1, 2004	\$ 400
Borrowings	715
Repayments	<u>(400)</u>
Outstanding, June 30, 2005	<u>\$ 715</u>

**Note 9. Risk Management**

The Water Supply Board is subject to various claims and litigation that arise in the ordinary course of its operations. Legal counsel and management are of the opinion that the Water Supply Board's liabilities in such cases, if decided adversely to the Water Supply Board, would not materially affect the financial statements.

The Water Supply Board self insures its workers' compensation insurance plan. The plan, which is administered by an insurance company, contains certain stop loss clauses that limit the Water Supply Board's liability in the event of catastrophic losses (\$500 per incident). Claims are accrued as incurred based on available claim information and management's estimate of claims incurred but not yet reported. Changes in workers' compensation claims liability during fiscal 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Liability at beginning of the year	\$ 646	\$ 646
Payments for claims	(558)	(512)
Adjustments necessary to record estimated losses	558	512
Balance at end of year	<u>\$ 646</u>	<u>\$ 646</u>

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The Water Supply Board is also exposed to property and casualty, unemployment, employee health, and life insurance claims. Insurance coverage and indemnification (in the case of self-insurance) is managed by the City of Providence on behalf of the Water Supply Board. Information regarding risk management as it relates to the aforementioned claims is presented in the City of Providence's basic financial statements. Amounts paid to the City include claims incurred but not reported.

**Note 10. Capital Assets**

The following is a summary of the activity in capital assets as of June 30, 2006 (in thousands):

	Balance June 30, 2005	Additions	Disposals	Balance June 30, 2006
<b>Capital assets not being depreciated:</b>				
Land	\$ 10,258	\$ 31	\$ -	\$ 10,289
Scituate Reservoir Project	18,682	-	-	18,682
Construction in progress	14,618	15,384	6,852	23,150
Total capital assets not being depreciated	<u>43,558</u>	<u>15,415</u>	<u>6,852</u>	<u>52,121</u>
<b>Capital assets being depreciated:</b>				
Buildings and improvements	25,034	566	-	25,600
Improvements other than buildings	157,202	6,774	-	163,976
Machinery and equipment	23,255	895	-	24,150
Assets under capital lease	14,728	-	-	14,728
Total capital assets being depreciated	<u>220,219</u>	<u>8,235</u>	<u>-</u>	<u>228,454</u>
<b>Less accumulated depreciation for:</b>				
Buildings and improvements	16,724	2,090	-	18,814
Improvements other than buildings	57,947	6,070	-	64,017
Machinery and equipment	16,537	1,419	-	17,956
Assets under capital lease	3,011	312	-	3,323
	<u>94,219</u>	<u>9,891</u>	<u>-</u>	<u>104,110</u>
Total capital assets being depreciated, net	<u>126,000</u>	<u>(1,656)</u>	<u>-</u>	<u>124,344</u>
Total capital assets, net	<u>\$ 169,558</u>	<u>\$ 13,759</u>	<u>\$ 6,852</u>	<u>\$ 176,465</u>

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**NOTES TO FINANCIAL STATEMENTS, Continued**  
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The following is a summary of the activity in capital assets as of June 30, 2005 (in thousands):

	Balance June 30, 2004	Additions	Disposals	Balance June 30, 2005
Capital assets not being depreciated:				
Land	\$ 8,162	\$ 2,096	\$ -	\$ 10,258
Scituate Reservoir Project	18,682	-	-	18,682
Construction in progress	19,040	11,071	15,493	14,618
Total capital assets not being depreciated	<u>45,884</u>	<u>13,167</u>	<u>15,493</u>	<u>43,558</u>
Capital assets being depreciated:				
Buildings and improvements	21,981	3,053	-	25,034
Improvements other than buildings	146,363	10,839	-	157,202
Machinery and equipment	20,158	3,097	-	23,255
Assets under capital lease	14,728	-	-	14,728
	<u>203,230</u>	<u>16,989</u>	<u>-</u>	<u>220,219</u>
Less accumulated depreciation for:				
Buildings and improvements	14,256	2,468	-	16,724
Improvements other than buildings	52,436	5,511	-	57,947
Machinery and equipment	15,053	1,484	-	16,537
Assets under capital lease	2,702	309	-	3,011
	<u>84,447</u>	<u>9,772</u>	<u>-</u>	<u>94,219</u>
Total capital assets being depreciated, net	<u>118,783</u>	<u>7,217</u>	<u>-</u>	<u>126,000</u>
Total capital assets, net	<u>\$ 164,667</u>	<u>\$ 20,384</u>	<u>\$ 15,493</u>	<u>\$ 169,558</u>

**Note 11. Post employments Benefits**

The Water Supply pays health care benefits for certain retired employees and funds these benefits on a cash (pay-as-you-go) basis. During the year ended June 30, 2006, the cost of retiree health care benefits recorded by the Water Supply Board amounted to approximately \$300,000 (see Note 12).

**Note 12. Pronouncements Issued, Not Yet Effective**

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2006 that have effective dates that may impact future financial presentations.

Management has not currently determined what, if any, impact implementation of the following statements may have on the financial statements:

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- ◆ GASB Statement Number 43, "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans," issued April 2004, will be effective for the City beginning with its year ended June 30, 2007. This Statement establishes uniform financial reporting standards for OPEB (other postemployment benefits) and supersedes the interim guidance included in Statement No. 26, "Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans."
- ◆ GASB Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions," issued June 2004, will be effective for the City beginning with its year ending June 30, 2008. This Statement establishes standards for the measurement, recognition and display of other postemployment benefits, expenses and related liabilities or assets, not disclosures and, if applicable, required supplementary information in the financial reports.
- ◆ Statement No. 48, "Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues," issued September 2006, is effective for periods beginning after December 15, 2006. This Statement establishes accounting and financial reporting standards for transactions in which a government receives, or is entitled to, resources in exchange for future cash flows generated by collecting specific receivables or specific future revenues. It also provides disclosure requirements for a government that pledges or commits future cash flows from a specific revenue source. In addition, this Statement establishes accounting and financial reporting standards for intra-entity transfers of assets and future revenues.