

CITY OF PROVIDENCE, RHODE ISLAND
WATER SUPPLY BOARD

FINANCIAL STATEMENTS

FOR THE FISCAL YEARS ENDED
JUNE 30, 2007 AND 2006

CITY OF PROVIDENCE, RHODE ISLAND
WATER SUPPLY BOARD

TABLE OF CONTENTS
YEARS ENDED JUNE 30, 2007 AND 2006

PAGE(S)

FINANCIAL SECTION:

| | |
|---|---------|
| Independent Auditor's Report | 1 |
| Basic Financial Statements and Required Supplementary Information: | |
| Management's Discussion and Analysis | 2 - 5 |
| Financial Statements: | |
| Statement of Net Assets | 6 - 7 |
| Statements of Revenues and Expenses and Changes in Fund Net Assets | 8 |
| Statements of Cash Flows | 9 |
| Notes to Financial Statements..... | |
| | 10 - 20 |

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of net assets of the Providence Water Supply Board (the "Water Supply Board") (an enterprise fund of the City of Providence, Rhode Island) as of June 30, 2007, and the related statements of revenues and expenses and changes in fund net assets and cash flows for the year then ended. 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 audit. The financial statements of the Water Supply Board as of June 30, 2006, were audited by other auditors whose report dated November 3, 2006, expressed an unqualified opinion on those statements.

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 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 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 audit provides a reasonable basis for our opinion.

In our opinion, the 2007 financial statements referred to above present fairly, in all material respects, the financial position of the Providence Water Supply Board as of June 30, 2007, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with "Government Auditing Standards", we have also issued our report dated December 26, 2007, on our consideration of the Providence 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.

The management's 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.

Braver, PC
Providence, Rhode Island



December 26, 2007

Boston

Newton

Providence

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2007 AND 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, 2007 and 2006.

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.

(CONTINUED)

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2007 AND 2006

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

| | <u>2007</u> | <u>2006</u> |
|---|--------------------------|--------------------------|
| Current assets | \$ 37,145 | \$ 36,113 |
| Capital assets, net | <u>180,113</u> | <u>176,465</u> |
| Total assets | <u>217,258</u> | <u>212,578</u> |
| Current liabilities | 15,631 | 17,307 |
| Noncurrent liabilities | <u>12,043</u> | <u>14,829</u> |
| Total liabilities | <u>27,674</u> | <u>32,136</u> |
| Net assets: | | |
| Invested in capital assets, net of related debt | 165,284 | 157,507 |
| Restricted | 17,397 | 16,746 |
| Unrestricted | <u>6,903</u> | <u>6,189</u> |
| Total net assets | <u>\$ 189,584</u> | <u>\$ 180,442</u> |
| Operating revenues | <u>\$ 52,748</u> | <u>\$ 52,432</u> |
| Operating expenses | 35,046 | 32,556 |
| Depreciation | <u>10,135</u> | <u>9,890</u> |
| Total operating expenses, including depreciation | <u>45,181</u> | <u>42,446</u> |
| Operating income | 7,567 | 9,986 |
| Nonoperating expense | (38) | (351) |
| Capital grants and contributions | <u>1,613</u> | <u>1,309</u> |
| Increase in net assets | <u>\$ 9,142</u> | <u>\$ 10,944</u> |

(CONTINUED)

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2007 AND 2006

Financial Highlights

The Water Supply Board's net assets totaled \$ 189.6 million at June 30, 2007. Total net assets increased by \$9.2 million, or about 5.1% from June 30, 2006.

During the year, the Water Supply Board had operating revenues that exceeded operating expenses by \$7.5 million. This is primarily due to the large commitment to the replacement of infrastructure included in water rates.

At June 30, 2007, the Water Supply Board's net assets totaled \$ 189.6 million. Total assets were \$217.3 million, up \$ 4.7 million from last year's total assets of \$ 212.6 million.

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 the prior year's total assets of \$ 201.4 million.

The Water Supply Board's total operating revenues were \$ 52.7 million at June 30, 2007, which increased from \$52.4 million at June 30, 2006. The total cost of operating the water system, including property taxes and depreciation, was \$ 45.2 million. This resulted in an operating income of \$ 7.5 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 (\$.04) million, with capital grants of \$ 1.6 million. The total increase in net assets was \$ 9.1 million.

The Water Supply Board's total operating revenues were \$ 52.4 million at June 30, 2006 which increased from \$48.8 million at 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 (\$.4) million, with capital grants of \$ 1.3 million. The total increase in net assets was \$ 10.9 million.

The increase in expenditures in both 2007 and 2006 were a result of normal inflation, contractual and external factors.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2007, the Water Supply Board had \$ 180.1 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 \$ 3.6 million, or 2.0%, over last year.

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 the prior year.

(CONTINUED)

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2007 AND 2006

Major project expenditures included (In millions):

- Sludge handling and disposal, \$1.0
- Various distribution improvements, \$0.6
- Replace fire hydrants, \$0.1
- Replace lead services, \$0.2
- Replace meters, \$1.9
- AMR system, \$0.8
- Geographic Info. Systems (GIS), \$0.7
- Aqueduct Pump Station, \$0.6
- Neutaconkanut Reservoir, \$0.6
- Replace water mains, \$0.6
- Fire safety improvements, \$0.4
- 102" aqueduct improvements, \$1.1
- Sand Filters, \$0.6
- Clarification Optimization, \$0.6
- Access Roads, fencing and security, \$0.2
- Electrical and process control upgrades, \$0.7

The Water Supply Board's fiscal 2008 capital budget includes projected expenditures of \$23 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, 2007, the Water Supply Board had \$ 11.8 million in bonds and notes outstanding versus \$ 14.7 million in the previous year. This represented a decrease of \$ 2.9 million or 19.7%.

No new debt was issued in 2007.

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%.

No new debt was issued in 2006.

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.

(CONCLUDED)

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

STATEMENT OF NET ASSETS
JUNE 30, 2007 AND 2006

| | 2007 | 2006 |
|--|----------------|----------------|
| ASSETS | | |
| Current unrestricted assets | | |
| Cash and cash equivalents (Note 3) | \$ 3,064 | \$ 4,200 |
| Accounts receivable, net of allowance for uncollectible accounts of \$2,929 in 2007 and \$2,173 in 2006 | 8,056 | 6,670 |
| Accounts receivable - unbilled | 4,479 | 4,338 |
| Inventory | 295 | 403 |
| Other assets | 1,510 | - |
| Due from other funds | - | 41 |
| Total current unrestricted assets | 17,404 | 15,652 |
| Current restricted assets (Note 2) | | |
| Cash and cash equivalents (Note 3) | 17,191 | 18,079 |
| Investments (Note 3) | 1,715 | 1,476 |
| Accounts receivable | 297 | 373 |
| Accounts receivable - unbilled | 538 | 533 |
| Total current restricted assets | 19,741 | 20,461 |
| Total current assets | 37,145 | 36,113 |
| Capital Assets (Note 10) | | |
| Land | 11,091 | 10,289 |
| Building and improvements | 28,224 | 25,600 |
| Improvements other than buildings | 169,755 | 163,976 |
| Machinery and equipment | 25,478 | 24,150 |
| Assets under capital leases (Note 7) | 13,846 | 14,728 |
| Scituate Reservoir Project | 18,682 | 18,682 |
| Construction in progress | 27,282 | 23,150 |
| | 294,358 | 280,575 |
| Less accumulated depreciation and amortization | 114,245 | 104,110 |
| Total capital assets, net | 180,113 | 176,465 |
| Total assets | 217,258 | 212,578 |

(CONTINUED)

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

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

STATEMENT OF NET ASSETS
JUNE 30, 2007 AND 2006

| | 2007 | 2006 |
|--|-------------------------|-------------------------|
| <hr/> | | |
| LIABILITIES | | |
| Current liabilities | | |
| Due to City of Providence General Fund (Note 6) | \$ 4,697 | \$ 2,901 |
| Accounts payable | 1,947 | 2,261 |
| Accrued expenses | 1,825 | 2,662 |
| Unearned revenues | 1,732 | 1,639 |
| Current portion of long-term debt (Note 5) | 1,836 | 2,829 |
| Current portion of obligations under capital lease (Note 7) | 950 | 915 |
| Line of credit (Note 8) | 300 | 385 |
| | <hr/> 13,287 | <hr/> 13,592 |
| Amounts to be paid from current restricted assets (Note 2) | | |
| Due to Water Resources Board | 453 | 450 |
| Accounts payable | 1,891 | 3,265 |
| | <hr/> 2,344 | <hr/> 3,715 |
| Total current liabilities | <hr/> 15,631 | <hr/> 17,307 |
| Non-current liabilities | | |
| General revenue bonds (Note 5) | 10,043 | 11,879 |
| Obligations under capital lease (Note 7) | 2,000 | 2,950 |
| Total non-current liabilities | <hr/> 12,043 | <hr/> 14,829 |
| Total liabilities | <hr/> 27,674 | <hr/> 32,136 |
| Commitments and contingencies (Note 9) | | |
| NET ASSETS | | |
| Invested in capital assets, net of related debt | 165,284 | 157,507 |
| Restricted | 17,397 | 16,746 |
| Unrestricted | 6,903 | 6,189 |
| Total net assets | <hr/> <u>\$ 189,584</u> | <hr/> <u>\$ 180,442</u> |

(CONCLUDED)

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

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, 2007 AND 2006

| | 2007 | 2006 |
|---|-------------------|-------------------|
| Operating Revenues | | |
| Charges for services: | | |
| Water sales (Note 1): | | |
| General customers | \$ 35,493 | \$ 35,020 |
| Other local water suppliers | 12,927 | 12,908 |
| Fire protection services | 1,564 | 1,514 |
| Maintenance charges and other revenue | 2,764 | 2,990 |
| Total operating revenues | 52,748 | 52,432 |
| Operating Expenses | | |
| Source of supply | 1,895 | 1,737 |
| Pumping operations | 781 | 724 |
| Water treatment | 6,931 | 6,202 |
| Transmission and distribution | 3,806 | 3,811 |
| Charge for services provided by other City departments (Note 6) | 730 | 730 |
| Customer accounts and service | 4,072 | 2,215 |
| Administrative and general | 12,406 | 11,106 |
| Depreciation and amortization | 10,135 | 9,891 |
| Property taxes - other local governments | 4,425 | 6,030 |
| Total operating expenses | 45,181 | 42,446 |
| Operating Income | 7,567 | 9,986 |
| Nonoperating Revenues (Expenses) | | |
| Interest income | 885 | 864 |
| Interest expense and other | (923) | (1,215) |
| Net nonoperating expenses | (38) | (351) |
| Capital Grants and Contributions | 1,613 | 1,309 |
| Change in net assets | 9,142 | 10,944 |
| Net Assets , beginning of year | 180,442 | 169,498 |
| Net Assets , end of year | \$ 189,584 | \$ 180,442 |

The accompanying notes are an integral part of these 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, 2007 AND 2006

| | 2007 | 2006 |
|---|------------------|------------------|
| Cash Flows From Operating Activities | | |
| Cash received from customers | \$ 49,875 | \$ 54,914 |
| Cash paid to vendors | (24,058) | (12,963) |
| Cash paid to employees | (13,402) | (16,622) |
| Net cash provided by operating activities | <u>12,415</u> | <u>25,329</u> |
| Cash Flows From Non-Capital and Related Financing Activities | | |
| Due to/from other funds | <u>1,837</u> | <u>2,297</u> |
| Cash Flows From Capital and Related Financing Activities | | |
| Acquisition and construction of capital assets | (13,783) | (16,798) |
| Interest paid on debt | (923) | (1,215) |
| Repayment to line of credit | (85) | (330) |
| Repayment of long-term debt and capital leases | (3,744) | (3,849) |
| Capital grants | 1,613 | 1,309 |
| Net cash used in capital and related financing activities | <u>(16,922)</u> | <u>(20,883)</u> |
| Cash Flows From Investing Activities | | |
| Purchase of investment securities | (239) | (144) |
| Investment income | 885 | 864 |
| Net cash provided by investing activities | <u>646</u> | <u>720</u> |
| Net increase (decrease) in cash and cash equivalents | <u>(2,024)</u> | <u>7,463</u> |
| Cash and cash equivalents | | |
| Beginning | <u>22,279</u> | <u>14,816</u> |
| Ending | <u>\$ 20,255</u> | <u>\$ 22,279</u> |
| Unrestricted cash and cash equivalents | \$ 3,064 | \$ 4,200 |
| Restricted cash and cash equivalents | <u>17,191</u> | <u>18,079</u> |
| | <u>\$ 20,255</u> | <u>\$ 22,279</u> |
| Reconciliation of Operating Income to | | |
| Net Cash Provided by Operating Activities: | | |
| Operating income | \$ 7,567 | \$ 9,986 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation and amortization | 10,135 | 9,891 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (1,456) | 2,482 |
| Inventories | 108 | 755 |
| Other assets | (1,510) | 77 |
| Accounts payable | (2,522) | 2,055 |
| Unearned revenue | 93 | 83 |
| Net cash provided by operating activities | <u>\$ 12,415</u> | <u>\$ 25,329</u> |

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

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

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).

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.

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 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.

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 retirement. Sick leave and vacation vest and may be carried forward into the following calendar year, but not to exceed 135 days and 30 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. 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:

| | Fair Value |
|--------------------------------------|------------------|
| Cash and cash equivalents | \$ 3,064 |
| Restricted cash and cash equivalents | 17,191 |
| Equity Mutual Funds | 1,715 |
| Total | <u>\$ 21,970</u> |

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 3. CASH AND INVESTMENTS (CONTINUED)

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, 2007 and 2006, the City recorded a liability for unpaid pension contributions of \$122,000 and \$121,000, 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 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, 2007 were \$2,701 and \$2,566, respectively. 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 employer and employees contribution rates are approximately 25% and 23%, respectively, for both 2007 and 2006.

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, 2007 and 2006 were as follows:

| | 2007 | | | | |
|-------------------------------|----------------------|-----------|------------|-------------------|------------------------|
| | Beginning Balance | Increases | Decreases | Ending Balance | Due Within One Year |
| Bonds payable: | | | | | |
| Revenue bonds | \$ 14,708 | \$ - | \$ (2,829) | \$ 11,879 | \$ 1,836 |
| Notes payable | - | - | - | - | - |
| Total bonds and notes payable | 14,708 | - | (2,829) | 11,879 | 1,836 |
| Capital leases | 3,865 | - | (915) | 2,950 | 950 |
| | \$ 18,573 | \$ - | \$ (3,744) | \$ 14,829 | \$ 2,786 |

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 5. LONG-TERM DEBT (CONTINUED)

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

The following is a summary of bonds and notes outstanding at June 30, 2007 and 2006 (amounts in thousands):

| Description | June 30, 2007 | |
|---|------------------|------------------|
| | Interest Rate | Balance |
| Revenue bonds: | | |
| Safe Drinking Water Bonds (CWFA FY2002) | 4.81% | \$ 2,001 |
| Safe Drinking Water Bonds (CWFA FY2003) | 2.59% | 415 |
| Scituate Reservoir Project (PPBA I) | 7.21% | 2,825 |
| Safe Drinking Water Bonds (CWFA FY2005) | 2.25% | 6,638 |
| | | <u>\$ 11,879</u> |

| 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% | 7,378 |
| | | <u>\$ 14,708</u> |

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 5. LONG-TERM DEBT (CONTINUED)

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

| | Principal | Interest | Balance |
|-----------------------------|------------------|-----------------|------------------|
| Fiscal year ending June 30: | | | |
| 2008 | \$ 1,836 | \$ 382 | \$ 2,218 |
| 2009 | 1,471 | 326 | 1,797 |
| 2010 | 1,524 | 271 | 1,795 |
| 2011 | 1,570 | 213 | 1,783 |
| 2012 | 1,372 | 158 | 1,530 |
| 2013-2017 | 3,323 | 322 | 3,645 |
| 2018-2022 | 783 | 70 | 853 |
| | <u>\$ 11,879</u> | <u>\$ 1,742</u> | <u>\$ 13,621</u> |

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, 2007, the amount of defeased debt outstanding but removed from the Water Supply Board's statements was \$6,580.

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 amounted to \$730 for each of the years ended June 30, 2007 and 2006. 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, 2007 and 2006 totaled \$3,208 and \$2,901, respectively.

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, 2009. 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.

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 7. LEASES (CONTINUED)

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, 2007 and 2006 amounted to \$185 and \$239, respectively. Summary of book value is as follows:

| | <u>2007</u> | <u>2006</u> |
|--------------------------|------------------|------------------|
| Cost | \$ 13,846 | \$ 13,846 |
| Accumulated amortization | (2,589) | (2,404) |
| Book value | <u>\$ 11,257</u> | <u>\$ 11,442</u> |

Minimum future lease payments under capital leases as of June 30, 2007 are as follows:

| | <u>RI Water Resources Board</u> |
|-----------------------------------|---|
| 2008 | \$ 1,070 |
| 2009 | 1,083 |
| 2010 | <u>1,014</u> |
| Total minimum lease payments | 3,167 |
| Less amount representing interest | <u>(217)</u> |
| | <u><u>\$ 2,950</u></u> |

NOTE 8. LINE OF CREDIT

The Water Supply Board has a \$2,750 line of credit with an outstanding balance of \$300 and \$385 as of June 30, 2007 and 2006. The line of credit bears interest at a rate not to exceed 50% of the floating LIBOR rate and matures August 10, 2007. The LIBOR rate at June 30, 2007 and 2006 was 5.4% AND 5.77%, respectively.

Line of credit transactions for the year ended June 30, 2007 were as follows:

| | |
|----------------------------|---------------|
| Outstanding, July 1, 2006 | \$ 385 |
| Borrowings | - |
| Repayments | <u>(85)</u> |
| Outstanding, June 30, 2007 | <u>\$ 300</u> |

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> |

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 9. COMMITMENTS AND CONTINGENCIES

Risk Management

The Water Supply Board has a complete comprehensive insurance program protecting all facilities, employees and liability claims.

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.

Union Contract

The labor force of the Water Supply Board, with the exception of management, is covered by a union contract which expired June 30, 2007. The contract is currently under negotiation.

Contingent Liability to City of Providence per Rhode Island G.L.

A law passed in 2003 (R.I.G.L. § 39-3-11.3 and § 46-15.3-21) required an annual payment by the Water Supply Board to the City of Providence of 5% of the Board's gross revenues for the fiscal years ending June 30, 2004, 2005 and 2006. The law specifically provides that this payment shall not be included as part of the Water Supply Board's rates for these years. These payments would total approximately \$2,500 per year.

The Water Supply Board has no material funds (other than revenues from rates) from which to make these payments and therefore has not made the payments. Further, since the payments can not be made from rate revenues the Board believes it is not liable for any amount to the City and therefore has not accrued an amount for the potential liability.

No action has been taken by either the City of Providence or the Rhode Island Public Utilities Commission concerning this matter.

Lead Service Replacement Program

The Water Supply Board is required to test for lead and copper. In August 2006, 16 of 100 samples taken throughout the water system tested for trace lead levels higher than the 15 parts per billion measurement allowed by the U.S. Environmental Protection Agency (EPA). The U.S. EPA allows up to 10 of the 100 test samples to exceed the 15 ppb measurement. While there is no detectable lead in the drinking water that leaves the Water Supply Board's treatment plant, some older homes with lead pipes and lead connections to the water main in the street can show trace amounts of lead in the water.

Due to the results of the testing, the Water Supply Board is required by U.S. EPA rules to conduct a public education program and to replace 7% of the active lead services in our system by September 30, 2007 and 7% per year thereafter. The Water Supply Board has entered into a consent agreement with the RI Department of Health to replace 14% of the active lead services by September 30, 2008 and 7% per year thereafter. There are approximately 26,000 lead services of the 75,000 total service connections in the Water Supply Board's distribution system.

In July 2007, the Water Supply Board embarked on a Lead Service Replacement (LSR) program and engaged an engineering consulting firm for three years to manage the LSR program and three construction firms for two years to do the actual replacement work. The Water Supply Board has entered into contracts not to exceed \$22 million with these firms.

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 9. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Retirees Health Care

During 2006 the City of Providence, as well as the Water Supply Board, discovered that the City was not charging the Water Supply Board for the health care costs for retired Water Supply Board employees. All City retirees are placed into a separate retirement payroll with associated fringe benefits. Former Water Supply Board employees were not separately tracked.

A schedule was prepared of the Water Supply Board's retiree's health care costs for 2006, which was paid to the City of Providence. A schedule was also prepared including the Water Supply Board's actual retiree's health care costs for 2004 and 2005 and the calculated costs for the years from 1997 through 2003. This amount was included in the Water Supply Board's rate filing to the RI Public Utilities Commission (PUC) in March of 2007. During discovery for the rate case, the outstanding obligation amount was revised to \$1,489. The Water Supply Board agreed with the Division of Public Utilities, to a repayment term of six years, without interest. The RI PUC at an open meeting on October 30, 2007 denied the Water Supply Board's request to repay the City of Providence. Management believes the City intends to appeal that decision. A liability for \$1,489 is included in Due to City of Providence General Fund on the Statement of Net Assets as of June 30, 2007.

NOTE 10. CAPITAL ASSETS

The following is a summary of the activity in capital assets as of June 30, 2007:

| | Balance June 30, 2006 | Additions | Disposals | Balance June 30, 2007 |
|---|--------------------------|-----------|-----------|--------------------------|
| Capital assets not being depreciated: | | | | |
| Land | \$ 10,289 | \$ 802 | \$ - | \$ 11,091 |
| Scituate Reservoir Project | 18,682 | - | - | 18,682 |
| Construction in progress | 23,150 | 11,315 | 7,183 | 27,282 |
| Total capital assets not being depreciate | 52,121 | 12,117 | 7,183 | 57,055 |
| Capital assets being depreciated: | | | | |
| Buildings and improvements | 25,600 | 2,624 | - | 28,224 |
| Improvements other than buildings | 163,976 | 5,779 | - | 169,755 |
| Machinery and equipment | 25,032 | 446 | - | 25,478 |
| Assets under capital lease | 13,846 | - | - | 13,846 |
| Total capital assets being depreciated | 228,454 | 8,849 | - | 237,303 |
| Less accumulated depreciation for: | | | | |
| Buildings and improvements | 18,814 | 1,937 | - | 20,751 |
| Improvements other than buildings | 64,017 | 6,572 | - | 70,589 |
| Machinery and equipment | 17,956 | 1,368 | - | 19,324 |
| Assets under capital lease | 3,323 | 258 | - | 3,581 |
| | 104,110 | 10,135 | - | 114,245 |
| Total capital assets being depreciated, | 124,344 | (1,286) | - | 123,058 |
| Total capital assets, net | \$ 176,465 | \$ 10,831 | \$ 7,183 | \$ 180,113 |

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 10. CAPITAL ASSETS (CONTINUED)

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

| | Balance June 30, 2005 | Additions | Disposals | Balance June 30, 2006 |
|---|--------------------------|-----------|-----------|--------------------------|
| Capital assets not being depreciated: | | | | |
| 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 depreciate | 43,558 | 15,415 | 6,852 | 52,121 |
| Capital assets being depreciated: | | | | |
| Buildings and improvements | 25,034 | 566 | - | 25,600 |
| Improvements other than buildings | 157,202 | 6,774 | - | 163,976 |
| Machinery and equipment | 24,137 | 895 | - | 25,032 |
| Assets under capital lease | 13,846 | - | - | 13,846 |
| | 220,219 | 8,235 | - | 228,454 |
| Less accumulated depreciation for: | | | | |
| 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 |
| | 94,219 | 9,891 | - | 104,110 |
| Total capital assets being depreciated, | 126,000 | (1,656) | - | 124,344 |
| Total capital assets, net | \$ 169,558 | \$ 13,759 | \$ 6,852 | \$ 176,465 |

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. The cost of retiree health care benefits paid by the Water Supply Board for the year ended June 30, 2007 and 2006 amounted to \$421 and \$331, respectively (see Note 12).

NOTE 12. PRONOUNCEMENTS ISSUED, NOT YET EFFECTIVE

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2007 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:

- ♦ 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.

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 12. PRONOUNCEMENTS ISSUED, NOT YET EFFECTIVE (CONTINUED)

- 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.
- GASB Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations," issued November 2006, is effective for periods beginning after December 15, 2007. This Statement establishes accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities.

(CONCLUDED)