

CITY OF PROVIDENCE, RHODE ISLAND
WATER SUPPLY BOARD

**FINANCIAL STATEMENTS
FOR THE FISCAL YEARS ENDED
JUNE 30, 2010 AND 2009**

CITY OF PROVIDENCE, RHODE ISLAND
WATER SUPPLY BOARD

TABLE OF CONTENTS
YEARS ENDED JUNE 30, 2010 AND 2009

	<u>PAGE(S)</u>
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
 Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	 21 - 22

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, 2010 and 2009, and the related statements of revenues and expenses and changes in fund net assets and cash flows for the years 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.

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 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 Providence Water Supply Board as of June 30, 2010 and 2009, 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.

In accordance with "Government Auditing Standards", we have also issued our report dated January 27, 2011, 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



Boston

Newton

Taunton

Concord

January 27, 2011

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2010 AND 2009

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, 2010 and 2009.

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 non-operating 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, 2010 AND 2009

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.

	2010	2009	2008
Current assets	\$ 49,147	\$ 60,976	\$ 67,255
Capital assets, net	235,100	204,233	190,522
Total assets	284,247	265,209	257,777
Current liabilities	17,235	12,450	13,215
Noncurrent liabilities	53,780	43,465	45,009
Total liabilities	71,015	55,915	58,224
Net assets:			
Invested in capital assets, net of related debt	179,800	159,670	143,479
Restricted	30,408	43,370	47,986
Unrestricted	3,024	6,254	8,088
Total net assets	\$ 213,232	\$ 209,294	\$ 199,553
Operating revenues	\$ 54,976	\$ 59,575	\$ 56,032
Operating expenses	39,447	38,150	36,144
Depreciation	11,421	10,646	10,714
Total operating expenses, including depreciation	50,868	48,796	46,858
Operating income	4,108	10,779	9,174
Nonoperating expense	(943)	(1,813)	(103)
Capital grants and contributions	773	775	898
Increase in net assets	\$ 3,938	\$ 9,741	\$ 9,969

(CONTINUED)

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2010 AND 2009

Financial Highlights

The Water Supply Board's net assets totaled \$ 213 million at June 30, 2010. Total net assets increased by \$4 million, or about 1.9% from June 30, 2009.

During the year, the Water Supply Board had operating revenues that exceeded operating expenses by \$4.1 million. This is primarily due to the large commitment to the replacement of infrastructure included in water rates.

At June 30, 2010, the Water Supply Board's net assets totaled \$ 213 million. Total assets were \$284.2 million, up \$ 19 million from last year's total assets of \$ 265.2 million.

At June 30, 2009, the Water Supply Board's net assets totaled \$ 209 million. Total assets were \$265.2 million, up \$ 7.4 million from the prior year's total assets of \$ 257.8 million.

The Water Supply Board's total operating revenues were \$55 million at June 30, 2010, which decreased from \$59.6 million at June 30, 2009. The total cost of operating the water system, including property taxes and depreciation, was \$50.9 million. This resulted in an operating income of \$4.1 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 (\$.9) million, with capital grants of \$.8 million. The total increase in net assets was \$4 million.

The Water Supply Board's total operating revenues were \$ 59.6 million at June 30, 2009, which increased from \$56 million at June 30, 2008. The total cost of operating the water system, including property taxes and depreciation, was \$ 48.8 million. This resulted in an operating income of \$ 10.8 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 (\$1.8) million, with capital grants of \$.8 million. The total increase in net assets was \$ 9.8 million.

The decrease in revenue is attributable to the one time revenue in 2009 that did not re-occur in 2010. The increase in expenditures in both 2010 and 2009 were a result of normal inflation, contractual and external factors.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2010, the Water Supply Board had \$ 235.1 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 \$ 30.9 million, or 15.1%, over last year.

At June 30, 2009, the Water Supply Board had \$ 204.2 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 \$ 13.7 million, or 7.2%, 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, 2010 AND 2009

Major project expenditures included (in millions):

- Various distribution improvements, \$0.1
- Replace valves, \$0.1
- Replace fire hydrants, \$0.1
- Replace lead services, \$10.7
- Sludge Maintenance, \$1.0
- Geographic Info. Systems (GIS), \$0.2
- Replace water mains, \$1.4
- 102" aqueduct improvements, \$0.1
- Sand Filters, \$11.8
- Access Roads, fencing and security, \$0.4
- Electrical and process control upgrades, \$0.3
- Storage facilities, \$0.1
- Gainer Dam stone wall rehab, \$0.4

The Water Supply Board's fiscal 2011 capital budget includes projected expenditures of \$33 million for infrastructure and capital projects. The major projects are filter replacements, pump station upgrades, sludge removal and disposal, SCADA and plant system upgrades, meter, lead service and water main replacements, transmission main inspection and rehabilitation, valve and hydrant maintenance, GIS system, CO² system, Mlog installation and land acquisition. 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, 2010, the Water Supply Board had \$ 55.3 million in bonds and notes outstanding versus \$ 43.6 million in the previous year. This represented an increase of \$ 11.7 million or 26.8%.

\$ 13.25 million in new debt was issued in 2010 to fund water main replacements, meters and electronic radio transmitters, hydrant locks and Mlog leak detection devices.

At June 30, 2009, the Water Supply Board had \$ 43.6 million in bonds and notes outstanding versus \$ 45 million in the previous year. This represented a decrease of \$ 1.4 million or 3%.

No new debt was issued in 2009.

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, 2010 AND 2009 (000's)

	2010	2009
ASSETS		
Current unrestricted assets		
Cash and cash equivalents (Note 3)	\$ 2,811	\$ 3,367
Accounts receivable, net of allowance for uncollectible accounts of \$3,122 in 2010 and \$2,411 in 2009	7,653	7,370
Accounts receivable - unbilled	2,774	3,375
Inventory	851	479
Other assets	523	380
Total current unrestricted assets	14,612	14,971
Current restricted assets (Note 2)		
Cash and cash equivalents (Note 3)	27,844	36,118
Investments (Note 3)	4,303	1,209
Accounts receivable	547	19
Accounts receivable - unbilled	545	545
Due from City of Providence General Fund (Note 6)	1,296	-
Due from other governmental units	-	8,114
Total current restricted assets	34,535	46,005
Total current assets	49,147	60,976
Capital Assets (Note 9)		
Land	13,574	12,551
Building and improvements	48,637	37,038
Improvements other than buildings	217,731	198,828
Machinery and equipment	26,554	26,292
Assets under capital leases (Note 7)	13,846	13,846
Scituate Reservoir Project	18,682	18,682
Construction in progress	43,102	32,601
	382,126	339,838
Less accumulated depreciation and amortization	147,026	135,605
Total capital assets, net	235,100	204,233
Total assets	284,247	265,209

(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, 2010 AND 2009 (000's)

	2010	2009
LIABILITIES		
Current liabilities		
Due to City of Providence General Fund (Note 6)	315	2,067
Accounts payable	1,674	1,363
Accrued expenses	4,837	1,968
Unearned revenues	1,945	1,903
Current portion of long-term debt (Note 5)	2,869	1,524
Current portion of obligations under capital lease (Note 7)	-	990
	<u>11,640</u>	<u>9,815</u>
Amounts to be paid from current restricted assets (Note 2)		
Due to Water Resources Board	354	348
Accounts payable	5,241	2,287
	<u>5,595</u>	<u>2,635</u>
Total current liabilities	<u>17,235</u>	<u>12,450</u>
Non-current liabilities		
General revenue bonds (Note 5)	52,430	42,048
Other post employment benefits (Note 10)	1,350	1,417
Total non-current liabilities	<u>53,780</u>	<u>43,465</u>
Total liabilities	<u>71,015</u>	<u>55,915</u>
NET ASSETS		
Invested in capital assets, net of related debt	179,800	159,670
Restricted	30,408	43,370
Unrestricted	3,024	6,254
Total net assets	<u>\$ 213,232</u>	<u>\$ 209,294</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, 2010 AND 2009 (000's)**

	<u>2010</u>	<u>2009</u>
Operating Revenues		
Charges for services:		
Water sales (Note 1):		
General customers	\$ 36,362	\$ 35,813
Other local water suppliers	14,294	14,278
Fire protection services	1,815	1,784
Maintenance charges and other revenue	2,505	7,700
Total operating revenues	<u>54,976</u>	<u>59,575</u>
Operating Expenses		
Source of supply	2,322	2,321
Pumping operations	780	572
Water treatment	7,829	6,142
Transmission and distribution	5,149	5,332
Charge for services provided by other City departments (Note 6)	839	839
Customer accounts and service	2,712	2,693
Administrative and general	13,122	13,920
Depreciation and amortization	11,421	10,646
Property taxes - other local governments	6,694	6,331
Total operating expenses	<u>50,868</u>	<u>48,796</u>
Operating income	<u>4,108</u>	<u>10,779</u>
Nonoperating Revenues (Expenses)		
Interest income	492	202
Interest expense and other	(1,435)	(2,015)
Net nonoperating expenses	<u>(943)</u>	<u>(1,813)</u>
Capital Grants and Contributions	<u>773</u>	<u>775</u>
Change in net assets	3,938	9,741
Net Assets, beginning of year	<u>209,294</u>	<u>199,553</u>
Net Assets, end of year	<u><u>\$ 213,232</u></u>	<u><u>\$ 209,294</u></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)

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009 (000's)

	2010	2009
Cash Flows From Operating Activities		
Cash received from customers	\$ 54,665	\$ 61,638
Cash paid to vendors	(20,412)	(25,015)
Cash paid to employees	(13,334)	(13,281)
Net cash provided by operating activities	<u>20,919</u>	<u>23,342</u>
Cash Flows From Non-Capital and Related Financing Activities		
Due to/from other funds	<u>(3,048)</u>	<u>261</u>
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of capital assets	(42,288)	(24,357)
Interest paid on debt	(1,435)	(1,585)
Repayment of long-term debt and capital leases	(2,513)	(2,481)
Proceeds from long-term debt and capital leases	21,364	24,904
Capital grants	773	775
Net cash used in capital and related financing activities	<u>(24,099)</u>	<u>(2,744)</u>
Cash Flows From Investing Activities		
Purchase of investment securities	(3,094)	376
Investment income (loss)	492	(228)
Net cash provided by (used in) investing activities	<u>(2,602)</u>	<u>148</u>
Net increase (decrease) in cash and cash equivalents	(8,830)	21,007
Cash and cash equivalents		
Beginning	<u>39,485</u>	<u>18,478</u>
Ending	<u>\$ 30,655</u>	<u>\$ 39,485</u>
Unrestricted cash and cash equivalents	\$ 2,811	\$ 3,367
Restricted cash and cash equivalents	<u>27,844</u>	<u>36,118</u>
	<u>\$ 30,655</u>	<u>\$ 39,485</u>
Reconciliation of Operating Income to		
Net Cash Provided by Operating Activities:		
Operating income	\$ 4,108	\$ 10,779
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	11,421	10,646
Changes in assets and liabilities:		
Accounts receivable	(210)	1,975
Inventories	(372)	(39)
Other assets	(143)	70
Accounts payable and accrued expenses	6,073	(107)
Unearned revenue	42	18
Net cash provided by operating activities	<u>\$ 20,919</u>	<u>\$ 23,342</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, 2010 AND 2009 (000's)

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, 2010 AND 2009 (000's)

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, 2010 AND 2009 (000's)

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.

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.

3. CASH AND INVESTMENTS

The following is a summary of cash and investments:

	Fair Value
Cash and cash equivalents	\$ 2,811
Restricted cash and cash equivalents	27,844
Equity Mutual Funds	4,303
Total	<u>\$ 34,957</u>

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009 (000's)

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.

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, 2010 and 2009, the City recorded a liability for unpaid pension contributions of \$132,767 and \$127,487, 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, 2010 were \$2,788. The Water Supply Board's allocation of the actuarial required contribution and amount contributed for the year ended June 30, 2009 were \$2,701. The employer and employees contribution rates are approximately 25% and 23%, respectively, for both 2010 and 2009.

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.

5. LONG-TERM DEBT

Long-term liability activity for the years ended June 30, 2010 and 2009 were as follows:

	2010				
	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Bonds payable:					
Revenue bonds	\$ 43,572	\$ 13,250	\$ (1,523)	\$ 55,299	\$ 2,869
Total bonds	43,572	13,250	(1,523)	55,299	2,869
Capital leases	990	-	(990)	-	-
Total long-term liabilities	\$ 44,562	\$ 13,250	\$ (2,513)	\$ 55,299	\$ 2,869

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009 (000's)

5. LONG-TERM DEBT (CONTINUED)

	2009				
	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Bonds payable:					
Revenue bonds	\$ 45,043	\$ -	\$ (1,471)	\$ 43,572	\$ 1,524
Total bonds	45,043	-	(1,471)	43,572	1,524
Capital leases	2,000	-	(1,010)	990	990
Total long-term liabilities	\$ 47,043	\$ -	\$ (2,481)	\$ 44,562	\$ 2,514

The following is a summary of bonds and notes outstanding at June 30, 2010 and 2009:

Description	June 30, 2010	
	Interest Rate	Balance
Revenue bonds:		
Safe Drinking Water Bonds (CWFA FY2002)	2.97%	\$ 1,678
Scituate Reservoir Project (PPBA I)	5.40%	1,057
Safe Drinking Water Bonds (CWFA FY2005)	2.25%	4,314
Safe Drinking Water Bonds (CWFA FY2008)	2.85%	35,000
Safe Drinking Water Bonds (CWFA FY2010)	2.21%	13,250
		<u>\$ 55,299</u>

Description	June 30, 2009	
	Interest Rate	Balance
Revenue bonds:		
Safe Drinking Water Bonds (CWFA FY2002)	2.97%	\$ 1,789
Scituate Reservoir Project (PPBA I)	5.40%	1,675
Safe Drinking Water Bonds (CWFA FY2005)	2.25%	5,108
Safe Drinking Water Bonds (CWFA FY2008)	2.85%	35,000
		<u>\$ 43,572</u>

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009 (000's)

5. LONG-TERM DEBT (CONTINUED)

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

Fiscal year ending June 30:	ARRA Principal			
	Principal	Forgiveness	Interest	Total
2011	\$ 2,869	\$ -	\$ 1,410	\$ 4,279
2012	3,822	(260)	1,403	4,965
2013	3,481	(264)	1,437	4,654
2014	3,566	(268)	1,384	4,682
2015	3,659	(273)	1,293	4,679
2016-2020	11,442	(662)	5,397	16,177
2021-2025	11,958	(550)	3,573	14,981
2026-2030	13,879	(652)	1,364	14,591
2031-2035	623	(144)	9	488
	<u>\$ 55,299</u>	<u>\$ (3,073)</u>	<u>\$ 17,270</u>	<u>\$ 69,496</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, 2010, the amount of defeased debt outstanding but removed from the Water Supply Board's statements was \$4,495.

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 \$839 for each the years ended June 30, 2010 and 2009, respectively. 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 Due To City of Providence General Fund balance on the statement of net assets are the related balances due for these services, pension and post employment benefit payments which at June 30, 2010 and 2009 totaled \$315 and \$2,067, respectively. Included within the Due From City of Providence General Fund balance on the statement of net assets at June 30, 2010 are \$1,296 of depreciation funds that were transferred by the City in error and returned after the end of the year.

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, 2010 AND 2009 (000's)

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 amounted to \$185 for each of the years ended June 30, 2010 and 2009. Summary of book value is as follows:

	2010	2009
Cost	\$ 13,846	\$ 13,846
Accumulated amortization	(3,068)	(2,883)
Book value	<u>\$ 10,778</u>	<u>\$ 10,963</u>

8. 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 is effective for the period of July 1, 2008 to June 30, 2011.

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.

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009 (000's)

8. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Lead Service Replacement Program

The Water Supply Board is required to test for lead and copper in its water. In August 2006, 16 of 100 samples taken throughout the water system tested for trace lead levels higher than 15 parts per billion (ppb). The U.S. Environmental Protection Agency (EPA) regulations mandate specific actions that need to be taken by water utilities when more than 10% of test samples exceed the 15 ppb lead level. 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 was required by the U.S EPA, through the Rhode Island Department of Health (RIDOH), to engage in public education efforts related to lead in water, and to replace a minimum of 7% (1,800 services) of the 25,600 active lead services in its system by September 30, 2007, and 7% each year thereafter. The Water Supply Board entered into a consent agreement with RIDOH to replace 14% of its active lead services by September 30, 2008, and to then continue on with a minimum of 7% in each ensuing year.

In July 2007, the Water Supply Board embarked on a Lead Service Replacement (LSR) program and engaged an engineering firm for a period of three years to provide assistance in managing the LSR program, and contracted with three construction firms for two-year periods to perform the actual replacement work. The Water Supply Board entered into contracts not to exceed \$22 million with these firms, and not only met but exceeded the requirement for the 3,600 service replacements to be completed by September 30, 2008.

The lead service replacement has been continuing ever since, with new construction contracts having been awarded. As of the end of December 2010, approximately 9,600 lead services have been replaced since the start of the program effort, at a total cost of nearly \$40 million.

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. The City appealed the decision to the Supreme Court which in the fiscal year ended June 30, 2010 upheld the RI PUC ruling.

A liability for \$1,489 was included in Due to City of Providence General Fund on the Statement of Net Assets as of June 30, 2009. As a result of the Supreme Court decision, the Water Supply Board reversed the \$1,489 liability and adjusted operating expenses for the year ended June 30, 2010.

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009 (000's)

9. CAPITAL ASSETS

The following is a summary of the activity in capital assets as of June 30, 2010:

	Balance June 30, 2009	Additions	Disposals	Balance June 30, 2010
Capital assets not being depreciated:				
Land	\$ 12,551	\$ 1,023	\$ -	\$ 13,574
Scituate Reservoir Project	18,682	-	-	18,682
Construction in progress	32,601	40,509	30,007	43,103
Total capital assets not being depreciated	63,834	41,532	30,007	75,359
Capital assets being depreciated:				
Buildings and improvements	37,038	11,599	-	48,637
Improvements other than buildings	198,827	18,903	-	217,730
Machinery and equipment	26,293	261	-	26,554
Assets under capital lease	13,846	-	-	13,846
	276,004	30,763	-	306,767
Less accumulated depreciation for:				
Buildings and improvements	25,454	3,103	-	28,557
Improvements other than buildings	84,843	7,340	-	92,183
Machinery and equipment	21,357	793	-	22,150
Assets under capital lease	3,951	185	-	4,136
	135,605	11,421	-	147,026
Total capital assets being depreciated, net	140,399	19,342	-	159,741
Total capital assets, net	\$ 204,233	\$ 60,874	\$ 30,007	\$ 235,100

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009 (000's)

The following is a summary of the activity in capital assets as of June 30, 2009:

	Balance June 30, 2008	Additions	Disposals	Balance June 30, 2009
Capital assets not being depreciated:				
Land	\$ 11,091	\$ 1,460	\$ -	\$ 12,551
Scituate Reservoir Project	18,682	-	-	18,682
Construction in progress	30,874	24,911	23,184	32,601
Total capital assets not being depreciated	60,647	26,371	23,184	63,834
Capital assets being depreciated:				
Buildings and improvements	31,110	5,928	-	37,038
Improvements other than buildings	184,077	14,750	-	198,827
Machinery and equipment	25,801	492	-	26,293
Assets under capital lease	13,846	-	-	13,846
Total capital assets being depreciated	254,834	21,170	-	276,004
Less accumulated depreciation for:				
Buildings and improvements	23,255	2,199	-	25,454
Improvements other than buildings	77,589	7,254	-	84,843
Machinery and equipment	20,349	1,008	-	21,357
Assets under capital lease	3,766	185	-	3,951
	124,959	10,646	-	135,605
Total capital assets being depreciated, net	129,875	10,524	-	140,399
Total capital assets, net	\$ 190,522	\$ 36,895	\$ 23,184	\$ 204,233

(CONTINUED)

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

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009 (000's)

10. POST EMPLOYMENT BENEFITS

The Water Supply Board adopted GASB Statement No. 45 "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions", during the fiscal year ended June 30, 2008.

The Water Supply Board's Post-Retirement Benefits Program of the City of Providence (the "Program") is a defined-benefit, single-employer post-retirement health and life insurance program. The Program provides lifetime health care and life insurance benefits to substantially all retired employees and their spouses. Disclosures about this program, as a whole, are presented in the City of Providence, Rhode Island's basic financial statements. As of June 30, 2010 and 2009, the City recorded a liability for unpaid post-retirement contributions of \$23,371 and \$13,047, 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.

The Water Supply Board's allocation of the actuarial required contribution was \$970 and no amount was contributed for the year ended June 30, 2009. The unpaid balance of the actuarial required contribution at June 30, 2009 of \$1,417 is included in non-current liabilities on the Statement of Net Assets.

The Water Supply Board's allocation of the actuarial required contribution was \$1,018 and \$1,085 was contributed for the year ended June 30, 2010. The unpaid balance of the actuarial required contribution at June 30, 2010 of \$1,350 is included in non-current liabilities on the Statement of Net Assets.

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

(CONCLUDED)

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Water Supply Board
City of Providence, Rhode Island

We have audited the financial statements of the Providence Water Supply Board (the "Water Supply Board"), as of and for the year ended June 30, 2010, and have issued our report thereon dated January 27, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Water Supply Board's financial statements will not be prevented, or detected and corrected, on a timely basis.

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

Compliance and Other Matters

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

We noted certain matters that we reported to management of the Water Supply Board, in a separate letter dated January 27, 2011.

This report is intended solely for the information and use of management and the Water Supply Board and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Brian, PC". The signature is written in a cursive, flowing style.

Providence, Rhode Island

January 27, 2011