



Reading Area Water Authority
A Component Unit of the City of Reading

Financial Statements

December 31, 2013 and 2012

Reading Area Water Authority
A Component Unit of the City of Reading

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December 31, 2013 and 2012

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REINSEL KUNTZ LESHER
certified public accountants & consultants

Independent Auditor's Report

To the Members of the Board
Reading Area Water Authority
Reading, Pennsylvania

Report on the Financial Statements

We have audited the accompanying financial statements of the Reading Area Water Authority, a component unit of the City of Reading, which comprise the statement of net position as of December 31, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Reading Area Water Authority as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in Note 13 to the financial statements, the City of Reading has passed a resolution to dissolve the Reading Area Water Authority. The City of Reading must satisfy all outstanding obligations of the Authority prior to dissolution. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on Pages 3 to 8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Reinsel Kuntz Lesher LLP

July 16, 2014
Wyomissing, Pennsylvania

**Reading Area Water Authority
A Component Unit of the City of Reading**

Management's Discussion and Analysis
December 31, 2013

The management of the Reading Area Water Authority (the Authority) offers readers of our financial statements the following narrative overview and analysis of our financial activities for the year ended December 31, 2013.

Financial Highlights

- Unrestricted current assets exceed current liabilities by \$14,815,338 at the close of the year. This is compared to \$10,457,261 and \$4,539,606 at the close of the 2012 and 2011 years, respectively.
- Total net position increased by \$1,893,367 and \$420,670 at the close of the 2013 and 2012 years over the total net position balance at the close of the 2012 and 2011 years, respectively. The 2013 increase is largely due to the Authority's increase in water billing revenue, implementation of the trash and recycling billings offset by the trash and recycling expenses that were a responsibility of the City of Reading in previous years, and a reduction in lease payments to the City of Reading. The 2012 increase is largely due to the net effect of a change in estimate of the allowance for uncollectible accounts receivable and increases in operational costs offset by a reduction in lease payments to the City of Reading.
- The Authority had net operating income of \$5,820,328 for 2013 compared to net operating income of \$2,325,059 and \$900,712 for the 2012 and 2011 years, respectively. This increase in net operating income is the result of an increase in water billings of \$2,074,463, combined with a decrease in lease payments to the City of Reading of \$4,498,186 and an increase in chemical supplies of \$872,151.
- During 2013, the Authority entered an agreement to bill and collect all charges for trash and recycling services rendered by the City of Reading. The City of Reading sold the accounts receivable that result from the trash and recycling service charges by the Authority beginning after January 1, 2013. In return, the Authority is to pay amounts stated in the agreement to the City of Reading, who remains solely responsible for providing the trash and recycling services.
- During 2012, the processing of the Authority's monthly operating costs was transitioned from the City of Reading to the Authority, resulting in the reduction of the lease payments made to the City of Reading and an offsetting increase in operational expenses. The lease payments to the City of Reading decreased by approximately \$4,500,000 from 2012 to 2013. This reduction was offset by an increase in operating expenses of approximately \$2,700,000.
- During 2012, the Authority changed the methodology of the calculation of the allowance for uncollectible accounts receivable which resulted in a reduction of the allowance for uncollectible accounts receivable and a change in accounting estimate of \$2,332,339 being recorded.

**Reading Area Water Authority
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Management's Discussion and Analysis
December 31, 2013

Basic Financial Statements

Our basic financial statements are prepared on the accrual basis of accounting using an economic resources measurement focus, which is basically the same as what is used for profit businesses in the private-sector. The basic financial statements include a statement of net position, statement of revenues, expenses and changes in net position, statement of cash flows and notes to the financial statements.

Statement of Net Position - The statement of net positions presents information on the assets and liabilities, with the difference between assets and liabilities reported as net position. The increases and decreases in net position over time may be a useful indicator of the finances of the Authority as to whether it is improving or deteriorating.

Statement of Revenues, Expenses and Changes in Net Position - The statement of revenues, expenses and changes in net position of the Authority for the year shows the detail of net income or loss being combined with the beginning net position balance, resulting in the ending net position for the year.

Statement of Cash Flows - The statement of cash flows reports cash activities for the year resulting from operating activities, noncapital 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 balance at the end of the current year.

Notes to Financial Statements - The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

Financial Information

Net Position - The following schedule presents a summary of net position comparison for the years ended December 31, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Assets			
Unrestricted current assets	\$ 19,757,390	\$ 16,575,667	\$ 9,061,742
Restricted current assets	35,340,618	46,408,723	57,562,261
Capital assets, net	47,549,824	41,242,111	35,551,858
Other assets	<u>1,020,000</u>	<u>1,020,000</u>	<u>1,118,086</u>
Total Assets	<u>\$ 103,667,832</u>	<u>\$ 105,246,501</u>	<u>\$ 103,293,947</u>
Liabilities			
Current liabilities	\$ 4,942,052	\$ 6,118,406	\$ 4,522,136
Long-term debt	<u>93,065,733</u>	<u>95,361,415</u>	<u>96,264,787</u>
Total Liabilities	<u>\$ 98,007,785</u>	<u>\$ 101,479,821</u>	<u>\$ 100,786,923</u>
Deferred Inflows of Resources, Interest Rate Swap	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 124,391</u>

**Reading Area Water Authority
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Management's Discussion and Analysis
December 31, 2013

Financial Information (continued)

Net Position (continued)

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Net Position			
Net investment in capital assets	\$ -	\$ -	\$ -
Restricted for debt service	4,067,766	4,099,908	4,060,685
Unrestricted (deficit)	<u>1,592,281</u>	<u>(333,228)</u>	<u>(1,678,052)</u>
Total Net Position	<u>\$ 5,660,047</u>	<u>\$ 3,766,680</u>	<u>\$ 2,382,633</u>

Current liabilities decreased by 19.2% in 2013 compared to an increase of 11.7% in 2012 and compared to a decrease of 1.1% in 2011. The 2013 decrease is attributable to decreases in capital accounts payable and amounts due to the City of Reading.

Revenues - The following schedule presents a summary of revenues for the years ended December 31, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating Revenues			
Water billings	\$ 25,363,651	\$ 23,289,188	\$ 22,544,371
Interest and penalty charges	406,039	457,101	491,790
Tampered meter and other charges	864,513	822,344	474,164
Tapping and connection fees	61,258	202,631	133,518
Abandonment fees	<u>71,207</u>	<u>38,673</u>	<u>23,531</u>
Total Operating Revenues	<u>\$ 26,766,668</u>	<u>\$ 24,809,937</u>	<u>\$ 23,667,374</u>

The 2013 fiscal year's total operating revenue increased by 7.9% compared to 2012 and increased by 4.8% in 2012 and 13.6% in 2011, respectively.

**Reading Area Water Authority
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Management's Discussion and Analysis
December 31, 2013

Financial Information (continued)

Expenses - The following schedule presents a summary of expenses for the years ended December 31, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating Expenses			
Lease payments, City of Reading	\$ 8,831,775	\$ 13,329,961	\$ 16,875,521
Chemical supplies	1,251,861	379,710	-
Meter reading	539,483	538,924	523,137
Salaries and payroll taxes	3,920,613	3,674,642	1,629,458
Contracted services	1,202,805	848,176	183,813
Other	<u>3,377,115</u>	<u>2,066,210</u>	<u>2,283,460</u>
Total Operating Expenses	<u>\$ 19,123,652</u>	<u>\$ 20,837,623</u>	<u>\$ 21,495,389</u>

The \$1,713,971 decrease in expenses is primarily the result of the \$4,498,186 decrease in lease payments to the City of Reading combined with an increase of \$872,151 in chemical supplies expense, \$459,906 increase in repairs and maintenance, \$324,592 increase in utilities expense and \$354,629 increase in contracted services expenses.

Changes in Net Position - The following schedule presents a summary of changes in net position for the years ended December 31, 2013, 2012 and 2011:

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Operating revenues	\$ 26,766,668	\$ 24,809,937	\$ 23,667,374
Operating expenses	<u>19,123,652</u>	<u>20,837,623</u>	<u>21,495,389</u>
Operating Income before Depreciation	7,643,016	3,972,314	2,171,985
Depreciation	<u>1,822,688</u>	<u>1,647,255</u>	<u>1,271,273</u>
Operating Income	5,820,328	2,325,059	900,712
Nonoperating revenues (expenses), net	<u>(3,926,961)</u>	<u>(1,904,389)</u>	<u>(2,439,535)</u>
Increase (Decrease) In Net Position	<u>\$ 1,893,367</u>	<u>\$ 420,670</u>	<u>\$ (1,538,823)</u>

**Reading Area Water Authority
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Management's Discussion and Analysis
December 31, 2013

Financial Information (continued)

Changes in Net Position (continued)

**Statement of Changes in Net Position
Year Ended December 31, 2013**

	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Net investment in capital assets	\$ -	\$ -	\$ -
Restricted	4,099,908	(32,142)	4,067,766
Unrestricted (deficit)	<u>(333,228)</u>	<u>1,925,509</u>	<u>1,592,281</u>
Total Net Position	<u>\$ 3,766,680</u>	<u>\$ 1,893,367</u>	<u>\$ 5,660,047</u>

**Statement of Changes in Net Position
Year Ended December 31, 2012**

	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Net investment in capital assets	\$ -	\$ -	\$ -
Restricted	4,060,685	39,223	4,099,908
Unrestricted (deficit)	<u>(714,675)</u>	<u>381,447</u>	<u>(333,228)</u>
Total Net Position	<u>\$ 3,346,010</u>	<u>\$ 420,670</u>	<u>\$ 3,766,680</u>

**Statement of Changes in Net Position
Year Ended December 31, 2011**

	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Net investment in capital assets	\$ -	\$ -	\$ -
Restricted	4,044,555	16,130	4,060,685
Unrestricted (deficit)	<u>840,278</u>	<u>(1,554,953)</u>	<u>(714,675)</u>
Total Net Position	<u>\$ 4,884,833</u>	<u>\$ (1,538,823)</u>	<u>\$ 3,346,010</u>

Capital Assets

The Authority's investment in capital assets includes leasehold improvements, equipment, vehicles, computers and software, and construction-in-progress. Major additions are funded by the issuance of water revenue bonds and notes or funds held in the Authority's construction accounts.

**Reading Area Water Authority
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Management's Discussion and Analysis
December 31, 2013

Capital Assets (continued)

The Authority's capital assets as of December 31, 2013, 2012 and 2011, net of accumulated depreciation, amounted to \$47,549,824, \$41,242,111 and \$35,551,858, respectively. For the year ended December 31, 2013, this amount represents a net increase (including additions, deletions and depreciation) of \$6,307,713 from the prior year. See Note 5 for more information on capital assets.

**Capital Assets at December 31
(Net of Accumulated Depreciation)**

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Leasehold improvements	\$ 30,209,641	\$ 21,198,542	\$ 20,824,547
Acquired systems	828,314	850,308	875,762
Equipment	5,105,612	4,806,427	4,870,530
ehicles	801,215	614,318	400,574
Computers and software	205,007	256,759	95,974
Construction-in-progress	<u>10,400,035</u>	<u>13,515,757</u>	<u>8,484,471</u>
	<u>\$ 47,549,824</u>	<u>\$ 41,242,111</u>	<u>\$ 35,551,858</u>

Debt Administration

At December 31, 2013, the Authority had \$98,344,790 of Guaranteed Revenue Bonds and loans payable, compared to \$101,239,276 and \$102,751,257 at the years ended 2012 and 2011, respectively. The proceeds from these long-term borrowings were used for renovations and improvements to the water system. See Note 6 for additional information on the Authority's debt.

Economic Factors

The Authority will continue to address the existing infrastructure by addressing the rehabilitation needs of the system, as well as pursue possible extension of the water system into new areas.

Request for Information

This financial report is intended to provide an overview of the finances of the Reading Area Water Authority for those with an interest in the Authority. Questions concerning any information contained in the report may be directed to the Executive Director, Reading Area Water Authority, 1801 Kutztown Road, Reading, PA 19604.

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	December 31,	
	2013	2012
Liabilities		
Current Liabilities		
Accounts payable, capital	\$ 658,963	\$ 1,594,030
Accounts payable, trade	515,456	532,157
Accrued payroll and compensated absences	442,430	331,885
Accrued interest payable	323,233	324,800
Escrow deposits	77,921	60,290
Other	10,061	13,884
Due to City of Reading	-	366,864
Current maturities of long-term debt	2,913,988	2,894,496
Total Current Liabilities	4,942,052	6,118,406
Long-Term Debt, Less Current Maturities	93,065,733	95,361,415
Total Liabilities	98,007,785	101,479,821
Net Position		
Net investment in capital assets	-	-
Restricted for debt service	4,067,766	4,099,908
Unrestricted (deficit)	1,592,281	(333,228)
Total Net Position	5,660,047	3,766,680
Total Liabilities and Net Position	\$ 103,667,832	\$ 105,246,501

Reading Area Water Authority
A Component Unit of the City of Reading

Statement of Revenues, Expenses and Changes in Net Position

	Years Ended December 31,	
	2013	2012
Operating Revenues		
Water billings	\$ 25,363,651	\$ 23,289,188
Interest and penalty charges	406,039	457,101
Tampered meter and other charges	864,513	822,344
Tapping and connection fees	61,258	202,631
Abandonment fees	71,207	38,673
	<u>26,766,668</u>	<u>24,809,937</u>
Total Operating Revenues		
Operating Expenses		
Lease payments, City of Reading	8,831,775	13,329,961
Chemical supplies	1,251,861	379,710
Meter reading	539,483	538,294
Engineering	66,780	67,930
Legal fees	321,048	207,199
Salaries and payroll taxes	3,920,613	3,674,642
Insurance	109,819	79,549
Employee benefits	745,080	773,182
Grant expenditures	136,064	75,183
Utilities	644,426	319,834
Contracted services	1,202,805	848,176
Repairs and maintenance	696,325	236,419
Audit and accounting	49,596	50,235
Bank charges	159,054	66,314
Dues and subscriptions	13,761	10,188
Advertising	12,008	6,719
Education	11,662	8,568
Supplies	299,439	126,238
Bad debt expense	67,184	30,538
Lake Ontelaunee dredging	44,869	1,725
Other professional services, rate study	-	7,019
	<u>19,123,652</u>	<u>20,837,623</u>
Total Operating Expenses		
Operating Income before Depreciation	7,643,016	3,972,314
Depreciation	<u>1,822,688</u>	<u>1,647,255</u>
Operating Income	<u>5,820,328</u>	<u>2,325,059</u>

See accompanying notes.

Reading Area Water Authority
A Component Unit of the City of Reading

Statement of Revenues, Expenses and Changes in Net Position (continued)

	Years Ended December 31,	
	2013	2012
Nonoperating Revenues (Expenses)		
Investment income	\$ 167,270	\$ 231,529
Miscellaneous income	56,744	24,762
Interest expense	(4,510,379)	(4,520,451)
Miscellaneous expense	(115,925)	(76,793)
Trash/recycling collections, net	475,329	-
Change in estimate for allowance for uncollectible accounts receivable	-	2,332,339
Change in value of interest rate swap	-	124,391
Debt issuance costs	-	(45,693)
Swap income, net	-	25,527
Total Nonoperating Revenues (Expenses), Net	<u>(3,926,961)</u>	<u>(1,904,389)</u>
Increase in Net Position	1,893,367	420,670
Net Position at Beginning of Year	<u>3,766,680</u>	<u>3,346,010</u>
Net Position at End of Year	<u><u>\$ 5,660,047</u></u>	<u><u>\$ 3,766,680</u></u>

See accompanying notes.

Reading Area Water Authority
A Component Unit of the City of Reading

Statement of Cash Flows

	Years Ended December 31,	
	2013	2012
Cash Flows from Operating Activities		
Cash receipts from water customers	\$ 26,336,310	\$ 26,315,476
Cash receipts from trash and recycling customers	4,278,359	-
Cash payments to suppliers for goods and services	(15,829,144)	(14,862,545)
Cash payments to employees for services	(3,920,613)	(3,545,611)
Cash payments to City of Reading for trash and recycling	(4,899,249)	-
Other receipts	56,744	24,762
Other payments	(115,925)	(76,793)
Increase in escrow liability, net	17,631	3,229
Increase (decrease) in other liabilities	(3,823)	13,884
	<u>5,920,290</u>	<u>7,872,402</u>
Net Cash Provided by Operating Activities		
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(9,065,468)	(6,910,517)
Principal paid on long-term debt	(2,894,486)	(5,063,466)
Interest paid on long-term debt	(3,893,650)	(3,811,003)
Proceeds from issuance of debt	-	3,649,571
Debt issuance costs	-	(45,693)
	<u>(15,853,604)</u>	<u>(12,181,108)</u>
Net Cash Used in Capital and Related Financing Activities		
Cash Flows from Investing Activities		
Decrease in restricted assets, net	11,068,105	11,153,538
Investment income received	167,270	231,405
Swap income received, net	-	25,527
	<u>11,235,375</u>	<u>11,410,470</u>
Net Cash Provided by Investing Activities		
Net Increase in Cash	1,302,061	7,101,764
Cash at Beginning of Year	<u>12,568,624</u>	<u>5,466,860</u>
Cash at End of Year	<u>\$ 13,870,685</u>	<u>\$ 12,568,624</u>

See accompanying notes.

Reading Area Water Authority
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Statement of Cash Flows (continued)

	Years Ended December 31,	
	2013	2012
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating income	\$ 5,820,328	\$ 2,325,059
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	1,822,688	1,647,255
Trash and recycling, net	475,329	-
Miscellaneous income	56,744	24,762
Miscellaneous expenses	(115,925)	(76,793)
(Increase) decrease in assets:		
Accounts receivable, water billings	(180,259)	1,536,077
Unbilled water usage	(182,915)	-
Accounts receivable, trash and recycling billings	(1,096,219)	-
Due from City of Reading	(373,172)	1,477,135
Inventory	(34,550)	(107,799)
Prepaid expenses	(12,547)	(21,735)
Increase (decrease) in liabilities:		
Accounts payable	(16,701)	407,158
Accrued payroll and compensated absences	110,545	277,306
Due to City of Reading	(366,864)	366,864
Other liabilities	(3,823)	13,884
Net Cash Provided by Operating Activities	\$ 5,902,659	\$ 7,869,173
Noncash Capital and Financing Activities		
Payment by City of Reading, PENNVEST loan assumption applied to PENNVEST note payable	\$ -	\$ 98,086

Reading Area Water Authority
A Component Unit of the City of Reading

Notes to Financial Statements
December 31, 2013 and 2012

Note 1 - Nature of Activity

The Reading Area Water Authority (the Authority), a component unit of the City of Reading (the City), was created as an operating authority in 1994 in compliance with the Pennsylvania Municipality Authorities Act. The Authority was formed to provide water services to residential, commercial and industrial users of the water system for the City and certain surrounding municipalities. The Authority is governed by a five-member Board, each of whom is appointed by the City.

Note 2 - Summary of Significant Accounting Policies

The accompanying financial statements conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The following is a summary of the more significant accounting policies used by the Authority.

The Financial Reporting Entity

The Authority is a water supply and distribution entity which operates under a board of directors form of government. Accounting principles generally accepted in the United States of America require that the reporting entity consists of the primary government and organizations for which the primary government is financially accountable. In addition, the primary government may determine through the exercise of management's professional judgment that the inclusion of an organization that does not meet the financial accountability criteria that is necessary in order to prevent the reporting entity's financial statements from being misleading. In such instances, that organization should be included as a component unit if the nature and significance of their relationship with the primary government or other component units are such that exclusion from the financial reporting entity would render the financial reporting entity's financial statements incomplete or misleading. In evaluating how to define the reporting entity, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made based upon the above criteria. There are no agencies or entities which should be presented with the Authority.

The Authority is a component unit of the City of Reading, Pennsylvania.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The preparation of 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 at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

**Reading Area Water Authority
A Component Unit of the City of Reading**

Notes to Financial Statements
December 31, 2013 and 2012

Note 2 - Summary of Significant Accounting Policies (continued)

**Measurement Focus, Basis of Accounting and Financial Statement Presentation
(continued)**

Operating revenues and expenses are distinguished from nonoperating items in the statement of revenues, expenses and changes in net position. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. The principal operating revenues of the Authority are charges to customers for the sale of water. Operating expenses include the cost of providing services, administrative expenses, depreciation on capital assets and amortization on bond premium. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. The principal nonoperating revenues and expenses of the Authority are interest expense and investment income.

When restricted and unrestricted resources are available for its use, it is the Authority's policy to use restricted resources first.

Assets, Liabilities and Net Position

Project Accounts

In accordance with the terms of the trust indenture dated September 15, 2002, the first supplemental indenture dated July 1, 2003, the second supplemental indenture dated July 15, 2007 and the third supplemental indenture dated December 19, 2011 (hereinafter collectively referred to as the "indentures"), relating to the bonded debt, funds of the Authority are accounted for by separate trust accounts; segregated for specific use and held for the benefit of the bondholders. In accordance with the indentures, the trust accounts maintained by the independent trustee are accounted for, by the trustee, using the cash basis method of accounting. A brief description of the purposes of the several revenue bond trust restricted accounts follows:

Clearing Account

Funds are deposited herein to cover principal and interest payments due on the bonds. Transfers are made to the Debt Service Account to make these payments.

Construction Account

The Construction Account consists of funds deposited from the Settlement Account for the purpose of paying costs of capital additions.

Debt Service Account

Semiannual transfers from the Clearing Account are recorded in this Account. Current debt service and sinking fund requirements of the bond issues are paid from this Account.

**Reading Area Water Authority
A Component Unit of the City of Reading**

Notes to Financial Statements
December 31, 2013 and 2012

Note 2 - Summary of Significant Accounting Policies (continued)

Assets, Liabilities and Net Position (continued)

Project Accounts (continued)

Debt Service Reserve Account

This Account was funded by the trust indentures. The aggregate balance provides additional collateral for the bondholders.

Cash

For purposes of reporting cash flows, the Authority considers all cash accounts, which are not subject to withdrawal restrictions or penalties, and all highly-liquid debt investments purchased with a maturity of three months or less to be cash.

Accounts Receivable

Accounts receivable are shown net of an allowance for uncollectibles, as applicable. Accounts receivable are evaluated for collectibility and an allowance is established as deemed necessary, based on the best information available and in an amount that management believes is adequate. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Unbilled Water Usage

Water usage that is not billed by year-end is recorded using subsequent billings for water used through December 31.

Investments

The Board and trustee are permitted to invest the Authority's funds as defined in the Local Government Unit Debt Act, the Municipality Authorities Act and the related trust indentures. Authorized types of investments include the following:

- A. U. S. Treasury Bills.
- B. Short-term obligations of the U. S. Government and federal agencies.
- C. Insured savings and checking accounts and certificates of deposit in banks, savings and loan associations and credit unions.
- D. General obligation bonds of the federal government, the Commonwealth of Pennsylvania or any state agency, or of any Pennsylvania political subdivision.
- E. Shares of mutual funds whose investments are restricted to the above categories.

**Reading Area Water Authority
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Notes to Financial Statements
December 31, 2013 and 2012

Note 2 - Summary of Significant Accounting Policies (continued)

Assets, Liabilities and Net Position (continued)

Investments (continued)

When making investments, the Board and trustee can combine funds from more than one fund under the Authority's control for the purchase of a single investment and join with other political subdivisions and municipal authorities in the purchase of a single investment.

Investments are carried at fair value.

Capital Assets

Capital assets are stated at cost. Depreciation of capital assets is computed on the straight-line method over the following estimated useful lives:

Leasehold improvements	10 to 40 years
Acquired systems	40 years
Equipment	3 to 40 years
Vehicles	5 to 7 years
Computers and software	3 to 5 years

Maintenance and repairs of capital assets are charged to operations and major improvements are capitalized. Upon retirement, sale or other disposition of capital assets, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations. Interest costs incurred during the construction period of major projects are capitalized and amortized over the life of the asset. The total interest expense incurred by the Authority for the year ended December 31, 2012 was \$4,589,445. Of this amount, \$68,994 was included as part of the cost of capital assets under construction.

Bond/Note Premiums/Discounts

Bond/note premiums/discounts are deferred and amortized over the term of the bonds/notes. Unamortized bond premiums/discounts are presented as an addition or deduction to the face amount of the revenue bonds payable.

Compensated Absences

The Authority records its obligation to compensate employees for earned but unused sick time as the liability is incurred. The liability has been determined according to personnel policies of the Authority.

Reading Area Water Authority
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Notes to Financial Statements
 December 31, 2013 and 2012

Note 4 - Cash and Investments (continued)

Cash

The Authority's available cash is invested in demand deposit accounts.

The Authority has custodial credit risk on cash deposits. This is the risk that in the event of a financial institution failure, the Authority's deposits may not be returned to the Authority. The Authority has a deposit policy for custodial risk that requires depository institutions to pledge securities as collateral for deposits that exceed depository insurance.

At December 31, 2013 and 2012, the carrying amounts of the Authority's bank deposits were \$13,948,067 and \$12,628,534, respectively, and the bank balances were \$13,937,206 and \$12,758,536, respectively, of which \$500,000 and \$750,000 were covered by Federal Depository Insurance, respectively. The remaining \$13,437,206 and \$12,008,536, respectively, of deposits were exposed to custodial risk because they were uninsured and collateralized with securities held by the pledging financial institution's trust department or agent, but not in the Authority's name.

Investments

As of December 31, 2013 and 2012, the Authority has the following investments with M&T Bank:

	Investment Maturities (in Years)	
	Fair Value	Less than One Year
December 31, 2013		
Federated Treasury Obligation Funds	\$ 31,503,093	\$ 31,503,093
Federal National Mortgage Association Notes	3,759,604	3,759,604
	<u>\$ 35,262,697</u>	<u>\$ 35,262,697</u>
December 31, 2012		
Federated Treasury Obligation Funds	\$ 42,566,833	\$ 42,566,833
Federal National Mortgage Association Notes	3,781,600	3,781,600
	<u>\$ 46,348,433</u>	<u>\$ 46,348,433</u>

Interest Rate Risk

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

**Reading Area Water Authority
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Notes to Financial Statements
December 31, 2013 and 2012

Note 4 - Cash and Investments (continued)

Credit Risk

The Authority does not have an investment policy that would limit its investment choices to certain credit ratings. However, the Authority limits the type of investments permitted as defined in the Local Government Unit Debt Act, the Municipality Authorities Act and the related trust indentures. Permitted investments are defined in Note 2.

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. As of December 31, 2013 and 2012, \$35,262,697 and \$46,348,433, respectively, is held by the investment's counterparty, not in the name of the Authority.

Note 5 - Capital Assets

Capital asset activity for the years ended December 31, 2013 and 2012 was as follows:

	Balance January 1, 2013	Additions	Deletions	Balance December 31, 2013
Capital assets not being depreciated:				
Construction-in-progress	\$ 13,515,757	\$ 6,797,699	\$ 9,913,421	\$ 10,400,035
Capital assets being depreciated:				
Leasehold improvements	26,128,777	9,925,303	-	36,054,080
Acquired systems	879,745	-	-	879,745
Equipment	7,150,390	887,241	-	8,037,631
Vehicles	2,040,851	411,188	-	2,452,039
Computers and software	689,883	22,391	-	712,274
Total capital assets being depreciated	36,889,646	11,246,123	-	48,135,769

**Reading Area Water Authority
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Notes to Financial Statements
December 31, 2013 and 2012

Note 5 - Capital Assets (continued)

	Balance January 1, 2012	Additions	Deletions	Balance December 31, 2012
Less accumulated depreciation for:				
Leasehold improvements	\$ 4,077,395	\$ 852,840	\$ -	\$ 4,930,235
Acquired systems	7,359	22,078	-	29,437
Equipment	1,811,006	532,957	-	2,343,963
Vehicles	1,254,218	172,315	-	1,426,533
Computers and software	366,059	67,065	-	433,124
Total accumulated depreciation	<u>7,516,037</u>	<u>1,647,255</u>	<u>-</u>	<u>9,163,292</u>
Total capital assets being depreciated, net	<u>27,067,387</u>	<u>669,967</u>	<u>11,000</u>	<u>27,726,354</u>
Total capital assets, net	<u>\$ 35,551,858</u>	<u>\$ 9,049,655</u>	<u>\$ 3,359,402</u>	<u>\$ 41,242,111</u>

Note 6 - Long-Term Debt

At December 31, 2013 and 2012, long-term debt consists of the following:

	Balance Outstanding January 1, 2013	Additions (Payments)	Balance Outstanding December 31, 2013
Guaranteed Water Revenue Bonds, Series of 2003 (Capital Appreciation Bonds), initial issue \$21,080,000, various interest rates ranging from 3.600% to 4.620%, maturing in amounts ranging from \$610,000 to \$2,690,000 through 2020	\$ 18,535,000	\$ (2,030,000)	\$ 16,505,000
Guaranteed Water Revenue Bonds, Series of 2007, initial issue \$25,000,000, various interest rates ranging from 4.250% to 5.000%, maturing in amounts ranging from \$125,000 to \$3,860,000 through 2027	24,740,000	(135,000)	24,605,000

Reading Area Water Authority
A Component Unit of the City of Reading

Notes to Financial Statements
 December 31, 2013 and 2012

Note 6 - Long-Term Debt (continued)

	Balance Outstanding January 1, 2013	Additions (Payments)	Balance Outstanding December 31, 2013
Note payable to PENNVEST, maximum drawdown of \$6,550,000, interest only for the first 36 months of the loan, principal and interest due monthly thereafter; interest at 1.274% for the first five years and 2.547% thereafter through 2032, guaranteed by the City of Reading	\$ 5,591,276	\$ (272,496)	\$ 5,318,780
Water Revenue Bond, Series of 2011, initial issue \$50,000,000, various interest rates ranging from 2.350% to 5.250%, maturing in amounts ranging from \$100,000 to \$6,975,000 through 2036	50,000,000	-	50,000,000
Water Revenue Note, Series of 2012, initial issue \$2,459,000, interest at 2.100%, maturing in amounts ranging from \$86,000 to \$249,000 through 2017	2,373,000	(456,990)	1,916,010
	<u>\$ 101,239,276</u>	<u>\$ (2,894,486)</u>	<u>\$ 98,344,790</u>
	Balance Outstanding January 1, 2012	Additions (Payments)	Balance Outstanding December 31, 2012
Guaranteed Water Revenue Bonds, Series of 2003 (Capital Appreciation Bonds), initial issue \$21,080,000, various interest rates ranging from 3.600% to 4.620%, maturing in amounts ranging from \$610,000 to \$2,690,000 through 2020	\$ 20,470,000	\$ (1,935,000)	\$ 18,535,000
Guaranteed Water Revenue Bonds, Series of 2007, initial issue \$25,000,000, various interest rates ranging from 4.250% to 5.000%, maturing in amounts ranging from \$125,000 to \$3,860,000 through 2027	24,875,000	(135,000)	24,740,000

Reading Area Water Authority
A Component Unit of the City of Reading

Notes to Financial Statements
 December 31, 2013 and 2012

Note 6 - Long-Term Debt (continued)

	Balance Outstanding January 1, 2012	Additions (Payments)	Balance Outstanding December 31, 2012
Note payable to PENNVEST, maximum drawdown of \$6,550,000, interest only for the first 36 months of the loan, principal and interest due monthly thereafter; interest at 1.274% for the first five years and 2.547% thereafter through 2032, guaranteed by the City of Reading	\$ 4,681,660	\$ 909,616	\$ 5,591,276
Water Revenue Bond, Series of 2011, initial issue \$50,000,000, various interest rates ranging from 2.350% to 5.250%, maturing in amounts ranging from \$100,000 to \$6,975,000 through 2036	50,000,000	-	50,000,000
Water Revenue Note, Series of 2012, initial issue \$2,459,000, interest at 2.100%, maturing in amounts ranging from \$86,000 to \$249,000 through 2017	-	2,373,000	2,373,000
Note payable to PENNVEST, due in monthly payments of \$18,405, including interest at 3.997% to December 2017, secured by a lien and security interest in substantially all Authority assets	1,176,511	(1,176,511)	-
Note payable to PENNVEST, due in monthly payments of \$111,998, including interest at 1.000% through January 2012, guaranteed by the City of Reading	98,086	(98,086)	-
Guaranteed Water Revenue Bonds, Series of 2002, initial issue \$3,250,000, various interest rates ranging from 1.300% to 4.400%, maturing in amounts ranging from \$190,000 to \$265,000 through 2017	1,450,000	(1,450,000)	-
	<u>\$ 102,751,257</u>	<u>\$ (1,511,981)</u>	<u>\$ 101,239,276</u>

Reading Area Water Authority
A Component Unit of the City of Reading

Notes to Financial Statements
 December 31, 2013 and 2012

Note 6 - Long-Term Debt (continued)

Aggregate maturities required on the long-term debt at December 31, 2013 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
Years Ending December 31:			
2014	\$ 2,913,988	\$ 4,029,468	\$ 6,943,456
2015	3,247,525	4,088,352	7,335,877
2016	3,258,859	4,205,225	7,464,084
2017	3,280,375	4,281,971	7,562,346
2018	3,285,152	4,555,056	7,840,208
2019-2023	16,838,840	21,976,663	38,815,503
2024-2028	20,811,750	14,521,553	35,333,303
2029-2033	24,808,301	9,142,768	33,951,069
2034-2036	19,900,000	2,125,200	22,025,200
	<u>\$ 98,344,790</u>	<u>\$ 68,926,256</u>	<u>\$ 167,271,046</u>
		<u>2013</u>	<u>2012</u>
Total long-term debt		\$ 98,344,790	\$ 101,239,276
Less current maturities		(2,913,988)	(2,894,496)
Less unamortized bond discount		(248,950)	(259,794)
Plus unamortized bond premium		624,178	669,029
Less unamortized interest on capital appreciation bonds		(2,740,297)	(3,392,600)
		<u>\$ 93,065,733</u>	<u>\$ 95,361,415</u>

Covenants

The Water Revenue Bond, Series of 2011, is subject to financial covenants, including a rate covenant. At December 31, 2013, the Authority was in compliance with these financial covenants.

Bonds Payable

The bonds are secured under the indentures by an assignment and pledge to the trustee of receipts and revenues from the water system.

Derivative Financial Instrument

In July 2005, the Authority entered into a forward interest rate swap agreement with a financial institution in conjunction with its Guaranteed Water Revenue Bonds, Series of 2003. The agreement used an underlying index of 67% of the 30-day LIBOR versus the BMA Municipal Bond Index.

Reading Area Water Authority
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Notes to Financial Statements
 December 31, 2013 and 2012

Note 6 - Long-Term Debt (continued)

Derivative Financial Instrument (continued)

The swap was a cash flow hedge - a pay-fixed interest rate swap. The classification of the interest rate swap was deferred outflow. In September 2012, the Authority terminated its interest rate swap.

2012					
Original Notional Amount	Effective Date	Maturity Date	January 1, Beginning	Increase (Decrease)	December 31, Ending
\$ 20,470,000	July 1, 2005	November 1, 2020	\$ (124,391)	\$ 124,391	\$ -

Note 7 - Operating Lease

The Authority has entered into a 99-year operating lease, effective June 1, 1994, with the City for the operations of the water system through 2093. Lease payments are the sum of agreed-upon administrative expenses, operating expenses, debt service expenses and financing fees of the City. In addition, the Authority must provide water service free of charge to the City. Lease payments are made monthly based on an estimate of the anticipated lease payments for the year. At the end of the year, the Authority receives an annual reconciliation statement, which reflects a credit due to the Authority or a payment due to the City. Total lease expense for the years ended December 31, 2013 and 2012 was \$8,831,775 and \$13,329,961, respectively.

In December 2010, a Second Addendum to the lease was agreed upon by the City and the Authority. The Addendum authorized the Authority to directly employ the City's Water Department employees at various dates beginning in January 2011, as defined therein. During 2012, the Authority began to directly pay and record operating expenses. Prior to 2012, the various operating expenses were paid by the City and reimbursed by the Authority through the lease payment. The lease payment has decreased as a result of a corresponding increase in other operating expenses.

The Addendum also required the payment by the Authority to the City of \$1,020,000 for restriction on the City's Ontelaunee Township property. Under the Addendum, except in the exercise of its Take-Back Powers or with the Authority's prior written approval, the City cannot voluntarily convey or transfer any property interest in the approximate 120-acre parcel of land located in Ontelaunee Township.

**Reading Area Water Authority
A Component Unit of the City of Reading**

Notes to Financial Statements
December 31, 2013 and 2012

Note 7 - Operating Lease (continued)

In June 2012, a Third Addendum to the lease was agreed upon by the City and the Authority to facilitate additional payments to the City by the Authority to assist in the Act 47 recovery program of the City. In addition to the lease payment to the City for operational and administrative expenses, the Authority is to pay a financing fee and meter surcharge payment. Financing fees due subsequent to December 31, 2014 will be calculated and paid in accordance with the terms of the original amended lease agreement. The meter surcharge payment shall continue annually in accordance with the original amended agreement. The following is a schedule of the future minimum lease payments under the Third Addendum for the financing fee and meter surcharge payment:

Years Ending December 31:	
2014	\$ 8,370,000
2015	4,907,027
2016	4,955,453
2017	5,004,610
2018	5,054,510
Thereafter	<u>603,007,637</u>
	<u>\$ 631,299,237</u>

Note 8 - Retirement Plan

During 2011, the Authority adopted a retirement plan covering salary deferral for those employees who meet the eligibility requirements set forth in the plan. The amount of the contribution for salary deferral is at the discretion of the employee subject to the provisions of Section 457(b) of the Internal Revenue Code. Under terms of the plan, the Authority may make discretionary matching contributions. The Authority reflects its contributions to the plan as an operating expense. For the years ended December 31, 2013 and 2012, \$66,841 and \$68,965, respectively, was contributed to the plan.

Note 9 - Commitments and Contingencies

Commitments

Management Agreement

The Authority has entered into an agreement with Miller Environmental, Inc. for the services of a water filter plant manager and the services of Executive Director, who is responsible for the management of all operational and maintenance activities of the water filter plant. The agreement is automatically renewable annually unless one of the parties gives written notice of their intent to terminate the agreement. Total expense under the agreement for the years ended December 31, 2013 and 2012 was \$357,433 and \$214,849, respectively.

**Reading Area Water Authority
A Component Unit of the City of Reading**

Notes to Financial Statements
December 31, 2013 and 2012

Note 9 - Commitments and Contingencies (continued)

Commitments (continued)

Water Reading Services Agreement

The Authority has entered into an agreement with Miller Environmental, Inc. to perform water reading services in the Authority's service area. The agreement was amended in February 2012. Under the terms of the amended agreement, the Authority pays a monthly operating fee of \$44,957 beginning March 1, 2012, plus additional hourly charges for services performed outside the scope of the agreement. The amended agreement expires February 28, 2015 and is automatically renewable for three-year terms unless one of the parties gives written notice of their intent to terminate the agreement. Total expense under the agreement for the years ended December 31, 2013 and 2012 was \$539,483 and \$538,294, respectively.

Capital Improvements

The Authority has entered into contracts for various capital improvements. Outstanding commitments on these contracts totaled approximately \$705,000 as of December 31, 2013.

Trash and Recycling Billing Agreement

In April 2013, the Authority entered a Memorandum of Understanding with the City related to charges for trash and recycling. The Authority assumed the billing and collection billings, at no charge to the City, beginning after January 1, 2013. In addition, the City released to the Authority the accounts receivable that result from the billing of such trash and recycling service charges. In exchange for the transfer of the receivables, the Authority is to make payments to the City of a determined amount on April 30, 2013 and September 30, 2013. The Authority will also pay a differential on the amount collected on delinquent accounts from January 1, 2013 through December 31, 2013. For years after 2013, the payments to be made to the City are as defined in the agreement and are paid monthly. The agreement is through December 31, 2014 and, thereafter, on a year-to-year basis unless either party notifies the other by August 31 of any calendar year of its intention to terminate the agreement. The net revenue earned from trash and recycling for the years ended December 31, 2013 and 2012 was \$475,329 and \$-0-, respectively.

Contingencies

Letter of Credit

The Authority has a letter of credit of \$800,000 for general Authority matters. The Authority also has letters of credit required by the Commonwealth of Pennsylvania in connection with capital improvement projects in the amount of \$2,566,580. At December 31, 2013, all letters of credit were unused.

Reading Area Water Authority
A Component Unit of the City of Reading

Notes to Financial Statements
December 31, 2013 and 2012

Note 9 - Commitments and Contingencies (continued)

Contingencies (continued)

Concentration of Labor

The Authority has entered into a collective bargaining agreement with the employees who operate and maintain the Authority's facilities effective through December 31, 2015. Of the Authority's total workforce, 90% is covered by the agreement.

Litigation

At December 31, 2013, the Authority was a defendant in a lawsuit regarding the accuracy of customer receivable balances. In May 2014, an unfavorable ruling was made in the matter and, in June 2014, the Authority appealed the Judge's ruling. At December 31, 2013, the Authority's portion of the amount in dispute was approximately \$207,000, of which \$186,000 has been reserved as uncollectible.

In the normal course of business, the Authority is involved in various legal proceedings. In the opinion of management, any liability resulting from such proceedings would not have a material adverse effect on the financial statements.

Note 10 - Change in Accounting Estimate

During 2012, the Authority changed the methodology of the calculation of the allowance for uncollectible accounts receivable. The change resulted in a reduction of the allowance for uncollectible accounts receivable of \$2,332,339 for the year ended December 31, 2012.

Note 11 - Reclassification of 2012 Financial Statements

Certain items on the 2012 financial statements have been reclassified to conform to the 2013 financial statement presentation.

**Reading Area Water Authority
A Component Unit of the City of Reading**

Notes to Financial Statements
December 31, 2013 and 2012

Note 12 - Restatement of 2012 Financial Statements

The 2012 financial statements were restated to record additional unbilled water usage and to expense accrued compensated absences. The following financial statement line items for the years ended December 31, 2013 and 2012 were affected by this restatement:

Statement of Net Position, December 31, 2012			
	Previously Stated	Restated	Effect of Change
Assets			
Unbilled water usage	\$ -	\$ 612,124	\$ 612,124
Liabilities			
Accrued payroll and compensated absences	\$ 59,726	\$ 331,885	\$ 272,159
Net Position			
Unrestricted (deficit)	\$ (673,193)	\$ (333,228)	\$ 339,965
Statement of Revenues, Expenses and Changes in Net Position, Year Ended December 31, 2012			
	Previously Stated	Restated	Effect of Change
Operating Revenues			
Water billings	\$ 22,677,064	\$ 23,289,188	\$ 612,124
Operating Expenses			
Salaries and payroll taxes	\$ 3,402,483	\$ 3,674,642	\$ 272,159
Net Position at End of Year	\$ 3,426,715	\$ 3,766,680	\$ 339,965

Note 13 - Subsequent Events

The Authority has evaluated subsequent events through July 16, 2014. This date is the date the financial statements were available to be issued. The following subsequent events were noted:

In April 2014, the Authority and the City began negotiations regarding the terms of the water system lease agreement. As of the date of this report, there are no ongoing negotiations.

Reading Area Water Authority
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Notes to Financial Statements
December 31, 2013 and 2012

Note 13 - Subsequent Events (continued)

In May 2014, the City passed a resolution under Section 5619 of the Pennsylvania Municipal Authorities Act to terminate the lease and operating agreement, dissolve the Authority and require the Authority to convey the water system and all property of the Authority to the City. Under the Act, the City must satisfy all outstanding obligations of the Authority prior to transfer of the assets. The City has also requested that all current Authority Board Members resign their positions so that a new Board can be appointed. Substantial doubt about the Authority's ability to continue as a going concern is raised as a result of the above mentioned items.