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READING AREA WATER AUTHORITY

A COMPONENT UNIT OF THE CITY OF READING

FINANCIAL REPORT

DECEMBER 31, 2010

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the Reading Area Water Authority, a component unit of the City of Reading, Pennsylvania, as of and for the years ended December 31, 2010 and 2009, as listed in the table of contents. These financial statements are the responsibility of the Reading Area Water Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, 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 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.

As of December 31, 2010, the Authority was unable to provide records that reflect accounts receivable balances due by customer.

In our opinion, except for the effects of such adjustments on the 2010 financial statements, if any, as might have been determined necessary had we been able to examine records reflecting accounts receivable balances due by customer, 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, 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.

The Management's Discussion and Analysis on Pages 2 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

**Wyomissing, Pennsylvania
, 2011**

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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, 2010.

Financial Highlights

- Unrestricted current assets exceed current liabilities by \$ 6,412,769 at the close of the year. This is compared to \$ 8,369,835 and \$ 7,383,330 at the close of the 2009 and 2008 years, respectively.
- Total net assets increased (decreased) by \$ (1,145,295) and \$ 947,971 at the close of the 2010 and 2009 years over the total net assets balance at the close of the 2009 and 2008 years, respectively. The 2010 decrease is largely due to an increase in lease payments to the City of \$ 2,718,937 in addition to \$ 308,000 in expenses related to a rate study, ISO flow testing and dredging of Lake Ontelaunee.
- The Authority had a net operating income of \$ 606,164 at the close of the year compared to a net operating income of \$ 2,127,292 and \$ 1,401,145 at the close of the 2009 and 2008 years, respectively. This decrease in net operating income is the result of and an increase in operating expenses of \$ 3,221,000.
- The statement of cash flows, which identifies the sources and uses of cash activities for the fiscal year, indicates that operating cash increased by \$ 314,998 and decreased \$ 1,598,967 and \$ 665,979 at the close of the 2010 and 2009 fiscal years, respectively, compared to the cash balance at the close of the 2009 and 2008 years, respectively. The 2010 increase is largely due to the increase in net cash provided by operating activities.
- During the year ended December 31, 2010, the Authority adopted Government Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivates*. The December 31, 2010 and 2009 statements of net assets include a liability for interest rate swaps of \$ 332,995 and \$ 226,475, respectively. The statements of revenues, expenses and changes in net assets for the years ended December 31, 2010 and 2009 include a nonoperating revenue (expense) item of \$ (106,520) and \$ 582,057, respectively, for the change in value of the interest rate swaps. The January 1, 2009 net assets were decreased by \$ 808,532 to reflect the interest rate swap liability at January 1, 2009.

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 in for profit businesses in the private sector. The basic financial statements include statements of net assets, statements of revenues, expenses and changes in net assets, statements of cash flows and notes to the financial statements.

The statements of net assets present information on the assets and liabilities, with the difference between assets and liabilities reported as net assets. The increases and decreases in net assets over time may be a useful indicator of the finances of the Authority as to whether it is improving or deteriorating.

The statements of revenues, expenses and changes in net assets of the Authority for the year show the detail of net income or loss being combined with the beginning net assets balance, resulting in the ending net assets for the year.

The statements of cash flows report 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.

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 Assets. The following schedule presents a summary of net assets comparison for the years ended December 31, 2010, 2009 and 2008:

	2010	2009	2008
Unrestricted current assets	\$ 10,983,068	\$ 10,962,104	\$ 10,734,442
Restricted current assets	16,610,866	20,246,512	24,852,146
Capital assets, net	28,439,474	20,734,347	16,568,878
Other assets, net	<u>3,286,527</u>	<u>3,653,376</u>	<u>5,027,071</u>
Total assets	<u>59,319,935</u>	<u>55,596,339</u>	<u>57,182,537</u>
Current liabilities	4,570,299	2,592,269	3,351,112
Other long term liability, interest rate swap	332,995	226,475	808,532
Long-term debt, net	<u>48,699,114</u>	<u>45,914,773</u>	<u>47,108,042</u>
Total liabilities	<u>53,602,408</u>	<u>48,733,517</u>	<u>51,267,686</u>
Net assets:			
Invested in capital assets, net	-	-	-
Restricted for debt service	4,044,555	4,399,356	5,442,317
Unrestricted assets	<u>1,672,972</u>	<u>2,463,466</u>	<u>472,534</u>
Total net assets	<u>\$ 5,717,527</u>	<u>\$ 6,862,822</u>	<u>\$ 5,914,851</u>

A large portion of the Authority's total current assets is invested in construction funds, (e.g., cash restricted for infrastructure and improvements).

Current liabilities increased by 76.3% in 2010 compared to a decrease of 22.6% in 2009, mostly because of the increase in current maturities of long-term debt and increase in trade accounts payable, specifically for a \$ 1,020,000 payment to the City of Reading for rights to leased land.

Revenues. The following schedule presents a summary of revenue for the years ended December 31, 2010, 2009 and 2008:

	2010	2009	2008
Water billings	\$ 19,987,932	\$ 18,237,476	\$ 16,604,898
Interest and penalty charges	395,410	415,319	341,901
Tampered meter and other charges	397,579	282,498	189,553
Tapping and connection fees	157,335	157,979	283,575
Abandonment fees	<u>51,519</u>	<u>21,419</u>	<u>87,264</u>
Total operating revenues	<u>\$ 20,989,775</u>	<u>\$ 19,114,691</u>	<u>\$ 17,507,191</u>

The 2010 fiscal year's total operating revenue increased by 9.8% compared to 2009 and increased by 9.2% in 2009 and decreased (1.8%) in 2008.

Expenses. The following schedule presents a summary of expenses for the years ended December 31, 2010, 2009 and 2008:

	2010	2009	2008
Operating expenses:			
Lease payments, City of Reading	\$ 16,790,137	\$ 14,071,200	\$ 13,276,508
Meter reading	498,226	474,501	451,906
Other	<u>1,950,421</u>	<u>1,471,949</u>	<u>1,642,129</u>
Total operating expenses	<u>\$ 19,238,784</u>	<u>\$ 16,017,650</u>	<u>\$ 15,370,543</u>

The largest portion of the \$ 3,221,134 increase in expenses is the result of an increase in lease payments to the City of Reading in the amount of \$ 2,718,937.

Changes in Net Assets. The following schedule presents a summary of changes in net assets for the years ended December 31, 2010, 2009 and 2008:

	2010	2009	2008
Operating revenues	\$ 20,989,775	\$ 19,114,691	\$ 17,507,191
Operating expenses	<u>19,238,784</u>	<u>16,017,650</u>	<u>15,370,543</u>
Operating income before depreciation and amortization	1,750,991	3,097,041	2,136,648
Depreciation and amortization	<u>1,144,827</u>	<u>969,749</u>	<u>735,503</u>
Operating income	606,164	2,127,292	1,401,145
Nonoperating revenues (expenses)	<u>(1,751,459)</u>	<u>(1,179,321)</u>	<u>(1,403,342)</u>
Income (loss) before capital contributions	(1,145,295)	947,971	(2,197)
Capital contributions	<u>-</u>	<u>-</u>	<u>1,460,134</u>
Increase in net assets	<u>\$ (1,145,295)</u>	<u>\$ 947,971</u>	<u>\$ 1,457,937</u>

**Statement of Changes in Net Assets
Year Ended December 31, 2010**

	Beginning Balance	Increase (Decrease)	Ending Balance
Invested in capital assets, net	\$ -	\$ -	\$ -
Restricted	4,399,356	(354,801)	4,044,555
Unrestricted	<u>2,463,466</u>	<u>(790,494)</u>	<u>1,672,972</u>
Total net assets	<u>\$ 6,862,822</u>	<u>\$ (1,145,295)</u>	<u>\$ 5,717,527</u>

**Statement of Changes in Net Assets
Year Ended December 31, 2009**

	Beginning Balance	Increase (Decrease)	Ending Balance
Invested in capital assets, net	\$ -	\$ -	\$ -
Restricted	5,442,317	(1,042,961)	4,399,356
Unrestricted	<u>472,534</u>	<u>1,990,932</u>	<u>2,463,466</u>
Total net assets	<u>\$ 5,914,851</u>	<u>\$ 947,971</u>	<u>\$ 6,862,822</u>

**Statement of Changes in Net Assets
Year Ended December 31, 2008**

	Beginning Balance	Increase	Ending Balance
Invested in capital assets, net	\$ -	\$ -	\$ -
Restricted	4,456,914	985,403	5,442,317
Unrestricted	<u>-</u>	<u>472,534</u>	<u>472,534</u>
Total net assets	<u>\$ 4,456,914</u>	<u>\$ 1,457,937</u>	<u>\$ 5,914,851</u>

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

The Authority's capital assets as of December 31, 2010, 2009 and 2008, net of accumulated depreciation, amounted to \$ 28,439,474, \$ 20,734,347 and \$ 16,568,878, respectively. For the year ended December 31, 2010 this amount represents a net increase (including additions, deletions and depreciation) of \$ 7,705,127 from the prior year. See Note 4 for more information on capital assets.

Debt Administration. At December 31, 2010, the Authority had \$ 55,196,820 of Guaranteed Revenue Bonds and loans payable, compared to \$ 52,331,047 and \$ 54,079,591 at the end of the 2009 and 2008 years, respectively. The proceeds from these long-term borrowings were used for renovations and improvements to the water system. See Note 4 for additional information on the Authority's debt.

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

	2010	2009	2008
Leasehold improvements	\$ 15,730,869	\$ 13,259,803	\$ 13,464,297
Equipment	2,427,454	1,511,080	1,313,418
Vehicles	559,299	561,427	408,689
Computers and software	120,237	73,282	64,145
Construction in process	<u>9,601,615</u>	<u>5,328,755</u>	<u>1,318,329</u>
	<u>\$ 28,439,474</u>	<u>\$ 20,734,347</u>	<u>\$ 16,568,878</u>

Economic Factors

The Reading Area Water 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.

Future investments include relining of water mains throughout the existing system, replacement of water meters to increase revenue, cleaning of finished water reservoirs to uphold water quality, address PADEP requirements for the Lake Ontelaunee Dam and address sediment within Lake Ontelaunee.

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, 815 Washington Street, Reading, PA 19601.

READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING

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STATEMENTS OF NET ASSETS
December 31, 2010 and 2009

ASSETS	2010	2009
UNRESTRICTED CURRENT ASSETS		
Cash	\$ 5,876,463	\$ 5,561,465
Accounts receivable, billings, net of allowance 2010 \$ 2,761,231; 2009 \$ 2,079,125	2,366,265	2,287,226
Due from City of Reading	2,696,356	2,885,349
Accrued interest receivable	43,984	25,082
Accounts receivable, other	-	153,874
Prepaid expenses	-	49,108
	10,983,068	10,962,104
RESTRICTED CURRENT ASSETS		
Developer escrow deposits, cash	96,376	111,835
Trust accounts, cash and investments:		
Clearing Account	93,107	10,177
Construction Account	12,376,828	15,725,144
Debt Service Account	3	334,295
Debt Service Reserve Account	4,044,552	4,065,061
	16,514,490	20,134,677
	16,610,866	20,246,512
CAPITAL ASSETS		
Capital assets not being depreciated, construction in progress	9,601,615	5,328,755
Capital assets being depreciated:		
Leasehold improvements	19,167,334	16,107,640
Equipment	3,808,904	2,588,931
Vehicles	1,654,792	1,491,011
Computers and software	451,593	382,334
	25,082,623	20,569,916
Less accumulated depreciation	6,244,764	5,164,324
	18,837,859	15,405,592
	28,439,474	20,734,347
OTHER ASSETS		
Due from City of Reading, Pennvest loan assumption	1,433,833	2,756,295
Unamortized bond issuance costs, net of accumulated amortization 2010 \$ 360,044; 2009 \$ 295,657	832,694	897,081
Leased land rights	1,020,000	-
	3,286,527	3,653,376
	\$ 59,319,935	\$ 55,596,339

See Notes to Financial Statements.

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READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended December 31, 2010 and 2009

	2010	2009
Operating revenues:		
Water billings	\$ 19,987,932	\$ 18,237,476
Interest and penalty charges	395,410	415,319
Tampered meter and other charges	397,579	282,498
Tapping and connection fees	157,335	157,979
Abandonment fees	51,519	21,419
	<hr/>	<hr/>
Total operating revenues	20,989,775	19,114,691
Operating expenses:		
Lease payments, City of Reading	16,790,137	14,071,200
Meter reading	498,226	474,501
Engineering	38,974	95,930
Legal fees	118,231	85,337
Salaries and payroll taxes	197,650	116,393
Collections expense	155,764	177,026
Insurance	99,231	47,018
Employee benefits	13,854	8,566
Grant expenditures	56,280	112,985
Telephone	11,066	11,032
Contracted services	136,990	123,628
Repairs and maintenance	49,801	86,346
Audit and accounting	64,309	61,356
Bank charges	5,778	12,989
Advertising	1,404	1,860
Education	2,255	4,038
Supplies	8,383	4,385
Bad debt expense	682,106	523,060
Other professional services, rate study	23,045	-
ISO flow testing	122,093	-
Lake Ontelaunee dredging	163,207	-
	<hr/>	<hr/>
Total operating expenses	19,238,784	16,017,650
Operating income before depreciation and amortization	1,750,991	3,097,041

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READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (CONTINUED)
Years Ended December 31, 2010 and 2009

	2010	2009
Depreciation and amortization:		
Depreciation	\$ 1,080,440	\$ 905,362
Amortization of bond issuance costs	<u>64,387</u>	<u>64,387</u>
	<u>1,144,827</u>	<u>969,749</u>
Operating income	<u>606,164</u>	<u>2,127,292</u>
Nonoperating revenues (expenses):		
Investment income	220,419	221,745
Swap income, net	12,587	3,682
Miscellaneous income	26,587	15,607
Change in value of interest rate swap	(106,520)	582,057
Interest expense	(1,994,785)	(1,973,668)
Miscellaneous expense	(11,341)	(33,017)
Grant income	<u>101,594</u>	<u>4,273</u>
	<u>(1,751,459)</u>	<u>(1,179,321)</u>
Increase (decrease) in net assets	(1,145,295)	947,971
Net assets, beginning	<u>6,862,822</u>	<u>5,914,851</u>
Net assets, ending	<u>\$ 5,717,527</u>	<u>\$ 6,862,822</u>

See Notes to Financial Statements.

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**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

**STATEMENTS OF CASH FLOWS
Years Ended December 31, 2010 and 2009**

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	\$ 20,228,630	\$ 18,315,947
Cash payments to suppliers for goods and services	(17,859,672)	(19,707,745)
Cash payments to employees for services	<u>(197,650)</u>	<u>(116,393)</u>
Net cash provided by (used in) operating activities	<u>2,171,308</u>	<u>(1,508,191)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Increase (decrease) in escrow liability, net	(15,798)	(39,173)
Miscellaneous income received	26,587	15,607
Miscellaneous expenses paid	(11,341)	(33,017)
Cash receipts from grants	<u>101,594</u>	<u>4,273</u>
Net cash provided by (used in) noncapital financing activities	<u>101,042</u>	<u>(52,310)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(8,620,505)	(4,513,559)
Proceeds from issuance of debt	6,069,642	-
Principal paid on long-term debt	(1,881,407)	(439,236)
Interest paid on long-term debt	(1,374,832)	(1,384,995)
Capital contributions received	<u>-</u>	<u>1,460,134</u>
Net cash used in capital and related financing activities	<u>(5,807,102)</u>	<u>(4,877,656)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Decrease in restricted assets, net	3,635,646	4,605,634
Swap income received, net	12,587	3,682
Investment income received	<u>201,517</u>	<u>229,874</u>
Net cash provided by investing activities	<u>3,849,750</u>	<u>4,839,190</u>
Net increase (decrease) in cash	314,998	(1,598,967)
Cash:		
Beginning	<u>5,561,465</u>	<u>7,160,432</u>
Ending	<u>\$ 5,876,463</u>	<u>\$ 5,561,465</u>

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**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

**STATEMENTS OF CASH FLOWS (CONTINUED)
Years Ended December 31, 2010 and 2009**

	2010	2009
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES		
Operating income	\$ 606,164	\$ 2,127,292
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Depreciation	1,080,440	905,362
Amortization	64,387	64,387
Changes in assets and liabilities:		
(Increase) in accounts receivable	(79,039)	(275,684)
(Increase) decrease in accounts receivable, other	153,874	(153,874)
(Increase) decrease in prepaid expenses	49,108	(42,135)
Increase in accounts payable	107,381	5,292
(Increase) decrease in due from City of Reading	188,993	(2,885,349)
(Decrease) in due to City of Reading	-	(1,253,482)
	<u>2,171,308</u>	<u>(1,508,191)</u>
Net cash provided by (used in) operating activities	\$ 2,171,308	\$ (1,508,191)
NONCASH CAPITAL AND FINANCING ACTIVITIES		
Payment by City of Reading, Pennvest loan assumption applied to Pennvest note payable	\$ 1,322,462	\$ 1,309,308

See Notes to Financial Statements.

**READING AREA WATER AUTHORITY
A COMPONENT UNIT OF THE CITY OF READING**

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies

Nature of activity:

The Reading Area Water Authority (the "Authority"), a component unit of the City of Reading, was created as an operating authority in 1995 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 of Reading and certain surrounding municipalities. The Authority is governed by a five-member board, each of whom is appointed by the City of Reading.

A summary of the Authority's significant accounting policies follows:

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.

A. THE FINANCIAL REPORTING ENTITY

Accounting principles generally accepted in the United States of America require that the reporting entity include the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. There are no agencies or entities which should be presented with the Authority.

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

B. 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 timing of related cash flows.

Private-sector standards of accounting and financial reporting issued prior to December 31, 1989 are generally followed to the extent that these standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Authority has elected to follow subsequent private-sector guidance, subject to the same limitation.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies (Continued)

A summary of the Authority's significant accounting policies follows (continued):

B. MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION (CONTINUED)

Operating revenues and expenses are distinguished from nonoperating items in the statements of revenues, expenses and changes in net assets. 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 and issue costs. 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, investment income, change in value of interest rate swap and capital contributions.

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

C. ASSETS, LIABILITIES AND NET ASSETS

In accordance with the terms of the trust indenture dated September 15, 2002, the first supplemental indenture dated July 1, 2003, and the second supplemental indenture dated July 15, 2007 (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:

Project accounts:

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 were recorded herein. Current debt service and sinking fund requirements of the bond issues are paid from this Account.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies (Continued)

A summary of the Authority's significant accounting policies follows (continued):

C. ASSETS, LIABILITIES AND NET ASSETS (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 receivables are evaluated for collectability 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.

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.

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.

NOTES TO FINANCIAL STATEMENTS

Note 1. Nature of Activity and Significant Accounting Policies (Continued)

A summary of the Authority's significant accounting policies follows (continued):

C. ASSETS, LIABILITIES AND NET ASSETS (CONTINUED)

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:

	Years
Leasehold improvements	10-40
Equipment	3-7
Vehicles	5-7
Computers and software	3-5

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.

Bond/note premiums/issuance costs:

Bond/note premiums and issuance costs are deferred and amortized over the term of the bonds/notes. Bond premiums are presented as an addition to the face amount of the revenue bonds payable, whereas issuance costs are recorded as an other asset.

Derivatives:

Changes in fair value for effective hedges that are achieved with derivative instruments are recognized in the reporting period to which they relate. Changes in fair value of these hedging derivative instruments do not affect the current period, but are instead reported as deferrals in the statement of net assets. Derivative instruments that either do not meet the criteria for an effective hedge or are associated with investments that are already reported at fair value are classified as investment derivative instruments for financial reporting purposes. Changes in fair value of those derivative instruments are reported in the current reporting period.

NOTES TO FINANCIAL STATEMENTS**Note 1. Nature of Activity and Significant Accounting Policies (Continued)**

A summary of the Authority's significant accounting policies follows (continued):

C. ASSETS, LIABILITIES AND NET ASSETS (CONTINUED)**Net assets:**

Net assets are classified into three categories as follows:

Invested in capital assets consists of capital assets, net of accumulated depreciation and debt incurred for the acquisition of capital assets.

Restricted net assets are amounts that have externally imposed restrictions on how the funds can be spent.

Unrestricted net assets are amounts that do not meet the definitions of "invested in capital assets" or "restricted" and are available for Authority operations.

D. RECENT ACCOUNTING PRONOUNCEMENT

The Authority adopted Government Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivatives*. GASB Statement No. 53 addresses the recognition, measurement and disclosure of information regarding derivative instruments for the year ended December 31, 2010.

Note 2. Stewardship, Compliance and Accountability**Compliance with finance-related legal and contractual provisions:**

The Authority had no material violations of finance-related legal and contractual provisions in regard to the terms, covenants, provisions or conditions contained in the trust indentures relating to the bond issues.

NOTES TO FINANCIAL STATEMENTS

Note 3. Cash and Investments

The carrying amounts of cash and investments at December 31, 2010 and 2009 consist of the following:

	2010	2009
Petty cash	\$ 300	\$ 300
Demand deposit accounts	5,972,539	5,673,000
Investments	<u>16,514,490</u>	<u>20,134,677</u>
	<u>\$ 22,487,329</u>	<u>\$ 25,807,977</u>
Classification per statements of net assets:		
Unrestricted current assets, cash	\$ 5,876,463	\$ 5,561,465
Restricted current assets:		
Developer escrow deposits, cash	96,376	111,835
Trust accounts, cash and investments	<u>16,514,490</u>	<u>20,134,677</u>
	<u>\$ 22,487,329</u>	<u>\$ 25,807,977</u>

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. 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, 2010 and 2009, the carrying amounts of the Authority's bank deposits were \$ 5,972,539 and \$ 5,673,000, respectively, and the bank balances were \$ 5,792,059 and \$ 5,527,419, respectively, of which \$ 500,000 was covered by Federal Depository Insurance each year. The remaining \$ 5,292,059 and \$ 5,027,419, 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. The Authority has a petty cash balance of \$ 300 at December 31, 2010.

NOTES TO FINANCIAL STATEMENTS

Note 3. Cash and Investments (Continued)

Investments:

As of December 31, 2010 and 2009, the Authority has the following investments with M&T Bank:

December 31, 2010	Investment Maturities (in Years)	
	Fair Value	Less than One Year
Federated Treasury Obligation Funds	\$ 5,772,210	\$ 5,772,210
Federal National Mortgage Association Note	3,742,280	3,742,280
Certificates of deposit	7,000,000	7,000,000
	\$ 16,514,490	\$ 16,514,490
December 31, 2009		
Federated Treasury Obligation Funds	\$ 491,546	\$ 491,546
Morgan Stanley Institutional Liquidity Funds, Government Portfolio	16,059,438	16,059,438
Federal Home Loan Mortgage Corp Discount Note	2,530,747	2,530,747
Federal National Mortgage Association Note	1,052,946	1,052,946
	\$ 20,134,677	\$ 20,134,677

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.

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 1.

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, 2010 and 2009, \$ 16,514,490 and \$ 20,134,677, respectively, is held by the investment's counterparty, not in the name of the Authority.

NOTES TO FINANCIAL STATEMENTS

Note 4. Capital Assets

Capital asset activity for the years ended December 31, 2010 and 2009 was as follows:

	----- 2010 -----			
	Balance January 1,	Additions	Deletions	Balance December 31,
Capital assets not being depreciated, construction in progress	<u>\$ 5,328,755</u>	<u>\$ 8,361,436</u>	<u>\$ 4,088,576</u>	<u>\$ 9,601,615</u>
Capital assets being depreciated:				
Leasehold improvements	16,107,640	3,059,694	-	19,167,334
Equipment	2,588,931	1,219,973	-	3,808,904
Vehicles	1,491,011	163,781	-	1,654,792
Computers and software	<u>382,334</u>	<u>69,259</u>	-	<u>451,593</u>
Total capital assets being depreciated	<u>20,569,916</u>	<u>4,512,707</u>	<u>-</u>	<u>25,082,623</u>
Less accumulated depreciation for:				
Leasehold improvements	2,847,837	588,628	-	3,436,465
Equipment	1,077,851	303,599	-	1,381,450
Vehicles	929,584	165,909	-	1,095,493
Computers and software	<u>309,052</u>	<u>22,304</u>	-	<u>331,356</u>
Total accumulated depreciation	<u>5,164,324</u>	<u>1,080,440</u>	<u>-</u>	<u>6,244,764</u>
Total capital assets being depreciated, net	<u>15,405,592</u>	<u>3,432,267</u>	<u>-</u>	<u>18,837,859</u>
Total capital assets, net	<u>\$ 20,734,347</u>	<u>\$ 11,793,703</u>	<u>\$ 4,088,576</u>	<u>\$ 28,439,474</u>

NOTES TO FINANCIAL STATEMENTS

Note 4. Capital Assets (Continued)

	2009			
	Balance January 1,	Additions	Deletions	Balance December 31,
Capital assets not being depreciated, construction in progress	\$ <u>1,318,329</u>	\$ <u>4,246,085</u>	\$ <u>235,659</u>	\$ <u>5,328,755</u>
Capital assets being depreciated:				
Leasehold improvements	15,834,380	273,260	-	16,107,640
Equipment	2,150,491	438,440	-	2,588,931
Vehicles	1,168,306	322,705	-	1,491,011
Computers and software	<u>356,334</u>	<u>26,000</u>	-	<u>382,334</u>
Total capital assets being depreciated	<u>19,509,511</u>	<u>1,060,405</u>	-	<u>20,569,916</u>
Less accumulated depreciation for:				
Leasehold improvements	2,370,083	477,754	-	2,847,837
Equipment	837,073	240,778	-	1,077,851
Vehicles	759,617	169,967	-	929,584
Computers and software	<u>292,189</u>	<u>16,863</u>	-	<u>309,052</u>
Total accumulated depreciation	<u>4,258,962</u>	<u>905,362</u>	-	<u>5,164,324</u>
Total capital assets being depreciated, net	<u>15,250,549</u>	<u>155,043</u>	-	<u>15,405,592</u>
Total capital assets, net	<u>\$ 16,568,878</u>	<u>\$ 4,401,128</u>	<u>\$ 235,659</u>	<u>\$ 20,734,347</u>

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt

At December 31, 2010 and 2009, long-term debt consisted of the following:

	2010		
	Balance Outstanding January 1,	Additions (Payments)	Balance Outstanding December 31,
Note payable to a bank in quarterly principal payments ranging from \$21,366 to \$23,300, plus monthly interest payments calculated at a variable rate through February 2011	\$ 114,636	\$ (91,214)	\$ 23,422
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	1,510,116	(163,475)	1,346,641
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	2,756,295	(1,322,462)	1,433,833
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	1,870,000	(205,000)	1,665,000
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	21,080,000	-	21,080,000
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	25,000,000	-	25,000,000
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 first 5 years and 2.547% thereafter. Guaranteed by the City of Reading	-	2,875,070	2,875,070

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt (Continued)

	2010		
	Balance Outstanding January 1,	Additions (Payments)	Balance Outstanding December 31,
Water Revenue Note, Series of 2009, maximum drawdown of \$ 6,550,000, interest payable monthly at 3.15%, with principal due October 2012.	<u>\$ -</u>	<u>\$ 1,772,854</u>	<u>\$ 1,772,854</u>
	<u>\$ 52,331,047</u>	<u>\$ 2,865,773</u>	<u>\$ 55,196,820</u>
	2009		
	Balance Outstanding January 1,	Payments	Balance Outstanding December 31,
Note payable to a bank in quarterly principal payments ranging from \$ 21,366 to \$ 23,300, plus monthly interest payments calculated at a variable rate through February 2011	\$ 201,792	\$ (87,156)	\$ 114,636
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	1,667,196	(157,080)	1,510,116
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	4,065,603	(1,309,308)	2,756,295
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	2,065,000	(195,000)	1,870,000
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	\$ 21,080,000	\$ -	\$ 21,080,000
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	<u>25,000,000</u>	<u>-</u>	<u>25,000,000</u>
	<u>\$ 54,079,591</u>	<u>\$ (1,748,544)</u>	<u>\$ 52,331,047</u>

NOTES TO FINANCIAL STATEMENTS

Note 5. Long-Term Debt (Continued)

Aggregate maturities required on the long-term debt at December 31, 2010 are as follows:

Year Ending	Principal	Interest	Total
2011	\$ 2,479,300	\$ 1,423,974	\$ 3,903,274
2012	4,332,996	1,511,422	5,844,418
2013	2,690,946	1,608,068	4,299,014
2014	2,716,326	1,661,046	4,377,372
2015	2,742,085	1,710,295	4,452,380
2016-2020	14,878,424	10,042,037	24,920,461
2021-2025	16,640,661	4,548,400	21,189,061
2026-2030	8,358,427	669,634	9,028,061
2031-2032	<u>357,655</u>	<u>9,565</u>	<u>367,220</u>
	<u>\$ 55,196,820</u>	<u>\$ 23,184,441</u>	<u>\$ 78,381,261</u>
		2010	2009
Total long-term debt payable		\$ 55,196,820	\$ 52,331,047
Less current maturities		(2,479,300)	(1,782,478)
Plus unamortized bond premium		758,731	803,582
Less unamortized interest on capital appreciation bonds		<u>(4,777,137)</u>	<u>(5,437,378)</u>
		<u>\$ 48,699,114</u>	<u>\$ 45,914,773</u>

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:

Interest rate swap - 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 uses an underlying index of 67% of the 30-day LIBOR versus the BMA Municipal Bond Index.

The swap is a cash flow hedge – a pay-fixed interest rate swap. The classification of the interest rate swap is deferred outflow. The fair value liability as of December 31, 2010 and 2009 was as follows:

----- 2010 -----					
Notional Amount	Effective Date	Maturity Date	January 1, Beginning	Increase (Decrease)	December 31, Ending
\$ 21,080,000	July 1, 2005	November 1, 2020	\$ (226,475)	\$ (106,250)	\$ (332,995)
----- 2009 -----					
\$ 21,080,000	July 1, 2005	November 1, 2020	\$ (808,532)	\$ 582,057	\$ (226,475)

Note 6. Operating Lease

The Authority has entered into a 99-year operating lease, effective June 1, 1994, with the City of Reading for the operations of the water system. Lease payments are the sum of agreed-upon administrative expenses, operating expenses, debt service expenses and financing fees of the City of Reading. 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, 2010 and 2009 was \$ 16,790,137 and \$ 14,071,200, respectively.

In December 2010, a Second Addendum to the lease was agreed upon by the City of Reading and the Authority. The Addendum authorizes the Authority to directly employ the City's Water Department employees at various dates beginning in January 2011, as defined therein. Upon employment by the Authority of each employee, the lease payment to the City of Reading shall be reduced by the operational expenses and administrative expenses directly attributed to the City's employment of such employee for the period following such employment.

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 approximately 120 acre parcel of land located in Ontelaunee Township.

Note 7. Commitments and Contingency

Commitments:

Management agreement:

The Authority has entered into an agreement with Miller Environmental, Inc. for the services of a qualified water filter plant manager, 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, 2010 and 2009 was \$ 136,990 and \$ 123,628, respectively.

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. Under the terms of the original agreement, the Authority pays a monthly operating fee of \$ 29,624 plus additional hourly charges for services performed outside the scope of the agreement. The monthly fee and hourly rates are subject to a 5% increase per year, effective March 1 of each year. The agreement was extended March 1, 2006 for a three-year term and is automatically renewable for three-year terms unless one of the parties give written notice of their intent to terminate the agreement. Total expense under the agreement for the years ended December 31, 2010 and 2009 was \$ 498,226 and \$ 474,501, respectively.

NOTES TO FINANCIAL STATEMENTS**Note 7. Commitments and Contingency (Continued)****Commitments (continued):***Capital Improvements:*

The Authority has entered into contracts for various capital improvements. Outstanding commitments on these contracts totaled approximately \$ 1,578,000 as of December 31, 2010.

Purchase of water system:

The Authority has entered into an agreement of sale to purchase a water system in the amount of \$ 800,000. Settlement is expected to occur in 2011.

Contingency:

The Authority has an unused letter of credit of \$ 800,000 at December 31, 2010.

Note 8. Change in Accounting Principle

In connection with the adoption of GASB Statement No. 53, the Authority restated its 2009 financial statements. The effect on the 2009 financial statements was to increase long-term liability, interest rate swap by \$ 226,475, increase the increase in net assets by \$ 582,057 and decrease unrestricted net assets by \$ 808,532. The effect on the 2010 financial statements was to increase long-term liability, interest rate swap by \$ 106,520 and increase the decrease in net assets by \$ 106,520.

Note 9. Subsequent Events

The Authority has evaluated subsequent events through _____, 2011. This date is the date the financial statements were available to be issued. The following subsequent events were noted:

Capital projects:

From January through June 2011, the Authority awarded various contracts for capital projects totaling \$ 3,972,000.

Purchase of property:

In June 2011, the Authority purchased property to be used as administrative offices for \$ 365,000.

Transfer of City of Reading employees:

In July 2011, the City of Reading transferred employment of 42 water department employees to the Authority in accordance with the Second Addendum to the Lease between the City of Reading and the Authority. The estimated annual payroll related to these employees is approximately \$ 1,600,000.

Note 9. Subsequent Events (Continued)

Union contract:

In April 2011, the Authority entered into an agreement with the American Federation of State, County and Municipal Employees, AFL-CIO, and its District Council 88, Local 2763E "Union"). Except for management level employees, supervisors, first-level supervisors, confidential employees and guards, all full-time and part-time nonprofessional employees are represented by the Union.