



A Component Unit of the City of Reading

Financial Statements

December 31, 2016 and 2015



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

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December 31, 2016 and 2015

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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, Berks County, Pennsylvania, a component unit of the City of Reading, as of and for the years ended December 31, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Reading Area Water Authority's basic financial statements as listed in the table of contents.

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, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Report on 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 Governmental Accounting Standards Board 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.

Handwritten signature in black ink that reads "RKL LLP". The letters are stylized and cursive.

August 28, 2017
Wyomissing, Pennsylvania

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

Management's Discussion and Analysis December 31, 2016 and 2015

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 years ended December 31, 2016 and 2015.

Financial Highlights

- Current unrestricted assets exceeded current liabilities by \$14,678,367 at the close of the year. This is compared to \$15,205,652 and \$14,091,165 at the close of the 2015 and 2014 years, respectively.
- Total net position increased by \$1,873,779 and decreased by \$1,972,232 and \$1,278,245 for the years ended 2016, 2015 and 2014, respectively. The 2016 increase is mainly driven by the large increase in water billings as a result of a rate increase in December 2015. The 2015 decrease is largely due to increases in the lease payment to the City of Reading, offset by increases in water billings and other operating revenues and reductions in chemical supplies, repairs and maintenance, and advertising costs. The 2014 decrease is mainly due to increases in the lease payment, chemical supply costs, salaries and employee benefits, contracted services and advertising expenses.
- The Authority had net operating income of \$5,387,351 for 2016, compared to net operating income of \$1,743,646 and \$2,673,073 for 2015 and 2014, respectively. This increase in net operating income is the result of an increase in water billings of \$3,427,243 and a decrease of contracted services of \$392,622.
- 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 resulted from the trash and recycling service charges by the Authority beginning after January 1, 2013. In return, the Authority paid amounts stated in the agreement to the City of Reading, who remained solely responsible for providing the trash and recycling services. This agreement was terminated as of January 1, 2016, however, the Authority continues to bill and collect the trash and recycling charges on behalf of the City of Reading and remits the collections to the City.
- During 2015, the Authority issued Water Revenue Bonds, Series of 2015, in the amount of \$25,130,000. The Bonds were issued to advance refund the Authority's Water Revenue Bonds, Series of 2007.

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.

Reading Area Water Authority
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Management's Discussion and Analysis
 December 31, 2016 and 2015

Basic Financial Statements (continued)

Statement of Net Position - The statement of net position presents information on the assets, deferred outflow of resources, and liabilities, with the difference between assets and deferred outflow of resources 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 increase (decrease) in net position 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 the 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 at December 31, 2016, 2015, and 2014:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Assets			
Unrestricted current assets	\$ 20,614,911	\$ 20,166,451	\$ 21,521,380
Restricted current assets	19,177,064	23,989,566	29,387,551
Capital assets, net	55,262,527	50,940,036	50,269,989
Other asset	1,020,000	1,020,000	1,020,000
Deferred Outflow of Resources	<u>1,346,286</u>	<u>1,500,668</u>	<u>-</u>
Total Assets and Deferred Outflow of Resources	<u>\$ 97,420,788</u>	<u>\$ 97,616,721</u>	<u>\$ 102,198,920</u>
Liabilities			
Current liabilities	\$ 5,936,544	\$ 4,960,799	\$ 7,430,215
Long-term debt	<u>87,200,895</u>	<u>90,246,352</u>	<u>90,386,903</u>
Total Liabilities	<u>\$ 93,137,439</u>	<u>\$ 95,207,151</u>	<u>\$ 97,817,118</u>

Reading Area Water Authority
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Management's Discussion and Analysis
 December 31, 2016 and 2015

Financial Information (continued)

Net Position (continued)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Net Position			
Net investment in capital assets	\$ (22,222,481)	\$ (24,573,489)	\$ (21,640,001)
Restricted for debt service	7,409,503	7,511,562	7,585,313
Unrestricted	<u>19,096,327</u>	<u>19,471,497</u>	<u>18,436,490</u>
Total Net Position	<u>\$ 4,283,349</u>	<u>\$ 2,409,570</u>	<u>\$ 4,381,802</u>

Current liabilities increased by 19.7% in 2016 compared to a decrease by 33.2% in 2015 and an increase of 50.4% in 2014. The 2016 increase is attributable to increases in capital accounts payable.

Revenues - The following schedule presents a summary of revenues for the years ended December 31, 2016, 2015 and 2014:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating Revenues			
Water billings	\$ 29,622,297	\$ 26,195,054	\$ 25,069,812
Interest and penalty charges	586,502	583,221	489,792
Tampered meter and other charges	591,344	789,520	732,964
Tapping and connection fees	86,244	103,322	102,241
Abandonment fees	<u>32,001</u>	<u>14,633</u>	<u>4,333</u>
Total Operating Revenues	<u>\$ 30,918,388</u>	<u>\$ 27,685,750</u>	<u>\$ 26,399,142</u>

The 2016 fiscal year's total operating revenue increased by 11.7% compared to 2015 and increased by 4.6% in 2015 and decreased by 1.4% in 2014, respectively.

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Management's Discussion and Analysis
December 31, 2016 and 2015

Financial Information (continued)

Expenses - The following schedule presents a summary of expenses for the years ended December 31, 2016, 2015 and 2014:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating Expenses			
Lease payments, City of Reading	\$ 11,441,419	\$ 11,522,675	\$ 9,089,655
Chemical supplies	1,197,002	1,120,987	1,563,904
Meter reading	539,483	539,483	539,483
Salaries, payroll taxes and employee benefits	5,480,794	5,307,826	5,266,892
Contracted services	1,089,676	1,482,298	1,439,900
Other	<u>2,835,981</u>	<u>3,025,602</u>	<u>3,295,956</u>
Total Operating Expenses	<u>\$ 22,584,355</u>	<u>\$ 22,998,871</u>	<u>\$ 21,195,790</u>

The \$414,516 decrease in expenses is primarily the result of the decrease in contracted services of \$392,622.

Changes in Net Position - The following schedule presents a summary of changes in net position for the years ended December 31, 2016, 2015 and 2014:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating revenues	\$ 30,918,388	\$ 27,685,750	\$ 26,399,142
Operating expenses	<u>22,584,355</u>	<u>22,998,871</u>	<u>21,195,790</u>
Operating Income before Depreciation	8,334,033	4,686,879	5,203,352
Depreciation	<u>2,946,682</u>	<u>2,943,233</u>	<u>2,530,279</u>
Operating Income	5,387,351	1,743,646	2,673,073
Nonoperating revenues (expenses), net	<u>(3,513,572)</u>	<u>(3,715,878)</u>	<u>(3,951,318)</u>
Increase (Decrease) in Net Position	<u>\$ 1,873,779</u>	<u>\$ (1,972,232)</u>	<u>\$ (1,278,245)</u>

**Reading Area Water Authority
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Management's Discussion and Analysis
December 31, 2016 and 2015

Financial Information (continued)

Changes in Net Position (continued)

**Statement of Changes in Net Position
Year Ended December 31, 2016**

	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Net investment in capital assets	\$ (24,573,489)	\$ 2,351,008	\$ (22,222,481)
Restricted for debt service	7,511,562	(102,059)	7,409,503
Unrestricted (deficit)	<u>19,471,497</u>	<u>(375,170)</u>	<u>19,096,327</u>
Total Net Position	<u>\$ 2,409,570</u>	<u>\$ 1,873,779</u>	<u>\$ 4,283,349</u>

**Statement of Changes in Net Position
Year Ended December 31, 2015**

	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Net investment in capital assets	\$ (21,640,001)	\$ (2,933,488)	\$ (24,573,489)
Restricted for debt service	7,585,313	(73,751)	7,511,562
Unrestricted (deficit)	<u>18,436,490</u>	<u>1,035,007</u>	<u>19,471,497</u>
Total Net Position	<u>\$ 4,381,802</u>	<u>\$ (1,972,232)</u>	<u>\$ 2,409,570</u>

**Statement of Changes in Net Position
Year Ended December 31, 2014**

	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Net investment in capital assets	\$ (23,290,042)	\$ 1,650,041	\$ (21,640,001)
Restricted for debt service	10,122,842	(2,537,529)	7,585,313
Unrestricted (deficit)	<u>18,827,247</u>	<u>(390,757)</u>	<u>18,436,490</u>
Total Net Position	<u>\$ 5,660,047</u>	<u>\$ (1,278,245)</u>	<u>\$ 4,381,802</u>

Capital Assets

The Authority's investment in capital assets includes leasehold improvements, acquired systems, 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.

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Management's Discussion and Analysis
December 31, 2016 and 2015

Capital Assets (continued)

The Authority's capital assets as of December 31, 2016, 2015 and 2014, net of accumulated depreciation, amounted to \$55,262,527, \$50,940,036 and \$50,269,989, respectively. For the year ended December 31, 2016, this amount represents a net increase (including additions, deletions and depreciation) of \$4,322,491 from the prior year. See Note 6 for more information on capital assets.

Capital Assets at December 31
(Net of Accumulated Depreciation)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Leasehold improvements	\$ 38,360,830	\$ 40,037,706	\$ 37,616,723
Acquired systems	762,446	784,326	806,320
Equipment	5,095,974	5,209,505	5,122,523
Vehicles	425,542	537,612	598,521
Computers and software	125,576	86,741	138,743
Construction in progress	<u>10,492,159</u>	<u>4,284,146</u>	<u>5,987,159</u>
	<u>\$ 55,262,527</u>	<u>\$ 50,940,036</u>	<u>\$ 50,269,989</u>

Debt Administration

At December 31, 2016, the Authority had \$89,899,433 of Guaranteed Revenue Bonds and notes payable, compared to \$93,003,292 and \$95,430,816 at the years ended 2015 and 2014, respectively. The proceeds from these long-term borrowings were used for renovations and improvements to the water system. During April 2015, the Authority issued Water Revenue Bonds, Series of 2015, to advance refund the Authority's Water Revenue Bonds, Series of 2007. See Note 7 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.

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

Statement of Net Position

	December 31,	
	2016	2015
Assets		
Current Assets, Unrestricted		
Cash	\$ 15,407,934	\$ 14,376,069
Accounts receivable, water billings, net of allowance 2016 \$1,907,825; 2015 \$1,608,489	3,695,550	3,350,950
Accounts receivable, trash and recycling billings, net of allowance 2016 \$307,193; 2015 \$458,807	37,624	1,010,684
Unbilled water usage	1,210,803	1,075,561
Inventory	222,532	215,376
Prepaid expenses	40,468	137,811
Total Current Assets, Unrestricted	20,614,911	20,166,451
Current Assets, Restricted		
Developer escrow deposits, cash	77,570	141,986
Trust accounts, cash and investments		
Clearing Account	22,881	22,867
Construction Account	11,689,991	16,336,018
Debt Service Account	36	101,741
Debt Service Reserve Account	7,386,586	7,386,954
Total Current Assets, Restricted	19,099,494	23,847,580
Total Current Assets, Restricted	19,177,064	23,989,566
Capital Assets		
Capital assets not being depreciated, construction in progress	10,492,159	4,284,146
Capital assets being depreciated		
Leasehold improvements	49,836,471	49,456,591
Acquired systems	879,745	879,745
Equipment	9,950,024	9,447,037
Vehicles	2,674,806	2,605,395
Computers and software	835,496	726,614
	64,176,542	63,115,382
Accumulated depreciation	(19,406,174)	(16,459,492)
	44,770,368	46,655,890
Total Capital Assets, Net	55,262,527	50,940,036
Other Asset		
Leased land rights	1,020,000	1,020,000
Deferred Outflow of Resources, Refinancing Loss	1,346,286	1,500,668
Total Assets and Deferred Outflow of Resources	97,420,788	97,616,721

See accompanying notes.

	December 31,	
	2016	2015
Liabilities		
Current Liabilities		
Accounts payable, capital	\$ 1,076,056	\$ 498,998
Accounts payable, trade	278,930	276,728
Accrued payroll and compensated absences	588,602	567,245
Accrued interest payable	303,461	300,208
Escrow deposits	77,570	141,986
Other	1,855	1,318
Due to City of Reading	289,680	70,457
Current maturities of long-term debt	<u>3,320,390</u>	<u>3,103,859</u>
Total Current Liabilities	5,936,544	4,960,799
Long-Term Debt, Less Current Maturities	<u>87,200,895</u>	<u>90,246,352</u>
Total Liabilities	<u>93,137,439</u>	<u>95,207,151</u>
Net Position		
Net Position		
Net investment in capital assets	(22,222,481)	(24,573,489)
Restricted for debt service	7,409,503	7,511,562
Unrestricted	<u>19,096,327</u>	<u>19,471,497</u>
Total Net Position	<u>\$ 4,283,349</u>	<u>\$ 2,409,570</u>

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,	
	2016	2015
Operating Revenues		
Water billings	\$ 29,622,297	\$ 26,195,054
Interest and penalty charges	586,502	583,221
Tampered meter and other charges	591,344	789,520
Tapping and connection fees	86,244	103,322
Abandonment fees	32,001	14,633
	30,918,388	27,685,750
Operating Expenses		
Lease payments, City of Reading	11,441,419	11,522,675
Chemical supplies	1,197,002	1,120,987
Meter reading	539,483	539,483
Engineering	48,347	66,906
Legal fees	291,985	319,867
Salaries and payroll taxes	4,432,634	4,284,946
Insurance	151,568	140,636
Employee benefits	1,048,160	1,022,880
Grant expenditures	118,149	229,424
Utilities	565,058	671,628
Contracted services	1,089,676	1,482,298
Repairs and maintenance	658,044	579,027
Audit and accounting	28,750	35,250
Bank charges	237,495	197,778
Dues and subscriptions	20,170	42,184
Advertising	53,440	174,157
Education	4,970	6,208
Supplies	418,509	395,338
Bad debt expense	239,496	167,199
	22,584,355	22,998,871
	8,334,033	4,686,879
Depreciation	2,946,682	2,943,233
	5,387,351	1,743,646

Reading Area Water Authority
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Statement of Revenues, Expenses, and Changes in Net Position (continued)

	Years Ended December 31,	
	2016	2015
Nonoperating Revenues (Expenses)		
Investment income	\$ 124,283	\$ 557,075
Miscellaneous income	525,368	96,533
Interest expense	(4,069,636)	(4,196,513)
Debt issuance costs	-	(297,960)
Miscellaneous expense	(144,484)	(112,421)
Trash and recycling collections, net	50,897	237,408
	<u>(3,513,572)</u>	<u>(3,715,878)</u>
Nonoperating Revenues (Expenses), Net		
	1,873,779	(1,972,232)
Increase (Decrease) in Net Position		
	1,873,779	(1,972,232)
Net Position at Beginning of Year	<u>2,409,570</u>	<u>4,381,802</u>
Net Position at End of Year	<u><u>\$ 4,283,349</u></u>	<u><u>\$ 2,409,570</u></u>

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

Statement of Cash Flows

	Years Ended December 31,	
	2016	2015
Cash Flows from Operating Activities		
Cash receipts from water customers	\$ 30,199,050	\$ 27,261,159
Cash receipts from trash and recycling customers	1,023,957	6,325,881
Cash payments to suppliers for goods and services	(17,600,076)	(19,022,949)
Cash payments to employees for services	(4,411,277)	(4,214,144)
Cash payments to City of Reading for trash and recycling	-	(5,961,887)
Other receipts	525,368	96,533
Other payments	(144,484)	(112,421)
	<u>9,592,538</u>	<u>4,372,172</u>
Net Cash Provided by Operating Activities		
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(6,692,115)	(5,432,424)
Proceeds from long-term debt	-	25,130,000
Premium on long-term debt	-	2,318,963
Principal paid on long-term debt	(3,103,859)	(3,097,524)
Long-term debt escrow deposit	-	(27,138,072)
Interest paid on long-term debt	(3,637,068)	(3,216,197)
Debt issuance costs	-	(297,960)
	<u>(13,433,042)</u>	<u>(11,733,214)</u>
Net Cash Used in Capital and Related Financing Activities		
Cash Flows from Investing Activities		
Decrease in restricted assets, net	4,748,086	5,462,172
Investment income received	124,283	557,075
	<u>4,872,369</u>	<u>6,019,247</u>
Net Cash Provided by Investing Activities		
	<u>1,031,865</u>	<u>(1,341,795)</u>
Net Increase (Decrease) in Cash		
Cash at Beginning of Year	<u>14,376,069</u>	<u>15,717,864</u>
Cash at End of Year	<u>\$ 15,407,934</u>	<u>\$ 14,376,069</u>

Reading Area Water Authority
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Statement of Cash Flows (continued)

	Years Ended December 31,	
	2016	2015
Reconciliation of Operating Income to Net Cash		
Provided by Operating Activities		
Operating income	\$ 5,387,351	\$ 1,743,646
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	2,946,682	2,943,233
Trash and recycling, net	50,897	237,408
Miscellaneous income	525,368	96,533
Miscellaneous expenses	(144,484)	(112,421)
(Increase) decrease in assets		
Accounts receivable, water billings	(344,600)	(100,284)
Unbilled water usage	(135,242)	(157,108)
Accounts receivable, trash and recycling billings	973,060	126,586
Other receivable	-	81,121
Inventory	(7,156)	(16,163)
Prepaid expenses	97,343	78,982
Increase (decrease) in liabilities		
Accounts payable	2,202	(249,929)
Accrued payroll and compensated absences	21,357	70,802
Due to City of Reading	219,223	(371,064)
Other liabilities	537	830
Net Cash Provided by Operating Activities	\$ 9,592,538	\$ 4,372,172

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

Notes to Financial Statements
December 31, 2016 and 2015

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 seven-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 director's 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 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 component units required to be included in the Authority's reporting entity.

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

Use of Estimates

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.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

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
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Notes to Financial Statements
December 31, 2016 and 2015

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, and depreciation on capital assets. 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.

Assets, Deferred Outflow of Resources, 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, the third supplemental indenture dated December 19, 2011, and the fourth supplemental indenture dated April 15, 2015 (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.

Debt Service Reserve Account

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

Reading Area Water Authority
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Notes to Financial Statements
December 31, 2016 and 2015

Note 2 - Summary of Significant Accounting Policies (continued)

Assets, Deferred Outflow of Resources, Liabilities, and Net Position (continued)

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.

When making investments, the Board and trustee (as governed by the trust indentures) 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.

Reading Area Water Authority
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Notes to Financial Statements
December 31, 2016 and 2015

Note 2 - Summary of Significant Accounting Policies (continued)

Assets, Deferred Outflow of Resources, Liabilities, and Net Position (continued)

Capital Assets

Capital assets are recorded at cost and depreciated utilizing the straight-line method over their estimated useful lives as follows:

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.

Bond Premiums, Discounts, and Deferred Refinancing Losses

Bond premiums, discounts, and deferred refinancing losses are deferred and amortized over the term of the bonds using the effective interest method. Unamortized bond premiums and discounts are presented as an addition or deduction to the face amount of the revenue bonds payable, whereas deferred refinancing losses are recorded as a deferred outflow of resources.

Deferred Outflow of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflow of resources. This separate financial statement element represents a consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expense) until then. The Authority has a deferred outflow of resources related to a loss on refunding of bonds that results from the difference in the carrying value of refunded debt and its reacquisition price. The amount is deferred and amortized over the shorter of the life of the refunded or refunding debt.

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, 2016 and 2015

Note 2 - Summary of Significant Accounting Policies (continued)

Assets, Deferred Outflow of Resources, Liabilities, and Net Position (continued)

Net Position

Net position is classified into three categories as follows:

Net investment in capital assets - Consists of capital assets, net of accumulated depreciation, deferred outflow of resources, refinancing loss, and debt incurred for the acquisition of capital assets.

Restricted - Amounts that have externally imposed restrictions on how the funds can be spent.

Unrestricted - Amounts that do not meet the definitions of "investment in capital assets" or "restricted" and are available for Authority operations.

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

Recent Accounting Pronouncement

Effective January 1, 2016, the Authority adopted Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurement and Application*. This Statement provides guidance for determining a fair value measurement for financial reporting purposes and defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement also provides guidance for applying fair value to certain investments and disclosures related to fair value measurements.

Note 3 - Stewardship, Compliance, and Accountability

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.

Note 4 - Cash and Investments

The Authority's available cash is invested in demand deposit accounts, petty cash, and investments. The carrying amounts of cash and investments consist of the following at December 31:

	<u>2016</u>	<u>2015</u>
Petty cash	\$ 550	\$ 550
Demand deposit accounts	15,484,954	14,517,505
Money market mutual funds	17,880,255	22,627,963
U.S. Treasury securities	1,219,239	1,219,617
	<u>\$ 34,584,998</u>	<u>\$ 38,365,635</u>

Reading Area Water Authority
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Notes to Financial Statements
 December 31, 2016 and 2015

Note 4 - Cash and Investments (continued)

The Authority's cash and investments were classified per the statement of net position as follows at December 31:

	<u>2016</u>	<u>2015</u>
Unrestricted current assets, cash	\$ 15,407,934	\$ 14,376,069
Restricted current assets		
Developer escrow deposits, cash	77,570	141,986
Trust accounts, cash and investments	<u>19,099,494</u>	<u>23,847,580</u>
	<u>\$ 34,584,998</u>	<u>\$ 38,365,635</u>

Custodial Credit Risk - Cash

Custodial risk is the risk that, in the event of a bank 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, 2016 and 2015, the carrying amounts of the Authority's bank deposits were \$15,484,954 and \$14,517,505, respectively, and the bank balances were \$15,991,016 and \$14,510,549, respectively, of which \$453,204 and \$357,108 were covered by Federal Depository Insurance, respectively. The remaining \$15,537,812 and \$14,153,441, 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

The Authority has the following investments as of December 31:

	<u>Investment Maturities (in Years)</u>	
	<u>Fair Value</u>	<u>Less than One Year</u>
2016		
Federated Treasury Obligation Funds	\$ 17,880,255	\$ 17,880,255
Federal Home Loan Bank Note	<u>1,219,239</u>	<u>1,219,239</u>
	<u>\$ 19,099,494</u>	<u>\$ 19,099,494</u>
2015		
Federated Treasury Obligation Funds	\$ 22,627,963	\$ 22,627,963
Federal Home Loan Bank Note	<u>1,219,617</u>	<u>1,219,617</u>
	<u>\$ 23,847,580</u>	<u>\$ 23,847,580</u>

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

Notes to Financial Statements
December 31, 2016 and 2015

Note 4 - Cash and Investments (continued)

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 2.

Custodial Credit Risk - Investments

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, 2016 and 2015, \$19,099,494 and \$23,847,580, respectively, is held by the investment's counterparty, not in the name of the Authority.

Note 5 - Fair Value Measurements

The Authority categorizes its fair value measurements within the fair value hierarchy established by United States of America generally accepted accounting principles. The hierarchy sets out a fair value hierarchy with the highest priority being quoted prices in active markets (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement). Accordingly, the degree of judgment exercised in determining fair value is greatest for instruments categorized in Level 3. The inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the fair value hierarchy classification is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Fair value measurements will be classified and disclosed in one of the following three categories:

Level 1 - Quoted market prices in active markets for identical assets or liabilities.

Level 2 - Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3 - Unobservable inputs that are not corroborated by market data.

Reading Area Water Authority
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Notes to Financial Statements
 December 31, 2016 and 2015

Note 5 - Fair Value Measurements (continued)

The following tables present the balances of fair value measurements on a recurring basis by level within the hierarchy as of December 31:

Fair Value Measurements at December 31, 2016				
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Investments Measured at Fair Value				
U.S. Treasury securities, Federal Home Loan Bank Note	\$ -	\$ 1,219,239	\$ -	\$ 1,219,239
Investment Measured at Net Asset Value (NAV)				
Federated Treasury Obligation Funds				<u>17,880,255</u>
				<u>\$ 19,099,494</u>

Fair Value Measurements at December 31, 2015				
Investments Measured at Fair Value				
U.S. Treasury securities, Federal Home Loan Bank Note	\$ -	\$ 1,219,617	\$ -	\$ 1,219,617
Investment Measured at Net Asset Value (NAV)				
Federated Treasury Obligation Funds				<u>22,627,963</u>
				<u>\$ 23,847,580</u>

Investments classified in Level 2 are valued using a matrix pricing technique. Matrix pricing is used to value securities based on the securities' relationship to benchmark quoted prices.

The Federated Treasury Obligations Funds are valued at net asset value (NAV) of units held. This Fund invests primarily in short-term U.S. Treasury securities and seeks to maintain a stable net asset value of \$1.00 per share. However, it is possible to lose money. Investments in the Federated Treasury Obligation Funds are not insured or guaranteed by the Federal Deposit Insurance Company or any other government agency.

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Notes to Financial Statements
December 31, 2016 and 2015

Note 6 - Capital Assets

Capital asset activity was as follows at December 31:

	Balance January 1, 2016	Additions	Deletions	Balance December 31, 2016
Capital assets not being depreciated				
Construction in progress	\$ 4,284,146	\$ 6,208,013	\$ -	\$ 10,492,159
Capital assets being depreciated				
Leasehold improvements	49,456,591	379,880	-	49,836,471
Acquired systems	879,745	-	-	879,745
Equipment	9,447,037	502,987	-	9,950,024
Vehicles	2,605,395	69,411	-	2,674,806
Computers and software	726,614	108,882	-	835,496
Total capital assets being depreciated	<u>63,115,382</u>	<u>1,061,160</u>	<u>-</u>	<u>64,176,542</u>
Less accumulated depreciation for				
Leasehold improvements	9,418,885	2,056,756	-	11,475,641
Acquired systems	95,419	21,880	-	117,299
Equipment	4,237,532	616,518	-	4,854,050
Vehicles	2,067,783	181,481	-	2,249,264
Computers and software	639,873	70,047	-	709,920
Total accumulated depreciation	<u>16,459,492</u>	<u>2,946,682</u>	<u>-</u>	<u>19,406,174</u>
Total capital assets being depreciated, net	<u>46,655,890</u>	<u>(1,885,522)</u>	<u>-</u>	<u>44,770,368</u>
Total capital assets, net	<u>\$ 50,940,036</u>	<u>\$ 4,322,491</u>	<u>\$ -</u>	<u>\$ 55,262,527</u>

Reading Area Water Authority
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Notes to Financial Statements
December 31, 2016 and 2015

Note 6 - Capital Assets (continued)

	<u>Balance January 1, 2015</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance December 31, 2015</u>
Capital assets not being depreciated				
Construction in progress	\$ 5,987,159	\$ 2,580,653	\$ 4,283,666	\$ 4,284,146
Capital assets being depreciated				
Leasehold improvements	45,030,425	4,426,166	-	49,456,591
Acquired systems	879,745	-	-	879,745
Equipment	8,698,678	748,359	-	9,447,037
Vehicles	2,475,627	129,768	-	2,605,395
Computers and software	714,614	12,000	-	726,614
Total capital assets being depreciated	<u>57,799,089</u>	<u>5,316,293</u>	<u>-</u>	<u>63,115,382</u>
Less accumulated depreciation for				
Leasehold improvements	7,413,702	2,005,183	-	9,418,885
Acquired systems	73,425	21,994	-	95,419
Equipment	3,576,155	661,377	-	4,237,532
Vehicles	1,877,106	190,677	-	2,067,783
Computers and software	575,871	64,002	-	639,873
Total accumulated depreciation	<u>13,516,259</u>	<u>2,943,233</u>	<u>-</u>	<u>16,459,492</u>
Total capital assets being depreciated, net	<u>44,282,830</u>	<u>2,373,060</u>	<u>-</u>	<u>46,655,890</u>
Total capital assets, net	<u>\$ 50,269,989</u>	<u>\$ 4,953,713</u>	<u>\$ 4,283,666</u>	<u>\$ 50,940,036</u>

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

Notes to Financial Statements
 December 31, 2016 and 2015

Note 7 - Long-Term Debt

Long-term debt consists of the following at December 31:

	Balance Outstanding January 1, 2016	Additions (Payments)	Balance Outstanding December 31, 2016	Due Within One Year
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	\$ 12,445,000	\$ (2,185,000)	\$ 10,260,000	\$ 2,190,000
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 the first five years and 2.547% thereafter through 2032, guaranteed by the City of Reading	4,763,267	(265,859)	4,497,408	263,365
Water Revenue Bonds, 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	49,685,000	(165,000)	49,520,000	170,000
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	980,025	(488,000)	492,025	492,025

Reading Area Water Authority
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Notes to Financial Statements
 December 31, 2016 and 2015

Note 7 - Long-Term Debt (continued)

	<u>Balance Outstanding January 1, 2016</u>	<u>Additions (Payments)</u>	<u>Balance Outstanding December 31, 2016</u>	<u>Due Within One Year</u>
Water Revenue Bonds, Series of 2015, initial issue \$25,130,000, various interest rates ranging from 3.000% to 5.000%, maturing in amounts ranging from \$57,000 to \$577,000 through 2027	\$ 25,130,000	\$ -	\$ 25,130,000	\$ 205,000
	<u>\$ 93,003,292</u>	<u>\$ (3,103,859)</u>	<u>\$ 89,899,433</u>	<u>\$ 3,320,390</u>
	<u>Balance Outstanding January 1, 2015</u>	<u>Additions (Payments)</u>	<u>Balance Outstanding December 31, 2015</u>	<u>Due Within One Year</u>
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	\$ 14,475,000	\$ (2,030,000)	\$ 12,445,000	\$ 2,185,000
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. The Bonds were refunded during 2015	24,460,000	(24,460,000)	-	-

Reading Area Water Authority
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Notes to Financial Statements
December 31, 2016 and 2015

Note 7 - Long-Term Debt (continued)

	Balance Outstanding January 1, 2015	Additions (Payments)	Balance Outstanding December 31, 2015	Due Within One Year
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	\$ 5,042,792	\$ (279,525)	\$ 4,763,267	\$ 265,859
Water Revenue Bonds, 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	(315,000)	49,685,000	165,000
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	1,453,024	(472,999)	980,025	488,000
Water Revenue Bonds, Series of 2015, initial issue \$25,130,000, various interest rates ranging from 3.000% to 5.000%, maturing in amounts ranging from \$57,000 to \$577,000 through 2027	-	25,130,000	25,130,000	-
	<u>\$ 95,430,816</u>	<u>\$ (2,427,524)</u>	<u>\$ 93,003,292</u>	<u>\$ 3,103,859</u>

Reading Area Water Authority
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Notes to Financial Statements
December 31, 2016 and 2015

Note 7 - Long-Term Debt (continued)

Aggregate maturities required on the long-term debt at December 31, 2016 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
2017	\$ 3,320,390	\$ 4,059,027	\$ 7,379,417
2018	3,395,152	4,232,369	7,627,521
2019	3,362,113	4,310,163	7,672,276
2020	3,379,254	4,388,616	7,767,870
2021	3,401,579	3,542,301	6,943,880
2022-2026	19,494,553	15,321,560	34,816,113
2027-2031	22,976,392	11,319,317	34,295,709
2032-2036	30,570,000	5,089,086	35,659,086
	<u>\$ 89,899,433</u>	<u>\$ 52,262,439</u>	<u>\$ 142,161,872</u>
		<u>2016</u>	<u>2015</u>
Total long-term debt		\$ 89,899,433	\$ 93,003,292
Less current maturities		(3,320,390)	(3,103,859)
Less unamortized bond discount		(216,420)	(227,263)
Plus unamortized bond premium		1,942,768	2,165,550
Less unamortized interest on capital appreciation bonds		(1,104,496)	(1,591,368)
		<u>\$ 87,200,895</u>	<u>\$ 90,246,352</u>

Covenants

The Water Revenue Bonds, Series of 2011 and Series of 2015, are subject to financial covenants, including a rate covenant. At December 31, 2016, 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.

Refunding of Series of 2007 Guaranteed Water Revenue Bonds

In April 2015, the Authority issued \$25,130,000 in Water Revenue Bonds, Series of 2015, to advance refund the Authority's Guaranteed Water Revenue Bonds, Series of 2007, pay issuance costs and deposit funds into the 2015 Debt Service Reserve Fund. The proceeds of the new bonds were placed in an irrevocable trust to provide for future debt service payments on the Series of 2007 Bonds. The advance refunding resulted in an economic gain (difference between the present value of the debt service payments on the old and new debt) of \$1,534,685. For financial reporting purposes, the debt has been considered defeased. As of December 31, 2016, there was \$24,155,000 of defeased bonds outstanding.

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Notes to Financial Statements
December 31, 2016 and 2015

Note 8 - 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. Under the original lease, the lease payments were 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, 2016 and 2015 was \$11,441,419 and \$11,522,675, 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 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.

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.

In November 2014, a Fourth Addendum to the lease was agreed upon by the City and the Authority. The Addendum states that beginning January 1, 2015, the financing fee component of the lease payment shall be \$9,275,000, which reflects the fair rental value of the Water System. Beginning January 1, 2020, the fee shall be increased by an amount equal to the positive change in the Consumer Price Index for the most recently completed twelve month period multiplied by the amount of the financing fee component of the lease payment for the immediately preceding January 1st or 2.5% per annum, whichever is greater. The meter surcharge payment shall continue annually in accordance with the original amended agreement.

Reading Area Water Authority
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Notes to Financial Statements
December 31, 2016 and 2015

Note 8 - Operating Lease (continued)

During June 2017, the Authority entered into a new lease agreement with the City to repeal and replace the original lease agreement and all addendums in an effort to organize all proceeding agreements and addendums into one complete document. The new lease agreement is effective January 1, 2017 and shall continue until November 30, 2046. The lease payment under the new agreement for 2017 is \$9,275,000, increased by 2% on January 1st of each respective year for 2018 and 2019. For 2020, 2021, and 2022, the amount of the lease payment shall be increased by 1.5% on January 1st of each respective year. For subsequent years the City and the Authority shall engage in good faith negotiations regarding any further annual increases in the lease payments. In the event that both parties are unable to agree on an amount of any further increase, beginning January 1, 2023 and for each year thereafter, the amount of the lease payment shall be increased by 1.5% effective January 1st of each respective year.

In addition, if the Authority enters a contract to supply new commercial customers with water in excess of 10% of the current permitted capacity, the Authority shall pay to the city 25% of the net annual revenues generated by the contract.

The following is a schedule of the future minimum lease payments under the new lease agreement:

2017	\$	9,275,000
2018		9,460,500
2019		9,649,710
2020		9,794,456
2021		9,941,373
Thereafter		<u>303,350,731</u>
	\$	<u>351,471,770</u>

Note 9 - 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, 2016 and 2015, \$80,847 and \$80,815, respectively, was contributed to the plan.

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Notes to Financial Statements
December 31, 2016 and 2015

Note 10 - Commitments and Contingencies

Commitments

Management Agreement

The Authority entered into an agreement with Miller Environmental, Inc. for the services of a water filter plant manager and the services of the executive director, who was responsible for the management of all operational and maintenance activities of the water filter plant. The agreement was automatically renewable annually unless one of the parties gave written notice of their intent to terminate the agreement. During February 2015, the Authority hired a full-time water plant manager and amended the portion of the agreement for these services. In September 2016, the agreement was terminated. Total expense under the agreement for the years ended December 31, 2016 and 2015 was \$296,028 and \$365,097, respectively.

Water Reading Services Agreement

The Authority 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 paid 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 expired February 28, 2015. The agreement was terminated in February 2017. Total expense under the agreement was \$539,483 for each of the years ended December 31, 2016 and 2015.

Capital Improvements

The Authority has entered into contracts for various capital improvements. Outstanding commitments on these contracts totaled approximately \$3,846,000 as of December 31, 2016.

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 of the 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 made payments to the City of a determined amount on April 30, 2013 and September 30, 2013. The Authority also paid a differential on the amount collected on delinquent accounts from January 1, 2013 through December 31, 2013. The agreement was 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.

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

Notes to Financial Statements
December 31, 2016 and 2015

Note 10 - Commitments and Contingencies (continued)

Commitments (continued)

Trash and Recycling Billing Agreement (continued)

In March 2014, a first amendment was approved establishing payments to be made on a monthly basis for 2014 as defined in the amendment. For years after 2014, payments to be made to the City were as defined in the agreement and were to be paid monthly.

The agreement was terminated as of January 1, 2016. The Authority continues to bill and collect the trash and recycling charges on behalf of the City and remits the collections to the City. The net revenue earned from trash and recycling for the years ended December 31, 2016 and 2015 was \$50,897 and \$237,408, respectively.

Contingencies

Letters 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. The maximum amount that can be drawn on the letters of credit is \$4,000,000. At December 31, 2016, all letters of credit were unused.

Concentration of Labor

The Authority has entered into collective bargaining agreements with the employees who operate and maintain the Authority's facilities effective through December 31, 2019. Of the Authority's total workforce, 86% is covered by the agreement.

Litigation

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 11 - Subsequent Events

The Authority has evaluated subsequent events through August 28, 2017. This date is the date the financial statements were available to be issued. The following event was noted subsequent to December 31, 2016:

In July 2017, the Authority entered into a settlement agreement with a customer related to under-billed water usage. The settlement resulted in a payment to the Authority from the customer in the amount of \$1,008,881, which was paid in full during August 2017.

No other material events subsequent to December 31, 2016 were noted.