



**A Component Unit of the City of Reading**

## **Financial Statements**

**December 31, 2017 and 2016**



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

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Table of Contents

December 31, 2017 and 2016

	<b>Page</b>
<b>INDEPENDENT AUDITOR'S REPORT</b>	1 and 2
<b>MANAGEMENT'S DISCUSSION AND ANALYSIS</b>	3 to 8
<b>FINANCIAL STATEMENTS</b>	
Statement of Net Position	9 and 10
Statement of Revenues, Expenses, and Changes in Net Position	11 and 12
Statement of Cash Flows	13 and 14
Notes to Financial Statements	15 to 32



## **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, 2017 and 2016, 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, 2017 and 2016, 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.

RKL LLP

June 19, 2018  
Wyomissing, Pennsylvania

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

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Management's Discussion and Analysis  
December 31, 2017 and 2016

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, 2017 and 2016.

### **Financial Highlights**

- Current unrestricted assets exceeded current liabilities by \$19,066,779 at the close of the year. This is compared to \$14,678,367 and \$15,205,652 at the close of the 2016 and 2015 years, respectively.
- Total net position increased by \$3,088,512, \$1,873,779, and decreased by \$1,972,232 for the years ended 2017, 2016, and 2015, respectively. The 2017 increase is mainly due to an increase in miscellaneous income, and decreases in chemical supply costs, meter reading expense, and contracted services. 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 Authority had net operating income of \$5,550,058 for 2017, compared to net operating income of \$5,342,212 and \$1,702,022 for 2016 and 2015, respectively.
- 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. The agreement to purchase trash and recycling was terminated as of January 1, 2016.
- Per a new agreement, effective January 1, 2016, the Authority continues to bill and collect 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**  
**A Component Unit of the City of Reading**

Management's Discussion and Analysis  
 December 31, 2017 and 2016

**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, 2017, 2016, and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Assets</b>			
Unrestricted current assets	\$ 24,371,571	\$ 20,614,911	\$ 20,166,451
Restricted current assets	11,067,725	19,177,064	23,989,566
Capital assets, net	59,036,648	55,262,527	50,940,036
Other asset	1,020,000	1,020,000	1,020,000
<b>Deferred Outflow of Resources</b>	<u>1,197,798</u>	<u>1,346,286</u>	<u>1,500,668</u>
<b>Total Assets and Deferred Outflow of Resources</b>	<u>\$ 96,693,742</u>	<u>\$ 97,420,788</u>	<u>\$ 97,616,721</u>
<b>Liabilities</b>			
Current liabilities	\$ 5,304,792	\$ 5,936,544	\$ 4,960,799
Long-term debt	<u>84,017,089</u>	<u>87,200,895</u>	<u>90,246,352</u>
<b>Total Liabilities</b>	<u>\$ 89,321,881</u>	<u>\$ 93,137,439</u>	<u>\$ 95,207,151</u>

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

Management's Discussion and Analysis  
 December 31, 2017 and 2016

**Financial Information (continued)**

**Net Position (continued)**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Net Position</b>			
Net investment in capital assets	\$ (23,596,474)	\$ (22,222,481)	\$ (24,573,489)
Restricted for debt service	7,426,839	7,409,503	7,511,562
Unrestricted	<u>23,541,496</u>	<u>19,096,327</u>	<u>19,471,497</u>
<b>Total Net Position</b>	<u>\$ 7,371,861</u>	<u>\$ 4,283,349</u>	<u>\$ 2,409,570</u>

Current liabilities decreased by 10.64% in 2017 compared to an increase by 19.7% in 2016 and a decrease by 33.2% in 2015. The 2017 decrease is attributable to decreases in capital accounts payable.

**Revenues** - The following schedule presents a summary of revenues for the years ended December 31, 2017, 2016, and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Operating Revenues</b>			
Water billings	\$ 29,736,140	\$ 29,622,297	\$ 26,195,054
Interest and penalty charges	472,340	586,502	583,221
Tampered meter and other charges	449,933	591,344	789,520
Tapping and connection fees	177,175	86,244	103,322
Abandonment fees	<u>60,907</u>	<u>32,001</u>	<u>14,633</u>
<b>Total Operating Revenues</b>	<u>\$ 30,896,495</u>	<u>\$ 30,918,388</u>	<u>\$ 27,685,750</u>

The 2017 fiscal year's total operating revenue decreased by 0.1% compared to 2016, and increased by 11.7% and 4.6% in 2016 and 2015, respectively.

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

Management's Discussion and Analysis  
December 31, 2017 and 2016

**Financial Information (continued)**

**Expenses** - The following schedule presents a summary of expenses for the years ended December 31, 2017, 2016, and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Operating Expenses</b>			
Lease payments, City of Reading	\$ 11,426,339	\$ 11,441,419	\$ 11,522,675
Chemical supplies	746,486	1,197,002	1,120,987
Meter reading	-	539,483	539,483
Salaries, payroll taxes, and employee benefits	5,843,215	5,480,794	5,307,826
Contracted services	849,520	1,089,676	1,482,298
Other	<u>3,176,042</u>	<u>2,881,120</u>	<u>3,067,226</u>
<b>Total Operating Expenses</b>	<u>\$ 22,041,602</u>	<u>\$ 22,629,494</u>	<u>\$ 23,040,495</u>

The \$586,586 decrease in expenses is primarily the result of the decrease in chemical supplies, meter reading expense, and contracted services offset by increases in salaries and payroll taxes, employee benefits, repairs and maintenance, and audit and accounting expenses.

**Changes in Net Position** - The following schedule presents a summary of changes in net position for the years ended December 31, 2017, 2016, and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Operating revenues	\$ 30,896,495	\$ 30,918,388	\$ 27,685,750
Operating expenses	<u>22,041,602</u>	<u>22,629,494</u>	<u>23,040,495</u>
<b>Operating Income before Depreciation</b>	<b>8,854,893</b>	8,288,894	4,645,255
Depreciation	<u>3,304,835</u>	<u>2,946,682</u>	<u>2,943,233</u>
<b>Operating Income</b>	<b>5,550,058</b>	5,342,212	1,702,022
Nonoperating revenues (expenses), net	<u>(2,461,546)</u>	<u>(3,468,433)</u>	<u>(3,674,254)</u>
<b>Increase (Decrease) in Net Position</b>	<u>\$ 3,088,512</u>	<u>\$ 1,873,779</u>	<u>\$ (1,972,232)</u>



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

Management's Discussion and Analysis  
December 31, 2017 and 2016

**Financial Information (continued)**

**Changes in Net Position (continued)**

**Statement of Changes in Net Position  
Year Ended December 31, 2017**

	<u>Beginning Balance</u>	<u>Increase (Decrease)</u>	<u>Ending Balance</u>
Net investment in capital assets	\$ (22,222,481)	\$ (1,373,993)	\$ (23,596,474)
Restricted for debt service	7,409,503	17,336	7,426,839
Unrestricted (deficit)	<u>19,096,327</u>	<u>4,445,169</u>	<u>23,541,496</u>
<b>Total Net Position</b>	<b><u>\$ 4,283,349</u></b>	<b><u>\$ 3,088,512</u></b>	<b><u>\$ 7,371,861</u></b>

**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>
<b>Total Net Position</b>	<b><u>\$ 2,409,570</u></b>	<b><u>\$ 1,873,779</u></b>	<b><u>\$ 4,283,349</u></b>

**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>
<b>Total Net Position</b>	<b><u>\$ 4,381,802</u></b>	<b><u>\$ (1,972,232)</u></b>	<b><u>\$ 2,409,570</u></b>

**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.

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

Management's Discussion and Analysis  
December 31, 2017 and 2016

**Capital Assets (continued)**

The Authority's capital assets as of December 31, 2017, 2016, and 2015, net of accumulated depreciation, amounted to \$59,036,648, \$55,262,527, and \$50,940,036, respectively. For the year ended December 31, 2017, this amount represents a net decrease (including additions, deletions, and depreciation) of \$7,246,543 from the prior year. See Note 6 for more information on capital assets.

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

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Leasehold improvements	\$ 42,511,647	\$ 38,360,830	\$ 40,037,706
Acquired systems	740,452	762,446	784,326
Equipment	5,320,486	5,095,974	5,209,505
Vehicles	446,419	425,542	537,612
Computers and software	114,896	125,576	86,741
Construction in progress	<u>9,902,748</u>	<u>10,492,159</u>	<u>4,284,146</u>
	<u>\$ 59,036,648</u>	<u>\$ 55,262,527</u>	<u>\$ 50,940,036</u>

**Debt Administration**

At December 31, 2017, the Authority had \$86,579,043 of Guaranteed Revenue Bonds and notes payable, compared to \$89,899,433 and \$93,003,292 at the years ended 2016 and 2015, 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,	
	2017	2016
<b>Assets</b>		
<b>Current Assets, Unrestricted</b>		
Cash	\$ 19,136,396	\$ 15,407,934
Accounts receivable, water billings, net of allowance 2017 \$1,881,156; 2016 \$1,907,825	3,866,937	3,695,550
Accounts receivable, trash and recycling billings, net of allowance 2017 \$191,257; 2016 \$307,193	28,426	37,624
Unbilled water usage	1,015,535	1,210,803
Inventory	283,809	222,532
Prepaid expenses	40,468	40,468
<b>Total Current Assets, Unrestricted</b>	<b>24,371,571</b>	<b>20,614,911</b>
<b>Current Assets, Restricted</b>		
Developer escrow deposits, cash	59,565	77,570
Trust accounts, cash and investments		
Clearing Account	21,209	22,881
Construction Account	3,581,321	11,689,991
Debt Service Account	21,310	36
Debt Service Reserve Account	7,384,320	7,386,586
	<b>11,008,160</b>	<b>19,099,494</b>
<b>Total Current Assets, Restricted</b>	<b>11,067,725</b>	<b>19,177,064</b>
<b>Capital Assets</b>		
Capital assets not being depreciated, construction in progress	9,902,748	10,492,159
Capital assets being depreciated		
Leasehold improvements	56,404,007	49,836,471
Acquired systems	879,745	879,745
Equipment	10,815,128	9,950,024
Vehicles	2,876,463	2,674,806
Computers and software	869,566	835,496
	<b>71,844,909</b>	<b>64,176,542</b>
Accumulated depreciation	<b>(22,711,009)</b>	<b>(19,406,174)</b>
	<b>49,133,900</b>	<b>44,770,368</b>
<b>Total Capital Assets, Net</b>	<b>59,036,648</b>	<b>55,262,527</b>
<b>Other Asset</b>		
Leased land rights	1,020,000	1,020,000
<b>Deferred Outflow of Resources, Refinancing Loss</b>	<b>1,197,798</b>	<b>1,346,286</b>
<b>Total Assets and Deferred Outflow of Resources</b>	<b>96,693,742</b>	<b>97,420,788</b>

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

Statement of Net Position (continued)

	December 31,	
	2017	2016
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Accounts payable, capital	\$ 432,950	\$ 1,076,056
Accounts payable, trade	332,434	278,930
Accrued payroll and compensated absences	575,619	588,602
Accrued interest payable	301,130	303,461
Escrow deposits	59,565	77,570
Other	3,798	1,855
Due to City of Reading	204,144	289,680
Current maturities of long-term debt	<u>3,395,152</u>	<u>3,320,390</u>
<b>Total Current Liabilities</b>	<b>5,304,792</b>	<b>5,936,544</b>
<b>Long-Term Debt, Less Current Maturities</b>	<b><u>84,017,089</u></b>	<b><u>87,200,895</u></b>
<b>Total Liabilities</b>	<b><u>89,321,881</u></b>	<b><u>93,137,439</u></b>
<b>Net Position</b>		
<b>Net Position</b>		
Net investment in capital assets	(23,596,474)	(22,222,481)
Restricted for debt service	7,426,839	7,409,503
Unrestricted	<u>23,541,496</u>	<u>19,096,327</u>
<b>Total Net Position</b>	<b><u>\$ 7,371,861</u></b>	<b><u>\$ 4,283,349</u></b>

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

Statement of Revenues, Expenses, and Changes in Net Position

	<b>Years Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>Operating Revenues</b>		
Water billings	\$ 29,736,140	\$ 29,622,297
Interest and penalty charges	472,340	586,502
Tampered meter and other charges	449,933	591,344
Tapping and connection fees	177,175	86,244
Abandonment fees	60,907	32,001
	<b>30,896,495</b>	<b>30,918,388</b>
<b>Operating Expenses</b>		
Lease payments, City of Reading	11,426,339	11,441,419
Chemical supplies	746,486	1,197,002
Meter reading	-	539,483
Engineering	156,804	48,347
Legal fees	400,633	291,985
Salaries and payroll taxes	4,633,052	4,432,634
Insurance	146,091	151,568
Employee benefits	1,210,163	1,048,160
Grant expenditures	74,402	118,149
Utilities	593,650	565,058
Contracted services	849,520	1,089,676
Repairs and maintenance	847,105	660,613
Professional services	31,550	28,750
Bank charges	323,014	280,065
Dues and subscriptions	40,105	20,170
Advertising	48,129	53,440
Education	14,844	4,970
Supplies	400,447	418,509
Bad debt expense	99,268	239,496
	<b>22,041,602</b>	<b>22,629,494</b>
	<b>8,854,893</b>	<b>8,288,894</b>
<b>Depreciation</b>	<b>3,304,835</b>	<b>2,946,682</b>
	<b>5,550,058</b>	<b>5,342,212</b>

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

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

	<b>Years Ended December 31,</b>	
	<b>2017</b>	<b>2016</b>
<b>Nonoperating Revenues (Expenses)</b>		
Investment income	\$ 292,510	\$ 124,283
Miscellaneous income	1,464,438	525,368
Interest expense	(3,993,436)	(4,069,636)
Miscellaneous expense	(277,227)	(99,345)
Trash and recycling collections, net	52,169	50,897
	<u>(2,461,546)</u>	<u>(3,468,433)</u>
<b>Nonoperating Revenues (Expenses), Net</b>		
	<u>(2,461,546)</u>	<u>(3,468,433)</u>
<b>Increase in Net Position</b>	<b>3,088,512</b>	<b>1,873,779</b>
<b>Net Position at Beginning of Year</b>	<b>4,283,349</b>	<b>2,409,570</b>
	<u>4,283,349</u>	<u>2,409,570</u>
<b>Net Position at End of Year</b>	<b>\$ 7,371,861</b>	<b>\$ 4,283,349</b>
	<u>\$ 7,371,861</u>	<u>\$ 4,283,349</u>

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

Statement of Cash Flows

	Years Ended December 31,	
	2017	2016
<b>Cash Flows from Operating Activities</b>		
Cash receipts from water customers	\$ 30,821,108	\$ 30,199,050
Cash receipts from trash and recycling customers	61,367	1,023,957
Cash payments to suppliers for goods and services	(17,400,648)	(17,645,215)
Cash payments to employees for services	(4,646,035)	(4,411,277)
Other receipts	1,464,438	525,368
Other payments	(277,227)	(99,345)
	<u>10,023,003</u>	<u>9,592,538</u>
<b>Net Cash Provided by Operating Activities</b>		
<b>Cash Flows from Capital and Related Financing Activities</b>		
Acquisition and construction of capital assets	(7,307,282)	(6,205,243)
Principal paid on long-term debt	(3,320,390)	(3,103,859)
Interest paid on long-term debt	(4,050,713)	(4,123,940)
	<u>(14,678,385)</u>	<u>(13,433,042)</u>
<b>Net Cash Used in Capital and Related Financing Activities</b>		
<b>Cash Flows from Investing Activities</b>		
Decrease in restricted assets, net	8,091,334	4,748,086
Investment income received	292,510	124,283
	<u>8,383,844</u>	<u>4,872,369</u>
<b>Net Cash Provided by Investing Activities</b>		
	<b>3,728,462</b>	1,031,865
<b>Net Increase in Cash</b>		
<b>Cash at Beginning of Year</b>	<u>15,407,934</u>	<u>14,376,069</u>
<b>Cash at End of Year</b>	<u>\$ 19,136,396</u>	<u>\$ 15,407,934</u>

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

Statement of Cash Flows (continued)

	Years Ended December 31,	
	2017	2016
<b>Reconciliation of Operating Income to Net Cash</b>		
<b>Provided by Operating Activities</b>		
Operating income	\$ 5,550,058	\$ 5,342,212
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	3,304,835	2,946,682
Trash and recycling, net	52,169	50,897
Miscellaneous income	1,464,438	525,368
Miscellaneous expenses	(277,227)	(99,345)
(Increase) decrease in assets		
Accounts receivable, water billings	(171,387)	(344,600)
Unbilled water usage	195,268	(135,242)
Accounts receivable, trash and recycling billings	9,198	973,060
Inventory	(61,277)	(7,156)
Prepaid expenses	-	97,343
Increase (decrease) in liabilities		
Accounts payable	53,504	2,202
Accrued payroll and compensated absences	(12,983)	21,357
Due to City of Reading	(85,536)	219,223
Other liabilities	1,943	537
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 10,023,003</b>	<b>\$ 9,592,538</b>



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

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Notes to Financial Statements  
December 31, 2017 and 2016

### **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 Authority operates as an enterprise fund. An enterprise fund is used to account for the financing of services to the general public where all or most of the costs involved are paid in the form of charges to users of such services.

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

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Notes to Financial Statements  
December 31, 2017 and 2016

**Note 2 - Summary of Significant Accounting Policies (continued)**

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

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.

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 investment income and interest expense.

**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**  
**A Component Unit of the City of Reading**

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Notes to Financial Statements  
December 31, 2017 and 2016

**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. Cash and cash equivalents held in trust accounts are considered to be investments.

**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  
A Component Unit of the City of Reading**

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Notes to Financial Statements  
December 31, 2017 and 2016

**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	5 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**  
**A Component Unit of the City of Reading**

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Notes to Financial Statements  
December 31, 2017 and 2016

**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.

**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>2017</u>	<u>2016</u>
Petty cash	\$ 930	\$ 550
Demand deposit accounts	19,195,031	15,484,954
Money market mutual funds	9,794,328	17,880,255
U.S. Treasury securities	1,213,832	1,219,239
	<u>\$ 30,204,121</u>	<u>\$ 34,584,998</u>

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

Notes to Financial Statements  
 December 31, 2017 and 2016

**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>2017</u>	<u>2016</u>
Unrestricted current assets, cash	\$ 19,136,396	\$ 15,407,934
Restricted current assets		
Developer escrow deposits, cash	59,565	77,570
Trust accounts, cash and investments	<u>11,008,160</u>	<u>19,099,494</u>
	<u>\$ 30,204,121</u>	<u>\$ 34,584,998</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, 2017 and 2016, the carrying amounts of the Authority's bank deposits were \$19,195,031 and \$15,484,954, respectively, and the bank balances were \$19,256,314 and \$15,991,016, respectively, of which \$357,140 and \$453,204 were covered by Federal Depository Insurance, respectively. The remaining \$18,899,174 and \$15,537,812, 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>
<b>2017</b>		
Federated Treasury Obligation Funds	\$ 9,794,328	\$ 9,794,328
Federal Home Loan Bank Note	<u>1,213,832</u>	<u>1,213,832</u>
	<u>\$ 11,008,160</u>	<u>\$ 11,008,160</u>
<b>2016</b>		
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>

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

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Notes to Financial Statements  
December 31, 2017 and 2016

**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, 2017 and 2016, \$11,008,160 and \$19,099,494, 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**  
**A Component Unit of the City of Reading**

Notes to Financial Statements  
 December 31, 2017 and 2016

**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:

<b>Fair Value Measurements at December 31, 2017</b>				
	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Total</b>
<b>Investments Measured at Fair Value</b>				
U.S. Treasury securities, Federal Home Loan Bank Note	\$ -	\$ 1,213,832	\$ -	\$ 1,213,832
<b>Investment Measured at Net Asset Value (NAV)</b>				
Federated Treasury Obligation Funds				9,794,328
				<u>\$ 11,008,160</u>
<b>Fair Value Measurements at December 31, 2016</b>				
<b>Investments Measured at Fair Value</b>				
U.S. Treasury securities, Federal Home Loan Bank Note	\$ -	\$ 1,219,239	\$ -	\$ 1,219,239
<b>Investment Measured at Net Asset Value (NAV)</b>				
Federated Treasury Obligation Funds				17,880,255
				<u>\$ 19,099,494</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.



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

Notes to Financial Statements  
December 31, 2017 and 2016

**Note 6 - Capital Assets**

Capital assets activity was as follows at December 31:

	Balance January 1, 2017	Additions	Deletions	Balance December 31, 2017
Capital assets not being depreciated				
Construction in progress	\$ 10,492,159	\$ 6,202,765	\$ 6,792,176	\$ 9,902,748
Capital assets being depreciated				
Leasehold improvements	49,836,471	6,567,536	-	56,404,007
Acquired systems	879,745	-	-	879,745
Equipment	9,950,024	865,104	-	10,815,128
Vehicles	2,674,806	201,657	-	2,876,463
Computers and software	835,496	34,070	-	869,566
Total capital assets being depreciated	64,176,542	7,668,367	-	71,844,909
Less accumulated depreciation for				
Leasehold improvements	11,475,641	2,416,719	-	13,892,360
Acquired systems	117,299	21,994	-	139,293
Equipment	4,854,050	640,592	-	5,494,642
Vehicles	2,249,264	180,780	-	2,430,044
Computers and software	709,920	44,750	-	754,670
Total accumulated depreciation	19,406,174	3,304,835	-	22,711,009
Total capital assets being depreciated, net	44,770,368	4,363,532	-	49,133,900
Total capital assets, net	\$ 55,262,527	\$ 10,566,297	\$ 6,792,176	\$ 59,036,648

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

Notes to Financial Statements  
December 31, 2017 and 2016

**Note 6 - Capital Assets (continued)**

	<u>Balance January 1, 2016</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance December 31, 2016</u>
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**  
**A Component Unit of the City of Reading**

Notes to Financial Statements  
 December 31, 2017 and 2016

**Note 7 - Long-Term Debt**

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

	<b>Balance Outstanding January 1, 2017</b>	<b>Payments</b>	<b>Balance Outstanding December 31, 2017</b>	<b>Due Within One Year</b>
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	\$ 10,260,000	\$ (2,190,000)	\$ 8,070,000	\$ 2,690,000
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	4,497,408	(263,365)	4,234,043	270,152
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	49,520,000	(170,000)	49,350,000	155,000
Water Revenue Note, Series of 2012, initial issue \$2,459,000, interest at 2.100%, matured December 2017	492,025	(492,025)	-	-

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

Notes to Financial Statements  
December 31, 2017 and 2016

**Note 7 - Long-Term Debt (continued)**

	<u>Balance Outstanding January 1, 2017</u>	<u>Payments</u>	<u>Balance Outstanding December 31, 2017</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	\$ (205,000)	\$ 24,925,000	\$ 280,000
	<u>\$ 89,899,433</u>	<u>\$ (3,320,390)</u>	<u>\$ 86,579,043</u>	<u>\$ 3,395,152</u>
	<u>Balance Outstanding January 1, 2016</u>	<u>Payments</u>	<u>Balance Outstanding December 31, 2016</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	\$ 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

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

Notes to Financial Statements  
 December 31, 2017 and 2016

**Note 7 - Long-Term Debt (continued)**

	<b>Balance Outstanding January 1, 2016</b>	<b>Payments</b>	<b>Balance Outstanding December 31, 2016</b>	<b>Due Within One Year</b>
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
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>

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

Notes to Financial Statements  
 December 31, 2017 and 2016

**Note 7 - Long-Term Debt (continued)**

Aggregate maturities required on the long-term debt at December 31, 2017 are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Service</u>
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	3,574,093	3,380,387	6,954,480
2023-2027	20,225,129	14,576,502	34,801,631
2028-2032	23,356,723	10,288,912	33,645,635
2033-2036	25,885,000	3,484,162	29,369,162
	<u>\$ 86,579,043</u>	<u>\$ 48,203,412</u>	<u>\$ 134,782,455</u>
		<u>2017</u>	<u>2016</u>
Total long-term debt		<b>\$ 86,579,043</b>	\$ 89,899,433
Less current maturities		<b>(3,395,152)</b>	(3,320,390)
Less unamortized bond discount		<b>(205,576)</b>	(216,420)
Plus unamortized bond premium		<b>1,728,490</b>	1,942,768
Less unamortized interest on capital appreciation bonds		<b>(689,716)</b>	(1,104,496)
		<u><b>\$ 84,017,089</b></u>	<u>\$ 87,200,895</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, 2017, 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. At December 31, 2016 there was \$24,155,000 of defeased bonds outstanding. The bonds were refunded on June 1, 2017.

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

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Notes to Financial Statements  
December 31, 2017 and 2016

**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, 2017 and 2016 was \$11,426,339 and \$11,441,419, 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**  
**A Component Unit of the City of Reading**

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Notes to Financial Statements  
December 31, 2017 and 2016

**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 was 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:

2018	\$	9,460,500
2019		9,649,710
2020		9,794,456
2021		9,941,372
2022		10,090,493
Thereafter		<u>293,260,238</u>
	\$	<u>342,196,769</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, 2017 and 2016, \$100,229 and \$80,847, respectively, was contributed to the plan.



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

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Notes to Financial Statements  
December 31, 2017 and 2016

**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 2016, 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 year ended December 31, 2016 was \$296,028.

**Capital Improvements**

The Authority has entered into contracts for various capital improvements. Outstanding commitments on these contracts totaled approximately \$460,687 as of December 31, 2017.

**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.

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, 2017 and 2016 was \$52,169 and \$50,897, respectively.

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

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Notes to Financial Statements  
December 31, 2017 and 2016

**Note 10 - Commitments and Contingencies (continued)**

**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 \$3,242,640. The maximum amount that can be drawn on the letters of credit is \$4,000,000. The Authority also has a letter of credit of \$676,060 in connection with capital improvement projects. At December 31, 2017, 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 - Reclassification of 2016 Financial Statements**

Certain items on the 2016 financial statements were reclassified to conform to the 2017 presentation. The reclassification had no impact on the Authority's change in net position.

**Note 12 - Subsequent Events**

The Authority has evaluated subsequent events through June 19, 2018. This date is the date the financial statements were available to be issued. No material events subsequent to December 31, 2017 were noted.