

CITY OF PROVIDENCE, RHODE ISLAND
WATER SUPPLY BOARD

FINANCIAL STATEMENTS
FOR THE YEARS ENDED
June 30, 2013 and 2012

CITY OF PROVIDENCE, RHODE ISLAND
WATER SUPPLY BOARD

TABLE OF CONTENTS
YEARS ENDED JUNE 30, 2013 AND 2012

	<u>PAGE(S)</u>
FINANCIAL SECTION:	
Report of Independent Auditors	1 - 2
 Basic Financial Statements and Required Supplementary Information:	
Management's Discussion and Analysis	3 - 7
 Financial Statements:	
Statement of Net Position	8 - 9
Statements of Revenues and Expenses and Changes in Net Position.....	10
Statements of Cash Flows.....	11
 Notes to the Financial Statements	12 - 24
 Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	25 - 26

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors of
Providence Water Supply Board
Providence, Rhode Island

We have audited the accompanying financial statements of Providence Water Supply Board of Providence, Rhode Island, as of and for the years ended June 30, 2013 and 2012, and the related notes to the 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 auditors' 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 opinions.

Basis for Adverse Opinion

As discussed in Note 1, the financial statements present only the Providence Water Supply Board. Accounting principles generally accepted in the United States of America require that the City of Providence, Rhode Island's financial statements present the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Providence, Rhode Island.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion" paragraph, the financial statements referred to above do not present fairly the financial position of the City of Providence, Rhode Island as of June 30, 2013 and 2012, or the changes in financial position or cash flows thereof for the years then ended.

Unmodified Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Providence Water Supply Board of Providence, Rhode Island, as of June 30, 2013 and 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 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.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated December 31, 2013, on our consideration of the City of Providence, Rhode Island's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering City of Providence, Rhode Island's internal control over financial reporting and compliance.



Providence, Rhode Island
December 31, 2013

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2013 AND 2012

The management of the Providence Water Supply Board (the "Water Supply Board") offers readers of our financial statements the following narrative overview and analysis of our financial activities for the years ended June 30, 2013 and 2012.

Financial Statements

Our financial statements are prepared using proprietary fund (enterprise fund) accounting that uses the same basis of accounting as private-sector business enterprises. Under this method of accounting an economic resources measurement focus and the accrual basis of accounting is used.

Revenue is recorded when earned and expenses are recorded when incurred. The financial statements include statements of net position, statements of revenues, expenses and changes in net position, and statements of cash flows. These statements are followed by notes to the financial statements.

- The statements of net position present information on the assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Water Supply Board is improving or deteriorating.
- The statements of revenues, expenses, and changes in net position report the operating and non-operating revenues and expenses of the Water Supply Board for the fiscal year with the difference – the net income or loss – being combined with any capital contributions to determine the net change in assets for the fiscal year. That change combined with the previous year-end net position total reconciles to the net position at the end of the fiscal year.
- The statements of cash flows report cash and cash equivalents activity for the fiscal year resulting from operating activities, non-capital financing activities, capital and related financing activities, and investing activities. The net result of these activities added to the beginning of the year cash balance reconciles to the cash and cash equivalents balance at the end of the fiscal year.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2013 AND 2012

Condensed Financial Information (in thousands)

Condensed financial information from the statements of net position and revenues, expenses, and changes in net position is presented below.

	<u>2013</u>	<u>2012</u>	<u>2011</u>
Current assets	\$ 52,115	\$ 39,753	\$ 40,695
Capital assets, net	295,297	266,247	254,291
Total assets	<u>347,412</u>	<u>306,000</u>	<u>294,986</u>
Current liabilities	16,107	12,469	12,780
Noncurrent liabilities	78,322	52,081	51,896
Total liabilities	<u>94,429</u>	<u>64,550</u>	<u>64,676</u>
Net position:			
Net investment in capital assets	217,210	213,758	201,281
Restricted	31,512	18,649	18,028
Unrestricted	4,261	9,043	11,001
Total net position	<u>\$ 252,983</u>	<u>\$ 241,450</u>	<u>\$ 230,310</u>
Operating revenues	<u>\$ 61,070</u>	<u>\$ 61,727</u>	<u>\$ 64,017</u>
Operating expenses	38,041	37,404	34,674
Depreciation	<u>12,264</u>	<u>12,191</u>	<u>11,380</u>
Total operating expenses, including depreciation	<u>50,305</u>	<u>49,595</u>	<u>46,054</u>
Operating income	10,765	12,132	17,963
Nonoperating expense	(1,332)	(1,192)	(1,395)
Capital grants and contributions	<u>2,100</u>	<u>200</u>	<u>510</u>
Increase in net position	<u>\$ 11,533</u>	<u>\$ 11,140</u>	<u>\$ 17,078</u>

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2013 AND 2012

Financial Highlights

The Water Supply Board's net position totaled \$ 253 million at June 30, 2013. Total net position increased by \$12 million, or about 5% from June 30, 2012.

During the year, the Water Supply Board had operating revenues that exceeded operating expenses by \$10.8 million. This is primarily due to the large commitment to the replacement of infrastructure included in water rates.

At June 30, 2013, the Water Supply Board's net position totaled \$ 253 million. Total assets were \$347 million, up \$ 41 million from last year's total assets of \$ 306 million.

At June 30, 2012, the Water Supply Board's net position totaled \$ 241 million. Total assets were \$306 million, up \$ 11 million from the prior year's total assets of \$ 295 million.

The Water Supply Board's total operating revenues were \$61 million at June 30, 2013, which decreased from \$61.7 million at June 30, 2012. The total cost of operating the water system, including property taxes and depreciation, was \$50.3 million. This resulted in an operating income of \$10.8 million. Non-operating revenue consists of interest and dividend income. Interest on long-term restricted debt is the largest non-operating expense, followed by miscellaneous and other expenses. Non-operating expense for the fiscal year totaled (\$1.3) million, with capital grants of \$2 million. The total increase in net asset was \$11.5 million.

The decrease in revenue in 2013 was attributable to the decrease in consumption based revenue. The small increase in operating expenses were result of a combination of increases in pension contribution, insurance expenses, and a decrease in chemical and bad debt expenses.

The Water Supply Board's total operating revenues were \$61.7 million at June 30, 2012, which decreased from \$64 million at June 30, 2011. The total cost of operating the water system, including property taxes and depreciation, was \$49.6 million. This resulted in an operating income of \$12.1 million. Non-operating revenue consists of interest and dividend income. Interest on long-term restricted debt is the largest non-operating expense, followed by miscellaneous and other expenses. Non-operating expense for the fiscal year totaled (\$1.2) million, with capital grants of \$.2 million. The total increase in net asset was \$ 11.1 million.

The decrease in revenue in 2012 compared to the 2011 was an attributable to a decrease in consumption base revenue rates. The increases in expenses were result of increase in chemical costs, pension contribution insurance and depreciation expenses, and an increase in bad debt expense.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2013, the Water Supply Board had \$ 295.3 million invested in various capital assets, including land, buildings and improvements, transmission and distribution reservoirs, mains, services, hydrants and appurtenances, machinery and equipment and construction work in progress. This amount represents a net increase of \$ 29 million, or 9.8%, over last year.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2013 AND 2012

Capital Assets and Debt Administration (Continued)

Capital Assets

At June 30, 2012, the Water Supply Board had \$ 266.2 million invested in various capital assets, including land, buildings and improvements, transmission and distribution reservoirs, mains, services, hydrants and appurtenances, machinery and equipment and construction work in progress. This amount represents a net increase of \$ 12 million, or 4.7%, over previous year.

Major project expenditures included (in millions):

- ◆ Replace and Upgrade water mains, \$8.7
- ◆ Sand Filters, \$2.9
- ◆ Sludge maintenance, \$1.0
- ◆ 78" Aqueducts assessment, \$1.0
- ◆ Water Quality Assessment Study, \$0.9
- ◆ Replace fire hydrants, \$0.4
- ◆ Valve & Hydrant Assessment, \$0.5
- ◆ Replace lead services, \$0.6
- ◆ Geographic Info. Systems (GIS), \$0.1
- ◆ Various distribution system improvements \$0.3
- ◆ 102" aqueduct improvements, \$0.5
- ◆ Replace distribution valves, \$0.5
- ◆ Unidirectional Flushing program development, \$0.2
- ◆ Treatment plant architectural upgrades, \$0.1
- ◆ Pump Station improvements, \$0.2

The Water Supply Board's fiscal 2014 capital budget includes projected expenditures of \$26.1 million for infrastructure and capital projects. The major projects are filter replacements, water main replacements and upgrade, plant influent and aerator upgrade, and sludge removal and disposal, Source Water Improvements, treatment plant system upgrades, GIS system, and land acquisition. Other projects will be funded from bond proceeds issued in fiscal year 2013, and with restricted cash funding from rate revenues. The majority of infrastructure projects are financed on a pay-as-you-go, cash basis. New capital additions, that benefit the ratepayers for many years, are paid for with debt financing on an as needed basis.

Debt

At June 30, 2013, the Water Supply Board had \$78.0 million in bonds and notes outstanding versus \$53 million in the previous year. This represented an increase of \$25.6 million or 33%. Total of \$29.2 million in new debts was issued in 2013 to fund watershed land acquisition and water main and/or lead service replacements.

At June 30, 2012, the Water Supply Board had \$52.5 million in bonds and notes outstanding versus \$53 million in the previous year. This represented a decrease of \$.5 million or .9%. \$ 3 million in new debt was issued in 2012 to fund watershed land acquisition

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2013 AND 2012

Contacting Providence Water's Financial Management

This financial report is designed to provide our customers, investors and creditors with a general overview of the Water Supply Board's finances and to show the Water Supply Board's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Finance Department at the Providence Water Supply Board, 552 Academy Avenue, Providence, RI 02908.

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

STATEMENTS OF NET POSITION
JUNE 30, 2013 AND 2012 (000's)

	2013	2012
ASSETS		
Current unrestricted assets		
Cash and cash equivalents (Note 3)	\$ 4,883	\$ 3,174
Accounts receivable, net of allowance for uncollectible accounts of \$1,465 in 2013 and \$2,786 in 2012	8,318	8,439
Accounts receivable - unbilled, net of allowance for uncollectible accounts of \$0 in 2013 and 2012	4,618	4,828
Inventory	645	637
Other assets	744	479
Total current unrestricted assets	19,208	17,557
Current restricted assets (Note 3)		
Cash and cash equivalents (Note 3)	26,628	16,770
Investments (Note 3)	6,261	4,474
Accounts receivable	18	952
Total current restricted assets	32,907	22,196
Total current assets	52,115	39,753
Capital Assets (Note 4)		
Land	21,918	21,917
Building and improvements	74,388	69,296
Improvements other than buildings	270,994	234,158
Machinery and equipment	30,450	28,995
Scituate Reservoir Project	18,682	18,682
Construction in progress	61,726	63,796
	478,158	436,844
Less accumulated depreciation and amortization	182,861	170,597
Total capital assets, net	295,297	266,247
Total assets	347,412	306,000

(CONTINUED)

The accompanying notes are an integral part of these financial statements.

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

STATEMENTS OF NET POSITION
JUNE 30, 2013 AND 2012 (000's)

	2013	2012
LIABILITIES		
Current liabilities		
Due to City of Providence General Fund (Note 6)	1,793	542
Accounts payable	844	819
Accrued expenses	3,260	1,980
Unearned revenues	1,997	1,979
Line of credit	3,000	-
Current portion of long-term debt (Note 5)	3,818	3,602
	<hr/>	<hr/>
	14,712	8,922
Amounts to be paid from current restricted assets (Note 2)		
Due to Water Resources Board	464	376
Accounts payable	931	3,171
	<hr/>	<hr/>
	1,395	3,547
Total current liabilities	<hr/>	<hr/>
	16,107	12,469
Non-current liabilities		
General revenue bonds (Note 5)	74,269	48,887
Other post employment benefits (Note 10)	4,053	3,194
	<hr/>	<hr/>
Total non-current liabilities	78,322	52,081
Total liabilities	<hr/>	<hr/>
	94,429	64,550
NET POSITION		
Net investment in capital assets	217,210	213,758
Restricted	31,512	18,649
Unrestricted	4,261	9,043
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Total net position	\$ 252,983	\$ 241,450
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(CONCLUDED)

The accompanying notes are an integral part of these financial statements.

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

**STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012 (000's)**

	2013	2012
Operating Revenues		
Charges for services:		
Water sales (Note 1):		
General customers	\$ 40,548	\$ 40,823
Other local water suppliers	15,789	16,777
Fire protection services	1,956	1,738
Maintenance charges and other revenue	2,777	2,389
Total operating revenues	61,070	61,727
 Operating Expenses		
Source of supply	2,008	1,997
Pumping operations	631	790
Water treatment	8,155	7,097
Transmission and distribution	5,337	4,180
Charge for services provided by other City departments (Note 6)	839	839
Customer accounts and service	2,798	2,258
Administrative and general	11,895	13,820
Depreciation and amortization	12,264	12,191
Property taxes - other local governments	6,378	6,423
Total operating expenses	50,305	49,595
 Net operating income	10,765	12,132
 Nonoperating Revenues (Expenses)		
Interest income	297	294
Interest expense and other	(1,629)	(1,486)
Net nonoperating expenses	(1,332)	(1,192)
 Capital Grants and Contributions	2,100	200
 Change in net position	11,533	11,140
 Net Position, beginning of year	241,450	230,310
 Net Position, end of year	\$ 252,983	\$ 241,450

The accompanying notes are an integral part of these financial statements.

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

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND 2012 (000's)

	2013	2012
Cash Flows From Operating Activities		
Cash received from customers	\$ 62,070	\$ 61,559
Cash paid to vendors	(24,499)	(23,343)
Cash paid to employees	(13,520)	(13,603)
Net cash provided by operating activities	24,051	24,613
Cash Flows From Non-Capital and Related Financing Activities		
Due to/from other funds	1,251	(2)
Net cash provided by (used in) capital and related financing activities	1,251	(2)
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of capital assets	(41,314)	(24,146)
Interest paid on debt	(1,629)	(1,486)
Proceeds from line of credit	3,000	-
Repayment of long-term debt	(3,602)	(3,521)
Proceeds from long-term debt	29,200	3,000
Capital grants	2,100	200
Net cash used in capital and related financing activities	(12,245)	(25,953)
Cash Flows From Investing Activities		
Purchase of investment securities	(1,787)	(171)
Investment income (loss)	297	294
Net cash provided by (used in) investing activities	(1,490)	123
Net increase (decrease) in cash and cash equivalents	11,567	(1,219)
Cash and cash equivalents		
Beginning	19,944	21,163
Ending	\$ 31,511	\$ 19,944
Unrestricted cash and cash equivalents	\$ 4,883	\$ 3,174
Restricted cash and cash equivalents	26,628	16,770
	\$ 31,511	\$ 19,944
Reconciliation of Net Operating Income to Net Cash Provided by Operating Activities:		
Net operating income	\$ 10,765	\$ 12,132
Adjustments to reconcile net operating income to net cash provided by operating activities:		
Depreciation and amortization	12,264	12,191
Change in allowance for doubtful accounts	(1,321)	408
Changes in assets and liabilities:		
Accounts receivable	2,586	(597)
Inventories	(8)	74
Other assets	(265)	8
Accounts payable and accrued expenses	12	384
Unearned revenue	18	13
Net cash provided by operating activities	\$ 24,051	\$ 24,613

The accompanying notes are an integral part of these financial statements.

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

NOTES TO THE FINANCIAL STATEMENTS
June 30, 2013 and 2012 (000's)

1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Reporting entity

The Providence Water Supply Board, an enterprise fund of the City of Providence, (the "Water Supply Board") was created in 1940 by Chapter 832 of the Public Laws of the State of Rhode Island. Membership of the Water Supply Board is comprised of four persons appointed by the Mayor, who serve for four-year staggered terms and two City Council members elected by the City Council who serve during their four-year City Council term. The Finance Director of the City of Providence also serves as an ex-officio Water Supply Board member.

The Water Supply Board provides water supply services through metered sales in Providence and parts of the surrounding communities of North Providence, Johnston and Cranston. The Water Supply Board also sells water to other local water supply systems on a wholesale basis. The Water Supply Board's source of water supply is the Scituate Reservoir, located in the Town of Scituate, Rhode Island, and five tributary reservoirs.

Significant accounting policies are as follows:

Basis of Presentation

The Water Supply Board is considered an enterprise fund of the City of Providence (the "City"). The operations of the Water Supply Board are accounted for with a separate set of self-balancing accounts organized on a Proprietary Fund type (Enterprise Fund) basis.

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (including depreciation) of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or change in net position is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Water Supply Board utilizes the accrual basis of accounting, under which revenues are recognized when earned and expenses are recognized when incurred.

Regulations and Operations

The Water Supply Board is subject, as to rates and other matters, to the regulatory authority of the State of Rhode Island Public Utilities Commission ("PUC").

Cash equivalents

The Water Supply Board considers all highly liquid instruments with an original maturity of three months or less, when purchased, to be cash equivalents.

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
June 30, 2013 and 2012 (000's)

1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments

The Water Supply Board accounts for investments at fair values which are established by quoted market prices in active markets that are accessible at the measurement date for identical, unrestricted assets.

Inventory

Inventory, consisting of materials and supplies, is valued at the lower of average cost or market using the first-in, first-out method.

Capital assets, depreciation and amortization

Capital assets owned by the Water Supply Board are stated at cost. They are defined as assets with an initial cost of more than \$3,000 and an estimated useful life in excess of 1 year. Depreciation and amortization is provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Building, source of supply structures, and improvements	5-75 years
Improvements other than buildings	3-75 years
Equipment	3-50 years

Depreciation expense is not reflected for construction in progress until such time as it is placed in service. Assets under capital leases are amortized under the Water Supply Board's normal depreciation policies for similar assets.

Restricted funds for construction of assets

Restricted funds for construction of assets represent unexpended revenue bond proceeds obtained specifically for construction of water facilities. These funds are included in restricted assets.

Capital contributions

Capital contributions consist of property and equipment paid for by customers for water installations. Once the installation is complete, the property and equipment transfers to the Water Supply Board at fair value.

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

NOTES TO THE FINANCIAL STATEMENTS
June 30, 2013 and 2012 (000's)

1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenues, operating revenues and expenses

Revenues include amounts billed and unbilled to all customers, including those customers outside the City of Providence, Rhode Island. All billed charges are based on rates approved by the PUC. Revenues for unbilled amounts to general customers are estimated based on billing amounts subsequent to year-end. The Water Supply Board distinguishes operating revenues and expenses from non-operating. Operating revenues result from charges to customers for water and related services. Operating expenses include the cost of operations, maintenance, sales and service, administrative expenses and depreciation. All revenues and expenses not meeting this definition are reported as non-operating or capital contributions.

Concentration of credit risk

The Water Supply Board's financial instruments that are exposed to concentrations of credit risk consist primarily of accounts receivable. Exposure to losses on receivables is principally dependent on each customer's financial condition. Concentration of credit risk with respect to receivables is limited due to the large number of customers. The Water Supply Board monitors its exposure for credit losses and maintains allowances for anticipated losses.

Use of estimates

The preparation of the financial statements, in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Compensated absences

Employees accumulate sick leave hours for subsequent use or for payment upon retirement. Sick leave and vacation may be carried forward into the following calendar year, but not to exceed 135 days and 30 days, respectively.

Vested sick leave and accumulated vacation leave are recorded as expenses and liabilities as the benefits accrue to employees.

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
June 30, 2013 and 2012 (000's)

2. RESTRICTED ASSETS

The State of Rhode Island enacted the Public Drinking Water Protection Act of 1987 (the "Act") that empowers suppliers of public drinking water to levy a surcharge (the "surcharge") of one cent (\$0.01) per hundred gallons of water for all customers. The surcharge has been amended several times since 1987. The last increase was on July 1, 2002, when the surcharge increased to \$0.0292 per hundred gallons of water for all customers. In addition to the increase, the Water Supply Board will retain 36.1% of the surcharge in its Water Quality Protection fund, remit 57.0% to the State Water Resources Board and retain 6.9% for general operations. The funds collected in the Water Quality Protection fund are to be expended in the following manner:

- 1) at a minimum, 55% of the funds are to be spent for the acquisition of land or land rights or physical improvements to acquired land to protect the quality of the raw water of the water supply system;
- 2) 35% may be used to acquire a fee simple interest or a conservation restriction that directly protects the quality and safety of the public drinking water supply; and
- 3) 10% may be used by the supplier for any purpose relating to its operations.

The restricted investments are pooled with the cash and cash equivalents and investments of other funds maintained by the City of Providence. The earnings from investments are allocated in proportion to each fund's balance.

3. CASH AND INVESTMENTS

The following is a summary of cash and investments:

	<u>Fair Value</u>
Cash and cash equivalents	\$ 4,883
Restricted cash and cash equivalents	26,628
Equity Mutual Funds	<u>6,261</u>
Total	<u>\$ 37,772</u>

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
June 30, 2013 and 2012 (000's)

3. CASH AND INVESTMENTS (CONTINUED)

Responsibility for custodial credit risk of deposits, investment risk, interest rate risk and concentration of investments rests with the City; accordingly separate disclosure is not possible. The City's financial statements should be read to determine the associated risks of the Water Supply Board's deposits and investments.

4. CAPITAL ASSETS

The following is a summary of the activity in capital assets as of June 30, 2013:

	Balance June 30, 2012	Additions	Disposals / Reclasses	Balance June 30, 2013
Capital assets not being depreciated:				
Land	\$ 21,917	\$ 1	\$ -	\$ 21,918
Scituate Reservoir Project	18,682	-	-	18,682
Construction in progress	63,796	39,478	41,548	61,726
Total capital assets not being depreciated	<u>104,395</u>	<u>39,479</u>	<u>41,548</u>	<u>102,326</u>
Capital assets being depreciated:				
Buildings and improvements	69,296	5,092	-	74,388
Improvements other than buildings	234,158	36,836	-	270,994
Machinery and equipment	28,995	1,455	-	30,450
	<u>332,449</u>	<u>43,383</u>	<u>-</u>	<u>375,832</u>
Less accumulated depreciation for:				
Buildings and improvements	42,057	6,363	-	48,420
Improvements other than buildings	103,366	5,019	-	108,385
Machinery and equipment	25,174	882	-	26,056
	<u>170,597</u>	<u>12,264</u>	<u>-</u>	<u>182,861</u>
Total capital assets being depreciated, net	<u>161,852</u>	<u>31,119</u>	<u>-</u>	<u>192,971</u>
Total capital assets, net	<u>\$ 266,247</u>	<u>\$ 70,598</u>	<u>\$ 41,548</u>	<u>\$ 295,297</u>

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
 June 30, 2013 and 2012 (000's)

4. CAPITAL ASSETS (CONTINUED)

The following is a summary of the activity in capital assets as of June 30, 2012:

	Balance June 30, 2011	Additions	Disposals / Reclasses	Balance June 30, 2012
Capital assets not being depreciated:				
Land	\$ 19,305	\$ 2,612	\$ -	\$ 21,917
Scituate Reservoir Project	18,682	-	-	18,682
Construction in progress	52,543	25,572	14,319	63,796
Total capital assets not being depreciated	<u>90,530</u>	<u>28,184</u>	<u>14,319</u>	<u>104,395</u>
Capital assets being depreciated:				
Buildings and improvements	55,263	14,033	-	69,296
Improvements other than buildings	225,819	8,339	-	234,158
Machinery and equipment	27,239	1,756	-	28,995
Assets under capital lease	13,846	-	13,846	-
Total capital assets being depreciated	<u>322,167</u>	<u>24,128</u>	<u>13,846</u>	<u>332,449</u>
Less accumulated depreciation for:				
Buildings and improvements	33,812	6,000	(2,245)	42,057
Improvements other than buildings	97,049	5,194	(1,123)	103,366
Machinery and equipment	24,108	813	(253)	25,174
Assets under capital lease	3,437	184	3,621	-
	<u>158,406</u>	<u>12,191</u>	<u>-</u>	<u>170,597</u>
Total capital assets being depreciated, net	<u>163,761</u>	<u>11,937</u>	<u>13,846</u>	<u>161,852</u>
Total capital assets, net	<u>\$ 254,291</u>	<u>\$ 40,121</u>	<u>\$ 28,165</u>	<u>\$ 266,247</u>

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
 June 30, 2013 and 2012 (000's)

5. LONG-TERM DEBT

Long-term debt activity for the years ended June 30, 2013 and 2012 were as follows:

	2013				
	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Bonds payable:					
Revenue bonds	\$ 52,489	\$ 29,200	\$ (3,602)	\$ 78,087	\$ 3,818
Total bonds	52,489	29,200	(3,602)	78,087	3,818
Total long-term debt	\$ 52,489	\$ 29,200	\$ (3,602)	\$ 78,087	\$ 3,818

	2012				
	Beginning Balance	Increases	Decreases	Ending Balance	Due Within One Year
Bonds payable:					
Revenue bonds	\$ 53,010	\$ 3,000	\$ (3,521)	\$ 52,489	\$ 3,602
Total bonds	53,010	3,000	(3,521)	52,489	3,602
Total long-term debt	\$ 53,010	\$ 3,000	\$ (3,521)	\$ 52,489	\$ 3,602

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND 2012 (000's)

5. LONG-TERM DEBT (CONTINUED)

The following is a summary of bonds and notes outstanding at June 30, 2013 and 2012:

Description	June 30, 2013	
	Interest Rate	Balance
Revenue bonds:		
Safe Drinking Water Bonds (CWFA FY2002)	3.61%	\$ 1,321
Scituate Reservoir Project (PPBA FY 2011)	5.40%	761
Safe Drinking Water Bonds (CWFA FY2005)	2.22%	1,802
Safe Drinking Water Bonds (CWFA FY2008)	2.85%	31,014
Safe Drinking Water Bonds (CWFA FY2010)	.0410% to 3.14%	10,990
Safe Clean Water Bonds (CWFA FY2012)	.072% to 3.26%	2,999
Safe Clean Water Bonds (CWFA FY2013)	.019% - 2.53%	4,200
Safe Drinking Water Bonds (CWFA FY2013)	.022% - 2.63%	25,000
		\$ 78,087

Description	June 30, 2012	
	Interest Rate	Balance
Revenue bonds:		
Safe Drinking Water Bonds (CWFA FY2002)	3.61%	\$ 1,444
Scituate Reservoir Project (PPBA 1996)	5.40%	882
Safe Drinking Water Bonds (CWFA FY2005)	2.22%	2,663
Safe Drinking Water Bonds (CWFA FY2008)	2.85%	32,376
Safe Drinking Water Bonds (CWFA FY2010)	.0410% to 3.14%	12,124
Safe Clean Water Bonds (CWFA FY2012)	.072% to 3.26%	3,000
		\$ 52,489

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND 2012 (000's)

5. LONG-TERM DEBT (CONTINUED)

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

Year ending June 30:	ARRA Principal			
	Principal	Forgiveness	Interest	Total
2014	\$ 3,818	\$ (284)	\$ 1,639	\$ 5,173
2015	4,095	(307)	1,926	5,714
2016	4,297	(372)	1,967	5,892
2017	3,558	(186)	1,457	4,829
2018	1,240	(78)	687	1,849
2019-2023	18,692	(996)	8,396	26,092
2024-2028	20,400	(1,138)	5,920	25,182
2029-2033	18,394	(1,182)	2,801	20,013
2034-2038	3,593	(229)	322	3,686
	<u>\$ 78,087</u>	<u>\$ (4,772)</u>	<u>\$ 25,115</u>	<u>\$ 98,430</u>

6. TRANSACTIONS WITH CITY OF PROVIDENCE, RHODE ISLAND

The City of Providence performs various services for the Water Supply Board including certain accounting, personnel and cash management services and working capital support. The total billing to the Water Supply Board for services performed amounted to \$839 for each of the years ended June 30, 2013 and 2012, respectively. This amount is established by the City, approved by the Water Supply Board and ultimately approved by the PUC. The Water Supply Board also provides services to various City funds and departments, the charges for which have been included as revenue in the accompanying financial statements. Included within the Due To City of Providence General Fund balance on the statements of net position are the related balances due for the services described above. The balance also includes payments for pension and post-employment benefits. The total balance due to the City of Providence General Fund at June 30, 2013 and 2012 totaled \$1,793 and \$301, respectively.

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND 2012 (000's)

7. LINE OF CREDIT

Providence Water Supply Board opened a line of credit with Century Bank of \$3,000 in 2013. This line of credit is used for infrastructure replacement and renewed annually per the agreement terms.

8. COMMITMENTS AND CONTINGENCIES

Risk Management

The Water Supply Board has a complete comprehensive insurance program protecting all facilities, employees and liability claims.

The Water Supply Board is subject to various claims and litigation that arise in the ordinary course of its operations. Legal counsel and management are of the opinion that the Water Supply Board's liabilities in such cases, if decided adversely to the Water Supply Board, would not materially affect the financial statements.

Union Contract

The labor force of the Water Supply Board, with the exception of management, is covered by a union contract which is effective for the period January 1, 2011 to June 30, 2015.

Contingent Liability to City of Providence per Rhode Island G.L.

A law passed in 2003 (R.I.G.L. § 39-3-11.3 and § 46-15.3-21) required an annual payment by the Water Supply Board to the City of Providence of 5% of the Water Supply Board's gross revenues for the years ending June 30, 2004, 2005 and 2006. The law specifically provides that this payment shall not be included as part of the Water Supply Board's rates for these years. These payments would total approximately \$2,500 per year.

The Water Supply Board has no material funds (other than revenues from rates) from which to make these payments and therefore has not made the payments. Further, since the payments cannot be made from rate revenues the Board believes it is not liable for any amount to the City and therefore has not accrued an amount for the potential liability.

No action has been taken by either the City of Providence or the Rhode Island Public Utilities Commission concerning this matter.

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND 2012 (000's)

8. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Lead Service Replacement Program

The EPA Lead and Copper Rule requires that systems monitor drinking water at the customer tap. In accordance with the Rule, if after corrosion control optimization is implemented, lead concentrations exceed an action level of 15 ppb in more than 10% of customer taps sampled, the system is required to replace lead service lines under its ownership. The regulations require that the utility must replace annually 7% of the total amount of lead services in the system. In accordance with EPA requirements, the Rhode Island Department of Health found that Providence Water exceeded the lead action level on September 30, 2006 (the date of conclusion of that monitoring period) and was required to begin the annual replacement of 7% of its 25,600 lead services. Because of lead-time in gearing up for an undertaking of this magnitude, RIDOH and Providence Water agreed to a compliance schedule that fulfilled the intent of the regulation whereby 14% of the lead services were to be replaced over the two-year period ending September 30, 2008 and 7% annually thereafter.

By September of 2010, Providence Water exceeded the lead service replacement requirement by over 2,200 services and as a result of being approximately one year ahead of the regulatory required pace, we were informed by RIDOH that the mandated replacements of lead service could be suspended until October 2011.

During this period, various concerns were raised about the effectiveness of partial lead service replacements, the persistence of lead levels in the water, and the difficulty of finding a proven solution for reducing the levels. In June 2012, the RIDOH in concert with the USEPA, agreed to enter into a consent agreement with Providence Water which granted a stay of the lead service replacement requirement for construction season 2012. As part of the agreement, RIDOH and the USEPA required that Providence Water convene a panel of national water quality experts, to include regulators, water professionals, and members of academia, to recommend studies and / or treatment modifications with the objective of reducing lead levels in the water.

In April 2013, Providence Water and RIDOH granted Providence Water a stay of the lead service replacement requirement for the 2013 construction season. By consent order Providence was required to:

1. Continue with the consultation with its expert panel to evaluate corrosion control treatment in the system.
2. Conduct studies to examine alternative treatment schemes for optimization of corrosion control.
3. Institute a unidirectional flushing program.
4. Increase efforts to rehabilitate and replace unlined cast iron mains that are usually found to be problematic in terms of both water quality and delivery capacity.

Even though the lead service replacement program is temporarily suspended, lead services are still replaced in conjunction with the water main replacement program. Lead services are also replaced on an ongoing basis where customers are voluntarily replacing their private side lead services. Lead services continue to be replaced in areas of local and state road resurfacing projects, and on projects initiated by private or outside entities. Providence Water's own crews replace lead services which are found to be leaking. The replacement work is subject to all of the EPA regulatory notification, testing, and reporting requirements.

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND 2012 (000's)

8. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Lead Service Replacement Program (Continued)

Since inception of the reporting of the IFR program and the lead service replacement program to the RIPUC (July 1, 1996), Providence Water has replaced 15,008 lead services to the end of fiscal year 2013 (June 30, 2013) at a cost of \$55.

Since the inception of the LSR Program in 2007, as of November 2012, approximately 10,100 lead services have been replaced of the original lead service inventory of 25,600 by the LSR Program, various water main replacement projects, and in-house Water Supply Board forces.

As part of the Lead Abatement contribution agreement between the Rhode Island Department of Health and Providence Water, a payment of \$500 was made in fiscal year 2013, and final payment of \$250 will be made in fiscal year 2014. These payments are part of the consent order in lieu of the Department granting Providence Water a stay during the fiscal year 2012 season on its 7% service line replacement equipment.

9. PENSION PLANS

Substantially all employees of the Water Supply Board participate in the Employees' Retirement System of the City of Providence (the "Plan"), a defined-benefit, single-employer plan. Disclosures about this plan, as a whole, are presented in the City of Providence, Rhode Island's basic financial statements. As of June 30, 2013 and 2012, the City recorded a liability for unpaid pension contributions of \$151,884 and \$149,478, respectively. Separate actuarial information related to the Water Supply Board employees is not available. Accordingly, only disclosures about the Water Supply Board's participation in the Plan are presented herein.

Water Supply Board employees participating in the Plan are eligible to retire at age 55 if hired prior to July 1, 2004, at age 60 if hired between July 1, 2004 and June 30, 2009, at age 62 with 10 years of service if hired on or after July 1, 2009 or at any age after 25 years of service if hired prior to July 1, 1995, or at any age after 30 years of service if hired on or after July 1, 1995. The total retirement allowance is equal to an annuity, which is the actuarial equivalent of accumulated contributions at the time of retirement, plus a pension which when added together either; 1) equals 1/40 of final compensation for each year of total service up to 20 years and 1/50 of final compensation for each year of service in excess of 20 years if hired prior to July 1, 1996 or; 2) equals 1/50 of final compensation for each year of total service credited if hired on or after July 1, 1996. These benefit provisions and all other requirements are established by City ordinance.

The Water Supply Board's allocation of the actuarial required contribution and amount contributed for the year ended June 30, 2013 was \$2,762. The Water Supply Board's allocation of the actuarial required contribution and amount contributed for the year ended June 30, 2012 was \$2,315. The employer and employees contribution rates are approximately 25% and 8%, respectively, for both 2013 and 2012.

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

(CONTINUED)

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND 2012 (000's)

10. POST EMPLOYMENT BENEFITS

The Water Supply Board follows GASB Statement No. 45 "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions".

The Water Supply Board's Post-Retirement Benefits Program of the City of Providence (the "Program") is a defined-benefit, single-employer post-retirement health and life insurance program. The Program provides lifetime health care and life insurance benefits to substantially all retired employees and their spouses. Disclosures about this program, as a whole, are presented in the City of Providence, Rhode Island's basic financial statements. As of June 30, 2013 and 2012, the City recorded a liability for unpaid post-retirement contributions of \$172,106 and \$135,200, respectively. Separate actuarial information related to the Water Supply Board employees is not available. Accordingly, only disclosures about the Water Supply Board's participation in the Plan are presented herein.

The Water Supply Board's allocation of the actuarial required contribution was \$1,305 and \$446 was contributed for the year ended June 30, 2013.

The Water Supply Board's allocation of the actuarial required contribution was \$1,229 and \$442 was contributed for the year ended June 30, 2012.

The unpaid balance of the actuarial required contribution at June 30, 2013 and June 30, 2012 of \$4,053 and \$3,194, respectively, is included in non-current liabilities on the Statements of net position.

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

11. RECLASSIFICATIONS

Certain 2012 financial statement amounts have been reclassified to conform to the 2013 presentation. There is no change in the reported change in net position.

(CONCLUDED)

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

REPORT OF INDEPENDENT AUDITORS

To the Water Supply Board
City of Providence, Rhode Island

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Providence Water Supply Board (the "Water Supply Board"), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Water Supply Board's basic financial statements, and have issued our report thereon dated December 31, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Water Supply Board's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Water Supply Board's internal control. Accordingly, we do not express an opinion on the effectiveness of Water Supply Board's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Brewer P.C." with a period at the end. The signature is written in a cursive, professional style.

Providence, Rhode Island
December 31, 2013