



**MASSACHUSETTS WATER RESOURCES AUTHORITY**  
Financial Statements,  
Required Supplementary Information and Supplemental Schedules  
June 30, 2004 and 2003  
(With Independent Auditors' Report Thereon)

# MASSACHUSETTS WATER RESOURCES AUTHORITY

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**KPMG LLP**  
99 High Street  
Boston, MA 02110-2371

Telephone 617 988 1000  
Fax 617 988 0800  
Internet [www.us.kpmg.com](http://www.us.kpmg.com)

## **Independent Auditors' Report**

The Board of Directors  
Massachusetts Water Resources Authority:

We have audited the balance sheets of the Massachusetts Water Resources Authority (the Authority) as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. 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 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 3 through 10 and the historical pension required supplementary information on page 37 are not a required part of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audits of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report on pages 43 and 44, dated August 16, 2004, on our consideration of the Authority'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 the



internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

KPMG LLP

August 16, 2004  
Boston, Massachusetts

## MASSACHUSETTS WATER RESOURCES AUTHORITY

### Required Supplementary Information Management's Discussion and Analysis

This section of the Authority's annual financial report presents our discussion and analysis of the Authority's financial performance during the fiscal years ended June 30, 2004 and 2003. Please read it in conjunction with the Authority's financial statements, which immediately follow this section.

#### **Financial Highlights – Fiscal 2004**

The 2004 rate revenues were approximately \$432 million and were \$15.1 million higher than fiscal 2003 rate revenues, due to an increase in assessments. This was offset by a decrease in revenues from other user charges of \$1.3 million or 16%. This decrease was primarily due to Marlborough and Southborough becoming rate base communities in fiscal 2004.

Total operating expenses, excluding depreciation, were approximately \$203.3 million in fiscal 2004. The 2.6% decrease in total operating expenses over 2003 is the result of lower salaries and wages caused by the Authority's early retirement program and staff reductions. Operating expenses for fiscal 2004 were 0.4% less than the annual operating budget.

Net nonoperating expenses increased \$28 million or 15% primarily due to a \$24 million change in unrealized losses recorded on the Authority's investments.

Total assets at June 30, 2004 were approximately \$7.9 billion, a \$171 million or 2.2% increase over total assets at June 30, 2003.

Total capital assets (net of depreciation) were approximately \$6.6 billion at June 30, 2004, a \$1.6 million or 0.03% increase over June 30, 2003. The increase in total capital assets is primarily the result of the ongoing water system construction projects, including the MetroWest Water Supply Tunnel, the Walnut Hill Water Treatment Plant and the Norumbega Covered Storage Project.

#### **Financial Highlights – Fiscal 2003**

During fiscal year 2003, the Commonwealth of Massachusetts eliminated funding for the debt service assistance program. Debt service assistance has been available to all cities, towns and authorities in the Commonwealth to offset capital financing expenses for sewer (and some water) related improvements. In its fiscal year 2003 budget adopted by the board of directors in June 2002, the Authority estimated that its share of the statewide debt service assistance appropriation would be \$47.1 million. In response to the mid-year elimination of this expected assistance, the Authority implemented a three-part plan to cover the \$47.1 million revenue loss:

- (1) Assessment of a 4% mid-year rate increase to raise \$15.7 million, bringing the overall fiscal 2003 increase to 6.97%.
- (2) Use of rate stabilization and bond redemption funds to increase revenue and reduce expenses by \$15.7 million.
- (3) \$15.7 million in reductions to operating and debt service expenses. As part of the operating reductions, MWRA reduced its workforce by 50 positions (about 3.6%), through attrition and layoffs.

The 2003 rate revenues were approximately \$417 million and were 6.97% higher than fiscal 2002 rate revenues, due to an increase in assessments. This was offset by a decrease in other customer services revenues of

## MASSACHUSETTS WATER RESOURCES AUTHORITY

### Required Supplementary Information Management's Discussion and Analysis

\$1.9 million or 19%. This decrease was primarily due to a reduction in water services provided to the City of Cambridge in fiscal 2003 as compared to fiscal 2002.

Total operating expenses, excluding depreciation, were approximately \$208.7 million in fiscal 2003. The 0.7% decrease in total operating expenses over 2002 is the result of lower salaries and wages caused by the Authority's early retirement program and staff reductions. Operating expenses for fiscal 2003 were 4% greater than the annual operating budget.

Net nonoperating expenses increased \$53.6 million or 41% primarily due to a \$50 million decrease in debt service assistance from the Commonwealth of Massachusetts.

Total assets at June 30, 2003 were approximately \$7.7 billion, a \$40.7 million or 0.5% increase over total assets at June 30, 2002.

Total capital assets (net of depreciation) were approximately \$6.6 billion at June 30, 2003, a \$109 million or 1.7% increase over June 30, 2002. The increase in total capital assets is primarily the result of the ongoing water system construction projects, including the MetroWest Water Supply Tunnel, the Walnut Hill Water Treatment Plant and the Norumbega Covered Storage Project.

#### **Overview of the Financial Statements**

The financial section of this annual report consists of three parts: management's discussion and analysis (this section), the financial statements and related notes to the financial statements, and other supplementary information.

The financial statements provide both long-term and short-term information about the Authority's overall financial status. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of other supplementary information that further explains and supports the information in the financial statements.

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**Financial Analysis of the Authority**

*Net Assets*

The Authority's total net assets at June 30, 2004 were approximately \$2.2 billion, a \$49 million decrease from June 30, 2003. Total assets increased \$171 million or 2.2% to \$7.9 billion, and total liabilities increased 4.1% to \$5.6 billion.

The Authority's total net assets at June 30, 2003 were approximately \$2.3 billion, a \$49 million decrease from June 30, 2002. Total assets increased \$40.7 million or 0.5% to \$7.7 billion, and total liabilities increased 1.7% to \$5.4 billion.

**Net Assets**

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<b>Percentage change 2004-2003</b>	<b>Percentage change 2003-2002</b>
Current assets	\$ 97,914	106,813	102,393	(8.3)%	4.3%
Restricted assets	750,454	655,613	756,572	14.5%	(13.3)%
Capital assets	6,552,821	6,551,209	6,441,861	0.0%	1.7%
Other assets	<u>482,228</u>	<u>398,513</u>	<u>370,591</u>	<u>21.0%</u>	<u>7.5%</u>
Total assets	7,883,417	7,712,148	7,671,417	2.2%	0.5%
Current liabilities	419,787	413,848	481,091	1.4%	(14.0)%
Payable from restricted assets	89,515	108,840	101,648	(17.8)%	7.1%
Long-term debt	4,884,943	4,607,288	4,386,967	6.0%	5.0%
Long-term lease	36,436	36,785	37,108	(0.9)%	100.0%
Other liabilities	<u>204,311</u>	<u>247,607</u>	<u>317,801</u>	<u>(17.5)%</u>	<u>(22.1)%</u>
Total liabilities	5,634,992	5,414,368	5,324,615	4.1%	1.7%
Net assets:					
Invested in capital assets, net of related debt	1,805,352	1,956,432	2,005,980	(7.7)%	(2.5)%
Restricted	169,348	123,409	128,190	37.2%	(3.7)%
Unrestricted	<u>273,725</u>	<u>217,939</u>	<u>212,632</u>	<u>25.6%</u>	<u>2.5%</u>
Total net assets	\$ <u><u>2,248,425</u></u>	<u><u>2,297,780</u></u>	<u><u>2,346,802</u></u>	<u><u>(2.1)%</u></u>	<u><u>(2.1)%</u></u>

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**Changes in Net Assets**

The decrease in net assets at June 30, 2004 was \$49 million or 2.1% as compared to June 30, 2003. The Authority's total operating revenues increased by 4.2% to \$447 million and total operating expenses increased 0.3% to \$365 million.

The decrease in net assets at June 30, 2003 was \$49 million or 2.1% as compared to June 30, 2002. The Authority's total operating revenues increased by 6.3% to \$429 million and total operating expenses decreased 0.4% to \$364 million.

**Change in Net Assets**

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<b>Percentage change 2004-2003</b>	<b>Percentage change 2003-2002</b>
Operating revenues:					
Customer services revenues	\$ 440,949	426,666	401,391	3.3%	6.3%
Other revenue	5,928	2,381	2,091	149.0%	13.9%
Total operating revenue	<u>446,877</u>	<u>429,047</u>	<u>403,482</u>	<u>4.2%</u>	<u>6.3%</u>
Operating expenses:					
Operations	77,344	78,417	80,907	(1.4)%	(3.1)%
Maintenance	18,611	17,214	16,346	8.1%	5.3%
Payments in lieu of taxes	5,029	4,966	4,911	1.3%	1.1%
Engineering, general, and administrative	102,334	108,101	108,003	(5.3)%	0.1%
Depreciation	161,492	155,159	155,258	4.1%	(0.1)%
Total operating expenses	<u>364,810</u>	<u>363,857</u>	<u>365,425</u>	<u>0.3%</u>	<u>(0.4)%</u>
Operating income	82,067	65,190	38,057	25.9%	71.3%
Nonoperating items:					
Regulatory accounting provisions	74,255	63,124	27,953	17.6%	125.8%
Net nonoperating expenses	(211,344)	(183,256)	(129,685)	15.3%	41.3%
Capital grants and contributions	5,667	5,920	5,853	(4.3)%	1.1%
Change in net assets	<u>(49,355)</u>	<u>(49,022)</u>	<u>(57,822)</u>	<u>0.7%</u>	<u>(15.2)%</u>
Total net assets, beginning of year	<u>2,297,780</u>	<u>2,346,802</u>	<u>2,404,624</u>	<u>(2.1)%</u>	<u>(2.4)%</u>
Total net assets, end of year	\$ <u>2,248,425</u>	<u>2,297,780</u>	<u>2,346,802</u>	<u>(2.1)%</u>	<u>(2.1)%</u>

During fiscal 2004, the increases in customer services revenues were primarily due to the increase in the rate revenue requirement (\$15.1 million). This was offset by a decrease in other customer services revenues of \$1.3 million or 16%. This decrease was primarily due to the towns of Marlborough and Southborough becoming rate base communities in fiscal 2004.



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During fiscal 2003, the increases in customer services revenues were primarily due to the 6.97% increase in the rate revenue requirement (\$25.3 million). This was offset by a decrease in other customer services revenues of \$19 million or 19%. This decrease was primarily due to a reduction in water services provided to the City of Cambridge in fiscal 2003 as compared to fiscal 2002.

Total operating costs in fiscal 2004 were \$5.4 million or 2.6% less than in fiscal 2003. This decrease is the total of \$3.6 million in lower direct operating costs and \$1.8 million in lower indirect expenses. Total wages and salaries expenses were \$1.9 million less than in fiscal 2003, primarily because of lower staffing levels resulting from staff reductions. Overall operating expense decreases are also attributable to a directed slowdown in all areas of spending resulting from the loss of debt service assistance.

Total operating costs in fiscal 2003 were \$1.5 million or 0.7% less than in fiscal 2002. This decrease is the net of \$3.1 million in lower direct operating costs offset by \$1.5 million in greater indirect expenses. Total wages and salaries expenses were \$5.8 million less than in fiscal 2002, primarily because of lower staffing levels resulting from the early retirement program implemented in fiscal 2002 and the fiscal 2003 staff reductions. Overall operating expense decreases are also attributable to a directed slowdown in all areas of spending resulting from the loss of debt service assistance.

Fiscal 2004 net nonoperating expenses increased \$28 million or approximately 15%. This was attributable to a \$24 million change in the unrealized losses of the Authority's investments.

Fiscal 2003 net nonoperating expenses increased \$53.6 million or 41% primarily due to the decrease of \$50 million in debt service assistance from the Commonwealth of Massachusetts.

**Operating Costs by Functionality**

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<b>Percentage change 2004-2003</b>	<b>Percentage change 2003-2002</b>
Wastewater treatment and transport	\$ 79,492	78,064	78,559	1.8%	(0.6)%
Water treatment and transport	20,505	18,087	18,571	13.4%	(2.6)%
Water and wastewater quality	8,209	9,356	9,101	(12.3)%	2.8%
Metering and monitoring	3,791	3,778	3,501	0.3%	7.9%
Facilities planning, design, and construction	10,116	10,133	12,308	(0.2)%	(17.7)%
MIS	9,356	8,710	9,418	7.4%	(7.5)%
Administration and support	40,040	46,981	46,754	(14.8)%	0.5%
Total direct operating costs	<u>171,509</u>	<u>175,109</u>	<u>178,212</u>	(2.1)%	(1.7)%
Indirect operating costs	<u>31,809</u>	<u>33,589</u>	<u>31,955</u>	(5.3)%	5.1%
Total operating costs	<u>\$ 203,318</u>	<u>208,698</u>	<u>210,167</u>	(2.6)%	(0.7)%

Expenses for wages and salaries decreased in almost all functional areas due to lower staffing levels, largely as a result of early retirement.

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This increase in water treatment and transport is due to increased maintenance for purchases of pipeline materials, services, and specialized services. The increase in MIS is for the purchase of additional computer hardware and equipment, which had been deferred from the prior year.

The decrease in water and wastewater quality is due to less lab and testing analysis due to reductions in the Authority's National Pollutant Discharge Elimination System (NPDES) permit required monitoring. The decrease in administration and support is due to consolidation of space leased by the Authority and the change in health care contribution paid by the Authority.

The decrease in indirect costs is due to lower operating and debt services costs associated with watershed protection provided by the Commonwealth and funded by the Authority.

**Capital Asset and Debt Administration**

***Capital Assets***

As of June 30, 2004 and 2003, the Authority had approximately \$6.6 billion of capital assets (net of depreciation). This includes land, construction in progress, plant and equipment for the water and sewer systems, furniture and fixtures, leasehold improvements and motor vehicles and equipment. The Authority's net capital assets increased approximately \$1.6 million or 0.03% during fiscal 2004 and \$109 million or 1.7% during fiscal 2003.

**Capital Assets**

(Net of depreciation, dollars in thousands)

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<b>Percentage change 2004-2003</b>	<b>Percentage change 2003-2002</b>
Land	\$ 13,932	16,806	16,806	(17.1)%	0.0%
Construction in progress	868,639	822,349	1,177,074	5.6%	(30.1)%
Plant and equipment, water, and sewer systems	5,659,271	5,699,757	5,245,583	(0.7)%	8.7%
Furniture and fixtures	9,065	9,917	21	(8.6)%	47,123.8%
Leasehold improvements	1,310	1,756	1,734	(25.4)%	100.0%
Motor vehicles and equipment	604	624	643	(3.2)%	(3.0)%
Total net assets	\$ <u>6,552,821</u>	<u>6,551,209</u>	<u>6,441,861</u>	0.0%	1.7%

Increases in construction in progress are primarily due to ongoing CIP work, including the Braintree/Weymouth Relief Facilities, the Walnut Hill Treatment Plant, the Norumbega Covered Storage facility, and the Combined Sewer Overflow (CSO) Program.

***Debt Administration***

The Authority's bond sales must be approved by the board of directors and must comply with rules and regulations of the United States Treasury Department and United States Securities and Exchange Commission. Neither the Commonwealth of Massachusetts (the Commonwealth) nor any political subdivision thereof shall be

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### Required Supplementary Information Management's Discussion and Analysis

obligated to pay the principal of, premium or interest on any debt outstanding and neither faith and credit nor taxing power of the Commonwealth or any political subdivision thereof is pledged to such payment.

#### ***Bond Resolutions***

Under the General Bond Resolution rate covenant, the Authority is required to maintain revenues sufficient to pay: current expenses; debt service on indebtedness; required deposits to reserves; costs of maintenance, replacement and/or improvement to the wastewater and water systems that are considered current expenses; and additional amounts the Authority may be required to pay by any law or contract.

In addition to the rate covenant the Authority is required to meet two covenants with respect to debt service coverage. The primary debt service coverage requires that the Authority fix and adjust rates and charges to provide revenues available for bond debt service in an amount equal to 1.2 times that required for debt service on all outstanding bonds, not including subordinated bonds. The subordinated debt service coverage requires that the Authority fix and adjust rates and charges to provide revenues available for bond debt service in an amount equal to 1.1 times that required for debt service on all outstanding bonds, including subordinated bonds.

#### ***Credit Rating***

Of the \$5.1 billion of revenue bonds the Authority currently has outstanding, \$3.7 billion is credit enhanced by a combination of bond insurance, liquidity, or letters of credit. The Authority's enhanced revenue bonds are rated "AAA" by FITCHRATINGS, "Aaa" by Moody's Investors Service, and "AAA" by Standard and Poor's. The Authority's unenhanced \$0.7 billion long-term, senior debt is rated "AA-" by FITCHRATINGS, "Aa3" by Moody's Investors Service, and "AA" by Standard and Poor's.

#### ***Economic Factors and Next Year's Budget***

In June 2004, the Board of Directors (the Board) approved the fiscal 2005 Current Expense Budget (CEB), which totals \$501.5 million in expenses before debt service offsets of \$8.9 million, for a net expense total of \$492.6 million. The \$8.9 million in debt service offsets is comprised of \$1.6 million in variable rate debt savings rolled forward from prior fiscal years and \$7.3 million in variable rate savings assumed for fiscal 2005.

The \$501.5 million expense total (before debt service offsets) is comprised of \$290.8 million (58%) in capital financing costs and \$210.7 million (42%) in operating expenses, of which \$176.1 million (84%) is for direct expenses and \$34.6 million (16%) is for indirect expenses. The total represents an increase of \$17.7 million from fiscal 2004 spending; comprised of \$7.3 million in higher operating costs and \$10.4 million higher debt service.

The fiscal 2005 rate revenue requirement approved by the Board is \$453.0 million; an increase of 3.9% compared to the fiscal 2004 budget. Subsequent to the Board's approval, the Authority learned that it expects to receive approximately \$8.7 million of state debt service assistance in fiscal 2005. The Authority has since reduced the rate revenue requirement by this amount, reducing the increase in rate revenue requirement to 1.9% as compared to the fiscal 2004 budget.

Fiscal 2005 nonrate revenue totals \$39.6 million, a decrease of \$4.9 million from actual fiscal 2004 nonrate revenue. The decrease is due to continued lower interest rates resulting in less investment income and one-time other revenue recognized in fiscal 2004. The nonrate revenue budget is comprised of \$28.7 million in investment income, including swap receipts, \$10.5 million in other user charges and other revenue, and \$0.4 million in entrance fees.

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#### ***CIP 10 Year Plan***

The Authority's planned spending for capital improvements in future years reflects the continuation and completion of projects now underway. These include:

- Completion of the Walnut Hill Water Treatment Plant to ensure continued provision of high quality drinking water to all customers.
- Completion of covered storage facilities, including Norumbega and Blue Hills Covered Storage, to provide safe, reliable storage for water treated at Walnut Hill and transported through the MetroWest Tunnel and Hultman Aqueduct.
- Rehabilitation of the Wachusett and Hultman Aqueducts as well as rehabilitation of top shaft structures on the Quabbin Tunnel, Dorchester Tunnel, City Tunnel, Southborough Tunnel, and City Tunnel Extension.
- Rehabilitation of a significant portion of the West Roxbury Tunnel.
- Completion of the long-term Combined Sewer Overflow (CSO) control plan, resulting in closing of 36 of 84 CSO outfalls and reducing CSO discharges to Boston Harbor and the Mystic, Charles, and Neponset River systems by 88% from 1987, when MWRA accepted responsibility for CSO control, with 95% of remaining discharges receiving treatment.
- Construction of new interceptor facilities to serve Braintree, Hingham, Holbrook, Randolph, Weymouth, and sections of Quincy, and to reduce sewage overflows into the Weymouth Fore River.
- Continued rehabilitation of the water distribution system at a rate of seven to ten miles per year (2.5% to 3% of the total 265 miles of MWRA pipeline).
- Improvement and replacement of equipment on Deer Island to ensure that the plant continues to operate efficiently and effectively.
- Security improvements to protect MWRA facilities.

#### **Contacting the Authority's Financial Management**

This report is designed to provide our bondholders, member communities and other interested parties with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the revenue it receives. If you have questions about this report or need additional information, contact the Massachusetts Water Resources Authority, Finance Division, 100 First Avenue, Boston, MA 02129.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Balance Sheets

June 30, 2004 and 2003

(Dollars in thousands)

<b>Assets</b>	<b>2004</b>	<b>2003</b>
Unrestricted current assets:		
Cash and cash equivalents (note 4)	\$ 30,930	30,249
Investments (note 4)	53,059	53,920
Intergovernmental loans (note 7)	12,248	12,767
Accounts receivable	<u>1,677</u>	<u>9,877</u>
Total unrestricted current assets	<u>97,914</u>	<u>106,813</u>
Restricted assets:		
Cash and investments (note 4)	741,499	646,662
Interest receivable	6,526	6,580
Grants receivable:		
Billed	2,221	2,163
Unbilled	<u>208</u>	<u>208</u>
Total restricted assets	<u>750,454</u>	<u>655,613</u>
Capital assets, not being depreciated (note 8)	882,571	839,155
Capital assets, being depreciated, net (note 8)	5,670,250	5,712,054
Deferred charges (notes 3 and 9)	292,088	239,280
Other assets, net (note 7)	<u>190,140</u>	<u>159,233</u>
Total assets	\$ <u><u>7,883,417</u></u>	\$ <u><u>7,712,148</u></u>
<b>Liabilities and Net Assets</b>		
Current liabilities:		
Accounts payable and accrued expenses (note 13)	\$ 60,259	54,422
Commercial paper notes (note 6)	307,000	311,000
Current portion of long-term debt (note 6)	<u>52,528</u>	<u>48,426</u>
Total current liabilities	<u>419,787</u>	<u>413,848</u>
Payable from restricted assets:		
Accounts payable for construction	21,478	41,956
Accrued interest on bonds payable	<u>68,037</u>	<u>66,884</u>
Total payable from restricted assets	<u>89,515</u>	<u>108,840</u>
Retainage on construction in progress	19,412	41,261
Long-term debt, less current portion (note 6)	4,884,943	4,607,288
Long-term capital lease (note 10)	36,436	36,785
Reserves (note 5)	99,184	119,184
Deferred credits (note 3)	<u>85,715</u>	<u>87,162</u>
Total liabilities	<u>5,634,992</u>	<u>5,414,368</u>
Net assets		
Invested in capital assets, net of related debt	1,805,352	1,956,432
Restricted	169,348	123,409
Unrestricted	<u>273,725</u>	<u>217,939</u>
Total net assets	<u>2,248,425</u>	<u>2,297,780</u>
Commitments and contingencies (notes 10, 12, and 13)		
Total liabilities and net assets	\$ <u><u>7,883,417</u></u>	\$ <u><u>7,712,148</u></u>

See accompanying notes to financial statements.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Statements of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2004 and 2003

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
Operating revenues (note 2):		
Customer services	\$ 440,949	426,666
Other	5,928	2,381
	<u>446,877</u>	<u>429,047</u>
Operating expenses:		
Operations	77,344	78,417
Maintenance	18,611	17,214
Payments in lieu of taxes	5,029	4,966
Engineering, general, and administrative	102,334	108,101
	<u>203,318</u>	<u>208,698</u>
Income from operations before depreciation	243,559	220,349
Depreciation and amortization	<u>161,492</u>	<u>155,159</u>
Operating income	<u>82,067</u>	<u>65,190</u>
Regulatory accounting provisions:		
Decrease in reserves	20,000	—
Increase in deferrals, net (note 3)	54,255	63,124
	<u>74,255</u>	<u>63,124</u>
Nonoperating revenues (expense):		
Debt service grants	4,063	—
Investment income	14,107	40,263
Interest expense	(229,514)	(223,519)
	<u>(211,344)</u>	<u>(183,256)</u>
Net loss before capital contributions	(55,022)	(54,942)
Capital grants and contributions	<u>5,667</u>	<u>5,920</u>
Decrease in net assets	(49,355)	(49,022)
Total net assets, beginning of year	<u>2,297,780</u>	<u>2,346,802</u>
Total net assets, end of year	<u>\$ 2,248,425</u>	<u>2,297,780</u>

See accompanying notes to financial statements.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Statements of Cash Flows

Years ended June 30, 2004 and 2003

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$ 446,209	418,589
Cash paid to suppliers for goods and services	(92,639)	(112,896)
Cash paid to employees for services	(96,580)	(81,382)
Cash paid in lieu of taxes	(5,029)	(4,966)
Other operating receipts	5,895	2,381
	<u>257,856</u>	<u>221,726</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of revenue bonds, loans and notes	369,222	331,109
Capital grants for construction	5,684	8,770
Capital contributions	—	432
Debt service grant	4,063	—
Capital lease principal payments	(349)	(323)
Capital lease interest payments	(2,868)	(2,894)
Repayment of debt	(103,787)	(206,146)
Interest paid on debt	(213,185)	(190,220)
Plant expenditures	(236,140)	(304,286)
	<u>(177,360)</u>	<u>(363,558)</u>
Cash flows from investing activities:		
Purchases of short-term investments	(69,066)	(132,713)
Sales and maturities of short-term investments	47,271	298,030
Increase in restricted cash and investments, net	(87,542)	(55,696)
Interest received	29,522	28,402
	<u>(79,815)</u>	<u>138,023</u>
Net increase (decrease) in cash and cash equivalents	681	(3,809)
Cash and cash equivalents, beginning of year	<u>30,249</u>	<u>34,058</u>
Cash and cash equivalents, end of year	\$ <u>30,930</u>	\$ <u>30,249</u>
Reconciliation of operating income to net cash provided from operating activities:		
Operating income	\$ 82,067	65,190
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	161,492	155,159
Decrease (increase) in other accounts, net	5,486	(7,490)
Increase in accounts payable	8,811	8,867
Net cash provided by operating activities	\$ <u>257,856</u>	\$ <u>221,726</u>

Noncash financing activities:

In August 2002, general revenue refunding bonds in the aggregate principal amount of \$430,000 were issued to refinance outstanding 1992 Series B bonds. In December 2002, general revenue refunding bonds in the aggregate principal amount of \$400,410 were issued to refinance outstanding 1993 Series B bonds.

In June 2004, general revenue bonds in the aggregate principal amount of \$130,000 were issued to defease \$10,860 of bonds outstanding.

See accompanying notes to financial statements.

# MASSACHUSETTS WATER RESOURCES AUTHORITY

## Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

### (1) Organization

The Massachusetts Water Resources Authority (the Authority) was established in January 1985 pursuant to Chapter 372 (the Enabling Act) of the Act of 1984 of the Commonwealth of Massachusetts (the Commonwealth). The Authority, a successor agency to certain functions of the Metropolitan District Commission (the MDC) (which had become part of the Department of Conservation and Recreation (the DCR) in July 2003), is a public instrumentality and, effective July 1, 1985, provides water supply services and sewage collection, treatment, and disposal services to areas of the Commonwealth.

The Authority is governed by an eleven-member board of directors (the Board) chaired by the Secretary of Environmental Affairs for the Commonwealth. The Secretary and four other members are appointed by the Governor, one upon recommendation of the Mayor of Quincy and one upon recommendation of the Selectmen of Winthrop. Three members of the Board are appointed by the Mayor of Boston and three are appointed by the Authority's Advisory Board.

### (2) Summary of Significant Accounting Policies

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to government enterprises. The following is a summary of the Authority's significant accounting policies:

#### (a) Basis of Presentation

The Authority is required by the Enabling Act to establish user rates for its water and sewer services which provide sufficient funds to recover the costs of operations (excluding depreciation), debt service, maintenance, replacements, and improvements to its facilities, and appropriate reserves. The Authority's financial statements are reported on the accrual basis of accounting and the economic measurement focus as specified by the Governmental Accounting Standards Board's requirements for an enterprise fund.

The Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing water and sewer services to its member communities. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses. All operating revenues are pledged for repayment of outstanding debt service.

Under the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority has adopted the option to apply all Financial Accounting Standards Board (FASB) Statements and Interpretations issued before November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

In addition, the Authority has adopted the provisions of FASB No. 71, *Accounting for the Effects of Certain Types of Regulation*, to provide a better matching of revenues and expenses. The effect of this policy has been to defer certain costs, which will be recovered through future revenues in accordance with the Authority's rate model, and to record deferred credits for revenue collected



**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

through current rates for costs expected to be incurred in the future. The effects of the Authority's accounting policies under Statement No. 71 are discussed further in notes 3 and 9.

**(b) Capital Assets**

On July 1, 1985, ownership of the MDC's sewer and waterworks personal property was transferred to the Authority. Pursuant to the Enabling Act, ownership of the real property of the MDC sewer and waterworks systems was not transferred from the Commonwealth to the Authority; however, the Authority has the right to use, improve, maintain, and manage that property. In addition, ownership of the real and personal property of the watershed system remains with the Commonwealth; however, the Authority has the right to utilize the water therefrom for water supply purposes.

The personal property, together with the rights to the real property and watershed system, was recorded at its estimated fair market value of \$2,331,465 (including certain construction projects which were in progress as of July 1, 1985) based upon an appraisal performed by valuation specialists. Property, plant, and equipment acquired or constructed since July 1, 1985, is stated at historical cost, and includes the expenditure of capital grants in aid of construction.

Betterments and major renewals are capitalized and included in capital asset accounts, while expenditures for maintenance and repairs are charged to expense when incurred. The cost of depreciable assets and related accumulated depreciation are eliminated from the accounts when such items are disposed of or otherwise retired.

**(c) Interest Cost and Principal Payments on Construction**

During fiscal 2004 and 2003, none of the Authority's interest expense was capitalized to construction in progress, in accordance with its current policy of recovering such costs through rates as incurred. Rates collected for principal payments on debt related to assets under construction are deferred until the related asset is completed and depreciation commences.

**(d) Depreciation**

The Authority provides for depreciation by use of the straight-line method. Depreciation is intended to distribute the cost of depreciable properties, including those financed by capital grants in aid of construction, over the following estimated average useful lives:

	<u>Years</u>
Plant and equipment, water and sewerage systems	5-100
Motor vehicles and equipment	5
Furniture and fixtures	7
Leasehold improvements	3-5

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

**(e) Revenue Recognition**

The Authority recognizes revenue as amounts become collectible from its customers for water and sewer services provided. The majority of the Authority's billings to cities and towns are subject to, in the event of nonpayment, the local aid intercept allowed by the Enabling Act.

**(f) Cash and Cash Equivalents**

The Authority's policy is to treat unrestricted investments with a maturity date of three months or less when purchased as cash equivalents for purposes of the cash flow statements. Restricted cash and cash equivalents are combined with investments on the balance sheets, and shown separately on the statements of cash flows as an investing activity.

**(g) Payments in Lieu of Taxes**

The Enabling Act authorizes and directs the Authority to pay to the DCR (formerly the MDC) Division of Watershed Management an amount for payment to each city or town in which land of the Quabbin watershed and Ware River watershed is located. Each such payment is equal to the amount which the respective city or town would receive in property taxes, based upon the fair value of such land if such land were not tax exempt.

**(h) Investments**

Investments are recorded at fair value. Fair value is determined based on quoted market price. The Authority recorded unrealized losses of \$15,375 in fiscal 2004 and unrealized gains of \$8,776 in 2003 as part of investment income.

**(i) 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 expenditures during the reporting period. Actual results could differ from those estimates.

**(j) Reclassifications**

Certain reclassifications were made to the fiscal year 2003 financial statements to conform to the fiscal year 2004 presentation.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

**(3) Deferred Charges and Credits**

In accordance with FASB No. 71, deferred charges and credits result primarily from differences between depreciation on property, plant, and equipment not financed by grants or capital contributions, which is recovered through rates as principal payments on debt service and from amounts determined by the Board to be utilized in a subsequent year to reduce customer billings (rate stabilization).

A summary of the activity of FASB No. 71 charges (credits) for fiscal 2004 and 2003 is as follows:

	<u>Sewer</u>	<u>Water</u>	<u>Total</u>
Balance, June 30, 2002, net	\$ 39,547	49,447	88,994
Difference between depreciation of capital assets not financed by grants or capital contributions, and debt service in excess of interest expense	32,130	5,188	37,318
Bond redemption, net	41,442	(2,136)	39,306
Rate stabilization: current year usage	14,691	—	14,691
Other, net	<u>(30,969)</u>	<u>2,778</u>	<u>(28,191)</u>
Balance, June 30, 2003, net	96,841	55,277	152,118
Difference between depreciation of capital assets not financed by grants or capital contributions, and debt service in excess of interest expense	51,725	8,655	60,380
Bond redemption, net	13,408	(7,289)	6,119
Other, net	<u>(11,780)</u>	<u>(464)</u>	<u>(12,244)</u>
Balance, June 30, 2004, net	\$ <u>150,194</u>	<u>56,179</u>	<u>206,373</u>

The net balance at June 30, 2004 and 2003 is presented on the balance sheets as follows:

	<u>2004</u>	<u>2003</u>	<u>Current year change</u>
Deferred charges	\$ 292,088	239,280	52,808
Deferred credits	<u>(85,715)</u>	<u>(87,162)</u>	1,447
Net change in deferrals	\$ <u>206,373</u>	<u>152,118</u>	<u>54,255</u>

The balance in the rate stabilization reserve which is included in deferred credits was \$41,445 at June 30, 2004 and 2003.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

**(4) Deposits and Investments**

The Authority is authorized by its general bond resolution to invest in obligations of the U.S. Treasury, its agencies and instrumentalities, bonds, or notes of public agencies or municipalities, bank time deposits, guaranteed interest contracts, money market accounts, interest rate swap agreements, and repurchase agreements. These investments are recorded at fair value.

**(a) Deposits**

The Authority's deposits are classified as follows: those deposits that are fully insured or collateralized with securities held by the Authority or its agent in the Authority's name (Category 1), those deposits that are collateralized with securities held by the pledging financial institution's trust department or agent in the Authority's name (Category 2), and those deposits that are not collateralized (Category 3). Money market mutual funds are not categorized. A summary of these deposits as of June 30, 2004 and 2003 is as follows:

		<b>2004</b>				
		<b>Category</b>			<b>Total bank balance</b>	<b>Carrying amount</b>
		<b>1</b>	<b>2</b>	<b>3</b>		
Cash and cash equivalents	\$	200	—	34,614	34,814	34,030
Not categorized:						
Money market mutual funds					400,449	400,449
Total					\$ 435,263	434,479
		<b>2003</b>				
		<b>Category</b>			<b>Total bank balance</b>	<b>Carrying amount</b>
		<b>1</b>	<b>2</b>	<b>3</b>		
Cash and cash equivalents	\$	200	—	35,262	35,462	33,349
Not categorized:						
Money market mutual funds					312,907	312,907
Total					\$ 348,369	346,256

Outstanding checks largely account for the difference between the bank balance and the carrying amount of deposits.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

**(b) Investments**

The Authority's investments are categorized according to the level of risk assumed by the Authority. Category 1 includes investments that are insured, registered, or held by the Authority's trustee in the Authority's name. Category 2 includes uninsured and unregistered investments held by the counterparty's trust department or agent in the Authority's name. Category 3 includes uninsured or unregistered investments held by the counterparty, its trust department or agent but not in the Authority's name. A summary of these investments as of June 30, 2004 and 2003 is as follows:

	<b>2004</b>			
	<b>Category</b>			<b>Fair value</b>
	<b>1</b>	<b>2</b>	<b>3</b>	
U.S. Government obligations	\$ 23,926	—	—	23,926
U.S. Government Agency obligations	285,960	—	—	285,960
Guaranteed interest contracts	81,123	—	—	81,123
Total	\$ <u>391,009</u>	<u>—</u>	<u>—</u>	<u>391,009</u>
	<b>2003</b>			
	<b>Category</b>			<b>Fair value</b>
	<b>1</b>	<b>2</b>	<b>3</b>	
U.S. Government obligations	\$ 50,223	—	—	50,223
U.S. Government Agency obligations	253,229	—	—	253,229
Guaranteed interest contracts	81,123	—	—	81,123
Total	\$ <u>384,575</u>	<u>—</u>	<u>—</u>	<u>384,575</u>

**(5) Bond Resolution Reserves**

The components of the reserves required by the general and supplemental bond resolutions are as follows at June 30:

<b>Reserves</b>		<b>Sewer</b>	<b>Water</b>	<b>2004 Total</b>	<b>2003 Total</b>
Renewal and replacement	\$	17,300	11,701	29,001	44,001
Insurance		9,000	9,000	18,000	18,000
Operating		24,221	7,846	32,067	37,067
Community obligation and revenue enhancement		18,399	1,717	20,116	20,116
Total	\$	<u>68,920</u>	<u>30,264</u>	<u>99,184</u>	<u>119,184</u>

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

A renewal and replacement reserve of \$6,000 was established through grant receipts transferred from the Commonwealth in 1985 and is included in restricted net assets at June 30, 2004 and 2003.

**(6) Notes Payable and Long-Term Debt**

Long-term debt at June 30, consisted of the following:

	<u>2004</u>	<u>2003</u>
General Revenue Bonds:		
1990 Series A, 7 1/2%, issued February 15, 1990, due 2006	\$ 22,293	20,721
1992 Series A, 6 1/2%, issued April 8, 1992, due 2007 to 2019	387,845	387,845
1993 Series C, 4 3/4% to 6%, issued December 2, 1993, due 2006 to 2023	272,810	285,485
1994 Series A, 5 1/10% to 5 6/10%, issued August 16, 1994, due 2004	3,255	17,210
1995 Series B, 4% to 6 1/4%, issued January 4, 1996, due 2004 to 2024	217,705	223,630
1996 Series A, 5 1/10% to 6%, issued November 5, 1996, due 2004 to 2010	25,295	25,295
1998 Series A, 4 1/2% to 5 1/2%, issued January 27, 1998, due 2004 to 2032	190,445	193,710
2000 Series A, 4 1/2% to 6 1/8%, issued March 1, 2000, due 2004 to 2039	277,315	281,020
2002 Series B, 5% to 5 1/2%, issued March 15, 2002, due 2004 to 2027	175,875	179,365
2002 Series J, 3% to 5 1/2%, issued December 18, 2002, due 2008 to 2042	591,395	600,410
2003 Series D, 2% to 5%, issued January 7, 2004, due 2004 to 2028	165,000	—
2004 Series A, 2% to 5 1/8%, issued June 10, 2004, due 2005 to 2022	130,000	—
	<u>2,459,233</u>	<u>2,214,691</u>
General Revenue Refunding Bonds:		
1997 Series D, 4 1/4% to 6%, issued December 15, 1997, due 2004 to 2020	133,135	134,095
1998 Series B, 4 1/4% to 5 1/2%, issued January 27, 1998, due 2005 to 2022	104,545	104,545
	<u>237,680</u>	<u>238,640</u>

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
Subordinated debt:		
General Revenue Bonds with the Massachusetts Water Pollution Abatement Trust:		
1993 Series A, 4 5/8% to 5 1/2%, issued March 18, 1993, due 2004 to 2013	7,840	9,190
1993 Series D, 4 1/2% to 5 1/4%, issued January 6, 1994, due 2004 to 2014	6,230	7,060
1995 Series A, 4 1/2% to 6%, issued November 21, 1995, due 2004 to 2015	7,460	8,355
1998 Series C, 4% to 5 3/8%, issued July 9, 1998, due 2004 to 2018	14,300	15,655
1999 Series E Sewer, 4% to 5 3/8%, issued October 6, 1999, due 2004 to 2029	9,777	10,016
1999 Series E Water, 4% to 5 3/8%, issued October 6, 1999, due 2004 to 2029	10,158	10,646
1999 Series F, 4 2/10% to 6%, issued November 3, 1999, due 2004 to 2029	368,435	376,570
2000 Series E Sewer, 4 1/2% to 5 5/8%, issued November 1, 2000, due 2004 to 2030	70,377	71,869
2000 Series E Water, 4 1/2% to 5 5/8%, issued November 1, 2000, due 2004 to 2030	11,228	11,724
2001 Series C Water, 3% to 5 1/4%, issued July 26, 2001, due 2004 to 2021	4,839	5,056
2001 Series D Sewer, 4% to 5 3/4%, issued July 26, 2001, due 2004 to 2019	7,347	7,689
2001 Series D Water, 4% to 5 3/4%, issued July 26, 2001, due 2004 to 2019	1,435	1,504
2002 Series H Sewer, 3% to 5 1/4%, issued October 31, 2002, due 2004 to 2032	89,790	91,665
2002 Series H Water, 3% to 5 1/4%, issued October 31, 2002, due 2004 to 2032	31,905	33,135
2002 Series I Sewer, 4 1/4% to 5 5/8%, issued October 31, 2002, due 2004 to 2030	2,586	2,645
2002 Series I Water, 4 1/4% to 5 5/8%, issued October 31, 2002, due 2004 to 2030	29	30
2003 Series A Water, 3% to 5 1/4%, issued October 31, 2002, due 2004 to 2020	1,474	1,532
2003 Series B Water, 3% to 5 1/4%, issued July 24, 2003, due 2004 to 2021	4,368	—
2003 Series C Sewer, 2% to 5 1/2%, issued November 6, 2003, due 2004 to 2033	29,806	—
2003 Series C Water, 2% to 5 1/2%, issued November 6, 2003, due 2004 to 2023	21,630	—
	<u>701,014</u>	<u>664,341</u>

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
General Revenue Bonds (variable rate):		
1997 Series A, 0.55% to 1.18%, issued June 18, 1997, due 2004 to 2028	80,400	81,600
1997 Series B, 0.7% to 1.2%, issued June 18, 1997, due 2004 to 2028	80,400	81,600
1999 Series A, 0.65% to 1.15%, issued January 14, 1999, due 2004 to 2028	91,700	93,000
1999 Series B, 0.55% to 1.18%, issued January 29, 1999, due 2004 to 2028	91,700	93,000
1999 Series C, 0.6% to 1.0%, issued June 8, 1999, due 2004 to 2029	70,800	71,700
1999 Series D, 0.85% to 1.2%, issued June 8, 1999, due 2004 to 2029	70,800	71,700
2001 Series A, 0.55% to 1.16%, issued September 26, 2001, due 2004 to 2023	91,200	93,100
2001 Series B, 0.65% to 1.2%, issued September 26, 2001, due 2023 to 2031	85,000	85,000
	<u>662,000</u>	<u>670,700</u>
General Revenue Refunding Bonds (variable rate):		
1998 Series D, 0.7% to 1.2%, issued December 22, 1998, due 2008 to 2026	198,895	198,895
2000 Series B, 0.7% to 1.2%, issued March 22, 2000, due 2004 to 2037	134,200	134,600
2000 Series C, 0.7% to 1.2%, issued March 22, 2000, due 2004 to 2037	134,200	134,600
2002 Series C, 0.64% to 1.14%, issued August 15, 2002, due 2020	80,000	80,000
2002 Series D, 0.60% to 1.21%, issued August 15, 2002, due 2008 to 2017	76,450	76,450
2002 Series E, 0.75% to 1.0%, issued August 15, 2002, due 2010 to 2011	83,400	83,400
2002 Series F, 0.62% to 1.0%, issued August 15, 2002, due 2012 to 2013	90,900	90,900
2002 Series G, 0.61% to 1.0%, issued August 15, 2002, due 2014 to 2015	99,250	99,250
	<u>897,295</u>	<u>898,095</u>



**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

	<u>2004</u>	<u>2003</u>
General Revenue Bonds (fixed rates):		
2000 Series D, 5 1/2%, issued October 1, 2000, due 2009 to 2011	\$ 150,000	150,000
	<u>5,107,222</u>	<u>4,836,467</u>
Less:		
Unamortized issuance and discount costs	(30,175)	(32,599)
Unamortized excess of reacquisition price over net carrying amount of defeased bonds	(139,576)	(148,154)
Current portion of long-term debt	<u>(52,528)</u>	<u>(48,426)</u>
	<u>(222,279)</u>	<u>(229,179)</u>
Long-term debt, net	\$ <u>4,884,943</u>	<u>4,607,288</u>

Long-term debt at June 30, 2004 and 2003 consisted of the following:

	<u>2003</u> <u>Beginning</u> <u>balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>2004</u> <u>Ending</u> <u>balance</u>	<u>Due</u> <u>within</u> <u>one year</u>
General Revenue Bonds	\$ 3,035,391	296,572	60,730	3,271,233	29,190
General Revenue Refunding Bonds	1,136,735	—	1,760	1,134,975	1,900
General Revenue Bonds with the Massachusetts Water Pollution Abatement Trust	<u>664,341</u>	<u>56,002</u>	<u>19,329</u>	<u>701,014</u>	<u>21,438</u>
	\$ <u>4,836,467</u>	<u>352,574</u>	<u>81,819</u>	<u>5,107,222</u>	<u>52,528</u>
	<u>2002</u> <u>Beginning</u> <u>balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>2003</u> <u>Ending</u> <u>balance</u>	<u>Due</u> <u>within</u> <u>one year</u>
General Revenue Bonds	\$ 2,508,194	601,872	74,675	3,035,391	27,536
General Revenue Refunding Bonds	1,607,380	430,000	900,645	1,136,735	1,760
General Revenue Bonds with the Massachusetts Water Pollution Abatement Trust	<u>591,368</u>	<u>129,007</u>	<u>56,034</u>	<u>664,341</u>	<u>19,130</u>
	\$ <u>4,706,942</u>	<u>1,160,879</u>	<u>1,031,354</u>	<u>4,836,467</u>	<u>48,426</u>

The Authority is required to establish water and sewer rates and charges at a level sufficient to provide, among other things, primary and subordinated debt service coverage ratios of 110% and 120%, respectively. For the year ended June 30, 2004, the Authority had primary and subordinated debt service coverage ratios of 191% and 115%, respectively.

The Act of 1984 imposes a limitation of \$600,000 on the total amount of bonds and notes which may be outstanding at any one time. The Authority has requested increases in its debt limit as necessary to allow

# MASSACHUSETTS WATER RESOURCES AUTHORITY

## Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

for issuances of bonds in amounts required to finance the capital program. The state legislature increased the debt limit to \$5,800,000.

On January 7, 2004, the Authority issued General Revenue Bonds, 2003 Series D in the principal amount of \$165,000. The proceeds from these bonds will be used to fund ongoing capital projects. The interest rate on these bonds range from 2% to 5%.

On June 10, 2004, the Authority issued General Revenue Bonds, 2004 Series A in the principal amount of \$130,000. The proceeds from these bonds will be used to fund ongoing capital projects and to defease \$10,860 of bonds outstanding. The interest rate on these bonds range from 2% to 5 1/8%. The cash flow required to make principal and interest payments on the refunding bonds is approximately \$478 less than the debt service requirements for the defeased bonds. The economic gain (the difference between the present value of the debt service payments on the old and new debt) obtained from this refunding was \$470.

On August 15, 2002, the Authority issued Multi-Modal Subordinated General Revenue Refunding Bonds, 2002 Series C, 2002 Series D, 2002 Series E, 2002 Series F and 2002 Series G in the principal amounts of \$80,000, \$76,450, \$83,400, \$90,900 and \$99,250, respectively. The proceeds from these bonds were used to defease \$446,155 of bonds outstanding. Series C and D bonds have variable interest rates, which are currently reset daily. The interest rate for these bonds outstanding during fiscal 2004 ranged from 0.6% to 1.21%. Series E, F and G bonds have variable interest rates which are reset and payable on a weekly basis. The interest rate for these bonds outstanding during fiscal 2004 ranged from 0.61% to 1.0%.

The cash flow required to make principal and interest payments on the Refunding bonds is approximately \$14,484 less than the debt service requirements for the defeased bonds. The economic gain (the difference between the present values of the debt service payments on the old and new debt) obtained from this refunding was \$26,729.

On December 18, 2002, the Authority issued General Revenue Bonds, 2002 Series J in the principal amount of \$600,410. The proceeds from these bonds were used to defease \$428,090 of bonds outstanding. These bonds have a variable interest rate ranging from 3% to 5.5% per annum. The cash flow required to make principal and interest payments on the Refunding bonds is approximately \$13,383 less than the debt service requirements for the defeased bonds. The economic gain (the difference between the present values of the debt service payments on the old and new debt) obtained from this refunding was \$23,760.

In connection with several of its bond issues, the Authority has entered into various interest rate swap agreements to reduce the impact of changes in interest rates on its variable rate debt. Under these agreements, the Authority pays a fixed interest rate (ranging from 3.9% to 6.9%) and receives interest from the swap counterparties at a variable rate (either Bond Market Association (BMA) rate or 67% LIBOR). The BMA rate is based on the seven-day, high grade market index of tax-exempt, variable rate demand obligations. The Authority also has one swap where it receives a fixed rate of 4.9% and pays the BMA rate. Under these agreements the Authority incurred net interest expense of \$32,174 and \$28,562 in fiscal 2004 and fiscal 2003, respectively.

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(Dollars in thousands)

**Summary of Swap Transactions by Category**

*Synthetic Fixed Rate Swap Transactions*

<u>Date of execution</u>	<u>Notional amount</u>	<u>Termination date</u>	<u>Associated bonds</u>	<u>Fixed payable swap rate</u>	<u>Variable receivable swap rate</u>	<u>Lump-sum payment from counterparty</u>	<u>Counterparty credit rating at June 30, 2004</u>	<u>Fair value at June 30, 2004</u>
03/15/00	\$ 268,400	08/01/30	2000 Series B & C	5.130%	BMA	N/A	Aaa	\$ (28,330)
03/15/00	70,400	08/01/37	2000 Series B & C	6.935	BMA	N/A	Aaa	(1,418)
01/14/99	91,700	08/01/06	1999 Series A	3.947	BMA	N/A	Aaa	(2,764)
01/14/99	91,700	08/01/06	1999 Series B	3.949	BMA	N/A	Aaa	(2,847)
12/22/98	198,895	11/01/26	1998 Series D	3.994	BMA	N/A	Aaa	2,706
08/15/02	350,000	08/01/15	2002 Series D, E, F, G	4.127	67% LIBOR	N/A	A+	(21,793)

*Synthetic Variable Rate Swap Transactions*

<u>Date of execution</u>	<u>Notional amount</u>	<u>Termination date</u>	<u>Associated bonds</u>	<u>Fixed receivable swap rate</u>	<u>Variable payable swap rate</u>	<u>Lump-sum payment from counterparty</u>	<u>Counterparty credit rating at June 30, 2004</u>	<u>Fair value at June 30, 2004</u>
10/26/00	\$ 150,000	08/01/11	2000 Series D	4.906%	BMA	N/A	A+	\$ 12,335

*Risk Disclosure*

*Credit Risk.* Because all of the Authority's swaps rely upon the performance of the third parties who serve as swap counterparties, the Authority is exposed to credit risk, or the risk that a swap counterparty fails to perform according to its contractual obligations. The appropriate measurement of this risk at the reporting date is the fair value of the swaps, as shown in the columns labeled fair value in the tables above. All fair values have been calculated using the mark to market or par value method. To mitigate credit risk, the Authority maintains strict credit standards for swap counterparties. All swap counterparties for longer term swaps are rated in the A+ category or higher by at least two of the three rating agencies (FITCHRATINGS, Moody's Investors Service and Standard and Poor's).

*Basis Risk.* The Authority is exposed to basis risk if the relationship between the floating index the Authority receives on the swaps (BMA or 67% of LIBOR) falls short of the variable rate on the associated bonds. Should this occur, the expected savings may not be realized.

*Rollover Risk:* Because the swaps for the 1999 A and B bonds terminate prior to the maturity of such bonds, the Authority is exposed to rollover risk. Upon the termination of the swaps, the Authority will no longer realize the synthetic rate on these bonds and will be exposed to the floating rate risk on the underlying bonds if no new swap is put in place.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

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(Dollars in thousands)

At June 30, 2004, the following bonds outstanding are considered defeased in substance:

<b>Description</b>	<b>Redemption date</b>	<b>Redemption price</b>	<b>Outstanding principal amount</b>
1990 Series A	2005-2020	102%	\$ 626,980
1991 Series A	2004-2021	100% to 102%	239,620
1992 Series A	2012-2022	100% to 102%	283,500
1992 Series B	2004-2020	100%	442,140
1993 Series A	2004-2013	100% to 102%	73,415
1993 Series B	2005-2022	100% to 102%	402,050
1993 Series C	2017-2020	100% to 102%	96,885
1993 Series D	2004-2014	100% to 102%	49,375
1994 Series A	2005-2024	101.5%	124,005
1995 Series A	2004-2015	100% to 102%	52,845
1995 Series B	2005	100%	5,925
1996 Series A	2011-2026	100% to 102%	109,085
1998 Series C	2004-2018	100% to 102%	89,720
2000 Series A	2005	100%	1,940
2002 Series B	2005	100%	1,795

The proceeds and available funds were deposited in an irrevocable trust with an escrow agent in an amount which will provide for payment of interest due to the redemption date and redemption of the defeased bonds outstanding on such date. The defeased portion of such debt, accrued interest thereon, and related unamortized issuance and discount costs were removed from the balance sheet in an in-substance defeasance transaction.

Outstanding bonds that are redeemable before their scheduled due dates are as follows at June 30, 2004:

<b>Description</b>	<b>Redemption date</b>	<b>Redemption price</b>	<b>Outstanding principal amount</b>
1993 Series C	December 2004	100% to 102%	\$ 120,245
1995 Series B	December 2005	100% to 102%	179,730
1996 Series A	November 2006	100% to 101%	15,625
1997 Series D	August 2008	100% to 101%	113,375
1998 Series A	August 2008	100%	141,290
1998 Series B	August 2008	100%	72,945
2000 Series A	August 2010	100% to 101%	246,655
2002 Series B	August 2011	100% to 101%	161,885
2002 Series J	August 2012	100%	200,000
2003 Series D	August 2013	100%	77,995
2004 Series A	August 2014	100%	21,800

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The variable rate general revenue bonds are subject to redemption prior to maturity at the option of the Authority in whole or in part, on any interest payment date.

During fiscal 2004, the Authority executed loan agreements with Massachusetts Water Pollution Abatement Trust (MWPAT) providing for 2003 Series B Water and 2003 Series C Sewer and Water loans in the principal amounts of \$4,566, \$29,806, and \$21,630, respectively. All proceeds of these loans were received by June 30, 2004, except \$2,386 and \$661, principal and premium, respectively, for 2003 Series C Sewer.

During fiscal 2003, the Authority executed loan agreements with MWPAT providing for 2002 Series H Sewer and Water, 2002 Series I Sewer and Water, and 2003 Series A Water loans in the principal amounts of \$91,665, \$33,135, \$2,645, \$30, and \$1,532, respectively. All proceeds for these loans were received by June 30, 2003.

Federal and Commonwealth subsidies for purposes of offsetting principal payments aggregating \$141,850 will be recognized as capital grants in aid of construction over the term of the loans.

Interest is payable semiannually on all debt, except on the commercial paper and capital appreciation bonds, on which interest is payable upon maturity and the General Revenue Bonds with variable interest rates on which interest is payable monthly. The Senior General Revenue Bonds and the General Revenue Refunding Bonds are collateralized equally and ratably by a lien and pledge on substantially all of the Authority's cash and revenues, except the operating fund. The subordinated debt series, including the commercial paper are collateralized equally and ratably by a subordinated pledge on substantially all of the Authority's revenues and cash and investments, except the operating, debt service and debt service reserve funds. Discounts, issuance costs, and the excess of reacquisition price over the carrying amount of the defeased debt are being amortized over the lives of the respective issues.

The amounts of long-term debt, principal and interest, payable in future fiscal years are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2005	\$ 52,528	224,348	276,876
2006	65,924	229,047	294,971
2007	67,503	226,387	293,890
2008	86,528	222,851	309,379
2009	113,358	218,035	331,393
2010-2014	1,003,150	962,334	1,965,484
2015-2019	1,173,428	721,619	1,895,047
2020-2024	1,298,552	447,895	1,746,447
2025-2029	769,577	209,475	979,052
2030-2034	258,044	90,087	348,131
2035-2039	148,565	41,530	190,095
2040-2044	70,065	5,958	76,023
Total	<u>\$ 5,107,222</u>	<u>3,599,566</u>	<u>8,706,788</u>

# MASSACHUSETTS WATER RESOURCES AUTHORITY

## Notes to Financial Statements

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(Dollars in thousands)

The Authority issued commercial paper notes of \$307,000 to finance capital expenditures, which are secured by \$102,466 and \$224,000 irrevocable direct-pay letters of credit which expire on September 8, 2004 and March 14, 2008, respectively. These letters of credit carry a fee of 0.25% and 0.28% per annum, respectively, on the amount available.

The maximum aggregate principal amount of commercial paper which may be outstanding at any one time is \$350,000. At June 30, 2004 and 2003, the amounts outstanding were \$307,000 and \$311,000, respectively. The weighted average interest rate on commercial paper outstanding at June 30, 2004 and 2003 was 0.97% and 1.5%, respectively.

### **(7) Accounts Receivable/Intergovernmental Loans**

The Authority has entered into various interest-free loan agreements with certain member communities. Under these agreements, the Authority loaned these communities \$23,365 and \$26,965 in fiscal 2004 and 2003, respectively, to be received in five or ten equal annual installments.

The long-term portion of these loans at June 30, 2004 and 2003 is \$64,472 and \$53,637, respectively, and is included in other assets. This program is designed to assist member communities with sewer and water systems rehabilitation.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

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(Dollars in thousands)

**(8) Capital Assets**

Capital assets consisted of the following at June 30:

	<u>2003</u>	<u>Additions</u>	<u>Disposals/ transfers</u>	<u>2004</u>
Capital assets, not being depreciated:				
Land	\$ 16,806	22	(2,896)	13,932
Construction in progress	822,349	194,124	(147,834)	868,639
Total capital assets, not being depreciated	<u>839,155</u>	<u>194,146</u>	<u>(150,730)</u>	<u>882,571</u>
Capital assets, being depreciated:				
Plant and equipment, water and sewage system	7,207,416	107,830	—	7,315,246
Furniture and fixtures	29,151	3,081	—	32,232
Leasehold improvements	5,081	—	—	5,081
Motor vehicles and equipment	1,595	—	—	1,595
Total capital assets, being depreciated	<u>7,243,243</u>	<u>110,911</u>	<u>—</u>	<u>7,354,154</u>
Less accumulated depreciation for:				
Plant and equipment, water and sewage system	1,507,659	148,316	—	1,655,975
Furniture and fixtures	19,234	3,933	—	23,167
Leasehold improvements	3,325	446	—	3,771
Motor vehicles and equipment	971	20	—	991
Total accumulated depreciation	<u>1,531,189</u>	<u>152,715</u>	<u>—</u>	<u>1,683,904</u>
Total capital assets, being depreciated, net	<u>5,712,054</u>	<u>(41,804)</u>	<u>—</u>	<u>5,670,250</u>
Capital assets, net	\$ <u><u>6,551,209</u></u>	<u><u>152,342</u></u>	<u><u>(150,730)</u></u>	<u><u>6,552,821</u></u>

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June 30, 2004 and 2003

(Dollars in thousands)

Capital assets consisted of the following at June 30:

	<u>2002</u>	<u>Additions</u>	<u>Disposals/ transfers</u>	<u>2003</u>
Capital assets, not being depreciated:				
Land	\$ 16,806	—	—	16,806
Construction in progress	1,177,074	297,021	651,746	822,349
Total capital assets, not being depreciated	<u>1,193,880</u>	<u>297,021</u>	<u>651,746</u>	<u>839,155</u>
Capital assets, being depreciated:				
Plant and equipment, water and sewage system	6,608,337	599,079	—	7,207,416
Furniture and fixtures	19,234	9,917	—	29,151
Leasehold improvements	4,614	467	—	5,081
Motor vehicles and equipment	1,595	—	—	1,595
Total capital assets, being depreciated	<u>6,633,780</u>	<u>609,463</u>	<u>—</u>	<u>7,243,243</u>
Less accumulated depreciation for:				
Plant and equipment, water and sewage system	1,362,754	144,905	—	1,507,659
Furniture and fixtures	19,213	21	—	19,234
Leasehold improvements	2,880	445	—	3,325
Motor vehicles and equipment	952	19	—	971
Total accumulated depreciation	<u>1,385,799</u>	<u>145,390</u>	<u>—</u>	<u>1,531,189</u>
Total capital assets, being depreciated, net	<u>5,247,981</u>	<u>464,073</u>	<u>—</u>	<u>5,712,054</u>
Capital assets, net	<u>\$ 6,441,861</u>	<u>761,094</u>	<u>651,746</u>	<u>6,551,209</u>

Depreciation and amortization for fiscal 2004 and 2003 was \$161,492 and \$155,159, respectively.

**(9) Other Assets**

On December 17, 1997, the Authority sold to Massachusetts Heavy Industries, Inc. (MHI) certain land, buildings, machinery, equipment, and other items located within a former shipbuilding facility, known as



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Notes to Financial Statements

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the Fore River Shipyard, for a total purchase price of \$10,000. The Authority received \$3,000 in December 1997. The remaining balance of \$7,000 was due to be received beginning in December 1999. In accordance with FASB No. 71, the original loss of \$28,303 was accounted for as a deferred charge and is expected to be recovered through future rates. During fiscal 2000, the \$7,000 receivable was determined to be uncollectible increasing the deferred loss on the original sale to \$35,303.

**(10) Leases**

*(a) Operating*

The Authority leases electrical power assets, office space in Boston, and other property under long-term operating leases. Future minimum rental payments required under operating leases having initial or remaining noncancelable lease terms in excess of one year are as follows at June 30, 2004:

Year ending June 30:	
2005	\$ 9,665
2006	9,486
2007	6,824
2008	5,705
2009	5,533
2010-2014	25,322
2015-2019	<u>7,268</u>
	<u>\$ 69,803</u>

The Authority has the option to extend the lease agreements on the Boston offices for a subsequent five-year period at costs ranging from the current market rent at the extension date to an 18% increase.

Rental expense was \$14,177 and \$17,265 in fiscal years 2004 and 2003, respectively.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

**(b) Capital**

In fiscal 2003, the Authority entered into a 30-year capital lease agreement for the new maintenance facility. The interest rate for the capital lease is 7.83%. Future minimum lease payments for the capital lease are as follows at June 30, 2004:

	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
Year ending June 30:			
2005	\$ 377	2,840	3,217
2006	408	2,809	3,217
2007	441	2,776	3,217
2008	477	2,740	3,217
2009	516	2,701	3,217
2010-2014	3,279	12,806	16,085
2015-2019	4,844	11,241	16,085
2020-2024	7,157	8,929	16,086
2025-2029	10,572	5,513	16,085
2030-2032	8,365	1,019	9,384
Total	\$ 36,436	53,374	89,810

Under this lease, the Authority is also responsible for “Additional Rent,” as defined in the lease. The Additional Rent includes real estate taxes, assessments and other government charges.

**(11) Retirement Benefits**

**(a) Plan Description**

The Enabling Act provided for the establishment of the Massachusetts Water Resources Authority Employees’ Retirement System (the Plan), a contributory single-employer retirement system that is separate from the State Employees Retirement System. The Plan is a defined benefit pension plan covering those employees not employed by the MDC prior to July 1, 1985. Total payroll and covered payroll for all Authority employees in the Plan were \$68,241 and \$64,884, respectively, for the year ended June 30, 2004.

Under the provisions of the Plan, pension benefits vest after 10 years of full-time employment. An employee may retire after 20 years of service or at age 55 and completion of 10 years of service. At age 65, annual pension benefits equal 2 1/2% of the employee’s average regular compensation earned during the last three years of employment or any three consecutive years when compensation was higher, multiplied by each year of creditable service. The benefit is reduced if retirement occurs before age 65 or if survivor’s benefits are elected. The Plan also provides death and disability benefits. Ordinary disability benefits are available only to employees under age 55 with at least ten years of service. Complete financial statements for the Plan can be obtained from the Authority’s administrative offices at Charlestown Navy Yard, 100 First Avenue, Boston, Massachusetts 02129.

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(Dollars in thousands)

**(b) Funding Policy**

Contributions made by employees are based upon a percentage of employee base pay (5% for employees hired before December 31, 1974, 7% for employees hired between January 1, 1975 and December 31, 1983, 8% for employees hired between December 31, 1983 and June 30, 1996, and 9% for employees hired after July 1, 1996). Additionally, certain employees earning in excess of \$30 contribute an extra 2% of their salary effective January 1, 1979. Employees receive full payment of contributions upon withdrawal from the Plan and 50% of interest earned for employees with five to nine years of service or 100% of interest earned for employees with ten or more years of service.

The 2004 and 2003 contributions to the plan were based on an amount approved by the Retirement Board and the Authority's board of directors. The Authority's Enabling Act requires funding to be made in accordance with the Retirement Board's recommendation. In 2003, the Authority contributed an amount equal to the Annual Pension Cost (APC). In 2004, the Authority contributed \$1,194 more than the APC or \$3,882.

**(c) Annual Pension Cost**

The annual required contribution for the current year was determined as part of the January 1, 2001, actuarial valuation using the entry age normal cost method. The actuarial assumptions included (a) 8% investment rate of return and (b) projected salary increase of 5.5% per year. Liabilities for cost of living increases have been assumed at an annual increase of 3%, on the first \$12 of benefit payments. Assets are valued at market value.

**(d) Three-Year Trend Information**

	<b>Annual pension cost (APC)</b>	<b>Percentage of APC contributed</b>	<b>Net pension obligation</b>
Fiscal year ending:			
2004	\$ 2,688	144%	\$ —
2003	2,560	100%	—
2002	2,438	100%	—

**(e) Other Benefits**

All MDC personnel who became employees of the Authority on July 1, 1985, and were members of the State Employees Retirement System, retained their membership in that system. The Authority is not liable for retirement allowances paid to or on account of these employees. Funding of the pension liability of the State Employees Retirement System is the obligation of the Commonwealth. Employees covered by this plan become 100% vested after ten years of service. The Authority's covered payroll for members of this plan for the year ended June 30, 2004 was \$8,324.

The Authority's policy is to provide certain health care and life insurance benefits for retired employees. Substantially all of the Authority's employees may become eligible for those benefits if

# MASSACHUSETTS WATER RESOURCES AUTHORITY

## Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

they reach normal retirement age while working for the Authority. Those and similar benefits for active employees are provided through an insurance company whose premiums are based on the benefits paid during the year. Premiums for retired employees were \$992 and \$935 in fiscal 2004 and 2003, respectively.

### **(12) Commitments and Contingencies**

A major capital improvement program is currently in progress. As part of this program, the Authority has entered into a number of contracts for the design and construction of facilities. Commitments under these contracts aggregated approximately \$388,127 at June 30, 2004.

The Authority continues to be a defendant, along with the Boston Water and Sewer Commission (BWSC) and the Commonwealth, in an action brought by the United States on behalf of the Environment Protection Agency (EPA) and by certain citizens groups in the Federal District Court of Massachusetts for Clean Water Act violations. Under an Order of the Federal District Court, the Authority is required to undertake corrective actions necessary to meet wastewater treatment, discharge and CSO control requirements, with Court oversight. With the completion of the last battery of secondary treatment at the Deer Island Treatment Plant, the last major construction milestone related to the wastewater treatment plant, the Court allowed the Authority's motion to reduce Court oversight, for the most part, to CSO related requirements under a CSO compliance schedule requiring the Authority to undertake CSO controls by specified dates, currently ending in 2008. The Authority has notified the Federal District Court and the Court parties that modifications to the current CSO control plan and schedule will be required to take into account changes in projects in Cambridge and Boston resulting from the environmental review process under the Massachusetts Environmental Policy Act (MEPA) or under other regulatory review. Despite these modifications, the Authority is in substantial compliance with the schedule requirements for its CSO control plan and has completed 14 of the 25 CSO projects in its CSO control plan while the remainder are either in design or under construction.

As a result of a finding of liability for a Clean Water Act violation by the MDC's sewerage operations, a substantial part of the Authority's construction programs, as successor to the MDC, have been subject to court supervision. In addition, the Court has reserved the right to order further remedial action and assess penalties. The Authority cannot predict whether penalties will be requested by litigants or assessed by the Courts in the future. The Court has assessed no penalties to date. On September 30, 2004, the Authority received from the Massachusetts Department of Environmental Protection (DEP) a Notice of Enforcement Conference and, on October 20, 2004, a Draft Administrative Order with Penalty, the latter of which proposed a penalty of \$90 for discharges alleged to be in violation of the Massachusetts Clean Waters Act resulting from two power failures at the Authority's Deer Island Treatment Plant in April 2004. The Authority is reviewing these recent submittals from DEP and will consult with the agency concerning an appropriate resolution of the proposed enforcement action.

The Authority's operating and construction plans are designed to comply with the Federal District Court's schedule of actions. The Authority has incurred capital expenditures of approximately \$6,339,000 from fiscal 1986 through fiscal 2004, including those projects required to comply with the Federal District Court's schedule. The Authority anticipates spending an additional \$1,775,000 on these projects through fiscal 2014. These capital expenditures have been forecasted based upon certain preliminary assumptions

# MASSACHUSETTS WATER RESOURCES AUTHORITY

## Notes to Financial Statements

June 30, 2004 and 2003

(Dollars in thousands)

and estimates, which may change significantly as design and construction of the necessary facilities proceed. Funding is expected to come from various federal and state grants, as available and approved, and from the Authority's debt proceeds. To date, federal appropriations for the Boston Harbor Project have aggregated \$810,000.

The Authority is also a defendant in several legal actions arising out of the operations of the water and sewer systems. It is the opinion of management that any judgments that may result from these actions will not have a materially adverse effect upon the Authority.

### **(13) Risk Management**

The Authority is exposed to various risks of loss. The risk management program involves insurance and self insurance related to property, general liability, automobile liability, marine liability, public officials' errors and omissions, workers' compensation, unemployment liability, and employee health care and life insurance.

On July 1, 2001, the Authority renewed a three-year Alternative Risk Transfer insurance program, which combines the Authority's various insurance coverages into one program with a per occurrence deductible of \$2,500. The Authority reimburses the Commonwealth on a paid-claims basis for unemployment claims. Claims expensed during fiscal 2004 and 2003 were \$417 and \$1,039, respectively. The Authority is a licensed self-insurer for workers' compensation. Excess loss insurance is carried on workers' compensation as required by law in excess of \$500 per occurrence retention, with a limit of \$25,000 per occurrence.

The Authority participates in and pays premiums to the Commonwealth's Group Insurance Contract for employee health benefits. The Authority pays 80% of these health premiums, with employees paying the balance.

Insurance claims have not exceeded insurance coverage in any of the last three fiscal years.

The MetroWest Water Supply Tunnel is being insured under an Owner's Controlled Insurance Program (OCIP). The Authority provides workers' compensation, general liability, and pollution coverage for operations of the contractors on this project. There is a \$500 self-insurance retention for each coverage with a total aggregate self-insurance retention of \$1,250 for a combined claim under the OCIP.

The Authority also instituted a second OCIP for the Walnut Hill Water Treatment Plant. The Authority provides workers' compensation, general liability, and pollution coverage for operations of the contractors on this project. There is a \$500 self-insured retention per occurrence for each coverage.

GASB Statement No. 10 requires that liabilities for self insured claims be reported if it is probable that a loss has been incurred and the amount can be reasonably estimated. These losses include an estimate of claims that have been incurred but not reported. The Authority records such liabilities in accrued expenses.

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(Dollars in thousands)

Changes in the claims liability insurance reserves in fiscal 2004 and 2003 were as follows:

	<u>General liability and property</u>	<u>Workers' compensation</u>	<u>OCIP projects</u>
Liability balance, June 30, 2002	\$ 1,460	167	5,789
Provision to record estimated losses	3,826	3,195	3,198
Payments	<u>(1,623)</u>	<u>(1,352)</u>	<u>(4,633)</u>
Liability balance, June 30, 2003	3,663	2,010	4,354
Provision to record estimated losses	3,192	1,687	307
Payments	<u>(1,656)</u>	<u>(1,817)</u>	<u>(4,156)</u>
Liability balance, June 30, 2004	<u>\$ 5,199</u>	<u>1,880</u>	<u>505</u>

**(14) Subsequent Events**

On September 29, 2004, the Authority issued General Revenue Refunding Bonds 2004 Series B in the principal amount of \$65,255. Proceeds from these bonds will be used to refund \$68,350 of bonds outstanding.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Required Supplementary Information

June 30, 2004

(Dollars in thousands)

Schedule of Funding Progress

<b>Actuarial valuation</b>	<b>Assets (a)</b>	<b>Actuarial liability (AAL) – entry age (b)</b>	<b>Unfunded AAL (UAAL) (b-a)</b>	<b>Funded ratio (a/b)</b>	<b>Covered payroll (c)</b>	<b>UAAL as a percentage covered payroll ((b-a)/(c))</b>
1/1/2003	\$ 146,188	146,188	—	100%	\$ 66,711	—
1/1/2002	141,069	141,069	—	100	66,322	—
1/1/2001	128,385	128,385	—	100	65,955	—
1/1/1999	96,318	96,318	—	100	66,782	—
1/1/1998	77,712	77,712	—	100	63,579	—
1/1/1997	58,185	58,185	—	100	60,120	—

See accompanying independent auditors' report.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Supplemental Schedule of Accounts Established  
by the General Revenue Bond Resolution

For the year ended June 30, 2004 and  
comparative totals as of June 30, 2003

(Dollars in thousands)

	<u>Construction</u>	<u>Revenue</u>	<u>Debt service</u>	<u>Reserves</u>	<u>Total</u>
Balance at June 30, 2003	\$ 90,431	54,105	430,490	71,636	646,662
Proceeds from:					
Revenue bonds and loans	267,859	—	101,363	—	369,222
Cash received from customers	—	452,104	—	—	452,104
Debt service grant	—	—	4,063	—	4,063
Interest income	774	6,912	11,942	(5,254)	14,374
Grant receipts	18	—	5,667	—	5,685
Construction payments	(236,140)	—	—	—	(236,140)
Capital lease payments	(349)	—	(2,868)	—	(3,217)
Debt service payment	(1,452)	—	(315,520)	—	(316,972)
Other Commonwealth payments	—	(18,924)	—	—	(18,924)
Interfund transfers	7,768	(244,188)	256,426	(20,006)	—
Transfers (to) from operating account	167	(178,393)	2,868	—	(175,358)
Balance at June 30, 2004	\$ <u>129,076</u>	<u>71,616</u>	<u>494,431</u>	<u>46,376</u>	<u>741,499</u>

	<u>Sewer</u>	<u>Water</u>	<u>2004 Total</u>	<u>2003 Total</u>
Restricted cash and investments:				
Construction	\$ 106,672	22,404	129,076	90,431
Debt service reserves	182,015	61,363	243,378	230,288
Debt service	105,117	93,142	198,259	171,627
Revenue redemption	22,602	9,414	32,016	6,805
Revenue	36,615	35,001	71,616	54,105
Renewal and replacement reserve	18,087	10,292	28,379	53,639
Insurance	8,999	8,998	17,997	17,997
Community obligation and revenue enhancement	17,794	2,984	20,778	21,770
Total restricted cash and investments	\$ <u>497,901</u>	<u>243,598</u>	<u>741,499</u>	<u>646,662</u>

See accompanying independent auditors' report.



**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Supplemental Schedule  
Combining Balance Sheet

June 30, 2004

(Dollars in thousands)

<b>Assets</b>	<b>Sewer</b>	<b>Water</b>	<b>Combined total</b>
Unrestricted current assets:			
Cash and cash equivalents	\$ 22,522	8,408	30,930
Investments	36,828	16,231	53,059
Intergovernmental loans	5,395	6,853	12,248
Accounts receivable	546	1,131	1,677
Total unrestricted current assets	<u>65,291</u>	<u>32,623</u>	<u>97,914</u>
Restricted assets:			
Cash and investments	497,901	243,598	741,499
Interest receivable	4,815	1,711	6,526
Grants receivable:			
Billed	2,242	(21)	2,221
Unbilled	208	—	208
Total restricted assets	<u>505,166</u>	<u>245,288</u>	<u>750,454</u>
Capital assets, not being depreciated	333,974	548,597	882,571
Capital assets, being depreciated, net	3,706,470	1,963,780	5,670,250
Deferred charges	211,656	80,432	292,088
Other assets, net	137,008	53,132	190,140
Total assets	<u>\$ 4,959,565</u>	<u>2,923,852</u>	<u>7,883,417</u>
<b>Liabilities and Net Assets</b>			
Current liabilities:			
Accounts payable and accrued expenses	\$ 38,324	21,935	60,259
Commercial paper notes	—	307,000	307,000
Current portion of long-term debt	39,067	13,461	52,528
Total current liabilities	<u>77,391</u>	<u>342,396</u>	<u>419,787</u>
Payable from restricted assets:			
Accounts payable for construction	12,566	8,912	21,478
Accrued interest on bonds payable	47,695	20,342	68,037
Total payable from restricted assets	<u>60,261</u>	<u>29,254</u>	<u>89,515</u>
Retainage on construction in progress	5,357	14,055	19,412
Long-term debt, less current portion	3,486,411	1,398,532	4,884,943
Long-term capital leases	24,784	11,652	36,436
Reserves	68,920	30,264	99,184
Deferred credits	61,462	24,253	85,715
Total liabilities	<u>3,784,586</u>	<u>1,850,406</u>	<u>5,634,992</u>
Net assets:			
Invested in capital assets, net of related debt	902,985	902,367	1,805,352
Restricted	74,572	94,776	169,348
Unrestricted	197,422	76,303	273,725
Total net assets	<u>1,174,979</u>	<u>1,073,446</u>	<u>2,248,425</u>
Commitments and contingencies			
Total liabilities and net assets	<u>\$ 4,959,565</u>	<u>2,923,852</u>	<u>7,883,417</u>

See accompanying independent auditors' report.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Supplemental Schedule  
Combining Balance Sheet

June 30, 2003

(Dollars in thousands)

<b>Assets</b>	<b>Sewer</b>	<b>Water</b>	<b>Combined total</b>
Unrestricted current assets:			
Cash and cash equivalents	\$ 22,360	7,889	30,249
Investments	37,483	16,437	53,920
Intergovernmental loans	5,997	6,770	12,767
Accounts receivable	8,066	1,811	9,877
Total unrestricted current assets	<u>73,906</u>	<u>32,907</u>	<u>106,813</u>
Restricted assets:			
Cash and investments	464,707	181,955	646,662
Interest receivable	4,926	1,654	6,580
Grants receivable:			
Billed	2,219	(56)	2,163
Unbilled	208	—	208
Total restricted assets	<u>472,060</u>	<u>183,553</u>	<u>655,613</u>
Capital assets, not being depreciated	294,621	544,534	839,155
Capital assets, being depreciated, net	3,790,403	1,921,651	5,712,054
Deferred charges	167,503	71,777	239,280
Other assets, net	117,772	41,461	159,233
Total assets	<u>\$ 4,916,265</u>	<u>2,795,883</u>	<u>7,712,148</u>
<b>Liabilities and Net Assets</b>			
Current liabilities:			
Accounts payable and accrued expenses	\$ 29,295	25,127	54,422
Commercial paper notes	—	311,000	311,000
Current portion of long-term debt	34,889	13,537	48,426
Total current liabilities	<u>64,184</u>	<u>349,664</u>	<u>413,848</u>
Payable from restricted assets:			
Accounts payable for construction	21,149	20,807	41,956
Accrued interest on bonds payable	48,763	18,121	66,884
Total payable from restricted assets	<u>69,912</u>	<u>38,928</u>	<u>108,840</u>
Retainage on construction in progress	8,587	32,674	41,261
Long-term debt, less current portion	3,393,607	1,213,681	4,607,288
Long-term capital leases	25,017	11,768	36,785
Reserves	82,670	36,514	119,184
Deferred credits	70,662	16,500	87,162
Total liabilities	<u>3,714,639</u>	<u>1,699,729</u>	<u>5,414,368</u>
Net assets:			
Invested in capital assets, net of related debt	977,850	978,582	1,956,432
Restricted	74,530	48,879	123,409
Unrestricted	149,246	68,693	217,939
Total net assets	<u>1,201,626</u>	<u>1,096,154</u>	<u>2,297,780</u>
Commitments and contingencies			
Total liabilities and net assets	<u>\$ 4,916,265</u>	<u>2,795,883</u>	<u>7,712,148</u>

See accompanying independent auditors' report.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Supplemental Schedule  
Combining Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2004

(Dollars in thousands)

	<u>Sewer</u>	<u>Water</u>	<u>Combined total</u>
Operating revenues:			
Customer services	\$ 310,791	130,158	440,949
Other	5,710	218	5,928
	<u>316,501</u>	<u>130,376</u>	<u>446,877</u>
Operating expenses:			
Operations	52,011	25,333	77,344
Maintenance	15,072	3,539	18,611
Payments in lieu of taxes	—	5,029	5,029
Engineering, general, and administrative	73,009	29,325	102,334
	<u>140,092</u>	<u>63,226</u>	<u>203,318</u>
Income from operations before depreciation	176,409	67,150	243,559
Depreciation	<u>117,498</u>	<u>43,994</u>	<u>161,492</u>
Operating income	<u>58,911</u>	<u>23,156</u>	<u>82,067</u>
Regulatory accounting provisions:			
Decrease in reserves	13,750	6,250	20,000
Decrease in deferred credits, net	53,353	902	54,255
	<u>67,103</u>	<u>7,152</u>	<u>74,255</u>
Nonoperating income (expense):			
Debt service grants	3,421	642	4,063
Investment income	9,121	4,986	14,107
Interest expense	(170,389)	(59,125)	(229,514)
	<u>(157,847)</u>	<u>(53,497)</u>	<u>(211,344)</u>
Net loss before capital grants	(31,833)	(23,189)	(55,022)
Capital grants	<u>5,186</u>	<u>481</u>	<u>5,667</u>
Decrease in net assets	(26,647)	(22,708)	(49,355)
Total net assets, beginning of year	<u>1,201,626</u>	<u>1,096,154</u>	<u>2,297,780</u>
Total net assets, end of year	\$ <u>1,174,979</u>	<u>1,073,446</u>	<u>2,248,425</u>

See accompanying independent auditors' report.

**MASSACHUSETTS WATER RESOURCES AUTHORITY**

Supplemental Schedule  
Combining Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2003

(Dollars in thousands)

	<u>Sewer</u>	<u>Water</u>	<u>Combined total</u>
Operating revenues:			
Customer services	\$ 306,153	120,513	426,666
Other	2,154	227	2,381
	<u>308,307</u>	<u>120,740</u>	<u>429,047</u>
Operating expenses:			
Operations	51,577	26,840	78,417
Maintenance	14,249	2,965	17,214
Payments in lieu of taxes	—	4,966	4,966
Engineering, general, and administrative	76,844	31,257	108,101
	<u>142,670</u>	<u>66,028</u>	<u>208,698</u>
Income from operations before depreciation	165,637	54,712	220,349
Depreciation	116,142	39,017	155,159
Operating income	<u>49,495</u>	<u>15,695</u>	<u>65,190</u>
Regulatory accounting provisions:			
Decrease in deferred credits, net	57,294	5,830	63,124
	<u>57,294</u>	<u>5,830</u>	<u>63,124</u>
Nonoperating income (expense):			
Investment income	31,204	9,059	40,263
Interest expense	(169,826)	(53,693)	(223,519)
	<u>(138,622)</u>	<u>(44,634)</u>	<u>(183,256)</u>
Net loss before capital grants	(31,833)	(23,109)	(54,942)
Capital grants	5,267	653	5,920
Decrease in net assets	(26,566)	(22,456)	(49,022)
Total net assets, beginning of year	<u>1,228,192</u>	<u>1,118,610</u>	<u>2,346,802</u>
Total net assets, end of year	\$ <u><u>1,201,626</u></u>	<u><u>1,096,154</u></u>	<u><u>2,297,780</u></u>

See accompanying independent auditors' report.



**KPMG LLP**  
99 High Street  
Boston, MA 02110-2371

Telephone 617 988 1000  
Fax 617 988 0800  
Internet [www.us.kpmg.com](http://www.us.kpmg.com)

**Report on Internal Control over Financial Reporting and on Compliance  
and Other Matters Based on an Audit of Auditing Financial Statements  
Performed in Accordance with *Government Auditing Standards***

The Board of Directors  
Massachusetts Water Resources Authority:

We have audited the financial statements of the Massachusetts Water Resources Authority (the Authority) as of and for the years ended June 30, 2004, and have issued our report thereon dated August 16, 2004. We conducted our audits 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.

**Internal Control over Financial Reporting**

In planning and performing our audits, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting or its operation that we consider to be material weaknesses.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of 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 audits 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*.



This report is intended solely for the information and use of the Authority's board of directors, management, the United States Environmental Protection Agency, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.

KPMG LLP

August 16, 2004