ERIE COUNTY WATER AUTHORITY

Basic Financial Statements and Required Supplementary Information for the Years Ended December 31, 2012 and 2011

ERIE COUNTY WATER AUTHORITY
Basic Financial Statements
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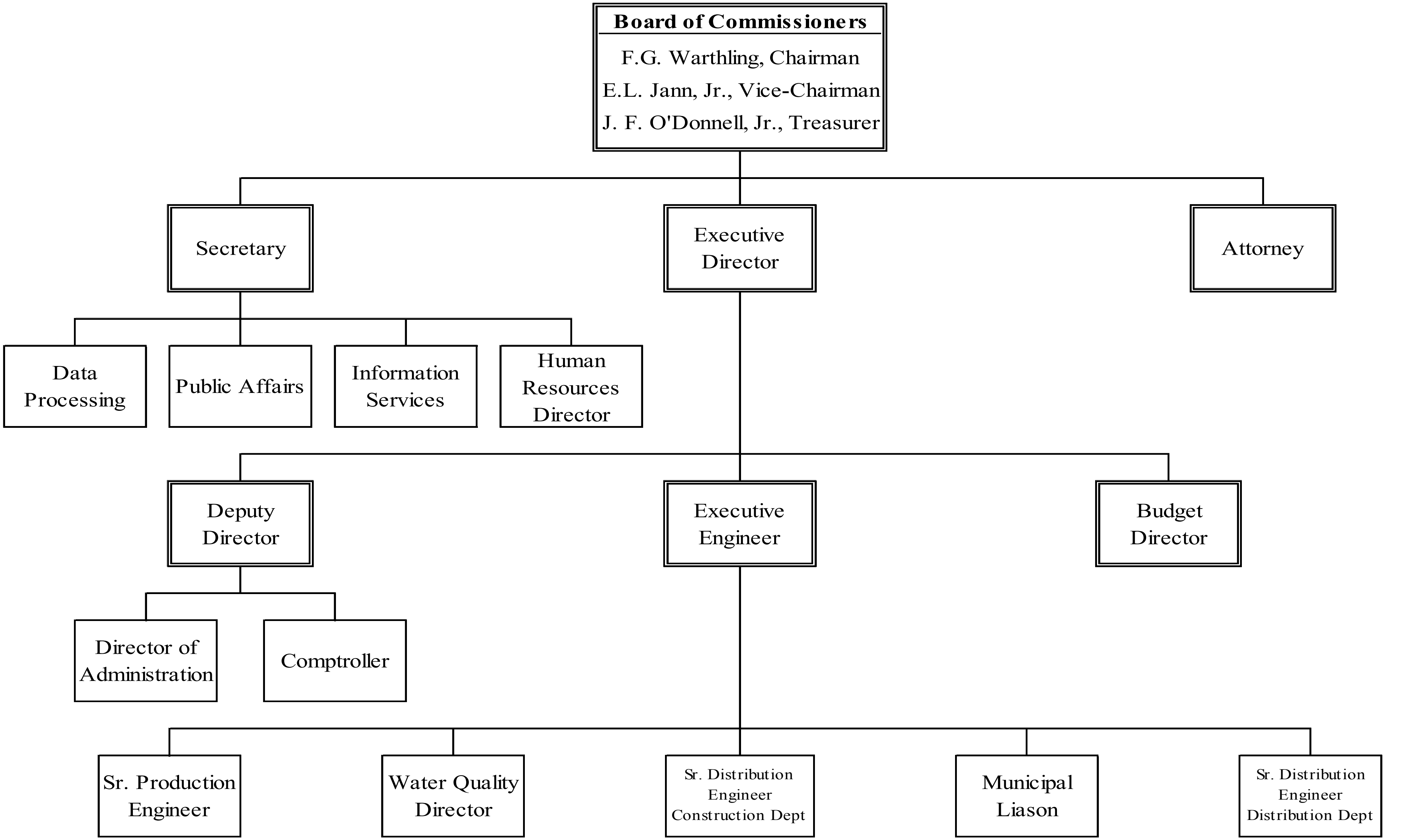
ERIE COUNTY WATER AUTHORITY
Members of the Board of Commissioners

Members of the Board of the Erie County Water Authority are appointed by the Chairman of the Erie County Legislature upon receiving nominations from the majority of the Majority Caucus or the Minority Caucus, subject to confirmation by a majority of the Legislature. Each Member is appointed to a three year term; and, not more than two members of the Authority's Board of Commissioners, at any time, shall belong to the same political party.

Board Members on 12/31/2012	Most Recent Appointment Date
Francis G. Warthling, Chairman	2012
Earl L. Jann, Jr., Vice Chairman	2011
John F. O'Donnell, Jr., Treasurer	2010

ERIE COUNTY WATER AUTHORITY
Organizational Chart



Lumsden McCormick LLP
CERTIFIED PUBLIC ACCOUNTANTS

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INDEPENDENT AUDITORS' REPORT

The Board of Commissioners
Erie County Water Authority

We have audited the accompanying financial statements of Erie County Water Authority (the Authority), a business-type activity, which comprise the statements of net position as of December 31, 2012 and 2011, and the related statements of revenue, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

As described in Note 2 to the financial statements, the Authority adopted GASB Statements No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and No. 65, *Items Previously Reported as Assets and Liabilities* in 2012.

Required Supplementary Information
Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 5 through 19 and the schedule of funding progress for other postemployment benefits on page 41 be presented to supplement the financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2013 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, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance

Lumsden & McCormick, LLP

March 26, 2013

ERIE COUNTY WATER AUTHORITY
Management's Discussion and Analysis
For the Years Ended December 31, 2012 and 2011
UNAUDITED

Management provides the following discussion and analysis ("MD&A") of the Erie County Water Authority's (the "Authority") financial activities and statements for the years ended December 31, 2012 and 2011. The information contained in this analysis should be used by the reader in conjunction with the information contained in the audited financial statements and the notes to those financial statements, all of which follow this narrative on the subsequent pages. The Authority is not required to legally adopt a budget; therefore, comparative budgetary information is not included in this report.

Financial Highlights

- The Authority's net position increased $8,810,374 as a result of activity for the year ended December 31, 2012. For 2012 $10,420,109 is net income before a loss of $3,494,544 from a special item resulting from a change in the estimate of useful lives of certain assets. The remaining increase of $1,884,809 represents capital contributions (contributions in aid of construction). The Authority's net position has been restated for 2011 to reflect the implementation of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities.* Restated net position increased $7,655,263 as a result of activity for the year ended December 31, 2011. For 2011 $6,670,031 is net income, and $985,232 represents capital contributions (contributions in aid of construction).
- The assets of the Authority exceeded its liabilities by $294,463,690 and $285,653,316, representing net position at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, unrestricted net position was $19,686,797 and $15,129,066 respectively, and may be used to meet the Authority's ongoing obligations.
- The Authority's bonded indebtedness, net of deferred amounts for bond premiums, increased $5,712,764 in 2012 compared to a decrease of $6,517,236 during 2011. The net increase resulted from a new bond issuance on June 8, 2012 for $12,500,000.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The financial statements are organized as follows:

- The ***Statement of Net Position*** presents information on all of the Authority's assets, deferred outflows, liabilities, and deferred inflows, with the difference reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.
- The ***Statement of Revenue, Expenses and Changes in Net Position*** presents information showing how the Authority's net position changed during the most recent reporting period. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future periods (e.g., earned but unused vacation leave and earned but unbilled revenue).
- The ***Statement of Cash Flows*** presents information depicting the Authority's cash flow activities for the reporting period and the effect that these activities had on the Authority's cash and cash equivalent balances.

- The ***Notes to Financial Statements*** present additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found following the financial statements section of this report.

Financial Analysis

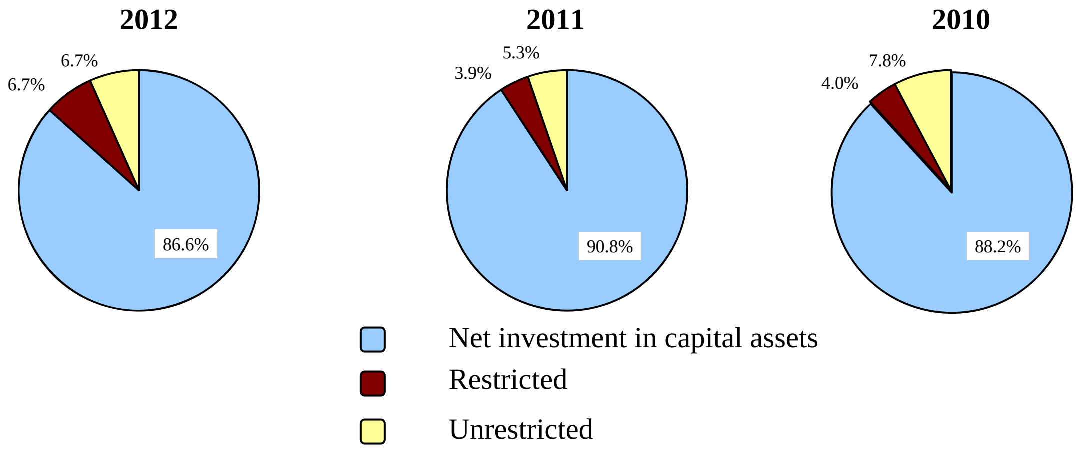
As noted earlier, net position may serve over time as a useful indicator of an entity's financial position. In the case of the Authority, assets exceeded liabilities by $294,463,690 at December 31, 2012 as compared to $285,653,316 at December 31, 2011, as presented below in Table 1:

Table 1 - Condensed Statement of Net Position

	2012	2011 (Restated)	Increase/(Decrease) Dollars	Increase/(Decrease) Percent
Current assets	$ 37,060,817	$ 33,731,489	$ 3,329,328	9.9
Noncurrent assets:				
Other noncurrent assets	35,251,132	22,493,695	12,757,437	56.7
Capital assets	348,725,268	347,171,722	1,553,546	0.4
Total assets	421,037,217	403,396,906	17,640,311	4.4
Current liabilities	18,178,378	17,040,662	1,137,716	6.7
Noncurrent liabilities	108,395,149	100,702,928	7,692,221	7.6
Total liabilities	126,573,527	117,743,590	8,829,937	7.5
Net investment in capital assets	255,114,864	259,274,082	(4,159,218)	(1.6)
Restricted	19,662,029	11,250,168	8,411,861	74.8
Unrestricted	19,686,797	15,129,066	4,557,731	30.1
Total net assets	$ 294,463,690	$ 285,653,316	$ 8,810,374	3.1

	2011 (Restated)	2010 (Restated)	Increase/(Decrease) Dollars	Increase/(Decrease) Percent
Current assets	$ 33,731,489	$ 32,618,968	$ 1,112,521	3.4
Noncurrent assets:				
Other noncurrent assets	22,493,695	29,383,276	(6,889,581)	(23.4)
Capital assets	347,171,722	339,622,802	7,548,920	2.2
Total assets	403,396,906	401,625,046	1,771,860	0.4
Current liabilities	17,040,662	20,156,959	(3,116,297)	(15.5)
Noncurrent liabilities	100,702,928	103,470,034	(2,767,106)	(2.7)
Total liabilities	117,743,590	123,626,993	(5,883,403)	(4.8)
Net investment in capital assets	259,274,082	245,207,926	14,066,156	5.7
Restricted	11,250,168	11,242,676	7,492	0.1
Unrestricted	15,129,066	21,547,451	(6,418,385)	(29.8)
Total net assets	$ 285,653,316	$ 277,998,053	$ 7,655,263	2.8

At December 31, 2012, the largest portion of the Authority's net position, 86.6%, consists of the Authority's net investment in capital assets, as compared to 90.8% and 88.2% at December 31, 2011 and 2010, respectively. This amount is presented net of any outstanding debt which was used to acquire such capital assets. The second portion of net position, 6.7%, at December 31, 2012, as compared to 5.3% and 7.8%, at December 31, 2011, and 2010, respectively consists of unrestricted assets. These assets are not limited in any way with regards to how and what they may be used for. The remainder of net position, 6.7%, 3.9% and 4.0% at December 31, 2012, 2011 and 2010, respectively, is restricted for various purposes.



The Authority's liabilities totaled $126,573,527, $117,743,590, and $123,626,993, at December 31, 2012, 2011 and 2010 respectively. The largest component of liabilities is outstanding water revenue bonds.

The Authority had current ratios of 2.04, 1.98, and 1.62, at December 31, 2012, 2011 and 2010, respectively. Such a ratio implies that the Authority has sufficient assets on hand to cover its liabilities that will come due in the ensuing year.

A comparison of current assets as compared to current liabilities of the Authority at December 31, 2012, 2011, and 2010 follows:

Table 2 - Comparison of current assets and current liabilities

	2012	2011 (Restated)	2010 (Restated)
Current assets	$ 37,060,817	$ 33,731,489	$ 32,618,968
Current liabilities	18,178,378	17,040,662	20,156,959
Ratio of current assets to current liabilities	2.04	1.98	1.62

Table 3 shows the changes in net position for the years ended December 31, 2012, 2011, and 2010:

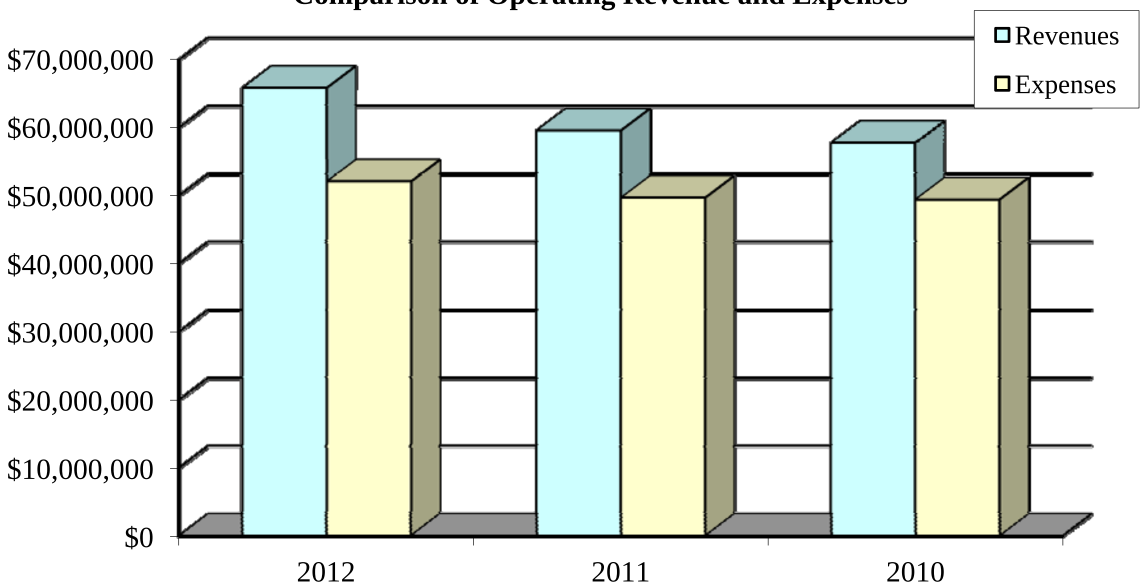
Table 3 - Changes in Net Position

	2012	2011 (Restated)
Operating revenue	$ 65,763,547	$ 59,529,303
Operating expenses:		
Operation and administration	21,831,010	23,412,515
Maintenance	15,681,903	10,985,943
Depreciation and amortization, net	11,872,392	11,207,095
Other postemployment benefits	2,660,748	4,021,089
Total operating expenses	52,046,053	49,626,642
Operating income	13,717,494	9,902,661
Nonoperating revenues (expenses):		
Interest income	414,187	458,260
Interest capitalization during construction	76,541	174,315
Interest expense	(3,788,113)	(3,865,205)
Total nonoperating revenues (expenses)	(3,297,385)	(3,232,630)
Net income before contributions in aid of construction & special item	10,420,109	6,670,031
Contributions in aid of construction	1,884,809	985,232
Special item from change in estimated useful lives of capital assets	(3,494,544)	-
Change in net position	8,810,374	7,655,263
Total net position - beginning of year (as restated)	285,653,316	277,998,053
Total net position - end of year	$ 294,463,690	$ 285,653,316

	2011 (Restated)	2010 (Restated)
Operating revenue	$ 59,529,303	$ 57,701,068
Operating expenses:		
Operation and administration	23,412,515	24,357,098
Maintenance	10,985,943	10,214,890
Depreciation and amortization, net	11,207,095	10,918,538
Other postemployment benefits	4,021,089	3,881,063
Total operating expenses	49,626,642	49,371,589
Operating income	9,902,661	8,329,479
Nonoperating revenues (expenses):		
Interest income	458,260	467,408
Gain on sale of investments	-	150,107
Interest capitalization during construction	174,315	45,125
Interest expense	(3,865,205)	(4,265,531)
Total nonoperating revenues (expenses)	(3,232,630)	(3,602,891)
Net income before contributions in aid of construction & special item	6,670,031	4,726,588
Contributions in aid of construction	985,232	1,088,835
Special item from change in estimated fair value of acquired assets	-	(17,604,796)
Change in net position	7,655,263	(11,789,373)
Total net position - beginning of year (as restated)	277,998,053	289,787,426
Total net position - end of year	$ 285,653,316	$ 277,998,053

The following chart depicts a 10.5% increase in operating revenue from $59,529,303 in 2011 to $65,763,547 in 2012, compared to a 3.2% increase in operating revenue from $57,701,068 in 2010 to $59,529,303 in 2011. Operating expenses increased 4.9% from $49,626,642 in 2011 to $52,046,053 in 2012, compared to a 0.5% increase from $49,371,589 in 2010 to $49,626,642 in 2011.

Comparison of Operating Revenue and Expenses



A summary of operating revenue for the years ended December 31, 2012, 2011 and 2010 is presented below in Table 4:

Table 4 - Summary of Operating Revenue

	2012	2011	Increase Dollars	Increase Percent
Water sales:				
Residential	$ 38,069,148	$ 35,663,644	$ 2,405,504	6.7
Commercial	7,482,928	6,866,248	616,680	9.0
Industrial	1,651,835	1,549,584	102,251	6.6
Public authorities	2,255,872	2,015,272	240,600	11.9
Fire protection	4,015,933	3,903,155	112,778	2.9
Sales to other utilities	5,206,479	5,086,522	119,957	2.4
Infrastructure investment charge	3,841,349	1,901,758	1,939,591	102.0
Other water sales	2,482,331	1,969,950	512,381	26.0
Total water sales	$ 65,005,875	$ 58,956,133	$ 6,049,742	10.3
Other operating income:				
Rents from water towers	538,936	487,231	51,705	10.6
Miscellaneous	218,736	85,939	132,797	154.5
Operating revenue	$ 65,763,547	$ 59,529,303	$ 6,234,244	10.5

	2011	2010	Increase/(Decrease) Dollars	Percent
Water sales:				
Residential	$ 35,663,644	$ 35,224,872	$ 438,772	1.2
Commercial	6,866,248	6,973,293	(107,045)	(1.5)
Industrial	1,549,584	1,604,491	(54,907)	(3.4)
Public authorities	2,015,272	2,170,750	(155,478)	(7.2)
Fire protection	3,903,155	3,816,992	86,163	2.3
Sales to other utilities	5,086,522	5,322,260	(235,738)	(4.4)
Infrastructure investment charge	1,901,758	-	1,901,758	100.0
Other water sales	1,969,950	1,861,997	107,953	5.8
Total water sales	$ 58,956,133	$ 56,974,655	$ 1,981,478	3.5
Other operating income:				
Rents from water towers	487,231	490,467	(3,236)	(0.7)
Miscellaneous	85,939	235,946	(150,007)	(63.6)
Operating revenue	$ 59,529,303	$ 57,701,068	$ 1,828,235	3.2

Water sales represent the vast majority of revenue for the Authority, 98.8% for the year ended December 31, 2012, 99.0% for the year ended December 31, 2011, and 98.7% for the year ended December 31, 2010.

Following are some of the issues and events effecting revenue in 2012:

- In January of 2012, the infrastructure investment charge was raised from $3.00 per quarter or $1.00 per month based on the length of the billing cycle to $6.00 quarterly or $2.00 per month. An additional $1,939,591 in revenue was generated from the increase in the infrastructure investment charge.

- Billed consumption increased 5.7% in 2012 across all account types resulting in higher revenues, including a 54%, or $508,844, increase in summer surcharges. Increased consumption was a direct result of a 42.6% decrease in rainfall in June and July of 2012. Annual rainfall decreased 32.9% in 2012 as compared to 2011.

- Rents from water towers increased $51,705 in 2012 due to automatic rate increases built into the terms of the lease agreements. The increase was somewhat offset by a lease cancelation which resulted from carrier consolidations.

- Miscellaneous nonoperating revenue increased $132,797 due to a $114,137 return of collateral from The Hartford Insurance Company and increased sale of non-inventoried scrap metal.

Comparatively, these issues and events impacted revenue in 2011:

- In January of 2011, the Authority implemented an infrastructure investment charge of $3.00 per quarter or $1.00 per month, based on the length of the billing cycle. Of the $1,981,478 increase in total water sales from 2010 to 2011, $1,901,758 was generated by the new charge.

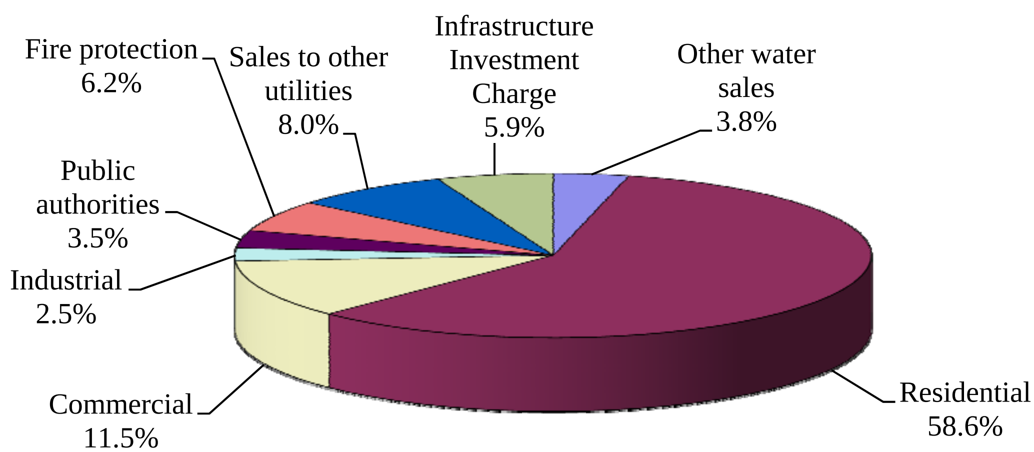
- Residential and other water sales increased 1.2% and 5.8% respectively, due mainly to a dry, hot July – resulting in increased consumption for July, and also an 8.1% increase in the summer surcharges.

- Sales to other utilities decreased 4.4% due to the conversion of the Village of Blasdell from a bulk sale customer to a direct service customer. That decrease was totally offset by an increase in residential sales, as the customers in the Village of Blasdell were added to that category.

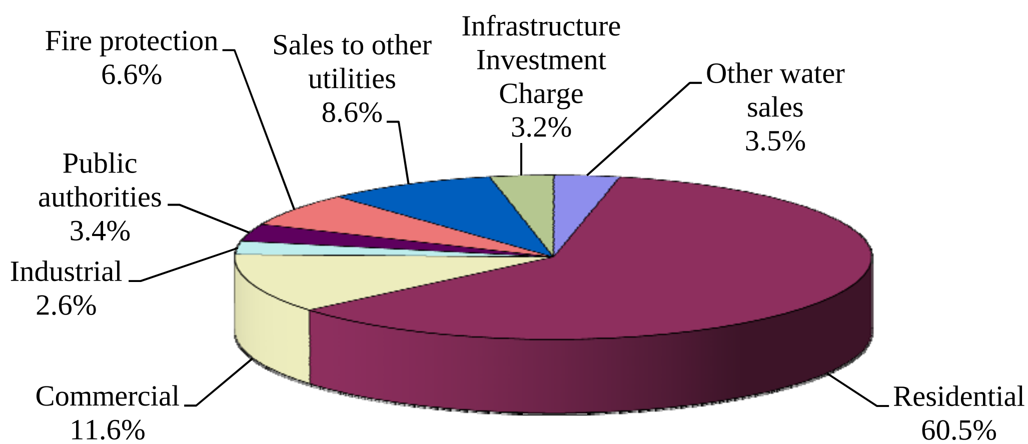
- Miscellaneous revenues decreased due to the receipt of a $190,000 incentive payment from New York State Energy Research and Development Authority (NYSERDA) in 2010 for power savings realized from the installation of variable frequency drives at major pump stations.

As presented in the illustration below, residential water sales represent the largest portion of water sales for the Authority, which was 58.6%, 60.5%, and 61.8% of total water sales for the years ended December 31, 2012, 2011 and 2010, respectively. The next largest water sales revenue component for the Authority is commercial water sales, which was 11.5%, 11.6%, and 12.2% of total water sales for the years ended December 31, 2012, 2011 and 2010, respectively.

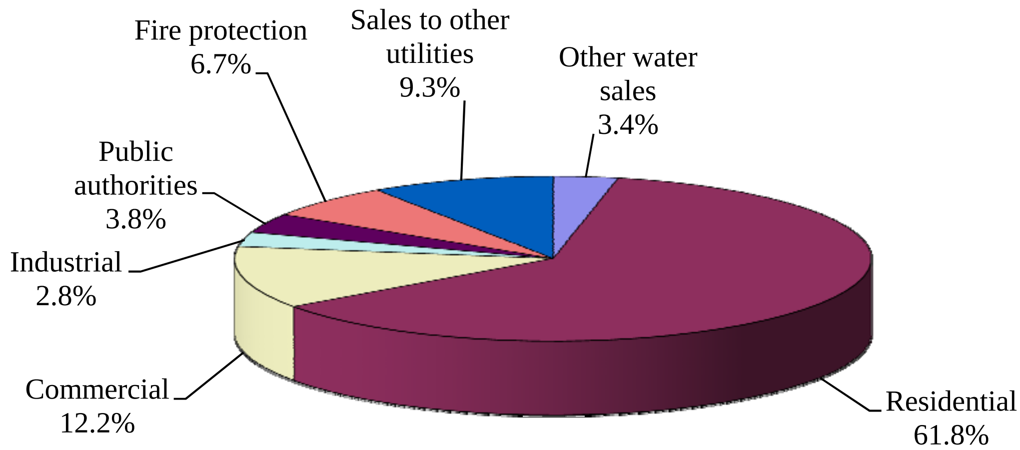
2012 Water Sales Revenue



2011 Water Sales Revenue



2010 Water Sales Revenue

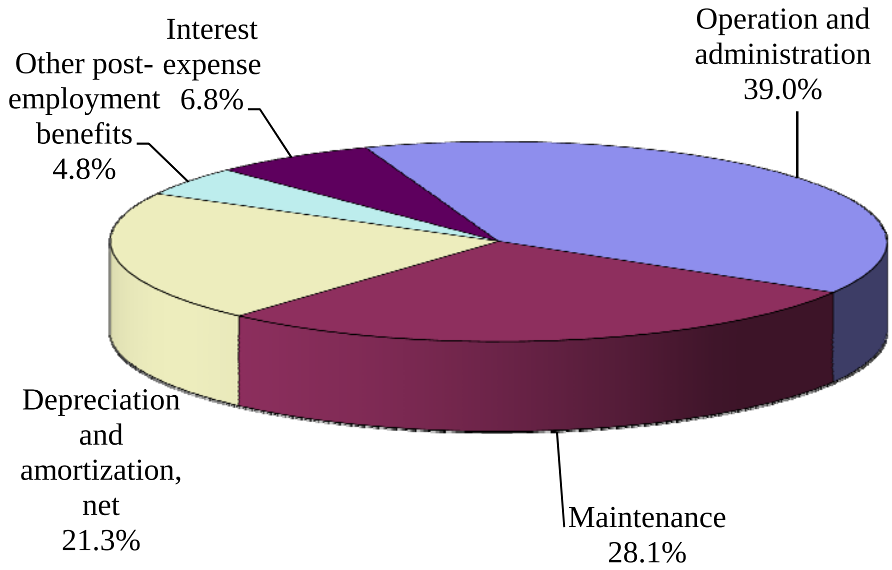


As illustrated below, operation and administration expenses are the largest expense and account for 39.0%, 43.8%, and 45.4% of the Authority's expenses for the years ended December 31, 2012, 2011 and 2010, respectively. The second largest expense for the Authority in 2012 was maintenance, which was 28.1%. Expenses associated with depreciation and amortization, which were 21.0% and 20.4%, for the years ended December 31, 2011, and 2010, respectively was the second highest expense in those years.

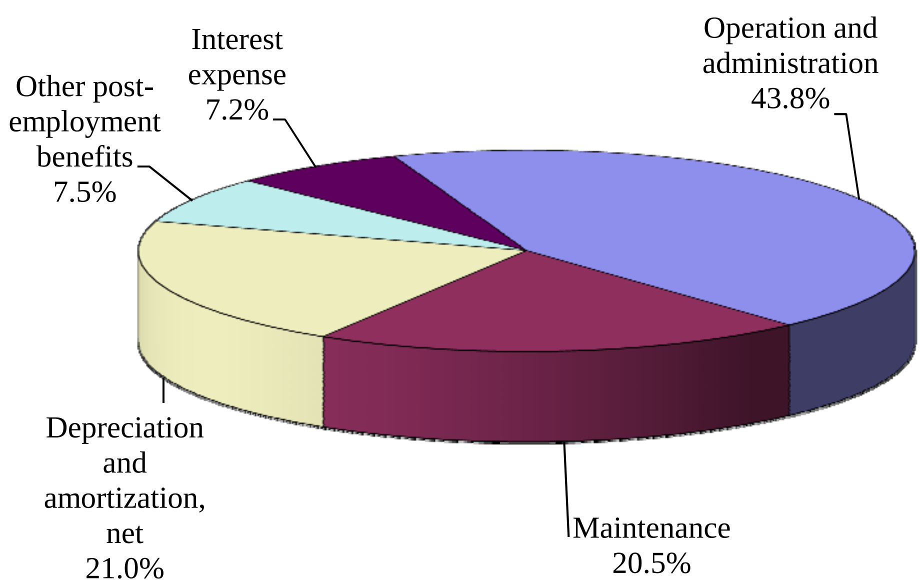
	2012	2011 (Restated)	Increase/(Decrease) Dollars	Percent
Operation and administration	$ 21,831,010	$ 23,412,515	$ (1,581,505)	(6.8)
Maintenance	15,681,903	10,985,943	4,695,960	42.7
Depreciation and amortization	11,872,392	11,207,095	665,297	5.9
Interest expense	3,788,113	3,865,205	(77,092)	(2.0)
Other postemployment benefits	2,660,748	4,021,089	(1,360,341)	(33.8)
Total	$ 55,834,166	$ 53,491,847	$ 2,342,319	4.4

	2011 (Restated)	2010 (Restated)	Increase/(Decrease) Dollars	Percent
Operation and administration	$ 23,412,515	$ 24,357,098	$ (944,583)	(3.9)
Maintenance	10,985,943	10,214,890	771,053	7.5
Depreciation and amortization	11,207,095	10,918,538	288,557	2.6
Interest expense	3,865,205	4,265,531	(400,326)	(9.4)
Other postemployment benefits	4,021,089	3,881,063	140,026	3.6
Total	$ 53,491,847	$ 53,637,120	$ (145,273)	(0.3)

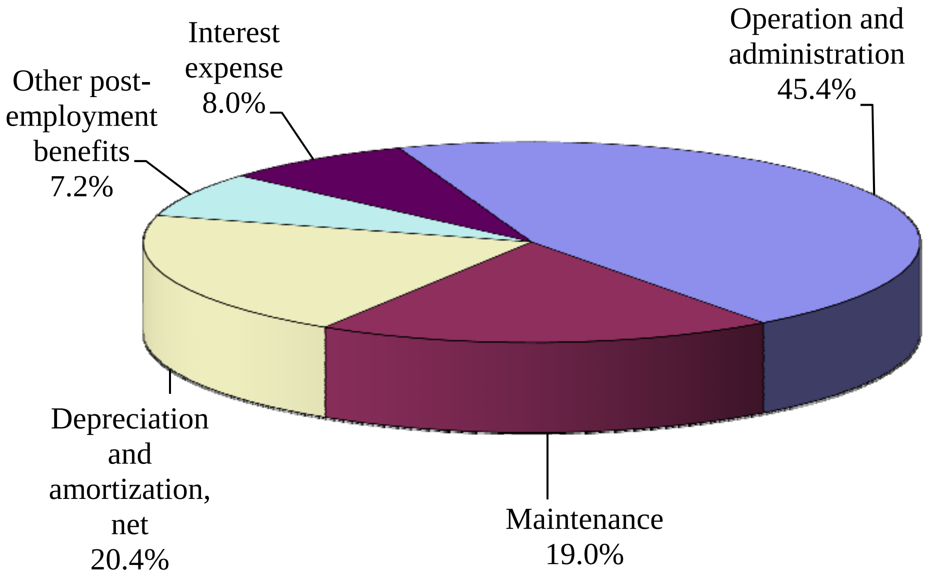
2012 Expenses



2011 Expenses



2010 Expenses



Following are some of the issues and events affecting expenses in 2012:

- Operating and administrative expenses decreased 6.8%, or $1,581,505, due, in part, to a change in the Authority's capitalization policy. A percentage of meter shop labor, transportation and fringe benefits ($857,123) associated with new meter installations was capitalized in 2012 - no capitalization occurred in 2011.

- The reserve for legal services was reduced $488,667 due to the settlement of a lawsuit for less than the reserved amount.

- Fringe benefit costs increased due to a $404,428 increase in pension expense, a $193,012 increase in workers' compensation insurance premiums, and a $1,157,555 increase in accrued sick pay resulting from changes to the policy governing health insurance coverage at retirement for non-represented employees. Although non-represented employees will now contribute to their health insurance premiums at retirement, the value of any unused sick time at retirement may be used to offset their cost.

- The increase in fringe benefits was somewhat offset by a decrease in health insurance costs resulting from $670,000 in decreased claims, and a change in the Authority's collective bargaining agreement with AFSCME requiring $113,075 in health insurance contributions in 2012.

- Maintenance expense increased $4,695,960 due largely to a change in the Authority's capitalization policy which requires tank maintenance and other costs be expensed in the period incurred rather than capitalized and depreciated over time. A new expense category - Renewals and Replacements - was added to the Authority's chart of accounts to accommodate major projects which do not qualify as capital expenditures. The amount of charges to this account in 2012 was $3,661,992.

- Payments to other contractors increased $376,575 due to the expiration of the Authority's contract for landscaping services. The contract was last bid in 2008 and the new contract resulted in increased unit costs.

Comparatively, these issues and events impacted expenses in 2011:

- Operating and administrative expenses decreased 3.9%, or $944,583, due, in part, to a 14.7% increase in capital spending which resulted in a $482,782 increase in applied overhead.

- A 23% decrease in chemical costs resulted from a $291,877 decline in caustic soda prices which went from $0.2592/lb in 2010 to $0.1405/lb in 2011.

- Refuse and waste disposal costs were $303,107 lower in 2011 due to a smaller amount of residuals estimated to be removed at the end of 2011 as compared to 2010. Removal costs are estimated and accrued annually.

- Maintenance costs increased 7.5%, or $771,053 due to an increase in the number of water main breaks in January and February of 2011 compared to the same period in 2010. The increase in water main breaks resulted in increases in overtime of $86,295, payments to repair contractors of $155,910, and stone and cold patch of $53,954.

- Fringe benefit costs rose 20% from $6,789,566 in 2010 to $8,158,350 in 2011. The increase represents a $795,607 increase in health insurance costs and a $586,560 increase in pension expense.

- Interest expense decreased $400,326 due to 2010 bond maturities and the redemption of the Series 1998B bonds on December 15, 2010.

Table 5 - Summary of Cash Flow Activities

	2012	2011	Increase/(Decrease) Dollars
Cash flows provided (used) by:			
Operating activities	$ 27,680,692	$ 19,830,755	$ 7,849,937
Capital and related financing activities	(12,873,007)	(28,863,172)	15,990,165
Investing activities	417,464	3,489,920	(3,072,456)
Net increase (decrease) in cash and cash equivalents	15,225,149	(5,542,497)	20,767,646
Cash and cash equivalents, beginning of year	32,231,138	37,773,635	(5,542,497)
Cash and cash equivalents, end of year	$ 47,456,287	$ 32,231,138	$ 15,225,149

Table 5 - Summary of Cash Flow Activities (cont'd)

	2011	2010	Increase/(Decrease) Dollars
Cash flows provided (used) by:			
Operating activities	$ 19,830,755	$ 23,185,455	$ (3,354,700)
Capital and related financing activities	(28,863,172)	(29,717,426)	854,254
Investing activities	3,489,920	(6,161,868)	9,651,788
Net decrease in cash and cash equivalents	(5,542,497)	(12,693,839)	7,151,342
Cash and cash equivalents, beginning of year	37,773,635	50,467,474	(12,693,839)
Cash and cash equivalents, end of year	$ 32,231,138	$ 37,773,635	$ (5,542,497)

At December 31, 2012, 2011, and 2010, cash and cash equivalents were restricted for various purposes as presented below:

Table 6 - Summary of Cash and Cash Equivalents

	2012	2011	2010
Unrestricted	$ 19,198,960	$ 17,141,131	$ 18,892,001
Restricted	28,257,327	15,090,007	18,881,634
Total	$ 47,456,287	$ 32,231,138	$ 37,773,635

Total cash and cash equivalents increased $15,225,149 from $32,231,138 in 2011 to $47,456,287 in 2012 due, in part, to increases in operating revenue and the issuance of $12,500,000 in bonds in June of 2012, the proceeds of which were not all spent during the year.

Total cash and cash equivalents decreased $5,542,497 from $37,773,635 in 2010 to $32,231,138 in 2011 due, in part, to the elimination of advance minimum billing of customers. This was offset by a decrease of $9,907,296 in purchases of investments.

Capital Assets

The Authority's investment in capital assets as of December 31, 2012 amounted to $348,725,268 (net of accumulated depreciation) as compared to $347,171,722 as of December 31, 2011 and $339,622,802 as of December 31, 2010. This investment includes land, buildings and structures, mains and hydrants, equipment, construction in progress and other (service installations, leasehold improvements, etc.). The Authority's greatest investment in capital assets is in mains and hydrants and buildings and structures.

Significant losses in capital assets were recognized in 2010 due to the change in estimated fair value of assets acquired as municipal water systems converted from bulk sale or lease managed service to direct service. It was determined that no additional revenue was generated from the conversions and the assets were contributions to capital with no marketable fair value.

Additional losses were incurred in 2012 as a result of a change in the estimated useful life of some assets, which experience has shown should be treated as maintenance costs.

Presented in Table 7 is a comparative summary of capital assets. Additional information on the Authority's capital assets can be found in Note 5 of the financial statements.

Table 7 - Summary of Capital Assets (Net of Depreciation)

	2012	2011	Increase/(Decrease) Dollars	Percent
Land	$ 2,218,274	$ 2,218,274	$ -	-
Construction work in progress	5,109,041	3,849,281	1,259,760	32.7
Total capital assets, not being depreciated	7,327,315	6,067,555	1,259,760	20.8
Buildings and structures	245,245,334	248,273,892	(3,028,558)	(1.2)
Mains and hydrants	208,362,617	203,761,489	4,601,128	2.3
Equipment	52,786,871	49,357,555	3,429,316	6.9
Other	52,211,342	51,041,459	1,169,883	2.3
Total capital assets, being depreciated	558,606,164	552,434,395	6,171,769	1.1
Less accumulated depreciation	217,208,211	211,330,228	5,877,983	2.8
Total capital assets, being depreciated, net	341,397,953	341,104,167	293,786	0.1
Total capital assets	$ 348,725,268	$ 347,171,722	$ 1,553,546	0.4

	2011	2010	Increase/(Decrease) Dollars	Percent
Land	$ 2,218,274	$ 2,218,274	$ -	-
Construction work in progress	3,849,281	4,826,542	(977,261)	(20.2)
Total capital assets, not being depreciated	6,067,555	7,044,816	(977,261)	(13.9)
Buildings and structures	248,273,892	241,896,893	6,376,999	2.6
Mains and hydrants	203,761,489	196,353,818	7,407,671	3.8
Equipment	49,357,555	45,900,451	3,457,104	7.5
Other	51,041,459	49,429,575	1,611,884	3.3
Total capital assets, being depreciated	552,434,395	533,580,737	18,853,658	3.5
Less accumulated depreciation	211,330,228	201,002,751	10,327,477	5.1
Total capital assets, being depreciated, net	341,104,167	332,577,986	8,526,181	2.6
Total capital assets	$ 347,171,722	$ 339,622,802	$ 7,548,920	2.2

Debt Administration

At December 31, 2012 the Authority had $93,610,404 in water revenue bond principal outstanding, net of bond premiums, as compared to $87,897,640 and $94,414,876 at December 31, 2011 and 2010. Water revenue bonds outstanding, net of bond premiums, increased $5,712,764 during the year ended December 31, 2012, as a result of issuing new bonds in the amount of $12,500,000 on June 8, 2012, offset by the principal payments shown below. A $6,517,236 decrease was recognized during the year ended December 31, 2011 due to principal repayments.

	2012	2011
Series 1998D	$ 890,000	$ 860,000
Series 2003F	660,000	645,000
Series 2007	710,000	685,000
Series 2008	4,225,000	4,025,000
Series 2012	-	-
Total water revenue bond payments	$ 6,485,000	$ 6,215,000
Bond premiums	302,236	302,236
Total water revenue bond payments and bond premiums	$ 6,787,236	$ 6,517,236

The Authority's issuance of Series 1998D and Series 2003F were through the New York State Environmental Facilities Corporation (EFC) and are rated based on the EFC's rating.

In 2008 the Authority applied for, and received upgrades from all three rating agencies. Moody's assigned the 2008 bonds and parity debt a long-term underlying rating of Aa3. Standard & Poor's assigned the 2008 bonds and parity debt a long-term underlying rating of AA+. Fitch Ratings assigned the 2008 bonds and parity debt a long-term underlying rating of AA.

For additional information on long term debt activity, see Note 6 to the financial statements.

Economic Factors

The local community has been experiencing the same economic difficulties that have impacted New York State and the nation. Concurrently, the Authority's customer base grew by less than one percent this past year. Additionally, after a steady decrease, water consumption increased in 2012 as compared to 2011. This was due entirely to a very dry June and July. Due to individual conservation efforts and changes in Federal and State laws and regulations which require appliances to use less water, significant increases in water sales other than those caused by extreme weather conditions are not expected.

Given the reality of rising repair and infrastructure costs, the Authority adopted an infrastructure investment charge with the 2011 budget. The infrastructure investment charge of $3.00 per quarter was implemented to maintain the Authority's aggressive investment program in very costly system-wide infrastructure, and to allow for a more equitable distribution among customer classifications of fixed costs to provide a dependable, high quality water supply and fire protection services to all customers. Revenues generated from the charge will be used for infrastructure improvements only. In January of 2012, the infrastructure investment charge was increased to $6 per quarter.

As noted earlier, the Authority's largest sources of operating revenues are water sales to customers. These revenues result from rates charged based on water usage by the individual customer. Rates can be adjusted accordingly in order to help meet the expenses of the Authority. Tariff rates are shown below:

Meters read and billed quarterly (To Nearest 1,000 Gallons)	2013	2012	2011	2010	
First 300,000 gallons per quarter	$ 2.96	$ 2.96	$ 2.96	$ 2.96	per 1,000 gallons
Next 1,950,000	2.63	2.63	2.63	2.63	per 1,000 gallons
Next 5,250,000	2.41	2.41	2.41	2.41	per 1,000 gallons
Over 7,500,000	2.12	2.12	2.12	2.12	per 1,000 gallons

Meters read and billed monthly (To Nearest 1,000 Gallons)	2013	2012	2011	2010	
First 100,000 gallons per month	$ 2.96	$ 2.96	$ 2.96	$ 2.96	per 1,000 gallons
Next 650,000	2.63	2.63	2.63	2.63	per 1,000 gallons
Next 1,750,000	2.41	2.41	2.41	2.41	per 1,000 gallons
Over 2,500,000	2.12	2.12	2.12	2.12	per 1,000 gallons

Annual hydrant charges	2013	2012	2011	2010	
Lease managed districts	$160.80	$160.80	$160.80	$160.80	per hydrant
Direct service areas	229.08	229.08	229.08	229.08	per hydrant

Size of Meter	Quarterly Minimum Charge ($)				Allowance per Quarter	Monthly Minimum Charge ($)		
(inches)	2013	2012	2011	2010	(gallons)	2013	2012	2011
5/8	$ 26.64	$ 26.64	$ 26.64	$ 26.64	9,000	$ 8.88	$ 8.88	$ 8.88
3/4	35.52	35.52	35.52	35.52	12,000	11.84	11.84	11.84
1	62.16	62.16	62.16	62.16	21,000	20.72	20.72	20.72
1 1/4	79.92	79.92	79.92	79.92	27,000	26.64	26.64	26.64
1 1/2	115.44	115.44	115.44	115.44	39,000	38.48	38.48	38.48
2	186.48	186.48	186.48	186.48	63,000	62.16	62.16	62.16
3	355.20	355.20	355.20	355.20	120,000	118.40	118.40	118.40
4	586.08	586.08	586.08	586.08	198,000	195.36	195.36	195.36
6	1,124.70	1,124.70	1,124.70	1,124.70	390,000	374.90	374.90	374.90
8	1,755.90	1,755.90	1,755.90	1,755.90	630,000	585.30	585.30	585.30
10	2,466.00	2,466.00	2,466.00	2,466.00	900,000	822.00	822.00	822.00
12	3,333.90	3,333.90	3,333.90	3,333.90	1,230,000	1,111.30	1,111.30	1,111.30
20	7,390.20	7,390.20	7,390.20	7,390.20	2,820,000	2,463.40	2,463.40	2,463.40
24	9,848.40	9,848.40	9,848.40	9,848.40	3,840,000	3,282.80	3,282.80	3,282.80

Requests for Information

This financial report is designed to provide a general overview of the Authority’s finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Robert J. Lichtenthal, Jr., Deputy Director, Erie County Water Authority, 295 Main Street, Rm. 350, Buffalo, New York 14203-2494.

BASIC FINANCIAL STATEMENTS

ERIE COUNTY WATER AUTHORITY

Statements of Net Position

	December 31, 2012	December 31, 2011 (Restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,198,960	$ 17,141,131
Restricted cash and cash equivalents	3,150,937	2,741,054
Customer accounts receivable, net of allowance for doubtful accounts	4,595,227	4,285,295
Materials and supplies	2,159,253	2,255,430
Accrued revenue	5,959,134	5,416,717
Prepaid expenses and other assets	1,997,306	1,891,862
Total current assets	37,060,817	33,731,489
Noncurrent assets:		
Investments	549,983	549,983
Restricted cash and cash equivalents	25,106,390	12,348,953
Restricted investments	9,594,759	9,594,759
Capital assets, not being depreciated	7,327,315	6,067,555
Capital assets, being depreciated, net of accumulated depreciation	341,397,953	341,104,167
Total noncurrent assets	383,976,400	369,665,417
Total assets	421,037,217	403,396,906
LIABILITIES		
Current liabilities:		
Accounts payable	4,810,812	4,704,738
Advances for construction	273,418	426,957
Construction retention	677,269	359,169
Accrued interest on water revenue bonds	500,797	503,884
Accrued liabilities	2,214,289	3,141,601
Compensated absences	1,549,557	1,117,077
Water revenue bonds - current portion	8,152,236	6,787,236
Total current liabilities	18,178,378	17,040,662
Noncurrent liabilities:		
Compensated absences	2,445,417	1,761,708
Other postemployment benefits	20,491,564	17,830,816
Water revenue bonds - long term	85,458,168	81,110,404
Total noncurrent liabilities	108,395,149	100,702,928
Total liabilities	126,573,527	117,743,590
NET POSITION		
Net investment in capital assets	255,114,864	259,274,082
Restricted		
Debt service reserve account	9,594,811	9,594,858
Debt service account	2,355,754	1,655,310
Construction	7,711,464	-
Unrestricted	19,686,797	15,129,066
Total net position	$ 294,463,690	$ 285,653,316

The notes to the financial statements are an integral part of these statements.

ERIE COUNTY WATER AUTHORITY

Statements of Revenue, Expenses and Changes in Net Position

	Year Ended December 31, 2012	2011 (Restated)
Operating revenue	$ 65,763,547	$ 59,529,303
Operating expenses:		
Operation and administration	21,831,010	23,412,515
Maintenance	15,681,903	10,985,943
Depreciation and amortization, net	11,872,392	11,207,095
Other postemployment benefits	2,660,748	4,021,089
Total operating expenses	52,046,053	49,626,642
Operating income	13,717,494	9,902,661
Nonoperating revenues (expenses):		
Interest income	414,187	458,260
Interest capitalization during construction	76,541	174,315
Interest expense	(3,788,113)	(3,865,205)
Total nonoperating revenues (expenses)	(3,297,385)	(3,232,630)
Net income before contributions in aid of construction and special item	10,420,109	6,670,031
Contributions in aid of construction	1,884,809	985,232
Special item resulting from a change in estimated useful life of capital assets	(3,494,544)	-
Change in net position	8,810,374	7,655,263
Net position - beginning of year (as restated - Note 2)	285,653,316	277,998,053
Net position - end of year	$ 294,463,690	$ 285,653,316

The notes to the financial statements are an integral part of these statements.

ERIE COUNTY WATER AUTHORITY

Statements of Cash Flows

	Year Ended December 31, 2012	2011 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 64,834,923	$ 54,979,845
Payments to contractors	(14,354,408)	(12,566,274)
Payments to employees including fringe benefits	(22,799,823)	(22,582,816)
Net cash provided by operating activities	27,680,692	19,830,755
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquistion and construction of capital assets	(16,904,618)	(19,873,281)
Proceeds from issuance of bonds	12,500,000	-
Bond principal repayments	(6,485,000)	(6,215,000)
Interest paid on revenue bonds, net of amount capitalized	(3,714,659)	(3,720,553)
Advances for construction	(153,539)	(39,570)
Contributions in aid of construction	1,884,809	985,232
Net cash used by capital and related financing activities	(12,873,007)	(28,863,172)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sale or maturity of investments	-	3,029,670
Interest received	417,464	460,250
Net cash provided by investing activities	417,464	3,489,920
Net increase (decrease) in cash and cash equivalents	15,225,149	(5,542,497)
Cash and cash equivalents - beginning of year (including amounts restricted for future construction, debt service reserve, and debt service, reserve for compensated absences, and customer deposits)	32,231,138	37,773,635
Cash and cash equivalents - end of year (including amounts restricted for future construction, debt service reserve, and debt service, reserve for compensated absences, and customer deposits)	$ 47,456,287	$ 32,231,138

(continued)

The notes to the financial statements are an integral part of these statements.

ERIE COUNTY WATER AUTHORITY

Statements of Cash Flows

(concluded)

		Year Ended December 31,		
		2012		**2011 (Restated)**
Reconciliation of operating income to net cash provided by operating activities:				
Operating income	$	13,717,494	$	9,902,661
Adjustments to reconcile operating income to net cash provided by operating activities:				
Depreciation expense		12,174,628		11,509,331
Bond premium amortization		(302,236)		(302,236)
Other postemployment benefits		2,660,748		4,021,089
Changes in assets and liabilities:				
(Increase) decrease in accounts receivable		(309,932)		35,270
(Increase) decrease in material and supplies		96,177		(138,216)
(Increase) decrease in other assets		(651,138)		(2,694,151)
Increase (decrease) in accounts payable		106,074		(694,432)
Increase (decrease) in accrued liabilities		(927,312)		(1,821,547)
Increase (decrease) in compensated absences		1,116,189		12,986
		13,963,198		9,928,094
Net cash provided by operating activities	$	27,680,692	$	19,830,755

The notes to the financial statements are an integral part of these statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting entity—The Erie County Water Authority (the "Authority") is a public benefit corporation created in 1949 by the State of New York. The accounts of the Authority are maintained generally in accordance with the Uniform System of Accounts prescribed by the New York State Public Service Commission ("PSC"), although the Authority is not subject to PSC rules and regulations. The rates established by the Authority do not require PSC approval.

The Authority operates its business activities on a direct service basis where the Authority owns the assets and is responsible for their operation, maintenance, improvement and replacement; on a leased managed service basis where the Authority is responsible for the operation and maintenance of the assets while the lessor is responsible for the improvement and replacement of assets; and on a bulk sales basis where the Authority contracts with the customer to provide water while the customer owns the assets and is responsible for their operation, maintenance, improvement and replacement as well as billings and customer collections.

Basis of accounting—The financial statements of the Authority have been prepared in conformity with generally accepted accounting principles ("GAAP") as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The Authority applies all GASB pronouncements as well as applicable accounting and financial reporting guidance of GASB No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*.

The activities of the Authority are accounted for similar to those often found in the private sector using the flow of economic resources measurement focus and the accrual basis of accounting. All assets, deferred outflows, liabilities, deferred inflows, net position, revenues and expenses are accounted for through a single enterprise fund with revenues recorded when earned and expenses recorded at the time liabilities are incurred.

Revenues from providing water services are reported as operating revenues. Operating revenues are recorded as water service is supplied. Water supplied, but not billed, as of the calendar year end is estimated based upon historical usage and has been accounted for as accrued revenue.

Transactions which are capital, financing or investing related are reported as nonoperating revenues. All expenses related to operating the system are reported as operating expenses. Interest expense and financing costs are reported as nonoperating expenses.

Budgets—The Authority is not required to have a legally adopted budget.

Vacation accruals and compensated absences—Authority employees are granted vacation and sick leave in varying amounts. In the event of termination or upon retirement, union employees are entitled to payment for accrued vacation and sick time limited to amounts defined under their respective collectively bargained agreements. All non-union employees are entitled to benefits as defined by Authority policy.

Retirement plan—The Authority provides retirement benefits for all of its employees through contributions to the New York State and Local Employees' Retirement System. The system provides various plans and options, some of which require employee contributions.

Cash and cash equivalents—For purposes of the statement of cash flows, the Authority considers cash and cash equivalents to be all unrestricted and restricted cash accounts and short-term investments purchased with an original maturity of three months or less.

Investments—The Authority considers investments that mature in more than three months but less than a year as investments. Investments that mature in more than one year are considered noncurrent. Investments are carried at market value based on quoted market prices. The cost of investments sold is determined using the specific identification method and then adjusted to market value changes to reflect the combined net change in these elements in the statements of revenue, expenses and changes in net position.

***Customer accounts receivable*—**All receivables are reported at their gross values and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. The Authority recognizes water revenues in the period in which the service is provided. Billings to customers generally consist of revenues earned from the prior three months for quarterly billed customers and revenues earned from the prior month for monthly-billed customers.

Materials and supplies—Materials and supplies are stated at the lower of cost or market, cost being determined on the basis of moving-average cost.

Accrued revenue—This account represents earned water revenues as of the end of the year that have not yet been billed to customers.

***Prepaid expenses and other assets*—**These consist primarily of certain payments reflecting costs applicable to future accounting periods and interest earned from securities and investments but not yet received.

***Capital assets*—**Capital assets are defined by the Authority as assets with an initial, individual cost of more than $10,000 and an estimated useful life in excess of two years. The cost of additions to capital assets, including purchased property or property contributed in aid of construction, and replacements of retired units of property, is capitalized. Cost includes direct material, labor, overhead and an allowance for funds used during construction equivalent to the average cost of borrowed funds advanced for construction purposes. Overhead is added proportionately to the cost of a project on a monthly basis. The cost of retirements of capital assets is charged against accumulated depreciation. Maintenance and repairs are charged to expenses as incurred, and major betterments are capitalized.

Depreciation of capital assets is computed using the composite and straight-line methods based upon annual rates established in accordance with PSC guidelines: buildings and structures, 15 to 76 years; mains and hydrants, 64 to 100 years; equipment, 5 to 43 years; and other, 4 to 50 years. Depreciation expense approximated 2.19% and 2.10% of the original cost of average depreciable property for the years ended December 31, 2012 and 2011 respectively.

Long-term obligations—Long term debt is reported as a liability in the statements of net position. Bond premiums and bond discounts are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount.

Debt issuance costs—Prior to 2012, bond issuance costs were reported as deferred charges and were amortized over the term of the related debt using the straight-line method. In 2012 the Authority implemented GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which requires bond issuance costs to be expensed as incurred. As required by Statement No. 65, the 2011 financial statements have been restated to reflect the change (Note 2).

Advances for construction—Advances for construction primarily represent amounts received from contractors for water system expansions. Upon completion of the expansion, the cost of the construction is transferred to contributions in aid of construction, with any remaining advance being refunded.

Accrued liabilities—Included are provisions for estimated losses and surcharges collected from customers on behalf of various municipalities and unpaid at year end.

Contributions in aid of construction—Contributions in aid of construction represent amounts received from individuals, governmental agencies, and others to reimburse the Authority for construction costs incurred on capital projects or the original cost of certain water plant systems conveyed to the Authority by municipalities and others. Only those water plant systems resulting in increased revenue generation are assigned any value and, therefore, recorded as a contribution in aid of construction.

Risk management—The Authority limits its risk exposure to risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters through various insurance policies. Insurance coverage and deductibles have remained relatively stable from the previous year. Insurance expense for the years ended December 31, 2012 and 2011 totaled $1,382,046 and $1,173,974, respectively. There were no settlements that significantly exceeded insurance coverage or reserved amounts for each of the last three years. Any unpaid claims outstanding as of December 31, 2012 and 2011 have been adequately reserved for.

Use of estimates—The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and related notes. Actual results could differ from those estimates.

Adoption of New Accounting Pronouncements—During the year ended December 31, 2012, the Authority implemented GASB Statements No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans;* No. 60, *Accounting and Financial Reporting for Service Concession Arrangements;* No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements;* No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* and No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions an amendment of GASB Statements No. 53* effective for the year ending December 31, 2012 which had no impact on the Authority's financial position or results of operations. The Authority also chose to early implement GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities.* As required, the cumulative effect of applying Statement No. 65 is reported as a restatement of beginning net position on the 2011 financial statements (Note 2).

Future impacts of accounting pronouncements—The Authority has not completed the process of evaluating the impact that will result from adopting GASB Statements No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34* and No. 66, *Technical Corrections - 2012 - an amendment of GASB Statements No. 10 and No. 62,* effective for the year ending December 31, 2013; No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25* and No. 69, *Government Combinations and Disposals of Government Operations* effective for the year ending December 31, 2014; and No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27,* effective for the year ending December 31, 2015. The Authority is therefore unable to disclose the impact that adopting these Statements will have on its financial position and results of operations when such statements are adopted.

2. CHANGE IN ACCOUNTING PRINCIPLE

Effective January 1, 2012, the Authority adopted GASB Statements No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and No. 65, *Items Previously Reported as Assets and Liabilities* (GASB 65). These statements require reporting of deferred outflows and inflows of resources separately from assets and liabilities and replace net assets with net position. In addition, certain items previously reported as assets and liabilities are now recognized as outflows or inflows of resources. Other than renaming net assets with net position, GASB No. 63 had no impact on the Authority's financial position or results of operation. However, GASB No. 65 results in expensing unamortized bond issuance costs and is applied retroactively by restating the prior period financial statements.

The following summarizes the effect of GASB 65 on the net position of the Authority as of January 1, 2011, the earliest period presented:

Net assets previously reported	$ 282,797,051
Bond issuance costs	(4,798,998)
Restated net assets	$ 277,998,053

In addition, the statements of revenue, expenses, and changes in net position have been retroactively restated for such change, which resulted in an increase in operation and administration expenses of $18,229; a decrease in depreciation and amortization, net, of $734,757; and an increase to the change in net position of $716,528. These differences reflect the removal of amortization of bond issuance costs and the recognition of additional insurance expense for prepaid insurance amounts that were previously included within bond issuance costs.

3. CASH AND INVESTMENTS

Deposits—All uninsured bank deposits are fully collateralized.

Investments—The Authority's bond resolutions and investment guidelines allow for monies to be invested in the following instruments:

- Obligations of the United States Government;
- Obligations of Federal Agencies which represent full faith and credit of the United States Government;

- Bonds issued by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation with remaining maturities not exceeding three years;
- Time deposits and money market accounts;
- Commercial paper which matures not more than 270 days after the date of purchase; and
- Municipal obligations of any state, instrumentality, or local governmental unit of such state.

Restricted cash, cash equivalents, and investments—Cash has been deposited into various trust accounts with a fiscal agent to satisfy certain legal covenants, or restricted internally through Board resolution. Further, the amounts are invested in compliance with the Authority's investment guidelines. The following is a brief synopsis of restricted cash:

Restricted for future construction—Cash restricted for future construction was established to maintain a construction account, which has been committed for future capital expenditures.

Restricted for debt service reserve**—**The Authority restricts investments in the debt service reserve account as required by various bond resolutions to maintain a specified amount to meet future debt service requirements.

Restricted for debt service—Cash restricted for debt service was established to fulfill the debt service requirements on the outstanding water revenue bonds as they become due and payable.

Restricted for sick pay reserve—Cash restricted for sick pay was established to set funds aside to pay employee sick pay benefits as eligible employees retire or otherwise terminate their employment. In 2012 the Authority's Board passed a resolution to eliminate the funding of the sick pay reserve and the balance is now included as unrestricted cash.

Restricted for customer deposits—Cash restricted for customer deposits was established to keep customer deposits for future work to be performed and deposits taken from customers to secure payment of their water bills segregated from the Authority's operating cash.

As of December 31, 2012 and 2011, the Authority had the following restricted cash, cash equivalents, and investments:

	December 31, 2012		December 31, 2011	
	Amortized Cost	Market Value	Amortized Cost	Market Value
Restricted for debt service:				
Cash	$ 1,043,843	$ 1,043,843	$ 1,655,310	$ 1,655,310
Cash equivalents - U.S. Treasury bills	947,970	947,977	-	-
Investments - U.S. Treasury bills	363,883	363,934	-	-
Total restricted for debt service	2,355,696	2,355,754	1,655,310	1,655,310
Restricted for sick pay reserve, current:				
Cash	-	-	92,722	92,722
Restricted for customer deposits:				
Cash	795,183	795,183	993,022	993,022
Current restricted cash, cash equivalents, and investments	$ 3,150,879	$ 3,150,937	$ 2,741,054	$ 2,741,054
Restricted for future construction:				
Cash and cash equivalents	$ 25,106,338	$ 25,106,338	$ 10,587,147	$ 10,587,147
Restricted for debt service reserve:				
Cash	52	52	99	99
State and Local Government Series Treasury bonds	9,594,759	9,594,759	9,594,759	9,594,759
Total restricted for debt service reserve	9,594,811	9,594,811	9,594,858	9,594,858
Restricted for sick pay reserve, long term:				
Cash	-	-	1,761,707	1,761,707
Noncurrent restricted cash, cash equivalents, and investments	$ 34,701,149	$ 34,701,149	$ 21,943,712	$ 21,943,712
Total restricted cash, cash equivalents and investments	$ 37,852,028	$ 37,852,086	$ 24,684,766	$ 24,684,766

Custodial credit risk**—**For deposits, this is the risk that in the event of a bank failure, the Authority's deposits may not be returned. For cash equivalents and investments, this is the risk that in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments that are in the possession of an outside party. By State statute all deposits in excess of FDIC insurance coverage must be collateralized. As of December 31, 2012 and 2011, all uninsured bank deposits were fully collateralized with securities held by the pledging financial institutions' trust departments or agents in the Authority's name and all of the Authority's cash equivalents and investments were registered in the Authority's name.

Interest rate risk—For investments, this is the risk that potential purchasers of debt securities will not agree to pay face value for those securities if interest rates subsequently increase. There is the prospect of a loss should those securities be sold prior to maturity. The Authority follows a policy to specifically identify the maturity for each individual investment and evaluate risk accordingly.

4. ACCOUNTS RECEIVABLE

Accounts receivable primarily represent amounts due from customers for current and past due water services provided, including penalties, unpaid bill charges, collection fees and shut-off charges.

Customers are billed either on a monthly or quarterly basis depending on the type of customer and the level of water usage. Customers are provided a fifteen day (15) payment period from the billing date to pay their current water charges. A late penalty of 10% is assessed on any unpaid balance 10 days after the due date. An account will receive a collection letter if the account is active, has a receivable balance greater than $75, has a receivable that is 90 days or greater in arrears and has no current collections activity. The collection letter indicates that the customer could be subject to the discontinuance of their water service and additional delinquent charges.

Following fifteen (15) days from the collection letter date, an unpaid account is sent to a collector who schedules a visit to the customer with an unpaid bill notice. At the visit, the account is "posted," and the customer has three (3) working days to either pay the bill in full, or submit a partial payment (25%-33%) with a signed promissory agreement for the remaining balance. The agreement is normally kept to a term of 90 days, with some exceptions to 180 days. A final bill that remains unpaid in a direct service area is referred to an outside collection agency. The collection agency keeps a predetermined portion of any collected monies. In agreements with lease managed water districts, unpaid water bills are referred to municipalities for payment per the terms of a lease management agreement. The outstanding balances of an unpaid final bill in a lease managed area are not referred to an outside agency, instead they are sent to the proper municipality for payment. Allowances for doubtful accounts at December 31, 2012 and 2011 total $315,551 and $693,532, respectively.

5. CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2012 and December 31, 2011 was as follows:

	Balance 1/1/2012	Additions	Deletions	Balance 12/31/2012
Non-depreciable capital assets:				
Land	$ 2,218,274	$ -	$ -	$ 2,218,274
Construction work in progress	3,849,281	6,335,474	(5,075,714)	5,109,041
Total non-depreciable capital assets	6,067,555	6,335,474	(5,075,714)	7,327,315
Depreciable capital assets:				
Buildings and structures	248,273,892	5,533,442	(8,562,000)	245,245,334
Mains and hydrants	203,761,489	4,650,587	(49,459)	208,362,617
Equipment	49,357,555	5,071,556	(1,642,240)	52,786,871
Other	51,041,459	1,173,348	(3,465)	52,211,342
Total depreciable capital assets	552,434,395	16,428,933	(10,257,164)	558,606,164
Less accumulated depreciation:				
Buildings and structures	113,221,693	6,597,908	(5,209,745)	114,609,856
Mains and hydrants	42,239,665	2,042,888	(55,531)	44,227,022
Equipment	26,902,648	2,388,406	(1,025,660)	28,265,394
Other	28,966,222	1,145,426	(5,709)	30,105,939
Total accumulated depreciation	211,330,228	12,174,628	(6,296,645)	217,208,211
Total depreciable capital assets, net	341,104,167	4,254,305	(3,960,519)	341,397,953
Total capital assets, net	$ 347,171,722	$ 10,589,779	$ (9,036,233)	$ 348,725,268

	Balance 1/1/2011	Additions	Deletions	Balance 12/31/2011
Non-depreciable capital assets:				
Land	$ 2,218,274	$ -	$ -	$ 2,218,274
Construction work in progress	4,826,542	8,776,144	(9,753,405)	3,849,281
Total non-depreciable capital assets	7,044,816	8,776,144	(9,753,405)	6,067,555
Depreciable capital assets:				
Buildings and structures	241,896,893	6,932,999	(556,000)	248,273,892
Mains and hydrants	196,353,818	7,506,254	(98,583)	203,761,489
Equipment	45,900,451	4,031,302	(574,198)	49,357,555
Other	49,429,575	1,611,884	-	51,041,459
Total depreciable capital assets	533,580,737	20,082,439	(1,228,781)	552,434,395
Less accumulated depreciation:				
Buildings and structures	107,694,084	6,140,063	(612,454)	113,221,693
Mains and hydrants	40,369,501	1,961,989	(91,825)	42,239,665
Equipment	25,088,949	2,291,274	(477,575)	26,902,648
Other	27,850,217	1,116,005	-	28,966,222
Total accumulated depreciation	201,002,751	11,509,331	(1,181,854)	211,330,228
Total depreciable capital assets, net	332,577,986	8,573,108	(46,927)	341,104,167
Total capital assets, net	$ 339,622,802	$ 17,349,252	$ (9,800,332)	$ 347,171,722

During 2012, management determined that water tanks were being refurbished more quickly than in the past and therefore not meeting the definition of "betterment" in the Authority's capitalization policy. As such, management determined that expenses related to tank refurbishments were better defined as repairs and maintenance. Effective January 1, 2012, such costs are expensed as incurred and items previously capitalized and having a remaining net book value of $3,494,544 have been written down to zero. This amount is recognized as a special item on the accompanying statements of revenue, expenses and changes in net position.

6. LONG-TERM DEBT

Summary of long-term debt—the following is a summary of the Authority's water revenue bonds at December 31, 2012:

Series	Final Annual Installment Payment Due	Year of Earliest Principal Payment	Interest Rate		Original Issue	Principal Outstanding 12/31/2012
Series 1998D	10/15/2019	2000	.845-3.35%	(*)	$ 16,859,700	$ 7,300,000
Series 2003F	7/15/2023	2004	.79-4.50%	(*)	15,544,443	9,990,000
Series 2007	12/1/2037	2008	4.50-5.00%		35,000,000	32,015,000
Series 2008	12/1/2018	2009	4.00-5.00%		45,770,000	29,895,000
Series 2012	6/1/2022	2013	2.41%		12,500,000	12,500,000
						91,700,000
Less portion due within one year						(7,850,000)
						$ 83,850,000

(*) Gross rates subject to subsidy from the New York State Environmental Facilities Corporation (EFC)

All outstanding bonds have been issued under the Authority's Fourth Resolution and, therefore, all of the current bondholders have equal claims against the Authority's revenues.

The Current Interest Series 1998D Bonds were issued to the EFC under their aggregate pool financing identified as New York State Environmental Facilities Corporation State Clean Water and Drinking Water Revolving Funds Revenue Bond Series 1998D in 1998. The 1998D bonds in the amount of $16,859,700, representing the Authority's portion of the financing, were issued to cover the costs of the construction of two new clearwell water tanks and a new pumping station at the Authority's Sturgeon Point plant.

Interest on the 1998D bonds ranges from .845% to 3.355% and is payable semi-annually on April 15 and October 15. Principal is payable on October 15. The final maturity of the bonds is October 15, 2019.

On July 24, 2003 the 2003F Series Bonds were issued to the EFC under their aggregate pool financings identified as New York State Environmental Facilities Corporation State Clean Water and Drinking Water Revolving Funds Revenue Bonds Series 2003F. The 2003F bonds in the amount of $15,544,443 representing the Authority's portion of this financing were issued to cover the following:

Description	Amount
Town of Lancaster pump station	$ 2,005,360
Harris Hill pump station & main construction	4,826,239
City of Tonawanda - meters, transmission main, pump station & tank	7,158,404
Debt service reserve account	1,554,440
	$ 15,544,443

Interest on the 2003F bonds ranges from .79% to 4.50% and is payable semi-annually on January 15 and July 15. Principal is payable on July 15. The final maturity of the bonds is July 15, 2023.

The terms of the EFC borrowings provide for an interest subsidy of approximately one-third of the stated interest rates shown above. The subsidy is generated from a United States Environmental Protection Agency grant to the EFC which the EFC invests and credits the borrower with the earnings on the invested funds as an offset to the interest payable on the bonds.

On September 13, 2007, the 2007 Series Bonds were issued for $35,194,288, which includes a premium of $194,288 that is amortized over the life of the bonds. The purpose of these bonds is to provide funds for the costs of acquisition and construction of various projects undertaken by the Authority as part of its capital improvement program. This includes the replacement of various water mains and valves in the distribution system, construction of new pump stations, upgrades to the coagulation basins, the replacement of electrical equipment, and installation of standby emergency generators at the Authority's Sturgeon Point and Van de Water Treatment Plants.

Interest on the 2007 Series Bonds ranges from 4.50% to 5.00% and is payable semi-annually on June 1 and December 1. The principal is payable on December 1. The final maturity of the bonds is December 1, 2037.

On June 25, 2008 the Authority issued $45,770,000 of Water Revenue Refunding Bonds, Series 2008 ("Series 2008 Bonds"). The Series 2008 Bonds carry an interest rate of 4.0% to 5.0% and mature December 1 of each year through December 1, 2018. The proceeds of the issue, including a $3,081,304 premium which is amortized over the life of the Series 2008 Bonds, were used to refund the principal of the Series 1993A and Series 1993B Bonds, $27,500,000 and $15,000,000, respectively. A portion of the proceeds covered the costs of issuance including a fee in connection with the termination of the swap agreement related to the Series 1993A and Series 1993B Bonds. The remaining portion of the proceeds, after the total $5,894,523 cost of refunding the bonds, including the final interest payment on the swap agreement of $81,679, were deposited into the Series 2008 Debt Service Reserve Account. The Series 1993A and Series 1993B Bonds were redeemed on July 25, 2008. The issuance of the Series 2008 refunding bonds reduced the debt service by $7,481,572 and has a net present value cash flow savings of $8,393,467.

On June 8, 2012, the Authority issued $12,500,000 of Bonds under a Bond Direct Purchase Agreement. The bonds were issued under the Authority's Fourth Bond Resolution. The purpose of these bonds is to provide funds for the acquisition and construction of Sturgeon Point clarifier/thickener improvements, pump station improvements, raw water pumps, Van De Water coagulation basins, and the Texas/Lang interconnection with the City of Buffalo.

Interest on the 2012 Series bonds is at 2.41% and is payable semi-annually on June 1 and December 1. The principal is payable on June 1. The final maturity of the bonds is June 1, 2022.

Prior to 1993, the Authority completed a plan of restructuring a significant portion of its debt through a series of bond issuances. The net proceeds from these issuances and certain existing funds were deposited with an escrow agent pursuant to refunding agreements, and invested in U.S. Government securities. The maturities of these invested funds and related earnings thereon are expected to provide sufficient cash flow to meet the debt service requirements of the defeased bonds as they mature. These advance refunding transactions effectively released the Authority from its obligation to repay these bonds and constituted in-substance defeasances. The principal outstanding on the bonds defeased prior to 1993 is $2,900,000 at December 31, 2012 with maturities in 2013 and 2014.

Long-term debt requirements—Long-term debt requirements are summarized as follows:

Year ending December 31,	Bond Principal	Interest on Bonded Debt
2013	$ 7,850,000	$ 3,881,272
2014	8,185,000	3,564,600
2015	8,525,000	3,228,923
2016	8,895,000	2,873,751
2017	9,255,000	2,497,290
2018-2022	23,470,000	8,059,746
2023-2027	8,520,000	5,077,730
2028-2032	7,565,000	3,423,422
2033-2037	9,435,000	1,444,450
	91,700,000	34,051,184
Less portion due within one year	7,850,000	3,881,272
	$ 83,850,000	$ 30,169,912

Summary of changes in long-term debt—the following is a summary of changes in water revenue bonds and other long-term debt for the years ended December 31, 2012 and December 31, 2011:

	Balance 1/1/2012	Additions and Appreciation	Deletions	Balance 12/31/2012	Due Within One Year
Series 1998D	$ 8,190,000	$ -	$ (890,000)	$ 7,300,000	$ 925,000
Series 2003F	10,650,000	-	(660,000)	9,990,000	670,000
Series 2007	32,725,000	-	(710,000)	32,015,000	740,000
Series 2008	34,120,000	-	(4,225,000)	29,895,000	4,395,000
Series 2012	-	12,500,000	-	12,500,000	1,120,000
Bonds payable	$ 85,685,000	$ 12,500,000	$ (6,485,000)	$ 91,700,000	$ 7,850,000
Bond premiums	2,212,640	-	(302,236)	1,910,404	302,236
Total bonds payable	$ 87,897,640	$ 12,500,000	$ (6,787,236)	$ 93,610,404	$ 8,152,236
Compensated absences	$ 2,878,785	$ 1,424,049	$ (307,860)	$ 3,994,974	$ 1,549,557

	Balance 1/1/2011	Additions and Appreciation	Deletions	Balance 12/31/2011	Due Within One Year
Series 1998D	$ 9,050,000	$ -	$ (860,000)	$ 8,190,000	$ 890,000
Series 2003F	11,295,000	-	(645,000)	10,650,000	660,000
Series 2007	33,410,000	-	(685,000)	32,725,000	710,000
Series 2008	38,145,000	-	(4,025,000)	34,120,000	4,225,000
Bonds payable	$ 91,900,000	$ -	$ (6,215,000)	$ 85,685,000	$ 6,485,000
Bond premiums	2,514,876	-	(302,236)	2,212,640	302,236
Total bonds payable	$ 94,414,876	$ -	$ (6,517,236)	$ 87,897,640	$ 6,787,236
Compensated absences	$ 2,865,799	$ 210,175	$ (197,189)	$ 2,878,785	$ 1,117,077

7. PENSION PLAN

Plan Description—The Authority participates in the New York State and Local Employees' Retirement System ("State Plan"), which is a cost-sharing, multiple-employer, public employee retirement system. The State Plan provides retirement, disability, and death benefits to members as authorized by the New York State Retirement and Social Security Law. Obligations of employers and employees to contribute and benefits to employees are governed by the New York State Retirement and Social Security Law ("NYSRSSL"). As set forth in the NYSRSSL, the Comptroller of the State of New York ("Comptroller") serves as the sole trustee and administrative head of the State Plan. The Comptroller shall adopt and may amend rules and regulations for the administration and transaction of the business of the State Plan and for the custody and control of their funds. The State Plan issues financial reports containing financial statements and required supplementary information. These reports are available to the public and may be obtained by writing to the New York State and Local Retirement Systems – Employees' Retirement System, 110 State Street, Albany, New York 12244 or on the Internet at www.osc.state.ny.us.

Funding Policy—Plan members who joined the State Plan before July 27, 1976 are not required to make contributions. Those joining on or after July 27, 1976 are required to contribute 3% of their annual salary for the first ten years of their membership, or credited service. For members hired after January 1, 2010 and before April 1, 2012, a 3% contribution for the duration of their membership is required. Contribution rates for members hired after April 1, 2012 are based on annual wages. Additionally, members who meet certain eligibility requirements will receive one month additional service credit for each completed year of service, subject to certain limitations. Under the authority of the NYSRSSL, the Comptroller shall certify annually the rates expressed as proportions of payroll of members, which shall be used in computing the contributions required to be made by employers to the pension accumulation fund.

The Authority's required contributions and rates over the past three years were:

Year	Amount	Rate
2012	$ 2,563,599	10.1% - 25.4%
2011	$ 2,207,764	12.7% - 21.5%
2010	$ 1,657,556	11.3% - 15.3%

Chapter 49 of the Laws of 2003 of the State of New York was enacted which made the following changes to the State Plan: requires minimum contributions by employers of 4.5% of payroll every year, including years in which the investment performance would make a lower contribution possible, and changes the cycle of annual billing such that the contribution for a given fiscal year will be based on the value of the pension fund on the prior April 1st (e.g., billings due February 2012 would be based on the pension value as of March 31, 2011).

The Authority has contributed 100% of the required contributions each year.

8. POSTEMPLOYMENT BENEFITS

Plan Description—The Authority provides retiree health plans through Labor Management Healthcare Fund ("LMHF"). Retirees must meet age and years of service requirements to qualify for health benefits under this multiple-employer defined benefit healthcare plan ("the Plan"). Retiree benefits continue for the lifetime of the retiree and spousal benefits continue for their lifetime unless they remarry. There were 150 and 137 retirees receiving health care benefits at December 31, 2012 and December 31, 2011 respectively.

Funding Policy—Authorization for the Authority to pay a portion, or all, of retiree health insurance premiums was enacted by resolution of the Authority's Board of Commissioners or through union contracts, which are ratified by the Board of Commissioners. Retired employees that met the age and years of service requirements and were enrolled in any healthcare plan prior to June 1, 2004 are required to make no contribution. Retirees enrolling in the Traditional Blue PPO 812 plan after June 1, 2004 are required to pay contributions equal to the difference between the Traditional Blue PPO 812 plan premium and the highest premium of any other plan offered to that retiree.

On November 23, 2011 the Board of Commissioners adopted a resolution accepting a new nine-year collective bargaining agreement with employees represented by the American Federation of State, County and Municipal Employees, AFL-CIO ("AFSCME"). Under the terms of the agreement, represented employees hired after November 23, 2011 who meet the eligibility requirements will pay 15% of the total premium of the Core Plan for the duration of their retirement. Eligibility criteria for all employees represented by AFSCME were increased from 55 to 58 years of age and, for employees hired after January 1, 2006, from 15 to 20 years of service.

The Board of Commissioners adopted an amendment to the Retiree Medical Insurance policy relative to non-represented employees on December 13, 2011. Effective April 1, 2012 retirees not represented by a collective bargaining agreement shall pay 15% of the full premium for single, double or family point of service ("POS") contract. Retirees who elect to enroll in the Traditional Blue PPO 812 plan will pay the difference between the Authority's share of the POS premium and the PPO premium.

On October 16, 2012 the Board of Commissioners entered into a new nine-year collective bargaining agreement with employees represented by the Civil Service Employees Association, Inc., Local 1000, AFSCME AFL-CIO ("CSEA"). Under the terms of the agreement, represented employees hired after July 26, 2012 who meet the eligibility requirements will pay 15% of the total premium of the Core Plan for the duration of their retirement. Eligibility criteria for all employees hired prior to January 1, 2008 was changed to age 55 with a minimum of ten years of service, while employees hired on or after January 1, 2008 must be 58 with a minimum of fifteen years of service with the Authority.

The Authority's annual postemployment benefit ("OPEB") cost is calculated based on the annual required contributions ("ARC") of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The ARC represents a level funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liability over a period not to exceed thirty years. The following table shows the components of the Authority's annual OPEB cost, the amount actually contributed to the plan, and the changes in the Authority's net OPEB obligation for 2012 and 2011.

	2012	2011
Annual required contribution	$4,214,135	$5,572,881
Interest on net OPEB obligation	891,541	690,486
Adjustment to annual required contribution	(1,159,920)	(898,343)
Annual OPEB costs (expense)	3,945,756	5,365,024
Contributions made	(1,285,008)	(1,343,935)
Increase in net OPEB obligation	2,660,748	4,021,089
Net OPEB obligation - beginning of year	17,830,816	13,809,727
Net OPEB obligation - end of year	$20,491,564	$17,830,816

Funding Status and Funding Progress—As of January 1, 2012, the most recent actuarial valuation date, the plan was not funded. Since there were no assets, the unfunded actuarial liability for benefits was $41,810,183.

The schedule of the Authority's annual OPEB cost, amount and percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation were as follows:

	Annual OPEB Cost	Contributions Made	Percentage Contributed	Net OPEB Obligation
January 1, 2012	$ 3,945,756	$ 1,285,008	32.6%	$ 20,491,564
January 1, 2011	5,365,024	1,343,935	25.0%	17,830,816
January 1, 2010	5,110,760	1,229,697	24.1%	13,809,727

Actuarial Methods and Assumptions—Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress for the past two actuarial valuations immediately follows the notes to the financial statements and presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Calculations are based on the types of benefits provided under the terms of the substantive plan, the plan as understood by the employer and the plan members at the time of the valuation, and on the pattern of cost sharing between the employer and plan members. The projection of benefits does not incorporate the potential effect of a change in the pattern of cost sharing between the employer and plan members in the future. Calculations reflect a long-term perspective, so methods and assumptions used include techniques that are designed to reduce short-term volatility.

In the January 1, 2012 actuarial valuation, the following actuarial methods and assumption were used:

Actuarial cost method – Projected Unit Credit
Investment rate of return and discount rate – 5%
Change in consumer price index for medical care (inflation rate) – 3.7%
Healthcare cost trend rate – Health insurance – 9.0% initially, reduced to a rate of 5.0% in 2020 and beyond for pre-65 retirees; 8.0% initially, reduced to 5.0% in 2020 and beyond for post-65 retirees. Prescription drug coverage has an assumed increase of 8.0% initially, declining to 5.0% for 2020 and beyond.
Amortization of actuarial accrued liability – Actuarial accrued liability is being amortized over thirty years using the level dollar method, on an open basis.
Mortality – The RP-2000 Mortality Table for annuitants and non-annuitants with projected mortality improvements; specifically as outlined in IRC Regulation 1.430(h)(3)-1 for 2012 valuations.
Turnover – Rates of turnover are based on experience under the New York State Employees' Retirement System (State Plan).
Retirement incidence – Rates of retirement are based on the experience under the State Plan.
Election percentage – It was assumed 100% of future retirees eligible for coverage will elect postretirement healthcare coverage.
Spousal coverage – 80% of future retirees are assumed to elect spousal coverage upon retirement.
Per capita costs – All retiree health plans are offered through LMHF. Actual claims experience from LMHF was used to develop retiree claim costs.

9. LABOR RELATIONS

Certain Authority employees are represented by two bargaining units, American Federation of State, County and Municipal Employees ("AFSCME") and Civil Service Employees Association, Inc. ("CSEA"). The CSEA and the Authority entered into a new nine-year collective bargaining agreement dated October 16, 2012. A new nine-year collective bargaining agreement was ratified by the AFSCME union and adopted by the Board on November 23, 2011. Both contracts are effective from April 1, 2008 through March 31, 2017.

10. NET POSITION AND RESERVES

The Authority financial statements utilize a net position presentation. Net position is categorized into net investment in capital assets, restricted and unrestricted.

Net investment in capital assets—This category groups all capital assets into one component of net position. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.

	December 31, 2012	December 31, 2011
Capital assets, net of accumulated depreciation	$348,725,268	$347,171,722
Related debt:		
Water revenue bonds issued for capital assets	(91,700,000)	(85,685,000)
Bond premium	(1,910,404)	(2,212,640)
Net investment in capital assets	$255,114,864	$259,274,082

Restricted net position—This category presents external restrictions imposed by creditors, grantors, contributors, or laws and regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

For the years ended December 31, 2012 and 2011, net position was restricted for the following purposes:

- ***Debt Service Reserve Account*** — During 1998, the Authority established a Debt Service Reserve Account as required by the Series 1998D bond resolution. During 2003, per the 2003F bond resolution the Authority established a Debt Service Reserve Account from a portion of the 2003F bond proceeds. For the Series 1998D bonds, the Authority established the debt service reserve as the average of the annual installments of debt service per the bond resolution. For the Series 2003F bonds, the Authority established the debt service reserve based on ten percent of the total principal of the loan. The required amount was determined by EFC and must remain on deposit until the bonds mature.

  During 2007, the Authority established a Debt Service Reserve Account as required by the Series 2007 bond resolution to maintain a specified amount of funds to meet future debt service requirements. The Authority established the Debt Service Reserve Account based on the maximum amount of principal and interest coming due in any succeeding calendar year on the outstanding Series 2007 bonds.

  During 2008, the Authority established a Debt Service Reserve Account as required by the Series 2008 bond resolution to maintain a specified amount of funds to meet future debt service requirements. The Authority established the Debt Service Reserve Account based on ten percent of the total principal of the loan.

- ***Debt Service Account*** — The 1992 Fourth Resolution, 1998D, 2003F, 2007, 2008 and 2012 Supplemental Fourth Resolution bond resolutions require that a specified amount of funds be maintained in the Debt Service Account. The requirements of the Debt Service Account state that the Authority must deposit funds to provide for monthly interest and principal payments to start not later than six months prior to the payment of interest and twelve months prior to the payment of principal.

- ***Construction Account* -** On June 8, 2012 the Authority issued the Series 2012 Bonds. As required by the 2012 Supplemental Fourth Resolution bond resolution the proceeds are restricted for capital projects. As of December 31, 2012 the balance in the construction account is $7,711,464.

Unrestricted net position—This category represents the amount of net position the Authority has not restricted for any project or other purpose. Management intends to utilize a portion of unrestricted net position to finance the Authority's projected five-year capital spending, which will require future financing in excess of $83,000,000.

When an expense is incurred for purposes for which both restricted and unrestricted amounts are available, the Authority's policy concerning which to apply first varies with the intended use and associated legal requirements. Management typically makes this decision on a transactional basis.

11. COMMITMENTS AND CONTINGENCIES

The Authority maintains and operates certain facilities employed in the sale and distribution of water which it leases from various local municipal water districts pursuant to lease management agreements. No financial consideration is afforded the municipalities in conjunction with these lease agreements. Such agreements generally are for at least ten-year terms and automatically renew for additional ten-year terms unless terminated by either party one year prior to expiration of the term. The agreements provide that the municipalities obtain water exclusively from the Authority. Future maintenance and operating costs to be incurred by the Authority under such arrangements presently in effect are not determinable.

The Authority is also committed under various operating leases for the use of certain equipment and office space. Rental expense for 2012 and 2011 aggregated $286,290 and $324,307. Future minimum annual rentals to be paid under such leases are not significant.

The Authority is subject to various laws and regulations, which primarily establish uniform minimum national water quality standards. The Authority has established procedures for the on-going evaluation of its operations to identify potential exposures and assure continued compliance with these regulatory standards.

The Authority is involved in litigation and other matters arising in its normal operating, financing, and investing activities. While the resolution of such litigation or other matters could have a material effect on earnings and cash flows in the year of resolution, the Authority has obtained various liability, property, and workers' compensation insurance policies which would reduce exposure to loss on the part of the Authority. Management has made provisions for anticipated losses in the accompanying financial statements as advised by legal counsel. None of this litigation and none of these other matters are expected to have a material effect on the financial condition of the Authority at this time.

ERIE COUNTY WATER AUTHORITY
Required Supplementary Information (Unaudited)
Schedule of Funding Progress
Other Postemployment Benefit Plan
For the Year Ended December 31, 2012

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Budgeted Covered Payroll	Ratio of UAAL To Budgeted Covered Payroll
January 1, 2008	$ -	$ 44,227,440	$ 44,227,440	-	$ 15,340,957	2.88
January 1, 2010	-	49,748,261	49,748,261	-	15,102,780	3.29
January 1, 2012	-	41,810,183	41,810,183	-	14,873,087	2.81

See independent auditors' report.

Lumsden McCormick LLP
CERTIFIED PUBLIC ACCOUNTANTS

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

INDEPENDENT AUDITORS' REPORT

The Board of Commissioners
Erie County Water Authority

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Erie County Water Authority (the Authority), which comprise the statement of net position as of December 31, 2012, and the related statements of revenue, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated March 26, 2013.

Internal Control over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Lumsden & McCormick, LLP

March 26, 2013

Lumsden McCormick LLP
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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH SECTION 2925(3)(f) OF THE NEW YORK STATE PUBLIC AUTHORITIES LAW

The Board of Commissioners
Erie County Water Authority

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Erie County Water Authority (the Authority), a business-type activity, which comprise the statement of net position as of December 31, 2012, and the related statements of revenue, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and we have issued our report thereon dated March 26, 2013.

In connection with our audit, nothing came to our attention that caused us to believe that the Authority failed to comply with §2925(3)(f) of the New York State Public Authorities Law regarding investment guidelines during the year ended December 31, 2012. However, our audits were not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the Authority's noncompliance with the above rules and regulations.

The purpose of this report is solely to describe the scope and results of our testing. This communication is not suitable for any other purpose.

Lumsden & McCormick, LLP

March 26, 2013