Erie County Water Authority



2004 Annual Report

Respectfully submitted to the:

Honorable George E. Patacki
Governor of the State of New York

Honorable Alan G. Hevesi
Comptroller of the State of New York

Honorable Joel A. Giambra
County Executive of Erie County

Honorable Namcy A. Naples
Comptroller of Erie County

Honorable George A. Holt, Jr.
Chairman, Erie County Legislature

Honorable Owen H. Johnson
Chairman, Senate Finance Committee

Honorable Herman D. Farrell, Jr.
Chairman, Assembly Ways and Means Committee

Honorable Members of the New York State Legislature

Honorable Members of the Erie County Legislature

Mission

The Erie County Water Authority is an organization of dedicated professionals who strive to continuously provide our customers with a plentiful supply of safe, clean drinking water at an affordable rate.

Vision

The Erie County Water Authority is united in one goal—to deliver a superior product and outstanding service that merits equal recognition from our customers and our peers. We take great pride in creating a work environment that achieves excellence through rewarding dedication, professionalism and a progressive vision.

Commissioners' Message

The Erie County Water Authority (ECWA) is an independent public benefit corporation created in 1949 under the jurisdiction of the Public Authorities Law of the State of New York.

The ECWA is not an agency of New York State nor Erie County government. It operates as a self-sustaining business enterprise and pays for operating expenses out of revenues generated from the sale of water to its customers. As a not-for-profit entity, all revenues received must be used for operating expenses, capital improvements and paying outstanding debts.

With the close of the 2004 fiscal year, the ECWA has justifiable pride in its achievements. These accomplishments are the direct result of the hard work and dedication of the ECWA's professional staff—past and present.

As it looks toward the future, the ECWA is well positioned to continue to efficiently meet the increasing demand for safe, affordable drinking water in the communities we serve.

It is in celebration of the ECWA's successful efforts at producing and reliably delivering the highest quality water to our customers, and our contributions to the quality of life throughout Western New York, that the Board of Commissioners submits the 51st Annual Report of the Erie County Water Authority.

From left to right: Robert J. Lichtenthal, Jr., Vice Chair, Frank E. Swiatek, Treasurer, and Acea Mosey-Pawlowski, Chair

Building a More Efficient System

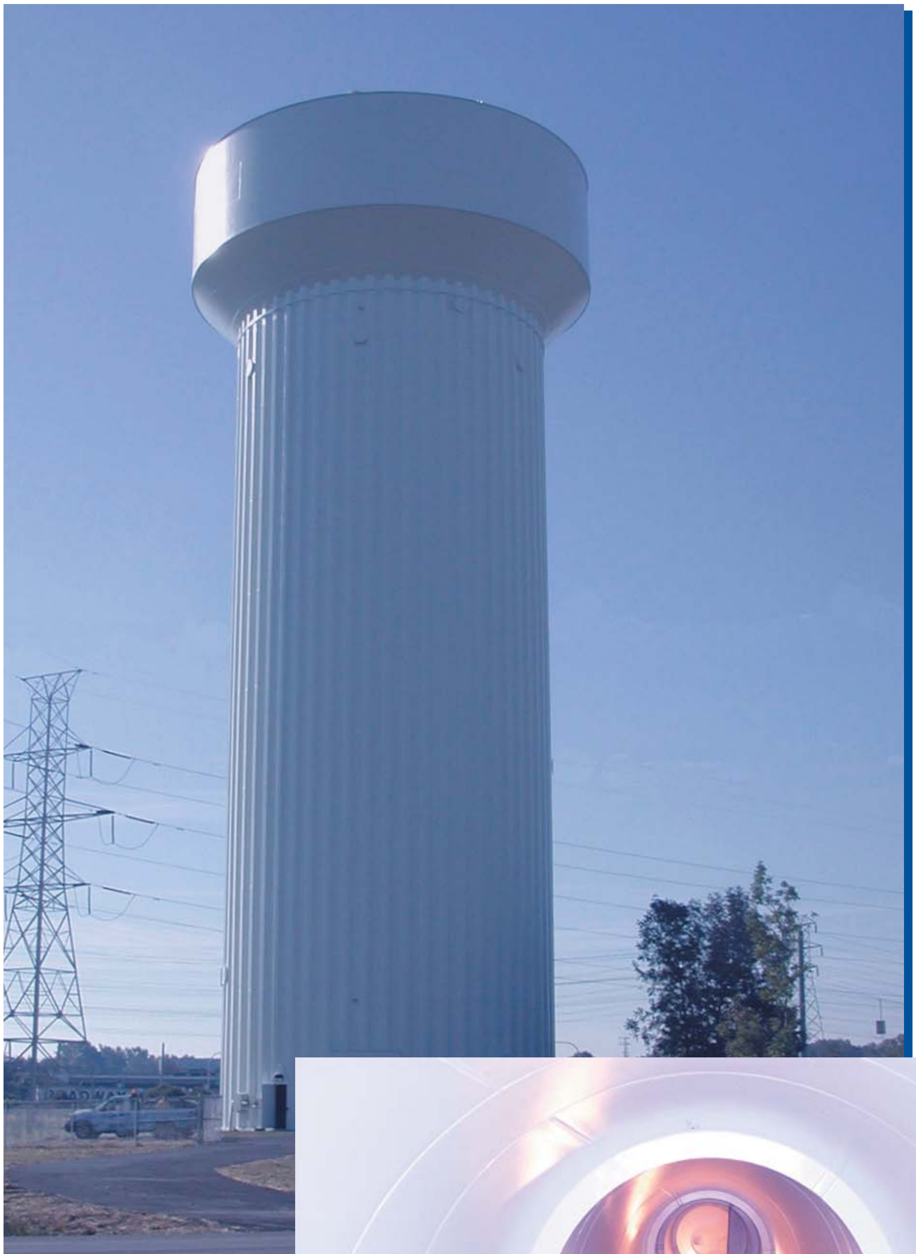
The ECWA spends millions of dollars every year enhancing its system in order to provide more efficient, reliable service to its customers and to prevent more costly capital improvements in the future. The Engineering Department plays a critical role in this effort.

ECWA's professional engineering staff oversees the study, design and construction of all capital improvements to the ECWA's production and distribution systems. The department also manages the ECWA's Geographical Information System (GIS) and property restoration resulting from maintenance and construction work.

Last year, Engineering supervised the design and construction of more than four miles of water mains in Cheektowaga, Lackawanna and Amherst, completed construction of the 1.25 million gallon Colvin Boulevard storage tank and the Veteran's Park pump station in the City of Tonawanda, which consolidated its water system with the ECWA on August 18, 2004, and refurbished the East Aurora and Ball Station storage tanks. The total cost for these system upgrades was $12,930,000.

The department also completed design work on several projects that are slated for completion in 2005, including the refurbishing of the Pine Hill storage tank in Cheektowaga and water main replacements in West Seneca, Lackawanna and Cheektowaga.

The ECWA's ongoing capital investment program will allow its system to better serve its current customers and to meet the demands of an expanding customer base resulting from future system consolidations with local municipalities.



The 1.25 million gallon Colvin Boulevard storage tank in the City of Tonawanda went into service on August 18, 2004.

Director of Production Robert Niederpruem and Control Operator Richard Nelson monitor ECWA's pump stations and storage tanks using the SCADA system.

Dependable — 24 Hours a Day, 365 Days a Year

Maintaining a reliable, efficient production system to ensure adequate service capacity for future growth needs is a major focus of the ECWA.

The Production Department manages the operations of two production facilities, 38 water storage tanks, 32 pump stations and 7 satellite chlorination sites throughout the ECWA's service district.

Last year, the department completed the final phase of a four-year capital project upgrading the Supervisory Control and Data Acquisition System (SCADA) at both ECWA treatment plants. This centralized, computer-based control system constantly monitors all pump stations and storage tanks through microwave communication and computer analysis. SCADA has become vital to the ECWA's system efficiencies and has improved operational controls by allowing for more data storage, management capabilities and system monitoring, especially during power surges.

In response to the August 14, 2003 blackout that crippled parts of the northeastern United States, the ECWA put into service two portable electric generators for use at its remote pump stations during power outages. Additional dollars will be identified in future budgets to purchase more alternative power sources for emergencies.

Continuing its objective of supporting environmentally friendly operations, the ECWA removed 7,319 tons of treatment plant residuals from its Sturgeon Point facility for use in the Indian Road landfill in Cheektowaga. Residuals were excavated and transported to the site where they are being used for clean fill and soil nutrients. This work was completed under the Beneficial Use Determination granted by the Department of Environmental Conservation.

The Production Department also oversaw additional upgrades to the ECWA's security systems at all of its facilities. The ECWA remains in a heightened state of alert and will continue to work diligently to protect our region's water supply.

Providing Water You Can Trust

The ECWA is recognized throughout the country as an industry leader for innovative water treatment strategies and analysis. Every year, the Water Quality Department conducts more than 70,000 tests for roughly 200 contaminants to meet regulatory compliance.

The ECWA's state-of-the-art water quality laboratory is certified for the analysis of potable and non-potable water by the National Environmental Laboratory Accreditation Program (NELAP) and New York State's Environmental Laboratory Approval Program (ELAP). In fact, it is one of the first laboratories in the United States to achieve Environmental Protection Agency (EPA) approval for Cryptosporidium analysis.

In early 2004, high levels of lead detected in drinking water in Washington, D.C., resulted in heightened concern among consumers. In an effort to assure customers that lead is not a threat in ECWA produced drinking water, the Water Quality Department doubled the required number of federally mandated samples for lead and copper. The results showed that ECWA drinking water far exceeded all government regulations.

The ECWA is steadfast in its commitment to provide customers safe, clean drinking water, and remains proactive in its development and evaluation of water quality-based security efforts. The ECWA was the first water system in the nation to integrate Microtox biotoxicity testing into its distribution monitoring program and continues to enhance its security systems as new equipment and methods are developed. In recognition of the ECWA's industry leadership, its Director of Water Quality was invited to make a presentation concerning the organization's Water Quality Surveillance Program at the American Water Works Association's Water Security Congress in Charlotte, North Carolina.

Water Quality staff continue to actively participate on Homeland Security advisory committees at the national and local levels to assist in developing monitoring methods for the rapid detection of contaminants. The ECWA's resolve to provide customers safe, uncompromised, high quality drinking water will continue during these times of heightened security for public water utilities.

James Dolce, Environmental Microbiology Laboratory Technician, performs tests on distribution system samples.

Preventative System Maintenance

The ECWA's system-wide, preventative maintenance program continues to enhance the dependability and efficiency of the distribution network and work productivity. That is why maintaining a superior distribution system is a major priority of the ECWA.

The Distribution Department is responsible for maintaining the extensive delivery system, which includes 2,353 miles of water mains, 15,742 fire hydrants and 25,644 valves. The department is also responsible for the ECWA's metering program and its vehicle fleet.

John Swanekamp and Paul Bigelow work on a large service meter at ECWA's meter shop.

Last year, line maintenance crews completed 1,800 repairs to water mains, hydrants and valves and performed 15,122 work orders, which was a slight increase from the previous year due to the consolidation of the City of Tonawanda's water system with the ECWA.

The department also continued the remote-read meter installation program, which allows meters to be read with a hand held computer from outside a home or business without inconveniencing customers. More than 75 percent of residential accounts and 90 percent of large commercial accounts have been changed to remote-read meters. This successful program has significantly reduced the hours needed to determine a customers' service volume and has resulted in more accurate accounts management and greater customer satisfaction.

More Affordable Service

The ECWA continued its cooperation with local municipalities in pursuit of regional opportunities to help provide more efficient, affordable water service to the residents of Western New York.

The Municipal Liaison assisted the effort by working with state, county and local government officials to develop strategies concerning the region's current and future water supply needs.

The ECWA continued its active participation in the Southtowns Water Consortium and the Inter-Community Water Board to study the potential of serving additional communities in southern Erie County and Cattaraugus and Chautauqua counties. In addition, the ECWA coordinated the planning, design and construction of water main projects to supply new residential and commercial developments in Amherst, Eden, Hamburg, Lancaster, Newstead, Orchard Park and West Seneca.

As a result of the positive impact the consolidation of public water systems has had on the community, the ECWA will continue to work with local governments to provide ratepayers water that is safe and affordable.

Workers install new water mains.

Professional Customer Assistance, Educated Consumers

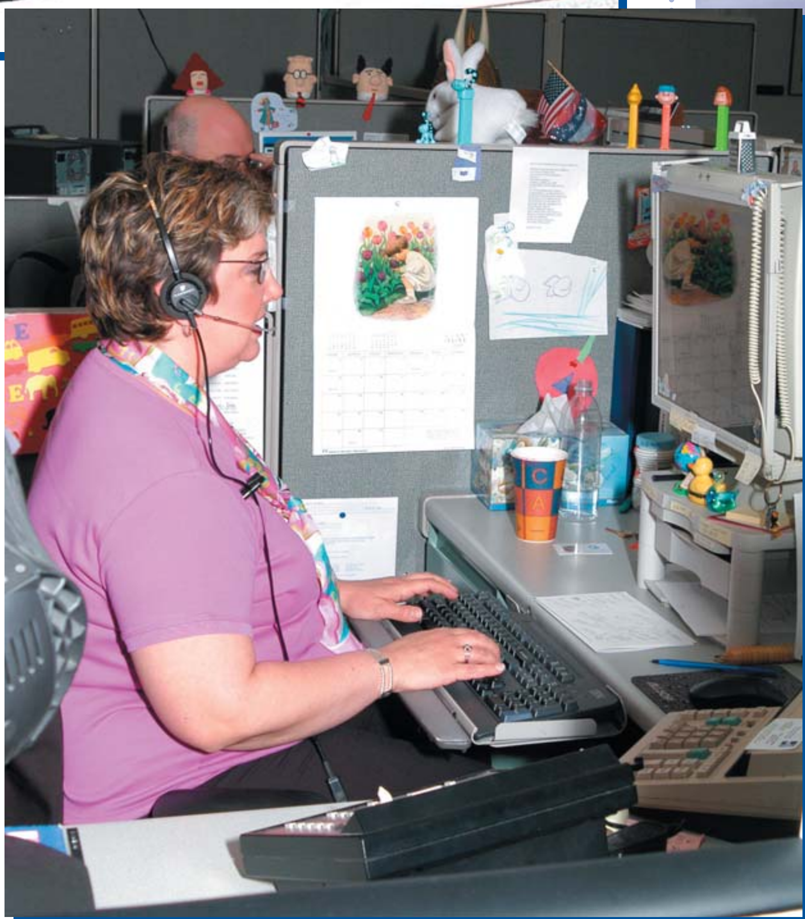
Customer Service has always been a high priority at the ECWA. Well trained Customer Service Representatives provide customers professional assistance that is prompt and courteous.

Last year, ECWA representatives handled 82,083 phone calls, processed 31,046 work orders, serviced 1,700 walk-in customers and issued thousands of letters and e-mails responding to customer inquiries. Total customer service correspondence increased from the previous year due to the addition of more than 8,000 new customers from system consolidations with the City of Tonawanda and the Town of Orchard Park. The ECWA now serves 153,495 customers without any additional staff in the Customer Service Department.

Customer Service is also responsible for maintaining accurate account information, preparing and mailing bills and read-by-mail post cards, processing payments, and administering internal collection procedures for all active accounts. Last year, Customer Service issued 1,057,474 water bills and read-by-mail post cards. ECWA had a 67 percent return rate for its meter reading cards, and on a historical basis ECWA averages a 99.9 percent collection rate for its billings. These respective bill collection and returned post card rates are among the highest of any local utility.

A major objective of the ECWA is to educate consumers so they can become better, more knowledgeable customers. The Public Affairs Office continued its efforts to inform the ECWA's publics about the organization's improved operations and water quality issues. The office distributed thousands of informational brochures, visited several area schools and responded to inquiries from customers, students, teachers, public officials, civic organizations and the media.

Public Affairs also participated in several community events to promote the "ECWA Pure Tap - Bottle Your Own" education campaign, promoted awareness about National Drinking Water Week by placing public service announcements with several local media outlets and implemented phase one of the ECWA web site upgrades that allow for more customer interaction.



Customer Service Representatives Donna Spencer and Susan Wood assist customers at ECWA's administrative offices.

Safety and Training

The ECWA's proactive approach to safety, higher education and professional training programs for its employees has benefited customers through reduced operating costs and improved productivity.

The Human Resources Department manages all of the ECWA's safety and training programs and makes sure that all Public Employee Safety and Health (PESH) regulations are met.

Last year, ECWA employees completed more than 4,000 hours of safety training in areas such as hazardous materials handling, backhoe safety, heavy equipment operation, confined space and work site safety. Employees also participated in educational programs and seminars, licensing certification and professional associations to develop their skills to the highest possible levels and stay ahead of the latest industry trends.

The ECWA is proud of its employees and will continue to offer them a safe and rewarding work environment.

Paul Riester, Director of Administration, conducts a training seminar for ECWA staff.

Supporting Cost-Effective Operations

The Administration Department's proficient management of the ECWA's procurement procedures, storage and inventories of materials and supplies, and operational support services continues to improve overall operations.

All of the ECWA's purchases are reviewed multiple times by trained buyers to ensure that the organization's policies and competitive bidding rules are being followed, and to obtain the lowest responsible price for goods and services. In 2004, 7,798 purchase orders were produced totaling $34,800,818. The ECWA's fully computerized document-imaging system processes, archives and identifies all aspects of every purchase, which allows for easy document retrieval for auditing purposes.

As an active member of statewide and national supply management professional organizations, the ECWA regularly contributes to various purchasing conferences and training seminars. In conjunction with the State Comptroller's Office, the ECWA co-sponsored a training workshop designed to improve the procurement procedures of Western New York's municipal governments and agencies.

Administration also continued its aggressive marketing of ECWA properties and facilities to wireless communication providers for the location of communication devices, such as cellular antennas. The ECWA leases space on its water storage facilities, which not only raises additional revenues on behalf of customers, it also reduces the aesthetic obstruction of additional towers at the ground level throughout the region's landscape and improves communication capabilities. The ECWA currently hosts sixteen carriers totaling $353,887 in leasing revenue.

Executive Director's Report

Robert A. Mendez

As a result of sound fiscal management practices and increased efficiencies, the ECWA had another successful year despite the negative impacts of a cool, wet summer that was experienced throughout Western New York.

Much of the ECWA's improved operations can be attributed to the implementation of a steadfast business model centered on technological initiatives and the philosophy that the organization could do more with less. The business practices that have been implemented have resulted in a more streamlined operation, which has benefited our ratepayers and positioned us well for the future.

The ECWA ended the year with a total of 250 employees, a reduction of 72 full-time positions, or 22 percent, since 1996. During the same eight year period, our customer base increased 26 percent, adding 31,764 new customers for a current total of 153,495. Our most recent customer additions occurred last year from consolidations with the City of Tonawanda and the Town of Orchard Park. The city is now out of the water business and its system is owned and operated by the ECWA. Orchard Park turned over its last remaining water districts to the ECWA, and the entire town is now under a lease-managed contract. As with past consolidations, ratepayers in these municipalities are benefiting through more efficient service at significantly lower costs.

Even with an increase in our service district and the addition of more than 8,000 new customers in 2004, actual expenditures were slightly below budget. This is further evidence of our ability to do more with less, and to keep annual spending and water rates stabilized and below the rate of inflation.

In addition, the ECWA is now under one health insurance provider through the Labor Management Healthcare Fund. Switching to a sole provider program will save the ECWA $400,000 on an annual basis while maintaining a comprehensive health benefits package for all employees.

These accomplishments are the direct result of our hard working, dedicated personnel who have trusted the leadership and direction provided by the Board of Commissioners and senior management over the last nine years.

As a well managed business organization, the ECWA is proud of its success during the past year. We look forward to continuing to efficiently and reliably serve the more than 540,000 consumers that rely on us every day, 24 hours a day.

Thank you for your continued support of our efforts.

Respectfully submitted,

Robert A. Mendez

Financial Statements

Erie County Water Authority

Basic Financial Statements for the
Year Ended December 31, 2004 and
Independent Auditors' Report

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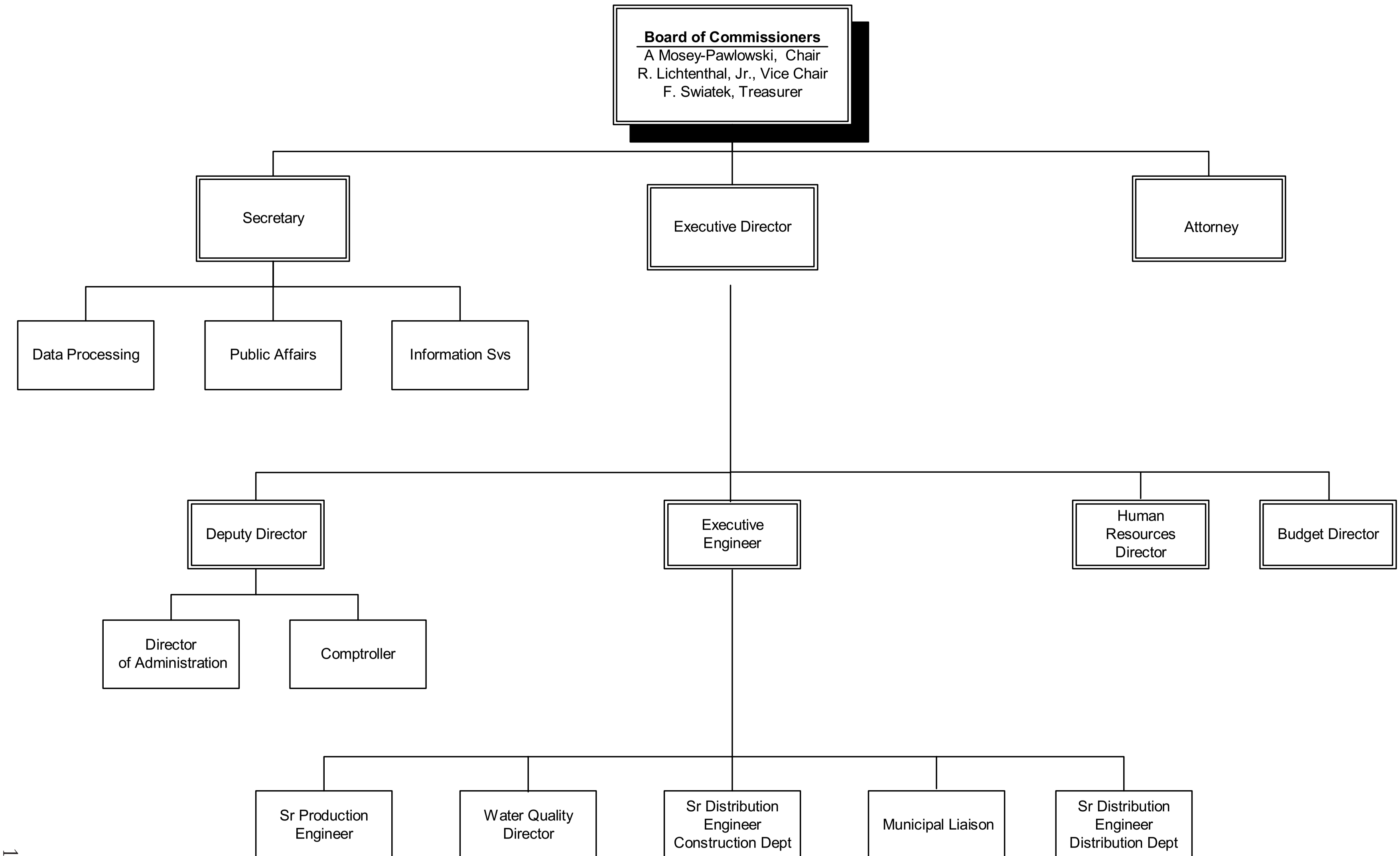
YEAR ENDED DECEMBER 31, 2004

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 office, at any time, shall belong to the same political party.

Current Board Members	**Most Recent Appointment Date**
Acea Mosey-Pawlowski, Chair	April 2003
Robert J. Lichtenthal, Jr., Vice-Chair	April 2002
Frank E. Swiatek, Treasurer	April 2004

ERIE COUNTY WATER AUTHORITY
Organizational Chart



Drescher & Malecki LLP
132 Cayuga Road, Suite 2C
Cheektowaga, New York 14225
Telephone: 716.565.2299
Fax: 716.565.2201

Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

To the Members of the
Erie County Water Authority

We have audited the statement of net assets of the Erie County Water Authority (the "Authority"), as of December 31, 2004, and the related statement of revenues, expenses and changes in net assets and statement of cash flows for the year ended December 31, 2004, which collectively comprise the Authority's basic financial statements. These financial statements are the responsibility of the management of the Authority. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Authority as of December 31, 2003 were audited by other auditors whose report dated March 26, 2004, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority at December 31, 2004, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as listed in the foregoing table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Authority's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Drescher & Malecki LLP

March 18, 2005

Management Team

Frank E. Swiatek
Treasurer

Acea Mosey-Pawlowski
Chair

Robert J. Lichtenthal, Jr.
Vice-Chair

Wesley C. Dust
Executive Engineer

Robert A. Mendez
Executive Director

Edward J. Kasprzak
Deputy Director

The Board of Commissioners and Senior Management would like to thank all of the ECWA's hardworking employees for another year of dedicated service.

ERIE COUNTY WATER AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2004

Management provides the following discussion and analysis (MD&A) of the Erie County Water Authority's (the "Authority") financial activities and statements for its fiscal year ended December 31, 2004. 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 legally required to adopt a budget; therefore, comparative budgetary information is not included in this report.

Financial Highlights

- The Authority's net assets increased $9,329,998 as a result of this year's activity. Of this amount, $6,159,092 is net income and $3,170,906 represents capital contributions (contributions in aid of construction).
- The assets of the Authority exceeded its liabilities at December 31, 2004 by $243,394,292 (net assets). Of this amount, $33,776,805 (unrestricted net assets) may be used to meet the Authority's ongoing obligations.
- The Authority's bonded indebtedness decreased $6,500,000 during the current year.

Overview of the Financial Statements

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

- The ***Statement of Net Assets*** presents information on all of the Authority's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.
- The ***Statement of Revenues, Expenses and Changes in Net Assets*** presents information showing how the Authority's net assets changed during the most recent reporting period. All changes in net assets 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 prior or future periods (e.g., earned but unused vacation leave and depreciation expense on fixed assets).
- The ***Statement of Cash Flows*** presents information depicting the Authority's cash flow activities for the reporting period ended and the effect that these activities had on the Authority's cash and cash equivalent balances.
- The ***Notes to the Financial Statements*** provide 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.

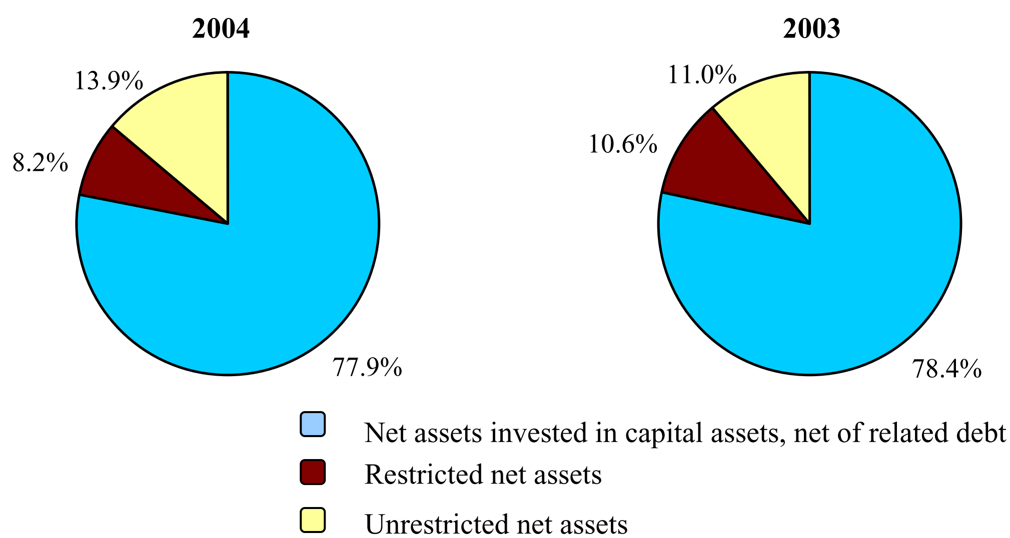
Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. In the case of the Authority, assets exceeded liabilities by $243,394,292 at December 31, 2004, as compared to $234,064,294 at December 31, 2003, as presented below in Table 1:

Table 1 - Condensed Statement of Net Assets

	2004	2003	Increase/(Decrease) Dollars	Increase/(Decrease) Percent
Current assets	$ 35,341,560	$ 33,704,255	$ 1,637,305	4.9
Noncurrent assets	310,285,279	308,317,224	1,968,055	0.6
Total assets	345,626,839	342,021,479	3,605,360	1.1
Current liabilities	15,488,727	14,503,140	985,587	6.8
Noncurrent liabilities	86,743,820	93,454,045	(6,710,225)	(7.2)
Total liabilities	102,232,547	107,957,185	(5,514,803)	(5.1)
Invested in capital assets, net of related debt	189,724,980	183,565,888	6,159,092	3.4
Restricted	19,892,507	24,758,568	(4,866,061)	(19.7)
Unrestricted	33,776,805	25,739,838	8,036,967	31.2
Total net assets	$ 243,394,292	$ 234,064,294	$ 9,329,998	4.0

The largest portion of the Authority's net assets (77.9%) consists of the Authority's investment in capital assets. This amount is presented net of any outstanding debt which was used to acquire such capital assets. The second largest portion of net assets (13.9%) consists of unrestricted net assets. These assets are not limited in any way with regards to how and what they may be used for. The remainder of net assets (8.2%) is restricted for various purposes.



A comparison of current assets as compared to current liabilities of the Authority at December 31, 2004 and December 31, 2003 follows:

Table 2 - Comparison of current assets and current liabilities

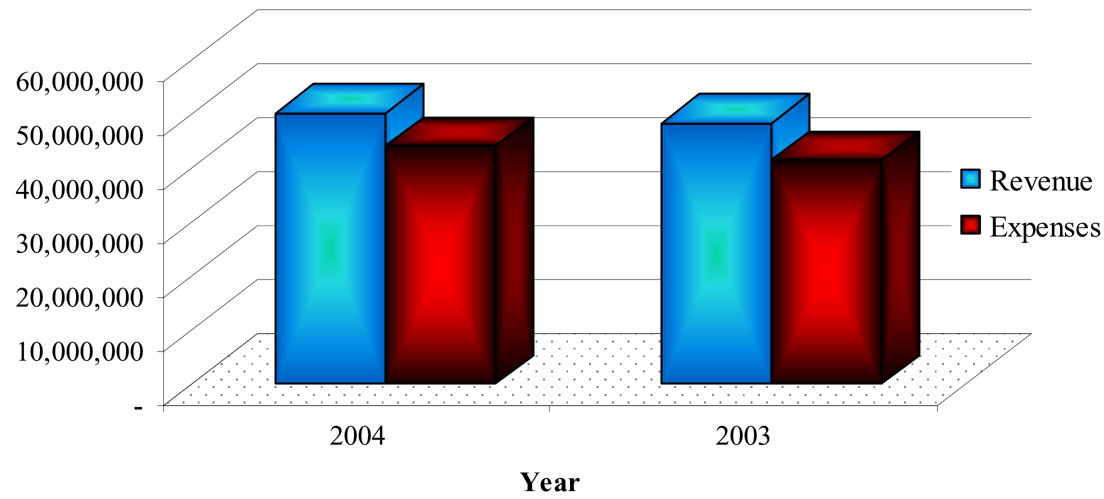
	2004	2003
Current assets	$ 35,341,560	$ 33,704,255
Current liabilities	15,488,727	14,503,140
Ratio of current assets to current liabilities	2.28	2.32

Table 3, as presented below, shows the changes in net assets for the years ending December 31, 2004 and December 31, 2003:

Table 3 - Condensed Statement of Revenues, Expenses and Changes in Net Assets

	Year Ended December 31, 2004	2003
Operating revenues, water sales	$ 48,982,522	$ 47,073,542
Operating expenses:		
Operation and adminstration	22,049,930	20,559,926
Maintenance	8,272,622	7,476,448
Depreciation and amortization	9,331,552	9,168,087
Total operating expenses	39,654,104	37,204,461
Operating income	9,328,418	9,869,081
Nonoperating revenues (expenses)	(3,169,326)	(3,047,463)
Net income before contributions in aid of construction	6,159,092	6,821,618
Contributions in aid of construction	3,170,906	3,424,130
Change in net assets	9,329,998	10,245,748
Total net assets - beginning of year	234,064,294	223,818,546
Total net assets - end of year	$ 243,394,292	$ 234,064,294

Comparison of Revenue and Expenses



A summary of operating revenue for the years ended December 31, 2004 and December 31, 2003 is presented below in Table 4:

Table 4 - Summary of Operating Revenue

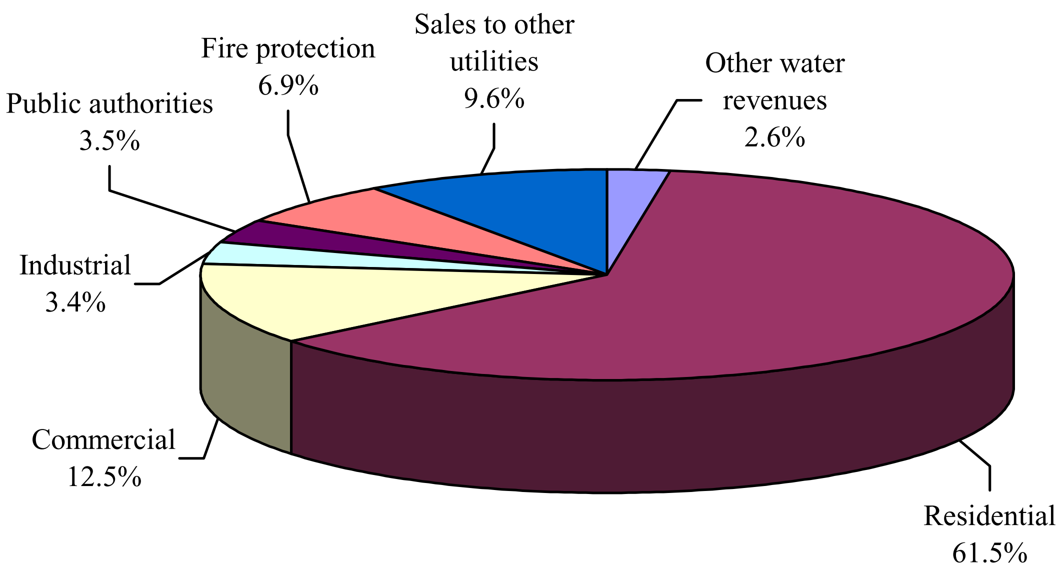
	2004	2003	Increase/(decrease) Dollars	Increase/(decrease) Percent
Water sales:				
Residential	$29,894,743	$28,482,355	$1,412,388	5.0
Commercial	6,096,444	5,757,113	339,331	5.9
Industrial	1,639,787	1,490,969	148,818	10.0
Public authorities	1,708,476	1,673,422	35,054	2.1
Fire protection	3,348,559	3,172,430	176,129	5.6
Sales to other utilities	4,674,682	4,681,735	(7,053)	(0.2)
Other water revenues	1,251,430	1,419,298	(167,868)	(11.8)
Total water sales	48,614,121	46,677,322	1,936,799	4.1
Other operating income:				
Rents from water towers	353,887	326,573	27,314	8.4
Miscellaneous	14,514	69,647	(55,133)	(79.2)
Total operating revenue	$48,982,522	$47,073,542	$1,908,980	4.1

Water sales represent the vast majority of revenue for the Authority, 99.3% and 99.1% of total revenue for the years ended December 31, 2004 and December 31, 2003, respectively.

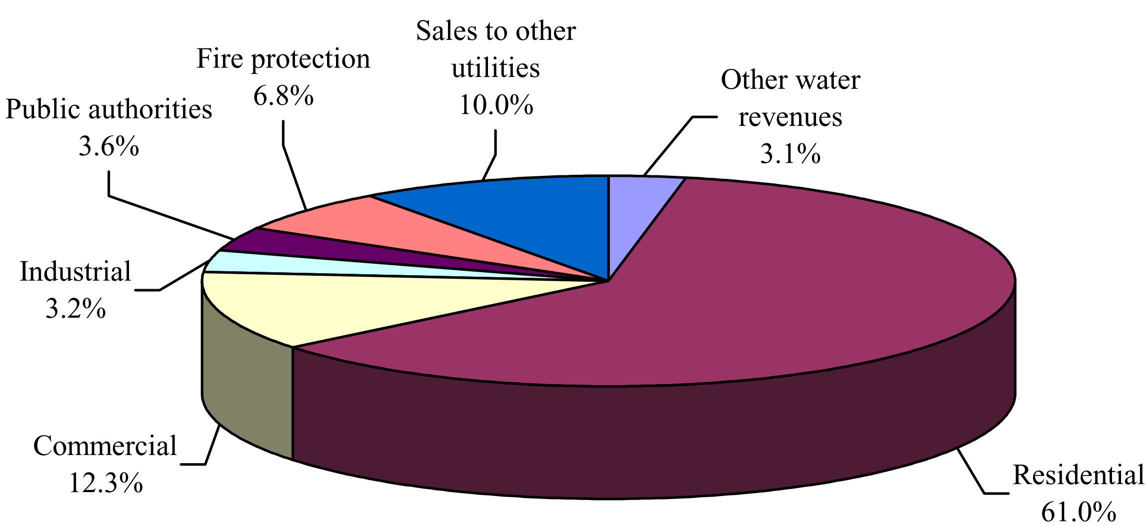
Overall operating revenues increased $1,908,980 due primarily to a 6.8% rate increase on January 1, 2004. There was an overall decrease in the production of water by 1,299,380,000 gallons, or 5.1% from 2003. A wet spring and summer resulted in decreased production of 1,183,300,000, or 7.8% through July of 2004 compared to the same period in 2003. This decrease was mitigated by the addition of 6,136 accounts when the Authority acquired the City of Tonawanda water supply and distribution system in August of 2004.

As presented in the illustration below, residential water sales represent the largest portion of water sales for the Authority, which was 61.5% and 61.0% of total water sales for the years ended December 31, 2004 and December 31, 2003, respectively. The next largest water sales revenue component for the Authority is commercial water sales, which was 12.5% and 12.3% of total water sales, for the years ended December 31, 2004 and December 31, 2003, respectively.

2004 Water Sales Revenue

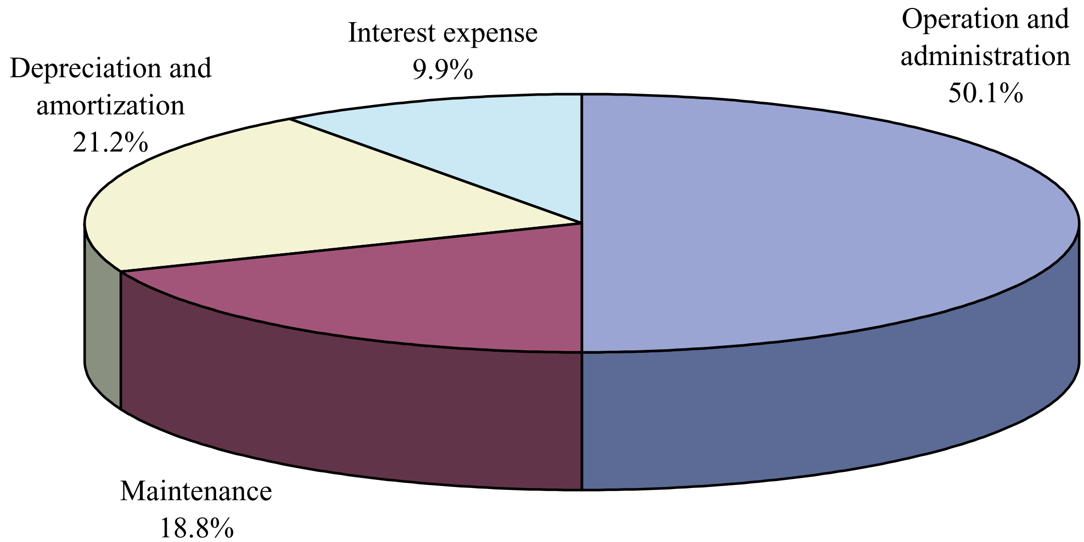


2003 Water Sales Revenue

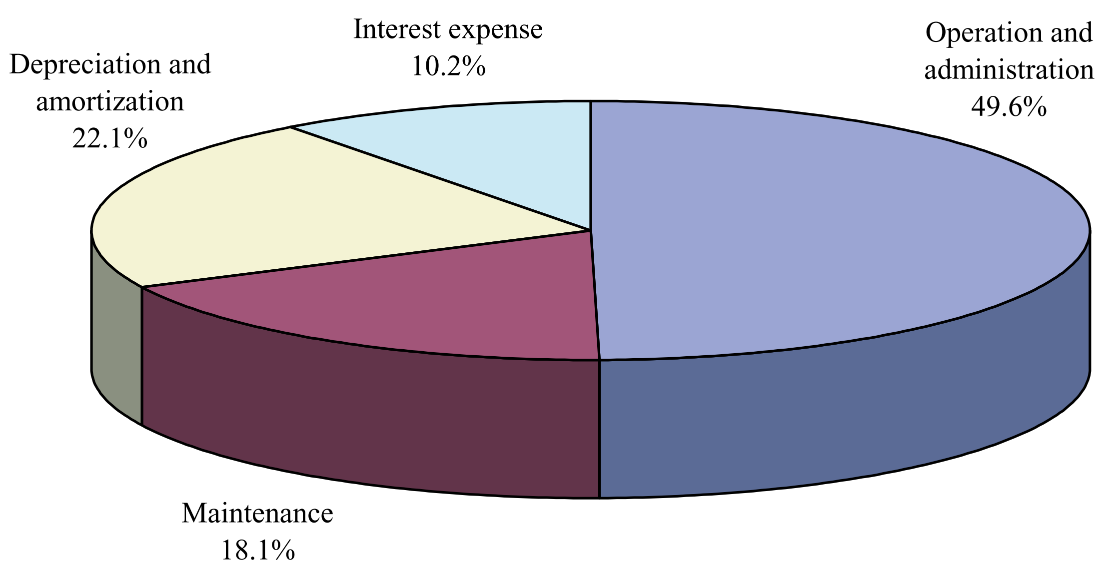


As illustrated below, operation and administration expenses are the largest expense and account for nearly 50.1% and 49.6% of the Authority's expenses for the years ended December 31, 2004 and December 31, 2003, respectively. The second largest expense for the Authority are the expenses associated with depreciation and amortization, which were 21.2% and 22.1% for the years ended December 31, 2004 and December 31, 2003, respectively.

2004 Expenses



2003 Expenses



Operating, administration and maintenance expenses increased a total of $2,286,178 due primarily to wage and salary costs which increased $1,408,125 from contract settlements with both the Civil Service Employees Association, Inc. (CSEA) and American Federation of State, County and Municipal Employees (AFSCME) resulting in current year increases of 2.75% and 2.0%, respectively. The increase in total wages was compounded by increases in the employee's base salary due to retroactive increases of 2.5% for CSEA and of 2.0% for AFSCME for 2003. Non-represented employees also received a current year increase of 2.75%.

Contributions in aid of construction were $3,170,906 for the year ended December 31, 2004, as compared with $3,424,130 for the year ended December 31, 2003. During 2004, the City of Tonawanda conveyed their water supply and distribution systems and the Town of Concord conveyed a portion of their water supply and distribution systems to the Authority. The Authority accepted such water and distribution systems. Thereby, the Authority assumed responsibility for the operation, maintenance and improvements to these water systems now and in the future. Accordingly, the Authority recorded notable contributions in aid of construction from the City of Tonawanda in the amount of $1,164,423 and from the Town of Concord in the amount of $490,162. The asset values were recorded at estimated fair value as of the date of acquisition.

Table 5 presents a summary of the Authority's cash flow activities for the years ended December 31, 2004 and 2003:

Table 5 - Summary of Cash Flow Activities

	2004	2003	Increase/(decrease) Dollars
Cash flows from:			
Operating activities	$17,799,643	$18,056,610	$ (256,967)
Noncapital financing activities	3,170,906	3,424,130	(253,224)
Capital and related financing activities	(27,922,310)	(12,964,677)	(14,957,633)
Investing activities	7,556,846	(8,261,238)	15,818,084
Net increase in cash and cash equivalents	605,085	254,825	350,260
Cash and cash equivalents, beginning of year	26,134,203	25,879,378	254,825
Cash and cash equivalents, end of year	$26,739,288	$26,134,203	$ 605,085

The Authority's available cash and cash equivalents increased by $605,085 for the year ended December 31, 2004, compared to an increase of $254,825 for the year ended December 31, 2003. Cash used in capital and related financing activities decreased by $14,957,633 due to a positive cash flow of $15,544,443 from the proceeds of the sale of revenue bonds that occurred during the year ended December 31, 2003 and did not occur in the year ended December 31, 2004. The $15,818,084 difference in investing activities between 2004 and 2003 resulted primarily because of payments for capital projects and related project expenditures during 2004.

Capital Assets

The Authority's investment in capital assets, as of December 31, 2004, amounted to $283,879,654 (net of accumulated depreciation), as compared to $275,574,009 as of December 31, 2003. This investment includes land, buildings and structures, mains and hydrants, equipment, and construction in progress. The Authority's greatest investment in capital assets is in buildings and structures and mains and hydrants.

Presented below, in Table 6, is a comparative summary of capital assets. Additional information on the Authority's capital assets can be found in Note 4 of the financial statements.

Table 6 - Summary of Capital Assets (Net of Depreciation)

			Increase/(decrease)	
	2004	2003	Dollars	Percent
Land	$ 2,200,935	$ 2,193,933	$ 7,002	0.3
Construction work in progress	1,859,624	6,028,366	(4,168,742)	(69.2)
Total capital assets, not being depreciated	4,060,559	8,222,299	(4,161,740)	(50.6)
Buildings and structures	180,889,906	173,833,731	7,056,175	4.1
Mains and hydrants	185,129,612	175,154,449	9,975,163	5.7
Equipment	31,417,518	28,870,117	2,547,401	8.8
Other	41,267,595	39,970,507	1,297,088	3.2
Less accumulated depreciation	(158,885,536)	(150,477,094)	(8,408,442)	5.3
Total capital assets, being depreciated, net	279,819,095	267,351,710	12,467,385	4.7
Total capital assets	$ 283,879,654	$ 275,574,009	$ 8,305,645	3.0

Debt Administration

At December 31, 2004 the Authority had $86,847,273 in water revenue bonds outstanding, with a current portion of $7,340,000, as compared to $93,347,273 at December 31, 2003. Long-term debt outstanding decreased $6,500,000 as a result of making scheduled payments on the Series 1993FR, Series 1998B, Series 1998D and Series 2003F.

The Authority's issuances of Series 1998B, Series 1998D and Series 2003F were through the New York State Environmental Facilities Corporation and are rated based on the Environmental Facilities Corporation's rating. The remaining issuances, Series 1992FR, Series 1993A, Series 1993B and Series 1993FR, were rated by Moody's at Aaa. Additional information on the Authority's long-term debt can be found in Note 5 of the financial statements.

Economic Factors

The local economy has experienced a steady decline in population and business. However, through emigration from unserved areas to suburban areas, where the Authority does provide water, the Authority has actually experienced about a one percent growth in its customer base.

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. An increasing net assets balance aids the Authority in stabilizing its water rates. During the year ending December 31, 2004, unrestricted net assets increased $9,329,998. Tariff rates are as follows:

Meters read and billed quarterly (To Nearest 1,000 Gallons)

	2004	2005	
First 300,000 gallons per quarter	$ 2.51	$ 2.56	per 1,000 gallons
Next 1,950,000	2.24	2.28	per 1,000 gallons
Next 5,250,000	2.05	2.09	per 1,000 gallons
Over 7,500,000	1.79	1.83	per 1,000 gallons

Meters read and billed monthly (To Nearest 1,000 Gallons)

	2004	2005	
First 100,000 gallons per month	$ 2.51	$ 2.56	per 1,000 gallons
Next 650,000	2.24	2.28	per 1,000 gallons
Next 1,750,000	2.05	2.09	per 1,000 gallons
Over 2,500,000	1.79	1.83	per 1,000 gallons

Size of Meter	Quarterly Minimum Charge ($)		Allowance per Quarter	Monthly Minimum Charge ($)	
(inches)	2004	2005	(gallons)	2004	2005
5/8	$ 22.59	$ 23.04	9,000	$ 7.53	$ 7.68
3/4	30.12	30.72	12,000	10.04	10.24
1	52.71	53.76	21,000	17.57	17.92
1 1/4	67.77	69.12	27,000	22.59	23.04
1 1/2	97.89	99.84	39,000	32.63	33.28
2	158.13	161.28	63,000	52.71	53.76
3	301.20	307.20	120,000	100.40	102.40
4	496.98	506.88	198,000	165.66	168.96
6	954.60	973.20	390,000	318.20	324.40
8	1,492.20	1,520.40	630,000	497.40	506.80
10	2,097.00	2,136.00	900,000	699.00	712.00
12	2,836.20	2,888.40	1,230,000	945.40	962.80
20	6,288.50	6,405.30	2,820,000	2096.50	2135.10
24	8,380.50	8,537.10	3,840,000	2793.50	2845.70

A minimum charge of $160.80 per hydrant per annum - changed from $155.28 for lease managed districts. The minimum charge of $229.08 per hydrant per annum for direct service did not change from 2003.

Requests for Information

This financial report is designed to provide a general overview of the Authority's finances for all those with an interest in the Authority's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Edward J. Kasprzak, Deputy Director, Erie County Water Authority, 350 Ellicott Square Building, 295 Main Street Buffalo, New York 14203-2494.

Erie County Water Authority
STATEMENT OF NET ASSETS

	December 31, 2004	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 26,739,288	$ 26,134,203
Customer accounts receivable, less allowance for doubtful accounts	4,694,486	4,326,506
Materials and supplies	1,590,281	1,511,776
Interest receivable and other assets	2,317,505	1,731,770
Total current assets	35,341,560	33,704,255
Noncurrent assets:		
Long-term investment	5,077,699	6,339,393
Restricted cash, cash equivalents, and investments	19,892,507	24,758,568
Deferred charges	1,435,419	1,645,254
Captial assets, not being depreciated	4,060,559	8,222,299
Capital assets, being depreciated, net of accumulated depreciation	279,819,095	267,351,710
Total noncurrent assets	310,285,279	308,317,224
Total assets	345,626,839	342,021,479
LIABILITIES		
Current liabilities:		
Accounts payable	5,005,568	4,575,048
Construction retention	201,435	398,924
Interest and other accrued liabilities	2,941,724	3,029,168
Water revenue bonds - current portion	7,340,000	6,500,000
Total current liabilities	15,488,727	14,503,140
Noncurrent liabilities:		
Accrued sick pay	1,753,179	1,629,834
Advances for construction	373,930	437,508
Long term interest payable	5,109,438	4,539,430
Water revenue bonds - long term	79,507,273	86,847,273
Total noncurrent liabilities	86,743,820	93,454,045
Total liabilities	102,232,547	107,957,185
NET ASSETS		
Invested in capital assets, net of related debt	189,724,980	183,565,888
Restricted	19,892,507	24,758,568
Unrestricted	33,776,805	25,739,838
Total net assets	$ 243,394,292	$ 234,064,294

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

Erie County Water Authority
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	December 31, 2004	December 31, 2003
Operating revenues, water sales	$ 48,982,522	$ 47,073,542
Operating expenses:		
Operation and adminstration	22,049,930	20,559,926
Maintenance	8,272,622	7,476,448
Depreciation and amortization	9,331,552	9,168,087
Total operating expenses	39,654,104	37,204,461
Operating income	9,328,418	9,869,081
Nonoperating revenues (expenses):		
Interest income	1,188,823	1,191,949
Interest capitalization during construction	143,381	365,823
Interest expense	(4,501,530)	(4,605,235)
Total nonoperating revenues (expenses)	(3,169,326)	(3,047,463)
Net income before contributions in aid of construction	6,159,092	6,821,618
Contributions in aid of construction	3,170,906	3,424,130
Change in net assets	9,329,998	10,245,748
Total net assets - beginning of year	234,064,294	223,818,546
Total net assets - end of year	$ 243,394,292	$ 234,064,294

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

Erie County Water Authority
STATEMENT OF CASH FLOWS

	Year Ended December 31, 2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 48,868,470	$ 47,595,123
Payments to contractors	(11,243,948)	(9,923,300)
Payments to employees including fringe benefits	(19,824,879)	(19,615,213)
Net cash provided by operating activities	17,799,643	18,056,610
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Contributions in aid of construction	3,170,906	3,424,130
Net cash provided by noncapital financing activities	3,170,906	3,424,130
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of revenue bonds	-	15,544,443
Acquisition and construction of capital assets, net	(17,560,673)	(18,776,675)
Principal paid on revenue bond maturitues	(6,500,000)	(5,805,000)
Interest paid on revenue bonds, net of amount capitalized	(3,798,059)	(3,497,183)
Payments of bond issue costs	-	(444,572)
Advances for construction	(63,578)	14,310
Net cash used by capital and related financing activities	(27,922,310)	(12,964,677)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investment securities	(260,554,333)	(276,959,206)
Proceeds from sale or maturity of investments	266,932,087	267,517,703
Interest received	1,179,092	1,180,265
Net cash provided (used) by investing activities	7,556,846	(8,261,238)
Net increase in cash	605,085	254,825
Cash and cash equivalents - beginning of year	26,134,203	25,879,378
Cash and cash equivalents - end of year	$ 26,739,288	$ 26,134,203

(continued)

	Year Ended December 31, 2004	2003
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income	$ 9,328,418	$ 9,869,081
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:		
Depreciation expense	9,057,539	8,919,187
Amortization expenses	274,013	248,900
Changes in assets and liabilities:		
(Increase) decrease in accounts receivable	(367,980)	(148,585)
(Increase) decrease in material and supplies	(78,505)	39,414
(Increase) decrease in other assets	(890,181)	670,166
Increase (decrease) in accounts payable	430,520	(291,472)
Increase (decrease) in other accrued liabilities	(77,526)	(1,291,654)
Increase (decrease) in accrued sick pay	123,345	41,573
Total adjustments	8,471,225	8,187,529
Net cash provided by operating activities	$ 17,799,643	$ 18,056,610

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 or those of any other state or federal regulatory agency. 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 leases the assets and 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.

The Authority began with a mandate to provide potable water to all locations within Erie County, except the City of Buffalo, Town of Tonawanda and Town of Grand Island; and, has fulfilled this mandate by providing water to over 540,000 residents of Erie County operating on one of the three bases set forth above - direct service, leased managed service or bulk service. The Authority has had a regional outlook for many years as evidenced by service expansion throughout the county and by the Inter-Community Transmission main built in the early 1990's to expand water service to the Cattaraugus Indian Reservation and some Chautauqua County customers. In August of 2002, the Authority began providing water to some parts of Western Genesee County. In addition, the Authority began to provide direct service to the City of Tonawanda and parts of the Town of Concord in 2004.

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 Government Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing government accounting and financial reporting principles. In accordance with the provisions of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, the Authority has elected not to apply all Financial Accounting Standards Board statements and interpretation issued after November 30, 1989.

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, liabilities, net assets, 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 earned but unbilled revenue. Billings in advance of water supplied are accounted for as a reduction to earned but unbilled revenue. Transactions which are capital, financing or investing related are reported as non-operating revenues. All expenses related to operating the systems are reported as operating expenses. Interest expense and financing costs are reported as non-operating expenses.

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

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

Payments of accrued vacation time and sick leave are dependent upon many factors; therefore, timing of future payments is not readily determinable. However, management believes that sufficient resources will be available for the payments of accrued vacation time and sick leave when such payments become due.

Retirement plan—The Authority provides retirement benefits for substantially all of its regular, full-time 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 cash accounts and short-term investments purchased with an original maturity of generally three months or less.

Investment securities—Investments are carried at market value based on quoted market prices for those investments subject to market forces and at amortized cost for investments not subject to market forces. 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 income statement. The Authority's deposits at December 31, 2004 were entirely covered by federal deposit insurance or by collateral held by the Authority's custodial banks in the Authority's name.

Long-term investment—The long-term investment is accounted for at cost plus accrued income. See further discussion at Note 2.

Customers' accounts receivables—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 has adopted a policy of recognizing 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.

Interest receivable and other assets—Account consists primarily of interest earned from securities and investments not yet received and prepayments. Prepayments are certain payments reflecting costs applicable to future accounting periods.

Capital assets—The cost of additions to capital assets including purchased or contributed property 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 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 straight-line method based upon annual rates established in accordance with PSC guidelines which range from 1% to 20%. Depreciation expense approximated 2.2% and 2.3% of the original cost of average depreciable property for years ended December 31, 2004 and 2003 respectively.

Long-term obligations—In the financial statements long-term debt is reported as a liability in the statement of net assets. 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— Bond issuance costs are reported as deferred charges and amortized over the term of the related debt using the straight-line method. This cost has been amortized over the term of the bonds issued. During 2004, $209,835 was amortized as an expense.

Advances for construction —Advances for construction primarily represent amounts received from contractors for water main extensions. Upon completion of the extension, the remaining advance is transferred to contributions in aid of construction.

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 water plant systems conveyed to the Authority by municipalities and others. During 2004, the City of Tonawanda conveyed their water supply and distribution systems and the Town of Concord conveyed a portion of their water supply and distribution systems to the Authority. Thereby, the Authority assumed responsibility for the operation, maintenance and improvements to these water systems now and in the future. Accordingly, the Authority recorded notable contributions in aid of construction from the City of Tonawanda in the amount of $1,164,423 and from the Town of Concord in the amount of $490,162. The asset values were recorded at estimated fair value as of the date of acquisition.

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 premiums for the years ended December 31, 2004 and 2003 totaled $1,827,111 and $1,693,837, respectively. There were no settlements that significantly exceeded insurance coverage for each of the last three years. There were no significant unpaid claims outstanding as of December 31, 2004 and 2003.

Reclassifications—Certain amounts relating to the financial statements as of and for the year ended December 31, 2003 have been reclassified in order to be consistent with the current year's presentation.

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

Future impacts of accounting pronouncements—The Authority has not completed the process of evaluating the impact that will result from adopting Governmental Accounting Standards Board (GASB) Statement No. 40, *Certain Financial Statement Note Disclosures*, GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries,* effective for the year ending December 31, 2005, GASB Statement No. 43, *Financial Reporting for Post Employment Benefit Plans Other Than Pension Plans*, effective for the year ending December 31, 2006*,* GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section – an amendment of NCGA Statement 1*, effective for the year ending December 31, 2006*,* GASB Statement No. 45, *Accounting and Financial Reporting for Post Employment Benefits Other Than Pensions*, effective for the year ending December 31, 2008, and GASB Statement 46, *Net Assets Restricted by Enabling Legislation – an amendment of GASB Statement No. 34,* effective for the year ending December 31, 2006. The Authority is, therefore, unable to disclose the impact that adopting GASB Statements Nos. 40, 42, 43, 44, 45 and 46 will have on its financial position and results of operations when such statements are adopted.

2. CASH AND INVESTMENTS

Deposits—All uninsured bank deposits are fully collateralized.

Investments—The Authority's bond resolutions 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.

As of December 31, 2004 and 2003, the Authority had the following unrestricted cash and cash equivalents:

	December 31, 2004		December 31, 2003	
	Amortized Cost	**Market Value**	**Amortized Cost**	**Market Value**
Unrestricted cash and cash equivalents:				
Cash and cash equivalents	$24,244,142	$24,244,142	$23,884,778	$23,884,778
Mortgage-backed securities	-	-	2,248,158	2,249,425
Commerial paper	2,495,146	2,495,146	-	-
Total unrestricted cash and cash equivalents	$26,739,288	$26,739,288	$26,132,936	$26,134,203

Restricted cash, cash equivalents, and investments—Cash has been deposited into various trust funds with a fiscal agent to satisfy certain legal covenants. Further, the amounts have been invested into various investments in compliance with the Authority's investment policy. The following is a brief synopsis of restricted cash.

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

Restricted for debt service reserve—The Authority restricts cash for debt service reserve fund as required by various bond resolutions to maintain a specified amount of funds to meet future debt service requirements.

Restricted for future construction—Cash restricted for future construction was established to maintain the construction reserve fund, which is used for committed funding for future capital expenditures.

As of December 31, 2004 and 2003, the Authority had the following restricted cash and cash equivalents:

	December 31, 2004		December 31, 2003	
	Amortized Cost	Market Value	Amortized Cost	Market Value
Restricted for future construction:				
Cash and cash equivalents	$ 7,027,158	$ 7,027,158	$ 9,260,898	$ 9,260,898
U.S. Treasury securities	395,650	395,655	3,753,688	3,753,573
Total restricted for future construction	7,422,808	7,422,813	13,014,586	13,014,471
Restricted for debt service reserve:				
Cash and cash equivalents	217,604	217,604	147,423	147,423
U.S. Treasury securities	3,267,116	3,267,116	3,267,116	3,267,116
Mortgage-backed securities	-	-	3,672,327	3,674,129
Commerial paper	3,593,027	3,593,032	-	-
Total restricted for debt service reserve	7,077,747	7,077,752	7,086,866	7,088,668
Restricted for debt service:				
Cash and cash equivalents	5,909	5,909	1,601,429	1,601,429
U.S. Treasury securities	5,380,113	5,386,033	3,052,733	3,054,000
Total restricted debt service	5,386,022	5,391,942	4,654,162	4,655,429
Total restricted cash and cash equivalents	$19,886,577	$19,892,507	$24,755,614	$24,758,568

Long-term investment—During 1990, the Authority entered into a zero coupon bond agreement which requires the Authority to make monthly deposits into an investment account through December 2008. During 1997, the Board established a policy that all earnings and proceeds to be distributed in conformance with the agreement shall be deposited into the capital fund to be used solely for future capital expenditures. At December 31, 2004 and 2003, the zero coupon bond investment balance is $5,077,699 and $6,339,393, respectively. Interest on the investment is compounded monthly at a rate of 7.45%. The annual deposit for next year will be approximately $197,000. The second year will be approximately $119,000, the third year will be approximately $49,000, and the fourth and final year will be approximately $21,000. On December 1, 2004 the Authority received $2,043,076 as the fifth guaranteed annual payment from this investment. Varying amounts will be received on the first of

December for each year through 2008. The total amount to be received in future years is approximately $6.2 million.

3. ACCOUNTS RECEIVABLE

Accounts Receivable primarily represents amounts due from customers for current and delinquent 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 (industrial or residential), 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 that $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 shut-off of their water service and additional delinquent charges.

Following fifteen (15) days from the letter date, an unpaid account is sent to a collector who schedules a visit to the customer with an "unpaid bill" notice. After the account is posted, 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 non-lien area is referred to an outside collection agency. The agency keeps a predetermined portion of any collected monies. The outstanding balances of an unpaid final bill in a lien area are not referred to an outside agency, instead they are sent to the proper town for a tax lien. Allowances for doubtful accounts at December 31, 2004 and 2003 total $351,964 and $355,518, respectively.

4. CAPITAL ASSETS

Capital asset activity for the year ended December 31, 2004 was as follows:

	Balance 1/1/2004	Additions	Deletions	Balance 12/31/2004
Capital assets, not being depreciated:				
Land	$ 2,193,933	$ 7,002	$ -	$ 2,200,935
Construction work in progress	6,028,366	14,596,844	(18,765,586)	1,859,624
Total capital assets, not being depreciated	8,222,299	14,603,846	(18,765,586)	4,060,559
Capital assets in service, being depreciated:				
Buildings and structures	173,833,731	7,056,175	-	180,889,906
Mains and hydrants	175,154,449	10,034,275	(59,112)	185,129,612
Equipment	28,870,117	3,043,915	(496,514)	31,417,518
Other	39,970,507	1,482,711	(185,623)	41,267,595
Total capital assets, being depreciated	417,828,804	21,617,076	(741,249)	438,704,631
Less accumulated depreciation	(150,477,094)	(9,057,539)	649,097	(158,885,536)
Total capital assets being depreciated, net	267,351,710	12,559,537	(92,152)	279,819,095
Total capital assets, net	$ 275,574,009	$ 27,163,383	$ (18,857,738)	$ 283,879,654

Capital asset activity for the year ended December 31, 2003 was as follows:

	Balance 1/1/2003	Additions	Deletions	Balance 12/31/2003
Capital assets, not being depreciated:				
Land	$ 2,193,933	$ -	$ -	$ 2,193,933
Construction work in progress	5,789,033	12,976,555	(12,737,222)	6,028,366
Total capital assets, not being depreciated	7,982,966	12,976,555	(12,737,222)	8,222,299
Capital assets in service, being depreciated:				
Buildings and structures	168,036,525	5,797,206	-	173,833,731
Mains and hydrants	165,039,186	10,219,421	(104,158)	175,154,449
Equipment	27,720,231	1,633,963	(484,077)	28,870,117
Other	39,087,705	1,654,075	(771,273)	39,970,507
Total capital assets, being depreciated	399,883,647	19,304,665	(1,359,508)	417,828,804
Less accumulated depreciation	(142,327,801)	(8,919,187)	769,894	(150,477,094)
Total capital assets being depreciated, net	257,555,846	10,385,478	(589,614)	267,351,710
Total capital assets, net	$ 265,538,812	$ 23,362,033	$ (13,326,836)	$ 275,574,009

Depreciation expense for the years ended December 31, 2004 and 2003 totaled $9,057,539 and $8,919,187, respectively.

5. LONG-TERM DEBT

Summary of long-term debt—the following is a summary of the long-term debt and water revenue bonds, for the Authority at December 31, 2004:

Series	Final Annual Installment Payment Due	Year of Earliest Principal Payment	Interest Rate		Original Issue	Principal Outstanding 12/31/2004
Series 1992FR	6/1/2008	2006	6.20-6.30%		$ 50,269,710	$ 4,472,830
Series 1993A	12/1/2016	2009	Variable		27,500,000	27,500,000
Series 1993B	12/1/2016	2009	Variable		15,000,000	15,000,000
Series 1993FR	12/1/2005	1997	4.88-6.17%		43,886,063	5,690,000
Series 1998B	12/15/2017	1998	3.65-5.20%	(*)	7,780,931	5,545,000
Series 1998D	10/15/2019	2000	3.90-5.15%	(*)	16,859,700	13,640,000
Series 2003F	7/15/2023	2004	0.79-4.50%	(*)	15,544,443	14,999,443
						86,847,273
		Less portion due within one year				(7,340,000)
						$ 79,507,273

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

The Series 1992 Fourth Resolution (FR) Bonds represent Capital Appreciation Serial Bonds (Appreciation Bonds), the Series 1993A and Series 1993B Bonds represent Variable Weekly Bonds and the Series 1993 Fourth Resolution Bonds represent Current Interest Bonds and Appreciation Bonds. Interest on the Current Interest Bonds and Variable Weekly Bonds is payable semi-annually on June 1 and December 1. Interest on the Appreciation Bonds is compounded semi-annually on June 1 and December 1 but is not payable until bond maturity. The accrued interest on the Appreciation Bonds is reflected as long-term interest payable.

As a means to lower its borrowing costs, when compared against fixed rate bonds at the time of issuance at March 11, 1993, the Authority entered into an interest rate swap in connection with its $27,500,000 and $15,000,000 Series 1993A and 1993B water revenue bonds. The intention of the swap was to stabilize the Authority's interest rate on the Series 1993A and 1993B water revenue bonds.

Terms. Under the swap, the Authority pays the counterparty, A.I.G. Financial Products Corp., a fixed payment of 5.24% and 5.89%, for the Series 1993A and 1993B, respectively. The Authority receives in return, from the counterparty, an amount equal to the interest that would accrue on a variable rate of interest. The floating rate paid by the counterparty will at all times equal the variable interest rate on the Series 1993A and 1993B water revenue bonds. The variable interest rate was 1.94% at December 31, 2004 for the Series 1993A and 1993B and 1.04% at December 31, 2003 for the Series 1993A and 1993B. Settlement with the counterparty occurs with the semi-annual payment of interest on May 31 and November 30. Amounts receivable or payable are accrued as a component of interest expense.

Fair value. Because interest rates have declined since execution of the swap, the Authority's swaps had negative fair values of $5,515,277 and $3,725,050 for the Series 1993A and 1993B, respectively, as of December 31, 2004. These values have been prepared based on market rates at the close of business on December 31, 2004. The fair value is consistent with the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

Credit risk. As of December 31, 2004, the Authority was not exposed to credit risk because the swaps had negative fair values. However, should interest rates change and the fair value of the swaps favor the Authority, the Authority would be exposed to credit risk in the amount of the swaps fair values. To mitigate the potential for credit risk, if the counterparty's credit quality falls below AA-, in the case of Standard & Poor's assigned rating, or below Aa3, in the case of Moody's Investors Service assigned rating, the fair value of the swap will be fully collateralized by the counterparty. Collateral would be posted with a third-party custodian.

Termination risk. The Authority or counterparty may terminate the swaps if the other party fails to perform under the terms of the contract. If at the time of termination the swaps have negative fair values, the Authority would be liable to the counterparty for a payment equal to the swaps' fair values.

Swap payments and associated debt. As rates vary, variable-rate bond interest payments and net swap payments will vary. Using rates as of December 31, 2004, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their terms, were as follows:

	Variable-Rate Bonds			
Year ending December 31,	**Principal**	**Interest**	**Interest Rate Swaps, net**	**Total**
2005	$ -	$ 824,500	$ 1,500,000	$ 2,324,500
2006	-	824,500	1,500,000	2,324,500
2007	-	824,500	1,500,000	2,324,500
2008	-	824,500	1,500,000	2,324,500
2009	4,300,000	824,500	1,500,000	6,624,500
2010-2014	25,700,000	2,760,620	5,024,150	33,484,770
2015-2016	12,500,000	366,660	667,900	13,534,560
Total	$ 42,500,000	$ 7,249,780	$ 13,192,050	$ 62,941,830

The Current Interest Serial 1998B and 1998D 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 1998B and Series 1998D in 1998. The 1998B and 1998D bonds in the amounts of $7,780,931 and $16,859,700, respectively, representing the Authority's portion of these financings, 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. Payments are made to the bondholders as follows:

Issue	**Interest**	**Principal**
1998B	June 15 and December 15	December 15
1998D	April 15 and October 15	October 15

The bonds bear different rates of interest ranging from 3.65% to 5.20% over their respective installment payment dates ending on December 15, 2017 and October 15, 2019, respectively.

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 const.	4,826,239
City of Tonawanda - meters, transmission main, pump station & tank	7,158,404
Debt service reserve fund	1,554,440
	$ 15,544,443

Interest on the 2003F bonds is payable semi-annually on January 15 and July 15. Principal is payable on July 15. The interest rates range from .79% to 4.50%. 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.

As provided by the respective bond resolutions, the Series 1993A Bonds and the Series 1993B Bonds are redeemable prior to maturity at the election of the Authority, at any time. In order to redeem these bonds the Authority would be required to unwind the swap agreements.

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 $38,398,835 at December 31, 2004 with maturities ranging from the year 2005 to the year 2014.

In November, 1999, the Authority defeased a portion of the 1993 Fourth Resolution Taxable Bonds. Available cash of $13,684,547 was deposited with an escrow agent pursuant to an escrow agreement, and invested in U.S. Government securities. The maturities of these securities and related earnings thereon are expected to provide sufficient cash flow to meet the debt service requirements of the defeased portion of the 1993 Fourth Resolution Taxable Bonds as they mature. This transaction effectively released the Authority from its obligation to repay the defeased portion of the Series 1993 Fourth Resolution Bonds and constituted an in-substance defeasance. The principal outstanding is $3,000,000 at December 31, 2004 with a 2005 maturity.

In December 2000, the Authority defeased a portion of the 1992 Fourth Resolution Bonds and a portion of the 1993 Fourth Resolution Taxable Bonds. Securities and available cash of $4,191,215 were deposited with an escrow agent pursuant to an escrow agreement, and invested in U.S. Government securities. The maturities of these securities and related earnings thereon are expected to provide sufficient cash flow to meet the debt service requirements of the defeased portion of the 1992 and 1993 Fourth Resolution Bonds as they mature. This transaction effectively released the Authority from its obligation to repay the defeased portion of the Series 1992 Fourth Resolution and the Series 1993 Fourth Resolution Bonds and constituted an in-substance defeasance. The principal outstanding is $1,678,000 at December 31, 2004 with maturities ranging from the year 2005 to the year 2007.

Summary of changes in long-term debt—the following is a summary of changes in water revenue bonds for the year ended December 31, 2004:

Series	**Balance 12/31/2003**	**Issued**	**Paid**	**Balance 12/31/2004**
Series 1992FR	$ 4,472,830	$ -	$ -	$ 4,472,830
Series 1993A	27,500,000	-	-	27,500,000
Series 1993B	15,000,000	-	-	15,000,000
Series 1993FR	10,625,000	-	4,935,000	5,690,000
Series 1998B	5,880,000	-	335,000	5,545,000
Series 1998D	14,325,000	-	685,000	13,640,000
Series 2003F	15,544,443	-	545,000	14,999,443
Total bonds payable	$93,347,273	$ -	$6,500,000	$86,847,273

Remaining annual maturities of long-term debt—Total principal and interest payments relating to Water Revenue Bonds through maturity are summarized as follows:

Year ending December 31,	**Bond Principal**	**CAB Interest**	**Current Interest**	**Total**
2005	$ 7,340,000	$ -	$ 4,039,335	$ 11,379,335
2006	3,843,020	2,996,423	3,724,440	10,563,883
2007	3,904,497	3,385,503	3,668,058	10,958,058
2008	1,929,756	250,244	3,607,215	5,787,215
2009	6,125,000	-	3,541,734	9,666,734
2010-2014	35,645,000	-	12,709,011	48,354,011
2015-2019	23,140,000	-	3,591,075	26,731,075
2020-2023	4,920,000	-	659,255	5,579,255
	86,847,273	6,632,170	35,540,123	129,019,566
Less portion due within one year	7,340,000	-	4,039,335	11,379,335
	$79,507,273	$6,632,170	$31,500,788	$117,640,231

6. 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 Systems. The Comptroller shall adopt and may amend rules and regulations for the administration and transaction of the business of the Systems and for the custody and control of their funds. The State Plan issues publicly available financial reports that contain financial statements and required supplementary information for the State Plan. The State Plan report may be obtained by writing to the New York State and Local Retirement Systems - Employees Retirement System, 110 State Street, Albany, New York 12244.

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. 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 is required to contribute at an actuarially determined rate. The Authority's required contributions to the State Plan amounted to $1,809,405, $1,309,653 and $300,598 in 2004, 2003 and 2002, respectively. The Authority's contributions were equal to 100 percent of the contributions required for each year. In May of 2003, the governor signed into law legislation which establishes a minimum employer contribution of 4.5% of reported wages each fiscal year.

7. OTHER POSTEMPLOYMENT BENEFITS

In addition to providing pension benefits, the Authority provides certain health care benefits to retired employees. The Authority's employees covered by collective bargaining units may become eligible for these benefits if they reach normal retirement age while working for the Authority for at least 15 years. For exempt employees the Authority uses a formula based on years of service and age. The Authority recognizes the cost of providing health care benefits to retired employees by expensing the annual premiums, which totaled $786,363 and $777,247 for 2004 and 2003, respectively. There were 99 and 98 retirees receiving health care benefits, at December 31, 2004 and December 31, 2003, respectively.

8. 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 has a contract settled thru March 31, 2006 and the AFSCME has a contract settled thru March 31, 2008.

9. NET ASSETS, RESERVES AND DESIGNATIONS

The Authority financial statements utilize a net assets presentation. Net assets are categorized as invested in capital assets (net of related debt), restricted and unrestricted.

Investment in capital assets, net of related debt—This category groups all capital assets into one component of net assets. 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.

Restricted net assets—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 ending December 31, 2004 and 2003 net assets were restricted for the following purposes:

	December 31, 2004	December 31, 2003
Future construction fund	$ 7,422,813	$13,014,471
Debt service reserve fund	7,077,752	7,088,668
Debt servive fund	5,391,942	4,655,429
	$19,892,507	$24,758,568

- ***Future construction reserve fund***—The future construction reserve fund is used for committed funding for future capital expenditures. The bond proceeds provided by the Series 2003F Bonds are required to be maintained in this fund to pay for future acquisition and construction costs. Any unused bond proceeds are required to be used for payment of debt service costs. Receipts from the AIG Long Term Investment Contract are also included in the construction reserve fund since they are to be used for future capital expenditures. The Authority transfers funds into this reserve account monthly based upon the current year's budget.

- ***Debt service reserve fund***—During 1993, the Authority established a debt service reserve fund as required by the Series 1993A and 1993B bond resolutions to maintain a specified amount of funds to meet future debt service requirements. The Authority established the debt service reserve fund based on 125% of the average annual debt service on the Series 1993A and Series 1993B Bonds.

  The 1992 and 1993 Fourth Resolution Bond Series established a debt service reserve fund as required by the Series 1992 Fourth Resolution and Series 1993 Fourth Resolution bond resolutions to maintain a specified amount of funds to meet future debt service requirements. Of the permissible options, the Authority elected to purchase surety bonds. Surety bonds issued by AMBAC Indemnity Corporation have been deposited in the Reserve Account in full satisfaction of the Reserve Account Requirements for the Series 1992 Fourth Resolution and Series 1993 Fourth Resolution Bonds.

  During 1998, the Authority established a debt service reserve fund as required by the Series 1998B and 1998D bond resolutions. During 2003, per the 2003F bond resolution the Authority established a debt service reserve fund from a portion of the 2003F bond proceeds. For the Series 1998B and Series 1998D Bonds, the Authority established the debt service reserve as the average of the annual installments of debt service per the bond resolutions. 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.

- ***Debt service fund***—The 1992 Fourth Resolution, 1993A, 1993B, 1993 Fourth Resolution, 1998B, 1998D and 2003F bond resolutions require that a specified amount of funds be maintained in the debt service fund. The requirements of the debt service fund 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.

Unrestricted net assets—This category represents net assets of the Authority not restricted for any project or other purpose.

10. COMMITMENTS AND CONTINGENCIES

The Authority maintains and operates certain facilities employed in the sale and distribution of water which it leases from various local water district municipalities pursuant to lease management agreements. Such agreements generally are for 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 subject to various laws and regulations, which primarily establishes uniform minimum national 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 also committed under various operating leases for the use of certain equipment and office space. Rental expense for 2004 and 2003 aggregated $262,013 and $261,185 respectively. Future minimum annual rentals to be paid under such leases are not significant.

On July 22, 2004, the authority and the Buffalo Water Board executed a memorandum of understanding (MOU) for the purpose of the Authority to acquire the City of Buffalo water system. Among other terms and conditions, the MOU required that the City Council schedule a referendum as required by Article X Section 5 of the Constitution of the State of New York. The Council took no action with respect to this requirement. Additionally, the MOU expired because no Asset Purchase Agreement was negotiated by the November 1, 2004 deadline, and the City did not request an extension of time to negotiate the same. Although there are no current discussions taking place, the Authority is receptive to providing service to the City of Buffalo and its water rate payers.

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 mitigate any exposure to loss on the part of the Authority. 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.

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