MASSACHUSETTS WATER RESOURCES AUTHORITY

Financial Statements and Supplemental Schedules
and Required Supplementary Information

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

MASSACHUSETTS WATER RESOURCES AUTHORITY

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Independent Auditors' Report

The Board of Directors
Massachusetts Water Resources Authority:

We have audited the accompanying balance sheets of the Massachusetts Water Resources Authority (the Authority) as of June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority at June 30, 2010 and 2009, and the changes in net assets and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As described in note 2, the Authority, in fiscal 2010, implemented Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 5, 2010, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 10 and the schedules of funding progress on page 45 are not required parts of the financial statements but are supplementary information required by U.S. generally accepted accounting principles. We and the other auditors 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.

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

KPMG LLP

October 5, 2010

This section of the Authority's annual financial report presents our discussion and analysis of the Authority's financial performance during the fiscal years ended June 30, 2010 and 2009. Please read it in conjunction with the Authority's financial statements, which immediately follow this section.

Financial Highlights – Fiscal 2010

The fiscal 2010 customer service revenues were approximately $571.4 million. Of this amount, rate revenues represent approximately 98%, or $561.4 million, and were $20.6 million higher than fiscal 2009. This was due to an increase in assessments.

Total operating expenses, excluding depreciation, were approximately $260.8 million in fiscal 2010. The 0.2% increase in total operating expenses over fiscal 2009 is the result of increased personnel costs. Utility expenses (primarily diesel fuel) increased $1.5 million due to severe wet weather conditions in March 2010. These increases were offset by cost savings in on-going maintenance and other costs.

Net nonoperating expenses decreased $11.6 million, or 4.7%, primarily due to a $5.2 million increase in investment income and a $6.4 million decrease in interest expense. The increase in investment income was due to increases in unrealized gains on investments. Decreases in interest expense were due to lower interest rates during fiscal 2010 as compared to fiscal 2009.

Total assets at June 30, 2010 were approximately $8.3 billion, a $19.6 million, or 0.2%, increase over total assets at June 30, 2009.

During fiscal 2010, the Authority issued 2010 Series A and B bonds in the aggregate amount of $283.6 million. The Authority used $100 million to finance on-going capital projects, while it used $183.6 million to refund $201.9 million of bonds outstanding.

Total capital assets (net of depreciation) were approximately $6.4 billion at June 30, 2010, an $11 million, or 0.2%, decrease over June 30, 2009. The decrease was due to disposal of assets no longer in use.

Derivative Instruments

In fiscal 2010 the Authority recorded $64.4 million on its balance sheet to account for the fair value of derivative instruments in accordance with Governmental Accounting Standards Board (GASB) Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Derivative instruments are defined as a financial arrangements entered into to hedge against fluctuations in market conditions, including variable interest rate borrowing. The derivatives were determined to be effective hedging instruments, therefore, the fair value is offset by a deferred outflow on the balance sheet.

Financial Highlights – Fiscal 2009

The fiscal 2009 customer service revenues were approximately $550.7 million. Of this amount, rate revenues represent approximately 98%, or $540.8 million, and were $23 million higher than fiscal 2008. This was due to an increase in assessments.

Total operating expenses, excluding depreciation, were approximately $260.2 million in fiscal 2009. The 3.6% increase in total operating expenses over fiscal 2008 is the result of increased personnel costs, including the

(Continued)

recognition of additional post-employment benefits expense of $15.8 million and increased maintenance costs at Deer Island.

Net nonoperating expenses increased $21.1 million, or 9.4%, primarily due to the $17 million decrease in operating grant income. This represents debt service assistance from the Commonwealth, which the Authority did not receive in fiscal 2009.

Total assets at June 30, 2009 were approximately $8.3 billion, a $228.8 million, or 2.8%, increase over total assets at June 30, 2008. This increase was primarily reflected as an increase in restricted assets, due to an increase in the construction fund.

During fiscal 2009, the Authority issued 2009 Series A and B bonds in the aggregate amount of $383.2 million to finance on-going capital projects, to retire $77 million of Commercial Paper notes and to refund $228.6 million of bonds outstanding.

Total capital assets (net of depreciation) were approximately $6.4 billion at June 30, 2009, a $32.1 million, or 0.5%, decrease over June 30, 2008. The decrease was due to disposal of assets no longer in use.

Overview of the Financial Statements

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

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

Financial Analysis of the Authority

Net Assets

The Authority's total net assets at June 30, 2010 were approximately $1.9 billion, a $56.1 million decrease from June 30, 2009. Total assets increased $19.6 million, or 0.2%, to $8.3 billion, and total liabilities increased $75.7 million, or 1.2% to $6.4 billion.

The Authority's total net assets at June 30, 2009 were approximately $2 billion, a $92 million decrease from June 30, 2008. Total assets increased $228.8 million, or 2.8%, to $8.3 billion, and total liabilities increased $321 million, or 5.3% to $6.3 billion.

Net Assets

(Dollars in thousands)

	2010	2009	2008	Percentage change 2010-2009	Percentage change 2009-2008
Current assets	$ 118,708	118,948	114,348	(0.2)%	4.0%
Restricted assets	730,353	784,119	690,382	(6.9)	13.6
Capital assets	6,370,258	6,381,230	6,413,403	(0.2)	(0.5)
Other assets	1,036,908	967,129	854,070	7.2	13.2
Deferred outflows from derivative instruments	64,441	49,625	—	29.9	100.0
Total assets and deferred outflows	8,320,668	8,301,051	8,072,203	0.2	2.8
Current liabilities	308,006	320,609	323,667	(3.9)	(0.9)
Payable from restricted assets	210,182	210,801	219,067	(0.3)	(3.8)
Long-term debt	5,658,514	5,593,717	5,317,572	1.2	5.2
Long-term lease	33,659	34,217	34,733	(1.6)	(1.5)
Other liabilities	192,833	168,131	111,208	14.7	51.2
Total liabilities	6,403,194	6,327,475	6,006,247	1.2	5.3
Net assets:					
Invested in capital assets – net of related debt	1,076,654	1,120,891	1,289,563	(3.9)	(13.1)
Restricted	205,928	268,642	240,804	(23.3)	11.6
Unrestricted	634,892	584,043	535,589	8.7	9.0
Total net assets	$ 1,917,474	1,973,576	2,065,956	(2.8)%	(4.5)%

Changes in Net Assets

The decrease in net assets at June 30, 2010 was $56.1 million, or 2.8%, as compared with June 30, 2009. The Authority's total operating revenues increased by 3.4% to $574.3 million and total operating expenses increased 0.2% to $260.8 million.

The decrease in net assets at June 30, 2009 was $92 million, or 4.5%, as compared with June 30, 2008. The Authority's total operating revenues increased by 2.7% to $555.2 million and total operating expenses increased 3.6% to $260.2 million.

Changes in Net Assets

(Dollars in thousands)

	2010	2009	2008	Percentage change 2010-2009	Percentage change 2009-2008
Operating revenues:					
Customer service revenues	$ 571,360	550,720	534,809	3.7%	3.0%
Other revenues	2,938	4,473	5,600	(34.3)	(20.1)
Total operating revenues	574,298	555,193	540,409	3.4	2.7
Operating expenses:					
Operations	96,923	93,795	93,733	3.3	0.1
Maintenance	25,561	27,444	26,409	(6.9)	3.9
Payments in lieu of taxes	6,732	6,104	6,226	10.3	(2.0)
Engineering, general, and administrative	131,551	132,828	124,687	(1.0)	6.5
Total operating expenses	260,767	260,171	251,055	0.2	3.6
Depreciation and amortization	189,798	181,314	180,173	4.7	0.6
Operating income	123,733	113,708	109,181	8.8	4.1
Nonoperating items:					
Regulatory accounting provisions	67,995	48,974	64,912	38.8	(24.6)
Net nonoperating expenses	(234,588)	(246,164)	(225,106)	(4.7)	9.4
Capital grants and contributions	8,211	7,120	6,852	15.3	3.9
Loss on disposal of capital assets	(21,453)	(9,451)	—	127.0	100.0
Total nonoperating items	(179,835)	(199,521)	(153,342)	(9.9)	30.1
Change in net assets	(56,102)	(85,813)	(44,161)	(34.6)	94.3
Total net assets – beginning of year	1,973,576	2,065,956	2,110,117	(4.5)	(2.1)
Restatement to comply with GASB Statement No. 49	—	(6,567)	—	(100.0)	100.0
Total net assets – end of year	$ 1,917,474	1,973,576	2,065,956	(2.8)%	(4.5)%

During fiscal 2010, the increases in customer service revenues were primarily due to the 3.8% increase in the rate revenue requirement ($20.6 million).

During fiscal 2009, the increases in customer service revenues were primarily due to the 4.4% increase in the rate revenue requirement ($23 million).

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Total operating costs, before depreciation and amortization, were approximately $260.8 million in fiscal 2010. The 0.2% increase in total operating expenses over fiscal 2009 is the result of increased personnel costs, including recognition of additional post-employment benefits expense of $16.8 million. Utility expenses (primarily diesel fuel) increased $1.5 million due to severe wet weather conditions in March 2010. These increases were offset by cost savings in on-going maintenance and other costs.

Total operating costs, before depreciation and amortization, in fiscal 2009 were $260.2 million; a $9.1 million or 3.6% increase over fiscal 2008. This increase is primarily due to increases in OPEB obligation ($15.8 million) and total personnel costs ($3.1 million). OPEB expenses increased due to compliance with GASB 45 which requires the eventual recognition of the unfunded actuarially required contribution. Total personnel costs increased due to union contract increases for salaries and wages and increased health and dental insurance costs.

In fiscal 2010, net nonoperating expenses decreased $11.6 million, or 4.7%, primarily due to a $5.2 million increase in investment income and a $6.4 million decrease in interest expense.

In fiscal 2009, net nonoperating expenses increased $21 million, or 9.4%, primarily due to a $17 million decrease in operating grant income. This represents debt service assistance from the Commonwealth, which the Authority did not receive in fiscal 2009.

Operating Costs by Functionality

(Dollars in thousands)

		2010	2009	2008	Percentage change 2010-2009	Percentage change 2009-2008
Wastewater treatment and transport	$	100,157	98,211	97,310	2.0%	0.9%
Water treatment and transport		29,843	29,915	29,153	(0.2)	2.6
Water and wastewater quality		8,668	8,398	8,584	3.2	(2.2)
Metering and monitoring		5,174	4,732	4,612	9.3	2.6
Facilities planning, design, and construction		10,527	10,472	10,495	0.5	(0.2)
Management information systems		8,810	9,059	8,941	(2.7)	1.3
Administration and support		42,981	44,954	43,324	(4.4)	3.8
Total direct operating costs		206,160	205,741	202,419	0.2	1.6
Indirect operating costs		54,607	54,430	48,636	0.3	11.9
Total operating costs	$	260,767	260,171	251,055	0.2%	3.6%

Across all functionalities increases in expense were incurred due to increased wages and salaries due to union-negotiated contractual increases. In addition, Wastewater treatment and transport expenses increased due to the severe wet weather events in March which resulted in higher overtime wages and higher diesel fuel costs. Metering and monitoring expenses increased due to purchases on additional metering equipment. Decreases in administration and support are due to decreases in health insurance costs resulting from employee contribution rates increasing from 15% to 20% in fiscal 2010.

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Capital Assets and Debt Administration

Capital Assets

As of June 30, 2010 and 2009, the Authority had $6.4 billion of capital assets (net of depreciation), respectively. This includes land, construction in progress, plant and equipment for the water and sewer systems, furniture and fixtures, leasehold improvements, and motor vehicles and equipment. The Authority's net capital assets decreased approximately $11 million, or 0.2% during fiscal 2010, primarily due to disposal of assets no longer in use.

Capital Assets

(Net of depreciation, dollars in thousands)

	2010	2009	2008	Percentage change 2010-2009	Percentage change 2009-2008
Land	$ 13,413	6,618	6,692	102.7%	(1.1)%
Construction in progress	424,133	367,593	285,941	15.4	28.6
Plant and equipment, water, and sewer systems	5,930,317	6,006,101	6,119,821	(1.3)	(1.9)
Furniture and fixtures	1,529	21	21	7,181.0	—
Leasehold improvements	370	382	394	(3.1)	(3.0)
Motor vehicles and equipment	496	515	534	(3.7)	(3.6)
	$ 6,370,258	6,381,230	6,413,403	(0.2)%	(0.5)%

Increases in construction in progress are primarily due to increased spending for the East Boston Branch sewer relief CSO, primary and secondary clarifier rehabilitation at Deer Island, North Dorchester Bay CSO dewatering station and the Lower Hultman aqueduct rehabilitation.

Debt Administration

The Authority's bond sales must be approved by its board of directors (the Board) and must comply with rules and regulations of the United States Treasury Department. Neither the Commonwealth of Massachusetts (the Commonwealth) nor any political subdivision thereof shall be obligated to pay the principal of, or premium or interest on, any debt outstanding and neither the faith and credit nor the taxing power of the Commonwealth or any political subdivision thereof is pledged to such payment.

Bond Resolutions

Pursuant to its general bond resolution, the Authority must comply with a rate covenant that requires it to set rates to maintain revenues sufficient to pay: current expenses; debt service on indebtedness; required deposits to reserves; costs of maintenance, replacement, and/or improvements to the wastewater and water systems that are considered current expenses and any additional amounts the Authority may be required to pay by any law or contract.

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

Credit Rating

Of the $5.6 billion of revenue bonds the Authority currently has outstanding, $2.5 billion is credit enhanced by a combination of bond insurance, and/or letters of credit. The Authority's enhanced revenue bonds are rated "AAA" by FitchRatings, "Aaa" by Moody's Investors Service, and "AAA" by Standard and Poor's. The Authority's unenhanced $0.9 billion long-term, senior debt is rated "AA+" by FitchRatings, "Aa1" by Moody's Investors Service, and "AA+" by Standard and Poor's. Remaining unenhanced subordinated debt of $1.1 billion is rated "AA" by FitchRatings, "Aa2" by Moody's Investors Service and "AA" by Standard and Poor's. Both FitchRatings and Moody's Investor Service global ratings were recalibrated during the fiscal year. The subordinated debt of $1.1 billion with the Massachusetts Water Pollution Abatement Trust is not rated as the Authority's debt.

Economic Factors and Next Year's Budget

In June 2010, the Board approved the fiscal 2011 Current Expense Budget (CEB), which totals $601.9 million in expenses. There are no debt service offsets in fiscal 2011.

The $601.9 million expense total is comprised of $354.3 million (58.9%) in capital financing costs and $247.6 million (41.1%) in operating expenses, of which $209.6 million (84.7%) is for direct expenses and $38.0 million (15.3%) is for indirect expenses. The total represents an increase of $12.6 million from fiscal 2010 spending, which is comprised of $3.5 million in higher operating costs and $9.1 million in higher debt service costs.

The fiscal 2011 rate revenue requirement approved by the Board is $569.8 million; an increase of 1.49% compared with the fiscal 2010 budget.

Fiscal 2011 budgeted nonrate revenue totals $32.1 million, a decrease of $3.3 million from actual fiscal 2010 nonrate revenue. The nonrate revenue budget is comprised of $15.3 million in investment income, $11.1 million in other user charges and other revenue, $5 million in rate stabilization usage and $0.7 million in entrance fees.

CIP 10 Year Plan

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

- Improvement and replacement of equipment on Deer Island to ensure that the plant continues to operate efficiently and effectively.

- Completion of the long-term CSO control plan, resulting in closing CSO outfalls and the reducing of CSO discharges to Boston Harbor and the Mystic, Charles, and Neponset River systems.
- Rehabilitation of the Hultman Aqueduct to provide transmission redundancy in order to ensure reliable water delivery and provide sufficient hydraulic capacity to support the John J. Carroll water treatment plant and covered storage facilities.
- Install ultraviolet light disinfection facilities at the John J. Carroll water treatment plan.
- Completion of covered storage facilities to provide safe, reliable storage for water treated at John J. Carroll water treatment plan and transported through the MetroWest Tunnel and Hultman Aqueduct.
- Demonstrate continued dedication to using resources efficiently, responding to climate change and reducing the environmental impacts of the Authority's daily operations by installing alternative energy sources.

Contacting the Authority's Financial Management

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

MASSACHUSETTS WATER RESOURCES AUTHORITY

Balance Sheets

June 30, 2010 and 2009

(Dollars in thousands)

Assets and Deferred Outflows		2010	2009
Unrestricted current assets:			
Cash and cash equivalents (note 4)	$	42,378	44,298
Investments (note 4)		48,554	48,879
Intergovernmental loans (note 7)		27,235	25,324
Accounts receivable		541	447
Total unrestricted current assets		118,708	118,948
Restricted assets:			
Investments (note 4)		726,946	781,397
Interest receivable		3,197	2,722
Grants receivable		210	—
Total restricted assets		730,353	784,119
Capital assets – not being depreciated (note 8)		437,546	374,211
Capital assets – being depreciated – net (note 8)		5,932,712	6,007,019
Deferred charges (notes 3 and 9)		707,204	646,152
Other assets, net (notes 7 and 9)		329,704	320,977
Deferred outflows from derivative instruments (note 6)		64,441	49,625
Total	$	8,320,668	8,301,051
Liabilities and Net Assets			
Current liabilities:			
Accounts payable and accrued expenses (note 14)	$	46,704	44,877
Commercial paper notes (note 6)		194,000	194,000
Current portion of long-term debt (note 6)		67,302	81,732
Total current liabilities		308,006	320,609
Payable from restricted assets:			
Accounts payable for construction		23,328	22,595
Accrued interest on bonds payable		81,121	81,819
Reserves (note 5)		105,733	106,387
Total payable from restricted assets		210,182	210,801
Retainage on construction in progress		14,710	15,373
Long-term debt – less current portion (note 6)		5,658,514	5,593,717
Long-term capital lease (note 10)		33,659	34,217
Other postemployment benefits (note 12)		46,072	29,234
Liability for derivative instruments (note 6)		64,441	49,625
Deferred credits (note 3)		67,610	73,899
Total liabilities		6,403,194	6,327,475
Net assets:			
Invested in capital assets, net of related debt		1,076,654	1,120,891
Restricted		205,928	268,642
Unrestricted		634,892	584,043
Total net assets		1,917,474	1,973,576
Commitments and contingencies (notes 10, 11, 12, 13, and 14)			
Total	$	8,320,668	8,301,051

See accompanying notes to financial statements.

MASSACHUSETTS WATER RESOURCES AUTHORITY

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010 and 2009

(Dollars in thousands)

		2010	2009
Operating revenues (note 2):			
Customer services	$	571,360	550,720
Other		2,938	4,473
Total operating revenues		574,298	555,193
Operating expenses:			
Operations		96,923	93,795
Maintenance		25,561	27,444
Payments in lieu of taxes		6,732	6,104
Engineering, general, and administrative		131,551	132,828
Total operating expenses		260,767	260,171
Income from operations before depreciation		313,531	295,022
Depreciation and amortization		189,798	181,314
Operating income		123,733	113,708
Regulatory accounting provisions:			
Change in reserves (note 5)		654	(1,746)
Change in deferrals, net (note 3)		67,341	50,720
Total regulatory accounting provisions		67,995	48,974
Nonoperating revenues (expenses):			
Investment income		26,403	21,247
Interest expense		(260,991)	(267,411)
Loss on disposal of capital assets		(21,453)	(9,451)
Total nonoperating expenses		(256,041)	(255,615)
Net loss before capital contributions		(64,313)	(92,933)
Capital grants and contributions		8,211	7,120
Decrease in net assets		(56,102)	(85,813)
Total net assets, beginning of year		1,973,576	2,065,956
Restatement to comply with GASB Statement No. 49		—	(6,567)
Total net assets, end of year	$	1,917,474	1,973,576

See accompanying notes to financial statements.

MASSACHUSETTS WATER RESOURCES AUTHORITY

Statements of Cash Flows

Years ended June 30, 2010 and 2009

(Dollars in thousands)

		2010	2009
Cash flows from operating activities:			
Cash received from customers	$	571,269	550,930
Cash paid to suppliers for goods and services		(117,694)	(126,125)
Cash paid to employees for services		(117,039)	(132,453)
Cash paid in lieu of taxes		(6,732)	(6,104)
Other operating receipts		2,938	4,473
Net cash provided by operating activities		332,742	290,721
Cash flows from capital and related financing activities:			
Proceeds from sale of revenue bonds, loans, and notes		152,582	375,574
Capital grants for construction		7,651	7,120
Capital lease principal payments		(558)	(516)
Capital lease interest payments		(2,659)	(2,701)
Repayment of debt		(135,559)	(178,755)
Interest paid on debt		(225,765)	(223,379)
Plant expenditures		(211,059)	(193,593)
Net cash used for capital and related financing activities		(415,367)	(216,250)
Cash flows from investing activities:			
Purchases of short-term investments		(114,918)	(111,322)
Sales and maturities of short-term investments		72,112	83,242
Increase (decrease) in restricted cash and investments – net		108,893	(66,223)
Interest received		14,618	20,722
Net cash (used for) provided by investing activities		80,705	(73,581)
Net (decrease) increase in cash and cash equivalents		(1,920)	890
Cash and cash equivalents, beginning of year		44,298	43,408
Cash and cash equivalents, end of year	$	42,378	44,298
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	123,733	113,708
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		189,798	181,314
(Increase) decrease in other accounts		(107)	11
Increase (decrease) in accounts payable		19,318	(4,312)
Net cash provided by operating activities	$	332,742	290,721

Noncash capital and related financing activities:

In May 2010, general revenue refunding bonds in the aggregate principal amount of $183,570 were issued to defease $201,940 of bonds outstanding.

In February 2009, general revenue refunding bonds in the aggregate principal amount of $285,200 were issued to retire $77,000 in Commercial Paper notes and to defease $228,580 of bonds outstanding.

See accompanying notes to financial statements.

(1) Organization

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

The Authority is governed by an 11-member board of directors (the Board) chaired by the Secretary of Energy and Environmental Affairs for the Commonwealth. The Secretary and two other members are appointed by the Governor. Three members of the Board are appointed by the Mayor of Boston and three are appointed by the Authority's Advisory Board. One member is appointed by the Mayor of Quincy and one by the Winthrop Council President.

(2) Summary of Significant Accounting Policies

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

(a) Basis of Presentation

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

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

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

In addition, the Authority has adopted the provisions of FASB Accounting Standards Codification for Regulated Operations, to provide a better matching of revenues and expenses. The effect of this policy has been to defer certain costs, which will be recovered through future revenues in accordance with the Authority's rate model, and to record deferred credits for revenue collected through current rates for costs expected to be incurred in the future. The effects of the Authority's accounting policies under FASB Accounting Standards Codification are discussed further in notes 3 and 9.

During 2010, the Authority implemented GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Statement No. 53 requires that the fair value of a hedging derivative instrument be reported in the financial statements. The Statement states that changes in fair value of effective hedging derivative instruments, as defined, be deferred until the last transaction involving the hedged item ends. In compliance with the Statement, the Authority has recorded a deferred outflow and corresponding liability on the balance sheet.

(b) Capital Assets

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

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

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

(c) Interest Cost and Principal Payments on Construction

During fiscal 2010 and 2009, none of the Authority's interest expense was capitalized to construction in progress in accordance with its current policy of recovering such costs through rates as incurred. Rates collected for principal payments on debt related to assets under construction are deferred until the related asset is completed and depreciation commences.

(Continued)

(d) Depreciation

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

	Years
Plant and equipment, water and sewerage systems	5 – 100
Motor vehicles and equipment	5
Furniture and fixtures	7
Leasehold improvements	3 – 5

(e) Revenue Recognition

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

(f) Cash and Cash Equivalents

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

(g) Payments in Lieu of Taxes

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

(h) Investments

Investments, other than guaranteed investment contracts, are recorded at fair value. Fair value is determined based on quoted market price. Guaranteed investment contracts are recorded at cost. The Authority recorded unrealized gains of $11,180 and $915 in fiscal 2010 and fiscal 2009, respectively, as part of investment income.

(i) Use of Estimates

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

(Dollars in thousands)

(j) Compensated Absences

Employees of the Authority may accumulate unused sick time of which 30% will be paid in cash upon retirement from the Authority. The liability for vacation leave is based on the amount earned but not used; for sick leave, it is based on a percentage of the amount accumulated at the statement of net assets dates. The liability for both amounts is calculated based on the pay or salary rates in effect at the statements of net assets dates.

(3) Deferred Charges and Credits

In accordance with FASB Accounting Standards Codification for Regulated Operations, deferred charges and credits result primarily from differences between depreciation on property, plant, and equipment not financed by grants or capital contributions, which is recovered through rates as principal payments on debt service, and from amounts determined by the Board to be utilized in a subsequent year to reduce customer billings (rate stabilization).

A summary of the activity of charges (credits) for fiscal 2010 and 2009 is as follows:

		Sewer	Water	Total
Balance – June 30, 2008 – net	$	405,246	64,683	469,929
Difference between depreciation of capital assets not financed by grants or capital contributions, and debt service in excess of interest expense		49,350	(9,391)	39,959
Rate stabilization, net		(11,644)	9,679	(1,965)
Other – net		62,906	1,424	64,330
Balance – June 30, 2009 – net		505,858	66,395	572,253
Difference between depreciation of capital assets not financed by grants or capital contributions, and debt service in excess of interest expense		46,371	14,681	61,052
Rate stabilization, net		8,248	(8,462)	(214)
Other – net		1,161	5,342	6,503
Balance – June 30, 2010 – net	$	561,638	77,956	639,594

(Dollars in thousands)

The net balance at June 30, 2010 and 2009, is presented on the balance sheets as follows:

		2010	2009	Current year change
Deferred charges	$	707,204	646,152	61,052
Deferred credits		(67,610)	(73,899)	6,289
Net change in deferrals	$	639,594	572,253	67,341

The balance in the rate stabilization reserve, which is included in deferred credits, was $41,986 and $41,772 at June 30, 2010 and 2009, respectively.

(4) Deposits and Investments

The following represents essential risk information about the Authority's deposits and investments.

(a) Custodial Credit Risk – Deposits

The custodial credit risk for deposits and certificates of deposit is the risk that, in the event of a bank failure, the Authority's deposits may not be recovered. The deposits in the bank in excess of the insured amount are uninsured and uncollateralized.

The bank deposits at June 30, 2010 and 2009 were $43,670 and $50,804, respectively. Of these amounts, $43,420 and $50,554 were exposed to custodial credit risks as uninsured and uncollateralized.

(b) Investments

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

The following guaranteed investment contract was in force as of June 30, 2010 and 2009, respectively. Such contracts are fully collateralized and recorded at cost:

Investment agreement provider	Rate	Maturity		2010	2009
Wachovia Bank	5.17	August 1, 2016	$	14,456	14,456
Total			$	14,456	14,456

(Dollars in thousands)

(c) Credit Ratings

All debt securities purchased, such as FNMA, FHLMC, and FHLB issues have an implied credit rating of AAA or they have been collateralized to AAA. The guaranteed investment contracts themselves are not rated. Further, the certificates of deposits and money market funds are not rated.

The general bond resolution limits the Authority to investing in securities that are rated in the three highest rating categories as defined by S&P and Moody's.

(d) Concentration Risk

The Authority has no investments, at fair value, which exceeds 5% of the Authority's total investments as of June 30, 2010 and 2009.

(e) Interest Rate Risk

The following is a listing of the Authority's fixed income investments and related maturity schedule as of June 30, 2010 and 2009:

June 30, 2010
Investment maturities (in years)

Investment type	Fair value	<1	1–3	4–8	>9
Certificate of deposit	$ 3,000	3,000	—	—	—
Money market mutual funds	455,730	455,730	—	—	—
U.S. Treasury notes and bonds	4,389	—	—	4,389	—
U.S. agency obligations	297,925	—	67,812	74,994	155,119
Guaranteed investment contract	14,456	—	—	14,456	—
Total	$ 775,500	458,730	67,812	93,839	155,119

June 30, 2009
Investment maturities (in years)

Investment type	Fair value	<1	1–3	4–8	>9
Certificate of deposit	$ 3,000	3,000	—	—	—
Money market mutual funds	564,624	564,624	—	—	—
U.S. Treasury notes and bonds	4,282	—	—	4,282	—
U.S. agency obligations	243,914	7,309	13,626	107,930	115,049
Guaranteed investment contract	14,456	—	—	14,456	—
Total	$ 830,276	574,933	13,626	126,668	115,049

The Authority's bond resolution limits maturities to less than 15 years. The majority of the Authority's investments are long-term investments held in the debt service reserve funds where the intent is to hold until maturity. This reduces the exposure to fair value losses arising from increasing interest rates.

(Dollars in thousands)

(f) Restricted Investments by Fund

The following summarizes restricted investments as of June 30, 2010 and 2009 by various funds and accounts established by the Authority for debt covenants and other purposes:

		2010	2009
Restricted investments:			
Construction	$	135,921	199,641
Debt service reserves		240,717	231,228
Debt service		160,761	176,360
Revenue redemption		33,245	33,159
Revenue		73,417	62,749
Renewal and replacement reserve		38,567	34,212
Insurance		18,997	18,997
Community obligation and revenue enhancement		20,932	20,769
Insurance related escrow deposits		4,389	4,282
Total restricted investments	$	726,946	781,397

(5) Bond Resolution Reserves

The components of the reserves required by the general and supplemental bond resolutions at June 30, 2010 and 2009 are as follows:

Reserves		Sewer	Water	Total 2010	Total 2009
Renewal and replacement	$	17,300	11,701	29,001	29,001
Insurance		9,500	9,500	19,000	19,000
Operating		27,077	10,539	37,616	38,270
Community obligation and revenue enhancement		18,399	1,717	20,116	20,116
Total	$	72,276	33,457	105,733	106,387

A renewal and replacement reserve of $6,000 was established through grant receipts transferred from the Commonwealth in 1985 and is included in restricted net assets at June 30, 2010 and 2009.

(Dollars in thousands)

(6) Notes Payable and Long-Term Debt

Long-term debt at June 30, 2010 and 2009 consisted of the following:

	2010	2009
General Revenue Bonds:		
1993 Series C, 5 1/4% to 6%, issued December 2, 1993, due 2010 to 2015	$ 36,095	48,095
1998 Series A, 4 3/4%, issued January 27, 1998, due 2028 to 2032	—	52,525
2002 Series B, 5% to 5 1/8%, issued March 15, 2002, due 2021 to 2027	—	74,415
2002 Series J, 5% to 5 1/2%, issued December 18, 2002, due 2011 to 2042	529,295	547,835
2003 Series D, 4 5/8% to 5%, issued January 7, 2004, due 2022 to 2028	113,340	113,340
2004 Series A, 4 3/4% to 5 1/8%, issued June 10, 2004, due 2021 to 2029	104,870	104,870
2006 Series A, 4% to 5%, issued March 16, 2006, due 2023 to 2046	200,000	200,000
2007 Series A, 4 3/8% to 5%, issued February 1, 2007 due 2022 to 2046	200,000	200,000
2009 Series A, 3% to 5%, issued February 19, 2009 due 2011 to 2039	98,000	98,000
2010 Series A, 3% to 5%, issued May 6, 2010 due 2015 to 2040	100,000	—
	1,381,600	1,439,080
General Revenue Refunding Bonds:		
1997 Series D, 6%, issued December 15, 1997, due 2014	7,310	14,210
1998 Series B, 5 1/2%, issued January 27, 1998, due 2010 to 2016	24,240	24,675
2004 Series B, 5%, issued September 29, 2004, due 2016 to 2020	49,390	49,390
2005 Series A, 5% to 5 1/4%, issued April 14, 2005, due 2010 to 2034	380,350	400,270
2005 Series B, 5%, issued April 14, 2005, due 2031 to 2035	80,290	80,290
2006 Series B, 4% to 5%, issued March 16, 2006, due 2015 to 2040	264,945	264,945
2007 Series B, 5 1/4%, issued February 1, 2007 due 2023 to 2038	647,950	647,950
2009 Series B, 3% to 5%, issued February 19, 2009 due 2011 to 2039	285,200	285,200
2010 Series B, 5%, issued May 6, 2010 due 2014 to 2032	183,570	—
	1,923,245	1,766,930

(Dollars in thousands)

		2010	2009
General Revenue Bonds with the Massachusetts Water Pollution Abatement Trust:			
1993 Series A, 5 1/2%, issued March 18, 1993, due 2010 to 2013	$	1,735	2,450
1993 Series D, 5 1/8% to 5 1/4%, issued January 6, 1994, due 2010 to 2014		2,000	2,590
1995 Series A, 5% to 5 1/2%, issued November 21, 1995, due 2010 to 2015		2,640	3,340
1998 Series C, 4 1/2% to 5 3/8%, issued July 9, 1998, due 2010 to 2018		6,740	7,920
1999 Series E Sewer, 4 1/2% to 5 3/8%, issued October 6, 1999, due 2010 to 2029		8,205	8,486
1999 Series E Water, 4 1/2% to 5 3/8%, issued October 6, 1999, due 2010 to 2019		6,935	7,512
1999 Series F, 5 1/4% to 6%, issued November 3, 1999, due 2010 to 2029		306,800	318,875
2000 Series E Sewer, 5% to 5 5/8%, issued November 1, 2000, due 2010 to 2030		60,499	62,300
2000 Series E Water, 5% to 5 5/8%, issued November 1, 2000, due 2010 to 2020		7,953	8,539
2001 Series C Water, 5% to 5 1/4%, issued July 26, 2001, due 2011 to 2021		3,431	3,683
2001 Series D Sewer, 5% to 5 3/4%, issued July 26, 2001, due 2010 to 2029		5,127	5,521
2001 Series D Water, 5% to 5 3/4%, issued July 26, 2001, due 2010 to 2019		981	1,063
2002 Series H Sewer, 3 1/2% to 5 1/4%, issued October 31, 2002, due 2010 to 2032		77,410	79,635
2002 Series H Water, 3 1/2% to 5 1/4%, issued October 31, 2002, due 2010 to 2022		23,765	25,235
2002 Series I Sewer, 4 1/4% to 5 5/8%, issued October 31, 2002, due 2010 to 2030		2,196	2,266
2002 Series I Water, 4 1/4% to 5 5/8%, issued October 31, 2002, due 2010 to 2020		21	24
2003 Series A Water, 3 3/4% to 5 1/4%, issued October 31, 2002, due 2010 to 2022		1,096	1,163
2003 Series B Water, 5% to 5 1/4%, issued July 24, 2003, due 2011 to 2021		3,098	3,323
2003 Series C Sewer, 3% to 5 1/2%, issued November 6, 2003, due 2010 to 2033		27,836	28,583

(Dollars in thousands)

	2010	2009
2003 Series C Water, 3% to 5 1/2%, issued November 6, 2003, due 2010 to 2023	$ 16,199	17,127
2004 Series C Sewer, 3% to 5 1/2%, issued October 26, 2004, due 2010 to 2033	9,452	9,706
2004 Series C Water, 3 3/4% to 5 1/4%, issued October 26, 2004, due 2010 to 2022	1,260	1,353
2004 Series D Sewer, 3% to 5 1/4%, issued November 29, 2004, due 2010 to 2034	54,775	56,919
2004 Series D Water, 3% to 5 1/4%, issued November 29, 2004, due 2010 to 2024	10,839	11,374
2005 Series C Sewer, 3% to 5 1/2%, issued November 3, 2005, due 2010 to 2033	6,436	6,654
2005 Series C Water, 3% to 5 1/2%, issued November 3, 2005, due 2010 to 2023	846	894
2005 Series D Sewer, 2% to 2 3/10%, issued November 16, 2005, due 2010 to 2035	59,655	61,550
2005 Series D Water, 0% to 2%, issued November 16, 2005, due 2010 to 2025	12,076	12,797
2005 Series E Sewer, 2%, issued November 16, 2005, due 2010 to 2025	327	347
2005 Series E Water, 2%, issued November 16, 2005, due 2010 to 2025	71	76
2006 Series C Sewer, 3% to 5 1/4%, issued October 26, 2006, due 2010 to 2034	7,913	8,164
2006 Series D Sewer, 2% to 2 3/10%, issued December 14, 2006, due 2010 to 2036	60,421	62,634
2006 Series D Water, 0% to 2%, issued November 16, 2006, due 2010 to 2026	25,636	27,076
2006 Series E Sewer, 2%, issued December 14, 2006, due 2010 to 2026	327	343
2006 Series E Water, 2%, issued December 14, 2006, due 2010 to 2026	147	154
2007 Series C Sewer, 2% to 2 3/10%, issued November 9, 2007, due 2010 to 2035	4,238	4,511
2007 Series C Water, 2%, issued November 9, 2007, due 2010 to 2025	2,430	2,579
2007 Series D Sewer, 2 3/10%, issued November 9, 2007, due 2010 to 2036	22,387	22,973
2007 Series E Sewer, 2% to 2 2/5%, issued December 18, 2007, due 2010 to 2037	57,326	58,742

(Dollars in thousands)

		2010	2009
2007 Series E Water, 2%, issued December 18, 2007, due 2010 to 2027	$	18,318	18,869
2008 Series G Sewer, 2%, issued December 9, 2008, due 2010 to 2026		5,567	5,852
2008 Series G Water, 2%, issued December 9, 2008, due 2010 to 2026		1,153	1,210
2009 Series C Sewer, 2% to 2 2/5%, issued March 18, 2009, due 2010 to 2038		87,747	81,489
2009 Series C Water, 2%, issued March 18, 2009, due 2010 to 2028		29,106	29,648
2009 Series D Sewer, 2% to 2 2/5%, issued December 15, 2009, due 2010 to 2037		11,001	—
2009 Series D Water, 2%, issued December 15, 2009, due 2010 to 2027		1,265	—
		1,055,386	1,075,549
General Revenue Bonds (variable rates):			
1999 Series B, 0.14% to 0.35%, issued January 29, 1999, due 2013 to 2028		72,600	72,600
		72,600	72,600
General Revenue Refunding Bonds (variable rates):			
2002 Series C, 0.12% to 0.33%, issued August 15, 2002, due 2020		70,575	70,575
2002 Series D, 0.10% to 0.36%, issued August 15, 2002, due 2016 to 2017		56,450	66,450
2008 Series A, 0.19% to 0.65%, issued May 29, 2008, due 2014 to 2037		337,675	338,005
2008 Series B, 0.14% to 0.35%, issued May 29, 2008, due 2016 to 2031		123,130	124,595
2008 Series C, 0.20% to 1.00%, issued May 29, 2008, due 2010 to 2026		189,200	194,900
2008 Series D, 0.20% to 1.00%, issued May 29, 2008, due 2011		12,240	73,140
2008 Series E, 0.10% to 0.50%, issued May 29, 2008, due 2012 to 2037		210,670	224,770
2008 Series F, 0.08% to 0.35%, issued May 29, 2008, due 2016 to 2029		184,910	191,705
		1,184,850	1,284,140
		5,617,681	5,638,299

(Dollars in thousands)

		2010	2009
Less:			
Unamortized bond premiums and discounts	$	181,047	164,308
Unamortized excess of reacquisition price over net carrying amount of defeased bonds		(148,182)	(178,762)
Current portion of long-term debt		(67,302)	(81,732)
		(34,437)	(96,186)
Long-term debt, net	$	5,583,244	5,542,113

Long-term obligations at June 30, 2010 and 2009 consisted of the following:

		2009 beginning balance	Additions	Reductions	2010 ending balance	Due within one year
General Revenue Bonds	$	1,511,680	100,000	157,480	1,454,200	6,885
General Revenue Refunding Bonds		3,051,070	183,570	126,545	3,108,095	15,170
General Revenue Bonds with the Massachusetts Water Pollution Abatement Trust		1,075,549	47,576	44,073	1,079,052	45,247
Borrowings associated with derivative instruments		51,604	—	—	51,604	—
	$	5,689,903	331,146	328,098	5,692,951	67,302

		2008 beginning balance	Additions	Reductions	2009 ending balance	Due within one year
General Revenue Bonds	$	1,483,445	98,000	69,765	1,511,680	3,375
General Revenue Refunding Bonds		2,988,775	285,200	222,905	3,051,070	34,285
General Revenue Bonds with the Massachusetts Water Pollution Abatement Trust		992,329	120,030	36,810	1,075,549	44,072
Borrowings associated with derivative instruments		—	51,604	—	51,604	—
	$	5,464,549	554,834	329,480	5,689,903	81,732

The Authority is required to establish water and sewer rates and charges at a level sufficient to provide, among other things, primary and subordinated debt service coverage ratios of 120% and 110%, respectively. For the year ended June 30, 2010, the Authority had primary and subordinated debt service coverage ratios of 204% and 118%, respectively.

Under the Authority's General Revenue Bond Resolution, all revenues, together with the investment earnings thereon, except to the extent that such earnings are required to be deposited in the Rebate Fund pursuant to a Supplemental Resolution, are pledged for payment of the Bonds.

The Act of 1984 imposes a limitation of $600,000 on the total amount of bonds and notes which may be outstanding at any one time. The Authority has requested increases in its debt limit as necessary to allow for issuances of bonds in amounts required to finance the capital program. The state legislature increased the debt limit to $6,450,000.

On June 2, 2010, the Authority executed Bond Anticipation Notes with the Massachusetts Water Pollution Abatement Trust (MWPAT) for funding under the American Reinvestment and Recovery Act of 2009 (ARRA). The principal on these notes, totaling $33,036, will be forgiven upon issuance of a Project Completion Certificate and the Authority's compliance with the requirements of ARRA. The Authority drew down $23,666 during the fiscal year which is presented as long-term debt on the Authority's balance sheet.

On May 6, 2010, the Authority issued General Revenue Bonds, 2010 Series A, and General Revenue Refunding Bonds, 2010 Series B in the principal amounts of $100,000 and $183,570, respectively.

The proceeds from the Series A bonds were used to fund on-going capital projects. The interest rate on these bonds is 3% to 5%.

The proceeds from the Series B bonds were used to refund $52,525 of General Revenue Bonds 1998 Series A, $74,415 of General Revenue Bonds 2002 Series B, $60,900 of General Revenue Refunding Bonds 2008 Series D and $14,100 of General Revenue Refunding Bonds 2008 Series E. The interest rate on these bonds is 5%. The cash flow required to make principal and interest payments on the refunding bonds is approximately $24,157 less than the debt service requirements of the refunded bonds. The economic gain (the difference between the present values of the debt service payments on the old and new debt) obtained from this refunding was $6,366.

On February 19, 2009, the Authority issued General Revenue Bonds, 2009 Series A, and General Revenue Refunding Bonds, 2009 Series B in the principal amounts of $98,000 and $285,200, respectively.

The proceeds from the Series A bonds were used to fund on-going capital projects. The interest rate on these bonds is 3% to 5%.

The proceeds from the Series B bonds were used to retire $77,000 of Commercial Paper Notes and refund $107,805 of General Revenue Refunding Bonds 1997 Series D, $47,830 of General Revenue Bonds 1998 Series A and $72,945 of General Revenue Refunding Bonds 1998 Series B. The interest rate on these bonds is 3% to 5%. The cash flow required to make principal and interest payments on the refunding bonds is approximately $28,484 less than the debt service requirements of the refunded bonds. The economic gain (the difference between the present values of the debt service payments on the old and new debt) obtained from this refunding was $19,526.

Synthetic Fixed Rate Swap Transactions

In connection with several of its bond issues, the Authority has entered into various interest rate swap agreements to reduce the impact of changes in interest rates on its variable rate debt. Under these agreements, the Authority pays a fixed interest rate (ranging from 3.9% to 6.9%) and receives interest from the swap counterparties at a variable rate (either Securities Industry and Financial Markets Association

(Dollars in thousands)

(SIFMA) rate or a percentage of LIBOR). The SIFMA rate is based on the seven-day high-grade market index of tax-exempt variable rate demand obligations.

Item	Type	Objective	Effective Date	Notional amount	Termination date	Fixed payable swap rate	Variable receivable swap rate	Fair value at June 30, 2010
A	Pay - fixed interest rate swap	Hedge changes in cash flows on the 2008 Series A Bonds	October 28, 2008	$ 133,300	August 1, 2030	4.470%	SIFMA	$ (10,732)
B	Pay - fixed interest rate swap	Hedge changes in cash flows on the 2008 Series E Bonds	October 28, 2008	133,300	August 1, 2030	4.470	SIFMA	(10,732)
C	Pay - fixed interest rate swap	Hedge changes in cash flows on the 2008 Series A & E Bonds	August 1, 2030	70,400	August 1, 2037	6.935	SIFMA	794
D	Pay - fixed interest rate swap	Hedge changes in cash flows on the 2008 Series C Bonds	May 29, 2008	113,215	November 1, 2026	3.994	SIFMA	(9,112)
E	Pay - fixed interest rate swap	Hedge changes in cash flows on the 2008 Series C Bonds	May 29, 2008	75,480	November 1, 2026	4.032	SIFMA	(12,153)
F	Pay - fixed interest rate swap	Hedge changes in cash flows on the 2002 Series D, 2008 Series A, D & E Bonds	August 15, 2002	273,550	August 1, 2015	4.127	67% LIBOR	(22,506)

Under these interest rate swap agreements, the Authority incurred net interest expense of $29,238 and $23,195 in fiscal 2010 and fiscal 2009, respectively.

For the swap execution on October 28, 2008, with a current notional amount of $266,600, the fixed rate paid by the Authority is as follows: 5.130% from execution through August 2005, 4.470% from August 2005 through August 2013, 5.494% from August 2013 through August 2019, and 6.935% from August 2019 through August 2030.

The aggregate fair value balance of the derivative instruments at June 30, 2010 and 2009 is $(64,441) and $(49,625), respectively, and is reflected on the Authority's balance sheets as liability for derivative instruments. This liability is offset by deferred outflows from derivative instruments.

The fair values of the interest rate swaps were estimated using 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 on the swaps.

During fiscal year 2009, the Authority replaced the counterparties to two swap agreements due to the bankruptcy of Lehman Brothers Holdings, Inc., and its associated subsidiary companies. The first swap, with a notional amount of $266,600, was replaced by two separate swap agreements of $133,300 each, covering the period from October 28, 2008 until August 1, 2030. The second swap has a notional amount of $70,400, and covers the period from August 1, 2030 until the bonds mature in 2037. Payments received from the replacement counterparties exceeded the amount of the termination payments made by the Authority. The amounts received from the replacements counterparties, $53.7 million, are included in long-term debt and will be amortized over the life of the interest rate swaps.

Risk Disclosure

Credit Risk – Because all of the Authority's swaps rely upon the performance of the third parties who serve as swap counterparties, the Authority is exposed to credit risk, or the risk that a swap counterparty fails to perform according to its contractual obligations. The appropriate measurement of this risk at the reporting date is the fair value of the swaps, as shown in the columns labeled Fair Value in the tables above. All fair values have been calculated using the mark to market or par value method. To mitigate credit risk, the Authority maintains strict credit standards for swap counterparties. The Authority monitors swap counterparties' credit ratings by the three rating agencies (FitchRatings, Moody's Investors Service, and Standard and Poor's). Collateral is obtained from any counterparty that does not maintain a set credit rating.

The following represents the credit ratings of the counterparties as of June 30, 2010:

Derivative instrument	Counterparty credit rating
Derivative A	AA-
Derivative B	AA
Derivative C	AA-
Derivative D	A+
Derivative E	A
Derivative F	Aa3

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

Termination Risk – The Authority or its counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. If, at the time of termination, a derivative is in a liability position, the Authority would be liable to the counterparty for a payment equal to the liability, subject to netting arrangements.

Rollover Risk – The Authority is exposed to rollover risk on hedging derivative instruments that are hedges of debt that mature prior to the maturity of the debt. Derivative instruments A, B and F have a maturity date that is before the maturity date of the associated debt.

Swap Payments and Associated Bonds Outstanding

Bonds outstanding include certain variable rate bonds where the Authority pays a fixed interest rate and receives interest at a variable rate from a counterparty. The table below presents the debt service requirements and related net swap payments for these bonds. As rates vary, variable rate interest payments will vary.

(Dollars in thousands)

Using rates as of June 30, 2010, debt service requirements of the variable rate bonds and net swap payments, assuming current interest rates remains constant, were as follows:

		Variable-rate		Interest rate	
		Principal	Interest	swaps, net	Total
Fiscal year ending June 30:					
2011	$	1,500	36,677	27,267	65,444
2012		18,240	35,874	23,286	77,400
2013		43,810	33,762	17,939	95,511
2014		45,820	31,342	13,950	91,112
2015		55,320	28,560	10,932	94,812
2016 – 2020		199,530	110,581	33,234	343,345
2021 – 2025		201,535	53,412	24,244	279,191
2026 – 2030		65,205	22,578	11,897	99,680
2031 – 2035		29,060	16,268	9,202	54,530
2036 – 2038		41,680	4,337	1,747	47,764
Total	$	701,700	373,391	173,698	1,248,789

At June 30, 2010, the following bonds outstanding are considered defeased in-substance:

Description	Redemption date	Redemption price		Outstanding principal amount
1992 Series A	2010 – 2019	100	$	307,805
1993 Series C	2010 – 2015	100		78,545
1995 Series B	2011 – 2013	100		24,330
1997 Series D	2013	100		6,900
1998 Series A	2010 – 2014	100		25,890
1998 Series B	2011 – 2013	100		5,615
2000 Series A	2010	100		266,690
2000 Series D	2010 – 2011	100		100,000
2002 Series B	2010 – 2011	100 to 101		166,285
2002 Series J	2012 – 2013	100		56,855
2003 Series D	2010 – 2013	100		40,500
2004 Series A	2010 – 2014	100		19,120
2004 Series B	2014	100		15,865
2005 Series A	2010 – 2013	100		16,135
2006 Series B	2015 – 2018	100		21,375

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

(Dollars in thousands)

In June 2010, the Authority used funds on hand to defease $8,625 of the 1993 Series C and $18,540 of the 2002 Series J General Revenue bonds outstanding and $6,900 of the 1997 Series D, $435 of the 1998 Series B, and $9,925 of the 2005 Series A General Revenue Refunding bonds outstanding.

In June 2009, the Authority used funds on hand to defease $5,180 of the 1998 Series B, $3,520 of the 2005 Series A and $10,475 of the 2008 Series D General Revenue Refunding bonds outstanding.

At June 30, 2010, outstanding bonds that are redeemable before their scheduled due dates are as follows:

Description	Redemption date	Redemption price	Outstanding principal amount
2002 Series J	August 2012	100	$ 200,000
2003 Series D	August 2013	100	113,340
2004 Series A	August 2014	100	104,870
2004 Series B	December 2014	100	49,390
2005 Series A	August 2017	100	284,990
2005 Series B	August 2017	100	80,290
2006 Series A	August 2018	100	19,385
2006 Series A	August 2016	100	180,615
2006 Series B	August 2018	100	123,335
2006 Series B	August 2016	100	138,440
2007 Series A	February 2017	100	200,000
2009 Series A	August 2019	100	76,445
2009 Series B	August 2019	100	181,885
2010 Series A	August 2020	100	92,545
2010 Series B	August 2020	100	114,565

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

During fiscal 2010, the Authority executed loan agreements with the MWPAT providing for 2009 Series D Sewer and Water loans in the principal amounts of $11,001 and $1,265 respectively. All proceeds for these loans were received by June 30, 2010

During fiscal 2009, the Authority executed loan agreements with Massachusetts Water Pollution Abatement Trust (MWPAT) providing for 2008 Series G Sewer and Water loans and 2009 Series C Sewer and Water loans in the principal amounts of $5,852, $1,210, and $91,648 and $30,458, respectively. All proceeds for these loans were received by June 30, 2009, except $10,969, principal for 2009 Series C Sewer and Water. The remaining funds were drawn down in fiscal 2010.

(Dollars in thousands)

Federal and Commonwealth subsidies for purposes of offsetting principal payments aggregating $96,324 will be recognized as capital grants in aid of construction over the term of the loans.

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

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

		Principal	Interest	Total
Year ending June 30:				
2011	$	67,302	237,251	304,553
2012		97,739	237,683	335,422
2013		103,948	234,313	338,261
2014		111,046	230,478	341,524
2015		164,933	224,658	389,591
2016 – 2020		1,061,695	1,002,613	2,064,308
2021 – 2025		1,430,398	733,282	2,163,680
2026 – 2030		1,175,859	446,005	1,621,864
2031 – 2035		704,901	238,726	943,627
2036 – 2040		464,589	101,610	566,199
2041 – 2045		180,000	28,673	208,673
2046 – 2049		55,271	2,380	57,651
Total	$	5,617,681	3,717,672	9,335,353

The Authority issued commercial paper notes of $194,000 to finance capital expenditures, which are secured by $100,000 and $250,000 irrevocable direct-pay letters of credit which expire on September 8, 2012, and November 30, 2015, respectively. These letters of credit carry a fee of 0.27% and 0.30% per annum, respectively, on the amount available. The maximum aggregate principal amount of commercial paper which may be outstanding at any one time is $350,000.

(Dollars in thousands)

Commercial paper at June 30, 2010 and 2009 consisted of the following:

	2010 Beginning balance	Additions	Reductions	2010 Ending balance
0.79% commercial paper	$ —	84,000	—	84,000
0.47% commercial paper	—	87,000	—	87,000
0.52% commercial paper	—	23,000	—	23,000
2.77% commercial paper	84,000	—	84,000	—
3.16% commercial paper	87,000	—	87,000	—
1.66% commercial paper	23,000	—	23,000	—
	$ 194,000	194,000	194,000	194,000

	2009 Beginning balance	Additions	Reductions	2009 Ending balance
2.77% commercial paper	$ —	84,000	—	84,000
3.16% commercial paper	—	87,000	—	87,000
1.66% commercial paper	—	23,000	—	23,000
3.70% commercial paper	52,000	—	52,000	—
3.75% commercial paper	139,000	—	139,000	—
	$ 191,000	194,000	191,000	194,000

(7) Accounts Receivable/Intergovernmental Loans

The Authority has entered into various interest-free loan agreements with certain member communities. Under these agreements, the Authority loaned these communities $29,339 and $29,591 in fiscal 2010 and 2009, respectively, to be received in five or ten equal annual installments.

The long-term portion of these loans at June 30, 2010 and 2009, is $102,258 and $100,355, respectively, and is included in other assets. The loans due within one year total $27,235 and $25,324 at June 30, 2010 and 2009, respectively. This program is designed to assist member communities with sewer and water systems rehabilitation.

MASSACHUSETTS WATER RESOURCES AUTHORITY

Notes to Financial Statements

June 30, 2010 and 2009

(Dollars in thousands)

(8) Capital Assets

Capital assets at June 30, 2010 and 2009, consisted of the following:

	2009	Additions	Disposals/ transfers	2010
Capital assets – not being depreciated:				
Land	$ 6,618	6,884	(89)	13,413
Construction in progress	367,593	188,089	(131,549)	424,133
Total capital assets – not being depreciated	374,211	194,973	(131,638)	437,546
Capital assets – being depreciated:				
Plant and equipment – water and sewage system	8,358,741	120,698	(49,741)	8,429,698
Furniture and fixtures	13,047	3,967	—	17,014
Leasehold improvements	2,423	—	—	2,423
Motor vehicles and equipment	948	—	—	948
Total capital assets – being depreciated	8,375,159	124,665	(49,741)	8,450,083
Less accumulated depreciation for:				
Plant and equipment – water and sewage system	2,352,640	175,029	(28,288)	2,499,381
Furniture and fixtures	13,026	2,459	—	15,485
Leasehold improvements	2,041	12	—	2,053
Motor vehicles and equipment	433	19	—	452
Total accumulated depreciation	2,368,140	177,519	(28,288)	2,517,371
Total capital assets – being depreciated – net	6,007,019	(52,854)	(21,453)	5,932,712
Capital assets – net	$ 6,381,230	142,119	(153,091)	6,370,258

(Dollars in thousands)

Capital assets at June 30, 2009 and 2008, consisted of the following:

		2008	Additions	Disposals/ transfers	2009
Capital assets – not being depreciated:					
Land	$	6,692	—	(74)	6,618
Construction in progress		285,941	147,980	(66,328)	367,593
Total capital assets – not being depreciated		292,633	147,980	(66,402)	374,211
Capital assets – being depreciated:					
Plant and equipment – water and sewage system		8,430,845	66,302	(138,406)	8,358,741
Furniture and fixtures		33,061	—	(20,014)	13,047
Leasehold improvements		5,081	26	(2,684)	2,423
Motor vehicles and equipment		1,595	—	(647)	948
Total capital assets – being depreciated		8,470,582	66,328	(161,751)	8,375,159
Less accumulated depreciation for:					
Plant and equipment – water and sewage system		2,311,024	170,571	(128,955)	2,352,640
Furniture and fixtures		33,040	—	(20,014)	13,026
Leasehold improvements		4,687	38	(2,684)	2,041
Motor vehicles and equipment		1,061	19	(647)	433
Total accumulated depreciation		2,349,812	170,628	(152,300)	2,368,140
Total capital assets – being depreciated – net		6,120,770	(104,300)	(9,451)	6,007,019
Capital assets – net	$	6,413,403	43,680	(75,853)	6,381,230

Depreciation and amortization for fiscal 2010 and 2009, was $189,798 and $181,314, respectively.

(9) Other Assets

On December 17, 1997, the Authority sold to Massachusetts Heavy Industries, Inc. (MHI) certain land, buildings, machinery, equipment, and other items located within a former shipbuilding facility, known as the Fore River Shipyard, for a total purchase price of $10,000. The Authority received $3,000 in December 1997. The remaining balance of $7,000 was due to be received beginning in December 1999. In accordance with FASB Accounting Standards Codification for Regulated Operations, the original loss of

(Dollars in thousands)

$28,303 was accounted for as a deferred charge and is expected to be recovered through future rates. During fiscal 2000, the $7,000 receivable was determined to be uncollectible increasing the deferred loss on the original sale to $35,303.

(10) Leases

(a) Operating

The Authority leases electrical power assets, office space in Boston, and other property under long-term operating leases. Future minimum rental payments required under operating leases having initial or remaining noncancelable lease terms in excess of one year at June 30, 2010, are as follows:

Year ending June 30:		
2011	$	5,710
2012		5,340
2013		5,511
2014		5,679
2015		4,842
2016 – 2020		12,014
Total	$	39,096

Rental expense was $6,057 and $7,291 in fiscal years 2010 and 2009, respectively.

(b) Capital

In fiscal 2003, the Authority entered into a 30-year capital lease agreement for the new maintenance facility. The interest rate for the capital lease is 7.83%. Future minimum lease payments for the capital lease at June 30, 2010, are as follows:

		Principal	Interest	Total
Year ending June 30:				
2011	$	603	2,614	3,217
2012		652	2,565	3,217
2013		705	2,512	3,217
2014		762	2,455	3,217
2015		824	2,393	3,217
2016 – 2020		5,237	10,848	16,085
2021 – 2025		7,737	8,348	16,085
2026 – 2030		11,431	4,655	16,086
2031 – 2035		5,708	458	6,166
Total	$	33,659	36,848	70,507

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

The associated capital asset is reported in plant and equipment – water and sewage system at a cost of $37,134 with $9,904 of accumulated depreciation as of June 30, 2010.

(11) Retirement Benefits

(a) Plan Description

The Enabling Act provided for the establishment of the Massachusetts Water Resources Authority Employees' Retirement System (the Plan), a contributory single-employer retirement system that is separate from the State Employees Retirement System. The Plan is a defined benefit pension plan covering those employees not employed by the MDC prior to July 1, 1985. Covered payroll for all Authority employees in the Plan was $81,962 at the actuarial valuation date, January 1, 2010.

Under the provisions of the Plan, pension benefits vest after 10 years of full-time employment. An employee may retire after 20 years of service or at age 55 and completion of 10 years of service. At age 65, annual pension benefits equal 2.5% of the employee's average regular compensation earned during the last three years of employment or any three consecutive years when compensation was higher, multiplied by each year of creditable service. The benefit is reduced if retirement occurs before age 65 or if survivor's benefits are elected. The Plan also provides death and disability benefits. Ordinary disability benefits are available only to employees under age 55 with at least 10 years of service. Complete financial statements for the Plan can be obtained from the Authority's administrative offices at Charlestown Navy Yard, 100 First Avenue, Boston, MA 02129.

(b) Funding Policy

Contributions made by employees are based upon a percentage of employee base pay (5% for employees hired before December 31, 1974, 7% for employees hired between January 1, 1975 and December 31, 1983, 8% for employees hired between December 31, 1983, and June 30, 1996, and 9% for employees hired after July 1, 1996). Additionally, certain employees earning in excess of $30 contribute an extra 2% of their salary effective January 1, 1979. Employees receive full payment of contributions upon withdrawal from the Plan and 50% of interest earned for employees with five to nine years of service or 100% of interest earned for employees with 10 or more years of service.

The Authority's 2010 and 2009 contributions to the plan were based on an amount approved by the Retirement Board and the Authority's board of directors, which is based on an actuarially determined amount. The Authority's Enabling Act requires funding to be made in accordance with the Retirement Board's recommendation.

(Dollars in thousands)

(c) *Annual Pension Cost and Net Pension Obligation*

The annual required contribution for the current year, determined by the January 1, 2009 actuarial valuation, was as follows:

Annual required contribution	$	5,587
Contributions made		(5,587)
Increase (decrease) in net pension obligation		—
Net pension obligation, beginning of year		—
Net pension obligation, end of year	$	—

Although the Authority has a net pension asset, it has elected to reserve against this balance, in accordance with FASB Accounting Standards Codification for Regulated Operations. This balance is reserved because the net pension asset resulted from the timing of payments according to the funding schedule and cannot be accessed by the Authority unless the plan is terminated. The likelihood of such an event has been deemed remote.

(d) *Three-Year Trend Information*

		Annual pension cost (APC)	Percentage of ARC contributed		Net pension asset/ (obligation)
Fiscal year ending:					
2010	$	5,621	101%	$	—
2009		8,630	162		—
2008		4,259	100		—

(e) *Funded Status and Funding Progress*

As of January 1, 2010, the most recent actuarial valuation date, the funded status of the Plan was as follows:

Actuarial accrued liability	$	319,876
Actuarial value of assets		276,270
Unfunded actuarial accrued liability (UAAL)	$	43,606
Funded ratio		86.4%
Covered payroll	$	81,962
UAAL as percentage of covered payroll		53.2%

The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits. Effective for the January 1, 2007 actuarial valuation, the Authority changed to the entry age normal actuarial cost method. Prior actuarial valuations were completed using the aggregate cost method.

(f) Actuarial Methods and Assumptions

The annual required contribution for the current year was determined as part of the January 1, 2010, actuarial valuation using the entry age normal actuarial cost method. Under this method an unfunded actuarial accrued liability of $43.6 million was calculated. The actuarial assumptions included (a) 8% investment rate of return and (b) projected salary increase of 4.75% per year. Liabilities for cost of living increases have been assumed at an annual increase of 3%, on the first $12 of benefit payments. The actuarial value of assets is determined by projecting the market value of assets as of the beginning of the prior plan year with the assumed rate of return during that year (8.0%) and accounting for deposits and disbursements with interest at the assumed rate of return. An adjustment is then applied to recognize the difference between the actual investment return and expected return over a five year period. As of January 1, 2010 the unfunded actuarially accrued liability is being amortized over 14 years using an open group method which assumes a 4.5% per year increase in payroll.

(g) Other Benefits

All MDC personnel who became employees of the Authority on July 1, 1985, and were members of the State Employees Retirement System, retained their membership in that system. The Authority is not liable for retirement allowances paid to or on account of these employees. Funding of the pension liability of the State Employees Retirement System is the obligation of the Commonwealth. Employees covered by this plan become 100% vested after 10 years of service.

(12) Other Postemployment Benefits (OPEB)

(a) Plan Description

In addition to providing the pension benefits described, the Authority provides postemployment health care and life insurance benefits for retired employees through the Group Insurance Commission (GIC). The GIC is a quasi-independent state agency that administers an agent multi-employer defined benefit OPEB plan. The benefits, benefit levels, employee contributions and employer contributions are governed by the Authority and can be amended by the Authority. As of January 1, 2008, the actuarial valuation date, approximately 308 retirees and survivors and 1,128 active employees meet the eligibility requirements. The plan does not issue a separate financial report.

(Dollars in thousands)

(b) Benefits Provided

The Authority provides medical, prescription drug, mental health/substance abuse and life insurance to retirees and their covered dependents. All active employees who retire from the Authority and meet the eligibility criteria will receive these benefits.

(c) Funding Policy

Retirees who retired on or before July 1, 1994 contribute 10% of the cost of the health plans, as determined by the GIC. Those who retired after July 1, 1994 contribute 15% of the cost of the health plan and those who retired after October 1, 2009 contribute 20% of the cost of the health plan, as determined by the GIC. The Authority contributes the remainder of the health plan costs on a pay-as-you-go basis.

(d) Annual OPEB Costs and Net OPEB Obligation

The Authority's fiscal 2010 annual OPEB expense is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost per year and amortize the unfunded actuarial liability over a period of thirty years. The following table shows the components of the Authority's annual OPEB cost for the year ending June 30, 2010, the amount actually contributed to the plan, and the change in the Authority's net OPEB obligation based on an actuarial valuation as of January 1, 2008:

Annual Required Contribution (ARC)	$	18,896
Interest on net OPEB obligation		1,242
Adjustment to ARC		(1,149)
Annual OPEB cost		18,989
Contributions made		(2,151)
Increase in net OPEB obligation		16,838
Net OPEB obligation – beginning of year		29,234
Net OPEB obligation – end of year	$	46,072

(Dollars in thousands)

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

Fiscal year ended		Annual OPEB cost	Percentage of OPEB cost contributed		Net OPEB obligation
2010	$	18,989	11%	$	46,072
2009		17,614	10		29,234
2008		15,120	11		13,426

(e) Funded Status and Funding Progress

The funded status of the plan as of January 1, 2008, the date of the most recent actuarial valuation, was as follows:

Actuarial accrued liability (AAL)	$	180,833
Actuarial value of plan assets		—
Unfunded actuarial accrued liability (UAAL)	$	180,833
Funded ratio (actuarial value of plan assets/AAL)		—%
Covered payroll (active plan members)	$	79,298
UAAL as a percentage of covered payroll		228%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amount and assumptions about the probability of occurrence of events far into the future. Examples included assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(f) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the plan as understood by the Authority and the plan members and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the Authority and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the January 1, 2008 actuarial valuation the projected unit credit cost method was used. The actuarial value of assets was not determined as the Authority has not advance funded its obligation. The actuarial assumptions included a 4.25% investment rate of return and an initial annual healthcare cost trend rate of 10% which decreases to a 5% long-term trend rate for all healthcare benefits after ten years. The amortization costs for the initial UAAL is a level percentage of payroll for a period of 30 years, on a closed basis. This has been calculated assuming the amortization payment increases at a rate of 4.25%.

(13) Commitments and Contingencies

(a) General

The Authority's capital improvement program continues to proceed. As part of this program, the Authority has entered into a number of contracts for the design and construction of infrastructure and improvements to its facilities. Commitments under these contracts aggregated approximately $308,805 at June 30, 2010.

The Authority's operating and construction plans are designed to comply with the Federal District Court's schedule of actions. The Authority has incurred capital expenditures of approximately $7,883,000 from fiscal 1986 through fiscal 2010, including those projects required to comply with the Federal District Court's schedule. The Authority anticipates spending an additional $2,028,000 on these projects through fiscal 2020. These capital expenditures have been forecasted based upon certain preliminary assumptions and estimates, which may change significantly as design and construction of the necessary facilities proceed. Funding is expected to come from various federal and state grants, as available and approved, and from the Authority's debt proceeds. To date, federal appropriations for the Boston Harbor Project have aggregated $810,000.

(b) Boston Harbor Case

The Authority continues to be a defendant, along with Boston Water and Sewer Commission (BWSC) and the Commonwealth, in the federal Boston Harbor Case. The federal action was originally brought in 1985 by the United States on behalf of the United States Environmental Protection Agency (EPA) and by certain citizens' groups for alleged Clean Water Act violations. As part of the Boston Harbor Case, the Authority was required to undertake certain corrective actions to meet wastewater treatment, discharge and combined sewer overflow (CSO) requirements. The only corrective action remaining is CSO-related involving a series of projects currently scheduled for completion in 2015.

In March 2006, the Authority reached agreement with the United States and the Massachusetts Department of Environmental Protection (DEP) on the scope and schedule for the remaining CSO projects. That agreement was filed with the Court as part of a joint motion to amend the Court Schedule. In April 2006, the Court allowed the joint motion and issued an Order with a schedule. Under the Order, the Authority has until 2020 to complete the remaining CSO work and subsequent monitoring which will be used to verify that the long term CSO control goals are achieved.

As part of the agreement, DEP agreed to reissue and EPA agreed to approve five (5) consecutive variances of no more than three years duration each, through the year 2020, for the Charles River and Alewife Brook/Upper Mystic River, the terms of which are consistent with and limited to the requirements in the Authority's revised Long Term CSO Control Plan. Variances have most recently been issued by DEP in August 2007. The variances will remain in place, respectively, for the Charles River until October 1, 2010 and for the Alewife/Upper Mystic until September 1, 2010. In addition, the United States and the Authority agreed to withdraw the February 27, 1987 Stipulation of the United States and the Massachusetts Water Resources Authority on Responsibility and Legal Liability for Combined Sewer Overflows and replace it with a Second Stipulation that requires the Authority to implement the CSO requirements set forth in the Court Schedule and to meet the levels of control described in the Authority's long term CSO control plan. Upon completion of the long term CSO control plan and with results that demonstrate performance parameters are as predicted, the stipulation makes the Authority responsible for only those CSO outfalls which it owns and operates. As a result of the agreement, the Authority now has 35 CSO projects, 26 of which are complete, and seven of which are under construction. The estimated cost to complete the Authority's long term CSO control plan is now $188.7 million, including contingency and escalation of unawarded contracts.

The Authority and the City of Cambridge resumed design efforts in 2008 as to several CSO projects which comprise the Alewife Brook CSO control plan even though a Chapter 30A appeal commenced by a citizens' group remained pending in Suffolk Superior Court (SUCV2007-05011-F) at that time. The appeal was taken from an October 2007 Final Decision of DEP which upheld a Superseding Order of Conditions (Order) issued by DEP in March 2005 with respect to the City's Cambridge Park Drive Area Drainage Project. The Superior Court has since affirmed the DEP Final Decision and, based upon findings of a lack of standing of the plaintiff group, has denied efforts by that group to lodge a further appeal to the Massachusetts Appeals Court. As a result of the appeal process, the remaining CSO projects which comprise the Alewife Brook CSO control plan have been delayed at least 27 months beyond the corresponding milestones in Schedule Seven. Two of the five projects in the Alewife Brook CSO control plan are in construction, both managed by Cambridge with MWRA financial assistance. Plans are in place for the remaining three projects. MWRA and the City of Cambridge have submitted a proposed schedule for the Alewife projects to EPA and DEP and are seeking court party approvals for revisions to the Court's Schedule Seven.

There has been no imposition of penalties by the Court against MWRA on the merits of the claims originally asserted in the Boston Harbor Case to date. EPA and MWRA have previously settled a separate civil enforcement proceeding in which MWRA paid a small civil penalty and has performed three supplemental environmental projects, all directed at resolving allegations contained in a supplemental complaint filed with the Court in the Boston Harbor case on July 1, 2008. The Court entered the parties' settlement agreement as an Order in the case in September 2008.

In addition, the Court always retains the right to order remedial action and to assess penalties.

(Continued)

(c) *Deer Island Submarine Power Cable*

In 2004, the United States Army Corps of Engineers (Corps) asserted that Boston Edison Co. (NStar), its subsidiary Harbor Energy Electric Company (HEEC), and the Authority were in violation of a permit (MA BOSS 198900530, dated August 31, 1989) which authorized the installation of a submarine electric power cable. The cable runs under the channel bed of Boston Harbor and extends from South Boston to Deer Island and is used to provide electric power for Deer Island operations. The Corps alleges that the power cable, in places, has been installed at depths less than those required by the permit. The Corps has demanded that the permittees develop plans and an implementation schedule for bringing the cable's depth and location into compliance with the permit. The demand has been made in connection with proposed dredging operations intended to deepen the harbor channel so as to make it navigable by deep-draft vessels. The Authority has responded to the Corps stating that it had become a co-permittee only to facilitate issuance of the permit, that it did not install and has never owned the cable, and therefore, it has neither any right nor financial responsibility, nor the ability, to move or alter the position of the cable. In May 2005, the Department of Justice (DOJ) advised the permittees that the matter had been referred to DOJ by the Corps for the purpose of either commencing a lawsuit to compel the relocation of the cable or negotiating an amicable resolution that would bring the permittees into compliance with the permit's conditions. The Authority has informed the Court in the Boston Harbor Case of its position in its Compliance and Progress report filed on June 15, 2005. DOJ, the Corps and the permittees last met in March 2009. Discussions continue to involve the potential for use of a so-called "mechanical option" which involves protecting the cable from dredging operations by covering it with concrete mats. The Authority has advised NStar and HEEC that it believes it has no financial responsibility whatsoever for the costs of either protecting or relocating the cable.

(d) *Miscellaneous*

The Authority is also a defendant in several legal actions and administrative proceedings arising out of its operation, maintenance, and improvement of the water and sewer systems under its care. It is the opinion of management that any judgments or settlements that may result from these actions will not have a materially adverse effect upon the Authority.

(14) Risk Management

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

Buildings, plants, and equipment are fully insured on an all risk replacement basis to the extent that losses exceed $2,500 per occurrence. The Authority maintains insurance coverage for general liability, automobile liability, marine liability, and employers' liability to the extent that losses exceed $2,500 per occurrence, up to a limit of $35,000. In addition to the primary liability insurance, the Authority maintains an excess liability policy with an additional limit of $65,000. The Authority also maintains public officials' errors and omissions insurance with a limit of $5,000 per occurrence with a $1,000 deductible. All insurance policies are renewed on an annual basis.

(Dollars in thousands)

The Authority reimburses the Commonwealth on a paid-claims basis for unemployment claims. Claims expensed during fiscal 2010 and 2009 were $148 and $86, respectively. The Authority is a licensed self-insurer for workers' compensation. Excess loss insurance is carried on workers' compensation as required by law in excess of $500 per occurrence retention, with a limit of $25,000 per occurrence.

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

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

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

Changes in the claims liability insurance reserves in fiscal 2010 and 2009 were as follows:

		General liability and property	Workers' compensation
Liability balance – June 30, 2008	$	1,829	1,273
Provision to record estimated losses		271	1,841
Payments		(1,131)	(1,696)
Liability balance – June 30, 2009		969	1,418
Provision to record estimated losses		1,725	2,226
Payments		(1,138)	(1,862)
Liability balance – June 30, 2010	$	1,556	1,782

REQUIRED SUPPLEMENTARY INFORMATION

MASSACHUSETTS WATER RESOURCES AUTHORITY

Schedules of Funding Progress

Required Supplementary Information

June 30, 2010

(Unaudited)

(Dollars in thousands)

Employees' retirement system

Actuarial valuation	Assets (a)	Actuarial Accrued Liability (AAL) – (b)	Unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll ((b-a)/(c))
January 1, 2010	$ 276,270	319,876	43,606	86.4%	$ 81,962	53.2%
January 1, 2009	222,477	301,652	79,175	73.8	82,314	96.2
January 1, 2008	240,484	278,050	37,566	86.5	78,925	47.6
January 1, 2007	211,716	255,962	44,246	82.7	75,444	58.6
January 1, 2005	172,512	172,512	—	100.0	75,790	—
January 1, 2003	146,188	146,188	—	100.0	66,711	—

Effective for the January 1, 2007 actuarial valuation, the Authority changed actuarial cost methods. See footnote 11 (e).

Other postemployment benefits

Actuarial valuation	Assets (a)	Actuarial Accrued Liability (AAL) – (b)	Unfunded AAL (UAAL) (b-a)	Funded ratio (a/b)	Covered payroll (c)	UAAL as a percentage of covered payroll ((b-a)/(c))
January 1, 2008	$ —	180,833	180,833	—	$ 79,298	228.0%
January 1, 2006	—	154,449	154,449	—	72,476	213.1

See accompanying independent auditors' report.

SUPPLEMENTAL SCHEDULES

MASSACHUSETTS WATER RESOURCES AUTHORITY

Accounts Established by the General Revenue Bond Resolution

Year ended June 30, 2010
(comparative totals for June 30, 2009)

(Dollars in thousands)

		Construction	Revenue	Debt service	Reserves	Total
Balance – June 30, 2009	$	199,641	62,749	461,516	53,209	777,115
Proceeds from:						
Revenue bonds and loans		146,637	—	5,945	—	152,582
Cash received from customers		—	574,207	—	—	574,207
Interest income		619	5,780	14,395	4,361	25,155
Grant receipts		127	100	7,424	—	7,651
Construction payments		(211,081)	22	—	—	(211,059)
Capital lease payments		(561)		(2,656)	—	(3,217)
Debt service payment		(1,692)	(18,566)	(341,066)	—	(361,324)
Other commonwealth payments		—	(21,680)	—	—	(21,680)
Interfund transfers		3,662	(311,098)	307,441	(5)	—
Transfers from (to) operating account		(1,431)	(218,097)	2,656	(1)	(216,873)
Balance – June 30, 2010	$	135,921	73,417	455,655	57,564	722,557

		Sewer	Water	2010 total	2009 total
Restricted cash and investments:					
Construction	$	99,366	36,555	135,921	199,641
Debt service reserves		155,483	85,234	240,717	231,228
Debt service		109,203	51,558	160,761	176,360
Revenue redemption		6,131	27,114	33,245	33,159
Revenue		10,578	62,839	73,417	62,749
Renewal and replacement reserve		24,862	13,705	38,567	34,212
Insurance		9,499	9,498	18,997	18,997
Community obligation and revenue enhancement		17,916	3,016	20,932	20,769
Total restricted cash and investments	$	433,038	289,519	722,557	777,115

See accompanying independent auditors' report.

MASSACHUSETTS WATER RESOURCES AUTHORITY

Combining Balance Sheet

June 30, 2010

(Dollars in thousands)

Assets and Deferred Outflows		Sewer	Water	Combined total
Unrestricted current assets:				
Cash and cash equivalents	$	29,098	13,280	42,378
Investments		34,960	13,594	48,554
Intergovernmental loans		8,665	18,570	27,235
Accounts receivable		240	301	541
Total unrestricted current assets		72,963	45,745	118,708
Restricted assets:				
Cash and investments		435,979	290,967	726,946
Interest receivable		2,245	952	3,197
Grants receivable		210	—	210
Total restricted assets		438,434	291,919	730,353
Capital assets – not being depreciated		378,774	58,772	437,546
Capital assets – being depreciated – net		3,527,705	2,405,007	5,932,712
Deferred charges		573,044	134,160	707,204
Other assets – net		225,226	104,478	329,704
Deferred outflows from derivative instruments		57,954	6,487	64,441
Total	$	5,274,100	3,046,568	8,320,668
Liabilities and Net Assets				
Current liabilities:				
Accounts payable and accrued expenses	$	39,590	7,114	46,704
Commercial paper notes		135,000	59,000	194,000
Current portion of long-term debt		50,890	16,412	67,302
Total current liabilities		225,480	82,526	308,006
Payable from restricted assets:				
Accounts payable for construction		18,101	5,227	23,328
Accrued interest on bonds payable		53,664	27,457	81,121
Reserves		72,276	33,457	105,733
Total payable from restricted assets		144,041	66,141	210,182
Retainage on construction in progress		11,323	3,387	14,710
Long-term debt – less current portion		3,761,399	1,897,115	5,658,514
Long-term capital leases		22,920	10,739	33,659
Other postemployment benefits		33,114	12,958	46,072
Liability for derivative instruments		57,954	6,487	64,441
Deferred credits		11,406	56,204	67,610
Total liabilities		4,267,637	2,135,557	6,403,194
Net assets:				
Invested in capital assets – net of related debt		379,454	697,200	1,076,654
Restricted		139,477	66,451	205,928
Unrestricted		487,532	147,360	634,892
Total net assets		1,006,463	911,011	1,917,474
Commitments and contingencies				
Total	$	5,274,100	3,046,568	8,320,668

See accompanying independent auditors' report.

MASSACHUSETTS WATER RESOURCES AUTHORITY

Combining Balance Sheet

June 30, 2009

(Dollars in thousands)

Assets and Deferred Outflows		**Sewer**	**Water**	**Combined total**
Unrestricted current assets:				
Cash and cash equivalents	$	30,350	13,948	44,298
Investments		35,692	13,187	48,879
Intergovernmental loans		8,940	16,384	25,324
Accounts receivable		57	390	447
Total unrestricted current assets		75,039	43,909	118,948
Restricted assets:				
Cash and investments		482,493	298,904	781,397
Interest receivable		1,843	879	2,722
Total restricted assets		484,336	299,783	784,119
Capital assets – not being depreciated		258,244	115,967	374,211
Capital assets – being depreciated – net		3,625,451	2,381,568	6,007,019
Deferred charges		526,673	119,479	646,152
Other assets – net		233,266	87,711	320,977
Deferred outflows from derivative instruments		42,678	6,947	49,625
Total	$	5,245,687	3,055,364	8,301,051
Liabilities and Net Assets				
Current liabilities:				
Accounts payable and accrued expenses	$	36,610	8,267	44,877
Commercial paper notes		135,000	59,000	194,000
Current portion of long-term debt		58,757	22,975	81,732
Total current liabilities		230,367	90,242	320,609
Payable from restricted assets:				
Accounts payable for construction		19,714	2,881	22,595
Accrued interest on bonds payable		53,512	28,307	81,819
Reserves		73,228	33,159	106,387
Total payable from restricted assets		146,454	64,347	210,801
Retainage on construction in progress		11,504	3,869	15,373
Long-term debt – less current portion		3,717,717	1,876,000	5,593,717
Long-term capital leases		23,299	10,918	34,217
Other long-term liabilities		21,058	8,176	29,234
Liability for derivative instruments		42,678	6,947	49,625
Deferred credits		20,815	53,084	73,899
Total liabilities		4,213,892	2,113,583	6,327,475
Net assets:				
Invested in capital assets – net of related debt		395,094	725,797	1,120,891
Restricted		178,657	89,985	268,642
Unrestricted		458,044	125,999	584,043
Total net assets		1,031,795	941,781	1,973,576
Commitments and contingencies				
Total	$	5,245,687	3,055,364	8,301,051

See accompanying independent auditors' report.

MASSACHUSETTS WATER RESOURCES AUTHORITY

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

Year ended June 30, 2010

(Dollars in thousands)

		Sewer	Water	Combined total
Operating revenues:				
Customer services	$	384,685	186,675	571,360
Other		1,977	961	2,938
Total operating revenues		386,662	187,636	574,298
Operating expenses:				
Operations		62,759	34,164	96,923
Maintenance		20,710	4,851	25,561
Payments in lieu of taxes		—	6,732	6,732
Engineering, general, and administrative		93,027	38,524	131,551
Total operating expenses		176,496	84,271	260,767
Income from operations before depreciation		210,166	103,365	313,531
Depreciation		130,031	59,767	189,798
Operating income		80,135	43,598	123,733
Regulatory accounting provisions:				
Change in reserves		952	(298)	654
Change in deferred credits – net		55,780	11,561	67,341
Total regulatory accounting provisions		56,732	11,263	67,995
Nonoperating income (expense):				
Investment income		17,839	8,564	26,403
Interest expense		(174,842)	(86,149)	(260,991)
Loss on disposal of capital assets		(11,888)	(9,565)	(21,453)
Total nonoperating expense		(168,891)	(87,150)	(256,041)
Net loss before capital grants		(32,024)	(32,289)	(64,313)
Capital grants		6,692	1,519	8,211
Decrease in net assets		(25,332)	(30,770)	(56,102)
Total net assets – beginning of year		1,031,795	941,781	1,973,576
Total net assets – end of year	$	1,006,463	911,011	1,917,474

See accompanying independent auditors’ report.

MASSACHUSETTS WATER RESOURCES AUTHORITY

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

Year ended June 30, 2009

(Dollars in thousands)

	Sewer	Water	Combined total
Operating revenues:			
Customer services	$ 362,869	187,851	550,720
Other	3,678	795	4,473
Total operating revenues	366,547	188,646	555,193
Operating expenses:			
Operations	60,002	33,793	93,795
Maintenance	22,087	5,357	27,444
Payments in lieu of taxes	—	6,104	6,104
Engineering, general, and administrative	93,949	38,879	132,828
Total operating expenses	176,038	84,133	260,171
Income from operations before depreciation	190,509	104,513	295,022
Depreciation	132,433	48,881	181,314
Operating income	58,076	55,632	113,708
Regulatory accounting provisions:			
Change in reserves	(1,031)	(715)	(1,746)
Change in deferred credits – net	56,233	(5,513)	50,720
Total regulatory accounting provisions	55,202	(6,228)	48,974
Nonoperating income (expense):			
Investment income	12,685	8,562	21,247
Interest expense	(179,351)	(88,060)	(267,411)
Loss on disposal of capital assets	(1,341)	(8,110)	(9,451)
Total nonoperating expense	(168,007)	(87,608)	(255,615)
Net loss before capital grants	(54,729)	(38,204)	(92,933)
Capital grants	6,074	1,046	7,120
Decrease in net assets	(48,655)	(37,158)	(85,813)
Total net assets – beginning of year	1,080,963	984,993	2,065,956
Restatement to comply with GASB Statement No. 49 (note 2)	(513)	(6,054)	(6,567)
Total net assets – end of year	$ 1,031,795	941,781	1,973,576

See accompanying independent auditors' report.