

**RHODE ISLAND CLEAN WATER
FINANCE AGENCY**

**FINANCIAL STATEMENTS AND
SUPPLEMENTAL INFORMATION
FOR THE YEARS ENDED
JUNE 30, 2006 AND 2005**

RHODE ISLAND CLEAN WATER FINANCE AGENCY

Table of Contents

	<u>Page(s)</u>
Independent Auditor's Report.....	1 - 2
Management's Discussion and Analysis.....	3 - 9
<i>Financial Statements:</i>	
Statements of Net Assets.....	10
Statements of Revenues, Expenses, and Changes in Net Assets	11
Statements of Cash Flows	12
Notes to Financial Statements	13 - 28

CAYER CACCIA LLP

Certified Public Accountants and Business Consultants

INDEPENDENT AUDITOR'S REPORT

To the Board Members
Rhode Island Clean Water Finance Agency
Providence, Rhode Island

We have audited the accompanying financial statements of the RHODE ISLAND CLEAN WATER FINANCE AGENCY, a component unit of the State of Rhode Island and Providence Plantations (State), as of and for the years ended June 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Agency's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the 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 RHODE ISLAND CLEAN WATER FINANCE AGENCY as of June 30, 2006 and 2005, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2006, on our consideration of the RHODE ISLAND CLEAN WATER FINANCE AGENCY'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 - 9 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Cayer Caccia, LLP.

September 15, 2006

**Rhode Island Clean Water Finance Agency
Management's Discussion and Analysis**

The Rhode Island Clean Water Finance Agency (the "Agency") has the pleasure to offer readers of these financial statements this narrative overview and analysis of the financial activities of the Agency for the fiscal year ended June 30, 2006. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. The Agency encourages readers to consider the information presented here in conjunction with the financial statements as a whole.

FINANCIAL HIGHLIGHTS:

- The Agency's total assets at June 30, 2006 were \$874,960,654, which is an increase of \$47,060,999 or 6% over June 30, 2005.
- The Agency's capital assets at June 30, 2006 were \$42,961, which is a decrease of \$7,395 or 15% below June 30, 2005.
- The Agency's total operating revenues for the fiscal year ended June 30, 2006 were \$29,439,104, which is an increase of \$2,340,997 or 9% over the fiscal year ended June 30, 2005.
- The Agency's operating expenses for the fiscal year ended June 30, 2006 were \$26,943,003, which is an increase of \$3,339,728 or 14% over the fiscal year ended June 30, 2005.
- The Agency's total net assets for the fiscal year ended June 30, 2006 were \$318,189,174, which is an increase of \$26,426,756 or 9% over the fiscal year ended June 30, 2005.

2006 FISCAL SUMMARY:

In other activity, the Agency has assumed \$49,080,000 in new bond indebtedness; however the Agency has created additional assets by issuing new loans to Rhode Island borrowers totaling \$59,867,500.

- December 15, 2005, the Agency issued a \$49,080,000 Series 2005A Bond Issue. This bond issue was part of a total loan pool of \$57,479,000 made to ten borrowers in the Clean Water State Revolving Fund. The following is a list of the borrowers and their loan amount:

Bristol	\$ 3,655,000
Cranston	900,000
Jamestown	2,000,000
Middletown	6,000,000
NBC Pool # 9	30,000,000
Narragansett	350,000
South Kingstown	950,000
Warren	905,000
Warwick	5,000,000
West Warwick	7,719,000
	<u>\$57,479,000</u>

Rhode Island Clean Water Finance Agency Management's Discussion and Analysis

- July 11, 2005, the Agency issued a CSSLP loan to the town of Narragansett in the amount of \$250,000.
- January 2, 2006, the Agency issued a CSSLP loan to the town of South Kingstown in the amount of \$300,000.
- March 17, 2006, the Agency issued a CSSLP loan to the town of New Shoreham in the amount of \$250,000.
- March 17, 2006, the Agency issued a Drinking Water loan to West Greenwich in the amount of \$338,500.
- June 22, 2006, the Agency issued a Drinking Water loan to North Tiverton Fire District in the amount of \$1,250,000.

OVERVIEW OF THE FINANCIAL STATEMENTS:

The Agency's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied on an accrual basis. Under the accrual basis, revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred. The three basic financial statements presented within the financial statements are:

Statement of Net Assets – This statement presents information regarding the Agency's assets, liabilities and net assets. Net assets represent the total amount of assets less the total liabilities. The statement of net assets classifies assets, liabilities and net assets as current, non-current and restricted.

Statement of Revenues, Expenses and Changes in Net Assets – This statement presents the Agency's operating revenues, operating expenses and changes in net assets for the fiscal year.

Statement of Cash Flow – The Agency's statement of cash flows is presented on the direct method of reporting, which reflects cash flows from operating, non-capital financing, capital and investing activities.

**Rhode Island Clean Water Finance Agency
Management's Discussion and Analysis**

FINANCIAL ANALYSIS:

NET ASSETS

The Agency's total net assets at June 30, 2006 was \$318,189,174, which is an increase of \$26,426,756 or 9% over June 30, 2005. Components of the Agency's statement of net assets were as follows at June 30:

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Other assets	\$874,917,693	\$827,849,299	\$700,249,159
Capital assets	<u>42,961</u>	<u>50,356</u>	<u>57,762</u>
Total assets	<u>874,960,654</u>	<u>827,899,655</u>	<u>700,306,921</u>
Current liabilities	28,672,165	28,144,002	19,304,891
Non-current liabilities	<u>528,099,315</u>	<u>507,993,235</u>	<u>416,719,797</u>
Total liabilities	<u>556,771,480</u>	<u>536,137,237</u>	<u>436,024,688</u>
Net assets			
Invested in capital assets	42,961	50,356	57,762
Restricted for debt service	303,586,028	279,998,423	255,615,508
Unrestricted	<u>14,560,185</u>	<u>11,713,639</u>	<u>8,608,963</u>
Total net assets	<u>\$318,189,174</u>	<u>\$291,762,418</u>	<u>\$264,282,233</u>

The increases noted above in the Agency's total assets and liabilities are the confirmation of the Agency's steady growth. The 2006 increase results from the Agency closing a \$49 million Clean Water bond issue in December. Total assets grew from \$827,899,655 at June 30, 2005 to \$874,960,654 at June 30, 2006. Current liabilities grew from \$28,144,002 at June 30, 2005 to \$28,672,165 or 2% at June 30, 2006. The growth over the past year also relates to non-current liabilities totaling \$528,099,315 which is an increase of \$20,106,080 or 4% over June 30, 2005. The increases noted in unrestricted assets, restricted assets, and non-current liabilities are related to the increased level of loan activity through issuance of bonds.

**Rhode Island Clean Water Finance Agency
Management's Discussion and Analysis**

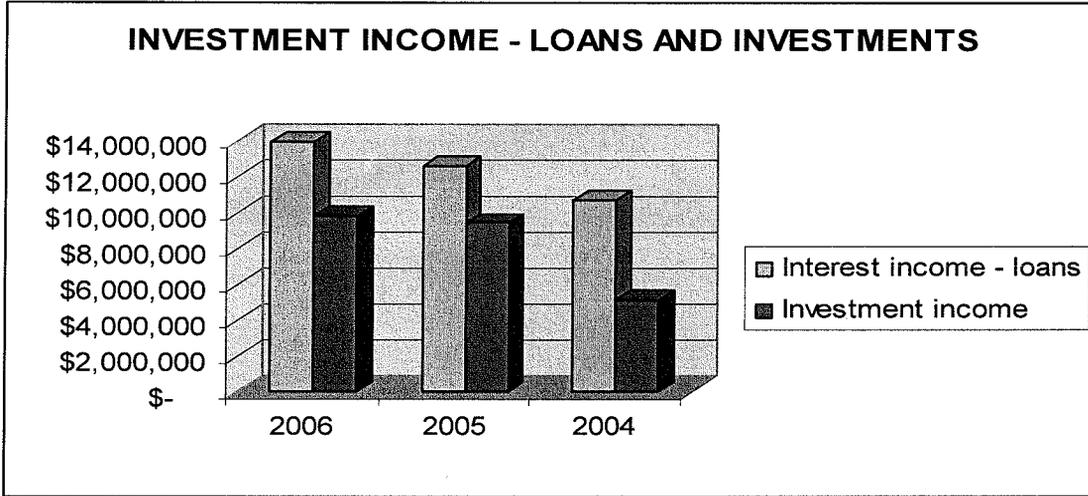
CHANGES IN NET ASSETS

The Agency's change in net assets for the fiscal year ended June 30, 2006 was \$26,426,756. The increase in investment income results from the following: an increase in interest rates on both short and long term investments. In 2006 grant income increased due to the continued maturing of the Drinking Water program, as well as an increase in construction draws, which caused more federal funds to be drawn to fund the Local Interest Subsidy Trust (LIST) accounts.

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Interest income - loans	\$13,945,467	\$ 12,635,671	\$ 10,681,840
Investment income	9,825,064	9,447,001	5,168,533
Grant income - DEM & DOH	2,478,586	2,349,948	2,272,236
Grant income - federal and state	23,930,655	23,985,353	16,434,411
Other operating revenues	<u>3,189,987</u>	<u>2,665,487</u>	<u>2,239,258</u>
Total income	<u>53,369,759</u>	<u>51,083,460</u>	<u>36,796,278</u>
Interest expense	23,376,912	20,265,522	16,244,743
Other operating expenses:			
Consulting fees :DEM & DOH	2,478,586	2,349,948	2,272,236
General administration	919,229	816,457	700,262
Professional fees	<u>168,276</u>	<u>171,348</u>	<u>150,812</u>
Operating expenses	<u>26,943,003</u>	<u>23,603,275</u>	<u>19,368,053</u>
Increase in net assets	26,426,756	27,480,185	17,428,225
Net assets, beginning of year	<u>291,762,418</u>	<u>264,282,233</u>	<u>246,854,008</u>
Total net assets, end of year	<u><u>\$318,189,174</u></u>	<u><u>\$291,762,418</u></u>	<u><u>\$264,282,233</u></u>

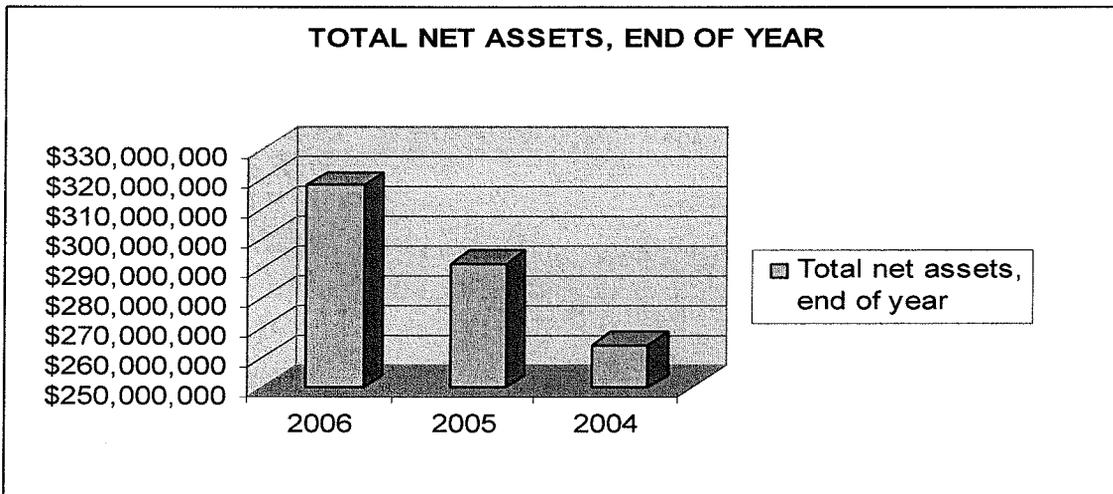
**Rhode Island Clean Water Finance Agency
Management's Discussion and Analysis**

As graphically portrayed below, the increase of 10% in interest income-loans is related to the growth in the Agency's portfolio.



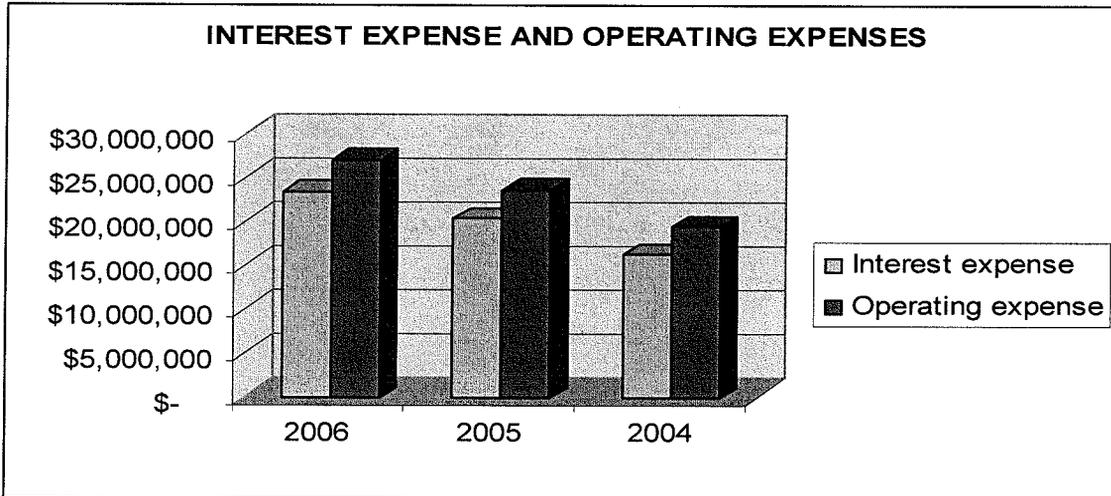
As graphically shown above and discussed earlier, investment income increased from \$9,447,001 at June 30, 2005 to \$9,825,064 at June 30, 2006 representing a modest 4% increase.

The increase in interest income combined with the increase in other operating revenue resulted in a 5% increase in total income. Total net assets at June 30, 2006 was \$318,189,174 which was an increase of 9% over fiscal year June 30, 2005.



Rhode Island Clean Water Finance Agency Management's Discussion and Analysis

An increase of 15% in interest expense is related to the Agency closing one bond issue in the Clean Water State Revolving Fund. As the Agency's outstanding debt increases, operating expenses will increase due to the additional administrative costs associated with overseeing its outstanding bonds and servicing its growing loan portfolio.



BUDGETARY RESULTS:

The Agency prepares an annual operating budget (approved by the Agency's Board of Directors) that is used as a management tool for tracking the various revenues and expenses. For the fiscal year ended June 30, 2006 the Agency realized a positive budgetary variance related to its administrative expenses.

DEBT ADMINISTRATION:

The Agency administers the Water Pollution Control and the Rhode Island Water Pollution Control revolving loan funds created under Title VI of the Federal Clean Water Act and its State counterpart which is known as the Clean Water State Revolving Fund (CWSRF). The Agency also administers the Drinking Water State Revolving Fund (DWSRF) created under the Federal Safe Drinking Water Act amendments of 1996. The Agency has established a Community Septic System Loan Program (CSSLP) as part of the Federal Clean Water State Revolving Fund. The Agency also provides conduit loans to municipalities for various water and wastewater system improvements. In addition, the Agency created a Rhode Island Zero Interest Loan Fund (RIZILF). This fund was established under the authority of Chapter 55 of the 2000 Public Laws of Rhode Island. The Agency received state bond proceeds totaling \$60,000,000 of which approximately \$57,000,000 was used to fund the RIZILF and \$3,000,000 was used to provide state match dollars for the Drinking Water State Revolving Fund (DWSRF) program.

At June 30, 2006, the Agency had \$535,850,000 of bond indebtedness, an increase of 6% from the \$504,660,000 outstanding at June 30, 2005. Detailed information related to its Agency's debt is presented in Note 2 to the bonds statement.

**Rhode Island Clean Water Finance Agency
Management's Discussion and Analysis**

The Agency (Board of Directors and Staff) is proud of the confidence placed in the Agency by the three nationally recognized rating services who continue to rate Agency Bonds as follows:

Fitch - IBCA	AAA
Standard & Poor's	AAA
Moody's	Aaa

The Agency has experienced growth in all aspects of its operations and the future of the Agency continues in a positive direction.

The Agency's Board of Directors voted to designate all net assets in excess of the Agency's annual operating budget to be used for interim and short-term loans to qualified borrowers.

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**STATEMENTS OF NET ASSETS
JUNE 30, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
<u>ASSETS</u>		
Current assets:		
Cash, cash equivalents and investments:		
Unrestricted:		
Cash	\$ 36,112,137	\$ 34,575,971
Cash equivalents	17,401,042	16,916,810
Investments	48,988,383	96,454,410
Total unrestricted cash, cash equivalents and investments	<u>102,501,562</u>	<u>147,947,191</u>
Restricted:		
Cash	1,897,771	1,259,622
Investments	143,899,447	126,832,370
Total restricted cash, cash equivalents and investments	<u>145,797,218</u>	<u>128,091,992</u>
Loans receivable, net	29,054,673	21,813,997
Accrued interest receivable:		
Loans	4,457,468	4,043,588
Investments	2,630,611	2,626,299
Accounts receivable – service fees	920,536	766,572
Prepaid expenses and other receivables	130,594	135,257
Total current assets	<u>285,492,662</u>	<u>305,424,896</u>
Noncurrent assets:		
Loans receivable, net	584,044,466	517,280,073
Bond issuance costs, net of accumulated amortization	5,380,565	5,144,330
Total noncurrent assets	<u>589,425,031</u>	<u>522,424,403</u>
Capital assets:		
Property and equipment, net of accumulated depreciation	42,961	50,356
TOTAL ASSETS	<u>874,960,654</u>	<u>827,899,655</u>
<u>LIABILITIES</u>		
Current liabilities:		
Bonds payable	21,830,000	17,890,000
Accrued interest payable	6,322,891	6,032,955
Accounts payable and accrued expenses	519,274	4,221,047
Total current liabilities	<u>28,672,165</u>	<u>28,144,002</u>
Noncurrent liabilities:		
Bonds payable, net of current portion	527,369,581	499,552,197
Bond anticipation note	0	7,719,000
Accrued arbitrage rebate	729,734	722,038
Total noncurrent liabilities	<u>528,099,315</u>	<u>507,993,235</u>
TOTAL LIABILITIES	<u>556,771,480</u>	<u>536,137,237</u>
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	42,961	50,356
Restricted	303,586,028	279,998,423
Unrestricted	14,560,185	11,713,639
TOTAL NET ASSETS	<u>\$318,189,174</u>	<u>\$291,762,418</u>

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Investment income.....	\$ 9,825,064	\$ 9,447,001
Interest income - loans.....	13,945,467	12,635,671
Grant income - operating.....	2,478,586	2,349,948
Service fees.....	2,627,925	2,148,916
Direct loan fees and other.....	122,552	132,047
Loan origination fees.....	439,510	384,524
Total operating revenues	<u>29,439,104</u>	<u>27,098,107</u>
Operating expenses:		
Interest expense.....	23,376,912	20,265,522
Consulting fees - D.E.M and D.O.H.....	2,478,586	2,349,948
Employee expense.....	456,403	395,474
Finance expense.....	2,101	2,593
Insurance expense.....	32,795	31,158
Legal fees.....	27,350	30,278
Office expense.....	82,773	87,619
Accounting, auditing, and arbitrage fees.....	18,572	26,655
Depreciation and amortization expense.....	319,541	272,314
Bank fees.....	94,354	79,915
Promotional expenses.....	8,737	10,358
Financial advisor fees.....	28,000	34,500
Dues and subscriptions.....	6,427	4,416
Seminars.....	1,470	1,455
Business and travel expense.....	7,124	7,734
Miscellaneous expense.....	1,858	3,336
Total operating expenses	<u>26,943,003</u>	<u>23,603,275</u>
Operating income.....	2,496,101	3,494,832
Nonoperating revenue:		
Grant income - non-operating.....	<u>23,930,655</u>	<u>23,985,353</u>
Changes in net assets.....	26,426,756	27,480,185
Net assets, beginning of the year	<u>291,762,418</u>	<u>264,282,233</u>
Net assets, end of the year	<u>\$318,189,174</u>	<u>\$291,762,418</u>

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2006 AND 2005**

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Cash receipts for operating grants.....	\$ 2,478,586	\$ 2,349,948
Cash receipts for loan origination fees.....	586,404	1,192,499
Cash receipts for service fees.....	2,473,961	1,964,324
Cash receipts for direct loan fees and other.....	122,552	132,047
Cash payments to suppliers.....	(6,487,257)	(782,700)
Cash payments to employees.....	(456,403)	(395,474)
Net cash provided by (used for) operating activities.....	(1,282,157)	4,460,644
Cash flows from capital and related financing activities:		
Purchases of property and equipment.....	(5,141)	(8,944)
Cash flows from non-capital financing activities:		
Proceeds from bond issuance.....	50,275,289	117,696,438
Repayment of bond principal.....	(17,890,000)	(19,650,000)
Non-operating grants received.....	23,930,655	23,985,353
Interest paid on revenue bonds.....	(23,714,880)	(20,011,853)
Bond issuance costs capitalized.....	(543,240)	(1,255,375)
Repayment of bond anticipation note.....	(7,719,000)	0
Net cash provided by non-capital financing activities.....	24,338,824	100,764,563
Cash flows from investing activities:		
Cash disbursed in lending activities, net.....	(74,151,964)	(83,664,916)
Investment income.....	9,828,448	8,595,597
Interest income – loan program.....	13,531,587	11,969,871
Purchase of investments.....	(66,319,823)	(114,365,520)
Proceeds from sale of investments.....	96,718,773	89,112,720
Net cash used for investing activities.....	(20,392,979)	(88,352,248)
Net increase in cash and cash equivalents.....	2,658,547	16,864,015
Cash and cash equivalents, beginning of the year.....	52,752,403	35,888,388
Cash and cash equivalents, end of the year.....	\$ 55,410,950	\$ 52,752,403
Reconciliation of operating income to net cash provided by (used for) operating activities:		
Operating income.....	\$ 2,496,101	\$ 3,494,832
Adjustments:		
Investment income.....	(9,832,761)	(9,322,111)
Interest income - loans.....	(13,945,467)	(12,635,671)
Interest expense.....	23,376,912	20,265,522
Depreciation/amortization.....	319,541	272,314
(Increase) decrease in prepaid expenses.....	4,663	(58,162)
Increase (decrease) in accounts payable and accrued expenses.....	(3,701,773)	1,945,427
Increase (decrease) in accrued arbitrage rebate.....	7,696	(124,890)
Increase in accounts receivable – service fees.....	(153,964)	(184,592)
Increase in deferred loan origination fees.....	146,895	807,975
Net cash provided by (used for) operating activities.....	\$ (1,282,157)	\$ 4,460,644

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Business Purpose and General Information

The Rhode Island Clean Water Finance Agency (Agency) was established by the State of Rhode Island Legislature as a body politic and corporate and public instrumentality of the State having distinct legal existence separate from the State and does not constitute a department of the State Government. The Agency was established for the express purpose of providing financial assistance in the form of loans to municipalities, sewer commissions and wastewater management districts in Rhode Island for the construction or upgrading of water pollution abatement projects. The Agency will be funded through Federal and State capitalization grants and is authorized to issue revenue bonds to finance the operation and administration of two state revolving fund loan programs.

The Agency commenced operations on July 29, 1990 and began lending activities during the first quarter of fiscal year 1992.

The Agency is a component unit of the State of Rhode Island for financial reporting purposes and as such, the financial statements of the Agency will be included in the State of Rhode Island's Comprehensive Annual Financial Report. The Agency is not subject to Federal or State income taxes.

The Agency adopted the provisions of Governmental Accounting Standards Board Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of activities and changes in net assets, and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in capital assets, net of related debt* – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.
- *Restricted* – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. The Agency's net assets are restricted by debt covenants and grantor restrictions.
- *Unrestricted net assets* – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

(b) Basis of Accounting

The financial statements of the Agency have been prepared on the accrual basis.

The Agency has elected not to apply Financial Accounting Standards Boards statements and interpretations, accounting principles, board opinions, and Accounting Research Bulletins of the Committee of Accounting Procedures issued after November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(c) Fund Accounting

In order to ensure observation of limitations and restrictions placed on the use of resources available to the Agency, the accounts of the Agency will be maintained in accordance with the principles of "Fund Accounting". This is a procedure by which resources for various purposes are classified for accounting and reporting purposes into funds that are in accordance with activities or objectives specified. Separate accounts are maintained for each fund; however, funds will be combined for the presentation of the Agency's financial position and results of operations.

There are currently four separate funds included in the accompanying financial statements:

Water Pollution Control Revolving Fund (WPCRF) – accounts for activity relating to the administering of the Federal Title VI SRF Loan Program (also known as the Clean Water SRF Program).

Rhode Island Water Pollution Control Revolving Fund (RIWPCRF) – accounts for activity relating to the administering of the State SRF Loan Program.

Operating Fund – accounts for the operating activities of the Agency as well as for servicing loans for the Clean Water SRF, the Drinking Water SRF, and the Drinking Water SRF Set-Aside Programs.

Drinking Water State Revolving Fund (DWSRF) – accounts for activity relating to the administering of the Drinking Water SRF Loan Program.

(d) Investment Income

Interest earned on investments is recognized as income in the fund in which the investments are held.

(e) Investments

The Agency's investments as of June 30, 2006 and 2005 consisted of Treasury obligations, U.S. guaranteed securities in the form of Repurchase Agreements and Guaranteed Investment Contracts (both restricted and unrestricted yields by the Indenture of Trust dated February 15, 1992 and subsequent amendments, between the trustee and the Agency). The Municipal Bond Investors Assurance Corporation and AMBAC has imposed restrictions on indentured funds as to the types of investments the Agency can purchase. These include obligations of the United States government or certain Agencies thereof, guaranteed investment contracts, repurchase agreements, certificates of deposit, money market funds, commercial paper, and notes or bonds of any State meeting specific rating requirements.

Guaranteed Investment Contract providers (GIC providers) are limited to financial institutions rated at least AA, Aa2 and AA from Standard & Poor's, Moody's and Fitch, respectively, or the equivalent for financial strength rating or claims paying ability. The GIC provider must meet the following ratings from S&P, Moody's and Fitch: domestic banks rated at least "AA/Aa2/AA"; US branches of foreign banks rated at least "AA/Aa2/AA" or "AA/Aa2/AA"; insurance companies (or corporations whose obligations are guaranteed by an insurance company (in the form of an insurance policy) or by an insurance holding company) rated "AAA/Aaa/AAA". The provider must be acceptable to the Issuer, MBIA and Ambac.

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Investments (Continued)

Should the GIC Provider's rating be suspended, withdrawn or downgraded below AA- Fitch, Aa3 by Moody's or AA – by S&P during the term of the Agreement, the Provider must notify the Trustee and, within fifteen (15) days of receipt of notice from the Trustee: (i) provide to the Trustee, or other mutually agreed upon third party custodian, collateral which will be valued and held such that the Provider maintains the applicable minimum rating for the duration and purpose of this Investment, or (ii) at the request of the Trustee, assign the Agreement to an eligible substitute provider, or (iii) at the request of the Trustee, repay the amount on deposit, plus accrued interest to the Trustee.

In accordance with Section 35-10.1-7 of the General Laws of the State of Rhode Island, dealing with the collateralization of public deposits, all time deposits with maturities of greater than 60 days and all deposits in institutions that do not meet its minimum capital standards as required by its Federal regulator must be collateralized. The Agency did not have any deposits in fiscal year 2006 and 2005 which required collateralization based on the aforementioned criteria.

GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," was implemented during 1998. Fair values are established by quoted market values. Unrealized gains and losses from the changes in fair value are recognized as investment income.

(f) Cash and Cash Equivalents

Cash equivalents include repurchase agreements with maturities of three months or less when purchased.

The Agency's cash management program includes the automatic "sweeping" of the Agency's bank accounts into overnight collateralized repurchase agreements. The Agency had repurchase agreements of \$17,401,042 and \$16,916,810 at June 30, 2006 and 2005, respectively.

(g) Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on the straight-line basis over the estimated useful lives of the assets. Depreciation expense for fiscal years 2006 and 2005 totaled \$12,536 and \$16,349, respectively. The Agency's capitalization threshold is any individual item with a total cost greater than \$500.

Depreciation is provided by use of the straight-line method over the following estimated useful lives of the assets:

<u>Asset Category</u>	<u>Estimated Useful Life</u>
Computer equipment	3 years
Equipment, furniture, and fixtures	3 – 5 years
Leasehold improvements	7 – 20 years

(h) Accrued Arbitrage Rebate

Investment income is limited to the bond yield on certain tax-exempt bond issues. Interest income in excess of this limit has been reserved for rebate in accordance with applicable financing documents. Investment income earned in excess of the allowable amounts will be remitted to the Federal Government as required by the applicable laws and regulations.

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Loan Related Fees and Costs

Loan fees and certain direct loan origination costs are deferred, and the net fee is recognized in income using the effective yield method over the contractual life of the loans. The Agency had unamortized deferred loan origination fees totaling \$5,103,816 and \$4,956,921 at June 30, 2006 and 2005, respectively.

(j) Bond Issuance Costs

Costs relating to bond issuance consist of professional fees and staff expenses and are capitalized and amortized on a straight-line basis over the life of the bond or to the date at which the Agency has the right to redeem the bond, whichever is less. Amortization expense for fiscal years 2006 and 2005 totaled \$307,004 and \$255,965, respectively.

(k) Bond Premium

Bond premiums are amortized using the effective interest method over the respective lives of the serial bonds. Amortization of bond premiums, which are charged against interest expense, totaled \$736,698 and \$572,734 for fiscal years 2006 and 2005, respectively.

(l) Allowance for Loan Losses

Management reviews loan receivable balances on a periodic basis for possible uncollectible amounts. In the event management determines a specific need for an allowance, provision for loss will then be provided. Should a borrower default on a loan, the remedy is found in the loan agreement which is backed by the full taxing power of the borrowing municipality in the form of a general obligation pledge or in the full revenue collecting ability of the Agency's revenue borrowers. Further, the Indenture of Trust as it relates to the Local Interest Subsidy Trust (LIST) serves as a debt service reserve fund. Based upon prior years' experience and management's evaluation of outstanding loan receivable balances, no allowance for loan losses has been provided at June 30, 2006 and 2005.

(m) Grant Revenue

The Agency recognizes state and federal grant revenues upon the acceptance of their request for drawdown of these revenues by the grantor agency.

(n) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(o) Operating Revenues and Expenses

Operating revenues and expenses consist of items related to the operating activities of the Agency, such as service fees, loan origination fees, and interest earned on loans receivable, and administrative expenses incurred by operations. All other revenues and expenses not meeting this criteria are reported as nonoperating revenue and expenses.

(p) Restricted Assets

Restricted assets of the Agency represent monies designated for debt service reserve and to subsidize borrower interest rates.

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(q) Recently Issued Accounting Standards

The Agency implemented GASB No. 40, Deposits and Investment Risk Disclosures, for the year ended June 30, 2005 which changed the way the Agency presents the details of its cash and investment disclosures.

The Agency adopted the following accounting pronouncements for the year ended June 30, 2006:

- √ GASB Statement No. 42 - Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.
- √ GASB Statement No. 46 – Net Assets Restricted by Enabling Legislation (an amendment of GASB Statement No. 34).
- √ GASB Statements No. 47 – Accounting for Termination Benefits.

The adoption of these Statements did not have an impact on the Agency's financial position or results of operations.

The Agency will adopt the following new accounting pronouncement in future years:

- √ GASB Statement No. 45 - Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions, effective for the Agency's fiscal year ending June 30, 2008.

The impact of this pronouncement on the Agency's financial statements has not been determined.

(r) Income Tax

The Agency is exempt from federal and state income taxes.

2. BONDS PAYABLE

Since its inception, the Agency has issued revenue bonds to local governments to finance water pollution abatement projects. The bonds are special obligations of the Agency payable solely from and secured by the particular funds, assets or revenues, generated by the Borrower Bonds. The Bonds do not constitute an indebtedness of the State or any of its subdivisions and none of its revenues are pledged. The Agency has no taxing power.

The Agency has the following revenue bonds outstanding at June 30:

	<u>2006</u>	<u>2005</u>
Water Pollution Control Revolving Fund Revenue Bonds:		
1992 Series A Bonds, dated February 15, 1992, with serial bonds of \$15,875,000 at rates varying from 3.5% to 6.6% due annually from October 1, 1993 through October 1, 2008 and term bonds of \$2,390,000 at 6.7% due October 1, 2010 and \$2,650,000 at 6.75% due October 1, 2013. On February 4, 1999, the Agency advance refunded \$9,210,000 of the outstanding bonds	\$ 900,000	\$ 1,120,000

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

2. BONDS PAYABLE (Continued)

	<u>2006</u>	<u>2005</u>
Water Pollution Control Revolving Fund Revenue Bonds (Continued):		
1993 Series A Bonds, dated February 15, 1993, with serial bonds of \$23,450,000 at rates varying from 3.8% to 9.2% due annually from October 1, 1996 through October 1, 2010 and a term bond of \$10,185,000 at 5.4% due October 1, 2015	19,320,000	21,010,000
1994 Series A Bonds, dated June 1, 1994, with serial bonds of \$18,495,000 at rates varying from 5.0% to 7.7% due annually from October 1, 1995 through October 1, 2012 and a term bond of \$3,935,000 at 5.875% due October 1, 2015. On February 4, 1999, the Agency advance refunded \$5,725,000 of the outstanding bonds....	6,800,000	7,910,000
1995 Series A Bonds, dated December 15, 1995, at rates varying from 4.15% to 7.00% due annually from October 1, 1997 through October 1, 2016	3,600,000	3,930,000
1999 Series A Bonds, dated January 1, 1999, with serial bonds of \$19,590,000 at rates varying from 3.7% to 5.25% due annually from October 1, 2002 through October 1, 2016 and term bonds of \$3,765,000 at 4.75% due October 1, 2018 and \$2,470,000 at 4.75% due October 1, 2020	24,675,000	24,970,000
1999 Series C Bonds, dated August 1, 1999, with serial bonds of \$24,010,000 at rates varying from 4.15% to 5.50% due annually from October 1, 2001 through October 1, 2019	19,165,000	20,325,000
2000 Series A Bonds, dated December 1, 2000 with serial bonds of 26,550,000 at rates varying from 4.50% to 5.125% due annually from October 1, 2001 through October 2020	20,930,000	22,080,000
2002 Series A Bonds, dated April 1, 2002, with serial bonds of \$29,305,000 at rates varying from 3.00% to 5.50% due annually from October 1, 2002 through October 1, 2022	25,710,000	26,890,000
2002 Series B Bonds, dated October 1, 2002, with serial bonds of \$76,035,000 at rates varying from 2.0% to 5.0% due annually from October 1, 2004 through October 1, 2022	67,300,000	70,650,000
2003 Series A Bonds, dated May 22, 2004, with serial bonds of \$14,870,000 at rates varying from 1.220% to 4.280% due annually from October 1, 2005 through October 1, 2023	14,320,000	14,870,000
2003 Series B Bonds, dated November 13, 2004, with serial bonds of \$67,965,000 at rates varying from 2.00% to 5.250% due annually from October 1, 2005 through October 1, 2024	64,965,000	67,965,000
2004 Series A Bonds, dated December 30, 2004, with serial bonds of \$69,625,000 at rates varying from 2.50% to 5.00% due annually from October 1, 2005 through October 1, 2025	67,950,000	69,625,000

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

2. BONDS PAYABLE (Continued)

	<u>2006</u>	<u>2005</u>
Water Pollution Control Revolving Fund Revenue Bonds (Continued):		
2005 Series A Bonds, dated December 15, 2005, with serial bonds of \$49,080,000 at rates varying from 4.00% to 5.00% due annually from October 1, 2006 through October 1, 2026	49,080,000	0
Safe Drinking Water Revenue Bonds:		
2003 Series A Bonds, dated December 17, 2003, with term bonds of \$5,840,000 at 5.00% due annually from October 1, 2025 through October 1, 2028 and term bonds of \$13,500,000 at 5.00% due annually from October 1, 2029 through October 1, 2035.....	19,340,000	19,340,000
2003 Series B bonds (federally taxable), dated December 17, 2003, with term bonds of \$7,655,000 at 6.00% due annually from October 1, 2025 through October 1, 2035	7,655,000	7,655,000
2004 Series A Bonds, dated March 11, 2004, with serial bonds of \$40,170,000 at rates varying from 2.00% to 5.00% due annually from October 1, 2005 through October 1, 2024	39,025,000	40,170,000
2005 Series A Bonds, dated March 23, 2005, with serial bonds of \$42,960,000 at rates varying from 3.00% to 5.00% due annually from October 1, 2006 through October 1, 2027	42,960,000	42,960,000
Wastewater Treatment System Revenue Bonds:		
1997 Series Bonds, dated August 1, 1997. The Series 1997 Bonds mature on September 1, 2022, with sinking fund payments due on September 1, 1999, and September 1, 2018 through September 1, 2022, inclusive. Interest of 5.8% is due annually on March 1, and September 1.....	28,490,000	28,490,000
Refunding Bonds:		
1999 Series B Bonds, dated January 1, 1999 with serial bonds of \$16,830,000 at rates varying from 3.0% to 4.75% due annually from October 1, 1999 through October 1, 2015	13,665,000	14,700,000
Subtotal	535,850,000	504,660,000
Less: amount deferred on refunding	(995,822)	(1,104,616)
Add: bond premium (discount) net of amortization	14,345,403	13,886,813
Total bonds payable	<u>\$549,199,581</u>	<u>\$517,442,197</u>

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

2. BONDS PAYABLE (Continued)

The following schedule reflects the changes in bonds payable:

	<u>June 30, 2006</u>	<u>June 30, 2005</u>
Balance at beginning of the year	\$504,660,000	\$411,725,000
Additions	49,080,000	112,585,000
Retirements.....	<u>(17,890,000)</u>	<u>(19,650,000)</u>
Balance at end of the year	<u>\$535,850,000</u>	<u>\$504,660,000</u>

Annual principal and interest requirements are as follows for the years ending June 30:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007.....	\$ 21,830,000	\$ 24,377,958	\$ 46,207,958
2008	24,530,000	23,545,869	48,075,869
2009	25,885,000	22,563,436	48,448,436
2010	26,300,000	21,521,951	47,821,951
2011	26,700,000	20,461,765	47,161,765
2012 - 2016	135,925,000	84,341,478	220,266,478
2017 - 2021	145,125,000	51,603,320	196,728,320
2022 - 2026	100,190,000	16,977,924	117,167,924
2027 - 2031	15,140,000	5,451,255	20,591,255
2032 - 2036	<u>14,225,000</u>	<u>1,961,375</u>	<u>16,186,375</u>
Total	<u>\$535,850,000</u>	<u>\$272,806,331</u>	<u>\$808,656,331</u>

Advanced Refunding of Debt

On February 4, 1999, the Agency issued the 1999 Series B Subordinated Refunding Bonds. The proceeds from this issue were used to defease portions of the 1992 and 1994 Series A Bonds. The Agency established an irrevocable escrow trust fund pursuant to a Refunding Trust Agreement between the Agency and US Bank Corporate Trust Services. The escrow fund is irrevocably pledged solely for the repayment of principal, redemption premium, if any, and interest on the aforementioned refunded bonds. Under the escrow agreement, the refunded bonds will be called for redemption at each series first applicable optional redemption date. As those bonds have, in effect, been redeemed under the defeasance, they are no longer outstanding under the Agency's Basic Bond Resolution and, therefore, they are not entitled to the pledge of the Basic Bond Resolution. Accordingly, these bonds and the related escrow funds are not reflected in these financial statements as of June 30, 2006 and 2005.

The following represents the refunded bonds and principal amount refunded:

<u>Series</u>	<u>Refunding Date</u>	<u>Principal Amount Refunded</u>	<u>Defeased Bonds Outstanding June 30, 2006</u>
1992	February 4, 1999	\$ 9,210,000	\$0
1994 A	February 4, 1999	<u>5,725,000</u>	<u>0</u>
	Total.....	<u>\$14,935,000</u>	<u>\$0</u>

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

2. BONDS PAYABLE (Continued)

Advanced Refunding of Debt (Continued)

The difference between the net carrying amount of the refunded bonds and the amount placed in escrow was \$1,469,895. This amount has been deferred and is being amortized over the shorter of the remaining life of the refunding bonds or the life of the 1994 Series A Bonds. The amount deferred on refunding is shown in the financial statements as a reduction of bonds payable and is being charged to operations through the fiscal year ending June 30, 2016 using the straight-line method, since use of the effective interest method is not deemed to be materially different. Amortization totaling \$87,755 was recorded in fiscal years 2006 and 2005. The Agency completed the advance refunding to reduce its total debt service payments over the next 17 years by \$1,351,567 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of approximately \$956,000.

Current Refunding

During fiscal year 2005, the Agency refunded its 1994 Series A bonds dated December 1, 1994 with an outstanding balance of \$7,765,000. The difference between the amount required to repay the previously issued debt (reacquisition price) and the net carrying amount of the old debt was \$210,388. This amount has been deferred and is being amortized over the shorter remaining life of the refunded bonds (120 months). The amount deferred on refunding is reported in the financial statements as a reduction of bonds payable and is being charged to operations through fiscal year ending 2015 using the straight-line method, since use of the effective interest method is not deemed to be materially different. Amortization totaling \$21,039 and \$5,260 was recorded in fiscal years 2006 and 2005, respectively. The Agency completed the current refunding to reduce its debt service payments over the next ten years by \$1,564,216 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of approximately \$1,213,000.

Bond Anticipation Note

On March 9, 2004, the Agency issued a 2004 Series A Bond Anticipation Note on behalf of a local community to provide interim financing. The Note principal was \$7,719,000, had an original maturity date of March 1, 2007, and required interest at 2.60%. The note was repaid in full on January 17, 2006.

3. LOANS RECEIVABLE

At June 30, 2006 and 2005, the Agency had loans receivable of \$618,202,955 and \$544,050,991 representing 107 and 94 outstanding loans, respectively. At June 30, 2006 and 2005, the current portion of loans receivable (net of loan origination fees) totaled \$29,054,673 and \$21,813,997, respectively. In addition, at June 30, 2006 and 2005, the Agency had outstanding unused commitments totaling approximately \$69,914,420 and \$118,129,964 for the disbursement of future loans. For financial reporting purposes on the statement of net assets, total 2006 outstanding loans receivable of \$618,202,955 have been reduced by unamortized loan origination fees totaling \$5,103,816. For 2005, total outstanding loans receivable of \$544,050,991 have been reduced by unamortized loan origination fees totaling \$4,956,921.

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

3. LOANS RECEIVABLE (Continued)

The borrowers are obligated to repay the full balance of loan agreements; however, funds are disbursed by the Agency in accordance with the loan agreements as costs are incurred for the projects for which the loans are intended. The Agency disburses funds to the borrowers and/or vendors, no more than once a month, after receipt of an official request for disbursement, which is accompanied by supporting documentation. The Agency is obligated to disburse funds only up to the value of the loan agreement, and is not responsible for any excess costs incurred by the borrower. The borrower, in turn, is obligated to make principal and interest payments in accordance with the repayment schedules per the loan documentation even if funds have not been fully disbursed by the Agency at the time of first payment. Loans are usually repaid over 20 years with either level principal or level total payments. The balances of the loan agreements may include financing for the interest expense to be incurred by the borrowers during the period of construction.

The Agency has established a Local Interest Subsidy Trust (LIST) Fund, which is restricted by the Indenture of Trust between the trustee and the Agency and may be used to make the required bond payments in the event of default by the borrowers.

At June 30, 2006, the Agency had outstanding loans receivable to two borrowers representing 58% of the Agency's total loan receivable balance. At June 30, 2005, the Agency had outstanding loans receivable to three borrowers representing 70% of the Agency's total loan receivable balance.

4. CASH, CASH EQUIVALENTS, INVESTMENTS AND RESTRICTED LIST INVESTMENTS

(a) Cash

Custodial Credit Risk, Deposits - The Agency does not have a deposit policy for custodial credit risk.

At June 30, 2006, the carrying amount of the Agency's cash balance was \$38,009,908. The bank balance was \$38,188,266 as of the same period. Of the bank balance at June 30, 2006, \$100,000 was covered by the Federal Depository Insurance Corporation (the "FDIC"), and \$38,088,266 (\$37,863,266 was held in money market trust accounts), was uninsured.

At June 30, 2005, the carrying amount of the Agency's cash balance was \$35,835,593. The bank balance was \$35,960,495 as of the same period. Of the bank balance at June 30, 2005, \$100,000 was covered by the Federal Depository Insurance Corporation (the "FDIC"), and \$35,860,495 (\$35,735,495 was held in money market trust accounts), was uninsured.

(b) Cash Equivalents, and Other Investments

The table below categorizes the Agency's investments so as to provide an indication of the level of market risk and credit risk assumed by the Agency at year end. Market risk is the risk that the market value of an investment, collateral securing the investment or securities underlying a repurchase agreement will decline. Credit risk can be associated with the issuer of a security, with a financial institution holding deposits, or with the custodian of securities or collateral. Category 1 includes insured or registered securities held by the Agency or its agent in the Agency's name. Category 2 includes uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Agency's name. Category 3 includes uninsured and unregistered with securities held by the counterparty or by its trust department or agent, but not in the Agency's name. The Agency does not have any investments within Category 3, and therefore is not subject to the custodial credit risk disclosures of GASB 40.

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

4. CASH, CASH EQUIVALENTS, INVESTMENTS AND RESTRICTED LIST INVESTMENTS (Continued)

(b) Cash Equivalents, and Other Investments (Continued)

At June 30, 2006 the investments held by the Agency were as follows:

<u>Description</u>	<u>Category</u>			<u>Fair Value</u>
	<u>1</u>	<u>2</u>	<u>3</u>	
Cash Equivalents:				
Collateralized Repurchase Agreements...	\$17,401,042	\$ 0	\$0	\$17,401,042
Other Investments:				
Federal National Mortgage Association ...		12,818,000		12,818,000
Collateralized Repurchase Agreements...	14,603,686			14,603,686
Subtotal	<u>\$32,004,728</u>	<u>\$12,818,000</u>	<u>\$0</u>	
Other Investments not subject to categorization:				
Collateralized Investment Contracts				67,672,327
Uncollateralized Investment Contracts				<u>97,793,817</u>
Subtotal				<u>192,887,830</u>
Total other investments				<u>\$210,288,872</u>

The following investment contracts represented more than 5% of the Agency's total investments at June 30, 2006:

	<u>Amount</u>	<u>Maturity Date</u>	<u>Interest Rate</u>
Collateralized Repurchase Agreements:			
Westdeutsche Landesbank	\$10,664,486	2019	6.28%
Collateralized Investment Contracts:			
AIG Matched Funding Corp	\$12,350,146	2022	4.75%
FSA Capital Management Services, LLC.	\$12,200,592	2024	4.71%
FSA Capital Management Services, LLC.	\$15,506,046	2025	4.67%
Uncollateralized Investment Contracts:			
Bayerische Landesbank	\$14,580,032	2009	5.33%
AIG Matched Funding Corp	\$17,693,843	2024	4.18%
XL Asset Funding	\$22,336,870	2007	4.44%
Transamerica Occidental Life Insurance Company	\$11,388,078	2025	4.77%
XL Asset Funding	\$20,178,458	2008	3.67%

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

4. CASH, CASH EQUIVALENTS, INVESTMENTS AND RESTRICTED LIST INVESTMENTS (Continued)

(b) Cash Equivalents, and Other Investments (Continued)

At June 30, 2005, the investments held by the Agency were as follows:

<u>Description</u>	<u>Category</u>			<u>Fair Value</u>
	<u>1</u>	<u>2</u>	<u>3</u>	
Cash Equivalents:				
Collateralized Repurchase Agreements...	\$16,916,810	\$ 0	\$0	\$ 16,916,810
Other Investments:				
Federal National Mortgage Association ...		13,889,000		13,889,000
Collateralized Repurchase Agreements...	26,249,579			26,249,579
Subtotal	<u>\$43,166,389</u>	<u>\$13,889,000</u>	<u>\$0</u>	
Other Investments not subject to categorization:				
Collateralized Investment Contracts				70,486,033
Uncollateralized Investment Contracts.....				<u>112,662,168</u>
Subtotal				<u>223,286,780</u>
Total other investments				<u>\$240,203,590</u>

The following investment contracts represented more than 5% of the Agency's total investments at June 30, 2005:

	<u>Amount</u>	<u>Maturity Date</u>	<u>Interest Rate</u>
Collateralized Investment Contracts:			
AIG Matched Funding Corp	\$12,927,372	2022	4.75%
FSA Capital Management Services, LLC.	\$12,764,000	2024	4.71%
FSA Capital Management Services, LLC.	\$15,888,700	2025	4.67%
Uncollateralized Investment Contracts:			
Bayerische Landesbank.....	\$14,591,283	2009	5.33%
AIG Matched Funding Corp	\$18,212,983	2024	4.18%
XL Asset Funding, LLC	\$26,967,631	2008	3.67%
Citigroup Financial Products, Inc	\$34,392,364	2006	2.68%

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

5. CAPITALIZATION GRANTS

(a) Clean Water State Revolving Fund (CWSRF):

The Agency receives capitalization grants from the Environmental Protection Agency for the Clean Water State Revolving Fund under Title VI of the Clean Water Act. These grants are used to fund the Agency's lending activities and to reimburse the State Department of Environmental Management for up to 4% of the capitalization grant for expenses incurred for services they provide the Agency related to these lending activities. In order to obtain the federal monies under the Title VI grant program, the Agency must also obtain a commitment for state matching funds of 20% of the federal award.

The following is a table of the federal and state matching funds awarded to the Agency and the balances remaining for drawdown under Title VI of the Clean Water Act as of June 30, 2006:

<u>Grant Year</u>	<u>Award</u>	<u>Balance Remaining for Drawdown</u>
1995:		
Federal award	\$ 8,254,100	\$ 0
State match	1,650,820	0
1996:		
Federal award	13,547,500	169,178
State match	2,709,500	0
1997:		
Federal award	4,127,100	164,460
State match	825,420	0
2001:		
Federal award	8,921,900	0
State match	1,784,380	0
2003:		
Federal award	8,883,300	57,682
State match	1,776,660	0
2004:		
Federal award	8,888,700	230,528
State match	1,777,740	0
2005:		
Federal award	7,208,600	0
State match	1,441,720	0
2006:		
Federal award (applied for August 2006)	5,839,300	5,839,300
State match (applied for August 2006)	1,167,860	1,167,860

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

5. CAPITALIZATION GRANTS (Continued)

(b) Drinking Water State Revolving Fund (DWSRF)

The Agency also receives capitalization grants from the Environmental Protection Agency for the Drinking Water State Revolving Fund under Section 1452 of the Safe Drinking Water Act Amendments of 1996. The grants will be used to provide loans to water suppliers for system improvements and to provide funding for various improvement programs administered by the RI Department of Health to bring water suppliers in the State up to the minimum standards promulgated by the Safe Drinking Water Act. As in the Clean Water SRF, up to 4% is to be used for program administration by both the Agency and Department of Health. In order to receive the funding from E.P.A., the Agency must commit 20% of the Federal award in the form of State matching funds. The Agency agrees to provide, through methods available to it, the appropriate state matching funds to each grant.

The following table shows the DWSRF federal awards and remaining balances as of June 30, 2006:

<u>Grant Year</u>	<u>Award</u>	<u>Balance Remaining for Drawdown</u>
1997:		
Federal award	\$12,558,800	\$ 772,577
State match	2,511,760	0
1998:		
Federal award	7,121,300	139,178
State match	1,424,260	0
1999:		
Federal award	7,463,800	156,348
State match	1,492,760	0
2000:		
Federal award	7,757,000	84,581
State match	1,551,400	0
2001:		
Federal award	7,789,100	217,690
State match	1,557,820	0
2002:		
Federal award	8,052,500	1,234,184
State match	1,610,500	0
2003:		
Federal award	8,004,100	6,157,264
State match	1,600,820	0
2004:		
Federal award	8,303,100	8,303,100
State match	1,660,620	1,660,620
2005:		
Federal award	8,285,500	8,285,500
State match	1,657,100	1,657,100

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

6. DEFERRED COMPENSATION

The Agency offers its employees "The Rhode Island Clean Water Protection Finance Agency Deferred Compensation Plan" (the Plan) created in accordance with Internal Revenue Code Section 457. The Plan, available to all Agency employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. The Agency's Board of Directors is responsible for establishing or amending the Plan's provisions and establishing or amending contribution requirements. The Plan is currently administered by ING Life Insurance and Annuity Company.

The Agency implemented the Governmental Accounting Standards Board, Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. All assets and income of the plan are held in trust for the exclusive benefit of the participants and their beneficiaries. As a result, deferred compensation investments and the respective liability have been removed from the Agency's financial statements for the years ended June 30, 2006 and 2005.

The Agency is obligated to remit to the administrator an amount equal to 5% of employee compensation on a monthly basis. The Agency's contribution totaled \$17,177 and \$15,430 for the years ended June 30, 2006 and 2005, respectively. Employees are allowed to make contributions to the plan up to, but not exceeding, the lesser of 33 1/3% of their individual compensation or \$15,000 (\$20,000 if age 50 or older) for 2006. There is no additional obligation incurred by the Agency as a result of the employee contributions. The Agency has an obligation to prudently manage these monies. Beginning in fiscal year 2007 the employer match has been increased to 10%.

7. OPERATING LEASE

On June 1, 1998, the Agency entered into a seven-year lease for the rental of its corporate offices. During fiscal year 2006, the Agency incurred rent expense of \$49,805, consisting of rent expense of \$49,744 plus \$61 in additional property tax assessments. During fiscal year 2005, the Agency incurred rent expense of \$49,840, consisting of scheduled lease payments of \$48,528, plus \$1,312 in additional property tax assessments. On April 10, 2003, the Agency amended its existing lease agreement due to the expansion of its facilities. The new lease is for a period of 60 months commencing June 1, 2003 and expires May 2008.

The following schedule summarizes the Agency's required future minimum lease payments:

<u>Year Ending June 30:</u>	<u>Amount</u>
2007.....	\$49,744
2008.....	<u>45,599</u>
Total	<u>\$95,343</u>

(CONTINUED)

RHODE ISLAND CLEAN WATER FINANCE AGENCY

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

8. PROPERTY AND EQUIPMENT

The summary of changes in property and equipment at June 30, 2006 are summarized below:

	<u>Balance at June 30, 2005</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance at June 30, 2006</u>
Cost:				
Computers.....	\$ 54,498	\$ 5,141	\$2,705	\$ 56,934
Furniture and fixtures	20,406			20,406
Equipment.....	15,424			15,424
Leasehold Improvements.....	29,701			29,701
Total cost	<u>120,029</u>	<u>5,141</u>	<u>2,705</u>	<u>122,465</u>
Accumulated depreciation:				
Computers.....	43,569	6,372	2,705	47,236
Furniture and fixtures	10,352	3,001		13,353
Equipment.....	13,524	1,678		15,202
Leasehold Improvements.....	2,228	1,485		3,713
Total accumulated depreciation	<u>69,673</u>	<u>12,536</u>	<u>2,705</u>	<u>79,504</u>
Net capital assets	<u>\$ 50,356</u>	<u>\$ (7,395)</u>	<u>\$ 0</u>	<u>\$ 42,961</u>

9. COMMITMENTS AND CONTINGENCIES

Capitalization Grants

The Rhode Island Clean Water Finance Agency receives grants from the Environmental Protection Agency (EPA) and the State of Rhode Island to fund its loan program activities. The activities of these programs through June 30, 2006 were subject to an audit under the Single Audit Act of 1996 by our independent auditors. In addition to being audited in accordance with the Single Audit Act of 1996, oversight agencies require periodic compliance audits by the grantors or their representatives. The Environmental Protection Agency conducts annual fiscal and regulatory compliance reviews to determine that Agency activities are in compliance with EPA regulations. As of June 30, 2006, no expenditures of the Agency have been disallowed. Agency officials believe that any future disallowance of expenditures would not be material.

10. DESIGNATION OF UNRESTRICTED NET ASSETS

The Agency's Board has designated its unrestricted net assets as follows:

Operating Fund - Interim/Short-term Loan Program

On October 4, 2004, the Board voted to designate all net assets in excess of the Agency's annual operating budget to be used for interim and short-term loans to qualified borrowers.

11. RISK MANAGEMENT

The Agency is exposed to various risks of loss related to tort; theft of, damage to, and destruction of assets; errors or omissions and injuries to employees. As a result, the Agency has purchased commercial insurance to protect itself from potential liabilities from losses or claims. To date, the Agency has not incurred any claims or losses. Accordingly, management has estimated the reserve for such claims to be \$0 at June 30, 2006 and 2005.

(CONCLUDED)