



ANNUAL FINANCIAL REPORT

Fiscal Year Ended June 30, 2003

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Compliance

Report of Independent Certified Public Accountants on
Compliance and on Internal Control Over Financial Reporting
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards*

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INTRODUCTION

The Beaufort-Jasper Water and Sewer Authority, hereafter referred to as the “Authority,” is pleased to present its fourth Annual Financial Report developed in compliance with Statement of Governmental Accounting Standard No. 34, entitled “Basic Financial Statements – and Management’s Discussion and Analysis – For State and Local Governments” (hereafter “GASB 34”), and related standards. Although GASB 34 did not require implementation by the Authority until this fiscal year, management elected early implementation to enhance information provided to the users of its financial statements, and the Governmental Accounting Standards Board (GASB) has recognized the Authority for early implementation. The Annual Financial Report is also made available via the Internet (www.bjwsa.org). The use of the Internet is consistent with the Authority’s objective to provide greater information to the public in a more efficient manner, reducing paperwork, labor and communications costs. Recommendations for further enhancement to the Annual Financial Report are welcome, and may be submitted via our website.

Mission

The mission of the Authority is to protect the public health and the environment by providing (1) abundant, affordable and high quality drinking water; (2) environmentally sound and affordable wastewater treatment and disposal; and (3) efficient, reliable and courteous service. This mission serves as the foundation for the Authority’s Strategic Plan, operational and financial initiatives of the departments and functions, and performance development for employees and systems. The Annual Financial Report is one of many tools used to communicate historical financial condition and performance results.

Responsibility and Controls

The Authority has prepared and is responsible for the financial statements and related information included in this report. A system of internal accounting controls is maintained to provide reasonable assurance that assets are safeguarded and that the books and records reflect only authorized transactions. Limitations exist in any system of internal controls. However, based on recognition that the cost of the system should not exceed its benefits, management believes its system of internal accounting controls maintains an appropriate cost/benefit relationship.

The Authority’s system of internal accounting controls is evaluated on an ongoing basis by the Authority’s internal financial staff. Independent external auditors also consider certain elements of the internal control system in order to determine their auditing procedures for the purpose of expressing an opinion on the financial statements.

The Finance Committee of the Authority Board of Directors serves the role of an Audit Committee. It is composed of three members of the Board who are not employees and who provide a broad overview of management’s financial reporting and control functions. Periodically, this Committee meets with management and the independent external auditors to ensure these groups are fulfilling their obligations and to discuss auditing, controls, and financial reporting matters.

Management believes that its policies and procedures provide guidance and reasonable assurance that the Authority’s operations are conducted according to management’s intentions and to a high standard of business ethics. In management’s opinion, the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the Authority in conformity with accounting principles generally accepted in the United States of America.

Audit Assurance

The unqualified (i.e. clean) opinion of our independent external auditors, Cherry, Bekaert & Holland, L.L.P., is included in this report. They have also performed a Single Audit of the Authority's federal awards, for which unqualified reports were the result. A summary of the Single Audit results may be found on the Authority's website, and the Data Control Form related to the Single Audit may be found on the Office of Management and Budget's website at <http://harvester.census.gov/sac>.

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section presents management's analysis of the Authority's financial condition and activities for the year. This information should be read in conjunction with the financial statements.

Financial Highlights

Management believes the Authority's financial condition is strong. The Authority is well within its debt covenants and the more stringent financial policies and guidelines set by the Board and management. The following are key financial highlights:

- The Authority issued \$47.14 million of revenue bonds in November 2001 to construct a new ultimate 45-MGD capacity water treatment plant in Jasper County, along with related transmission and distribution assets, and to refund \$5.835 million of higher rate revenue bonds and loan obligations. Construction of the 10-MGD phase one began in fiscal year 2002, with an expected completion date during the latter months of fiscal year 2004. At the end of this fiscal year, the water plant and the transmission main associated with the plant, represented 56% of the total cost in construction in progress.
- The Authority adopted a general consumption water and sewer rate increase of approximately 3.5% for most retail customers effective July 1, 2002. The Board has approved a Capital Improvement Program and has anticipated rate increases for the next three additional fiscal years to cover the supporting capital debt. Wholesale water customers' rates were also increased by varying amounts effective July 1, 2002 and are expected to remain at the same levels until fiscal year 2006. Additionally, the Authority increased capital contribution fees for water by 18% and for sewer by 30%, effective September 1, 2002. These fees are charged to all new customers who connect to the system.
- Total assets at year-end were \$254 million and exceeded liabilities in the amount of \$144 million (i.e. net assets). Of the \$18 million classified as unrestricted, \$12.2 million was board-restricted for capital activity and \$5.8 million was available to support short-term operations. Total assets and total net assets increased \$26 million and \$17 million, respectively. Unrestricted net assets increased by approximately \$2.7 million, due to an increase of \$1.4 million in board-restricted funds and an increase of \$1.2 million in funds available to support short-term operations. For the current fiscal year, sufficient operating income (excluding depreciation) and interest income was generated to cover the debt service and contributions to the contingency and depreciation fund (restricted asset), leaving a positive increase in unrestricted net assets available to support current operations.

- Debt service coverage, including capital contribution fees, was 242%, exceeding the 110% required by the Bond covenant. Debt service coverage, excluding capital contribution fees, was 137%, which exceeded the 125% established by Board policy.
- For fiscal year 2003, the Authority delivered 5.5 billion gallons of water and treated almost 1.8 billion gallons of wastewater, compared to 6.1 billion gallons of water and 1.6 billion gallons of wastewater in 2002.
- Operating revenues were \$22.1 million, an increase over year 2002 in the amount of \$1.5 million or 7.1%. Total operating revenues exceeded budget projections by 3.0%.
- Operating expense increased \$2.6 million or 13.4% from 2002, of which \$1.8 million resulted from an increase in depreciation. Depreciation increased 22% from the prior year due primarily to increased developer contributions of systems assets over the past two years. The increase was also the result of a change in accounting estimate for the Southside and Shell Point wastewater treatment facilities, which are anticipated to be taken off line during fiscal year 2007. The change in accounting estimate resulted in an increase to depreciation expense, and related decrease in net income, in the amount of \$148,221.
- Operating income for the year was approximately \$43 thousand, representing a 96% decrease over fiscal year 2002 and a 97% negative variance compared to budget. Net assets decreased \$3.4 million before capital contributions, and increased \$16.6 million after capital contributions. The decrease in net assets before capital contributions was primarily the result of the increase in interest and depreciation expense.
- The operating ratios (operating revenues divided by operating expenses less depreciation) were 1.82, 1.82, and 1.76, for 2003, 2002, and 2001. For both fiscal years 2003 and 2002, \$1.82 was generated from operating revenues for every \$1.00 expensed excluding depreciation and non-operating expenses.
- Capacity fees were \$7.9 million, an increase of \$135 thousand, or 1.7%, compared to year 2002. However, capacity fees fell \$2.9 million short of budget projections for fiscal year 2003. Developer contributions of facilities were \$11.6 million, a decrease of 1.9% from 2002.
- During 2003, the Authority entered into an agreement to acquire the Town of Port Royal utility system on July 1, 2003, for approximately \$4.4 million under a forty-year franchise agreement. The Authority will service approximately 3,200 former Town of Port Royal customers. For fiscal year 2003, the Town of Port Royal was reported as a wholesale customer.

Overview of Annual Financial Report

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements and supplementary information. The MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data, key financial and operational indicators used in the Authority's strategic plan, budget, bond resolutions and other management tools were used for this analysis.

The financial statements report information about the Authority using full accrual accounting methods as utilized by similar business activities in the private sector. However, rate-regulated accounting principles applicable to private sector utilities are not used by government utilities. The financial statements include a balance sheet; a statement of revenues, expenses, and changes in net assets; a statement of cash flows; and notes to the financial statements.

The **balance sheet** presents the financial position of the Authority on a full accrual historical cost basis. The balance sheet presents information on all of the Authority's assets and liabilities, with the difference reported as net assets. Over time, increases and decreases in net assets are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the balance sheet provides information about the nature and amount of resources and obligations at year-end, the **statement of revenues, expenses, and changes in net assets** presents the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs. Rate setting policies use different methods of cost recovery not fully provided for by generally accepted accounting principles. The primary objectives of the rate model are to improve equity among customer classes and to ensure that capital costs are allocated on the basis of long-term capacity needs, ensuring that growth pays for growth.

The **statement of cash flows** presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The **notes to the financial statements** provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any. **Supplementary information** comparing the budget to actual expenses, as well as important debt coverage data, is provided.

The financial statements were prepared by the Authority's staff from the detailed books and records of the Authority. The financial statements were audited and adjusted, if material, during the independent external audit process.

Summary of Organization and Business

The Authority was created under provisions of Act No. 784 enacted during the 1954 Session of the General Assembly of the State of South Carolina as a public, nonprofit corporation to acquire and distribute supplies of fresh water for industrial and domestic purposes within its service area. During its 1969 Session, the General Assembly enacted Act No. 598, which enlarged the functions and powers of the Authority to include the construction of facilities that provide for the collection, treatment, and disposal of sewage in thickly populated areas of Beaufort County. In 1971, the General Assembly created the Jasper County Water and Sewer Authority to provide an entity capable of providing water and sewer service in Jasper County for areas not served by municipal governments. In 1983, the Authority and the Jasper County Water and Sewer Authority were consolidated with the resulting entity being called the Beaufort-Jasper Water and Sewer Authority. The Authority is governed by a

board that consists of nine members who are appointed by the Governor of South Carolina upon recommendation of the legislative delegations for Beaufort County and Jasper County.

Although originally established to provide water and wastewater services only to the unincorporated areas, the Authority now also provides direct services to the citizens in the incorporated areas of the City of Beaufort, the Town of Bluffton, and the City of Hardeeville, as well as indirectly to thousands of additional citizens in the Beaufort and Hilton Head areas, as a result of providing wholesale services to other special purpose districts. The Authority's customer base as of June 30, 2003, was comprised of approximately 29,000 retail accounts and the following wholesale water customers: Local Government – Town of Port Royal; Military installations – Naval Hospital, Parris Island Recruit Depot, Marine Corps Air Station Beaufort, Laurel Bay Housing Facility; Utilities – Hilton Head PSD 1, Broad Creek PSD, Fripp Island PSD, Harbor Island Utilities, CUC, Inc., Water Oak Utility, and Warsaw Eustis Oaks Water Company. These wholesale customers resell and/or redistribute the Authority's water to their residents, resulting in total customers directly and indirectly serviced by the Authority in excess of 100,000. Authority headquarters are located on Highway 170, approximately thirteen miles south of the City of Beaufort.

The Authority has no taxing power. Operational and maintenance costs are funded from customer fees and charges. The acquisition and construction of capital assets are funded by capital (cash and systems) contributions from customers, including other utilities and developers, Federal and State grants and loans, and customer revenues.

The Authority provides reliable high quality supplies of potable water used for drinking, irrigation, fire protection and other purposes. The Chelsea surface water plant is the principal treatment facility, using the Savannah River as its source. The Purrysburg surface water plant, which is located in Jasper County and also will use the Savannah River as its source, is expected to be on line during fiscal year 2004. Ground water systems supplement the main system and also provide water to Point South, Palm Key, and Hardeeville. Wastewater services are provided from eight plants and include sanitary sewer services, industrial pretreatment programs and highly treated wastewater for irrigation.

Financial Analysis

The following comparative condensed financial statements and other selected information serve as the key financial data and indicators for management, monitoring and planning. Comments regarding budget-to-actual variances and year-to-year variances are included in each section by the name of the statement or account.

Condensed Financial Statements

Condensed Balance Sheet

	June 30		Variance	
	2003	2002	Dollars	%
Capital assets:			Increase (decrease)	
Producing assets	\$ 159,137,167	\$ 144,983,195	\$ 14,153,972	9.8%
Construction in progress	50,600,047	24,300,313	26,299,734	108.2%
Current assets, restricted assets and bond costs	44,225,424	59,031,457	(14,806,033)	-25.1%
Total assets	\$ 253,962,638	\$ 228,314,965	\$ 25,647,673	11.2%
Current liabilities	\$ 10,703,385	\$ 8,490,994	\$ 2,212,391	26.1%
Long term liabilities	99,449,829	92,638,308	6,811,521	7.4%
Total liabilities	110,153,214	101,129,302	9,023,912	8.9%
Net assets:				
Restricted or net invested in capital assets	125,729,066	111,799,797	13,929,269	12.5%
Unrestricted	18,060,358	15,385,866	2,694,492	17.5%
Total net assets	143,809,424	127,185,663	16,623,761	13.1%
Total liabilities and net assets	\$ 253,962,638	\$ 228,314,965	\$ 25,647,673	11.2%

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

Budget and Actual
Year Ended June 30,

	2003		2002		Variance of 2003 Actual Data To			
	Actual	Budget	Actual	Budget		2002 Actual		
				Dollars	%	Dollars	%	
Revenues:								
Water service revenues	\$ 13,332,759	\$ 13,398,676	\$ 13,098,907	\$ (65,917)	-0.5%	\$ 233,852	1.8%	
Wastewater service revenues	6,347,515	6,350,671	5,410,832	(3,156)	0.0%	936,683	17.3%	
Other revenues	2,473,021	1,768,000	2,176,478	705,021	39.9%	296,543	13.6%	
Total operating revenues	\$ 22,153,295	\$ 21,517,347	\$ 20,686,217	\$ 635,948	3.0%	\$ 1,467,078	7.1%	
Expenses:								
Operating, before depreciation								
Water operations	4,967,000	5,151,342	4,940,425	184,342	3.6%	(26,575)	-0.5%	
Wastewater operations	3,627,917	3,303,365	2,947,927	(324,552)	-9.8%	(679,990)	-23.1%	
Depreciation	9,912,117	8,000,000	8,101,293	(1,912,117)	-23.9%	(1,810,824)	-22.4%	
General, administrative, customer service and mapping	3,602,890	3,632,235	3,501,006	29,345	0.8%	(101,884)	-2.9%	
Total operating expenses	22,109,924	20,086,942	19,490,651	(2,022,982)	-10.1%	(2,619,273)	-13.4%	
Operating Income	43,371	1,430,405	1,195,566	(1,387,034)	-97.0%	(1,152,195)	-96.4%	
Non-operating revenue (expenses), net	(3,414,477)	(3,956,050)	(2,778,420)	541,573	13.7%	(636,057)	-22.9%	
Increase (decrease) in net assets, before contributions	(3,371,106)	(2,525,645)	(1,582,854)	(845,461)	-33.5%	(1,788,252)	-113.0%	
Capital contributions:								
Grants	474,164	N/A	2,106,996	N/A	N/A	(1,632,832)	-77.5%	
Capacity fees	7,921,826	10,799,135	7,786,679	(2,877,309)	-26.6%	135,147	1.7%	
Developer contributions of systems	11,598,877	N/A	11,821,973	N/A	N/A	(223,096)	-1.9%	
Total capital contributions	19,994,867	10,799,135	21,715,648	(2,877,309)	-26.6%	(1,720,781)	-7.9%	
Increase(decrease) in net assets	\$ 16,623,761	\$ 8,273,490	\$ 20,132,794	\$ (3,722,770)	-45.0%	\$ (3,509,033)	-17.4%	

Other Selected Information

	2003	2002	Change	
			Amount	%
Selected data for analysis:				
Employees at year end	119	109	10	9.2%
Average employees	116	107	9	8.4%
Water and wastewater customer accounts at year end:				
Water customers	28,930	25,234	3,696	14.6%
Wastewater customers	16,120	14,014	2,106	15.0%
Water consumption (millions of gallons):				
Wholesale	2,518	3,116	(598)	-19.2%
Retail residential and commercial	2,967	2,956	11	0.4%
Total water consumption	5,485	6,072	(587)	-9.7%
Wastewater treated (million of gallons):				
Wholesale	154	147	7	4.8%
Retail residential and commercial	1,620	1,472	148	10.1%
Total wastewater treated	1,774	1,619	155	9.6%
Per average employee:				
Total operating revenues	\$ 190,977	\$ 193,329	\$ (2,352)	-1.2%
Total operating expenses	\$ 190,603	\$ 182,156	\$ 8,447	4.6%
Revenues per thousand gallons consumed/treated:				
Water service revenues:				
Wholesale	\$ 1.44	\$ 1.33	\$ 0.11	8.3%
Retail residential and commercial	\$ 3.27	\$ 3.03	\$ 0.24	7.9%
Wastewater service revenues:				
Wholesale	\$ 3.17	\$ 2.67	\$ 0.50	18.7%
Retail residential and commercial	\$ 3.62	\$ 3.41	\$ 0.21	6.2%
Expenses per thousand gallons consumed/treated:				
Water service expenses:				
Expenses excluding depreciation, overhead & franchise	\$ 0.83	\$ 0.75	\$ 0.08	10.7%
Expenses excluding depreciation	\$ 1.38	\$ 1.22	\$ 0.16	13.1%
Expenses	\$ 2.19	\$ 1.84	\$ 0.35	19.0%
Wastewater service expenses:				
Expenses excluding depreciation, overhead & franchise	\$ 1.94	\$ 1.71	\$ 0.23	13.5%
Expenses excluding depreciation	\$ 2.62	\$ 2.44	\$ 0.18	7.4%
Expenses	\$ 5.70	\$ 5.13	\$ 0.57	11.1%
Ratio of operating revenue to:				
Operating expenses	1.00	1.06	(0.06)	-5.7%
Operating expenses net of depreciation	1.82	1.82	-	0.0%
Total assets	0.09	0.09	-	0.0%
Net assets	0.15	0.16	(0.01)	-6.3%
Debt related ratios				
Equity to Long-Term Debt (Net assets over long-term debt)	1.45	1.37	0.08	5.8%
Current ratio (current nonrestricted assets/ current liabilities to be paid from nonrestricted assets)	1.64	1.31	0.33	25.2%
Operating ratio (operating income/operating expenses less depreciation)	1.82	1.82	(0.00)	0.0%
Debt service coverage (including capacity fees)	2.42	3.20	(0.79)	-24.8%
Debt service coverage (excluding capacity fees)	1.37	1.78	(0.41)	-23.2%

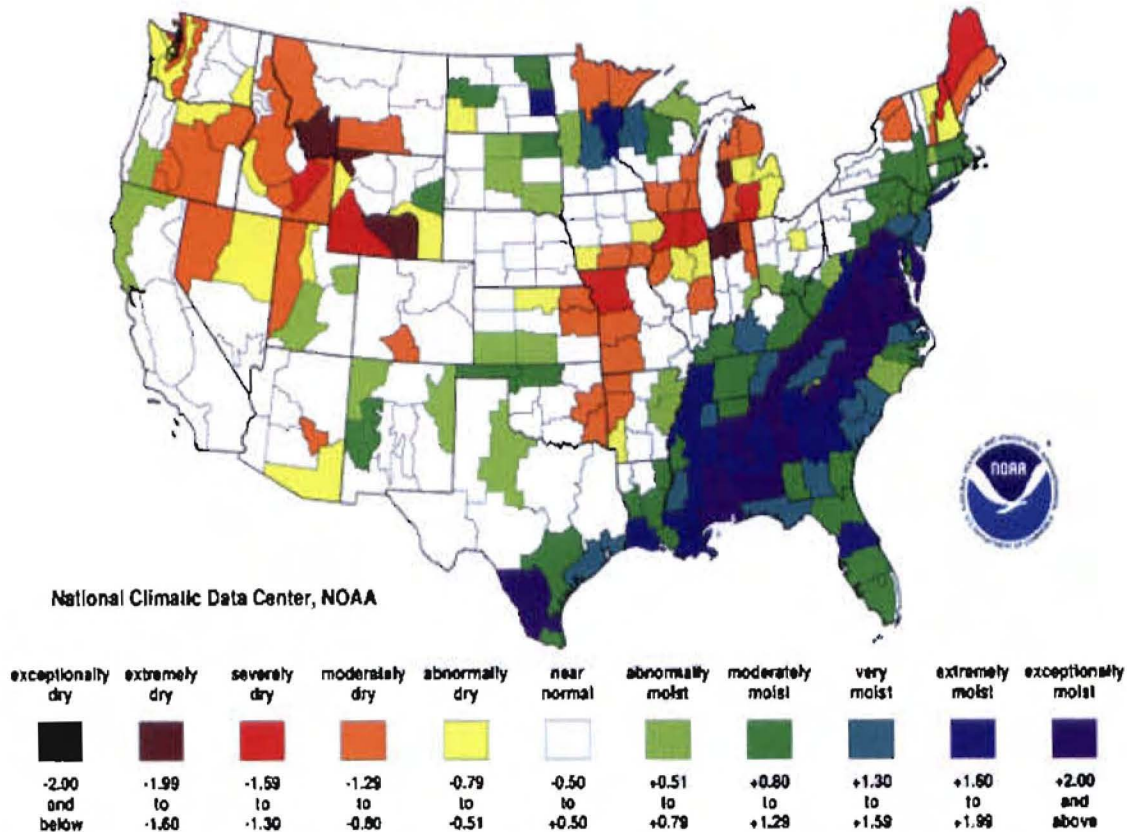
General Trends and Significant Events

The growth rate in Beaufort and Jasper counties over the last decade has been approximately 40% and 34%, respectively. Although the economy, particularly the construction industry, was negatively impacted by the events of September 11, 2001, individual customer growth has not been adversely impacted in the Authority's service area. Total customer accounts increased approximately 15% from 2002 to 2003. At year-end, the Authority served 28,930 water customers.

Weather temperatures during fiscal year 2003 remained consistent with historical averages, but rainfall increased significantly for the year. The average rainfall for the area is 50.1 inches per year. Rainfall recorded at the water plant for the year was 60.9 inches, 10.8 inches more than the historical average and 22.5 inches more than the previous fiscal year. The Standardized Precipitation Index published by the National Oceanic and Atmospheric Administration's National Climatic Data Center for July 2002 through June 2003 indicates that the coastal southeast region was very moist to exceptionally moist during the Authority's last fiscal year.

Standardized Precipitation Index Twelve Months

July 2002-June 2003



The volume of water sold in fiscal year 2003 was approximately 5.5 billion gallons, a decrease of 9.7% from fiscal year 2002. Although the Authority's service area continues to experience rapid growth, customer response to water conservation messages and increased rainfall resulted in lower demand. Retail water customers accounted for 54% of the volume sold, and 73% of the revenue earned on water sales. During fiscal year 2003, Hilton Head PSD #1 was the Authority's largest wholesale water customer, accounting for approximately 37% of wholesale water sales, as measured by gallons sold, and 17% of total water sales.

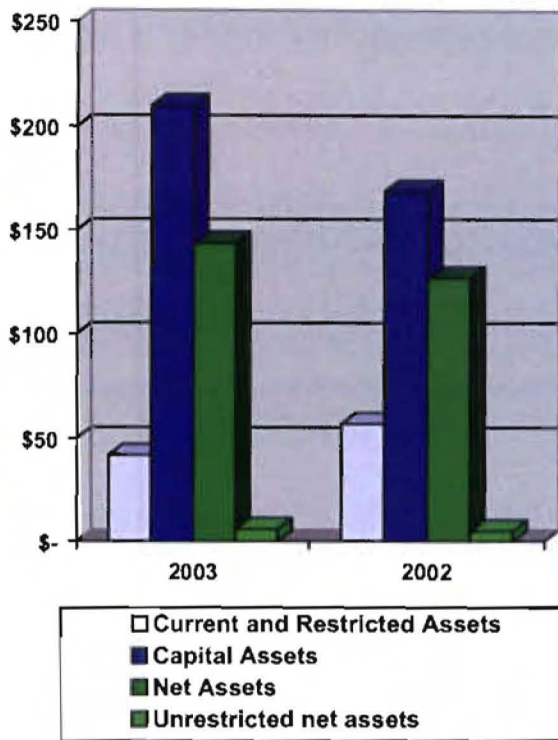
The volume of wastewater billed was 1.8 billion gallons, an increase of 9.6% over fiscal year 2002. Of the total volume, 91% was billed to retail customers and 9% to wholesale customers. The same weather patterns that resulted in lower water demand created additional flow into the wastewater treatment plants due to inflow/infiltration in many areas.

During 2003, the Authority entered into an agreement to acquire the Town of Port Royal utility system on July 1, 2003, for approximately \$4.4 million under a forty-year franchise agreement. The Authority will service approximately 3,200 former Town of Port Royal customers. For fiscal year 2003, the Town of Port Royal was reported as a wholesale customer. Management expects to complete other utility acquisitions during the next few years as governments and citizens become aware of the cost savings, enhanced environmental management and other benefits of regional consolidation of water and wastewater services.

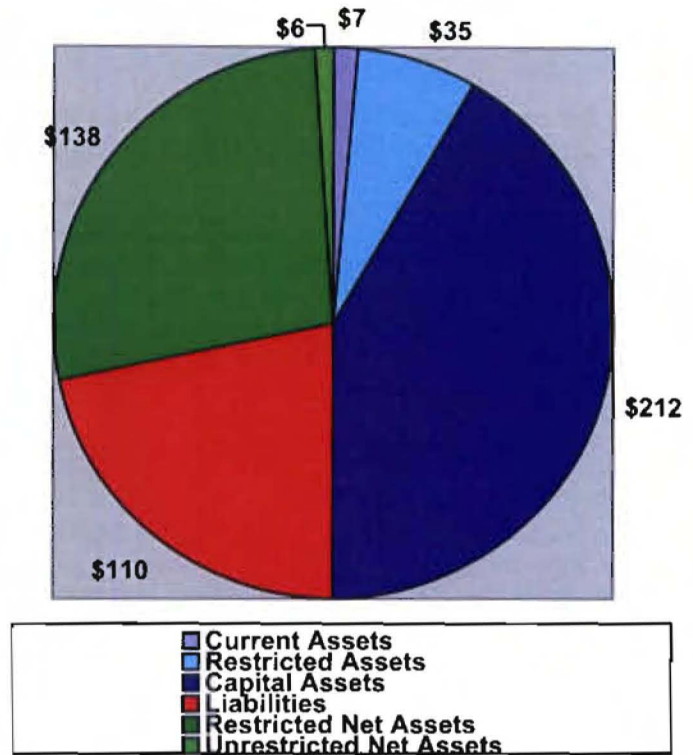
Financial Condition

The Authority's financial condition remained strong at year-end with adequate liquid assets, reliable plants and systems to meet demand and a reasonable level of unrestricted net assets. The current financial condition, technical support staff capabilities, and operating and expansion plans to meet anticipated customer needs are well balanced and under control. The following charts summarize the balance sheet with comparisons to the prior year.

**Assets and Net Assets
(in millions)**



**FY 2003 Balance Sheet
(in millions)**



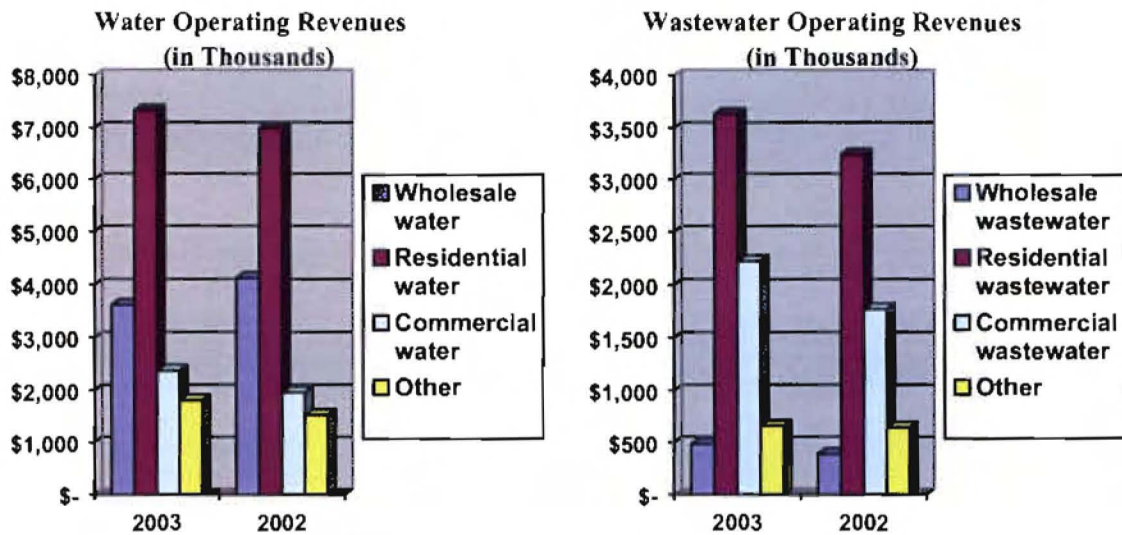
Total assets grew \$26 million or 11%. This increase was primarily related to the addition of capital assets, including work on the fiscal year 2003 capital improvement program, developer contributions, and other asset acquisitions. The net decrease in restricted assets of approximately \$14 million reflects the fact that more funds were expended on the acquisition of capital assets than were received as either debt proceeds or internally restricted earnings. This decrease was primarily attributable to the use of restricted bond funds to acquire capital assets.

Net assets increased \$16.6 million, resulting directly from capital contributions and capacity fees restricted to capital activity and debt service. Unrestricted net assets increased \$2.6 million or 17%, and represents 7% of total assets and 13% of total net assets. Of the \$18 million in unrestricted net assets, \$12.2 million is restricted by consistent board action to utilize these funds for capital activity.

Accounts receivable at year-end were 8.5% less than year-end 2002, and 2002 was 2.6% less than fiscal year 2001. This decrease, which is reflected in the increase in bad debt expense, is the result of an aggressive write-off policy that allows the Authority to improve collection rates while continuing to add customers to its retail base.

Results of Operations

Operating Revenues: Revenues from operations fall into three general categories: water service, wastewater service and ancillary charges. Ancillary charges include tap fees, account set up and penalty fees, engineering and inspection services, and charges for other miscellaneous services. The Authority has two classes of water and wastewater customers: wholesale and retail, with retail further subdivided into residential and commercial customers. The following chart depicts water and wastewater service revenues for the last two fiscal years.



The Authority adopted a rate increase along with the 2003 budget on June 27, 2002. The new rates were effective July 2002 and reflected an average increase of 3.5%. However, the rate increase and customer growth was offset by the consumption decreases due to higher than normal rainfall in the area. While water and wastewater service revenues were below budget for the year, total water operating revenue was within budget for the year due to higher than anticipated other water operating revenues, which include tap fees and ancillary charges.

The average realized rate from wholesale water sales increased 8.3% from \$1.33 to \$1.44 per thousand gallons from 2002 to 2003. Of the twelve wholesale customers (including the four military installations), all but three purchased less than projected quantities. Actual consumption for wholesale customers was 7.4% less than projected due to increased rainfall and the resulting decline in demand.

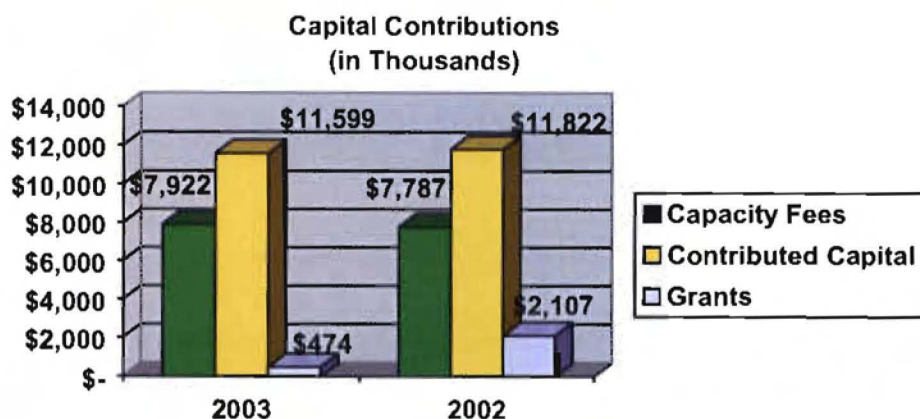
The average realized rate from retail water sales was \$3.03 per thousand gallons in 2002 and \$3.27 in 2003, an increase of 7.9%, which was a direct result of additional customers and the rate increase. Actual consumption for retail customers was within 1% of projected sales.

The average realized rate from retail wastewater sales was \$3.41 per thousand gallons in 2002 and \$3.62 in 2003, an increase of 6.2%, which was a direct result of additional customers and the rate increase. Retail wastewater customers account for 91% of total wastewater treated. The percentage of wastewater revenues to total operating revenues was 29% for 2003 and for 2002.

Capital Contributions and Grants: The Authority collects water and wastewater capacity fees in order to ensure that current customers do not bear the entire burden of growth. These fees are paid by new customers and represent on a residential equivalent unit basis the cost of the water and/or wastewater capacity represented by the new account. Most of these fees are paid for units of capacity purchased by residential and commercial real estate developers and wholesale customers.

The Authority also receives additions to its collections and distribution systems from developers. Prior to GASB 33 and 34 implementation, the money and system assets received were recorded as direct contributions to the equity. GASB 33 and 34 define these fees as non-operating revenues and requires reporting the amounts through the Statement of Revenues, Expenses and Changes in Net Assets.

The following chart depicts capital contribution activity.



Capacity fee contributions were \$7.9 million for 2003 compared to \$7.8 million for 2002. Actual contributions were \$2.9 million less than the budgeted amount of \$10.8 million for fiscal year 2003. This variance was the direct result of several large construction projects that were anticipated, but delayed by contractors. Because the Authority does not utilize capital fees to subsidize operations, these contributions do not impact operating income. The Authority restricts the use of capacity fee revenue to capital investment in its system.

The Authority also recognized \$474,164 in grants for fiscal year 2003. Of this amount, \$359,164 was the remainder of the \$2 million grant from the South Carolina Department of Commerce Water and Wastewater Infrastructure Fund (WWIF) for the Purrysburg Water Treatment Plant project; and \$115,000 was from the Environmental Protection Agency for a vulnerability assessment.

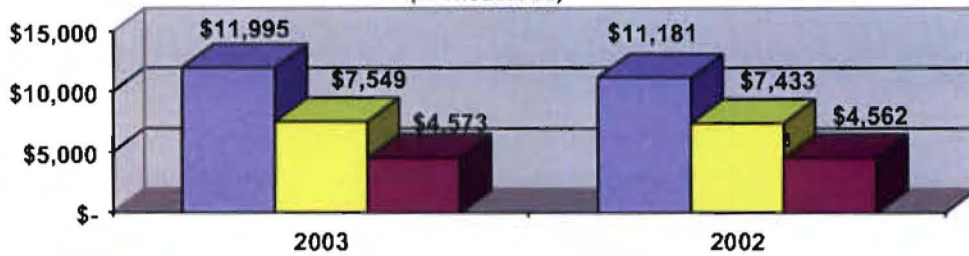
Developers contributed \$11.6 million in systems during 2003, of which \$4.7 million was in cash contributions primarily related to an agreement with South Carolina Electric & Gas Company (SCE&G) for participation in the Purrysburg Water Treatment Plant Project. SCE&G agreed to pay BJWSA aid to construction costs in the amount of \$4.4 million, primarily related to the new raw water pump station and pipeline, the reverse osmosis treatment facilities and pipeline, and other construction that was directly related to providing services to SCE&G from the new plant. Of the remaining \$6.9 million in total noncash contributions, only two projects were in excess of \$1 million, Palmetto Bluff Phase I and Bluffton Park, representing 16.8% and 15.3%, respectively. Developers convey primarily residential systems to the Authority upon completion in accordance with plans and specifications approved by the Authority. These contributions are not budgeted as they are generally non-cash, of limited relevance to rate setting, and the timing is not subject to Authority control.

Expenses: The Authority operates and maintains a potable water treatment and delivery system and a wastewater collection, treatment, and effluent disposal system. The bulk of the water production occurs at its 24 million gallon per day conventional surface water treatment plant. Wells are also used for some remote service areas and for peak management in the main system. The wastewater system includes eight wastewater treatment plants that range in size from below 200,000 gallons per day to 2 million gallons per day.

Total operating expenses of the Authority increased \$2.6 million over fiscal year 2002, and operating revenues increased \$1.5 million. Operating income was \$43 thousand for 2003 compared to \$1.1 million for 2002, a decrease in operating margin of approximately \$1 million. Operating expenses, including and excluding depreciation, for the last two years are pictured below:

Water Operating Expenses

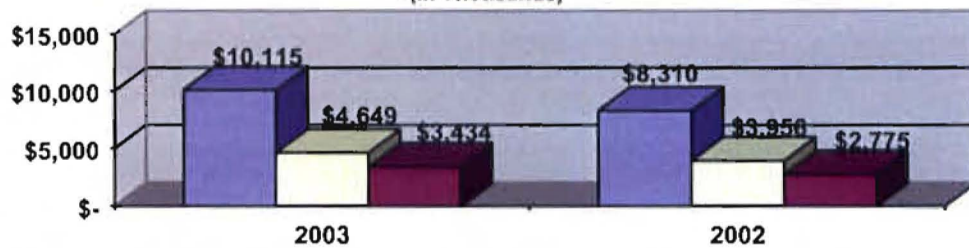
(In Thousands)



■ Total □ Excluding depreciation ■ Excluding depreciation, overhead & franchise

Wastewater Operating Expenses

(in Thousands)



■ Total □ Excluding depreciation ■ Excluding depreciation, overhead & franchise

The following chart provides percentage increases in water and wastewater system expenses with and without depreciation and allocated general and administrative expenses.

	Actual Amounts in 000s			
	2003	2002	Variance	% Change
Water operating expenses:				
Total	\$ 11,995	\$ 11,181	\$ 814	7.3%
Excluding depreciation	7,549	7,433	116	1.6%
Excluding depreciation, overhead & franchise	4,573	4,562	11	0.2%
Wastewater operating expenses:				
Total	\$ 10,115	\$ 8,310	\$ 1,805	21.7%
Excluding depreciation	4,649	3,956	693	17.5%
Excluding depreciation, overhead & franchise	3,434	2,775	659	23.7%

While depreciation was a significant factor in the overall operating increases for both water and wastewater, 7.3% and 21.7%, respectively, direct operational expenses also increased for the year. Wastewater expense, before depreciation, was over budget 7.3% and increased 17.5% over the prior year. Major factors causing the increase in wastewater operational expenses were infiltration/inflow costs in the wastewater system due to heavy rains during the fiscal year; inefficiencies in the newly

acquired Hardeeville utilities system that were resolved with maintenance expenditures; and unanticipated maintenance expense at the Southside and Cherry Point wastewater treatment plants. Depreciation for wastewater increased 25.6% over the prior year as a result of depreciation for contributed assets and a change in accounting estimate in the lives of both the Southside and Shell Point Wastewater Treatment facilities. The change in accounting estimate increased wastewater depreciation expense approximately \$150,000 for the current fiscal year.

Water operating expense, before depreciation, was within budget and only increased 1.6% over the prior year. Although water operational expenses were consistent with the prior year, consumption declined during the year due to precipitation causing the cost per thousand gallons to increase. The average total water operating cost per thousand gallons increased from \$1.84 to \$2.19 or 19%. Excluding depreciation, the average increased from \$1.22 to \$1.38, or 13.1%, indicating that the majority of the cost to produce and sell water, such as employees, base electrical costs, and system maintenance, is largely fixed and, therefore, is not necessarily proportional to consumption.

The average total wastewater operating expense per thousand gallons treated increased from \$5.13 to \$5.70 or 11%. Excluding depreciation the average cost increased \$2.44 to \$2.62 or 7.4% (as compared to a decrease from \$2.61 to \$2.44 or 6.5% from 2001 to 2002). As noted previously, the increase is directly attributable to higher infiltration/inflow costs and maintenance of the wastewater system.

The following table shows the composition of combined water and wastewater operating expenses by major classification of expense for the last two fiscal years:

	Actual Amounts in 000s					
	2003		2002		Increase(Decrease)	
Depreciation expense	\$ 9,912	45%	\$ 8,101	43%	\$ 1,811	22%
Wages and fringes	6,011	27%	5,330	27%	681	13%
Supplies	1,220	6%	1,184	6%	36	3%
Utilities and fixed charges	1,936	9%	1,717	9%	219	13%
Repairs and maintenance	1,224	6%	1,248	6%	(24)	-2%
Professional services	383	2%	471	2%	(88)	-19%
Franchise, licenses, permits	660	3%	609	3%	51	8%
Other expenses	764	3%	831	4%	(67)	-8%
Total operating expenses	\$ 22,110	101%	\$ 19,491	100%	\$ 2,619	13%

Wages and fringes increased 13% from 2002 to 2003. The Authority granted a 3% cost of living wage increase at the beginning of fiscal year 2003 and the average number of employees increased 9.2%, from 107 to 116. Professional services, which were higher in 2002 due to the Hardeeville acquisition and contract labor, decreased from the prior fiscal period. As in the prior year, the increase in depreciation expense represents the majority of the increase in operating expenses. This increase primarily resulted from unbudgeted asset acquisitions, such as contributed capital, and this trend has been considered in the 2004 budget.

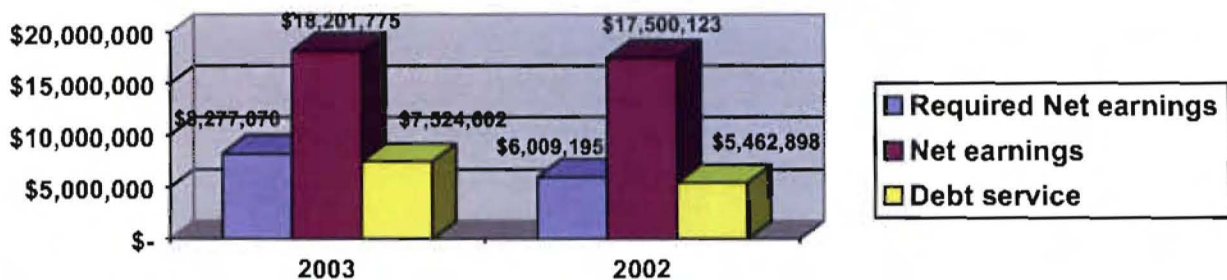
Rate Covenant

In the Bond Resolutions, the Authority covenants and agrees that it will, at all times, prescribe and maintain and thereafter collect rates and charges for the services and facilities furnished by the Authority, together with other income, that will yield annual Net Earnings in the fiscal year equal to at least one hundred ten percent (110%) of the sum of the annual debt service payments for all bonds outstanding. Net earnings is defined by the bond resolution to mean, for the period in question, the net operating income of the System determined in accordance with generally accepted accounting

principles, adding back depreciation, and including interest income not restricted to bond construction and cash capital contributions not received by way of government grants.

Although the Bond Resolutions allow the use of capacity fee revenue (i.e., cash capital contributions) in the calculation of debt service coverage, the Authority has adopted a more stringent internal policy of maintaining one hundred and twenty-five percent (125%) debt service coverage without consideration of capacity fee revenue. The rate covenant in the Bond Resolution obligates the Authority to review rates not less than once a year and to revise such rates and charges as necessary to meet the coverage test. The Authority further covenants in the Bond Resolution that it will maintain rates and charges that are at all times sufficient to provide for the payment of the bonds; to maintain the debt service funds, debt service reserve funds, and any other related funding instruments related to the debt of the system; to provide for the payment of administrative and operational expenses of the system preserving the system in good repair and working order; and to build and maintain a reserve for depreciation of the system. Revenue bond debt service coverage for 2003 and 2002 was 242% and 320%, respectively, including cash capital contributions, and 137% and 178%, without the contributions. The following table presents the net earnings available to service debt, with required earnings defined by the bond covenants as 110% of debt service:

Net Earnings Available for Debt Service



Cash Flow Activity

The following table shows the Authority’s ability to generate net operating cash. Net cash provided by operating activities is shown both in total dollars and as a percentage of operating revenues.

	2003	2002	Variance
Total operating revenues	\$ 22,153	\$ 20,686	\$ 1,467
Net cash provided by operations	\$ 9,343	\$ 10,381	\$ (1,038)
Net operating cash as a % of operating revenue	42%	50%	

Cash payments for construction and acquisition of capital assets increased \$18.2 million, or 80% from 2002 to 2003. See comments in the following section regarding major additions. Capital acquisitions were funded by bond construction funds, issuance of long term debt, and contractual commitments to fund construction. Total cash payments for debt service, which were anticipated in the bond financial feasibility report and fiscal year budget, were approximately \$7.5 million.

Capital Assets and Debt Administration

The investment in plant and equipment, net of related debt, grew \$13.6 million during 2003. Property, plant and equipment in service, excluding depreciation, increased \$50.3 million, with approximately \$20.5 million funded by the bond construction fund, \$11.6 million from cash and noncash developer contributions, \$7.6 million funded by debt, \$2.1 million funded from grants, and the remaining \$8.5 million funded by capacity fees and operating funds previously restricted for contingency and depreciation. Of the additions to capital assets, approximately \$1.6 million was expended on meter installations, with \$1 million funded by the bond program. General equipment purchases were \$328 thousand primarily for vehicles and other general operating equipment, and \$154 thousand for information technology equipment.

During the current fiscal year, \$41.5 million was expended on Construction in Progress, with \$20.7 million expended on the Purrysburg water treatment plant and \$3.7 million expended on the related transmission main. Significant capital investments in water construction projects also included over \$2 million on the Broad River crossing; almost \$900 thousand for the waterline extension to Davis Elementary; and \$563 thousand for the second phase of the aquifer storage recovery system north of the Broad River. Major water additions completed and capitalized during this fiscal year included the raw water reservoir expansion at the Chelsea plant; a 16-inch waterline at Burton Hill Road including Burton Area water system improvements; and a remote monitoring program for the Hardeeville water system.

Large construction in progress expenditures for wastewater included an additional \$3.4 million on the Cherry Point wastewater treatment plant expansion (\$5.3 million expended as of June 30, 2003); \$671 thousand for the Cherry Point wastewater treatment plant tertiary treatment; and approximately \$430 thousand for the force main and pump station at the Purrysburg water treatment facility. Major wastewater construction projects completed and capitalized during the fiscal year included \$2.8 million for the Rose Hill Diversion Project, which redirected wastewater to the Bluffton Regional Plant; \$2.3 million for the purchase of land for the Port Royal Island water reclamation facility; \$1.7 million for the Bluffton CDBG sewer project; \$440 thousand for the Buckwalter Road sewer force main; \$413 thousand for the Point South wastewater transmission system upgrade; \$410,000 for the Point South wastewater treatment plant upgrade; and approximately \$631 thousand for sewer pump station upgrades, including remote monitoring.

Bond funds were utilized on the construction of the Purrysburg water treatment plant, to install a radio-read system on all water meters, the water line extension to Exit 8 at Interstate 95, and the Palmetto Bluff water line. Bond funds were reprogrammed for the Port Royal Island water reclamation facility planned for fiscal year 2004, including the land purchase for the plant site, which was completed in 2003.

The Authority obtained state revolving fund loans for the Cherry Point wastewater treatment plant expansion, the Purrysburg transmission main, the new water lines across the Broad River, and an aquifer storage recovery well (phase II). As of June 30, 2003, the draws made on these loans and recorded as debt were \$4,157,367, \$2,947,695, \$1,517,723 and \$721,032, respectively. The Authority also closed on a loan for the water lines across the Chechessee River in the amount of \$1,176,665 for which draws will be made in fiscal year 2004. Other new debt included bank notes issued to pay off lines of credit utilized to purchase vehicles. Total debt to capital assets was 50% for 2003, as compared to 56% for 2002 and 36% for 2001. The significant increase in 2002 was a direct result of issuing \$47.14 million in bonds.

Final Comments

The Authority has adopted a strategic plan that guides Board and staff actions toward its mission of providing affordable, efficient, and reliable water and wastewater services. Part of this strategy is the pursuit of consolidation of smaller public and private utility systems into the Authority's system where such consolidation will yield rate stability and improved service for customers. The Strategic Plan is implemented in part by the multi-year financial plan and rate model, the capital improvement program, and the annual budget. It is expected that these tools will continue to provide management with sufficient long and short term planning information to complete the capital improvement program within originally projected rate increases.

Growth over the next several years and changing environmental regulations will require construction of a larger regional wastewater treatment facility in the central part of the Authority's service area, as well as the new surface water treatment plant currently under construction on the Savannah River in Jasper county.



Report of Independent Auditors

Beaufort-Jasper Water and Sewer Authority Governing Board
Beaufort, South Carolina

We have audited the accompanying balance sheet of Beaufort-Jasper Water and Sewer Authority (the "Authority") as of June 30, 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year 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 audit. The financial statements of Beaufort-Jasper Water and Sewer Authority as of June 30, 2002 were audited by other auditors whose report, dated October 9, 2002, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Beaufort-Jasper Water and Sewer Authority as of June 30, 2003, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 1, 2003 on our consideration of Beaufort-Jasper Water and Sewer Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion and analysis on pages 4 through 19 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. 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 this information and express no opinion thereon.

Our audit was conducted for the purpose of forming an opinion on the financial statements of Beaufort-Jasper Water and Sewer Authority as a whole. The introductory section and the supplementary information as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Cherry, Bekaert + Holland, L.L.P.

Augusta, Georgia
August 1, 2003

Beaufort-Jasper Water and Sewer Authority
Balance Sheets

Assets	June 30	
	2003	2002
Current assets:		
Cash and cash equivalents	\$ 4,124,283	\$ 4,545,216
Accounts receivable	2,602,779	2,844,564
Inventory and other assets	417,471	333,666
Total current assets	7,144,533	7,723,446
Restricted assets:		
Cash and cash equivalents	25,863,497	46,323,413
Investments	6,093,075	1,158,505
Restricted receivables	2,983,924	-
Grants receivable	-	1,640,836
Total restricted assets	34,940,496	49,122,754
Capital assets	209,737,214	169,283,508
Bonds/loans issuance costs and discounts, net	2,140,395	2,185,257
Total assets	\$ 253,962,638	\$ 228,314,965
Liabilities and Net Assets		
Current liabilities:		
Accounts payable and accrued expenses	\$ 1,281,292	\$ 2,265,410
Lines of credit and interest	-	346,855
Revenue bonds, state revolving loans and interest	2,588,182	2,852,952
Notes payable and accrued interest	423,763	226,050
Capital lease obligations	54,728	194,313
Total current liabilities	4,347,965	5,885,580
Current liabilities payable from restricted assets:		
Accounts payable for capital items	3,692,336	1,037,441
Revenue bonds, state revolving loans and interest	1,490,042	608,497
Notes payable	19,073	19,059
Deposit and escrow accounts	1,153,969	940,417
Total current liabilities payable from restricted assets	6,355,420	2,605,414
Long term liabilities:		
Revenue bonds, state revolving loans, and notes	99,449,829	92,572,249
Capital lease obligations	-	66,059
Total long term liabilities	99,449,829	92,638,308
Total liabilities	110,153,214	101,129,302
Net assets:		
Invested in capital assets, net of related liabilities	122,562,214	109,069,905
Restricted for capital activity and debt service	3,166,852	2,729,892
Unrestricted	18,080,358	15,385,866
Total net assets	143,809,424	127,185,663
Total liabilities and net assets	\$ 253,962,638	\$ 228,314,965

See accompanying notes.

Beaufort-Jasper Water and Sewer Authority
Statements of Revenues, Expenses and Changes in Net Assets

		Year Ended June 30,	
		2003	2002
Operating revenues:			
Water:	Wholesale	\$ 3,624,459	\$ 4,135,462
	Retail	9,708,300	8,963,445
	Other	1,811,622	1,532,555
Total water revenues		15,144,381	14,631,462
Wastewater:	Service	6,347,515	5,410,832
	Other	661,399	643,923
Total wastewater revenues		7,008,914	6,054,755
Total operating revenues		22,153,295	20,686,217
Operating expenses:			
Water:	Source of supply	504,642	340,719
	Water treatment	1,874,625	1,776,727
	Transmission and distribution	2,072,613	2,331,875
	Laboratory and testing	120,880	113,042
	Franchise fee	394,240	378,062
	Depreciation	4,446,057	3,748,074
	General, administrative, customer service and other	2,581,815	2,492,471
Total water operating expenses		11,994,872	11,180,970
Wastewater:	Collection and transmission	1,559,206	1,306,870
	Wastewater treatment	1,441,531	1,148,511
	Wastewater disposal	115,853	107,961
	Sludge management	153,933	89,126
	Laboratory and testing	163,592	122,260
	Franchise fee	193,802	173,199
	Depreciation	5,466,060	4,353,219
	General, administrative, customer service and other	1,021,075	1,008,535
Total wastewater operating expenses		10,115,052	8,309,681
Total operating expenses		22,109,924	19,490,651
Operating income (loss)		43,371	1,195,566
Non-operating revenue (expense):			
	Interest expense	(4,366,002)	(3,729,074)
	Investment income	324,461	416,585
	Bond investment income	697,906	568,359
	Net gain (loss) on disposal of assets	34,054	46,662
	Amortization of bond issuance costs	(104,896)	(80,952)
Total non-operating revenue (expense)		(3,414,477)	(2,778,420)
Increase (decrease) in net assets, before capital contributions		(3,371,106)	(1,582,854)
Capital contributions:			
	Grants	474,164	2,106,996
	Capacity fees	7,921,826	7,786,679
	Developer contributions of systems	11,598,877	11,821,973
Total capital contributions		19,994,867	21,715,648
Increase (decrease) in net assets		16,623,761	20,132,794
Net assets at beginning of year		127,185,663	107,052,869
Net assets at end of year		\$ 143,809,424	\$ 127,185,663

See accompanying notes.

Beaufort-Jasper Water and Sewer Authority
Statements of Cash Flows

	Year Ended June 30,	
	2003	2002
Cash flows from operating activities:		
Cash received from customers	\$ 22,395,080	\$ 20,762,735
Cash paid to suppliers and employees	(13,052,178)	(10,381,856)
Net cash provided (used) by operating activities	9,342,902	10,380,879
Cash flows from investing activities:		
Purchase of investments	(6,093,075)	(1,158,505)
Proceeds from sale of investments	1,158,505	2,121,744
Interest income	1,022,367	984,944
Net cash provided (used) by investing activities	(3,912,203)	1,948,183
Cash flows from capital and related financing activities:		
Purchase/construction of property, plant, and equipment	(41,035,215)	(22,810,397)
Proceeds from sale of equipment	34,054	46,662
Proceeds from issuance of long term debt	7,592,746	45,696,824
Proceeds from lines of credit	-	346,855
Proceeds from developer contributions of systems to pay for construction costs	4,739,921	-
Principal payments on debt	(2,997,062)	(3,331,627)
Interest paid on borrowings	(4,527,540)	(3,040,203)
Payment of bond issuance costs	(119,049)	(928,933)
Grant capital contributions	2,115,000	466,160
Capacity fees	7,885,597	7,786,679
Net cash provided (used) by capital and related financing activities	(26,311,548)	24,232,020
Increase (decrease) in cash and cash equivalents	(20,880,849)	36,561,082
Cash and cash equivalents at beginning of year	50,868,629	14,307,547
Cash and cash equivalents at end of year	\$ 29,987,780	\$ 50,868,629
Reconciliation to balance sheet:		
Unrestricted cash and cash equivalents	\$ 4,124,283	\$ 4,545,216
Restricted cash and cash equivalents	25,863,497	46,323,413
Total cash and cash equivalents	\$ 29,987,780	\$ 50,868,629
Reconciliation of operating income to net cash provided by operating activities:		
Operating income (loss)	\$ 43,371	\$ 1,195,566
Adjustments:		
Depreciation	9,912,117	8,101,293
Changes in assets and liabilities		
Decrease (increase) in: Receivables	241,785	76,518
Inventory and other assets	(83,805)	(17,694)
Increase (decrease) in: Accounts payable and accrued expenses	(984,118)	1,005,914
Deposits and escrow accounts	213,552	19,282
Net cash provided by operating activities	\$ 9,342,902	\$ 10,380,879
Noncash capital and related financing activities:		
Advance refunding of debt	\$ -	\$ 4,835,000
Developer contributions of systems	\$ 6,858,956	\$ 11,821,973
Acquisition of Hardeeville systems through assumption of debt	\$ -	\$ 2,902,603

See accompanying notes.

Notes to Financial Statements

1. Description of Entity

The Beaufort-Jasper Water and Sewer Authority (the Authority) was established by an act of the General Assembly of the State of South Carolina on April 23, 1954. The Authority is a special purpose governmental entity engaged in business-type activities. The Authority provides water to various areas of Beaufort and Jasper Counties and the three military installations located therein, and wastewater (i.e. sewer) services to several areas within the two counties.

2. Summary of Significant Accounting Policies

A. Basis of Presentation and Accounting

The Authority's financial statements are presented on the full accrual basis in accordance with accounting principles generally accepted in the United States of America. The Authority applies all Governmental Accounting Standards Board (GASB) pronouncements as well as Financial Accounting Standards Board (FASB) statements and interpretations, and the Accounting Principles Board (APB) of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Authority has not adopted the provisions of FASB No. 71, *Accounting for the Effects of Certain Types of Regulations*.

The Authority has adopted GASB Statements 33 through 38, and related interpretations issued through June 30, 2003. Statement No. 33 required contributions to be recorded in the Statement of Revenues, Expenses and Changes in Net Assets. Statement 34 and subsequent Statements and Interpretations required certain other changes in terminology, format and content, as well as inclusion of the management's discussion and analysis as required supplementary information.

All activities of the Authority are accounted for within a single proprietary (enterprise) fund. Proprietary funds are used to account for operations that are (a) financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the cost (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The transactions of the Authority are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operations are included on the balance sheet. Net assets (i.e., total assets net of total liabilities) are segregated into "invested in capital assets, net of related liabilities"; "restricted for capital activity and debt service"; and "unrestricted" components.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make certain estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date, and reported amounts of revenues and expenses during the reporting period. Estimates are used to determine depreciation expense, the allowance for doubtful accounts and certain claims and judgment liabilities, among other accounts. Actual results may differ from those estimates.

2. Summary of Significant Accounting Policies (Continued)

B. Budgetary Accounting

The Authority adopts flexible annual operating and capital budgets. Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. The current operating budget details the Authority's plans to earn and expend funds for charges incurred for operation, maintenance, certain interest and general functions, and other charges for the fiscal year. The capital budget details the plan to receive and expend cash basis capital contribution fees, special assessments, grants, borrowings and certain revenues for capital projects.

All unexpended and unencumbered appropriations in the operating budget lapse at the end of the fiscal year. No appropriation for a capital project in the capital budget lapses until the purpose for which the appropriation was made has been accomplished or abandoned.

Management submits a proposed budget to the Authority's Board of Directors prior to the May Board meeting. A budget is adopted by resolution prior to July 1. During the year, management is authorized to transfer budgeted amounts between line items within the Authority's divisions.

C. Cash Equivalents, Deposits and Investments

Cash and cash equivalents, for purposes of the statement of cash flows, include restricted and unrestricted cash on hand or on deposit, interest in State Treasurer's Pool, certificates of deposit, repurchase agreements and investments with a maturity of three months or less.

Investments are reported at their fair market value. The Authority is permitted to invest through various investment advisors in a pool managed by the South Carolina State Treasurer, certificates of deposit, repurchase agreements, and United States or State of South Carolina general obligations. Investments are stated at cost or amortized cost.

D. Restricted Assets

Restricted assets represent cash, investments and receivables maintained in accordance with bond resolutions, loan agreements, grant awards, and other resolutions and formal actions of the Authority or by agreement for the purpose of funding certain debt service payments, depreciation and contingency activities, and improvements and extensions to the utility systems.

E. Receivables and Payables

Receivables and payables between departments are eliminated. Customer receivables represent various volume, availability, impact and special assessment service fees earned, but not yet collected. Cycle billings at the end of the fiscal year are estimated to record revenues earned through year-end.

F. Inventories

Inventories consist of construction materials, repair parts, and chemicals. Materials and supplies inventories are stated at the lower of average cost or market.

2. Summary of Significant Accounting Policies (Continued)

G. **Capital Assets**

Property, plant and equipment in service and construction in progress are recorded at cost, if purchased or constructed. Assets acquired through contributions from developers or other customers are capitalized at their estimated fair market value, if available, or at engineers' estimated fair market value or cost to construct at the date of the contribution. Utility systems acquired from other governmental service providers are recorded at the purchase price, limited to fair market value. Internal engineering costs are capitalized to the extent of direct support and contribution to construction and expansion projects. Costs of studies that directly result in specific construction projects are capitalized.

Effective July 1, 2002, the Authority revised the estimated service lives of the Southside and Shell Point Wastewater Treatment Plants. These facilities are to be abandoned in fiscal year 2007 when the Port Royal Island Water Reclamation Facility is completed. The service life revision has been accounted for as a change in accounting estimate in accordance with generally accepted accounting principles resulting in charge to 2003 net income in the amount of \$148,221.

During fiscal year 1999, the Authority began capitalizing meters as a result of using significantly more radio-read meters versus the less expensive standard meters.

Maintenance and repairs, which do not significantly extend the value or life of property, plant and equipment, are expensed as incurred.

Interest cost is capitalized on the construction of qualified assets, whether or not borrowings exist for such projects, to the extent of amounts funded by debt or operating results. Interest is not capitalized on project costs funded by contributed capital, such as grants, gifts and impact fees. Interest costs of tax-exempt borrowings are capitalized net of related investment earnings on the proceeds. Interest costs are not capitalized for small projects under \$250,000 or those for which the construction period is less than six months as such amounts are immaterial.

Assets are depreciated on the straight-line method. Depreciation is calculated using the following estimated useful lives:

	<u>Years</u>
Source of supply equipment	15-50
Water treatment plant	10-40
Wastewater treatment plant	20-40
Transmission and distribution systems	10-50
Equipment	3-20
Structures and improvements, including buildings	10-50
Office furniture, equipment and vehicles	3-20
Meters	8

H. **Long-term Obligations and Costs**

Long-term obligations are reported at face value, net of applicable premiums and discounts. Premiums and discounts, issuance costs, and gains or losses on advance refundings and defeasances after June 30, 1994, are deferred and amortized over the life of the bonds.

2. Summary of Significant Accounting Policies (Continued)

I. Compensation for Future Absences

Accumulated vacation and the portion of sick leave eligible to be paid to employees at termination are recorded as an expense and liability as the benefits are earned.

J. Claims and Judgments

These events and obligations are recorded on the accrual basis, when the event occurs and the obligation arises.

K. Revenues and Rate Structure

Revenues from water and wastewater services are recognized on the accrual basis and as earned. Services are supplied to customers under a rate structure designed to produce revenues sufficient to provide for operating and maintenance costs, capital outlay, debt service, reserves and debt service coverage.

L. Capital Contributions

Contributions are recognized in the Statement of Revenues, Expenses and Changes in Net Assets when earned. Contributions include capacity fees, developer contributed utility systems, capital grants, and other supplemental support by other utilities and industrial customers and federal, state and local grants in support of system improvements.

M. Special and Extraordinary Items

Extraordinary items are transactions or other events that are both unusual in nature and infrequent in occurrence. Special items are significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence. If such items exist during the reporting period, they are reported separately in the statement of revenues, expenses and changes in net assets.

N. Net Assets

Net assets comprise the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Net assets are classified in the following three components: invested in capital assets, net of related liabilities; restricted for capital activity and debt service; and unrestricted net assets. Invested in capital assets, net of related debt, consists of all capital assets, net of accumulated depreciation and reduced by outstanding debt that is attributable to the acquisition, construction and improvement of those assets; debt related to unspent proceeds or other restricted cash and investments is excluded from the determination. Restricted for capital activity and debt service consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates, less any related liabilities. Unrestricted consists of all other net assets not included in the above categories.

O. General and Administrative Expense allocations

For the purposes of the Statement of Revenues, Expenses and Changes in Net Assets, general and administrative expenses were allocated 70% and 30% to the water and wastewater divisions for 2003 and 2002.

3. Deposits and Investments

Deposits include demand deposits and certificates of deposit in financial institutions. The carrying (balance sheet) amounts were \$29,169,297 and \$49,090,110 for June 30, 2003 and 2002, respectively. The bank balances were \$31,783,599 and \$49,365,375 for June 30, 2003 and 2002, respectively. All bank balances were covered by federal depository insurance or by collateral held by the Authority's agent in the Authority's name.

Investments at June 30, 2003 and 2002 were as follows:

	June 30, 2003		June 30, 2002	
	<u>Cost</u>	<u>Market Value</u>	<u>Cost</u>	<u>Market Value</u>
US Government securities	\$ 1,841,050	\$ 1,841,050	\$ 1,844,248	\$ 1,844,248
Repurchase agreements	<u>5,070,018</u>	<u>5,070,018</u>	<u>1,092,286</u>	<u>1,092,286</u>
Total investments	<u>\$ 6,911,068</u>	<u>\$ 6,911,068</u>	<u>\$ 2,936,534</u>	<u>\$ 2,936,534</u>

The Authority's investments are categorized into three categories of credit risk:

- (1) Investments that are insured or registered or for which the securities are held by the Authority or its agent in the Authority's name;
- (2) Uninsured and unregistered investments for which securities are held by the counter-party's trust department or agent in the Authority's name;
- (3) Uninsured and unregistered investments for which the securities are held by the counter party, or by its trust department or agent but not in the Authority's name.

At year-end, all of the investment balances were in Category 1.

The following reconciles deposits and investments to cash and cash equivalents, and investments, as presented in the balance sheet:

	June 30	
	<u>2003</u>	<u>2002</u>
Disclosures regarding deposits and investments:		
Cash on hand	\$ 490	\$ 490
Deposits	29,169,297	49,090,110
Investments	<u>6,911,068</u>	<u>2,936,534</u>
Total	<u>\$ 36,080,855</u>	<u>\$ 52,027,134</u>
Balance sheet and cash flow statement amounts:		
Cash and cash equivalents:		
Unrestricted	\$ 4,124,283	\$ 4,545,216
Restricted	<u>25,863,497</u>	<u>46,323,413</u>
Total cash and cash equivalents	<u>29,987,780</u>	<u>50,868,629</u>
Investments:		
Unrestricted	-	-
Restricted	<u>6,093,075</u>	<u>1,158,505</u>
Total investments	<u>6,093,075</u>	<u>1,158,505</u>
Total	<u>\$ 36,080,855</u>	<u>\$ 52,027,134</u>

4. Accounts Receivable

Accounts receivable were composed of the following:

	<u>June 30</u>	
	<u>2003</u>	<u>2002</u>
Wholesale and retail water and wastewater customers:		
Billed services	\$ 2,170,249	\$ 2,092,997
Unbilled services	605,530	834,567
Allowance for doubtful accounts	<u>(173,000)</u>	<u>(83,000)</u>
Total	<u>\$ 2,602,779</u>	<u>\$ 2,844,564</u>

5. Restricted Assets

Certain proceeds of revenue bonds and notes, as well as resources set aside for their repayment or to satisfy certain restrictive covenants of the bond agreements, are classified as restricted assets on the balance sheet because their use is limited by those bond covenants. The "debt service fund" accounts are used to segregate resources accumulated for debt service payments over the next twelve months. The "debt service reserve fund" accounts are used to report resources set aside to make up potential future deficiencies in revenue bond debt service funds or to effect whole or partial redemption of the bonds. The "depreciation and contingency fund" accounts are used to accumulate resources to be used for contingencies and for improvements, betterments, and extensions of the system; the Authority establishes these amounts annually.

The components of the restricted assets, liabilities payable from restricted assets and restricted net assets as of June 30, 2003 were as follows:

	<u>Total Restricted</u>	<u>Liabilities Payable From Restricted Assets</u>	<u>Net Restricted Assets</u>
Depreciation and contingency	\$ 7,416,017	\$ -	\$ 7,416,017
Capital projects (incl. Receivables)	24,678,467	(3,841,343)	20,837,124
Customer deposits	787,047	(787,047)	-
Maintenance bonds payable	217,915	(217,915)	-
Debt service and reserves	1,841,050	(1,509,115)	331,935
	<u>\$ 34,940,496</u>	<u>\$ (6,355,420)</u>	<u>\$ 28,585,076</u>

6. Capital Assets

Capital asset activity during the year was as follows:

	Balance at June				Balance at June
	30, 2002	Additions	Disposals	Transfers	30, 2003
Land and land rights	\$ 3,234,928	\$ -	\$ (13,334)	\$ 2,574,153	\$ 5,795,747
Administrative Facilities & Improv.	2,813,458	-	-	-	2,813,458
Structures and improvements	69,509,055	6,858,956	-	4,810,099	81,178,110
Source of supply	4,990,169	-	-	2,588,834	7,579,003
Water treatment plant	17,364,254	-	-	700,190	18,064,444
Wastewater treatment plant	28,171,268	-	-	3,273,248	31,444,516
Transmission & distribution system	51,848,198	1,665,009	-	1,127,049	54,640,256
Other general equipment	<u>3,550,680</u>	<u>327,996</u>	<u>(104,476)</u>	<u>153,890</u>	<u>3,928,090</u>
Property, plant and equipment					
in service	181,482,010	8,851,961	(117,810)	15,227,463	205,443,624
Construction in progress	<u>24,300,314</u>	<u>41,527,196</u>	<u>-</u>	<u>(15,227,463)</u>	<u>50,600,047</u>
Total property, plant and equipment	<u>205,782,324</u>	<u>50,379,157</u>	<u>(117,810)</u>	<u>-</u>	<u>256,043,671</u>
Accumulated depreciation	<u>(36,498,816)</u>	<u>(9,912,117)</u>	<u>104,476</u>	<u>-</u>	<u>(46,306,457)</u>
Net property, plant and equipment	<u>\$ 169,283,508</u>	<u>\$ 40,467,040</u>	<u>\$ (13,334)</u>	<u>\$ -</u>	<u>\$ 209,737,214</u>

Effective July 1, 2002, the Authority revised the estimated service lives of the Southside and Shell Point Wastewater Treatment Plants. These facilities are to be abandoned in fiscal year 2007 when the Port Royal Island Water Reclamation Facility is completed. The service life revision has been accounted for as a change in accounting estimate in accordance with generally accepted accounting principles resulting in an increase to 2003 accumulated depreciation in the amount of \$148,221.

Interest expense, net of applicable interest income, was capitalized in the amounts of \$422,009 and \$78,930 during 2003 and 2002 respectively. The increase in capitalized interest is directly related to increase in construction in progress, particularly those related to the Purrysburg water treatment plant, which is financed with bond proceeds.

Construction in progress includes \$24.5 million for the Purrysburg water treatment plant; \$5.3 million for the Cherry Point wastewater treatment plant expansion; \$3.9 million for the Purrysburg water treatment plant transmission main; \$2.1 million for the Broad River water line crossing; \$1.9 million for the water extension to Exit 8 at I-95; and \$1.8 million for the Bluffton loop project. The Purrysburg water treatment plant is projected to cost \$35 million, with completion in 2004.

7. Long-Term Debt

Bonds, notes and state revolving loans payable were as follows:

Bonds Payable:	June 30	
	2003	2002
Waterworks and Sewer System Refunding Revenue Bonds, Series 1988B, dated July 1, 1988, original principal of \$1,815,000; due in annual principal installments ranging from \$100,000 to \$165,000 through 2002, with interest at 3.5%, due July 1 and January 1.	\$ -	\$ 165,000

7. Long-Term Debt (Continued)

	June 30	
	2003	2002
Waterworks and Sewer System Improvement Revenue Bonds, Series 1999, dated November 1, 1999, original principal of \$9,400,000; due in annual principal installments ranging from \$143,000 to \$375,000 through 2020, with interest at 5.16%, due March 1 and September 1.	\$8,649,000	\$8,961,000
Waterworks and Sewer System Refunding and Improvement Revenue Bonds, Series 2000, dated January 13, 2000, original principal amount of \$9,444,000; due in annual principal installments ranging from \$60,000 to \$385,000 through 2020, with interest at 5.24%, due March 1, June 1, September 1 and December 1.	8,357,000	8,691,000
Waterworks and Sewer System Refunding and Improvement Revenue Bonds, Series 2001, dated December 1, 2001, original principal amount of \$47,140,000; due in annual principal installments ranging from \$35,000 to \$5,940,000 through 2026, with interest at 3.0% to 5.0%, due March 1 and September 1.	<u>46,730,000</u>	<u>47,105,000</u>
Total bonds payable	<u>\$ 63,736,000</u>	<u>\$ 64,922,000</u>

State Revolving Loans Payable to South Carolina State Budget and Control Board:

Waterworks and Sewer System Revenue Bonds, Series 1994, dated November 21, 1994, original principal amount of \$10,875,908 (SC Water Pollutions Control Revolving Loan Fund Number 025-94-520-11), with interest at 4%, principal and interest due quarterly.	\$7,766,575	\$8,236,687
Waterworks and Sewer System Junior Lien Revenue Bonds, Series 1996, dated March 21, 1996, original principal amount of \$1,678,871 (SC Water Pollution Control Revolving Loan Fund Number 032-95-520-05), with interest at 4.25%, principal and interest due quarterly.	1,279,409	1,348,230
Waterworks and Sewer System Revenue Bonds, Series 1998, dated February 23, 1998, original principal amount of \$517,387 (SC Infrastructure Revolving Loan Fund Number 2-004-97), with interest at 4.75%, principal and interest due quarterly.	429,699	448,931
Waterworks and Sewer System Revenue Bonds, Series 1998B, dated June 12, 1998, original principal amount of \$5,967,213 (SC Drinking Water Revolving Loan Fund Number 3-001-98-0720003-01), with interest at 4%, principal and interest due quarterly.	5,177,763	5,399,934

7. Long-Term Debt (Continued)

	June 30	
	2003	2002
Waterworks and Sewer System Improvement Revenue Parity Bonds, Series 1993, originally of the City of Beaufort, South Carolina, assumed by the Authority on November 1, 1999, original principal amount of \$5,197,143 (SC Water Pollutions Control Revolving Loan Fund Number 021-92-389-20), with interest at 4.25%, principal and interest due quarterly.	\$3,446,974	\$3,681,277
Waterworks and Sewer System Improvement Revenue Bonds, Series 2000B, dated January 28, 2000, principal amount of \$2,640,771 (SC Drinking Water Revolving Loan Fund Number 3-006-99-0720003-03), with interest at 3.5%, principal and interest due quarterly.	2,352,730	2,452,409
Waterworks and Sewer System Improvement Revenue Bonds, Series 2000C, dated as of April 28, 2000, expected principal amount of \$2,459,954 (SC Drinking Water Revolving Loan Fund Number 3-007-99-0720003-02), with interest at 3.5%, principal and interest due quarterly.	2,200,848	2,140,682
Waterworks and Sewer System Improvement Revenue Bonds, Series 2000D, dated on December 6, 2000, principal amount of \$2,666,060 (SC Water Pollution Control Revolving Loan Fund Number 1-065-00-520-13), with interest at 3.5%, principal and interest due quarterly.	2,519,879	2,203,875
Waterworks and Sewer System Improvement Revenue Parity Bonds, Series 1990, originally of the City of Hardeeville, South Carolina, assumed by the Authority on January 25, 2002, original principal amount of \$2,414,566 (SC Water Pollution Control Revolving Loan Fund Number 014-90-427-04), with interest at 4.5%, principal and interest due quarterly.	1,294,877	1,417,316
Waterworks and Sewer System Improvement Revenue Parity Bonds, Series 2000, originally of the City of Hardeeville, South Carolina, assumed by the Authority on January 25, 2002, original principal amount of \$875,085 (SC Water Pollution Control Revolving Loan Fund Number 1-067-00-427-04), with interest at 3.75%, principal and interest due quarterly.	821,262	852,083

7. Long-Term Debt (Continued)

	<u>June 30</u>	
	<u>2003</u>	<u>2002</u>
Waterworks and Sewer System Improvement Revenue Bonds, Series 2001B, dated on December 1, 2001, expected principal amount of \$869,453 (SC Water Drinking Water Revolving Loan Fund Number 3-011-02-0720003-06), with interest at 3.75%, principal and interest due quarterly.	719,640	-
Waterworks and Sewer System Improvement Revenue Bonds, Series 2002A, dated on March 4, 2002, expected principal amount of \$4,590,900 (SC Water Pollution Control Revolving Loan Fund Number 1-077-02-520-16), with interest at 3.75%, principal and interest due quarterly.	4,164,235	-
Waterworks and Sewer System Improvement Revenue Bonds, Series 2002B, dated on March 26, 2002, expected principal amount of \$4,464,122 (SC Water Drinking Water Revolving Loan Fund Number 3-012-01-0720003-05), with interest at 4.0%, principal and interest due quarterly.	1,517,723	-
Waterworks and Sewer System Improvement Revenue Bonds, Series 2003A, dated on February 11, 2003, expected principal amount of \$4,256,018 (SC Water Drinking Water Revolving Loan Fund Number 3-015-02-0720003-13), with interest at 3.75%, principal and interest due quarterly.	<u>2,947,695</u>	<u>-</u>
Total state revolving loans	<u>\$ 36,639,309</u>	<u>\$ 28,181,424</u>

Other Notes Payable:

GMAC Commercial Mortgage note payable, dated 1969, originally of the City of Hardeeville, South Carolina, assumed by the Authority on January 25, 2002, original principal of \$232,000 (GMAC Account No. 01-0528901), with interest at 4.75%, principal and interest due annually on January 1.	\$ 40,660	\$ 52,610
GMAC Commercial Mortgage note payable, dated 1979, originally of the City of Hardeeville, South Carolina, assumed by the Authority on January 25, 2002, original principal of \$186,400 (GMAC Account No. 01-0528902), with interest at 5%, principal and interest due annually on September 13.	109,822	115,118

7. Long-Term Debt (Continued)

	June 30	
	2003	2002
GMAC Commercial Mortgage note payable, dated 1983, originally of the City of Hardeeville, South Carolina, assumed by the Authority on January 25, 2002, original principal amounts of \$176,500 and \$12,900 (GMAC Account No. 01-0528904), with interest at 5.0%, principal and interest due annually on April 7.	128,786	132,450
Note payable to First National Bank, dated March 31, 1998, originally of the City of Hardeeville, South Carolina, assumed by the Authority on January 25, 2002, and renegotiated March 28, 2002, original principal amount of \$300,000, with interest at 3.57%, principal and interest payment of \$2,533.50 due the 28 th of each month.	228,358	250,070
Note payable to the City of Hardeeville, South Carolina, financing the net purchase price of \$2,378,000 for the Hardeeville water and sewer system, with interest at 5.0%, due in quarterly installments of principal and interest ranging from \$70,000 to \$47,500.	2,163,168	2,329,350
Note payable to Palmetto State Bank, dated July 17, 2002, original principal amount of \$431,556, with interest at 5.73%, secured by certain vehicles and related equipment, due in quarterly principal and interest payment of \$39,406, beginning October 17, 2002.	330,298	-
Note payable to Palmetto State Bank, dated June 24, 2003, original principal amount of \$150,000, with interest at 4.53%, secured by certain vehicles and related equipment, due in quarterly principal and interest payment of \$14,582, beginning September 24, 2003.	150,000	-
Total other notes payable	3,151,092	2,879,598
Total long-term debt	103,526,401	95,983,022
Less current portion	(3,374,433)	(2,610,576)
Total long-term portion of debt	100,151,968	93,372,446
Less deferred amount on refunding	(702,139)	(800,197)
Total long-term debt, net of deferred amounts	\$ 99,449,829	\$ 92,572,249

7. Long-Term Debt (Continued)

	Balance			Balance		Due Within
	June 30, 2002	Additions	Reductions	June 30, 2003	One Year	
Bonds and notes payable:						
Revenue bonds	\$ 64,922,000	\$ -	\$ (1,186,000)	\$ 63,736,000	\$ 1,080,000	
State revolving loans	28,181,424	9,958,885	(1,501,000)	36,639,309	1,888,854	
Notes payable	2,879,598	581,556	(310,062)	3,151,092	405,579	
	95,983,022	10,540,441	(2,997,062)	103,526,401	3,374,433	
Less deferred refunding	(800,197)	-	98,058	(702,139)	-	
Total bonds and notes	<u>\$ 95,182,825</u>	<u>\$ 10,540,441</u>	<u>\$ (2,899,004)</u>	<u>\$ 102,824,262</u>	<u>\$ 3,374,433</u>	

Remaining debt service payments at June 30, 2003, including annual sinking fund payments, are as follows:

	Revenue Bonds		SRF Loans		Notes Payable		Total	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2004	\$ 1,080,000	\$ 3,150,912	\$ 1,888,854	\$ 1,466,176	\$ 405,579	\$ 147,812	\$ 3,374,433	\$ 4,764,900
2005	1,116,000	3,102,956	2,077,000	1,516,551	593,700	125,321	3,786,700	4,744,828
2006	1,169,000	3,053,088	2,160,469	1,433,082	258,533	101,475	3,588,002	4,587,645
2007	1,225,000	2,999,717	2,247,309	1,346,242	158,871	91,324	3,631,180	4,437,283
2008	1,276,000	2,942,424	2,337,657	1,255,893	155,342	83,497	3,768,999	4,281,814
2009-2013	7,524,000	13,727,716	12,724,206	4,712,507	778,233	303,462	21,026,439	18,743,685
2014-2018	11,975,000	11,501,577	9,944,017	1,855,785	755,070	95,556	22,674,087	13,452,918
2019-2023	21,386,000	7,676,178	3,259,797	292,442	45,764	6,719	24,691,561	7,975,339
2024&after	16,985,000	1,726,000	-	-	-	-	16,985,000	1,726,000
	<u>\$ 63,736,000</u>	<u>\$ 49,880,568</u>	<u>\$ 36,639,309</u>	<u>\$ 13,878,678</u>	<u>\$ 3,151,092</u>	<u>\$ 955,166</u>	<u>\$ 103,526,401</u>	<u>\$ 64,714,412</u>

The components of the balance sheet accounts entitled "revenue bonds, revolving loans and interest" and "notes payable and accrued interest" follow:

	Current Liabilities	Current Liabilities Payable from Restricted Assets	Totals
Revenue bonds	\$ 786,000	\$ 270,000	\$ 1,056,000
State revolving loans	1,802,182	74,477	1,876,659
Notes payable	423,763	11,388	435,151
Accrued interest	-	1,153,250	1,153,250
Totals	<u>\$ 3,011,945</u>	<u>\$ 1,509,115</u>	<u>\$ 4,521,060</u>

7. Long-Term Debt (Continued)

The Authority issued Waterworks and Sewer System Refunding and Improvement Revenue Bond (Second Lien), Series 2000, in January 2000, taking advantage of the favorable interest rate to advance refund the Series 1992A and 1995 Bonds and provide funds for capital improvement projects. The refunding transaction resulted in an accounting loss of \$712,143 when the net carrying value of the two bond issues were compared to the reacquisition price paid to defease those issues. This loss on refunding is recorded as a reduction in the carrying balance of the bonds payable and is amortized using the effective interest method through fiscal year 2013. Amortization of this amount for fiscal years 2003 and 2002 is \$62,285 and \$64,122, respectively. The escrow agent reported that the 1992A bonds were called and redeemed March 1, 2002. As of June 30, 2003, the balance in the escrow account, covering the refunded 1995 bonds, was reported as \$5,293,404 and the outstanding debt, including interest, was reported as \$5,024,190.

The Authority issued \$47.1 million of Waterworks and Sewer System Improvement and Refunding Bonds (Second Lien), Series 2001, dated December 1, 2001, taking advantage of the favorable interest rate to advance refund the Series 1992B Bonds, pay the amount outstanding under an Equipment Lease/Purchase Agreement with First Union National Bank, and to provide funds for capital improvement projects. Proceeds in the amount of \$4,884,267 were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the outstanding Series 1992B Bonds. As a result, the 1992B Bonds are considered to be defeased and the related liability has been removed from the balance sheet. The refunding transaction resulted in an accounting loss of \$275,103 when the net carrying value of the two bond issues were compared to the reacquisition price paid to defease those issues. This loss on refunding is recorded as a reduction in the carrying balance of the bonds payable and is amortized using the effective interest method through fiscal year 2013. Amortization of this amount for fiscal year 2003 and 2002 is \$35,773 and \$36,695, respectively. The escrow account has been paid out to redeem the 1992B Bonds, which were called on March 1, 2002.

December 6, 1999, the Authority obtained a loan from the South Carolina Water Quality Revolving Fund Authority not to exceed \$2,460,106 for work on a raw water reservoir. The loan has an interest rate of 3.5% and a term of twenty years with quarterly principal and interest payments scheduled to begin August 1, 2001. The Authority made draws of \$2,370,818 and \$2,220,762 as of June 30, 2003, and 2002, respectively, on this loan. Interest, in the amount of \$6,731, was capitalized in 2002 when the project was substantially completed.

December 6, 2000, the Authority obtained a loan from the South Carolina Water Quality Revolving Fund Authority not to exceed \$2,787,822 for work on the Rose Hill Wastewater Treatment Plant Diversion. An amendment to the loan, dated May 22, 2003, revised the loan amount for the project to \$2,666,060. The loan has an interest rate of 3.5% and a term of twenty years with quarterly principal and interest payments scheduled to begin January 1, 2002. The July 1, 2003 payment was adjusted to accommodate the reduced quarterly payment amount. As of June 30, 2003, the Authority had completed draws of \$2,666,060. Interest, in the amount of \$24,689, was capitalized in 2002 when the project was substantially completed.

December 1, 2001, the Authority obtained a loan from the South Carolina Water Quality Revolving Fund Authority not to exceed \$875,468 for work on an aquifer storage and recovery system. The loan has an interest rate of 3.75% and a term of twenty years with quarterly principal and interest payments scheduled to begin June 1, 2003. As of June 30, 2003, draws had been made in the amount of \$721,032 and interest capitalized in the amount of \$6,005.

7. Long-Term Debt (Continued)

On January 25, 2002, the Authority acquired the City of Hardeeville water and sewer system, located in Jasper County. As part of the acquisition, the Authority also assumed two loans from the South Carolina Water Quality Revolving Fund Authority. The first loan was for work on the Hardeeville wastewater treatment plant upgrade, with an original amount, including capitalized interest, of \$2,414,566; the amount assumed by the Authority was \$1,476,511, at 4.5% interest with quarterly principal and interest payments. The second loan was for pump station upgrades in Hardeeville, with an original amount, including capitalized interest, of \$876,002; the amount assumed by the Authority was \$867,068, at 3.75% interest with quarterly principal and interest payments. The Authority also assumed \$559 thousand in notes payable as part of the Hardeeville acquisition and financed a portion of the net purchase price by issuing a note payable in the amount of \$2,378,000 to the City of Hardeeville.

March 4, 2002, the Authority obtained a loan from the South Carolina Water Quality Revolving Fund Authority not to exceed \$4,590,900 for work on the Cherry Point Wastewater Treatment Plant Expansion. The loan has an interest rate of 3.75% and a term of twenty years with quarterly principal and interest payments scheduled to begin June 1, 2003. As of June 30, 2003, draws had been made in the amount of \$4,157,367 and interest capitalized in the amount of \$46,045.

March 26, 2002, the Authority obtained a loan from the South Carolina Water Quality Revolving Fund Authority not to exceed \$4,464,122 for work on the waterline crossings at the Broad River. The loan has an interest rate of 4.0% and a term of twenty years with quarterly principal and interest payments scheduled to begin February 1, 2004. As of June 30, 2003, draws had been made in the amount of \$1,517,723.

February 11, 2003, the Authority obtained a loan from the South Carolina Water Quality Revolving Fund Authority not to exceed \$4,256,018 for work on the Purrysburg water transmission main. The loan has an interest rate of 3.75% and a term of twenty years with quarterly principal and interest payments scheduled to begin January 1, 2004. As of June 30, 2003, draws had been requested and approved in the amount of \$2,947,695. Since the funds were not received until July 2003, the proceeds were both recorded as a liability and a restricted receivable at fiscal year end.

Revenue bonds and state revolving loan payables are collateralized by an irrevocable pledge of income and revenues derived from the operation of the systems. The revenues derived from the operation of the respective systems are to be used for expenses in connection with the administration and operation of the systems.

The Authority's Bond Resolutions require that "Net Earnings" as defined in the Bond Resolution, equal to at least 110% of the annual principal and interest requirements of all series of bonds outstanding in such year. For the years ended June 30, 2003 and 2002, the Authority's "Net Earnings" were 242% and 320%, respectively, of its annual principal and interest requirements of all series of bonds. Management believes the Authority is in compliance with this and all other bond covenants and restrictions.

8. Lease Obligations

The Authority has entered into several lease purchase arrangements for vehicles. The total capitalized cost of these assets was \$692,276. The lease terms range from 36 months to 60 months. The future minimum payments under the leases follow:

Year Ending June 30,	Amount
2004	\$ 54,728
2005	-
Total minimum lease payments	54,728
Less interest payments	(1,082)
Present value of capital lease payments	53,646
Less principal due within one year	(53,646)
Total principal due after one year	\$ -

On April 25, 2003, the Authority entered into a non-cancelable operating lease with a 48-month term for certain office equipment. Should the Authority cancel the benefits of the lease, a commitment would remain in the amount of \$11,088 for fiscal years 2003 and 2004, respectively.

9. Pension Costs

The Authority is a member of the South Carolina Retirement System (SCRS), a division of the State Budget and Control Board. The Plan is a cost sharing, multi-employer defined benefit pension plan, offering retirement and disability benefits, group life insurance benefits and survivor benefits. The SCRS grants cost of living adjustments on an ad hoc basis, subject to approval by the State Budget and Control Board. The provisions of the SCRS are established under Title 9 of the South Carolina Code of Laws. A Comprehensive Annual Financial Report containing financial statements and required supplementary information for the SCRS is publicly available on their website at www.scrs.state.sc.us, or a copy may be obtained by submitting a request.

All part-time and full-time, permanent employees must participate unless specifically exempted by statute or are eligible and elect to participate in the State ORP. Mandatory employee contributions of 6% of earnable compensation are made through payroll deductions. All employers contribute at the actuarially required contribution rates. The Authority, as a Class II employer, is required to contribute at a rate of 6.7% of employee earnable compensation. For years ended June 30, 2003 and 2002, \$5,066,089 and \$4,463,491, of wages were subject to retirement, respectively, which is 97.77% and 97.29% of total salaries of \$5,181,258 and \$4,587,766, respectively. The Authority is also required to contribute .15% of earnable compensation to the system for group life insurance. The Authority's contribution for retirement and life insurance for the fiscal years ended June 30, 2003 and 2002 were \$347,027 and \$308,136, respectively, which is 6.85% and 6.85%, respectively, of covered salaries.

An employee is vested upon reaching five years of service. Employees who retire at or after age 65 or have twenty-eight years of credited service are entitled to an annual retirement benefit for life equal to 1.82% of average final compensation times years of credited service. Vested employees may retire at age 55 with 25 years of service, reduced 4% for each year of service under 28; or at age 60 with a 5% reduction for each year under age 65. The System also provides for disability retirement, which is based on the projection of service to age 65 with an actuarial reduction.

10. Net Assets and Contributed Capital

Net assets represent the difference between assets and liabilities. The restricted net asset amounts were as follows:

	June 30	
	2003	2002
Invested in Capital Assets, Net of Related Liabilities		
Net property, plant and equipment in service	\$ 209,737,214	\$ 169,283,508
Less: Debt as disclosed in note 7	(103,526,401)	(95,983,022)
Deferred amount on refunding	702,139	800,197
Bonds/loans issuance costs and discounts, net	2,140,395	2,185,257
Accounts payable for capital items	(3,692,336)	(1,037,441)
Other obligations for capital assets	(54,728)	(607,227)
Add: Funded debt from restricted assets	4,054,824	1,400,386
Unspent debt proceeds	<u>13,201,107</u>	<u>33,028,247</u>
	<u>122,562,214</u>	<u>109,069,905</u>
Restricted for Capital Activity and Debt Service:		
Restricted cash and equivalents	25,863,497	46,323,413
Restricted investments	6,093,075	1,158,505
Restricted receivables	2,983,924	1,640,836
Deductions:		
Current liabilities payable from restricted assets	(6,355,420)	(2,605,414)
Board restricted for capital activity	(12,217,117)	(10,759,201)
Unspent debt proceeds	<u>(13,201,107)</u>	<u>(33,028,247)</u>
	<u>3,166,852</u>	<u>2,729,892</u>
Unrestricted	<u>18,080,358</u>	<u>15,385,866</u>
Total net assets	<u>\$ 143,809,424</u>	<u>\$ 127,185,663</u>

Unrestricted net assets includes \$12,217,117 and \$10,759,201 for 2003 and 2002, respectively, which were internally restricted by consistent Board action. The Board believes these amounts are fairly presented as restricted assets as a result of consistent formal Board action to restrict these funds to expenditure for capital activity. Adherence to this long-standing practice has established precedence and obligations. Had these amounts been excluded from unrestricted net assets, the unrestricted net assets would have been presented as \$5,863,241 and \$4,626,665 for 2003 and 2002, respectively. Funds restricted for capital activity include the depreciation and contingency fund, which is established by contributions from operations during the year, and capital funds, which are funded by capacity fees levied during the year. Depreciation and contingency funds were \$3,415,228 and \$4,669,811 for June 30, 2003 and 2002, respectively. Capital funds, net of the related payables, were \$8,801,889 and \$6,089,390 for June 30, 2003 and 2002, respectively.

During fiscal year 2000, the Authority began accepting Letters of Credit from certain developers and commercial customers for the payment of capital contributions. Currently, the Authority does not recognize these receivables due to certain contingencies associated with them. As of June 30, 2003 and 2002, capital contributions under letters of credit, which are receivable in the future were approximately \$1,185,975 and \$102,308, respectively.

11. Commitments and Contingencies

Construction Commitments

In the normal course of its business, the Authority has numerous contracts for construction and other activities for which it is committed to complete and pay. As of June 30, 2003, the Authority had open contracts approximating \$57,122,806 for which \$19,383,198 remains to be paid upon further progress by the contractors.

Service Contracts

The Authority has entered into various long-term contracts to provide water and wastewater treatment services to retail and wholesale customers, including other local governments and utilities. Contracts vary as to the system's capacity allocations and periodic revision in service rates.

Grants

Amounts received or receivable from government agencies are subject to audit and adjustment by those agencies. The Authority has never experienced noncompliance and has never been subject to adjustments or refunds as a result of such audits.

12. Risk Management

The Authority is exposed to various risks of loss relating to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. To insure against casualty risks the Authority is a member of the State of South Carolina Insurance Reserve Fund, a public entity risk pool currently operating as a common risk management and insurance program for local governments in South Carolina.

The Authority acquires insurance from the State Accident Fund for job related injury and illness (workers' compensation) to its employees. Through June 30, 2003, medical insurance coverage, encompassing health, dental, life and other medical benefits to employees and their dependents, was obtained via the State's group insurance program with an independent insurance company.

During 2003 and 2002, the Authority did not experience any significant uninsured claims. Accordingly, there was no liability or expense recorded for actual claims, and management does not believe any provision for unasserted claims is necessary.

13. Major Customers

Revenues from the largest three customers represented 13.6% and 16.9% of total operating revenues for fiscal years 2003 and 2002, respectively. Sales to no single customer exceeded 10% of total operating revenues.

14. Subsequent Events

The Authority entered into an Agreement of Consolidation and Transfer with the Town of Port Royal, South Carolina, effective July 1, 2003, whereby the Authority acquired all \$4.4 million of utility system and support assets, and assumed specified liabilities and obligations in the amount of \$464 thousand, for a net purchase price of approximately \$3.9 million. The Authority paid approximately \$80 thousand in acquisition costs and issued a note payable to the Town, financing the net purchase price of \$3,935,700 over twelve years at 5.0% interest, quarterly payments due commencing September 30, 2003.

The terms of the Town of Port Royal agreement resulted in the following exchange:

Assets received:	
Current assets	-
Capital assets at purchase price	4,399,725
Liabilities assumed:	
Acquisition Costs	(79,726)
Note payable	(384,299)
Other	-
Net assets received/purchase price	<u>\$ 3,935,700</u>

The Agreement of Consolidation and Transfer provides the Authority with an exclusive franchise to furnish water and wastewater collection, treatment and disposal services within Port Royal for forty years, with a commitment by Port Royal to consider an additional forty-year period exclusive franchise subject to applicable laws. The Authority is obligated to pay a monthly franchise fee of 5% of gross sales, not to be less than \$5,000 per month.

The Authority adopted a general consumption water and sewer rate increase of approximately 5.0% for most retail customers effective July 1, 2003. This is the second of four annual planned rate increases that resulted from the significant increase in debt service needed to support the Capital Improvement Program.

Beaufort-Jasper Water and Sewer Authority
Budgetary Comparison Schedule
Year Ended June 30, 2003

(With comparative actual amounts for the fiscal year ended June 30, 2002)

	2003		2002	Variance of FY 2003 Actual Data To			
	Actual	Budget	Actual	Budget		2002 Actual	
				Dollars	%	Dollars	%
Operating revenues					Favorable (Unfavorable)		
Civilian wholesale	\$ 2,508,152	\$ 2,669,915	\$ 2,750,859	\$ (161,763)	-6.1%	\$ (242,707)	-8.8%
Military wholesale	1,116,307	1,278,711	1,384,603	(162,404)	-12.7%	(268,296)	-19.4%
Retail	9,708,300	9,450,050	8,963,445	258,250	2.7%	744,855	8.3%
Other	1,811,622	1,218,500	1,532,555	593,122	48.7%	279,067	18.2%
Total water operating revenues	15,144,381	14,617,176	14,631,462	527,205	3.6%	512,919	3.5%
Wastewater service	6,347,515	6,350,671	5,410,832	(3,156)	0.0%	936,683	17.3%
Other	661,399	549,500	643,923	111,899	20.4%	17,476	2.7%
Total wastewater operating revenues	7,008,914	6,900,171	6,054,755	108,743	1.6%	954,159	15.8%
Total operating revenues	22,153,295	21,517,347	20,686,217	635,948	3.0%	1,467,078	7.1%
Operating expenses							
Water operating expenses:							
Source of supply	504,642	493,186	340,719	(11,456)	-2.3%	(163,923)	-48.1%
Water treatment	1,874,625	1,852,173	1,776,727	(22,452)	-1.2%	(97,898)	-5.5%
Transmission and distribution	2,072,613	2,262,104	2,331,875	189,491	8.4%	259,262	11.1%
Laboratory and testing	120,880	135,009	113,042	14,129	10.5%	(7,838)	-6.9%
Franchise fee	394,240	408,870	378,062	14,630	3.6%	(16,178)	-4.3%
Engineering & construction services, incl. Mapping	192,109	175,718	166,556	(16,391)	-9.3%	(25,553)	-15.3%
Customer service, including meter reading	761,126	701,782	792,476	(59,344)	-8.5%	31,350	4.0%
General and administrative	1,628,580	1,723,481	1,533,439	94,901	5.5%	(95,141)	-6.2%
Total water operating expenses (excl. depr.)	7,548,815	7,752,323	7,432,896	203,508	2.6%	(115,919)	-1.6%
Wastewater operating expenses:							
Collection & transmission	1,559,206	1,444,422	1,306,870	(114,784)	-7.9%	(252,336)	-19.3%
Wastewater treatment	1,441,531	1,261,201	1,148,511	(180,330)	-14.3%	(293,020)	-25.5%
Wastewater disposal	115,853	107,750	107,961	(8,103)	-7.5%	(7,892)	-7.3%
Sludge management	153,933	160,000	89,126	6,067	3.8%	(64,807)	-72.7%
Laboratory and testing	163,592	154,762	122,260	(8,830)	-5.7%	(41,332)	-33.8%
Franchise fee	193,802	175,230	173,199	(18,572)	-10.6%	(20,603)	-11.9%
Customer service, including meter reading	328,801	301,439	362,895	(27,362)	-9.1%	34,094	9.4%
General and administrative	692,274	729,815	645,640	37,541	5.1%	(46,634)	-7.2%
Total wastewater operating expenses (excl. depr.)	4,648,992	4,334,619	3,956,462	(314,373)	-7.3%	(692,530)	-17.5%
Operating expenses before depreciation	12,197,807	12,086,942	11,389,358	(110,865)	-0.9%	(808,449)	-7.1%
Depreciation - Water	4,446,057	3,800,000	3,748,074	(646,057)	-17.0%	(697,983)	-18.6%
Depreciation - Wastewater	5,466,060	4,200,000	4,353,219	(1,266,060)	-30.1%	(1,112,841)	-25.6%
Total operating expenses	22,109,924	20,086,942	19,490,651	(2,022,982)	-10.1%	(2,619,273)	-13.4%
Operating income (loss)	43,371	1,430,405	1,195,566	(1,387,034)	-97.0%	(1,152,195)	-96.4%
Non-operating revenues (expenses), net	(3,414,477)	(3,956,050)	(2,778,420)	541,573	13.7%	(636,057)	-22.9%
Increase (decrease) In net assets, before capital contributions	(3,371,106)	(2,525,645)	(1,582,854)	(845,461)	-33.5%	(1,788,252)	-113.0%
Capacity fees	7,921,826	10,799,135	7,766,679	(2,877,309)	-26.6%	135,147	1.7%
Increase (decrease) In net assets (see note)	\$ 4,550,720	\$ 8,273,490	\$ 6,203,825	\$ (3,722,770)	-45.0%	\$ (1,653,105)	-26.6%

NOTE: For purposes of comparison to budget, the actual data excludes developer capital contributions and capital grants which were not budgeted.

Beaufort-Jasper Water and Sewer Authority

Schedule of Expenses by Natural Classification

Budget and Actual

Year Ended June 30, 2003

(With comparative actual amounts for the year ended June 30, 2002)

	2003			2002
	Original and Final	Actual	Variance	
	Budget		Favorable (Unfavorable)	
				Actual
Salaries and wages	\$ 4,613,843	\$ 4,668,814	\$ (54,971)	\$ 4,153,020
Payroll taxes and benefits	1,326,986	1,342,006	(15,020)	1,176,683
Repairs and maintenance	1,235,654	1,225,402	10,252	1,247,624
Supplies	1,310,399	1,220,129	90,270	1,183,466
Professional services	421,480	382,986	38,494	471,180
Utilities	1,209,902	1,353,126	(143,224)	1,260,320
Fixed charges	545,310	582,868	(37,558)	456,801
Franchise, licenses and permits	644,570	660,189	(15,619)	609,065
Safety training, supplies & services	75,620	74,289	1,331	-
Travel and training	208,071	127,840	80,231	166,290
Insurance	140,825	105,103	35,722	107,759
Other expense	354,282	455,053	(100,771)	557,150
Depreciation expense	8,000,000	9,912,117	(1,912,117)	8,101,293
Interest expense and amortization	4,756,050	4,470,898	285,152	3,810,026
Total expenses	<u>\$ 24,842,992</u>	<u>\$ 26,580,820</u>	<u>\$ (1,737,828)</u>	<u>\$ 23,300,677</u>

Schedule of Net Earnings for Debt Service and Debt Coverage

Years Ended June 30, 2003 and 2002

	2003	2002
Operating income	\$ 43,371	\$ 1,195,566
Adjustments to derive net earnings:		
Depreciation expense	9,912,117	8,101,293
Capacity fees - cash contributed capital	7,921,826	7,786,679
Interest income	324,461	416,585
Net earnings per bond resolution	<u>\$ 18,201,775</u>	<u>\$ 17,500,123</u>
Total debt service paid	<u>\$ 7,524,602</u>	<u>\$ 5,462,898</u>
Debt coverage	<u>242%</u>	<u>320%</u>



**Report of Independent Certified Public Accountants on
Compliance and on Internal Control Over Financial
Reporting Based on an Audit of Financial Statements Performed
In Accordance with *Government Auditing Standards***

Beaufort-Jasper Water and Sewer Authority Governing Board
Beaufort, South Carolina

We have audited the financial statements of Beaufort-Jasper Water and Sewer Authority as of and for the year ended June 30, 2003, and have issued our report thereon dated August 1, 2003. We conducted our audit 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.

Compliance

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

Internal Control over Financial Reporting

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

This report is intended solely for the information and use of the audit committee, management, others within Beaufort-Jasper Water and Sewer Authority, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Augusta, Georgia
August 1, 2003

Cherry, Bekaert + Holland, L.L.P.