

THE ISLAND WATER ASSOCIATION, INC.

FINANCIAL STATEMENTS

December 31, 1994 and 1993

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CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Members
The Island Water Association, Inc.
Sanibel Island, Florida

We have audited the accompanying balance sheets of the Island Water Association, Inc. as of December 31, 1994 and 1993, and the related statements of operations and system investment, and cash flows for the years then ended. These financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Island Water Association, Inc. as of December 31, 1994 and 1993, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Schultz, Chaipel & Co.
Schultz, Chaipel & Co.
Fort Myers, Florida
January 27, 1995

THE ISLAND WATER ASSOCIATION, INC.
BALANCE SHEETS
December 31,

	<u>1994</u>	<u>1993</u>
ASSETS		
PLANT PROPERTY		
Utility plant in service	\$23,178,300	\$22,131,600
Construction work in progress	<u>769,400</u>	<u>334,600</u>
	23,947,700	22,466,200
Less accumulated depreciation	<u>8,689,200</u>	<u>7,852,000</u>
Net plant property	<u>15,258,500</u>	<u>14,614,200</u>
CURRENT ASSETS		
Cash	111,200	23,300
Marketable securities	389,400	670,500
Accounts receivable	292,800	308,300
Unbilled revenues	192,700	267,900
Prepayments and other	32,900	28,100
Inventory	<u>7,500</u>	<u>12,300</u>
Total current assets	<u>1,026,500</u>	<u>1,310,400</u>
INVESTMENTS		
Participation certificates	<u>234,900</u>	<u>179,000</u>
BOARD RESTRICTED ASSETS		
Cash, Environmental Compliance Fund	-	185,000
Cash, R.O. Membranes Fund	-	240,000
Marketable securities, Environmental Compliance Fund	643,000	-
Marketable securities, R.O. Membranes Fund	<u>372,000</u>	<u>-</u>
Total board restricted assets	<u>1,015,000</u>	<u>425,000</u>
RESTRICTED ASSETS		
Marketable securities	<u>300,000</u>	<u>300,000</u>
	<u>\$17,834,900</u>	<u>\$16,828,600</u>

The accompanying notes are an integral part of these statements.

	<u>1994</u>	<u>1993</u>
CAPITALIZATION, LIABILITIES AND MEMBERS' CONTRIBUTIONS		
CAPITALIZATION		
Net revenues invested in the water system	\$ 4,149,000	\$ 3,283,400
Long-term debt, less current maturities	<u>2,318,200</u>	<u>2,355,800</u>
Total capitalization	<u>6,467,200</u>	<u>5,639,200</u>
CURRENT LIABILITIES		
Current maturities of long-term debt	38,100	34,400
Accounts payable and accrued expenses	<u>262,700</u>	<u>278,700</u>
Total current liabilities	<u>300,800</u>	<u>313,100</u>
MEMBERS' CONTRIBUTIONS IN AID OF CONSTRUCTION	<u>11,066,900</u>	<u>10,876,300</u>
	<u>\$17,834,900</u>	<u>\$16,828,600</u>

THE ISLAND WATER ASSOCIATION, INC.
 STATEMENTS OF OPERATIONS AND SYSTEM INVESTMENT
 For the Years Ended December 31,

	<u>1994</u>	<u>1993</u>
OPERATING REVENUES	<u>\$4,843,400</u>	<u>\$4,601,700</u>
OPERATING COSTS		
Operation	1,141,000	1,040,100
Maintenance	770,100	790,900
Administration	1,232,400	1,188,500
Depreciation	<u>837,300</u>	<u>950,400</u>
Total costs	<u>3,980,800</u>	<u>3,969,900</u>
Operating income	<u>862,600</u>	<u>631,800</u>
OTHER INCOME		
Interest	89,000	71,000
Other	<u>112,200</u>	<u>101,600</u>
Total other income	<u>201,200</u>	<u>172,600</u>
Income before interest charges	<u>1,063,800</u>	<u>804,400</u>
INTEREST CHARGES ON LONG-TERM DEBT	262,200	265,700
Less interest capitalized into capital projects	<u>64,000</u>	<u>57,100</u>
	<u>198,200</u>	<u>208,600</u>
Net income	865,600	595,800
NET REVENUES INVESTED IN THE WATER SYSTEM		
Beginning of year	<u>3,283,400</u>	<u>2,687,600</u>
End of year	<u>\$4,149,000</u>	<u>\$3,283,400</u>

The accompanying notes are an integral part of these statements.

THE ISLAND WATER ASSOCIATION, INC.
 STATEMENTS OF CASH FLOWS
 For the Years Ended December 31,

	<u>1994</u>	<u>1993</u>
CASH FLOWS PROVIDED BY (USED IN)		
OPERATING ACTIVITIES		
Cash received from customers	\$ 5,010,400	\$ 4,612,600
Cash paid to suppliers and employees	(3,158,800)	(2,925,800)
Interest received	89,000	71,000
Interest paid (net of amount capitalized)	<u>(199,000)</u>	<u>(208,100)</u>
Net cash flows provided by operating activities	<u>1,741,600</u>	<u>1,549,700</u>
CASH FLOWS PROVIDED BY (USED IN)		
INVESTING ACTIVITIES		
Capital expenditures (including capitalized interest of \$64,000 and \$57,100 for 1994 and 1993, respectively)	(1,481,500)	(1,354,600)
Proceeds from the sale of fixed assets	-	35,000
Purchases of marketable securities	(1,119,800)	(1,330,900)
Redemption of marketable securities	385,900	851,600
Investments in participation certificates	<u>(20,000)</u>	<u>(19,700)</u>
Net cash flows used in investing activities	<u>(2,235,400)</u>	<u>(1,818,600)</u>
CASH FLOWS PROVIDED BY (USED IN)		
FINANCIAL ACTIVITIES		
Payment of debt	(33,900)	(31,100)
Increase in members' contributions in aid of construction	<u>190,600</u>	<u>365,000</u>
Net cash flows provided by financing activities	<u>156,700</u>	<u>333,900</u>
Net increase (decrease) in cash	(337,100)	65,000
CASH, beginning of year	<u>448,300</u>	<u>383,300</u>
CASH, end of year	<u>\$ 111,200</u>	<u>\$ 448,300</u>
CASH BALANCES		
Unrestricted	\$ 111,200	\$ 23,300
Restricted	<u>-</u>	<u>425,000</u>
	<u>\$ 111,200</u>	<u>\$ 448,300</u>

The accompanying notes are an integral part of these statements.

THE ISLAND WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 1994 and 1993

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

The Island Water Association, Inc. (the Association) is a not-for-profit organization exempt from federal and state income taxes under Internal Revenue Code Section 501(c)(4). The Association provides water to commercial and residential structures on Sanibel and Captiva islands, two barrier islands located in southwest Florida.

Each connection for the services rendered by the Association entitles the subscriber to one membership certificate. At any meeting of the members of the Association, each member shall be entitled to only one vote, regardless of the number of certificates of membership held.

Significant Accounting Policies

Regulatory agency and franchise

On July 14, 1965, the Association was granted a thirty-year franchise by the Board of County Commissioners of Lee County, Florida (the County). The current franchise agreement states that all rate adjustments require the prior written consent of the County.

The franchise agreement is currently in the process of being renewed. The Association anticipates a renewal period shorter than the 30 year time frame allowed for under the current agreement and is also anticipating that the City of Sanibel will be involved in the new agreement.

The current franchise agreement gives the County the right at any time during the franchise period to purchase the property of the Association at a purchase price not to exceed the original cost of the facilities less depreciation. Upon the retirement by the Association of all of its outstanding debt, ownership will revert back to the County.

Utility plant in service

Utility plant in service is recorded at cost. Depreciation is provided over the estimated useful lives of the assets, using the straight-line method. The cost of depreciable plant assets retired, plus the cost of removal, less any sale proceeds, is charged against accumulated depreciation.

THE ISLAND WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 1994 and 1993

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Marketable securities

Marketable securities, which consist of FNMA and FHLMC certificates, are carried at cost. At December 31, 1994 the market value of these securities was \$1,470,500. These securities are not considered to be cash equivalents.

Unbilled revenues

Unbilled revenues represent revenues between the last dates of the cycle billings and year end.

Inventory

Inventory is stated at the lower of cost (first-in, first-out method) or market.

Investments

The Association is required to invest in participation certificates in the National Bank for Cooperatives. The Association recognizes income from this investment on the accrual basis. This method records income and increases the Association's invested amount, based on the patronage dividends declared by the Bank. Refer to Note 3 for a more complete explanation of these participation certificates.

Allowance for funds used during construction

Interest is capitalized on funds used during construction at the weighted average rate paid by the Association on its long-term debt.

Members' contributions in aid of construction

Members' contributions in aid of construction consists of connection fees received from members and distribution lines contributed to the Association by real estate developers since the inception of the Association. These distribution lines are valued at an estimate of the developers' costs and are added to the Association's transmission and distribution plant.

Cash and cash equivalents

For the purpose of the statement of cash flows, the Association considers funds subject to immediate withdrawal by check to be cash equivalents.

THE ISLAND WATER ASSOCIATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 1994 and 1993

NOTE 2 - UTILITY PLANT IN SERVICE

Utility plant in service consists of the following:

	<u>1994</u>	<u>1993</u>
Source of supply plant	\$ 3,127,200	\$ 3,089,300
Pumping plant	704,100	688,700
Water treatment plant	6,270,100	6,061,800
Transmission and distribution plant	10,785,900	10,042,600
General plant	<u>2,291,000</u>	<u>2,249,200</u>
	<u>\$23,178,300</u>	<u>\$22,131,600</u>

NOTE 3 - LONG-TERM DEBT

Long-term debt consists of the following:

	<u>1994</u>	<u>1993</u>
11.22% mortgage note payable in quarterly installments of \$62,825 including interest, due April, 2014	\$ 1,973,600	\$ 2,001,700
9.90% mortgage note payable to a financial institution, monthly payments of principal and interest in the amount of \$3,824, final payment due April, 2014	<u>382,700</u>	<u>388,500</u>
	2,356,300	2,390,200
Less current maturities	<u>38,100</u>	<u>34,400</u>
	<u>\$ 2,318,200</u>	<u>\$ 2,355,800</u>

Maturities of long-term debt are as follows:

<u>December 31,</u>	
1995	\$ 38,100
1996	42,500
1997	47,400
1998	52,800
1999	58,900
Thereafter	<u>2,116,600</u>
	<u>\$2,356,300</u>

THE ISLAND WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 1994 and 1993

NOTE 3 - LONG-TERM DEBT (Continued)

Substantially all assets are pledged as collateral for long-term debt.

The agreements with the National Bank for Cooperatives calls for the Association to maintain a cash or marketable securities balance of \$300,000 to be used for repair or replacement of plant assets, payments of principal and interest, and for expansion of plant assets with prior lender approval. The agreement precludes the Association from entering into other indebtedness and requires certain working capital and tangible net worth ratios be maintained.

The loan agreement provides for a penalty if the loan is paid off prior to maturity. The penalty approximates the net present value of the difference between current market interest rates and the debt's stated rate. At the end of 1994 and 1993, the approximate amount of the penalty would have been \$351,000 and \$707,000, respectively.

The Association is required to purchase Participation Certificates in the National Bank for Cooperatives. These certificates are required by the Farm Credit Act of 1971 and the Bank's capital plan, as adopted by its Board of Directors, and represent capital ownership by the Association in the Bank. Additionally, the Association is allocated income from these participation certificates based on the Bank's profitability.

NOTE 4 - PENSION PLAN

The Association established a defined-contribution pension plan covering substantially all employees beginning November 1, 1979. The defined-contribution plan requires the Association to contribute annually an amount equal to 10% of each employee's salary up to the taxable wage base, plus an additional 5.7% of any salary in excess of the taxable wage base. The Association's contributions for 1994 and 1993 were approximately \$127,500 and \$123,000, respectively.

THE ISLAND WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 1994 and 1993

NOTE 4 - PENSION PLAN (Continued)

The Organization has another retirement plan that is a deferred compensations agreement with its supervising personnel under the Internal Revenue Code (IRC) section 457. This IRC code allows for employees to defer a portion of their salary until retirement. These amounts legally remain the assets of the Organization until they are actually paid to the employees. Because of this, the Organization has a stewardship responsibility to ensure the funds are properly invested. The Delaware Group of Mutual Funds is administering the plan. The cumulative amount contributed through December 31, 1994 was \$8,905. The market value of the investment purchased with these contributions was \$8,412 at December 31, 1994.

NOTE 5 - CHANGE IN ESTIMATED USEFUL LIFE

During 1993, the Association revised the estimated useful life of the membranes at the Reverse Osmosis plant to 5 years. This revision is based on the Association's experience. The effect of this change was to increase depreciation expense and decrease the Association's 1993 net income by \$54,000.

NOTE 6 - COMMITMENTS

The Association had several uncompleted contracts outstanding at December 31, 1994. The contracts are for the completion of the Association's new administrative building and for improvements to the utility plant in service. All outstanding contracts are expected to be completed within a year. Capital contract commitments outstanding at December 31, 1994 were \$296,000.

THE ISLAND WATER ASSOCIATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 1994 and 1993

NOTE 7 - STATEMENTS OF CASH FLOWS

Presented below is the reconciliation of net income to net cash provided by operating activities.

RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>1994</u>	<u>1993</u>
Net income	\$ <u>865,600</u>	\$ <u>595,800</u>
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	837,300	950,400
(Increase) decrease in:		
Accounts receivable	15,500	68,200
Unbilled revenues	75,200	(87,300)
Prepayments and other	-	23,800
Investments	(35,900)	(34,900)
Increase (decrease) in:		
Accounts payable and accrued expenses	<u>(16,100)</u>	<u>33,700</u>
	<u>876,000</u>	<u>953,900</u>
Net cash provided by operating activities	<u>\$1,741,600</u>	<u>\$1,549,700</u>

The Association received distribution lines contributed by developers in the amount \$10,000 in 1993. These items represent noncash investing and financing activities.