

THE ISLAND WATER ASSOCIATION, INC.

FINANCIAL STATEMENTS

December 31, 1995 and 1994

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**SCHULTZ
CHAPEL
& CO.**

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying balance sheets of the Island Water Association, Inc. (the "Association"), as of December 31, 1995 and 1994, 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, 1995 and 1994, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Schultz, Chapel & Co.
Schultz, Chapel & Co.
February 9, 1996

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

	<u>1995</u>	<u>1994</u>
ASSETS		
PLANT PROPERTY		
Utility plant in service	\$24,706,800	\$23,178,300
Construction work in progress	<u>70,900</u>	<u>769,400</u>
	24,777,700	23,947,700
Less accumulated depreciation	<u>9,533,000</u>	<u>8,689,200</u>
Net plant property	<u>15,244,700</u>	<u>15,258,500</u>
CURRENT ASSETS		
Cash	492,600	102,300
Marketable securities	-	389,400
Accounts receivable	230,400	292,800
Unbilled revenues	292,500	192,700
Prepayments and other	67,500	32,900
Inventory	<u>19,000</u>	<u>7,500</u>
Total current assets	<u>1,102,000</u>	<u>1,017,600</u>
INVESTMENTS		
Participation certificates	<u>268,800</u>	<u>234,900</u>
BOARD RESTRICTED ASSETS		
Cash, R.O. Membranes Fund	255,200	-
Marketable securities, Environmental Compliance Fund	916,500	643,000
Marketable securities, R. O. Membranes Fund	<u>272,800</u>	<u>372,000</u>
Total board restricted assets	<u>1,444,500</u>	<u>1,015,000</u>
RESTRICTED ASSETS		
Cash, 457 plan	19,700	8,900
Marketable securities	<u>300,000</u>	<u>300,000</u>
	<u>319,700</u>	<u>308,900</u>
	<u>\$18,379,700</u>	<u>\$17,834,900</u>

The accompanying notes are an integral part of these statements.

	<u>1995</u>	<u>1994</u>
CAPITALIZATION, LIABILITIES AND MEMBERS' CONTRIBUTIONS		
CAPITALIZATION		
Net revenues reinvested in the water system	\$ 4,610,800	\$ 4,149,000
Long-term debt, less current maturities	<u>2,277,100</u>	<u>2,318,200</u>
Total capitalization	<u>6,887,900</u>	<u>6,467,200</u>
CURRENT LIABILITIES		
Current maturities of long-term debt	33,400	38,100
Accounts payable and accrued expenses	<u>236,900</u>	<u>262,700</u>
Total current liabilities	<u>270,300</u>	<u>300,800</u>
MEMBERS' CONTRIBUTIONS IN AID OF CONSTRUCTION		
	<u>11,221,500</u>	<u>11,066,900</u>
	<u>\$18,379,700</u>	<u>\$17,834,900</u>

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

	<u>1995</u>	<u>1994</u>
OPERATING REVENUES	\$4,306,200	\$4,843,400
OPERATING COSTS		
Operations	1,137,200	1,141,000
Maintenance	766,100	770,100
Administration	1,006,100	1,232,400
Depreciation	<u>843,800</u>	<u>837,300</u>
	<u>3,753,200</u>	<u>3,980,800</u>
Operating Income	<u>553,000</u>	<u>862,600</u>
OTHER INCOME AND EXPENSES		
Interest	112,400	89,000
Other	79,900	112,200
Loss on sale of securities	<u>(90,300)</u>	<u>-</u>
	<u>102,000</u>	<u>201,200</u>
Income before interest charges	<u>655,000</u>	<u>1,063,800</u>
INTEREST CHARGES ON LONG-TERM DEBT	257,900	262,200
Less interest capitalized into capital projects	<u>64,700</u>	<u>64,000</u>
	<u>193,200</u>	<u>198,200</u>
Net Income	461,800	865,600
NET REVENUES REINVESTED IN THE WATER SYSTEM		
Beginning of year	<u>4,149,000</u>	<u>3,283,400</u>
End of year	<u>\$4,610,800</u>	<u>\$4,149,000</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>1995</u>	<u>1994</u>
CASH FLOWS PROVIDED BY (USED IN)		
OPERATING ACTIVITIES		
Cash received from customers	\$ 4,229,400	\$ 5,010,400
Cash paid to suppliers and employees	(2,981,300)	(3,158,800)
Interest received	112,400	89,000
Interest paid (net of amount capitalized)	<u>(193,200)</u>	<u>(199,000)</u>
Net cash flows provided by operating activities	<u>1,167,300</u>	<u>1,741,600</u>
CASH FLOWS PROVIDED BY (USED IN)		
INVESTING ACTIVITIES		
Capital expenditures (including capitalized interest of \$64,700 and \$64,000 for 1995 and 1994, respectively)	(830,000)	(1,481,500)
Purchases of marketable securities	(1,159,800)	(1,119,800)
Redemption of marketable securities	1,374,900	385,900
Investments in participation certificates	<u>(4,900)</u>	<u>(20,000)</u>
Net cash flows used in investing activities	<u>(619,800)</u>	<u>(2,235,400)</u>
CASH FLOWS PROVIDED BY (USED IN)		
FINANCIAL ACTIVITIES		
Payment of debt	(45,800)	(33,900)
Increase in members' contributions in aid of construction	<u>154,600</u>	<u>190,600</u>
Net cash flows provided by financing activities	<u>108,800</u>	<u>156,700</u>
Net increase (decrease) in cash	656,300	(337,100)
CASH, beginning of year	<u>111,200</u>	<u>448,300</u>
CASH, end of year	<u>\$ 767,500</u>	<u>\$ 111,200</u>
CASH BALANCES		
Unrestricted	\$ 492,600	\$ 111,200
Restricted	<u>274,900</u>	<u>-</u>
	<u>\$ 767,500</u>	<u>\$ 111,200</u>

The accompanying notes are an integral part of these statements.

THE ISLAND WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 1995 and 1994

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 30 year franchise by the Board of County Commissioners of Lee County, Florida (the "County"). This franchise agreement expired during the current year and the Association entered into a new franchise agreement jointly with the City of Sanibel and with Lee County. The term of this new agreement is 20 years and requires that the City Council approve any rate changes requested by the Association. The agreement also allows either the City or the County to purchase the property of the Association at the then fair market value and requires the Association to give the City or the County the first right of refusal regarding the sale of the Association's property.

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, 1995 and 1994

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Significant Accounting Policies (Continued)

Estimates

Management uses estimates and assumptions in preparing these financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Marketable securities

Marketable securities, which consist of FNMA certificates, FHLMC certificates and U.S. Treasury Securities, are carried at cost. These securities are not considered to be cash equivalents.

The components of the marketable securities as of December 31, 1995 are as follows:

	<u>Cost</u>	<u>Market Value</u>
FNMA Certificates	\$ 186,400	\$ 172,200
FHLMC Certificates	243,100	242,400
Treasury Securities	<u>1,059,800</u>	<u>1,058,000</u>
	<u>\$1,489,300</u>	<u>\$1,472,600</u>

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.

THE ISLAND WATER ASSOCIATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 1995 and 1994

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Significant Accounting Policies (Continued)

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 Association also has on deposit with commercial banks amounts in excess of the FDIC insurance amounts.

NOTE 2 - UTILITY PLANT IN SERVICE

Utility plant in service consists of the following:

	<u>1995</u>	<u>1994</u>
Source of supply plant	\$ 3,143,200	\$ 3,127,200
Pumping plant	725,000	704,100
Water treatment plant	6,398,300	6,270,100
Transmission and distribution plant	11,019,700	10,785,900
General plant	<u>3,420,600</u>	<u>2,291,000</u>
	<u>\$24,706,800</u>	<u>\$23,178,300</u>

THE ISLAND WATER ASSOCIATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 1995 and 1994

NOTE 3 - LONG-TERM DEBT

Long-term debt consists of the following:

	<u>1995</u>	<u>1994</u>
11.22% mortgage note payable in quarterly installments of \$62,825 including interest, due April, 2014	\$1,934,800	\$1,973,600
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>375,700</u>	<u>382,700</u>
	2,310,500	2,356,300
Less current maturities	<u>33,400</u>	<u>38,100</u>
	<u>\$2,277,100</u>	<u>\$2,318,200</u>

Maturities of long-term debt are as follows:

December 31,

1996	\$ 33,400
1997	45,000
1998	50,200
1999	56,000
2000	62,500
Thereafter	<u>2,063,400</u>
	<u>\$2,310,500</u>

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 ISLAND WATER ASSOCIATION, INC.
NOTES TO FINANCIAL STATEMENTS
December 31, 1995 and 1994

NOTE 3 - LONG-TERM DEBT (Continued)

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 1995 and 1994, the approximate amount of the penalty would have been \$590,200 and \$351,000, 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 1995 and 1994 were approximately \$102,300 and \$127,500, respectively.

The Association 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 Association until they are actually paid to the employees. Because of this, the Association 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, 1995 was \$18,200. The market value of the investment purchased with these contributions was \$19,700 at December 31, 1995.

THE ISLAND WATER ASSOCIATION, INC.
 NOTES TO FINANCIAL STATEMENTS
 December 31, 1995 and 1994

NOTE 5 - COMMITMENTS

The Association had several uncompleted construction contracts outstanding at December 31, 1995. All outstanding contracts are expected to be completed within a year. Capital contract commitments outstanding at December 31, 1995 were \$328,325.

NOTE 6 - 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>1995</u>	<u>1994</u>
Net income	\$ <u>461,800</u>	\$ <u>865,600</u>
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	843,800	837,300
(Increase) decrease in:		
Accounts receivable	62,400	15,500
Unbilled revenues	(99,800)	75,200
Prepayments and other	(46,100)	-
Investments	(29,000)	(35,900)
Increase (decrease) in:		
Accounts payable and accrued expenses	<u>(25,800)</u>	<u>(16,100)</u>
	<u>705,500</u>	<u>876,000</u>
Net cash provided by operating activities	<u>\$1,167,300</u>	<u>\$1,741,600</u>