

**THE ISLAND WATER ASSOCIATION, INC.**

**FINANCIAL STATEMENTS**

**December 31, 1996 and 1995**

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SCHULTZ  
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& O.

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, 1996 and 1995, 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, 1996 and 1995, 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 14, 1997

4575 VIA ROYALE, SUITE 110  
FORT MYERS, FLORIDA 33919

(941) 939-5333

FAX (941) 939-4682

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

	<u>1996</u>	<u>1995</u>
<b>ASSETS</b>		
<b>PLANT PROPERTY</b>		
Utility plant in service	\$26,099,300	\$24,706,800
Construction work in progress	<u>289,900</u>	<u>70,900</u>
	26,389,200	24,777,700
Less accumulated depreciation	<u>10,447,200</u>	<u>9,533,000</u>
Net plant property	<u>15,942,000</u>	<u>15,244,700</u>
<b>CURRENT ASSETS</b>		
Cash	364,000	492,600
Accounts receivable	339,800	230,400
Unbilled revenues	233,100	292,500
Prepayments and other	80,000	67,500
Inventory	<u>20,700</u>	<u>19,000</u>
Total current assets	<u>1,037,600</u>	<u>1,102,000</u>
<b>INVESTMENTS</b>		
Participation certificates	<u>272,600</u>	<u>268,800</u>
<b>BOARD RESTRICTED ASSETS</b>		
Reserve fund, cash	499,200	255,200
Reserve fund, marketable securities	<u>1,299,500</u>	<u>1,189,300</u>
Total board restricted assets	<u>1,798,700</u>	<u>1,444,500</u>
<b>RESTRICTED ASSETS</b>		
Cash, 457 plan	40,900	19,700
Marketable securities	<u>300,000</u>	<u>300,000</u>
	<u>340,900</u>	<u>319,700</u>
	<u>\$19,391,800</u>	<u>\$18,379,700</u>

The accompanying notes are an integral part of these statements.

	<u>1996</u>	<u>1995</u>
<b>CAPITALIZATION, LIABILITIES AND MEMBERS' CONTRIBUTIONS</b>		
<b>CAPITALIZATION</b>		
Net revenues reinvested in the water system	\$ 5,363,800	\$ 4,610,800
Long-term debt, less current maturities	<u>2,220,700</u>	<u>2,277,100</u>
Total capitalization	<u>7,584,500</u>	<u>6,887,900</u>
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt	47,400	33,400
Accounts payable and accrued expenses	<u>295,100</u>	<u>236,900</u>
Total current liabilities	<u>342,500</u>	<u>270,300</u>
<b>MEMBERS' CONTRIBUTIONS IN AID OF CONSTRUCTION</b>	<u>11,464,800</u>	<u>11,221,500</u>
	<u>\$19,391,800</u>	<u>\$18,379,700</u>

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

	<u>1996</u>	<u>1995</u>
<b>OPERATING REVENUES</b>	<u>\$4,572,900</u>	<u>\$4,306,200</u>
<b>OPERATING COSTS</b>		
Operations	1,213,400	1,137,200
Maintenance	634,200	766,100
Administration	1,029,500	1,006,100
Depreciation	<u>914,300</u>	<u>843,800</u>
	<u>3,791,400</u>	<u>3,753,200</u>
Operating Income	<u>781,500</u>	<u>553,000</u>
<b>OTHER INCOME AND EXPENSES</b>		
Interest	120,900	112,400
Other	76,300	79,900
Loss on sale of securities	<u>(21,300)</u>	<u>(90,300)</u>
	<u>175,900</u>	<u>102,000</u>
Income before interest charges	<u>957,400</u>	<u>655,000</u>
<b>INTEREST CHARGES ON LONG-TERM DEBT</b>	253,100	257,900
Less interest capitalized into capital projects	<u>48,700</u>	<u>64,700</u>
	<u>204,400</u>	<u>193,200</u>
Net Income	753,000	461,800
<b>NET REVENUES REINVESTED IN THE WATER SYSTEM</b>		
Beginning of year	<u>4,610,800</u>	<u>4,149,000</u>
End of year	<u>\$5,363,800</u>	<u>\$4,610,800</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>1996</u>	<u>1995</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>		
Cash received from customers	\$ 4,586,700	\$ 4,229,400
Cash paid to suppliers and employees	(2,820,700)	(2,981,300)
Interest received	120,900	112,400
Interest paid (net of amount capitalized)	<u>(204,400)</u>	<u>(193,200)</u>
Net cash flows provided by operating activities	<u>1,682,500</u>	<u>1,167,300</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>INVESTING ACTIVITIES</b>		
Capital expenditures (including capitalized interest of \$48,700 and \$64,700 for 1996 and 1995, respectively)	(1,527,500)	(830,000)
Purchases of marketable securities	(1,100,300)	(1,159,800)
Redemption of marketable securities	968,800	1,374,900
Investments in participation certificates	<u>(3,800)</u>	<u>(4,900)</u>
Net cash flows used in investing activities	<u>(1,662,800)</u>	<u>(619,800)</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>FINANCIAL ACTIVITIES</b>		
Payment of debt	(42,400)	(45,800)
Increase in members' contributions in aid of construction	<u>159,300</u>	<u>154,600</u>
Net cash flows provided by financing activities	<u>116,900</u>	<u>108,800</u>
Net increase in cash	136,600	656,300
CASH, beginning of year	<u>767,500</u>	<u>111,200</u>
CASH, end of year	<u>\$ 904,100</u>	<u>\$ 767,500</u>

**NON-CASH INVESTING AND FINANCING ACTIVITIES**

During the year ended December 31, 1996, in accordance with an agreement, the Association received title to a distribution system from Churchwood Estates in the form of a contribution in aid of construction at a value of \$84,000.

The accompanying notes are an integral part of these statements.

THE ISLAND WATER ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 1996 and 1995

**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 16, 1996, the Association was granted a 20 year franchise by the Board of County Commissioners of Lee County, Florida (the County) and the City of Sanibel (the City). This franchise agreement 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.

**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.

THE ISLAND WATER ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 1996 and 1995

**NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Significant Accounting Policies (Continued)**

**Marketable securities**

Marketable securities, consist entirely of U.S. Treasury Securities and are carried at cost, which approximates their market value. 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.

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 1996 and 1995

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Significant Accounting Policies (Continued)

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.

For statement of cash flows purposes the cash balance is comprised of the following:

Cash Balances		
Unrestricted	\$364,000	\$492,600
Restricted	499,200	255,200
Cash 457 plan	<u>40,900</u>	<u>19,700</u>
	<u>\$904,100</u>	<u>\$767,500</u>

Reclassifications

Certain amounts in the 1995 financial statements have been reclassified to conform to the 1996 presentation.

NOTE 2 - UTILITY PLANT IN SERVICE

Utility plant in service consists of the following:

	<u>1996</u>	<u>1995</u>
Source of supply plant	\$ 3,206,400	\$ 3,143,200
Pumping plant	748,000	725,000
Water treatment plant	6,838,800	6,398,300
Transmission and distribution plant	11,801,900	11,019,700
General plant	<u>3,504,200</u>	<u>3,420,600</u>
	<u>\$26,099,300</u>	<u>\$24,706,800</u>

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 1996 and 1995

NOTE 3 - LONG-TERM DEBT

Long-term debt consists of the following:

	<u>1996</u>	<u>1995</u>
11.22% mortgage note payable in quarterly installments of \$62,825 including interest, due April, 2014	\$1,900,100	\$1,934,800
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>368,000</u>	<u>375,700</u>
	2,268,100	2,310,500
Less current maturities	<u>47,400</u>	<u>33,400</u>
	<u>\$2,220,700</u>	<u>\$2,277,100</u>

Maturities of long-term debt are as follows:

December 31,

1997	\$ 47,400
1998	52,800
1999	58,900
2000	65,600
2001	73,100
Thereafter	<u>1,970,300</u>
	<u>\$2,268,100</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, 1996 and 1995

**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 1996 and 1995, the approximate amount of the penalty would have been \$516,500 and \$590,200, 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 plus an additional 5.7% of any salary in excess of the taxable wage base. The Association's contributions for 1996 and 1995 were approximately \$117,100 and \$102,300, respectively.

The Association has another retirement plan that is a deferred compensation 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, 1996 was \$40,900. The market value of the investment purchased with these contributions was \$43,500 at December 31, 1996.

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 1996 and 1995

NOTE 5 - 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>1996</u>	<u>1995</u>
Net income	\$ <u>753,000</u>	\$ <u>461,800</u>
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	914,200	843,800
Loss on sale of investment securities	21,300	-
(Increase) decrease in:		
Accounts receivable	(109,400)	62,400
Unbilled revenues	59,400	(99,800)
Prepayments and other Investments	(14,200)	(46,100)
-	-	(29,000)
Increase (decrease) in:		
Accounts payable and accrued expenses	<u>58,200</u>	<u>(25,800)</u>
	<u>929,500</u>	<u>705,500</u>
Net cash provided by operating activities	<u>\$1,682,500</u>	<u>\$1,167,300</u>