

**THE ISLAND WATER ASSOCIATION, INC.**

**FINANCIAL STATEMENTS**

**December 31, 1998 and 1997**

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**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, 1998 and 1997, 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, 1998 and 1997, 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. LLP*  
Schultz, Chaipel & Co., L.L.P.  
January 22, 1999

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

	<u>1998</u>	<u>1997</u>
<b>ASSETS</b>		
<b>PLANT PROPERTY</b>		
Utility plant in service	\$ 28,093,100	\$ 27,399,400
Construction work in progress	237,100	397,300
	<u>28,330,200</u>	<u>27,796,700</u>
Less accumulated depreciation	12,215,800	11,406,200
Net plant property	<u>16,114,400</u>	<u>16,390,500</u>
<b>CURRENT ASSETS</b>		
Cash - operating	584,200	275,300
Cash - unexpended loan proceeds	3,013,800	-
Accounts receivable	486,300	324,200
Unbilled revenues	171,800	180,100
Prepayments and other	119,600	112,900
Total current assets	<u>4,375,700</u>	<u>892,500</u>
<b>INVESTMENTS</b>		
Participation certificates	<u>272,600</u>	<u>275,000</u>
<b>BOARD RESTRICTED ASSETS</b>		
Reserve fund, cash	400,500	392,000
Reserve fund, marketable securities	2,386,800	1,976,100
Total Board restricted assets	<u>2,787,300</u>	<u>2,368,100</u>
<b>RESTRICTED ASSETS</b>		
457 retirement plan assets	89,600	74,200
Marketable securities	600,000	300,000
	<u>689,600</u>	<u>374,200</u>
	<u>\$ 24,239,600</u>	<u>\$ 20,300,300</u>

The accompanying notes are an integral part of these statements.

**CAPITALIZATION, LIABILITIES AND  
MEMBERS' CONTRIBUTIONS**

**CAPITALIZATION**

Net revenues reinvested in the water system  
Long-term debt, less current maturities

	<u>1998</u>	<u>1997</u>
	\$ 6,978,400	\$ 6,084,600
	<u>5,109,000</u>	<u>2,167,900</u>
	<u>12,087,400</u>	<u>8,252,500</u>

**CURRENT LIABILITIES**

Current maturities of long-term debt  
Accounts payable and accrued expenses

	58,900	52,800
	<u>292,600</u>	<u>400,300</u>
Total current liabilities	<u>351,500</u>	<u>453,100</u>

**MEMBERS' CONTRIBUTIONS IN AID OF  
CONSTRUCTION**

	<u>11,800,700</u>	<u>11,594,700</u>
	<u>\$ 24,239,600</u>	<u>\$ 20,300,300</u>

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

	<u>1998</u>	<u>1997</u>
<b>OPERATING REVENUES</b>	<u>\$ 4,963,400</u>	<u>\$ 4,664,300</u>
<b>OPERATING COSTS</b>		
Operations	1,269,300	1,275,700
Maintenance	724,900	620,200
Administration	1,190,500	1,125,200
Depreciation	<u>958,000</u>	<u>938,300</u>
	<u>4,142,700</u>	<u>3,959,400</u>
Operating Income	<u>820,700</u>	<u>704,900</u>
<b>OTHER INCOME</b>		
Interest	202,800	149,900
Other	<u>102,600</u>	<u>51,900</u>
	<u>305,400</u>	<u>201,800</u>
Income before interest charges	<u>1,126,100</u>	<u>906,700</u>
<b>INTEREST CHARGES ON LONG-TERM DEBT</b>	264,500	248,100
Less interest capitalized into capital projects	<u>32,200</u>	<u>62,200</u>
	<u>232,300</u>	<u>185,900</u>
Net Income	893,800	720,800
<b>NET REVENUES REINVESTED IN THE WATER SYSTEM</b>		
Beginning of year	<u>6,084,600</u>	<u>5,363,800</u>
End of year	<u>\$ 6,978,400</u>	<u>\$ 6,084,600</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>1998</u>	<u>1997</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>		
Cash received from customers	\$ 4,912,200	\$ 4,763,800
Cash paid to suppliers and employees	(3,299,100)	(2,907,400)
Interest received	202,800	149,900
Interest paid (net of amount capitalized)	<u>(232,300)</u>	<u>(185,900)</u>
Net cash flows provided by operating activities	<u>1,583,600</u>	<u>1,820,400</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>INVESTING ACTIVITIES</b>		
Capital expenditures (including capitalized interest of \$32,200 and \$62,200 for 1998 and 1997, respectively)	(1,174,700)	(1,407,500)
Purchases of marketable securities	(1,410,700)	(1,626,600)
Redemption of marketable securities	700,000	950,000
Proceeds from the sale of assets	492,800	21,000
Investments in participation certificates	<u>2,400</u>	<u>(2,400)</u>
Net cash flows used in investing activities	<u>(1,390,200)</u>	<u>(2,065,500)</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>FINANCING ACTIVITIES</b>		
Proceeds from debt	3,000,000	-
Payment of debt	(52,800)	(47,400)
Increase in members' contributions in aid of construction	<u>206,000</u>	<u>129,900</u>
Net cash flows provided by financial activities	<u>3,153,200</u>	<u>82,500</u>
Net increase (decrease) in cash	3,346,600	(162,600)
CASH, beginning of year	<u>741,500</u>	<u>904,100</u>
CASH, end of year	<u>\$ 4,088,100</u>	<u>\$ 741,500</u>

The accompanying notes are an integral part of these statements.

THE ISLAND WATER ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 1998 and 1997

**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 Sanibel 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, 1998 and 1997

**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 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.

**Investments**

The Association is required to invest in participation certificates in the National Bank for Cooperatives as a requirement of its debt agreement. 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, 1998 and 1997

**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	<u>1998</u>	<u>1997</u>
Operating		
Loan proceeds	\$ 584,200	\$275,300
Restricted	3,013,800	-
Cash 457 plan	400,500	392,000
	<u>89,600</u>	<u>74,200</u>
	<u>\$4,088,100</u>	<u>\$741,500</u>

**NOTE 2 - UTILITY PLANT IN SERVICE**

Utility plant in service consists of the following:

	<u>1998</u>	<u>1997</u>
Source of supply plant		
Pumping plant	\$3,273,900	\$ 3,242,700
Water treatment plant	1,197,000	767,500
Transmission and distribution plant	7,309,900	7,133,300
General plant	13,091,500	12,651,800
	<u>3,220,800</u>	<u>3,604,100</u>
	<u>\$28,093,100</u>	<u>\$27,399,400</u>

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 1998 and 1997

**NOTE 3 - LONG-TERM DEBT**

Long-term debt consists of the following:

	<u>1998</u>	<u>1997</u>
11.22% mortgage note payable in quarterly installments of \$62,825 including interest, final payment due April, 2014	\$1,817,800	\$1,861,200
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	350,100	359,500
6.75% mortgage note payable to a financial institution, interest only payable monthly through December 1999, beginning January, 2000 principal and interest in the amount of \$20,703, final payment due December, 2024, unexpended proceeds are to be used for the Association's deep-well injection project.	<u>3,000,000</u>	<u>-</u>
Less current maturities	5,167,900 <u>58,900</u>	2,220,700 <u>52,800</u>
	<u>\$5,109,000</u>	<u>\$2,167,900</u>

Maturities of long-term debt are as follows:

<u>December 31,</u>	
1999	
2000	\$ 58,900
2001	116,800
2002	124,100
2003	136,000
Thereafter	149,100
	<u>4,583,000</u>
	<u>\$5,167,900</u>

Substantially all assets are pledged

THE ISLAND WATER ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 1998 and 1997

**NOTE 3 - LONG-TERM DEBT (Continued)**

The agreements with the National Bank for Cooperatives calls for the Association to maintain a cash or marketable securities balance of \$600,000 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 agreements provide for a penalty if the loans are 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 1998 and 1997, the approximate amount of the penalty would have been \$887,000 and \$635,800, 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 on November 1, 1979. This 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 social security taxable wage base. The Association's contributions for 1998 and 1997 were approximately \$136,600 and \$122,300, 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. The Delaware Group of Mutual Funds is administering the plan. The cumulative amount contributed through December 31, 1998 was \$73,220. The market value of the investments purchased with these contributions was \$89,600 at December 31, 1998.

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 1998 and 1997

**NOTE 4 - PENSION PLAN (Continued)**

During 1997, the Association adopted another defined contribution savings plan under Section 401(k) of the Internal Revenue Code (IRC) for all eligible employees. This plan allows employees to defer up to 8% of their income on a pretax basis, subject to IRC limitations, through payroll contributions. In accordance with the provisions of the plan, the Association may elect to match 100% of employee contributions up to a maximum amount of 5% of gross pay.

For the years ended December 31, 1998 and 1997, the Association recorded expense for the matching contributions of \$59,700 and \$57,100, respectively.

**NOTE 5 - STATEMENTS OF CASH FLOWS**

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

	<u>1998</u>	<u>1997</u>
Net income	\$ <u>893,800</u>	\$ <u>720,800</u>
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	958,000	938,300
(Increase) decrease in:		
Accounts receivable	(162,100)	15,600
Unbilled revenues	8,300	53,000
Prepayments and other	(6,700)	(12,200)
Increase (decrease) in:		
Accounts payable and accrued expenses	<u>(107,700)</u>	<u>104,900</u>
	<u>689,800</u>	<u>1,099,600</u>
Net cash provided by operating activities	<u>\$1,583,600</u>	<u>\$1,820,400</u>