

**THE ISLAND WATER ASSOCIATION, INC.**

**FINANCIAL STATEMENTS**

**December 31, 2002 and 2001**

## **TABLE OF CONTENTS**

<b>INDEPENDENT AUDITORS' REPORT</b>	1
<b>FINANCIAL STATEMENTS</b>	
Balance sheets	2
Statements of operations and system investment	3
Statements of cash flows	4
Notes to financial statements	5 – 10

David L. Schultz, CPA\* ABV  
Clifford Chaipel, CPA\*  
Martin A. Redovan, CPA\* CVA  
Russell T. Baker, CPA\*

**SCHULTZ  
CHAIPHEL  
CO. L.L.P.**

\*Regulated by the State of Florida

## 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, 2002 and 2001, 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 auditing standards generally accepted in the United States of America. 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, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

  
Schultz, Chaipel & Co., L.L.P.  
January 31, 2003

12660 World Plaza Lane  
Fort Myers, Florida 33907  
(239) 939-5333  
Fax: (239) 939-4682  
E-Mail: [sec@swtlepa.com](mailto:sec@swtlepa.com)  
Website: [www.swtlepa.com](http://www.swtlepa.com)

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

<b>ASSETS</b>	<u>2002</u>	<u>2001</u>
<b>PLANT PROPERTY</b>		
Utility plant in service	\$ 36,824,600	\$ 34,918,300
Construction work in progress	39,000	455,900
	<u>36,863,600</u>	<u>35,374,200</u>
Less accumulated depreciation	14,697,800	13,683,300
Net plant property	<u>22,165,800</u>	<u>21,690,900</u>
<b>CURRENT ASSETS</b>		
Cash - operating	921,800	309,100
Accounts receivable	402,800	426,600
Unbilled revenues	176,300	146,800
Prepayments and other	156,000	129,600
Total current assets	<u>1,656,900</u>	<u>1,012,100</u>
<b>INVESTMENTS</b>		
Participation certificates	<u>354,700</u>	<u>326,000</u>
<b>BOARD RESTRICTED ASSETS</b>		
Reserve fund, cash	553,700	356,800
Reserve fund, marketable securities	5,154,600	4,449,900
Total board restricted assets	<u>5,708,300</u>	<u>4,806,700</u>
<b>RESTRICTED ASSETS</b>		
457 retirement plan assets	53,700	62,400
Marketable securities	600,000	600,000
Total restricted assets	<u>653,700</u>	<u>662,400</u>
	<u>\$ 30,539,400</u>	<u>\$ 28,498,100</u>

The accompanying notes are an integral part of these statements.

<b>CAPITALIZATION, LIABILITIES AND MEMBERS' CONTRIBUTIONS</b>	<u>2002</u>	<u>2001</u>
<b>CAPITALIZATION</b>		
Net revenues reinvested in the water system	\$ 10,543,100	\$ 9,995,600
Long-term debt, less current maturities	<u>5,539,000</u>	<u>4,544,600</u>
Total capitalization	<u>16,082,100</u>	<u>14,540,200</u>
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt	304,200	185,800
Accounts payable and accrued expenses	<u>408,200</u>	<u>385,500</u>
Total current liabilities	<u>712,400</u>	<u>571,300</u>
<b>MEMBERS' CONTRIBUTIONS IN AID OF CONSTRUCTION</b>		
	<u>13,744,900</u>	<u>13,386,600</u>
	<u>\$ 30,539,400</u>	<u>\$ 28,498,100</u>

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

	<u>2002</u>	<u>2001</u>
<b>OPERATING REVENUES</b>	<u>\$ 5,635,400</u>	<u>\$ 5,314,800</u>
<b>OPERATING COSTS</b>		
Operations	1,396,800	1,400,000
Maintenance	749,600	685,500
Administration	1,715,200	1,584,100
Depreciation	<u>1,114,300</u>	<u>1,048,200</u>
	<u>4,975,900</u>	<u>4,717,800</u>
Operating Income	<u>659,500</u>	<u>597,000</u>
<b>OTHER INCOME</b>		
Interest and earnings from investments	204,300	487,100
Other	<u>142,900</u>	<u>111,100</u>
	<u>347,200</u>	<u>598,200</u>
Income before interest charges	<u>1,006,700</u>	<u>1,195,200</u>
<b>INTEREST CHARGES ON LONG-TERM DEBT</b>	489,400	426,400
Less interest capitalized into capital projects	<u>(30,200)</u>	<u>(53,100)</u>
	<u>459,200</u>	<u>373,300</u>
Net Income	547,500	821,900
<b>NET REVENUES REINVESTED IN THE WATER SYSTEM</b>		
Beginning of year	<u>9,995,600</u>	<u>9,173,700</u>
End of year	<u>\$ 10,543,100</u>	<u>\$ 9,995,600</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>2002</u>	<u>2001</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>OPERATING ACTIVITIES</b>		
Cash received from customers	\$ 5,778,800	\$ 5,601,000
Cash paid to suppliers and employees	(3,924,300)	(3,638,200)
Interest received	249,600	337,200
Interest paid (net of amount capitalized)	<u>(455,000)</u>	<u>(369,300)</u>
Net cash flows provided by operating activities	<u>1,649,100</u>	<u>1,930,700</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>INVESTING ACTIVITIES</b>		
Capital expenditures (including capitalized interest of \$30,200 and \$53,100 for 2002 and 2001, respectively)	(1,540,600)	(2,171,100)
Purchases of marketable securities	(2,600,000)	(1,850,000)
Redemption of marketable securities	1,850,000	1,850,000
Net investments in participation certificates	<u>(28,700)</u>	<u>(28,500)</u>
Net cash flows used in investing activities	<u>(2,319,300)</u>	<u>(2,199,600)</u>
<b>CASH FLOWS PROVIDED BY (USED IN)</b>		
<b>FINANCING ACTIVITIES</b>		
Payment of debt	(287,200)	(207,100)
Proceeds from long-term debt	1,400,000	-
Increase in members' contributions in aid of construction	<u>358,300</u>	<u>255,600</u>
Net cash flows provided by financial activities	<u>1,471,100</u>	<u>48,500</u>
Net increase (decrease) in cash	800,900	(220,400)
<b>CASH, beginning of year</b>	<u>728,300</u>	<u>948,700</u>
<b>CASH, end of year</b>	<u>\$ 1,529,200</u>	<u>\$ 728,300</u>

The accompanying notes are an integral part of these statements.

**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.

The Association is subject to various commitments, contingencies and restrictions due to obtaining permits from the state of Florida and from the South Florida Water Management District.

**Utility plant in service**

Utility plant in service is recorded at cost. Depreciation is provided over the estimated useful lives of the classes of 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.

**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.

**Cash and cash equivalents**

For the purpose of the statement of cash flows, the Association considers funds subject to immediate withdrawal to be cash equivalents. The Association also has on deposit with commercial banks amounts in excess of the FDIC insurance amounts.

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2002 and 2001

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

**Significant Accounting Policies (Continued)**

**Cash and cash equivalents (Continued)**

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

	<u>2002</u>	<u>2001</u>
Cash balances		
Operating	\$ 921,800	\$309,100
Restricted	553,700	356,800
Cash 457 plan	<u>53,700</u>	<u>62,400</u>
	<u>\$1,529,200</u>	<u>\$728,300</u>

**NOTE 2 - UTILITY PLANT IN SERVICE**

Utility plant in service consists of the following:

	<u>2002</u>	<u>2001</u>
Source of supply plant	\$ 7,495,400	\$ 6,874,300
Pumping plant	826,800	826,800
Water treatment plant	8,505,300	7,725,000
Transmission and distribution plant	16,524,500	16,136,200
General plant	<u>3,472,600</u>	<u>3,356,000</u>
	<u>\$36,824,600</u>	<u>\$34,918,300</u>

**NOTE 3 - LONG-TERM DEBT**

Long-term debt, all of which is payable to the National Bank of the Co-operatives, consists of the following:

	<u>2002</u>	<u>2002</u>
11.22% mortgage note payable in quarterly installments of \$62,825 including interest, final payment due April 2014	\$1,587,100	\$1,654,800

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2002 and 2001

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

	<u>2002</u>	<u>2001</u>
9.90% mortgage note payable, monthly payments of principal and interest in the amount of \$3,824, final payment due April 2014	301,700	315,600
6.75% mortgage note payable which financed the drilling of a deep injection well, monthly principal payment of \$10,000 plus interest, final payment due December 2024.	2,640,000	2,760,000
7.03% mortgage note payable which financed the repair of the deep injection well, monthly principal payment of \$7,778 plus interest, final payment due December 2016	1,314,400	-
	<u>5,843,200</u>	<u>4,730,400</u>
Less current maturities	<u>304,200</u>	<u>185,800</u>
	<u>\$5,539,000</u>	<u>\$4,544,600</u>

Maturities of long-term debt are as follows:

<u>December 31,</u>	
2004	\$ 314,600
2005	326,600
2006	339,200
2007	330,800
Thereafter	<u>4,228,200</u>
	<u>\$5,539,000</u>

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

The agreements with the National Bank for Cooperatives (Co-Bank) 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 ISLAND WATER ASSOCIATION, INC.  
NOTES TO FINANCIAL STATEMENTS  
December 31, 2002 and 2001

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

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 2002 and 2001, the approximate amount of the penalty was \$930,600 and \$644,000, respectively.

The Association is required to purchase Participation Certificates in Co-Bank. 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 2002 and 2001 were approximately \$174,800 and \$152,900, respectively.

The Association has another retirement plan, which 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 market value of the investments purchased with these contributions was \$53,700 at December 31, 2002.

In 1998 the Association adopted a defined contribution savings plan under Section 401(k) of the Internal Revenue Code (IRC) for all eligible employees. This plan was modified in 2002 and certain provisions of the plan were changed. The plan now allows employees to defer up to the maximum allowed by the limitations imposed by the Internal Revenue Code through payroll deductions. In accordance with the new provisions of the plan, the Association will match 100% of employee contributions up to a maximum amount of 5% of gross pay and the Association will also match 50% of the amount over 5% of gross pay.

For the years ended December 31, 2002 and 2001, the Association recorded expense for the matching contributions of \$92,500 and \$76,400, respectively.

THE ISLAND WATER ASSOCIATION, INC.  
 NOTES TO FINANCIAL STATEMENTS  
 December 31, 2002 and 2001

**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>2002</u>	<u>2001</u>
Net income	\$ <u>547,500</u>	\$ <u>821,900</u>
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	1,114,300	1,048,200
Net unrealized security (gains) losses	45,300	(149,900)
Proceeds from the sale of assets	6,200	54,000
(Increase) decrease in:		
Accounts receivable	23,800	61,800
Unbilled revenues	(29,500)	59,300
Prepayments and other	(26,400)	39,000
Increase (decrease) in:		
Accounts payable and accrued expenses	<u>(32,100)</u>	<u>(3,600)</u>
	<u>1,101,600</u>	<u>1,108,800</u>
Net cash provided by operating activities	<u>\$1,649,100</u>	<u>\$1,930,700</u>