

ARMSTRONG WATER SUPPLY CORPORATION

FINANCIAL STATEMENTS AS OF

September 30, 2019 and 2018

TOGETHER WITH INDEPENDENT AUDITORS' REPORT THEREON

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INDEPENDENT AUDITORS' REPORT

Board of Directors
Armstrong Supply Corporation
Holland, Texas

We have audited the accompanying financial statements of Armstrong Water Supply Corporation, which comprise the statements of financial position as of September 30, 2019 and 2018, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**INDEPENDENT AUDITORS' REPORT
(CONTINUED)**

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Armstrong Water Supply Corporation as of September 30, 2019 and 2018, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Broclawyn Busch, Audit Manager, P.C.

Temple, Texas
December 27, 2019

FINANCIAL STATEMENTS

ARMSTRONG WATER SUPPLY CORPORATION
STATEMENTS OF FINANCIAL POSITION
September 30, 2019 and 2018

	ASSETS		
		2019	2018
Current Assets			
Cash and cash equivalents		\$ 257,203	\$ 307,247
Invested funds		16,385	29,619
Trade accounts receivable		112,278	89,608
Prepaid expenses		5,773	5,773
Total Current Assets		391,639	432,247
Property, Plant and Equipment			
Property, plant and equipment		5,138,189	5,058,434
Less: accumulated depreciation		(2,104,359)	(1,933,862)
Property, Plant and Equipment, net		3,033,830	3,124,572
Other Assets			
Invested funds - reserve		173,019	148,808
Member investment		500	500
Investment in CoBank		27,716	21,725
Total Other Assets		201,235	171,033
Total Assets		\$ 3,626,704	\$ 3,727,852

The accompanying notes are an integral part of the financial statements.

LIABILITIES

	<u>2019</u>	<u>2018</u>
Current Liabilities		
Current portion of long term debt	\$ 67,707	\$ 66,339
Trade accounts payable	57,855	32,288
Regulatory assessment fee payable	3,308	3,711
Accrued interest	7,246	7,504
Member deposits	-	<u>20,000</u>
 Total Current Liabilities	 136,116	 129,842
 Long-Term Debt		
Long-term debt, net of current portion	<u>1,723,390</u>	<u>1,790,218</u>
 Total Liabilities	 1,859,506	 1,920,060

NET ASSETS

Net Assets		
Without Member Restrictions:		
Membership reserve	184,790	176,990
CoBank reserve	173,019	148,808
Undesignated	1,409,389	1,481,994
Total Net Assets	<u>1,767,198</u>	<u>1,807,792</u>
 Total Liabilities and Net Assets	 <u>\$ 3,626,704</u>	 <u>\$ 3,727,852</u>

ARMSTRONG SUPPLY CORPORATION
STATEMENTS OF ACTIVITIES
For the Years Ended September 30, 2019 and 2018

	2019	2018
Operating Revenues		
Metered water sales	\$ 853,671	\$ 1,023,941
Tap and equity fees	50,033	64,900
Penalty and reconnect fees	16,698	15,845
Service charges	2,250	2,285
Total Operating Revenues	922,652	1,106,971
Operating Expenses		
Water purchased	374,000	442,470
Salaries, wages and benefits	222,766	232,309
Depreciation and amortization	170,496	162,013
Interest expense	89,598	91,574
System repair and maintenance	59,758	54,050
Power for pumping and offices	30,987	34,631
Auto expense	21,062	17,911
Insurance expense	13,303	13,957
Miscellaneous expense	12,851	4,499
Professional fees	12,448	28,229
Office expense	10,221	10,278
Dues and subscriptions	4,305	4,173
Other utilities	2,473	1,732
Telephone	1,851	4,596
Bad debt	105	282
Total Operating Expenses	1,026,224	1,102,704
Excess (deficit) of operating revenues over operating expenses	(103,572)	4,267
Other Income (Expense)		
Investment and dividend income	24,025	28,812
Unrealized gain (loss) on investments	6,103	(5,347)
Contributions in aid of construction	25,050	30,400
Total Other Income (Expense)	55,178	53,865
Changes in net assets from operations	(48,394)	58,132
Changes in Unrestricted Net Assets		
Member fees, net	7,800	9,857
Change in net assets	(40,594)	67,989
Net assets - beginning of year	1,807,792	1,739,803
Net assets - end of year	\$ 1,767,198	\$ 1,807,792

The accompanying notes are an integral part of the financial statements.

ARMSTRONG SUPPLY CORPORATION
STATEMENTS OF CASH FLOWS
For the Years Ended September 30, 2019 and 2018

	2019	2018
Cash Flows from Operating Activities		
Changes in net assets from operations	\$ (48,394)	\$ 58,132
Adjustments to reconcile nets assets to net cash flows provided by operating activities:		
Depreciation and amortization	170,496	162,013
(Increase) decrease in:		
Accounts receivable	(22,670)	98,549
Prepays	-	(1,368)
Other assets	(5,991)	(2,116)
Increase (decrease) in:		
Accounts payable	25,567	(15,422)
Accrued liabilities	(661)	(8,775)
Member deposits	(20,000)	-
	146,741	232,881
Total Adjustments		
Net cash provided by operating activities	98,347	291,013
Cash Flows from Investing Activities		
Cash payments for the purchase capital assets	(79,754)	(109,138)
Purchase of investments	(10,977)	(26,154)
	(90,731)	(135,292)
Net cash used by investing activities		
Cash Flows from Financing Activities		
Proceeds from the issue of memberships, net	7,800	9,857
Principal payments on long term debt	(65,460)	(91,820)
	(57,660)	(81,963)
Net cash used by financing activities		
Net increase (decrease) in cash	(50,044)	73,758
Cash and cash equivalents - beginning of year	307,247	233,489
Cash and cash equivalents - end of year	\$ 257,203	\$ 307,247

Supplemental Cash Flow Information

Interest paid in the years ended September 30, 2019 and 2018, was \$ 82,352 and \$ 84,070, respectively.

The accompanying notes are an integral part of the financial statements.

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**ARMSTRONG WATER SUPPLY CORPORATION
NOTES TO FINANCIAL STATEMENTS**

1. Nature of Activities

Armstrong Water Supply Corporation (the Corporation) is a member-owned, non-profit organization incorporated pursuant to provisions of the Texas Revised Civil Statutes for the purpose of providing a potable water utility service, under the valid Certificate of Convenience and Necessity (CNN) number 10049, to members of the water utility. Member-consumers are located principally in rural areas between the towns of Belton, Holland and Little River – Academy. There are no large commercial consumers, although some farm operations use large amounts of water (in excess of 40,000 gallons) at various times during the year. Operating policies rates, tariffs and regulations are formulated by a Board of Directors, duly elected by the members of the organization.

2. Summary of Significant Accounting Policies

The following is a summary of certain significant accounting policies followed in the preparation of the financial statements of the Corporation.

Financial Statements Presentation

The Corporation is required to present its financial statements in accordance with ASC 958-205 Financial Statement Presentation for Not-for-Profit Entities. Under ASC 958-205 the Corporation is required to report information regarding its financial position and activities according to two classes of net assets: net assets with member restrictions and net assets without member restrictions. All of the Corporation's net assets were considered net assets without member restrictions as of September 30, 2019 and 2018.

The schedule of net assets without member restrictions is as follows:

	2019	2018
MEMBERSHIP RESERVE		
Balance, October 1,	\$ 176,990	\$ 167,133
Member investment - current year	7,800	9,857
Balance, September 30,	184,790	176,990
CoBANK RESERVE		
Balance, October 1,	148,808	133,206
Allocation from undesignated net assets	24,211	15,602
Balance, September 30,	173,019	148,808
UNDESIGNATED		
Balance, October 1,	1,481,994	1,439,464
Allocations to Reserve	(24,211)	(15,602)
Change in net assets from operations	(48,394)	58,132
Balance, September 30	1,409,389	1,481,994
Total Net Assets	\$ 1,767,198	\$ 1,807,792

ARMSTRONG WATER SUPPLY CORPORATION
NOTES TO FINANCIAL STATEMENTS

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Under the accrual basis of accounting, revenue is recognized when earned regardless of when collected and expenses are recognized when the obligation is incurred regardless of when paid.

Cash and Cash Equivalents

The Corporation considers all liquid investments purchased with an initial maturity of three months or less and not designated as a component of the Reserve Fund, to be cash equivalents.

Trade Accounts Receivable

Accounts receivable are recorded at the value of the revenue earned and requires payment within thirty days. Account balances with charges over thirty days old are considered delinquent and collection efforts begin at this time. Accounts receivable are shown net of an allowance for uncollectible amounts if applicable.

Property and Equipment

Property and equipment is carried on the basis of cost. Depreciation has been provided using the straight-line method in amounts sufficient to amortize the cost of depreciable assets over their estimated useful lives.

The following table summarizes the estimated lives in depreciating the fixed assets:

<u>Property</u>	<u>Life</u>
Distribution system	5 - 40 years
Equipment	5 - 12 years
Office equipment	3 - 10 years
Building and improvements	15 - 40 years

Invested Funds

Invested funds consist of reserve funds set aside as stipulated by the Corporation's debt agreements. These funds are stated at fair value.

ARMSTRONG WATER SUPPLY CORPORATION
NOTES TO FINANCIAL STATEMENTS

Fair Value Measurements

Generally accepted accounting principles provide a framework for measuring fair value. That framework provides a hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Assets and liabilities that are required to be recorded at fair value in the consolidated statement of financial position are categorized based on the inputs to valuation techniques as follows:

Level 1 - Quoted prices in active markets for identical assets.

Level 2 - Quoted prices for similar assets in active or inactive markets, or inputs derived from observable market data by correlation such as appraisals or other means such as calculations based on contractual rates and published tables.

Level 3 - Unobservable inputs that reflect management's assumptions and best estimates based on available data.

The Organization uses Level 1 measurements whenever possible, as they result in the most reliable measure of fair value.

Capitalized Interest

The Corporation capitalizes interest costs associated with the system improvement's debt during the active development and construction phases of the projects. Once the projects are substantially complete, the capitalized interest is considered part of the historical costs of the related assets and will be amortized over the assets' useful life.

Revenue Recognition

The Corporation generally sells water utility services under short-term, monthly billing cycles, using a tariff schedule approved by the Board of Directors. Revenues are recognized monthly, based on metered readings located at each member's place of residence or business.

Tax Exempt Status

The Corporation qualifies under state franchise tax regulations as an exempt organization. The Internal Revenue Service, under IRC Section 501(c)(12) has granted exempt status. A required information return (Form 990) is filed annually on or before the February 15 due date. The Corporation has not been examined by any major taxing jurisdictions for the fiscal years 2016-2018.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

ARMSTRONG WATER SUPPLY CORPORATION
NOTES TO FINANCIAL STATEMENTS

3. Adoption of Accounting Pronouncement

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities. The amendments in this ASU make improvements to the information provided in financial statements and accompanying notes. The Corporation has adjusted the presentation of its financial statements for fiscal year 2019 accordingly, applying the changes retrospectively to the comparative information presented. The new standards change the following aspects of the Corporation's financial statements:

- The unrestricted net asset class has been renamed net assets without member restrictions.
- The financial statements include a new disclosure about liquidity and availability of resources (Note 13).

4. Cash and Cash Equivalents

The Corporation maintains cash balances at several financial institutions located in Central Texas. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$ 250,000. As of September 30, 2019 and 2018, the Corporation maintained cash balances of \$ -0- and \$ 56,302, respectively, in excess of FDIC insured limits.

5. Invested Funds

As of September 30, 2019 and 2018, the Company has invested funds, categorized as Level 1, as follows:

2019	Interest	Maturity	Amount
Raymond James			
Mutual Fund	0.00%	Demand	\$ 16,385
Mutual Fund - reserve	0.00%	Demand	173,019
			<u>\$ 189,404</u>
2018			
Raymond James			
Mutual Fund	0.00%	Demand	\$ 29,619
Mutual Fund - reserve	0.00%	Demand	148,808
			<u>\$ 178,427</u>

ARMSTRONG WATER SUPPLY CORPORATION
NOTES TO FINANCIAL STATEMENTS

6. Property, Plant and Equipment

Property, plant and equipment consisted of the following at September 30:

	2019	2018
Land	\$ 147,913	\$ 147,913
Distribution system	4,745,251	4,665,496
Equipment	167,018	167,018
Office equipment	18,402	18,402
Buildings and improvements	59,605	59,605
Total	<u>\$ 5,138,189</u>	<u>\$ 5,058,434</u>

Depreciation expense was \$ 170,496 and \$ 162,013 for the years ended September 30, 2019 and 2018, respectively.

7. Invested Funds – Reserve

The Corporation is required, as long as indebted to CoBank, to maintain a reserve account at CoBank or any other financial institution acceptable to CoBank. At September 30, 2019 and 2018, the reserve account consisted of the following:

	2019	2018
Invested funds - Reserve	\$ 173,019	\$ 148,808
Required fund balance	157,500	157,500
Funds in excess (insufficient) of loan agreement	<u>\$ 15,519</u>	<u>\$ (8,692)</u>

Invested funds are categorized as Level 1.

8. Investment in Other Organizations

Central Texas Water Supply Corporation is a consortium of area rural water supply corporations formed to provide treated surface water to each individual entity's members. Membership requires a \$ 500 investment in order to use the system.

CoBank, a banking co-operative for rural infrastructure projects, requires as part of its lending policies, membership in the co-operative at an initial cost of \$ 1,000. Membership entitles members to participate in patronage dividends as declared by the CoBank board of directors. As of September 30, 2019 and 2018, the Corporation's investment in CoBank, including patronage dividends, was \$ 27,716 and \$ 21,725, respectively. This investment is categorized as Level 3.

ARMSTRONG WATER SUPPLY CORPORATION
NOTES TO FINANCIAL STATEMENTS

9. Changes in Long-Term Debt

Long-term debt activity for the year ended September 30, 2019 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Notes Payable:				
CoBank - 2871674	\$ 1,220,296	\$ -	\$ 33,003	\$ 1,187,293
CoBank - 2871656	636,261	-	32,457	603,804
Total Notes Payable:	<u>\$ 1,856,557</u>	<u>\$ -</u>	<u>\$ 65,460</u>	<u>\$ 1,791,097</u>

10. Long-Term Debt

Long-term debt activity for the year ended September 30, 2019 was as follows:

	2019	2018
CoBank - 5.10% construction note, payable in monthly installments, including interest, with a maturity date of August 20, 2044	\$ 1,187,293	\$ 1,220,296
CoBank - 4.35% construction note, payable in monthly installments, including interest, with a maturity date of August 20, 2034	603,804	636,261
	<u>1,791,097</u>	<u>1,856,557</u>
Less Current Portion	<u>(67,707)</u>	<u>(66,339)</u>
Long-Term Debt, net of current portion	<u>\$ 1,723,390</u>	<u>\$ 1,790,218</u>

All Assets of the Corporation are pledged as security for the above notes.

Repayment of the long-term debt, at September 30, 2019 is scheduled as follows:

Years Ending September 30,	
2020	\$ 67,707
2021	69,162
2022	70,708
2023	72,349
2024	76,113
2025 and after	1,435,058
	<u>\$ 1,791,097</u>