

LYON AND SIOUX RURAL WATER SYSTEM, INC.

ROCK RAPIDS, IOWA

DECEMBER 31, 2018

OFFICERS/BOARD OF DIRECTORS

<u>TITLE</u>	<u>NAME</u>	<u>TERM EXPIRES</u>
President	Paul Habbinga	2021
Vice-President	Jerry Van Voorst	2022
Secretary	Cory Altena	2019
Treasurer	Larry Van Roekel	2019
Board Member	Ryan Warner	2019
Board Member	Craig Metzger	2021
Board Member	Barry Pollema	2021
Board Member	Bruce Bonander	2022
Board Member	Tyler Klaassen	2022

EMPLOYEES

<u>POSITION</u>	<u>NAME</u>
Manager	Bonnie Koel
Supervisor of Operations	Dave Harmsen
Treatment Plant – Distribution Operators	Bruce Fick Todd Vande Kop Waylon Vande Kop Travis Van Otterloo
Office Staff	Cheryl Hulstein Tami Schweitzer



De Noble, Austin & Company PC

CERTIFIED PUBLIC ACCOUNTANTS



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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of the
Lyon and Sioux Rural Water System, Inc.,

Report on the Financial Statements

We have audited the accompanying financial statements of Lyon and Sioux Rural Water System, Inc. (a nonprofit organization), which comprise the statements of financial position as of December 31, 2018 and December 31, 2017, and the related statements of activities and cash flows for the calendar 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.

Auditor's Responsibility

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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.

MEMBERS

American Institute - Certified Public Accountants | Private Companies Practice Section | Iowa Society - Certified Public Accountants

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lyon and Sioux Rural Water System, Inc. as of December 31, 2018 and December 31, 2017, and the changes in its net assets and its cash flows for the calendar years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying information related to calendar years 2018 and 2017, which includes the schedules of statistical information, is presented for purposes of additional analysis and is not a required part of the financial statements. The accompanying schedule of operating expenses, schedule of insurance policies in effect and statistical information, are presented for purposes of additional analysis are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the 2018 and 2017 financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements for the calendar years ended December 31, 2018 and December 31, 2017, as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2019, on our consideration of Lyon and Sioux Rural Water System, Inc.'s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Lyon and Sioux Rural Water System, Inc.'s internal control over financial reporting and compliance.

De Noble, Austin & Company PC

De Noble, Austin & Company PC
Certified Public Accountants
Rock Rapids, Iowa

March 19, 2019

LYON AND SIOUX RURAL WATER SYSTEM, INC.**STATEMENTS OF FINANCIAL POSITION****DECEMBER 31, 2018 AND 2017**

	<u>2018</u>	<u>2017</u>
<u>Assets</u>		
Current Assets:		
Cash	\$ 30,010	\$ 28,217
Investments	108,319	276,429
Accounts Receivable	279,957	257,600
Notes Receivable – Current Portion	31,985	29,456
Accrued Interest Receivable	3,558	3,432
Inventory	166,999	161,327
Prepaid Insurance	36,680	36,206
Prepaid Expenses	5,175	5,699
Total Current Assets	<u>662,683</u>	<u>798,366</u>
Fixed Assets (Net):		
Fixed Assets	37,150,147	36,351,645
Less Accumulated Depreciation	(14,365,316)	(13,614,636)
Total Fixed Assets (Net)	<u>22,784,831</u>	<u>22,737,009</u>
Other Assets:		
Investments – Debt Covenants	502,765	487,189
CoBank Stock	80,771	98,262
Notes Receivable – Net of Current Portion	680,662	723,422
Total Other Assets	<u>1,264,198</u>	<u>1,308,873</u>
Total Assets	<u>\$ 24,711,712</u>	<u>\$ 24,844,248</u>

See Notes to Financial Statements.

LYON AND SIOUX RURAL WATER SYSTEM, INC.

STATEMENTS OF FINANCIAL POSITION

DECEMBER 31, 2018 AND 2017

	<u>2018</u>	<u>2017</u>
<u>Liabilities and Net Assets</u>		
Current Liabilities:		
Accounts Payable	\$ 76,977	\$ 88,607
Accrued Liabilities:		
Payroll Liabilities	4,337	6,676
Sales Taxes	4,896	5,697
Compensated Absences	4,024	3,155
Interest	26,199	31,589
Notes Payable – Current Portion	324,118	482,493
Total Current Liabilities	<u>440,551</u>	<u>618,217</u>
Long-Term Liabilities:		
Notes Payable – Net of Current Portion	10,563,306	10,887,441
Total Liabilities	<u>11,003,857</u>	<u>11,505,658</u>
Net Assets:		
Membership Certificates	679,210	669,750
Contributed Capital	4,965,725	4,965,725
Without Restrictions	8,062,920	7,703,115
Total Net Assets	<u>13,707,855</u>	<u>13,338,590</u>
Total Liabilities and Net Assets	<u>\$ 24,711,712</u>	<u>\$ 24,844,248</u>

See Notes to Financial Statements.

LYON AND SIOUX RURAL WATER SYSTEM, INC.**STATEMENTS OF ACTIVITIES****FOR THE CALENDAR YEARS ENDED DECEMBER 31, 2018 AND 2017**

	Unrestricted			
	2018		2017	
Water Sales	\$ 3,209,925	100.0%	\$ 3,263,458	100.0%
Cost of Water Purchased	(478,367)	(14.9)%	(486,469)	(14.9)%
Gross Profit on Sales	2,731,558	85.1%	2,776,989	85.1%
Operating Expenses	(2,092,287)	(65.2)%	(2,048,631)	(62.8)%
Net Income From Operations	639,271	19.9%	728,358	22.3%
Other Income (Expense):				
Interest Income	49,843	1.6%	49,508	1.5%
Finance Charges	19,159	0.6%	16,778	0.5%
Patronage Dividends	8,950	0.3%	8,421	0.2%
Gain on Trade-In of Fixed Assets	0	0.0%	8,377	0.2%
Net Change in Fair Value of Investments	0	0.0%	20	0.0%
Miscellaneous Income	55,672	1.7%	55,559	1.7%
Interest Expense	(413,090)	(12.9)%	(425,613)	(13.0)%
Total Other Income (Expense)	(279,466)	(8.7)%	(286,950)	(8.8)%
Changes in Net Assets	359,805	11.2%	441,408	13.5%
Net Assets Beginning of Year	7,703,115		7,261,707	
Net Assets End of Year	\$ 8,062,920		\$ 7,703,115	

See Notes to Financial Statements.

LYON AND SIOUX RURAL WATER SYSTEM, INC.**STATEMENTS OF CASH FLOWS****FOR THE CALENDAR YEARS ENDED DECEMBER 31, 2018 AND 2017**

	<u>2018</u>	<u>2017</u>
Cash Flows From (Used By) Operating Activities:		
Changes in Net Assets	\$ 359,805	\$ 441,408
Adjustments to Reconcile Changes in Net Assets to Net Cash Provided From Operating Activities:		
Depreciation	750,681	730,284
Gain on Trade-In of Fixed Assets	0	(8,377)
Net (Increase) in Fair Value of Investments	0	(20)
Net (Increase) in Accounts Receivable	(22,357)	(17,234)
Net (Increase) Decrease in Accrued Interest Receivable	(126)	6,628
Net (Increase) Decrease in Inventory	(5,672)	2,172
Net (Increase) in Prepaid Insurance	(474)	(1,894)
Net (Increase) Decrease in Prepaid Expenses	524	(115)
Net (Decrease) in Accounts Payable	(11,630)	(976)
Net (Decrease) in Accrued Payroll Liabilities	(2,339)	(3,725)
Net Increase (Decrease) in Accrued Sales Taxes	(801)	91
Net Increase (Decrease) in Accrued Compensated Absences	869	(3,879)
Net (Decrease) in Accrued Interest	(5,390)	(4,683)
Net Cash Flow Provided From Operating Activities	<u>1,063,090</u>	<u>1,139,680</u>
Cash Flows From (Used By) Investing Activities:		
Purchases of Fixed Assets	(798,502)	(816,535)
Net (Increase) Decrease in Investments – Brokerage Account	168,110	(93,414)
Payments Received on Notes Receivable	40,230	28,233
(Increase) in Investments – Debt Covenants	(15,576)	(14,844)
(Increase) Decrease of CoBank Stock	17,491	(477)
Net Cash Flow Used By Investing Activities	<u>(588,247)</u>	<u>(897,037)</u>
Cash Flows From (Used By) Financing Activities:		
Payments on Notes Payable	(482,510)	(558,513)
Issuance of Notes Payable	0	300,000
Membership Certificates Issued	11,610	17,000
Membership Certificates Retired	(2,150)	(1,980)
Net Cash Flow Used By Financing Activities	<u>(473,050)</u>	<u>(243,493)</u>

See Notes to Financial Statements.

LYON AND SIOUX RURAL WATER SYSTEM, INC.**STATEMENTS OF CASH FLOWS****FOR THE CALENDAR YEARS ENDED DECEMBER 31, 2018 AND 2017**

	<u>2018</u>	<u>2017</u>
Net Increase/(Decrease) in Cash and Cash Equivalents	1,793	(850)
Cash and Cash Equivalents Balance - Beginning of Year	<u>28,217</u>	<u>29,067</u>
Cash and Cash Equivalents Balance - End of Year	<u>\$ 30,010</u>	<u>\$ 28,217</u>
Supplemental Disclosures of Cash Flow Information:		
Cash Payments for Interest Expense	<u>\$ 418,481</u>	<u>\$ 430,296</u>

Supplemental Schedule of Noncash Investing and Financing Activities:

The Organization traded in one pickup truck during calendar year 2017 for \$22,405. The \$22,405 went directly toward the purchase of a new pickup truck. The Organization did not trade in any vehicles or equipment during calendar year 2018.

See Notes to Financial Statements.

LYON AND SIOUX RURAL WATER SYSTEM, INC

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND DECEMBER 31, 2017

1. NATURE OF OPERATIONS AND ECONOMIC DEPENDENCY (CONCENTRATION)

Lyon and Sioux Rural Water System, Inc. (hereafter – Organization) is organized and operates as an Iowa non-profit corporation whose mission is to provide high quality water and service to the members of the Organization at the lowest possible cost, consistent with sound business practices.

The Organization distributes water to rural residents in Lyon and Sioux Counties of Iowa, as well as the Cities of Alford, Boyden, Doon, Inwood, Lester, Matlock and Larchwood, Iowa. The Organization purchases water from the City of Rock Rapids and the Lewis and Clark Water System per a written contract. The contract expires on January 18, 2023. Water purchases from the City of Rock Rapids for the years ending December 31, 2018 and 2017 were \$204,800 and \$206,507 respectively; and \$257,734 and \$269,116 from the Lewis and Clark Water System in 2018 and 2017, respectively. Accordingly, the Organization is dependent upon these entities and economic/drought conditions within this limited geographical area.

2. INCOME TAX STATUS/UNCERTAIN TAX POSITIONS

In 1978, the Organization received final approval for recognition as a tax-exempt organization under Internal Revenue Code Section 501(c)(12). This exemption is contingent upon the Organization maintaining water sales to members of at least 85% of total revenue. For both the 2018 and 2017 calendar years, the 85% requirement has been satisfied and the Organization did not conduct any unrelated business activities. Accordingly, no provision for Federal or state income taxes is reported in the accompanying financial statements.

The Organization has evaluated for uncertain tax positions and management has expressed there are no uncertain tax positions as of December 31, 2018. Tax returns for the past three tax years remain open for examination by tax jurisdictions (calendar years 2017, 2016 and 2015 as of the audit report date).

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies is presented to assist in understanding the Organization's financial statements. The financial statements and notes are representations of the Organization's management who is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

A. Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The general accounting records are kept and the accompanying financial statements have been prepared on the accrual basis of accounting. Under this method of accounting, income is recognized when earned and expenses are recognized when incurred.

B. Cash and Cash Equivalents

The cash account in the statements of financial position represents money held in a checking account and petty cash. For purposes of the statements of cash flows, all short-term cash investments that are highly liquid are considered to be cash equivalents. Cash equivalents are readily convertible to known amounts of cash. Certificates of deposit maturing within a year are classified as current assets and certificates of deposit with a maturity longer than a year, if any, would be classified as other assets. The Organization does not consider the assets held as current investments to be cash equivalents. Current investments consist of brokerage and annuity investments not restricted for debt covenants. The Organization considers all cash, non-brokerage account money markets and non-brokerage account certificates of deposits classified as current to be cash and cash equivalents for purposes of the statements of cash flows.

C. Accounts Receivable/Bad Debts

Accounts receivable is recorded at the amount the Organization expects to collect on balances outstanding at the end of the calendar year. As disclosed above, the Organization has major concentrations of clientele located in Lyon and Sioux Counties. The Organization does not require collateral or other security to support the amounts recognized in the statements of financial position for accounts receivable. Management closely monitors outstanding balances and determines the need for write-offs. As of December 31, 2018 and 2017, all balances are deemed to be collectible as all deemed uncollectible accounts have been written-off by management.

Water sales are determined through a computerized system. Meter readings are taken on the first of each month and the computer determines the customer's charge based on the gallons of water used and the rate schedule in effect. Remittances are to be made on or before the fifteenth of each month. Amounts that have been billed are generally deemed due (current) within thirty days of the invoice date. Accounts receivable balances outstanding over 30 days are considered past due.

The following details the aging of accounts receivable as of December 31, 2018 and 2017:

Aged Balances (From Date of Invoices)	December 31, 2018		December 31, 2017	
	Amount	Percentage	Amount	Percentage
0 to 30 Days	\$ 260,419	93.02%	\$ 250,751	97.34%
31 to 60 Days	3,864	1.38%	6,562	2.54%
61 to 90 Days	15,596	5.57%	271	0.11%
Over 90 Days	78	0.03%	16	0.01%
Total	\$ 279,957	100.00%	\$ 257,600	100.00%

D. Inventory

Inventory is valued at the lower of cost or market using the first-in, first-out method for pipe, meters, regulators, etc. on hand at December 31, 2018 and 2017. The inventory is used for repairs on the water distribution system and is expensed when used.

E. Fixed Assets

Fixed assets are recorded at the cost of acquisition and, if purchased, or the total cost of construction, if built/constructed. Depreciation is expensed using a 40-year life for the fixed components of the water distribution system, 27 to 30-year life for the building components and 15-year life for the parking lot and five to ten years for vehicles, office furniture/fixtures and equipment. The straight-line method of depreciation is used on all assets. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any gain or loss on disposal is recognized in operations for the period.

Construction work in progress consists of costs incurred for construction of new water distribution systems. Interest costs have not been capitalized since it is the Organization's policy to not capitalize interest costs on assets constructed.

Fixed assets/accumulated depreciation of the Organization as follows as of December 31, 2018 and 2017 and the related depreciation expense for the calendar year then ended by category/classification are as follows:

<u>December 31, 2018</u>	Cost	Accumulated Depreciation	Depreciation Expense
Land	\$ 2,980,145	0	0
Building/Parking Lot	295,425	162,987	9,752
Water Distribution System	32,965,949	13,564,070	668,111
Vehicles	237,375	150,296	44,786
Office Furniture & Fixtures	103,011	86,236	3,129
Equipment	558,475	401,727	24,903
Construction in Progress	9,767	0	0
Totals	<u>\$ 37,150,147</u>	<u>14,365,316</u>	<u>750,681</u>

<u>December 31, 2017</u>	Cost	Accumulated Depreciation	Depreciation Expense
Land	\$ 2,980,145	0	0
Building/Parking Lot	295,425	153,235	9,753
Water Distribution System	32,279,077	12,895,960	650,406
Vehicles	237,375	105,510	48,448
Office Furniture & Fixtures	86,322	83,107	3,983
Equipment	473,301	376,824	17,694
Totals	<u>\$ 36,351,645</u>	<u>13,614,636</u>	<u>730,284</u>

F. Compensated Absences

The Organization policy allows for employees to accumulate a limited amount of earned but unused vacation benefits. Based on rates of pay for calendar years 2018 and 2017, respectively, the estimated vacation liability was \$4,024 as of December 31, 2018 and \$3,155 as of December 31, 2017.

The Organization also allows employees to earn one day of sick leave per month, which can be accumulated to a maximum of twenty-four days. These benefits are allowed for illness only, and upon termination of employment, any accumulated days are forfeited. As of December 31, 2018 and 2017, the maximum liability for sick pay was \$21,152 and \$27,021, respectively. No amounts have been included in the accompanying financial statements for accumulated sick pay.

G. Capital Structure (Membership Equity)/(Contributed Capital)

The Organization's capital structure consists of membership certificates. When a customer initially joins the system, a \$430 membership fee is charged to the customer. When the system was originally organized, the membership fee was \$230. If a customer becomes delinquent on their water bill, the amount due can be deducted from their membership fee.

The following detail presents the activity in the Membership Certificates account during the calendar years ended December 31, 2018 and 2017:

	2018	2017
Membership Certificates Issued	\$ 11,610	\$ 17,000
Membership Certificates Retired/Redeemed	(2,150)	(1,980)
Total Change in Membership Certificates	\$ 9,460	\$ 15,020

Contributed capital represents the total amount that the Organization has received from governmental entities as contributions toward capital costs. There were no contributions received during 2018 or 2017 by governmental entities toward capital costs.

H. Use of Estimates

The Organization's financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Accordingly, the Organization is required to make estimates, judgments, and assumptions that are believed to be reasonable based on contract terms, observance of known trends and information available from outside sources. The Organization's estimates affect the reported amounts of assets, liabilities, revenues/other income and expenses. The Organization's estimates are evaluated on a regular basis. Actual results may differ from those estimates.

I. Financial Instruments

Organization financial instruments consist of cash, investments and notes receivable for which the carrying amounts approximate reported in the statements of financial position fair values. The net increase (decrease) in fair value for the calendar year on all financial instruments is reported in the statements of activities. The estimated fair value amounts have been determined using available market information and appropriate valuation

methodologies. Considerable judgment is often necessary in interpreting market data to develop the estimates of fair value. The use of different market assumptions and/or estimation methodologies may have a material affect on the estimated fair value amounts.

J. Sales Taxes

Sales taxes required to be charged on customer billings and remitted to the appropriate state are reported in the statements of financial position as part of the accounts - accounts receivable and accrued liabilities: sales taxes. These sales tax charges and remittances do not affect the revenues/other income and expenses reported in the statements of activities.

K. Collateralization of Assets

Please see “Note to Financial Statements 9” for details as to which assets have been pledged and the extent those assets have been pledged as collateral for notes payable.

4. NOTES RECEIVABLE

The Organization has entered into a water sales agreement with the City of Doon, Iowa. As part of this agreement, the City of Doon has contributed \$423,751 for the capital cost of providing water to the City. A note receivable was issued for the entire amount of the contribution. The note accrues interest at a rate of 4.25% and is due in monthly payments of principal and interest of \$2,474. This note began in January 2008 and is scheduled to go until April 2027. As of December 31, 2018 and 2017, the outstanding balance was \$197,037 and \$228,191, respectively.

The Organization has entered into a water sales agreement with the City of Boyden, Iowa. As part of this agreement, the City of Boyden has contributed \$530,000 for the capital cost of providing water to the City. A note receivable was issued to the City of Boyden for \$591,157 (\$530,000 for the capital costs plus \$61,157 for additional internal construction in the City of Boyden). The note accrues interest at a rate of 4.25% with monthly payments of \$2,600 including principal and interest. This note began in January 2010 and is scheduled to go until June 2047. As of December 31, 2018 and 2017, the outstanding balance was \$515,610 and \$524,687, respectively.

Anticipated annual principal receipts on these two notes receivable as of December 31, 2018 are as follows:

<u>Calendar Year</u>	<u>Principal Receipts</u>
2019	\$ 31,985
2020	33,371
2021	34,817
2022	36,326
2023	37,901
Thereafter	538,247
	<u>\$ 712,647</u>

5. CONCENTRATIONS OF CREDIT RISK OF FINANCIAL INSTRUMENTS

The Organization maintains bank accounts at various local financial institutions that are members of the Federal Deposit Insurance Corporation (FDIC) which provides \$250,000 in insurance

coverage. Any amount invested in a financial institution in excess of the FDIC coverage is at risk should a financial institution fail. Balances in these accounts did not exceed the amount covered by FDIC in any financial institution during calendar year 2018 or 2017. The notes receivable with the Cities explained in “Note to the Financial Statements 4” are all essentially unsecured; therefore, the entire \$712,647 is at risk.

6. INVESTMENTS AND NOTES RECEIVABLE

Investments and the note receivable are reported at fair market value at December 31, 2018 and are summarized as follows:

<u>Investments</u>	Cost	Fair Market Value	Carrying Value
<u>Held Until Maturity:</u>			
Money Markets	\$ 8,790	8,790	8,790
Certificates of Deposit - Locally Held	40,000	40,000	40,000
Certificates of Deposit – Brokerage Account Held	254,074	205,686	254,074
Annuity	308,220	308,220	308,220
Total Investments	<u>\$ 611,084</u>	<u>562,696</u>	<u>611,084</u>
 <u>Notes Receivable</u>			
<u>Held Until Maturity:</u>			
Notes Receivable – Cities	<u>\$ 712,647</u>	<u>712,647</u>	<u>712,647</u>

The investments and notes receivable generated interest income of \$49,843 during the calendar year 2018. The money markets locally held cost and fair market value/carrying value remained equal; the brokerage account held certificates of deposit had no change in fair market value; and the notes receivable cost and fair market value are deemed to be the same. As of December 31, 2018, \$108,319 of the certificates of deposits – brokerage account and locally held is deemed to be a current asset. The remaining \$502,765 of investments is deemed to make up the other asset: investments – debt covenants account.

Fair Value Measurements

Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Topic 820 also specifies a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

- Level 1 – Observable inputs such as quoted prices in active markets for identical assets or liabilities.
- Level 2 – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.
- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In determining the fair value, the Organization utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. Following is a description of the valuation methodologies used to measure fair value. The carrying amounts of money market accounts and certificates of deposit held locally are a reasonable estimate of the fair value of the money markets and certificates of deposit. The certificates of deposit that are held in a brokerage account are valued at the closing price reported on the active markets on which the certificates of deposit are traded. The fair value of each note receivable is estimated to equal the carrying amount of each receivable.

The following table presents the fair value measurements of assets recognized in the Organization's accompanying Statements of Financial Position measured at fair value on a recurring basis and categorized into the fair value hierarchy as of December 31, 2018:

	<u>Fair Value Measurements at Reporting Date Using</u>		
	<u>Fair Value</u>	<u>Quoted Prices In Active Markets For Identical Assets (Level 1)</u>	<u>Unobservable Inputs (Level 3)</u>
Money Markets	\$ 8,790	\$ 8,790	\$ N/A
Certificates of Deposit – Locally Held	40,000	40,000	N/A
Certificates of Deposit – Brokerage Account Held	205,686	205,686	N/A
Annuity	308,220	308,220	N/A
Notes Receivable	712,647	N/A	712,647

7. INVESTMENTS – DEBT COVENANTS

The Organization has a loan resolution with CoBank, which is shown on the statements of financial position as investments – debt covenants. The Organization was required to set aside 10% of its monthly principal and interest payments until the restricted balance reached \$30,000 (as amended in 2005). If the Organization should ever reduce this restricted balance, annual restrictions will again be required until the reserve is replenished. As of December 31, 2018 and 2017, the entire \$30,000 balance was maintained.

The Organization also has five loan resolutions with the United States Department of Agriculture – Rural Development (RDA) requiring monthly set asides, which are also shown on the investments- debt covenants. Under the resolutions, the Organization is required to set aside monthly for each loan until it has accumulated the required reserve. As of December 31, 2018, loan 91-11 has a reserve balance of \$86,016, loan 91-13 has a reserve balance of \$68,820, loan 91-15/91-16 has a reserve balance of \$271,428, and loan 91-18 has a reserve balance of \$46,501 (total reserve balances of all four RDA loans is \$502,765). For the loans 91-11 and 91-13, the reserve balances meet the maximum reserve balance requirements. If Lyon and Sioux Rural Water System, Inc. should reduce these reserve balances, monthly set asides would again be required until the reserve is replenished. The resolution for loans 91-15/91-16 requires that \$2,268 per month is placed into reserve until the maximum reserve balance of \$272,160 is reached. The resolution for loan 91-18 requires that \$1,237 per month is placed into reserve until the maximum reserve balance of \$148,440 is reached. As of December 31, 2018 and 2017, the Organization has complied with the requirements under the loan resolutions for each of the loans with the RDA.

8. PENSION PLANS

The Organization has a pension plan which covers all of the Organization's employees. The plan is designed as an Individual Retirement Account for each employee whereby the Organization contributes 6% of each employee's annual salary to the plan. The plan is 100% vested immediately to the employee and withdrawal of benefits can be made at any time at the employee's discretion. Pension plan expense for the Organization for the years ended December 31, 2018 and 2017, was \$22,293 and \$24,382, respectively.

9. NOTES PAYABLE

At December 31, 2018 and 2017, the Organization was indebted to an individual, the Iowa Finance Authority (IFA), CoBank, and the United States Department of Agriculture – Rural Development (RDA). Notes payable consisted of the following at December 31, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
A note payable to CoBank with a variable interest rate (4.23% as of December 31, 2018); as of December 31, 2018, due in monthly installments of principal and interest of \$3,064 through May 2024. This note was paid in full during 2018.	\$ 0	\$ 16,618
A note payable to CoBank with a variable interest rate (3.57% as of December 31, 2018); This note was paid in full during 2018.	0	150,000
A note payable to RDA with a 4.25% interest rate; due in monthly installments of principal and interest of \$7,168 through August 2043. This note is collateralized by substantially all assets of the Organization.	1,310,899	1,340,518
A note payable to RDA with a 4.25% interest rate; due in monthly installments of principal and interest of \$5,735 through August 2043. This note is collateralized by substantially all assets of the Organization.	1,048,650	1,072,355
A note payable to RDA with a 4.25% interest rate; due in monthly installments of principal and interest of \$13,440 through March 25, 2048. This note is collateralized by substantially all assets of the Organization.	2,691,148	2,736,996
A note payable to RDA with a 4.125% interest rate; due in monthly installments of principal and interest of \$9,240 through March 25, 2048. This note is collateralized by substantially all assets of the Organization.	1,804,770	1,840,405

A note payable to RDA with a 2.625% interest rate; due in monthly installments of principal and interest of \$12,112 through November 2, 2055. This note is collateralized by substantially all assets of the Organization.

3,430,269 3,484,792

A note payable to IFA with a 1.75% interest rate as of December 31, 2018; payments of interest due semiannually on June 1 and December 1 of each year; annual payments of principal due through June 1, 2032. This note is secured by State Revolving Loan Revenue Bonds issued by the State of Iowa.

270,000 286,000

A note payable to an individual with a 5.00% interest rate for land purchased; annual payments of principal of \$110,563, along with accrued annual interest, are due through March 1, 2021. The note is collateralized by land. The book value of the land at December 31, 2018 and 2017 is \$994,500.

331,688 442,250

Total Notes Payable (Calendar Year End)	10,887,424	11,369,934
Less Current Portion of Notes Payable	324,118	482,493
Long-Term Notes Payable	<u>\$ 10,563,306</u>	<u>\$ 10,887,441</u>

The combined aggregate amount of principal maturities as of December 31, 2018, for all of the long-term notes payable, for each of the next five years and thereafter is as follows:

Year	Principal Balance
2019	\$ 324,118
2020	331,650
2021	340,480
2022	238,061
2023	246,527
Thereafter	9,406,588
Totals	<u>\$ 10,887,424</u>

10. FUNCTIONAL ALLOCATION OF EXPENSES

The functional allocation of operating expenses summarized in the statements of activities is allocated as follows between program activities and supporting services as of December 31, 2018 and 2017:

	2018	2017
Program Expenses:		
Water Treatment and Distribution	\$ 1,725,707	\$ 1,717,563
Supporting Services	366,580	331,068
Total Operating Expenses	<u>\$ 2,092,287</u>	<u>\$ 2,048,631</u>

11. SUBSEQUENT EVENTS

On February 12, 2019 the Board of Directors approved an Exploration Lease/Option to Purchase for land near Klondike.

SCHEDULE 1**LYON AND SIOUX RURAL WATER SYSTEM, INC.****SCHEDULES OF OPERATING EXPENSES****FOR THE CALENDAR YEARS ENDED DECEMBER 31, 2018 AND 2017**

	<u>2018</u>	<u>2017</u>	<u>Increase (Decrease)</u>
Salaries and Benefits	\$ 524,607	\$ 525,959	\$ (1,352)
Payroll Taxes	29,015	30,562	(1,547)
Pension Expense	22,293	24,382	(2,089)
Depreciation	750,681	730,284	20,397
Utilities	336,941	341,221	(4,280)
Office Expenses	18,107	15,432	2,675
Telephone/Internet	12,285	12,667	(382)
Supplies	11,285	7,506	3,779
Repairs and Maintenance	150,214	118,064	32,150
Vehicle Expenses	36,891	33,534	3,357
Meals and Travel	12,406	8,037	4,369
Water Testing and Treatment	56,062	57,617	(1,555)
Construction Permits	6,282	4,424	1,858
Generator Expense	22,937	20,070	2,867
Professional Fees	14,545	14,610	(65)
Directors' Fees	10,150	8,700	1,450
Insurance	43,094	36,190	6,904
Licenses and Dues	8,281	8,289	(8)
Meetings and Education	2,500	1,925	575
Miscellaneous	2,179	2,469	(290)
Advertising	9,976	9,085	891
Engineering	6,813	33,145	(26,332)
Property Tax (Land)	4,743	4,459	284
TOTAL	<u>\$ 2,092,287</u>	<u>\$ 2,048,631</u>	<u>\$ 43,656</u>

See Independent Auditor's Report.

SCHEDULE 2

**LYON AND SIOUX RURAL WATER SYSTEM, INC.
SCHEDULE OF INSURANCE POLICIES IN EFFECT
AS OF DECEMBER 31, 2018**

			<u>Policy Limits</u>	<u>Premiums*</u>
Allied World	5105-1697	Commercial Auto Policy	\$ 1,000,000	\$ 5,629
<u>Agent</u>		Commercial General Liability	3,000,000	2,801
Sieperda Foltz Insurance & RE		Commercial Property	18,187,000	15,108
P.O. Box 590		Commercial Excess Liability	2,000,000	1,505
Rock Rapids, IA 51246		Public Officials & Management	3,000,000	2,071
		Commercial Crime	500,000	750
		Terrorism	Included in each Policy	179
	WC020-0028800-2016	Workers Compensation	Statutory	10,982
<u>Agent</u>				
Northwest Consultants of				
Lyon County, Inc.				
P.O. Box 455				
George, IA 51237				
CNA Surety	PO 1000015C	Fidelity Bond	700,000	3,500
		Policy Fee		100
Total Premiums				<u>\$ 42,625</u>

*The amount disclosed in this schedule represents the annual premium for the policy in effect as of December 31, 2018 but does not necessarily represent the actual amount paid or incurred in 2018. Effective dates of the insurance policies vary.

See Independent Auditor's Report.

LYON AND SIOUX RURAL WATER SYSTEM, INC.**STATISTICAL INFORMATION****AS OF AND FOR THE CALENDAR YEARS ENDED DECEMBER 31, 2018, 2017, 2016, 2015 AND 2014**

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
LIQUIDITY RATIOS:					
Working Capital	\$ 222,132	\$ 153,504	\$ 136,937	\$ 575,424	\$ (397,628)
Current Ratio	1.50	1.29	1.25	1.92	0.64
SOLVENCY RATIOS:					
Ownership Ratio	55.47%	53.69%	52.24%	49.66%	48.15%
Changes in Net Assets to Water Sales	11.21%	14.07%	8.57%	6.97%	7.48%
Changes in Net Assets to Total Net Assets	1.46%	3.44%	2.02%	3.15%	1.79%
OPERATIONAL EFFICIENCY RATIOS:					
Salaries and Benefits & Pension Expense to Water Sales	17.04%	16.86%	18.14%	17.93%	18.48%
Water Sales to Net Fixed Assets	14.09%	14.35%	13.42%	12.83%	12.68%
Interest Expense to Water Sales	12.87%	13.04%	14.75%	17.03%	14.91%

See Independent Auditor's Report

