AQUA WATER SUPPLY CORPORATION

Financial Statements
as of and for the Years Ended
December 31, 2016 and 2015 and
Independent Auditors' Report

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Aqua Water Supply Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of Aqua Water Supply Corporation ("Aqua") (a nonprofit organization), which comprise the statements of financial position as of December 31, 2016 and 2015, 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 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 auditors' 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Aqua as of December 31, 2016 and 2015, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 2, 2017, on our consideration of Aqua's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and 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 Aqua's internal control over financial reporting and compliance.

Change in Accounting Principle

As discussed in Note 2 to the consolidated financial statements, the Aqua changed its method of accounting for debt issuance costs in 2015 as required by the provisions of Financial Accounting Standards Board Accounting Standards Update No. 2015-03. Our opinion is not modified with respect to this matter.

Maxwell Locke + Ritter LLP

Austin, Texas
February 2, 2017

AQUA WATER SUPPLY CORPORATION

STATEMENTS OF FINANCIAL POSITION
DECEMBER 31, 2016 AND 2015

	2016	2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 6,154,826	$ 5,169,938
Marketable investments	1,030,061	888,076
Trade accounts receivable, net of allowance for doubtful accounts of $40,000	1,208,460	1,104,544
Maintenance parts inventory	207,774	194,643
Total current assets	8,601,121	7,357,201
RESTRICTED MARKETABLE INVESTMENTS	129,336	266,088
PROPERTY AND EQUIPMENT, net	93,544,709	92,738,525
TOTAL	$ 102,275,166	$ 100,361,814
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable	$ 413,725	$ 320,828
Accrued expenses	315,252	293,327
Member deposits and other	125,784	124,244
Current maturities of long-term debt, net of unamortized debt issuance costs	1,935,533	1,810,672
Total current liabilities	2,790,294	2,549,071
LONG-TERM DEBT, net of unamortized debt issuance costs	21,261,668	23,058,299
Total liabilities	24,051,962	25,607,370
NET ASSETS:		
Unrestricted net assets from operations	13,032,351	12,610,920
Unrestricted net assets designated by board	1,000,000	1,000,000
Unrestricted net assets from non-operating revenues and expenses	63,170,601	60,064,553
Temporarily restricted net assets from contributed wastewater facilities	1,020,252	1,078,971
Total net assets	78,223,204	74,754,444
TOTAL	$ 102,275,166	$ 100,361,814

See notes to financial statements.

AQUA WATER SUPPLY CORPORATION

STATEMENTS OF ACTIVITIES
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CHANGES IN UNRESTRICTED NET ASSETS:		
OPERATING REVENUES:		
Water revenues	$ 15,070,326	$ 15,183,672
Other income	521,400	260,695
Total operating revenues	15,591,726	15,444,367
OPERATING EXPENSES:		
General and administrative	4,346,955	4,495,064
Salaries and wages	4,151,442	4,057,991
Depreciation	4,003,938	3,815,908
Interest expense	1,305,473	1,384,245
Materials, supplies, and maintenance	1,362,487	1,315,196
Total operating expenses	15,170,295	15,068,404
CHANGE IN NET ASSETS FROM OPERATIONS	421,431	375,963
Membership fees and contributions-in-aid-of-construction	3,047,329	2,718,950
Net assets released from restrictions	58,719	58,719
CHANGE IN UNRESTRICTED NET ASSETS	3,527,479	3,153,632
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS-		
Net assets released from restrictions	(58,719)	(58,719)
CHANGE IN NET ASSETS	3,468,760	3,094,913
NET ASSETS, beginning of year	74,754,444	71,659,531
NET ASSETS, end of year	$ 78,223,204	$ 74,754,444

See notes to financial statements.

AQUA WATER SUPPLY CORPORATION

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2016 AND 2015

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers	$ 14,967,950	$ 15,242,614
Cash paid to suppliers and employees	(9,651,196)	(9,810,743)
Other cash receipts	508,309	258,433
Interest paid	(1,305,473)	(1,377,357)
Net cash provided by operating activities	4,519,590	4,312,947
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net purchases of marketable investments	(5,233)	(3,245)
Proceeds from sales of property and equipment	141,650	2,262
Purchases of property and equipment	(5,039,657)	(5,935,620)
Net cash used in investing activities	(4,903,240)	(5,936,603)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term debt	(2,377,178)	(1,597,670)
Borrowings on long-term debt	710,500	1,000,000
Costs to issue debt	(12,113)	(6,210)
Membership fees and contributions-in-aid-of-construction	3,047,329	2,718,950
Net cash provided by financing activities	1,368,538	2,115,070
NET CHANGE IN CASH AND CASH EQUIVALENTS	984,888	491,414
CASH AND CASH EQUIVALENTS, beginning of year	5,169,938	4,678,524
CASH AND CASH EQUIVALENTS, end of year	$ 6,154,826	$ 5,169,938
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Change in net assets from operations	$ 421,431	$ 375,963
Adjustments to reconcile change in net assets from operations to net cash provided by operating activities:		
Depreciation	4,003,938	3,815,908
Non-cash interest expense	7,021	6,888
Gain on disposal of property and equipment	(20,112)	(2,262)
Changes in assets and liabilities that provided (used) cash:		
Trade accounts receivable	(103,916)	58,901
Maintenance parts inventory	(13,131)	25,809
Accounts payable and accrued expenses	222,819	31,699
Member deposits and other	1,540	41
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 4,519,590	$ 4,312,947
SUPPLEMENTAL NONCASH DISCLOSURE-		
Additions to property and equipment funded through accounts payable	$ -	$ 107,997

See notes to financial statements.

1. ORGANIZATION

Aqua Water Supply Corporation ("Aqua") is a non-profit cooperative headquartered in Bastrop County, Texas, owned by its customers who are its members, with each member holding one share in the corporation. More than 50,000 people rely on Aqua to provide water for their daily lives. Most are homeowners, farmers, and ranchers who count on Aqua for safe and reliable drinking water.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The accompanying financial statements are presented in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") as defined by the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC").

Classification of Net Assets - The financial statements report information regarding Aqua's financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. Net assets, revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, Aqua's net assets and changes therein are classified as follows:

Unrestricted net assets **-** Net assets not subject to donor-imposed stipulations.

Temporarily restricted net assets **-** Net assets subject to donor-imposed stipulations that require passage of time or the occurrence of a specific event. Additionally, unconditional promises to give without explicit donor-imposed stipulations but due in future periods require the passage of time to release the donor's implicit time restriction. Contributions received with temporary restrictions that are met in the same reporting period are reported as unrestricted support and increase unrestricted net assets. At December 31, 2016 and 2015, temporarily restricted net assets consisted of contributed wastewater facilities containing stipulations related to use.

Permanently restricted net assets **-** Net assets subject to donor-imposed stipulations that require resources be maintained in perpetuity to the exclusive benefit of Aqua. There were no such amounts as of December 31, 2016 or 2015.

Use of Estimates - The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Fair Value Measurements - Fair value is 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. Fair value accounting requires characterization of the inputs used to measure fair value into a three-level fair value hierarchy as follows:

Level 1 **-** Inputs based on quoted prices in active markets for identical assets or liabilities. An active market is a market in which transactions occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 **-** Observable inputs that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from sources independent from the entity.

Level 3 **-** Unobservable inputs that reflect the entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available.

There are three general valuation techniques that may be used to measure fair value: 1) market approach **-** uses prices generated by market transactions involving identical or comparable assets or liabilities, 2) cost approach **-** uses the amount that currently would be required to replace the service capacity of an asset (replacement cost), and 3) income approach **-** uses valuation techniques to convert future amounts to present amounts based on current market expectations.

Cash and Cash Equivalents - Aqua considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Marketable Investments - Investments in equity securities and certificates of deposit with readily determinable fair values and all debt securities are stated at fair value. Realized and unrealized gains and losses are reported in the statement of activities as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or by law.

Trade Accounts Receivable - Trade accounts receivable are recorded at the value of the revenue earned and require payment within thirty days. Account balances with charges over thirty days old are considered delinquent and management begins collection efforts at this time. Delinquent invoices do not accrue interest. Aqua continually monitors each customer's credit worthiness individually and recognizes allowances for estimated bad debts for incorrect meter readings and uncollectible accounts. Aqua regularly adjusts any allowance for subsequent collections and final determination that a trade account receivable is no longer collectible.

Maintenance Parts Inventory - Finished goods inventory is valued at the lower of cost (first-in, first-out) or market.

Property and Equipment - Property and equipment with a minimum cost of $5,000 are capitalized at cost if purchased or fair value if contributed; costs that are specifically attributable to a project included in construction in progress are capitalized regardless of their cost. It is Aqua's policy to imply a time restriction on all gifts of long-lived assets equal to the useful life of the assets. All property and equipment are depreciated using the straight-line method over the following useful lives:

Water lines and extensions	25 years
Pump station, well sites and easements	7-25 years
Furniture and equipment	5 years
Wastewater facilities	10-25 years
Buildings and improvements	25 years
Transportation equipment	5 years

Impairment of Long-Lived Assets - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the amount recorded may not be recoverable. An impairment loss is recognized by the amount in which the carrying amount of the asset exceeds the fair value, if the carrying amount of the asset is not recoverable. Management believes there had been no impairment as of December 31, 2016 or 2015.

Debt Issuance Costs - Debt issuance costs associated with debt are recorded as a reduction of the related outstanding debt balance, and amortized to interest expense over the term of the related debt arrangement using the effective interest rate method.

Board Designated Net Assets - In December 2009, the Board designated $1,000,000 for future operating needs.

Water Revenue - Aqua recognizes water revenues based on monthly usage at standard rates.

Membership Fees and Contributions-In-Aid-of-Construction - Aqua assesses its customers one-time, non-refundable fees consisting of a membership fee of $100 and a fee for contributions-in-aid-of-construction, which is based upon the meter size and number of dwelling units connected to the meter.

Income and Property Taxes - Aqua is a nonprofit organization exempt from federal income taxes under Section 501(c)(12) of the Internal Revenue Code, except for income tax related to unrelated business income. Aqua is also exempt from State of Texas franchise taxes and Bastrop County and Bastrop Independent School District property taxes. Aqua did not incur any significant tax liabilities due to unrelated business income during the years ended December 31, 2016 and 2015. Aqua files Form 990 tax returns and is subject to routine examinations of its returns; however, there are no examinations currently in progress.

Recently Issued Accounting Pronouncements - In May 2014 and August 2015, the FASB issued Accounting Standards Updates ("ASU") No. 2014-09 and No. 2015-14, *Revenue from Contracts with Customers*, which supersedes the revenue recognition requirements in ASC 605, *Revenue Recognition*, and most industry-specific guidance included in the ASC. The standard requires entities to recognize revenue in a way that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The standard is effective for fiscal years beginning after December 15, 2018, and is to be applied retrospectively and early application permitted. Aqua is currently evaluating the impact the new standard will have on its financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, which requires the recognition of lease assets and lease liabilities by lessees for all leases, including leases previously classified as operating leases, and modifies the classification criteria and accounting for sales-type and direct financing leases by lessors. Leases continue to be classified as finance or operating leases by lessees and both classifications require the recognition of a right-of-use asset and a lease liability, initially measured at the present value of the lease payments in the statements of financial position. Interest on the lease liability and amortization of the right-of-use asset are recognized separately in the statements of activities for finance leases and as a single lease cost recognized on the straight-line basis over the lease term for operating leases. The standard is effective using a modified retrospective approach for fiscal years beginning after December 15, 2019 and early adoption is permitted. Aqua is currently evaluating the impact the standard will have on its financial statements.

In August 2016, the FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*, which requires presentation on the face of the statements of financial position amounts for two classes of net assets at the end of the period, net assets with donor restrictions and net assets without donor restrictions, rather than the currently required three classes. The standard also requires the presentation on the face of the statements of activities the amount of the change in each of these two classes of net assets. The standard will no longer require the presentation or disclosure of the indirect method of reporting cash flows if an entity elects to use the direct method, however it will be required for an entity to provide enhanced disclosures about liquidity in the footnotes to the financial statements. The standard is effective for fiscal years beginning after December 15, 2017 and early adoption is permitted. Aqua is currently evaluating the impact the standard will have on its financial statements.

Change in Accounting Principle for Recently Adopted Accounting Pronouncement - As a result of changes in the accounting standards for debt issuance costs, debt issuance costs related to a recognized debt liability are presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than as a deferred charge presented as an asset. The standard was adopted effective January 1, 2016 and the guidance was applied retrospectively to debt issuance costs existing as of that date and recognized subsequent to that date.

3. CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject Aqua to credit risk consist of cash and cash equivalents, marketable investments and accounts receivable. Aqua places its cash and cash equivalents with a limited number of high quality financial institutions and may exceed the amount of insurance provided on such deposits. Management believes no significant risk exists with respect to cash and cash equivalents. Marketable investments are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investments, it is at least reasonably possible that changes in the near-term could materially affect the amounts reported in the statements of financial position. Aqua does not maintain collateral for its receivables and does not believe significant risk exists at December 31, 2016 and 2015.

4. MARKETABLE INVESTMENTS

Marketable investments, including restricted marketable investments, were comprised of the following as of December 31:

	2016	2015
CoBank stock	$ 1,000	$ 1,000
Certificates of deposit	1,158,397	1,153,164
	$ 1,159,397	$ 1,154,164

Marketable investments were measured at fair value using the market approach and are considered level 1 in the fair value hierarchy.

5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following as of December 31:

	2016	2015
Water lines and extensions	$ 69,813,275	$ 68,186,196
Well sites and easements	21,973,406	19,817,904
Pump station	20,094,457	19,607,901
Wastewater facilities	6,901,571	6,837,496
Furniture and equipment	6,825,160	6,557,010
Buildings and improvements	3,350,302	3,283,050
Transportation equipment	2,474,472	2,431,480
Construction-in-progress	6,951,748	7,205,373
Land	3,394,841	3,394,841
	141,779,232	137,321,251
Less accumulated depreciation	(48,234,523)	(44,582,726)
Property and equipment, net	$ 93,544,709	$ 92,738,525

Depreciation expense was $4,003,938 and $3,815,908 for the years ended December 31, 2016 and 2015, respectively.

6. LONG-TERM DEBT

Long-term debt consisted of the following as of December 31:

	2016	2015
$7 million CoBank Revolving Term Loan with interest due monthly at a weekly quoted CoBank variable rate (2.87% and 2.43% at December 31, 2016 and December 31, 2015, respectively), matures May 20, 2037	$ 4,750,000	$ 4,750,000
$2 million CoBank Revolving Term Loan with interest and principal due monthly at a weekly quoted CoBank variable rate (4.50% and 2.52% at December 31, 2016 and December 31, 2015, respectively) matures May 20, 2031	1,598,640	1,684,205
$9.2 million CoBank Revolving Term Loan with principal and interest due monthly at 6.87%, matures November 20, 2022	3,570,779	4,090,612
$4 million CoBank Revolving Term Loan with principal and interest due monthly at 6.45%, matures December 20, 2023	1,796,931	2,012,793
$9 million CoBank Revolving Term Loan with principal and interest due monthly at 6.98% for $5,932,842 and 6.82% for $1,171,782, matures September 20, 2024	4,806,087	5,313,841
$5.5 million CoBank Revolving Term Loan with principal and interest due monthly at 4.72%, matures January 20, 2028	4,161,484	4,382,310
$1,877,805 Note Payable to FHA, principal and interest paid in monthly installments totaling $11,218 at 6.25%, refinanced on October 7, 2016	-	777,143
$2,293,000 Note Payable to USDA, principal and interest paid in monthly installments of $10,778 at 4.75%, matures September 26, 2042, secured by all real property, personal property and assignment of income and contracts	1,855,743	1,893,042
$54,530 Loan Payable to Texas Water Development Board, principal and interest paid in monthly installments of ranging from $560 to $580 at a variable interest rate (2.80% and 2.22% at December 31, 2016 and December 31, 2015, respectively), matures March 15, 2024, secured by Aqua's gross revenues (exclusive of restricted gifts, grants, donations and contributions)	41,330	46,130

$710,500 CoBank Term Loan with interest and principal due monthly at a weekly quoted CoBank variable rate (3.18% at December 31, 2016) matures October 20, 2028	702,404	-
Total	23,283,398	24,950,076
Less: current maturities of long-term debt	(1,942,953)	(1,817,604)
Total long-term debt	$ 21,340,445	$ 23,132,472

Future long-term debt payments as of December 31, 2016 are as follows:

2017	$ 1,942,953
2018	2,163,990
2019	2,295,152
2020	2,436,708
2021	2,586,391
Thereafter	11,858,204
Total	$ 23,283,398

At December 31, 2016 and 2015, Aqua had a $2,000,000 CoBank line of credit, with interest due monthly at the weekly quoted CoBank variable rate, maturing on June 30, 2017. Aqua had no draws on the line of credit during the years ended December 31, 2016 and 2015.

The CoBank Revolving Term Loans (the "Loans") are under a Master Loan Agreement with CoBank dated November 25, 2002, which was amended and restated on May 5, 2010, May 14, 2013, November 6, 2013, and August 23, 2016. The Loans are secured by all real and personal property of Aqua. The Master Loan Agreement has cross default provisions, which would cause a default on the Loans if there were a default on any other obligations. It also contains a material adverse change provision, which would allow the bank to subjectively deem adverse changes in Aqua to be a default on the Loans. It requires compliance with financial covenants, including a debt service coverage ratio greater than 1.25 and a debt to capitalization ratio less than 0.65.

In prior years Aqua had reported debt issuance costs as a deferred charge in the statement of financial position and amortization of such costs in the statement of activities as depreciation and amortization. To comply with new GAAP presentation requirements, in 2016 Aqua began reporting such costs as a direct deduction from the face amount of the related debt (as shown in the table below) and reclassified prior year amounts, resulting in a reduction of total 2015 assets by $81,105. The change did not affect net assets.

Similarly, Aqua now reports amortization of debt issuance costs, $7,021 during the year ended December 31, 2016, as interest expense and reclassified 2015 amounts accordingly. As a result, reported interest expense during the year ended December 31, 2015 was increased and depreciation and amortization decreased by $6,888, with no net effect on the change in net assets.

	2016	2015
Principal amount	$ 23,283,398	$ 24,950,076
Less unamortized debt issuance costs	(86,197)	(81,105)
Long-term debt, net of unamortized debt issuance costs	$ 23,197,201	$ 24,868,971

7. RESTRICTED MARKETABLE INVESTMENTS

The note payable to the United States Department of Agriculture ("USDA") requires that Aqua reserve cash in designated accounts totaling $129,336 that cannot be withdrawn unless prior written approval is obtained from the lenders for such things as loan installments, emergency maintenance, extensions to facilities and replacement of short-lived assets. The reserve amounts are reported on the statement of financial position as restricted marketable investments. The notes payable have cross default provisions, which would cause a default on the notes if there were a default on any other obligations.

8. DEFINED CONTRIBUTION PLAN

Aqua sponsors a defined contribution plan under Section 401(k) of the Internal Revenue Code ("IRC") for all eligible employees who are age 21 or older and have completed one year of continuous service. Participating employees may contribute up to the maximum allowed by the IRC. Aqua may make matching contributions, qualified matching contributions and non-elective contributions at the sole discretion of Aqua's management. Total employer contributions to the plan during the years ended December 31, 2016 and 2015 were $345,150 and $340,088, respectively. Employer contributions are included general and administrative expenses in the statements of activities.

9. FUNCTIONAL ALLOCATION OF EXPENSES

Expenses are categorized into functional classifications dependent upon the nature and ultimate purpose of the expenses. Accordingly, certain expenses are allocated between functional categories. The functional allocation of expenses for the years ended December 31, 2016 and 2015 were as follows:

	2016	2015
Program services	$ 12,062,875	$ 11,934,937
Management and general	3,107,420	3,133,467
Total expenses	$ 15,170,295	$ 15,068,404

10. SUBSEQUENT EVENTS

Aqua has evaluated subsequent events through February 2, 2017, the date the financial statements were available to be issued, and no events have occurred from the statement of financial position date through that date that would impact the financial statements.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of
Aqua Water Supply Corporation:

We have audited, in accordance with the 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, the financial statements of Aqua Water Supply Corporation ("Aqua"), which comprise the statement of financial position as of December 31, 2016, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated February 2, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Aqua's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Aqua's internal control. Accordingly, we do not express an opinion on the effectiveness of Aqua's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Aqua's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Aqua's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Aqua's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Maxwell Locke + Ritter LLP

Austin, Texas
February 2, 2017