

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER
CONTROL AND IMPROVEMENT DISTRICT NO. 1**

AUDITED FINANCIAL STATEMENTS

DECEMBER 31, 2004

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Independent Auditor's Report

March 24, 2005

To the Board of Directors
Bexar-Medina-Atascosa Counties Water Control
and Improvement District No. 1
Natalia, Texas

I have audited the accompanying financial statements of the Bexar-Medina-Atascosa Counties Water Control and Improvement District No. 1 (the District) as of and for the year ended December 31, 2004, as listed in the table of contents. These financial statements are the responsibility of the District's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I plan and perform the audit 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. I believe that my audit provides a reasonable basis for my opinion.

As more fully discussed in note 5 to the financial statements, the District has not determined the quantity and value of land acquired for operation and expansion of the irrigation system since the District's creation in 1925. The District's records do not permit the application of alternative procedures regarding the value of such land at the time of acquisition.

In my opinion, except for the omission of the information discussed in the preceding paragraph and as discussed in note 5, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Bexar-Medina-Atascosa Counties Water Control and Improvement District No. 1 as of December 31, 2004, and the changes in financial position and cash flow for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1, the District has implemented a new financial reporting model, as required by the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended and interpreted, as of January 1, 2004.

The management's discussion and analysis and budgetary comparison information on pages 4 through 7 are not a required part of the financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

GREGORY R. SEIBERT
CERTIFIED PUBLIC ACCOUNTANT

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended December 31, 2004

The discussion and analysis of the Bexar-Medina-Atascosa Counties Water Control and Improvement District No. 1's (the District) financial performance provides an overview and analysis of the District's financial activities for the year ended December 31, 2004. It should be read in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

The assets of the District exceeded its liabilities at the close of the year ending December 31, 2004 by \$4,924,434. Of this amount, \$198,498 (unrestricted net assets) may be used to meet the District's ongoing obligations to landowners and creditors.

The District's total net assets increased by \$319,522 for the year ended December 31, 2004.

The District's total debt decreased by \$544,130 during the year ending December 31, 2004.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis serves as an introduction to the District's financial statements. The District's financial statements are comprised of two components, government-wide financial statements and notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

The financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private sector business.

The Statement of Net Assets presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The Statement of Activities presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future periods.

Reporting the District's Most Significant Funds

The District is a special-purpose government that is engaged only in a business-type activity, which is the sale of water for irrigation and municipal purposes.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found immediately following the basic financial statements.

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**
MANAGEMENTS DICUSSION AND ANALYSIS (Continued)
Year ended December 31, 2004

Other Information

In addition to the basic financial statements and accompanying notes, this report presents certain required supplementary information concerning budgetary comparative information

THE DISTRICT AS A WHOLE

The District's net assets were \$4,924,434 as of December 31, 2004. By far the largest portion of the District's net assets (88 percent) reflects its investment in capital assets (e.g., land, buildings, equipment, etc.), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to landowners; consequently, these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Table 1 - Summary of Net Assets

	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease)</u>
Current and other assets	\$ 4,027,903	\$ 4,071,702	\$ (43,799)
Capital assets	4,495,726	4,835,059	(339,333)
Total assets	<u>8,523,629</u>	<u>8,906,761</u>	<u>(383,132)</u>
Current liabilities	1,271,323	1,546,797	(275,474)
Long-term liabilities	2,327,872	2,755,052	(427,180)
Total liabilities	<u>3,599,195</u>	<u>4,301,849</u>	<u>(702,654)</u>
Net assets:			
Invested in capital assets, net of related debt	4,322,854	4,453,057	(130,203)
Restricted	403,082	87,375	315,707
Unrestricted	198,498	64,480	134,018
Total net assets	<u>\$ 4,924,434</u>	<u>\$ 4,604,912</u>	<u>\$ 319,522</u>

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Year ended September 30, 2004

THE DISTRICT'S FUNDS

Table 1 below presents a summary of revenues for 2004 and 2003 and the amount of change in relation to the prior year.

Table 1 - Revenues

	2003	2004	Increase (Decrease)
Fixed water assessments	\$ 366,235	\$ 351,409	\$ (14,826)
Irrigation water sales	124,139	78,249	(45,890)
Tecon water sales	43,180	30,766	(12,414)
Bexar-Met contract	1,288,620	1,402,305	113,685
Investment earnings	63,635	37,187	(26,448)
Other	55,944	72,329	16,385
	<u>\$ 1,941,753</u>	<u>\$ 1,972,245</u>	<u>\$ 30,492</u>

The decrease in fixed water assessments was due to a reduction in the assessment rate for 2004.

The reduction in irrigation water sales was due to more rainfall in 2004, which decreased the need for irrigation.

The increase in the Bexar-Met contract earnings was due to contractual provisions

The Table 2 below represents a summary of expenses for 2004 and 2003 and the amount of change in relation to the prior year.

Table 2 - Expenses

	2003	2004	Increase (Decrease)
Payroll	\$ 604,118	\$ 473,126	\$ (130,992)
Professional fees	116,452	135,299	18,847
Contracted services	169,594	36,597	(132,997)
Maintenance and repairs	16,543	20,949	4,406
Insurance	198,382	104,860	(93,522)
Materials	139,574	46,058	(93,516)
Taxes	44,227	46,539	2,312
Operations	285,087	468,829	183,742
Interest	170,766	149,099	(21,667)
Loss on sale/abandonment of assets	-	171,365	171,365
	<u>\$ 1,744,743</u>	<u>\$ 1,652,721</u>	<u>\$ (92,022)</u>

BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Year Ended September 30, 2004

Final Budget versus Actual Results

The District reported overall revenues of \$1,972,243 versus the budget estimate of \$1,867,600 for a positive variance of \$104,643.

REQUEST FOR INFORMATION

This financial report is designed to provide our landowners, customers, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions concerning any of the information provided in this report or requests for additional financial information, contact the District at P.O. Box 170, Natalia, Texas 78059.

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

STATEMENT OF NET ASSETS

December 31, 2004

ASSETS

	<u>Business-type Activities</u>
Current asset:	
Cash	\$ 742,586
Accounts receivable:	
Fixed water assessments - net	284,749
Accrued interest	6,511
Prepaid expenses	23,475
Total current assets	<u>1,057,321</u>
Property, plant and equipment	4,495,726
Restricted assets:	
Cash and cash equivalents	239,766
Investments - contract revenue notes escrow	2,677,352
Interest receivable	964
Deferred charge - debt issue costs - net	52,500
	<u>7,466,308</u>
	<u>8,523,629</u>

LIABILITIES

Current liabilities:	
Accounts payable	758,846
Deferred revenue	93,535
Accrued liabilities	58,942
Current portion of long-term debt	70,744
Current portion of contract revenue notes	360,000
Total current liabilities	<u>1,342,067</u>
Long-term debt	<u>102,128</u>
Contract revenue notes	<u>2,155,000</u>
Total liabilities	<u>3,599,195</u>

NET ASSETS

Invested in capital assets, net of related debt	4,322,854
Restricted for construction	403,082
Unrestricted	198,498
	<u>\$ 4,924,434</u>

See independent auditor's report and accompanying notes to financial statements.

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

**STATEMENT OF ACTIVITIES
Year Ended December 31, 2004**

	<u>Business-type Activities</u>
Revenues from operations:	
Fixed water assessments	\$ 351,407
Irrigation water sales	78,249
Tecon water sales	30,766
Other	72,329
	<u>532,751</u>
Operating expenses:	
Directors fees	12,600
Payroll	473,126
Professional fees	135,299
Contracted services	36,597
Maintenance and repairs	20,949
Insurance	104,860
Depreciation	142,513
Amortization	9,000
Telephone	11,342
Utilities	7,497
Fuel and lubricants	40,172
Water master fee	23,904
Materials	46,058
Bank charges	9,917
Supplies	8,998
Uniforms	5,433
Election costs	12,740
Postage	4,193
Legal notices & recording fees	2,822
Taxes - payroll	46,539
Dues and subscriptions	4,189
Contingency	28,270
Water efficiency	141,614
Loss on sale and abandonment of assets	171,365
Other	3,625
	<u>1,503,622</u>
Loss from operations	<u>(970,871)</u>
Nonoperating revenues (expenses):	
Bexar-Met contract	1,402,305
Interest and dividend income	37,187
Interest expense	(149,099)
	<u>1,290,393</u>
Change in net assets	319,522
Net assets at beginning of year	<u>4,604,912</u>
Net assets at end of year	<u>\$ 4,924,434</u>

See independent auditor's report and accompanying notes to financial statements.

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**
STATEMENT OF CASH FLOWS
Year Ended December 31, 2004

Operating activities:	
Receipts from Customers	\$ 525,520
Cash payments to suppliers of goods and services	(879,101)
Cash payments to employees	(531,740)
Net cash used in operating activities	<u>(885,321)</u>
Noncapital financing activities:	
Proceeds from Bexar-Met	1,402,305
Net cash provided by noncapital financing activities	<u>1,402,305</u>
Capital and related financing activities:	
Payments on long-term debt	(125,449)
Payments on contract revenue notes	(335,000)
Interest on long-term debt	(10,401)
Interest on contract revenue notes	(145,266)
Net cash used in capital and related financing activities	<u>(616,116)</u>
Investing activities:	
Interest income	37,187
Net cash provided by investing activities	<u>37,187</u>
Increase in cash and cash equivalents	(61,945)
Cash and cash equivalents at beginning of year	804,531
Cash and cash equivalents at end of year	<u>\$ 742,586</u>
Reconciliation of operating loss to net cash provided by operating activities:	
Operating loss	\$ (970,871)
Adjustments to reconcile operating loss to net cash used for operating activities:	
Depreciation	142,513
Amortization	9,000
Loss on sale/abandonment of assets	139,000
(Increase) decrease in operating asset items:	
Accounts receivable:	
Fixed water assessments - net	(56,941)
Prepaid expenses	11,853
Accrued interest	(1,351)
Increase (decrease) in operating liability items:	
Accounts payable	(180,410)
Deferred revenue	49,710
Accrued liabilities	(27,824)
Net cash used in operating activities	<u>\$ (885,321)</u>

See independent auditor's report and accompanying notes to financial statements.

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2004**

Note 1 - Summary of Significant Accounting Policies

The Bexar-Medina-Atascosa Counties Water Control and Improvement District No. 1 (the District) was organized as a municipal corporation under the Water Improvement District laws of Texas, Section 52, Article III, Texas Constitution; Chapter 2, Title 128, Article 7622 and subsequent, Revised Statutes of Texas of 1925; and Chapter 87 of the general laws passed by the Thirty-fifth Legislature at the regular session in 1917. The District currently operates under Article XVI, Section 59 of the Texas Constitution, Chapters 49, 50 and 51 of the Texas Water Code, and other applicable general laws of the State. The District was reorganized as a municipal corporation or Irrigation District on February 8, 1925. The District provides irrigation water to a three county area in south-central Texas. The District is under full control of a seven member Board of Directors. Board members are elected by the landowners of the District to serve a four year term.

Reporting Entity

The District, for financial purposes, includes all of the funds relevant to its operations.

Generally accepted accounting principles require that the financial statements of the District include those of separately administered organizations for which the District is financially accountable. Financial accountability is determined on the basis of budget adoption, taxing authority, funding and appointment of the respective governing board.

Based on the foregoing criteria, there are no component units required to be included in these financial statements.

Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all activities of the primary government. For the most part, the effect of Interfund activity has been removed from these statements

The statement of activities demonstrates the degree to which the direct expenses of a given function or identifiable activity are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or activity. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or activity and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or activity

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the District comes from fees charged to district landowners for irrigation water.

**BEXAR-MEDINA-ATASCOSA COUNTINES WARER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**
NOTES TO FINANCIAL STATEMENTS
 December 31, 2004

Note 1 - Summary of Significant Accounting Policies (Continued)

Measurement Focus, Basis of Accounting, and Financial Statement Presentation (Continued)

Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

As a general rule the effect of inter-fund activity has been eliminated from the financial statements. This includes inter-fund receivables and payables and the "doubling-up" effect of internal service fund activities.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Fund Accounting - The accounts of the District are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are summarized by providing a separate set of self-balancing accounts that include its assets, liabilities, fund equity, revenues, and expenditures or expenses. The following funds are used by the District:

Proprietary Fund Types:

Proprietary funds use the economic resources measurement focus. The accounting objectives are determination of net income, financial position, and cash flows. All assets and liabilities associated with a proprietary fund's activities are included on its balance sheet. Proprietary fund equity is segregated into contributed capital and retained earnings.

Basis of Accounting - The accrual basis of accounting is used in proprietary fund types. The accrual basis of accounting recognizes revenue when earned. Expenses are recorded when incurred.

Budgets and Budgetary Accounting - An annual operating budget is adopted by the Board of Directors as a management tool and to meet contractual obligations. Monthly budget reports are prepared for the Board to maintain proper budgetary control.

It is the District's policy to prepare the annual budget on the cash basis of accounting.

Cash and Cash Equivalents - For purposes of the statement of cash flows, all highly liquid investments with a maturity of three months or less are considered to be cash equivalents.

Property, Plant and Equipment - Property, plant and equipment are stated at historical costs. Donated fixed assets are stated at their fair value on the date donated. The District provides for depreciation over the estimated useful lives of the assets using the straight-line method. Estimated useful lives, in years, for depreciable assets are as follows:

Building	15 - 50
Machinery and equipment	7 - 30
Automobiles and trucks	5 - 10
Furniture and fixtures	3 - 30
Fencing	30
Communication equipment	10
Miscellaneous	3-30

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2004**

Note 1 - Summary of Significant Accounting Policies (Continued)

Compensated Absences - The District allows employees to accumulate vacation and sick leave within certain limitations. Pursuant to GASB pronouncements, the District does not record as expense non-vested sick leave. The accrued vacation payable at December 31, 2004 was immaterial and therefore was not recorded at year-end.

Risk Management - The District provides for potential losses due to insurable risks primarily through the purchase of commercial liability insurance. Such insurance covers risk areas such as losses related to property damage or theft and bonding of the Board of Directors.

Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts 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 reporting period. Actual results could differ from those estimates.

Note 2 - Deposits and Investments

Deposits (cash and certificates of deposit) are carried at cost, which approximates market value. The District's deposits are categorized to give an indication of the level of risk assumed by the District at year-end. The categories are described as follows:

Category 1 - Insured or collateralized with securities held by the District or by its agent in the District's name.

Category 2 - Collateralized with securities held by the pledging financial institution's trust department or agent in the District's name.

Category 3 - Uncollateralized.

Deposits, categorized by level of risk, are as follows:

	Bank	Category			Carrying Amount	Total
	Balance	1	2	3		
Cash and cash equivalents	\$ 217,028	\$ 217,028	\$ -	\$ -	\$ 210,999	\$ 210,999
Certificates of deposit	531,587	531,587	-	-	531,587	531,587
	<u>\$ 748,615</u>	<u>\$ 748,615</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 742,586</u>	<u>\$ 742,586</u>

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2004**

Note 2 - Deposits and Investments (Continued)

Investments consist of an escrow account with the Bank of New York where the proceeds of the issuance of contract revenue notes were deposited per an escrow agreement. These funds are invested in a Fidelity Treasury Fund. These funds are reported at cost which approximates market. The balance in this account as of December 31, 2004 was \$2,677,352.

Note 3 - Restricted Assets

Certain assets are restricted for construction funded through contract revenue notes.

Note 4 - Accounts Receivable

Accounts receivable consist of fixed water assessments of \$313,749 due as of December 31, 2004. A provision for estimated uncollectible accounts on these assessments in the amount of \$29,000 has been provided.

Note 5 - Property, Plant and Equipment

Property, plant and equipment is carried at cost, if purchased, or fair market value at the date of acquisition, if received as a donation. Depreciation is computed using the straight-line method over the asset's estimated service lives. Depreciation expense for the year ended December 31, 2004 totaled \$142,513.

The following is a summary of the change in the fixed asset accounts for the year ended December 31, 2004:

	Balance December 31, 2003	Additions	Deletions	Balance December 31, 2004
Land and easements	\$ 194,451	\$ -	\$ -	\$ 194,451
Buildings	170,245	-	-	170,245
Water system	3,229,428	-	-	3,229,428
Machinery and equipment	1,403,008	11,165	257,533	1,156,640
Vehicles	311,448	-	-	311,448
Furniture and fixtures	37,022	2,587	-	39,609
Fencing	22,189	-	-	22,189
Project development	381,289	-	-	381,289
Water system rehab project	777,099	35,793	-	812,892
	<u>6,526,179</u>	<u>49,545</u>	<u>257,533</u>	<u>6,318,191</u>
Less accumulated depreciation	1,691,120	142,513	11,168	1,822,465
	<u>\$ 4,835,059</u>	<u>\$ (92,968)</u>	<u>\$ 246,365</u>	<u>\$ 4,495,726</u>

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO.1**
NOTES TO FINANCIAL STATEMENTS
December 31, 2004

Note 5 - Property, Plant and Equipment (Continued)

The value of land acquired since 1925 by the District has not been established; therefore, it is not recorded on the books as of December 31, 2004. The land was deeded to the District by property owners at the time of creation of the District for the purpose of establishing the system of canals needed to complete the irrigation system. The total number of acres donated to the District has not been determined.

Note 6 - Long-Term Debt

The following is a summary of long-term debt as of December 31, 2004:

Various Notes payable bearing interest from 6.4% to 9.0%. These notes mature from 2004 to 2008; secured by vehicles and equipment.	\$ 172,872
Less current portion	<u>70,744</u>
	<u>\$ 102,128</u>

Current maturities of long-term debt are as follows:

2005	\$ 70,744
2006	66,104
2007	31,024
2008	<u>5,000</u>
	<u>\$172,872</u>

Note 7 - Contract Revenue Notes

On October 7, 2000 the Board of Directors approved a resolution authorizing the issuance of \$3,765,000 of contract revenue notes. The proceeds of these notes are restricted to the rehabilitation of the water delivery system. The notes are payable from revenue received from the water sales contract with the Bexar Metropolitan Water District.

The following is a summary of these notes as of December 31, 2004:

\$3,765,000 Series 2000 Contract Revenue Notes due in annual installments of \$300,000 to \$485,000 through February, 2010; interest is variable from 4.81% to 5.56% and is payable semi-annually	\$ 2,515,000
Less current portion	<u>360,000</u>
	<u>\$ 2,155,000</u>

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2004**

Note 7 - Contract Revenue Notes (Continued)

The annual requirements to amortize the debt, including interest payments of \$362,865 are as follows:

<u>Year Ending December 31</u>	
2005	360,000
2006	380,000
2007	405,000
2008	430,000
2009	455,000
2010	485,000
	<u>\$ 2,515,000</u>

Note 8 - Water Sales Contracts and Commitments

The district has entered into a series of agreements with the Bexar Metropolitan Water District (Bexar-Met). These agreements provide for the sale of water from the District's water system to Bexar-Met and for payments by Bexar-Met to the District to ensure future water availability for sale to Bexar-Met. Each agreement is described further in this note. In summary, a 1991 agreement provides for the sale of "excess water" (as determined by the District) at a fixed price on a take-or-pay basis; a 1992 agreement suspends for five years certain provisions of the 1991 agreement delaying the sale of excess water to Bexar-Met, with Bexar-Met making fixed annual payments for maintenance, repairs, and improvements to the District's water system; and a 1995 agreement provides that the District will sell specified amounts of water on a "priority basis" before determining the amount of excess water as defined in the 1991 agreement.

Long-Term Water Sales Agreement

The 1991 agreement provides for the sale of excess water from the District's adjudication of 66,000 acre-feet of water per year. The agreement is effective from September 1, 1991, for a period of twenty years with the option to extend the agreement for an additional ten years. Several options to terminate the agreement are available to the District. Bexar-Met may terminate the agreement effective December 31 of the year after Bexar-Met gives proper notices. Implementation of the agreement is subject to approval by the Texas Commission on Environmental Quality (TCEQ). In April 1998, the District's Certificate of Adjudication was amended by the TCEQ to authorize the use of 19,974 acre-feet of its 66,000 acre-foot adjudication for municipal purposes. Excess water is determined at the District's sole discretion. The agreement requires the District to evaluate the availability of excess water at least twice a year in the months of February and August. Bexar-Met agrees to purchase during each contract year all excess water as determined by the District whether or not Bexar-Met takes delivery of the water. The price of the water for the first three contract years shall be \$56.00 for each metered acre-foot, subject to adjustments thereafter. The District is committed to deliver the excess water only by gravity flows to Bexar-Met's designated point of diversion, which is the same as the District's point of diversion in the system.

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

**NOTES TO FINANCIAL STATEMENTS
December 31, 2004**

Note 8 - Water Sales Contracts and Commitments (Continued)

1992 Water Conservation Agreement

In 1992, the District entered into a water conservation agreement with Bexar-Met. The agreement provides that the District will take certain steps to ensure future excess waters, as defined in the water sales agreement, including measures to conserve water in the District's irrigation system. The agreement became effective September 1, 1992, for a period of five years. Bexar-Met paid the District \$300,000 each year that the contract was in effect.

The water conservation agreement required the District to waive its right to declare excess water during the five-year term of the agreement. Bexar-Met will receive credits against future billings for excess water under the water agreement to the extent of 85% of the first year's conservation agreement payments and 100% of future years' payments. Total credits to be given by the District will not exceed \$1,455,000, and the credit applied to future water purchases in any year may not be more than one-fifth of the total credits.

1995 Water Availability Contract

In 1995, The District completed an agreement with Bexar-Met to make water available to Bexar-Met on a priority basis up to 6,000 acre-feet of water per year, to the extent water is available in accordance with conditions stated in the 1995 agreement. The potential availability of excess water pursuant to the 1991 agreement is directly reduced on an acre-foot basis.

On each anniversary date, Bexar-Met will pay the District the purchase price for the entire quantity of water deliverable under the 1995 agreement during the twelve months following November 1, 1996. The District is entitled to the entire purchase price for the stated quantity of priority water whether or not Bexar-Met accepts the District's tender of the water.

In 1997, the parties amended this contract. In that amendment Bexar-Met agreed to pay \$168,000 for 3,000 acre-feet of water. Bexar-Met can receive the water in the twelve months starting April 1, 1998.

1999 Agreement

In November, 1999 the District entered into an agreement with Bexar-Met that merges and integrates the prior agreements. Per the 1999 agreement, the District will deliver 10,000 acre feet of priority water to Bexar-Met annually on a take or pay basis at \$69 per acre foot. This amount is to be paid in equal monthly installments of \$57,500 beginning December, 1999.

Bexar-Met will provide \$500,000 per year toward the federal matching fund obligation per the P.L. 83-566 project to rehabilitate the water delivery system. These payments will begin in 2001 and run through 2010. In consideration for Bexar-Met's funding of the annual matching project, the District shall annually convert 1,000 acre feet out of the 19,974 acre feet of water allocated for municipal use under the Certificate of Adjudication 19-2130 for purchase by Bexar-Met on a priority basis until the balance of the 19,974 acre feet of water is allocated to Bexar-Met.

**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**
NOTES TO FINANCIAL STATEMENTS
December 31, 2004

Note 8 - Water Sales Contracts and Commitments (Continued)

This agreement was amended in June, 2000 whereby Bexar-Met contractually agreed to provide in-kind payment or perform creditable activity in an amount not less than \$500,000 per year toward the federal matching fund obligation for the years 2001 through 2010.

Note 9 - Concentrations

The District derived approximately seventy one percent of its income for the year ended December 31, 2004 from the water sales contracts with the Bexar Metropolitan Water District. See note 8 for details of these contracts.

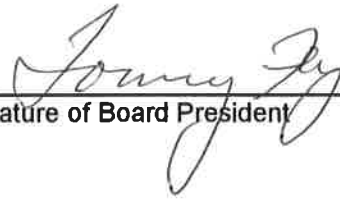
**BEXAR-MEDINA-ATASCOSA COUNTIES WATER CONTROL AND
IMPROVEMENT DISTRICT NO. 1**

CERTIFICATE OF THE BOARD OF DIRECTORS

We, the undersigned, do hereby certify that the audit report of the above named Bexar-Medina-Atascosa Counties Water Control and Improvement District No. 1 for the year ended December 31, 2004, was received by the Board of Directors on the 11th day of April, 2005 and was reviewed and approved at a meeting of the Board of Directors of the District on the 10th day of May, 2005.



Signature of Board Secretary



Signature of Board President