

Control Number: 42946



Item Number: 15

Addendum StartPage: 0

House Bill (HB) 1600 and Senate Bill (SB) 567 83rd
Legislature, Regular Session, transferred the functions
relating to the economic regulation of water and sewer
utilities from the TCEQ to the PUC effective
September 1, 2014.



McKAMIE KRUEGER, LLP

RECEIVED

2014 OCT 16 PM 2: 23

PUBLIC UTILITY COMMISSION
FILING CLERK

42946

JULIE Y. FORT
2007 N. Collins Blvd., Suite #501
Richardson, Texas 75080
214-253-2600
Julie@mckamiekrueger.com

April 22, 2011

Via First Class Mail and Email to bdickey@tceq.state.tx.us (on April 22, 2011)

Via CMRRR #7010 1060 0000 2963 8173 (on April 25, 2011)

Texas Commission on Environmental Quality
Water Supply Division
Utilities and District Section, MC-153
P.O. Box 13087
Austin, Texas 78711-3087

RECEIVED
APR 23 2011
ENVIRONMENTAL QUALITY

**Re: REQUEST FOR HEARING ON APPLICATION NOS. 36966-W AND 36967-S
FROM TOWN OF PROVIDENCE VILLAGE, TEXAS**

Dear Executive Director:

I am submitting this request for hearing in regard to the above referenced application numbers on behalf of my client, the Town of Providence Village, Texas ("Town"). The Town's mailing address and day time phone numbers are as follows:

Town of Providence Village
Attention: Mayor
P.O. Box 838
Aubrey, Texas 76227
Telephone Number is 940-484-4488 (Philip Mack Furlow).

My name is Julie Fort and my mailing address is:

McKamie Krueger, LLP
2007 N. Collins Blvd., Suite 501
Richardson, Texas, 75080
Telephone Number is 214-253-2600.

The applicant/transferor/seller is Providence Village Water Control and Improvement District of Denton County f/k/a Denton County Freshwater Supply District No. 9 ("District"), 19 Briarhollow Lane, Suite 245, Houston, Texas 77027-2801. Telephone: 713-621-3707. The applicant/transferor/purchaser is Mustang Special Utility District ("Mustang"), 7885 FM 2931, Aubrey, Texas 76227. Telephone: 940-440-9561. I believe the application numbers are 36966-W and 36967-S. The application submitted is an "Application for Sale, Transfer, or Merger of a Retail Public Utility" ("STM application").

The Town of Providence Village requests a public hearing on the STM application.

Background Information

The systems proposed to be transferred serve only citizens of the Town. The Town incorporated as a municipal corporation in 2010 with a population of around 5,000 citizens. The city limits of the Town are covered by dual water and sewer CCN's held by Mustang and the District. Mustang had the water CCN before the District. The District had the sewer CCN before Mustang. After Denton County authorized the creation of the District for a developer, the District (while controlled by the developer) and Mustang entered into a series of contracts with the first ones being dated June 18, 2001, one for water and one for sewer (together the "2001 Contracts"). In 2001, the area was rural and sparsely populated, but the developer wanted to build a large, high-density residential community. Mustang had no customers or distribution facilities on the developer's property. Mustang consented to the District obtaining a dual water CCN and allowing all of the new homes to be retail utility customers of the District, in part, because *Mustang was financially unable to construct the infrastructure or be the retail service provider to the new high-density development*. Mustang was created as a rural utility provider to service farms and ranches. Mustang's governing body consists solely of Mustang's rural water customers and has intentionally excluded residents of the high-density development from running for office.

In 2003, the District issued its first series of \$31 million in bond issues that paid for the construction of the infrastructure to be the retail utility water and sewer service provider to the developer's property. The District owns the infrastructure and still maintains its dual CCN. Many new homes were constructed over the last 10 years and the STM application reflects the District now has 1,846 retail water customers and 1,612 retail sewer customers. The STM application does not reflect that the service area includes an undeveloped area of the developer's property located in the Town and District on which approximately 300 new houses will be built and infrastructure will need to be constructed. The 2001 Contracts were amended in 2002, again in 2005 and then again in 2007. Under the contracts, the District pays Mustang as a service provider for Mustang to perform utility billing and collection services and for maintenance of the District's infrastructure (the 2005 contract is the current contract, as amended in 2007) ("Contracts" both enclosed herewith as Exhibit "C"). The STM application seeks to cancel the District's CCN and gift all of the District's water and sewer infrastructure to Mustang. Just as in 2001, Mustang still lacks adequate financial resources for the STM application to be granted.

The utility service currently provided by the District is adequate and should remain as-is. See 30 T.A.C. § 291.109(e)(5)(B).

Reasons Town's Request for Public Hearing should be Granted

Our description of how the Town of Providence Village and the public interest would be adversely affected by the transfer of ownership proposed in the STM application and the cancelation of the transferor's water and sewer CCN's are as follows:

www.mckamiekrueger.com

San Antonio
941 Proton Rd.
San Antonio, Texas 78258
(210) 546-2122 Fax (210) 546-2130

Austin
100 Congress Ave., Suite 2000
Austin, Texas 78701

Dallas
2007 N. Collins Blvd. Suite 501
Richardson, Texas 75080
(214) 253-2600 Fax (214) 253-2626

1. Notice has not been Provided to Town and is therefore Inadequate. (Water Code § 13.301(e)(1); 30 T.A.C. § 291.109(e)(1))

The Town has not received any notice from Mustang or the District of the pending STM application. The Town became aware of the pending application because some citizens of the Town provided a copy of the notices they received by mail to the Town Council. The notice was improper.

2. STM Application is Improper. (Water Code § 13.301(e)(1); 30 T.A.C. § 291.109(e)(1))

Number 19 on the STM application ask the applicants to attach a copy of a franchise agreement or consent letter from the city or district if the system being operated is within the corporate limits of a city or district. The system proposed to be transferred by the STM application is within the city limits of the Town. The Town has not and does not consent to the proposed transfer. In addition, the Town does not have a franchise agreement with Mustang, the transferee. Thus, not only was the notice not provided, the STM application submitted to TCEQ is improper.

3. Transferee lacks adequate financial capabilities. (Water Code § 13.301(e)(2); 30 T.A.C. § 291.109(e)(2))

The STM application lists Mustang as the transferee/purchaser under the application. The Town requests a hearing because Mustang lacks adequate financial resources as a transferee for multiple reasons, as set forth below. Mustang is required by Water Code § 13.301(e)(2) and 30 T.A.C § 291.109(e)(2) to demonstrate adequate financial, managerial and technical capability or the executive director may request a hearing. Mustang has failed to do so and is unable to do so for the reasons set forth below. Further, as recently as January 2010, the Executive Director for the TCEQ wrote:

Looking at what the ED does know about Mustang SUD's ability to serve, Mustang SUD's current capacity situation is a cause of concern.

See Executive Director's Exceptions to the Proposal for Decision, Page 8, SOAH Docket No. 582-08-1318, TCEQ Docket No. 2001-1956-UCR, Application of Mustang Special Utility District to Amend Sewer Certificate of Convenience and Necessity (CCN) No, 20930 in Denton County, Texas, Application No. 35709-C.

A. Mustang's Audited Financial Statements Show Significant Losses for 2009 and 2010 (Water Code § 13.301(e)(2) and (e)(4); 30 T.A.C. § 291.109(e)(2), (e)(3)(B) and (e)(5)(G))

For the fiscal year ended September 30, 2010, Mustang's net operating income is negative \$(536,591) and the change in net assets is negative \$(1,322,967). For the fiscal year ended September 30, 2009 Mustang's net operating income is negative \$(950,233) and the change in net assets is negative \$(1,366,859). These significant financial shortcomings demonstrate inadequate financial capabilities.

The following summarizes Mustang's audited financials:

	Amount of Mustang's Loss September 30, 2009	Amount of Mustang's Loss September 30, 2010
Mustang's Net Operating Income	\$ (950,233)	\$ (536,591)
Mustang's Net Assets	\$ (1,366,859)	\$ (1,322,967)

Mustang's September 30, 2010 audited financial statement is enclosed as Exhibit "A" (Summary of audit located on Page 45) and the September 30, 2009 audited financial statement is enclosed as Exhibit "B" (Summary of audit located on Page 45).

Mustang suffered these major losses even with a land developer providing the following "Capital Contributions" (as reflected on Page 45 of the audits) directly to Mustang in recent years:

September 30 Fiscal Year End	Amount of Capital Contribution to Mustang by Developer
2007	\$ 3,934,388
2008	\$ 139,450
2009	\$ 61,875

In 2010, Mustang had to give the developer a Capital Contribution refund of \$165,994. As the Capital Contributions from the developer decrease and come to an end, Mustang's financial condition has worsened, demonstrating an inability to service the large number of retail water and sewer customers in the Town without outside financial aid.

Regardless of any excuses Mustang may promulgate, the audited numbers speak for themselves. Mustang cannot afford the expense of the 1,846 retail water customers and 1,612 retail sewer customers it would receive if the STM application is granted. Adding retail customers and owning additional infrastructure generates expenses as much as it generates income. Further, approximately 300 additional new homes are going to be built in the Town and service area and all will need new water and sewer infrastructure.

The current Contract between Mustang and the District has the District paying Mustang as a service provider to bill the District's retail utility customers and to operate and maintain the District's infrastructure requested to be transferred to Mustang in the STM application. The Contracts are intentionally structured for Mustang to earn a profit on providing the services. Mustang is allowed to charge District the "actual costs plus a fifteen percent (15%) overhead charge" incurred by Mustang. See Second full paragraph on Page 5 of the "First Amendment to Merged, Amended, and Restated Agreement Related to Water and Sanitary Service" enclosed with Exhibit "C". Therefore, Mustang is operating at a

www.mckamiekrueger.com

loss even while being allowed to charge all of its actual costs in performing services plus a 15% overhead add-on. If the STM application is granted, the Contract will terminate and Mustang will then have to perform the same utility billing services and the same maintenance and operation of the water and sewer infrastructure, but it will no longer have the District to pay Mustang's actual costs and 15% overhead charge. Granting the STM application will remove the District from the equation and the customers will become Mustang's retail customers and the assets will then belong to Mustang. This loss of revenue from being a service provider to the District will only increase Mustang's financial troubles. It is illogical to assume Mustang can operate without experiencing losses after the transfer when it would become solely responsible for the actual costs and overhead when it is unable to do so prior to the transfer with the District paying Mustang's actual costs plus 15% overhead.

Mustang already struggles to maintain an adequate debt to equity ratio without taking on the full obligations of owning the additional system and having the sole CCNs for the 300 new homes going to be built, which it is seeking to acquire in the STM application. For example, in 2008 Mustang sought Attorney General approval to issue \$2.7 million dollars in bond indebtedness. The Attorney General informed Mustang that it could not issue such indebtedness unless it paid off at least \$833,000.00 of the indebtedness it incurred two years earlier in 2006. Regulations provide, in 30 T.A.C. § 291.209(e)(5)(G), that it is in the public interest to hold a hearing and investigate the financial stability of Mustang and the adequacy of its debt-equity ratio. The submitted STM application does not provide sufficient information about this problem for the Executive Director to evaluate it without a public hearing.

All of the above evidences Mustang's continuing mismanagement or misuse of revenues as a utility service provider and is grounds for a hearing to be granted under Water Code § 13.301(e)(2) and (e)(4) and 30 T.A.C. § 291.109(e)(3)(B).

B. Mustang has History of Billing Errors and Late Payments of Contractual Obligations (Water Code § 13.301(e)(3)(B); 30 T.A.C. § 291.109(e)(3)(B))

Currently the District contracts with Mustang for Mustang to provide utility billing and collection services for the District's retail water and sewer customers. The District compensates Mustang for this service. Mustang is responsible for sending utility bills, collecting the payments and then forwarding the utility revenue to the District, minus a collection fee for Mustang's services.

The March 17, 2009 letter attached hereto as Exhibit "D" from the District to Mustang outlines the problem of Mustang being incapable of timely transferring the collected utility revenue to the District. Such revenue collected by the Mustang does not even belong to Mustang. It is merely a pass-through because Mustang is providing a service. Even though the income is merely pass-through, Mustang still was unable to timely pay and meet its financial obligations to the District.

Mustang did not notice its own errors. The District discovered Mustang's errors and made Mustang aware of the problem. This demonstrates Mustang's lack of internal checks and balances. There is no way of knowing how long the errors would have remained undetected if Mustang were solely responsible for the utility accounts. Two newspapers articles are attached as Exhibit "E", one from March 15, 2009 and another from March 18, 2009 outlining Mustang's billing oversights and Mustang's inability

www.mckamiekrueger.com

San Antonio
941 Proton Rd.
San Antonio, Texas 78258
(210) 546-2122 Fax (210) 546-2130

Austin
100 Congress Ave., Suite 2000
Austin, Texas 78701

Dallas
2007 N. Collins Blvd. Suite 501
Richardson, Texas 75080
(214) 253-2600 Fax (214) 253-2626

to pay its own bills to the District in a timely manner. Granting the pending STM application will make Mustang solely responsible for the utility accounts because the District's retail customers will become Mustang's retail customers.

All of the above evidences Mustang's continuing mismanagement or misuse of revenues as a utility service provider and is grounds for a hearing to be granted under Water Code § 13.301(e)(3)(B) and 30 T.A.C. § 291.109(e)(3)(B).

C. The District still has Significant Bond Indebtedness from District Bonds that were Sold to Pay for the Water and Sewer Infrastructure Proposed to be Transferred to Mustang (Water Code § 13.301(e)(5); 30 T.A.C. § 291.109(e)(4) and (e)(5)(D))

The District sold \$31 million in bonds to construct the water and sewer infrastructure requested to be transferred to Mustang. The STM application requests to transfer the District's water and sewer infrastructure and the District's retail customers to Mustang and leave the District to continue paying the bond debt. Mustang is attempting to acquire the infrastructure and retail customers because it needs revenue to reduce the million dollar losses reported the last 2 years (*See Paragraph 3.A., above*). However, acquiring the 1,846 retail water customers and 1,612 retail sewer customers will create increased costs. Likewise, acquiring the undeveloped area of the developer's property located in the Town and District on which approximately 300 new houses will be built and infrastructure will need to be constructed will create increased costs. As discussed in Paragraph 3.A., the current Contracts between Mustang and the District will terminate if the STM application is granted. Then, Mustang will have to perform the same utility billing services and the same maintenance and operation of the water and sewer infrastructure that it performs now, but it will no longer have the District to pay Mustang's actual costs and 15% overhead charge. This loss of revenue from the District will only increase Mustang's financial troubles. It is illogical to assume Mustang can operate without experiencing losses after the transfer when it would be solely responsible for its own actual costs and overhead if it is unable to do so prior to the transfer with the District paying Mustang's actual costs plus 15% overhead. Likewise, the District will be left with bond indebtedness and continued assessments against District residents, yet the District will lose its utility revenue.

All of the above evidences Mustang's continuing mismanagement or misuse of revenues as a utility service provider and lack of financial ability are grounds for a hearing to be granted under Water Code § 13.301(e)(5) and 30 T.A.C. § 291.109(e)(3)(B) and (4). Further, regulations provide, in 30 T.A.C. § 291.209(e)(5)(D), that it is in the public interest to hold a hearing and investigate the effect of the transfer on the retail public utility, which is the District.

D. Mustang lack the Financial Ability to Provide Capital Investment to Build Infrastructure to the Final Phases of the Development (Water Code § 13.301(e)(4); 30 T.A.C. § 291.109(e)(4))

The property developer has an additional phase of approximately 300 residential homes to be developed within the Town and District. Under the Contracts, the District will sell more bonds to build the water and sewer infrastructure in the new residential area. If the District's CCN is cancelled and all of

www.mckamiekrueger.com

San Antonio
941 Proton Rd.
San Antonio, Texas 78258
(210) 546-2122 Fax (210) 546-2130

Austin
100 Congress Ave., Suite 2000
Austin, Texas 78701

Dallas
2007 N. Collins Blvd. Suite 501
Richardson, Texas 75080
(214) 253-2600 Fax (214) 253-2626

the District's infrastructure assets are transferred to Mustang under the STM application terminating the Contracts, Mustang does not have the cash or bonding ability to provide the necessary capital investment to provide adequate service. See Paragraph 3.C. above for details about Mustang's bond history and Paragraph 3.A. for details on operating losses. The fact that the Contracts provide that Mustang can take the infrastructure from the District **does not** equate to the transfer being in the public interest or within Mustang's financial capabilities. Whether the structure of such Contracts is even lawful is yet to be determined. It is Mustang's burden to demonstrate financial ability. Water Code § 13.301(e)(4) and 30 T.A.C. § 291.109(e)(4).

E. Mustang does not want Town Residents Participating in its Management or Overseeing its Finances (Water Code § 13.301(e)(2); 30 T.A.C. § 291.109(e)(2))

Prior to the year 2000, Mustang was a water supply corporation. Mustang then converted to a special utility district to which Chapter 65 of the Water Code applies. Mustang is governed by a 9 member Board of Directors each elected at-large ("Board"). Section 65.102 of the Water Code sets forth qualifications to serve on the Board, which are: (1) being 18 years old; (2) being a resident of Texas; and (3) owning land subject to taxation in the district or being a user of district facilities or being a qualified voter in the district. These Water Code requirements to serve in public office are generally sufficient for all administratively created special utility districts, except Mustang. Mustang had the requirements changed so that only the long-standing rural water customers could participate in its governance to the exclusion of residents of the Town and District living in the new high-density areas.

If Mustang were operating properly and financially secure, why would it exclude the new growth located in its CCN from participating in its governance by serving on the Board? When the growth was exploding, Mustang had a local bill filed in the legislature that enacted Chapter 7209 of the Special District Local Laws Code. Chapter 7209 excludes residents of the District and Town from serving on the Board. See H.B. No. 4044 enclosed as Exhibit "F". If the STM application is granted, Mustang has admittedly already started the process of eliminating at-large elections and dividing the Board into single-member districts to preserve the power of the rural customers even though they are the minority of the customers. See Item 10 on posted Board Agenda for May 24, 2010 Board meeting and Executive Session item on June 28, 2010 posted Board Agenda, both attached as Exhibit "G".

All of the above evidences Mustang's continuing mismanagement or misuse of revenues as a utility service provider and is grounds for a hearing to be granted under Water Code § 13.301(e)(2) and 30 T.A.C. § 291.109(e)(2) and (3)(B).

F. Granting the STM Application will Result in Higher Utility Rates for Customers (Water Code § 13.301(e)(5); 30 T.A.C. § 291.109(e)(5)(I))

The District has historically had lower rates than Mustang and the STM application will result in rate increases. The fact that Mustang cannot own the system without incurring rate increases is evidence of its lack of adequate financial resources for this STM application to be approved. In recent years, the District had lower rates than its present rate, however, based on the October 5, 2007 contract between the District and Mustang attached hereto as Exhibit "C", Mustang required the District to increase its rates,

www.mckamiekrueger.com

San Antonio
941 Proton Rd.
San Antonio, Texas 78258
(210) 546-2122 Fax (210) 546-2130

Austin
100 Congress Ave., Suite 2000
Austin, Texas 78701

Dallas
2007 N. Collins Blvd. Suite 501
Richardson, Texas 75080
(214) 253-2600 Fax (214) 253-2626

even though such rate increases were not needed by the District, so that the District could achieve rate parity (or equally high rates) with Mustang in preparation for the STM application. Prior to being forced to achieve rate parity, the District had significantly lower rates than Mustang. See 2006 Summary of Area Rates taken from Denton Record-Chronicle newspaper attached as Exhibit "H". Regulations provide, in 30 T.A.C. § 291.209(e)(5)(I), that it is in the public interest to hold a hearing and investigate whether there will be "probable improvement of service or lowering of costs to consumers in that area resulting from approving the transaction." (emphasis added).

G. The District's Utility Revenue Should not be Transferred to Mustang since it Pays for Fire and Sheriff Services Vital for Public Safety (Water Code § 13.301(e)(5); 30 T.A.C. § 291.109(e)(5)(D))

State law and regulations provide, in Water Code § 13.301(e)(5) and 30 T.A.C. § 291.209(e)(5)(D), that it is in the public interest to hold a hearing and investigate the effect of approving the STM application on any retail public utility already serving the area. The District is serving the area and approval of the STM application will negatively affect the District. The District currently funds contracts to pay neighboring local entities for fire and sheriff services from utility system revenue. See Letter from District to Mustang dated March 17, 2009 discussing these ongoing annual financial obligations attached as Exhibit "D". If the water and sewer infrastructure assets and/or customers are transferred by the District to Mustang, the District will no longer have the utility revenues it currently uses to pay for basic public safety services, such as fire and sheriff protection. Mustang does not currently pay for public safety services and does not intend to pay for public safety services after the transfer.

All of the above evidences the severe negative effects on the retail service provider, the District, already serving the area and is grounds for a hearing to be granted under Water Code § 13.301(e)(5) and 30 T.A.C. § 291.109(e)(5)(D).

4. The Transfer Will Not Serve the Public Interest (Water Code § 13.301(e)(5))

The Water Code provides that the Executive Director may request a public hearing on an STM application if: "*there are concerns that the transaction may not serve the public interest, after the application of the considerations provided by Section 13.246(c) for determining whether to grant a CCN.*" Quoting Water Code § 13.301(e)(5). Thus, in determining whether the public interest is served, the Executive Director may consider the following:

- (1) the adequacy of service currently provided to the requested area;
- (2) the need for additional service in the requested area, including whether any landowners, prospective landowners, tenants, or residents have requested service;
- (3) the effect of the granting of a certificate or of an amendment on the recipient of the certificate or amendment, on the landowners in the area, and on any retail public utility of the same kind already serving the proximate area;

www.mckamiekrueger.com

San Antonio
941 Proton Rd.
San Antonio, Texas 78258
(210) 546-2122 Fax (210) 546-2130

Austin
100 Congress Ave., Suite 2000
Austin, Texas 78701

Dallas
2007 N. Collins Blvd. Suite 501
Richardson, Texas 75080
(214) 253-2600 Fax (214) 253-2626

- (4) the ability of the applicant to provide adequate service, including meeting the standards of the commission, taking into consideration the current and projected density and land use of the area;
- (5) the feasibility of obtaining service from an adjacent retail public utility;
- (6) the financial ability of the applicant to pay for the facilities necessary to provide continuous and adequate service and the financial stability of the applicant, including, if applicable, the adequacy of the applicant's debt-equity ratio;
- (7) environmental integrity;
- (8) the probable improvement of service or lowering of cost to consumers in that area resulting from the granting of the certificate or amendment; and
- (9) the effect on the land to be included in the certificated area.

Quoting Water Code § 13.246(c). In regards to public interest, “public interest” is not defined by the statute or Commission Rules. However, in the case of *Texas Citizens for a Safe Future & Water v. R. R. Com’n of Texas*, 254 S.W. 3d 492, 507 (Tex. App.—Austin 2007), the Austin Court of Appeals ruled that such term required the Commission to consider a broad variety of impacts extending beyond those specifically addressed in the statute, with a concurring opinion by Judge Waldrop stating:

It appears to me that the term “public interest” could have been included in the statute without definition or elaboration for a legitimate reason. It could well have been intended to be broad enough to allow the Commission to address the myriad possible circumstances that might be presented in an . . . application, and to allow the Commission to consider *all* of the considerations that might impact the “public interest” in having the [application granted]. This does not mean that the Commission must take any particular action with respect to the public interest component of its charge, or consider such public interest outside the context of its duty to regulate The Commission is charged with considering the “public interest” in granting or denying an [application] and may give public interest considerations the weight it considers appropriate within its statutory grant of authority.

Below are the 9 factors that may be considered by statute in determining whether the public interest will be served, and the Town’s response to each factor:

(1) the adequacy of service currently provided to the requested area;

The current retail service provided by the District is adequate. Neither Mustang nor the District alleged to the contrary in the STM application. The District should remain as the retail utility provider in the Town.

(2) the need for additional service in the requested area, including whether any landowners, prospective landowners, tenants, or residents have requested service;

As discussed in detail in Paragraph 3.D. above, service has been requested by the developer for another phase of new, high-density residential development and Mustang lacks the financial ability to provide the

www.mckamiekrueger.com

San Antonio
941 Proton Rd.
San Antonio, Texas 78258
(210) 546-2122 Fax (210) 546-2130

Austin
100 Congress Ave., Suite 2000
Austin, Texas 78701

Dallas
2007 N. Collins Blvd, Suite 501
Richardson, Texas 75080
(214) 253-2600 Fax (214) 253-2626

capital investment and build the infrastructure. Both the water and sewer infrastructure will need to be built to serve the undeveloped portions of the service area in the Town. Paragraph 3.D. above is incorporated here for providing more detail in support hereof.

(3) the effect of the granting of a certificate or of an amendment on the recipient of the certificate or amendment, on the landowners in the area, and on any retail public utility of the same kind already serving the proximate area;

The District is the current retail utility provider. Transferring its utility infrastructure to Mustang, taking its retail customers and terminating its CCNs will have a negative effect on the District, particularly given the amount of bond debt it has outstanding. Paragraph 3.A. above is incorporated here to provide detail in support hereof.

(4) the ability of the applicant to provide adequate service, including meeting the standards of the commission, taking into consideration the current and projected density and land use of the area;

The area in question has 1,846 retail water customers and 1,612 retail sewer customers. Service has been requested by the developer for another phase of approximately 300 high-density residential houses, which is projected to push the final number of retail water customers to over 2,100. Mustang's ability to serve the increased population is discussed in detail in Paragraph 3, above, which is incorporated here to provide detail in support hereof.

(5) the feasibility of obtaining service from an adjacent retail public utility;

Service is already provided by the District. It is also feasible that the Town could provide retail public utility services. Mustang is not needed as a retail public utility provider in the Town.

(6) the financial ability of the applicant to pay for the facilities necessary to provide continuous and adequate service and the financial stability of the applicant, including, if applicable, the adequacy of the applicant's debt-equity ratio;

Mustang's financial inadequacy, including its debt-equity ratio, are discussed in detail in Paragraph 3, above, which is incorporated here to provide detail in support hereof.

(7) environmental integrity;

Town has little information regarding this factor and minimal information was provided with the STM application. Environmental integrity should be explored by public hearing.

(8) the probable improvement of service or lowering of cost to consumers in that area resulting from the granting of the certificate or amendment; and

The probable negative effect on the cost to customers and the service that would be provided by Mustang if the STM application were granted are discussed in detail in Paragraphs 3.B., 3.E., and 3.F, above, which are incorporated here to provide detail in support hereof.

(9) the effect on the land to be included in the certificated area.

The effect on the land if the STM application is granted is tremendously negative for all of the reasons discussed in detail in Paragraph 3, above, which is incorporated here to provide detail in support hereof. Of all the effects discussed in Paragraph 3, the effect on public fire protection and sheriff services discussed in Paragraph 3.G. is alarming.

For the foregoing reasons Towns requests a public hearing be held on the STM application. The Town's proposed adjustment to the STM application is that it be denied and the District remain the retail service provider in the Town and that the District retain ownership of its water and sewer infrastructure.

Sincerely,

McKAMIE KRUEGER, LLP



JULIE Y. FORT

JYF/tld
Enclosures

- Exhibit "A" -- Mustang's 9/30/2010 Audited Financial Statement
- Exhibit "B" -- Mustang's 9/30/2009 Audited Financial Statement
- Exhibit "C" -- current Contracts (2005 contract with 2007 amendment)
- Exhibit "D" -- March 17, 2009 Letter from District to Mustang
- Exhibit "E" -- Two Newspaper Articles
- Exhibit "F" -- House Bill No. 4044
- Exhibit "G" -- Agendas for May 24, 2010 and June 28, 2010 Mustang Board meetings
- Exhibit "H" -- Summary of area Rates in 2006

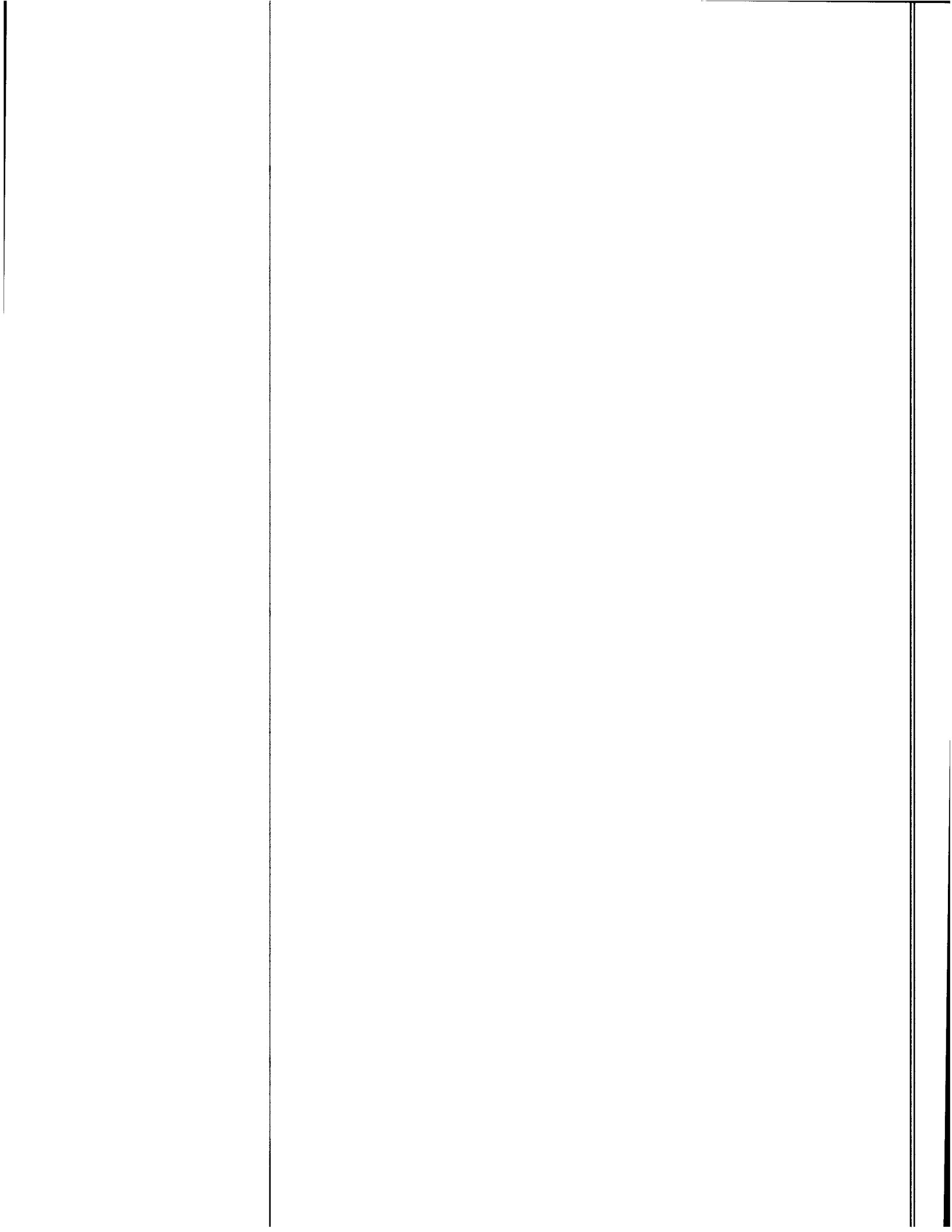
Cc: Philip Mack Furlow (via email April 22, 2011 and hand delivery April 25, 2011)
Mayor Roberson (via email April 22, 2011 and hand delivery April 25, 2011)
Alderman (via hand delivery April 25, 2011)

www.mckamiekrueger.com

San Antonio
941 Proton Rd.
San Antonio, Texas 78258
(210) 546-2122 Fax (210) 546-2130

Austin
100 Congress Ave., Suite 2000
Austin, Texas 78701

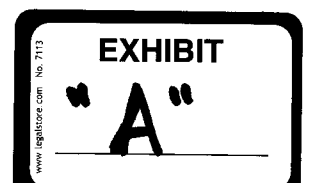
Dallas
2007 N. Collins Blvd. Suite 501
Richardson, Texas 75080
(214) 253-2600 Fax (214) 253-2626



MUSTANG SPECIAL UTILITY DISTRICT
ANNUAL FINANCIAL REPORT
YEAR ENDED SEPTEMBER 30, 2010

RECEIVED
APR 23 2011
MUSTANG SPECIAL UTILITY DISTRICT
ON
ENVIRONMENTAL QUALITY

RUTHERFORD, TAYLOR & COMPANY, P.C.
Certified Public Accountants
2802 Washington Street
Greenville, Texas 75401
(903) 455-6252



**MUSTANG SPECIAL UTILITY DISTRICT
ANNUAL FINANCIAL REPORT
YEAR ENDED SEPTEMBER 30, 2010**

TABLE OF CONTENTS

	<u>Page</u>	<u>Exhibits</u>
INTRODUCTORY SECTION		
Annual Filing Affidavit	3	
FINANCIAL SECTION		
<u>Independent Auditor's Reports:</u>		
Report on Basic Financial Statements	5	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	7	
Schedule of Findings and Questioned Costs.....	8	
Status of Prior Audit Findings	9	
Corrective Action Plan.....	10	
Management's Discussion and Analysis (Required Supplementary Information).....	11	
<u>Basic Financial Statements:</u>		
Statement of Fund Net Assets – Proprietary Funds	17	
Statement of Revenues, Expenses and Changes in Fund Net Assets – Proprietary Funds.....	19	
Statement of Cash Flows – Proprietary Funds	20	
Notes to the Financial Statements.....	21	
<u>Other Supplementary Information:</u>		
Budgetary Comparison Schedule – Enterprise Fund	32	
TEXAS SUPPLEMENTARY INFORMATION (TSI)		
Supplementary Schedules Included Within This Report.....	34	
Independent Auditor's Report on Supplementary Schedules	35	
Services and Rates.....	36	TSI-1
Enterprise Fund Expenditures.....	38	TSI-2
Temporary Investments.....	39	TSI-3
Long-Term Debt Service Requirements by Years	40	TSI-5
Changes in Long-Term Bonded Debt	44	TSI-6
Comparative Schedule of Revenues and Expenses - Enterprise Fund - Five Years	45	TSI-7
Board Members, Key Personnel and Consultants	46	TSI-8

MUSTANG SPECIAL UTILITY DISTRICT

ANNUAL FILING AFFIDAVIT

STATE OF TEXAS

COUNTY OF _____

I, _____ of the
(Name of Duly Authorized District Representative)

Mustang Special Utility District

(Name of District)

hereby swear, or affirm, that the District above has reviewed and approved at a meeting of the District's Board of Directors on the _____ day of _____,

its annual audit report for the fiscal period ended September 30, 2010

and that copies of the annual report have been filed in the District's office, located at _____

7985 FM 2931 Aubrey, TX 76227

(Address of the District's Office)

This filing affidavit and the attached copy of the audit report will be submitted to the Texas Commission on Environmental Quality to satisfy the annual filing requirements of Texas Water Code Section 49.194.

Date: _____, _____ By: _____

(Signature of District Representative)

(Typed Name and Title of District Representative)

Sworn to and subscribed to before me this _____ day of _____,

(SEAL)

(Signature of Notary)

My Commission Expires On: _____,

Notary Public of the State of Texas.

FINANCIAL SECTION

RUTHERFORD,
TAYLOR &
COMPANY, P.C.
Certified Public Accountants

2802 Washington Street

Greenville, Texas 75401

(903) 455-6252

Fax (903) 455-6667

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Mustang Special Utility District
7985 FM 2931
Aubrey, Texas 76227

Members of the Board:

We have audited the accompanying basic financial statements of the proprietary funds of the Mustang Special Utility District (District), as of and for the year ended September 30, 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic 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 basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Mustang Special Utility District as of September 30, 2010, and the results of its operations and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Audit Standards*, we have also issued our report dated February 8, 2011, on our consideration of the District'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance of the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements as a whole. The schedules identified as other supplementary information identified in the table of contents are presented for the purpose of additional analysis, are not a required part of the basic financial statements.

The supplementary information has been subjected to the auditing procedures applied in the audit of financial statements, and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves and other additional procedures in accordance with auditing standards generally accepted in the United States of America, and in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

February 8, 2011
Greenville, Texas

RUTHERFORD,
TAYLOR &
COMPANY, P.C.
Certified Public Accountants

2802 Washington Street

Greenville, Texas 75401

(903) 455-6252

Fax (903) 455-6667

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

Board of Directors
Mustang Special Utility District
7985 FM 2931
Aubrey, Texas 76227

Members of the Board:

We have audited the basic financial statements of the proprietary funds of the Mustang Special Utility District (District), as of and for the year ended September 30, 2010, which collectively comprise the District's basic financial statements, and have issued our report thereon dated February 8, 2011. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section, and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information of the District's management and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

February 8, 2011
Greenville, Texas

MUSTANG SPECIAL UTILITY DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED SEPTEMBER 30, 2010

**Schedule
Reference
Number**

Findings

NONE

MUSTANG SPECIAL UTILITY DISTRICT
STATUS OF PRIOR YEAR FINDINGS
YEAR ENDED SEPTEMBER 30, 2010

**Schedule
Reference
Number**

Prior Findings

NONE

MUSTANG SPECIAL UTILITY DISTRICT
CORRECTIVE ACTION PLAN
YEAR ENDED SEPTEMBER 30, 2010

**Schedule
Reference
Number**

Prior Findings

NONE

MUSTANG SPECIAL UTILITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2010

This section of Mustang Special Utility District's annual financial report presents our discussion and analysis of the District's financial performance during the year ended September 30, 2010. Please read it in conjunction with the District's basic financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total net assets were \$ 20,788,058 at September 30, 2010.
- The District did not issue any new debt during the year.
- During the year, the District's expenses were \$ 1,322,967 more than the \$ 4,523,416 generated from charges for services and other revenues for business-type activities.

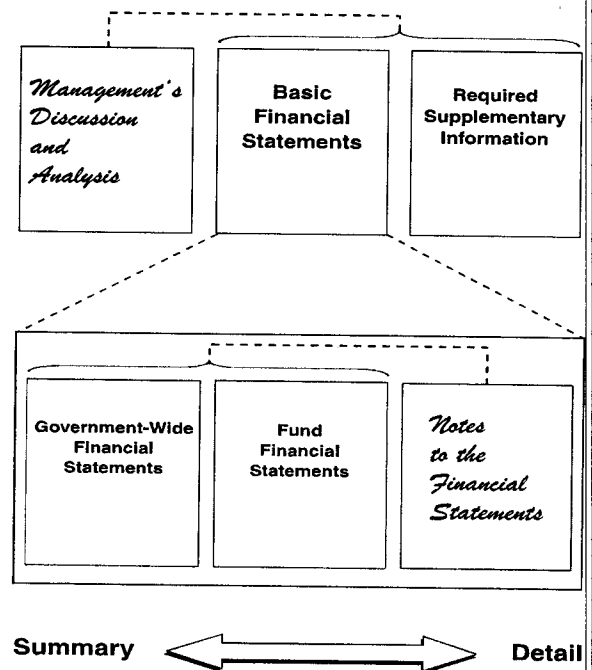
OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of three parts – Management's Discussion and Analysis (this section), the basic financial statements and required supplementary information. Management's Discussion and Analysis provides an overview of the financial activities of the District. The basic financial statements include three statements that present a financial view of the District: The Statement of Fund Net Assets presents financial information, including assets and liabilities, representing a one day snapshot; the Statement of Revenues, Expenses and Changes in Fund Net Assets presents a review of operating and non-operating activities for the fiscal period; the Statement of Cash Flows reflects the inflows and outflows of cash resources.

- Proprietary fund statements offer short- and long-term financial information about the activities the government operates like businesses, such as water sales.
- Fiduciary fund statements provide information about the financial relationships in which the District acts solely as a trustee or agent for the benefit of others, to whom the resources in question belong.

The basic financial statements also include notes that explain some of the information in the basic financial statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the information in the basic financial statements. Figure A-1 shows how the required parts of this annual report are arranged and related to one another.

Figure A-1, Required Components of the District's Annual Financial Report



**MUSTANG SPECIAL UTILITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2010**

Figure A-2. Major Features of the District's Government-wide and Fund Financial Statements

<i>Type of Statements</i>	Fund Statements			
	Government-wide	Governmental Funds	Proprietary Funds	Fiduciary Funds
<i>Scope</i>	Entire Agency's government (except fiduciary funds) and the Agency's component units	The activities of the district that are not proprietary or fiduciary	Activities the district operates similar to private businesses self insurance	Instances in which the district is the trustee or agent for someone else's resources
<i>Required financial statements</i>	<ul style="list-style-type: none"> * Statement of net assets * Statement of activities 	<ul style="list-style-type: none"> * Balance sheet * Statement of revenues, expenditures & changes in fund balances 	<ul style="list-style-type: none"> * Statement of net assets * Statement of revenues, expenses and changes in fund net assets * Statement of cash flows 	<ul style="list-style-type: none"> * Statement of fiduciary net assets * Statement of changes in fiduciary net assets
<i>Accounting basis and measurement focus</i>	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
<i>Type of asset/liability information</i>	All assets and liabilities, both financial and capital, short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term; the Agency's funds do not currently contain capital assets, although they can
<i>Type of inflow/outflow information</i>	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year, expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during year, regardless of when cash is received or paid	All revenues and expenses during year, regardless of when cash is received or paid

Figure A-2 summarizes the major features of the District's basic financial statements, including the portion of the District government they cover and the types of information they contain. The remainder of this overview section of management's discussion and analysis explains the structure and contents of each of the statements.

Government-wide Statements

The government-wide statements report information about the District as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes all of the government's assets and liabilities. All of the current year's revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the District's net assets and how they have changed. Net assets—the difference between the District's assets and liabilities—is one way to measure the District's financial health or position.

- Over time, increases or decreases in the District's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.

Fund Financial Statements

The fund financial statements provide more detailed information about the District's most significant funds—not the District as a whole. Funds are accounting devices that the District uses to keep track of specific sources of funding and spending for particular purposes.

- Some funds are required by State law and by bond covenants.
- The Board of Directors establishes other funds to control and manage money for particular purposes or to show that it is properly using certain funds.

The District has the following kinds of funds:

- Proprietary funds—Services for which the District charges customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both long-term and short-term financial information. We use enterprise funds to report activities that provide potable water and wastewater services for the District.

MUSTANG SPECIAL UTILITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2010

FINANCIAL ANALYSIS OF THE DISTRICT AS A WHOLE

The District's total net assets were \$ 20,788,058 at September 30, 2010.

Mustang Special Utility District's Net Assets			Table A-1
	Business - Type Activities		Total Percentage Change 2009-2010
	2010	2009	
Assets:			
Cash and Investments	\$ 443,244	\$ 683,745	-35.17%
Other Assets	676,332	1,175,223	-42.45%
Restricted Assets	4,285,364	5,041,077	-14.99%
Non-current Assets	27,220,630	28,349,618	-3.98%
Total Assets	\$ 32,625,570	\$ 35,249,663	-7.44%
Liabilities:			
Current Liabilities	\$ 1,710,960	\$ 2,491,507	-31.33%
Long-term Liabilities	10,126,552	10,528,753	-3.82%
Total Liabilities	\$ 11,837,512	\$ 13,020,260	-9.08%
Net Assets:			
Invested in Capital Assets, Net of Related Debt	\$ 10,656,424	\$ 9,858,403	8.09%
Unrestricted	10,131,634	12,371,000	-18.10%
Total Net Assets	\$ 20,788,058	\$ 22,229,403	-6.48%

Business-Type Activities

Changes in Mustang Special Utility District's Net Assets			Table A-2
	Business - Type Activities		Total Percentage Change 2009-2010
	2010	2009	
Program Revenues:			
Operating Revenue	\$ 4,496,702	\$ 4,433,126	1.43%
General Revenues:			
Interest Income	26,714	48,221	-44.60%
Total Revenues	\$ 4,523,416	\$ 4,481,347	0.94%
Expenses:			
Operating Expenses	\$ 5,033,293	\$ 5,383,359	-6.50%
Non-operating Expenses	647,096	526,722	22.85%
Total Expenses	\$ 5,680,389	\$ 5,910,081	-3.89%
Increase in Net Assets before Capital Contributions	\$ (1,156,973)	\$ (1,428,734)	-19.02%
Capital Contributions:			
Wastewater Capacity Fee Refunded to Developers	\$ (165,994)	\$ 61,875	-368.27%
Total Capital Contributions	\$ (165,994)	\$ 61,875	-368.27%
Increase (Decrease) in Net Assets	\$ (1,322,967)	\$ (1,366,859)	-3.21%

MUSTANG SPECIAL UTILITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2010

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At September 30, 2010, the District had invested \$ 27,912,892 in a broad range of capital assets, including land, distribution system, equipment and vehicles (See Table A-3).

Changes in Mustang Special Utility District's Net Assets			Table A-3
	Business - Type Activities		Total Percentage Change 2009-2010
	2010	2009	
Land and Improvements	\$ 469,255	\$ 469,255	0.00%
Construction in Progress	98,420	-	100.00%
Buildings and Improvements	1,360,966	1,360,966	0.00%
Water Distribution System	24,889,115	24,589,752	1.22%
Furniture and Fixtures	760,261	760,261	0.00%
Vehicles	334,875	318,038	5.29%
Totals at Historical Cost	\$ 27,912,892	\$ 27,498,272	1.51%
Total Accumulated Depreciation	(7,265,825)	(6,150,174)	18.14%
Net Capital Assets	\$ 20,647,067	\$ 21,348,098	-3.28%

Long Term Debt

At year-end, the District had \$ 10,041,205 in debt outstanding as shown in Table A-4. More detailed information about the District's debt is presented in the notes to the basic financial statements.

Changes in Mustang Special Utility District's Net Assets			Table A-4
	Business - Type Activities		Total Percentage Change 2009-2010
	2010	2009	
Bonds Payable	\$ 7,615,000	\$ 8,975,000	-15.15%
Loans Payable	2,375,643	2,461,595	-3.49%
Other Debt Payable	50,562	53,100	-4.78%
Total Debt Payable	\$ 10,041,205	\$ 11,489,695	-12.61%

MUSTANG SPECIAL UTILITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
YEAR ENDED SEPTEMBER 30, 2010

BUDGET, ECONOMIC ENVIRONMENT AND RATES

In past years, the economic factors impacting the District's budget were the development and tremendous growth of the Northeast Denton County area. Due to the fast-paced growth rate in the area, Mustang SUD increased staff, built new facilities and infrastructure for increased water capacity to accommodate current and future customers.

Despite past rapid growth realized in the surrounding area, the current economy remains slow, with growth remaining below 2%. Slower growth continues to impact housing communities surrounding the District, a phenomenon typical of the entire region. While the District continues to expand, we expect growth to remain slow, but steady, through 2011.

Any variances in the budgets are due to increased costs to meet the demands of the growth, system upgrades and/or maintenance of the current system.

Effects on our current and future financial position continue to be growth, system upgrades/maintenance, surface water purchase prices and consistency in performing Capital Improvement Projects.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the District's finances and to demonstrate the District's accountability for the funds it receives. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to Chris Boyd, General Manager for the District.

BASIC FINANCIAL STATEMENTS

MUSTANG SPECIAL UTILITY DISTRICT
STATEMENT OF FUND NET ASSETS - PROPRIETARY FUNDS
SEPTEMBER 30, 2010

	Business-Type Activities
ASSETS	
Current Assets:	
Cash and Investments	\$ 443,244
Accounts Receivable, Net	594,788
Other Assets	989
Prepaid Expenses, Supplies and Materials	80,555
Total Current Assets	\$ 1,119,576
Restricted Assets:	
Cash and Investments	\$ 4,285,364
Total Restricted Assets	\$ 4,285,364
Non-Current Assets:	
Equity Buy-in Fees, Net	\$ 6,294,588
SUD Conversion Costs, Net	94,827
Bond Issuance Costs, Net	184,148
Capital Assets:	
Land and Improvements	469,255
Construction in Progress	98,420
Buildings and Improvements, Net	1,115,991
Water Distribution System, Net	18,850,034
Vehicles, Net	23,769
Furniture and Equipment, Net	89,598
Total Non-Current Assets	\$ 27,220,630
Total Assets	\$ 32,625,570

The accompanying notes are an integral part of this statement.

MUSTANG SPECIAL UTILITY DISTRICT
STATEMENT OF FUND NET ASSETS - PROPRIETARY FUNDS
SEPTEMBER 30, 2010

	Business-Type Activities
LIABILITIES	
Current Liabilities:	
Accounts Payable	\$ 283,753
Other Payables	26,745
Due to Other Districts Payable from Restricted Assets	909,679
Accrued Interest Payable	54,528
Bonds Payable	345,000
Loans Payable	91,255
Total Current Liabilities	\$ 1,710,960
Non-Current Liabilities:	
Bonds Payable	\$ 7,270,000
Loans Payable	2,284,388
Other Debt Payable	50,562
Escrow Payable	119,160
Customer Deposits	402,442
Total Non-Current Liabilities	\$ 10,126,552
Total Liabilities	\$ 11,837,512
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	\$ 10,656,424
Unrestricted	10,131,634
Total Net Assets	\$ 20,788,058

The accompanying notes are an integral part of this statement.

MUSTANG SPECIAL UTILITY DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES
IN FUND NET ASSETS - PROPRIETARY FUND
YEAR ENDED SEPTEMBER 30, 2010

	Enterprise Fund
	Water Utilities
OPERATING REVENUES	
Water/Wastewater Sales	\$ 3,338,626
Customer Charges/Fees	1,134,975
Miscellaneous	23,101
	4,496,702
Total Operating Revenues	\$ 4,496,702
OPERATING EXPENSES	
Payroll and Benefits	\$ 756,843
Water Distribution System	2,260,955
Other Operating Costs	214,036
Professional and Legal Fees	109,688
Insurance	150,700
Amortization	425,420
Depreciation	1,115,651
	5,033,293
Total Operating Expenses	\$ 5,033,293
Operating Income (Expenses)	\$ (536,591)
NON-OPERATING REVENUE (EXPENSES)	
Interest Income	\$ 26,714
Interest Expense	(585,126)
Bad Debt Expense – Sale of CCN	(61,970)
	(620,382)
Total Non-Operating Revenue (Expenses)	\$ (620,382)
Change in Net Assets Before Capital Contributions	\$ (1,156,973)
CAPITAL CONTRIBUTIONS	
Wastewater Capacity Fee Refunded to Developers	\$ (165,994)
Total Capital Contributions	\$ (165,994)
Change in Net Assets	\$ (1,322,967)
Total Net Assets - Unadjusted Beginning (October 1)	22,229,403
Prior Period Adjustments	(118,378)
	22,111,025
Total Net Assets - Adjusted Beginning (October 1)	22,111,025
Total Net Assets - Ending (September 30)	\$ 20,788,058

The accompanying notes are an integral part of this statement.

MUSTANG SPECIAL UTILITY DISTRICT
STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS
YEAR ENDED SEPTEMBER 30, 2010

		Enterprise Fund
		Water Utilities
Cash Flows from Operating Activities:		
Cash Received from Customers	\$	4,830,938
Cash Payments for Goods and Services		(2,641,047)
Cash Payments to Employees		(757,993)
Net Cash Provided by (Used for) Operating Activities	\$	1,431,898
Cash Flows from Capital and Other Related Financing Activities:		
Escrow for Land Easements Received	\$	276
Principal Paid on Bonds and Notes		(1,445,952)
Interest Paid on Bonds and Notes		(643,035)
Wastewater Capacity Fee Received from Developers		5,000
Net Cash Provided by (Used for) Capital and Other Related Financing Activities	\$	(2,083,711)
Cash Flows from Noncapital Financing Activities:		
Increase (Decrease) in Customer Deposits	\$	36,316
Net Cash Provided by (Used for) Noncapital Financing Activities	\$	36,316
Cash Flows from Investing Activities:		
Acquisition and Construction of Capital Assets	\$	(398,985)
Interest Received		18,268
Net Cash Provided by (Used for) Investing Activities	\$	(380,717)
Net Increase (Decrease) in Cash and Investments	\$	(996,214)
Cash and Investments - Beginning (October 1)		5,724,822
Cash and Investments - Ending (September 30)	\$	4,728,608
Reconciliation of Operating Income to Net Cash Provided by Operating Activities		
Operating Income (Loss)	\$	(536,591)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation		1,115,651
Amortization		425,420
Change in Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable		230,754
(Increase) Decrease in Prepaid Expenses, Supplies and Materials		43,619
Increase (Decrease) in Accounts Payable		46,478
Increase (Decrease) in Other Payables		3,085
Increase (Decrease) in Due to Other Districts		103,482
Net Cash Provided by (Used for) Operating Activities	\$	1,431,898

The accompanying notes are an integral part of this statement.

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

(Page 1 of 10)

A. Summary of Significant Accounting Policies

The Mustang Special Utility District (District) was approved by the voters within the District on May 4, 2002. The Mustang Special Utility District is an organization as set forth under the terms and conditions of Article XVI, Section 59 of the Texas Constitution and Chapter 65 of the Texas Water Code. The Mustang Water Supply Corporation was dissolved and all assets, liabilities and equity of that organization were transferred to the newly created Mustang Special Utility District. This transfer of ownership took place on October 1, 2002, for financial reporting purposes.

The financial statements of the District have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the District's accounting policies are described below.

1. Reporting Entity

The Board of Directors (Board), a nine member group constituting an on-going entity, is the level of government which has governance responsibilities over all activities related to providing water services within the jurisdiction of the Mustang Special Utility District. Members of the Board are elected by the public; have the authority to make decisions, appoint administrators and managers, and significantly influence operations; and have the primary accountability for fiscal matters. The District is not included in any other governmental "Reporting Entity" as defined by GASB in its Statement No. 14, "The Financial Reporting Entity." There are no component units presented.

2. Basis of Presentation

The accounts of the District are organized on the basis of funds or account groups, each of which is considered to be a separate accounting entity. The operations of each fund or account group are summarized by providing a separate set of self-balancing accounts which include its assets, liabilities, fund equity, revenue and expenses. The fund type utilized by the District is described below:

a. Proprietary fund types include the following –

The *Enterprise Fund* is used to account for operations (a) that are financed and operated in a manner similar to private business enterprises – where the intent of the governing body is that the costs (expenses including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) the governing body has decided periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. Under GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting," all proprietary funds will continue to follow Financial Accounting Standards Board (FASB) standards issued on or before November 30, 1989 and continue to follow new FASB pronouncements unless they conflict with GASB guidance.

3. Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Proprietary fund types are accounted for on a flow of economic resources measurement focus and utilize the accrual basis of accounting. This basis of accounting recognizes revenues in the accounting period in which they are earned and become measurable and expenses in the accounting period in which they are incurred and become measurable. With this measurement focus, all assets and liabilities associated with the operation of these funds are included in the balance sheet. Fund equity is identified as net assets.

4. Budget

The Board adopts an annual budget for the Enterprise Fund. The Budget for the Enterprise Fund is adopted under a basis consistent with GAAP. The Board approves amendments to the annual budget as prepared by the General Manager of the District.

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

A. Summary of Significant Accounting Policies (Continued)

5. Property, Plant and Equipment

Additions to the utility system are recorded at cost or, if contributed property, at its estimated fair value at time of contribution. Repairs and maintenance are recorded as expenses; renewals and betterments are capitalized. The sale or disposal of fixed assets is recovered by removing cost and accumulated depreciation from the accounts and charging the resulting gain or loss to income. The District uses a capitalization policy of \$ 5,000.

Depreciation has been calculated on each class of depreciable property using the straight-line method. Estimated useful lives are as follows:

Vehicles	5 years
Office Furniture and Equipment	5-10 years
Machinery and Equipment	5-10 years
Water Distribution System	5-40 years
Buildings	20-40 years

6. Amortization of Equity Fee and Organizational Costs

The District has assets recorded in the basic financial statements entitled "UTRWD Equity Fee, Net, Bond Issuance Costs, Net and SUD Conversion Costs, Net." Accounting principles generally accepted in the United States of America require that the District capitalize the costs associated with these assets and amortize those costs over the life of the asset or loan, and not less than 60 months, respectively, rather than expensing the entire amount in the year acquired. The expense associated with this amortization appears in the basic financial statements as "Amortization." The amount expensed during the year ended September 30, 2010, was \$ 425,420. The amount recorded as assets (net of amortization) in the basic financial statements at September 30, 2010, totaled \$ 6,389,415.

7. Prepaid Expenses, Materials and Supplies

Prepaid expenses consist of items paid for in the current period to be used in the following accounting period. Prepaid materials and supplies consist of supplies and repair parts for the distribution system, valued at cost. The cost of materials and supplies is recorded as an expense when consumed rather than when purchased.

8. Cash and Investments

Cash and Investments are comprised of deposits in financial institutions including time deposits. For the purpose of the statement of cash flows, an investment is considered any highly liquid investment with a maturity of ninety days or less.

9. Retirement Plan

The District is a member of the Texas County & District Retirement System (TCDRS). The District matches up to 5% of employee contributions 1 to 1, and employees vest after 10 years of service. The plan also provides for disability retirement for members with 10 years of service or more. The District's contributions for the fiscal year totaled \$ 15,798.

10. Compensated Absences

District employees are entitled to certain compensated absences based on their length of employment. Sick leave does not vest but accumulates and is recorded as an expense as it is paid.

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

B. Changes in Property, Plant and Equipment

The following is a summary of changes in property, plant and equipment for the year:

	Beginning Balances	Additions and Reclassifications	Retirements	Ending Balances
Land	\$ 469,255	\$ -	\$ -	\$ 469,255
Buildings and Improvements	1,360,966	-	-	1,360,966
Construction in Progress	-	98,420	-	98,420
Water Distribution System	24,589,752	299,363	-	24,889,115
Furniture and Equipment	760,261	-	-	760,261
Vehicles	318,038	16,837	-	334,875
Totals at Historical Cost	\$ 27,498,272	\$ 414,620	\$ -	\$ 27,912,892
Less Accumulated Depreciation for:				
Buildings and Improvements	\$ 190,536	\$ 54,439	\$ -	\$ 244,975
Water Distribution System	5,043,125	995,956	-	6,039,081
Furniture and Equipment	621,959	48,704	-	670,663
Vehicles	294,554	16,552	-	311,106
Total Accumulated Depreciation	\$ 6,150,174	\$ 1,115,651	\$ -	\$ 7,265,825
Net Capital Assets	\$ 21,348,098	\$ (701,031)	\$ -	\$ 20,647,067

C. Restricted Assets

The District is required to maintain certain bank accounts to be in compliance with the bond covenants. The District also maintains separate bank accounts to account for monies collected from freshwater supply district customers to be remitted to the respective freshwater supply districts. At September 30, 2010, the District had the following accounts restricted for these purposes:

Cash - Northstar System Growth	\$ 93,653
Cash - Northstar Debt Service	34,904
Cash - Northstar Construction	1,052,570
Cash - Northstar I & S	36,500
Cash - Northstar Developer's Escrow	4,869
Cash - Logic Cust Deposits	419,627
Cash - Logic 2006 Debt Reserve	406,222
Cash - Logic System Growth	931,393
Cash - Logic UTRWD I&S	80,279
Cash - Logic Dev Escrow	105,291
Cash - DCFWSD #9 Providence	241,501
Cash - DCFWSD #8A Paloma Creek	38,938
Cash - DCFWSD #8B Paloma Creek	126,222
Cash - DCFWSD #11A Paloma Creek	138,535
Cash - DCFWSD #10 Savannah	180,087
Cash - DCFWSD #11B Paloma Creek	12,989
Cash - Northstar 08 Debt Reserve	265,811
Cash - Northstar 08 I & S	8,186
Cash - Northstar 09 I & S	6,983
Cash - Northstar 09 Debt Reserve	100,804
Total	\$ 4,285,364

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

C. Restricted Assets (Continued)

<u>Northstar System Growth</u> -	This account, held at Northstar Bank, represents monies designated for future expansion and system repair and maintenance.
<u>Northstar Debt Service</u> -	This account, held at Northstar Bank, represents the amount required by the bond covenant to be held in reserve until bond is paid in full.
<u>Northstar Construction</u> -	This account, held at Northstar Bank, represents bond proceeds held for future construction.
<u>Northstar I & S</u> -	This account, held at Northstar Bank, represents amounts set aside for the next principal and interest payment on bonded debt.
<u>Northstar Developer's Escrow</u> -	This account, held at Northstar Bank, represents amounts held by the District for utility easements on construction projects.
<u>Northstar 07 Revenue Note I & S</u> -	This account, held at Northstar Bank, represents amounts set aside for the next principal and interest payment on bonded debt.
<u>Logic Cust Deposits</u> -	This account, held at Logic, represents refundable customer deposits.
<u>Logic - 2006 Debt Service</u> -	This account, held at Logic, represents the amount required by the bond covenant to be held in reserve until bond is paid in full.
<u>Logic - System Growth</u> -	This account, held at Logic, represents monies designated for future expansion and system repair and maintenance.
<u>Logic - UTRWD Interest & Sinking</u> -	This account, held at Logic, represents amounts set aside for the next principal and interest payment on Upper Trinity Regional Water District Note.
<u>Logic - Developer's Escrow Account</u> -	This account, held at Logic, represents amounts held by the District for utility easements on construction projects.
<u>DCFWSD #9 - Providence</u> -	This account, held at Northstar Bank, represents the payments collected from Providence customers to be remitted to the Freshwater Supply District.
<u>DCFWSD #8A - Paloma Lakeview</u> -	This account, held at Northstar Bank, represents the payments collected from Paloma Lakeview customers to be remitted to the Freshwater Supply District.
<u>DCFWSD # 8B - Paloma North</u> -	This account, held at Northstar Bank, represents the payments collected from Paloma North customers to be remitted to the Freshwater Supply District.
<u>DCFWSD # 11A - Paloma South</u> -	This account, held at Northstar Bank, represents the payments collected from Paloma South customers to be remitted to the Freshwater Supply District.
<u>DCFWSD #11B - Paloma Creek</u> -	This account, held at Northstar Bank, represents the payment collected from Paloma Creek #11B customers to be remitted to the Freshwater Supply District.
<u>DCFWSD - Savannah</u> -	This account, held at Northstar Bank, represents the payments collected from Savannah customers to be remitted to the Freshwater Supply District.
<u>Northstar 08 Debt Reserve</u> -	This account held at Northstar Bank, represents the amount required by the bond covenant to be held in reserve until bond is paid in full.
<u>Northstar 08 I & S</u> -	This account, held at Northstar Bank, represents amounts set aside for the next principal and interest payment on bonded debt.
<u>Northstar 09 Debt Reserve</u> -	This account, held at Northstar Bank, represents the amount required by the bond covenant to be held in reserve until bond is paid in full.
<u>Northstar 09 I & S</u> -	This account, held at Northstar Bank, represents amounts set aside for the next principal and interest payment on bonded debt.

D. Deposits, Securities and Investments

The District's funds are deposited and invested under the terms of a depository contract. The contract requires the depository to pledge approved securities in an amount significant to protect the District's day-to-day balances. The pledge is waived only to the extent of the dollar amount of Federal Deposit Insurance Corporation (FDIC) insurance. At September 30, 2010, all District cash deposits appeared to be covered by FDIC insurance or by pledged collateral held by the depository in the District's name. The District's deposits appear to have been secured at all times throughout the fiscal year.

The District's investment policies and types of investments are governed by the Public Funds Investment Act. The Act requires specific training, reporting and establishment of local policies. The District appears to be in compliance with the requirements of the Act.

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

D. Deposits, Securities and Investments (Continued)

State statutes and local policy authorize the District to invest in the following types of investment goods:

- a. obligations of the U.S. or its agencies or instrumentalities,
- b. obligations of the State of Texas or its agencies,
- c. obligations guaranteed by the U.S. or State of Texas or their agencies or instrumentalities,
- d. obligations of other states, agencies or political subdivisions having a national investment rating of "A" or greater,
- e. guaranteed or securitized certificates of deposit issued by a bank domiciled in the State of Texas, or
- f. fully collateralized repurchase agreements.

District investments include deposits in external investment pools, such as LOGIC. All LOGIC investments are reported at share price (fair value) and are presented as cash and investments.

The LOGIC Investment Pool is managed by an elected Board of Directors. The Board is comprised of elected members of the organization. An advisory board of qualified investment members advises the Directors on investment decisions.

The following table categorizes the District's investment at September 30, 2010:

	Credit Rating	Fair Value
LOGIC	AAAm	\$ 1,942,812
Total		\$ 1,942,812

* Local government pool investments are based upon a contract and not the security itself. Therefore, these types of investments are not categorized above.

In addition, the following is disclosed regarding coverage of combined cash balances on the date of highest balance:

- a. Name of bank: NorthStar Bank of Texas, Denton, Texas.
- b. Amount of bond and/or security pledged as of the date of the highest combined balance on deposit was \$ 5,500,000.
- c. Largest cash, savings and time deposit combined account balances amounted to \$ 4,226,316 and occurred during the month of October, 2009.
- d. Total amount of FDIC coverage at the time of the highest combined balance was \$ 500,000.

GASB Statement No. 40 requires a determination as to whether the District was exposed to the following specific investment risks at year end and if so, the reporting of certain related disclosures:

a. Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The ratings of securities by nationally recognized agencies are designed to give an indication of credit risk. At year end, the District was not significantly exposed to credit risk.

b. Custodial Credit Risk

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized, collateralized with securities held by the pledging financial institution, or collateralized with securities held by the pledging financial institution's trust department or agent but not in the District's name.

Investment securities are exposed to custodial risk if the securities are uninsured, are not registered in the name of the government, and are held by either the counterparty or the counterparty's trust department or agent but not in the District's name. At year end, the District was not exposed to custodial credit risk.

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

D. Deposits, Securities and Investments (Continued)

c. Concentration of Credit Risk

This risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. At year end, the District was not exposed to concentration of credit risk.

d. Interest Rate Risk

This is the risk that changes in interest rates will adversely affect the fair value of an investment. At year end, the District was not exposed to interest rate risk.

e. Foreign Currency Risk

This is the risk that exchange rates will adversely affect the fair value of an investment. At year end, the District was not exposed to foreign currency risk.

E. Long - Term Obligations

The following schedule presents changes in long-term debt for the year ended September 30, 2010.

	Beginning Balances	Additions	Deletions	Ending Balances	Current Portion
Bonds Payable	\$ 8,975,000	\$ -	\$ 1,360,000	\$ 7,615,000	\$ 345,000
Loans Payable	2,461,595	-	85,952	2,375,643	91,255
Other Debt Payable	53,100	-	2,538	50,562	-
Total Debt Payable	\$ 11,436,595	\$ -	\$ 1,448,490	\$ 10,041,205	\$ 436,255

Loans

The District executed an agreement with Upper Trinity Regional Water District to provide for capital investments. The agreement requires semi-annual interest payments and annual principal payments. Principal maturing in the next twelve months has been classified as current liabilities. The District executed the following agreement:

Payee / Purpose	Original Issue Date	Original Amount	Interest Rate	Outstanding Balance 09/30/10
Upper Trinity Regional Water District % of Water Lines and Pump Station	4/19/2000	\$ 2,202,850	6.0%	\$ 2,375,643

Maturities of loan balances are as follows:

Year Ended September 30	Principal	Interest	Total Requirements
2011	\$ 91,255	\$ 143,002	\$ 234,257
2012	96,885	137,372	234,257
2013	102,862	131,395	234,257
2014	109,208	125,049	234,257
2015	115,945	118,312	234,257
2016 - 2020	696,265	475,020	1,171,285
2021 - 2025	939,226	232,059	1,171,285
2026 - 2030	223,997	10,260	234,257
Totals	\$ 2,375,643	\$ 1,372,469	\$ 3,748,112

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

E. Long - Term Obligations (Continued)

Payee / Purpose	Interest Rate	Original Amount	Outstanding Balances
Mustang SUD, Series 2006	4.00% – 5.00%	\$ 4,415,000	\$ 3,680,000
Mustang SUD, Series 2008	5.75% – 6.00%	2,715,000	2,715,000
Mustang SUD, Series 2009	3.00% – 6.00%	1,220,000	<u>1,220,000</u>
Totals			<u>\$ 7,615,000</u>

Maturities of revenue bonds are as follows:

Year Ended September 30	Principal	Interest	Total Requirements
2011	\$ 345,000	\$ 375,235	\$ 720,235
2012	370,000	357,698	727,698
2013	310,000	339,223	649,223
2014	315,000	325,423	640,423
2015	335,000	311,560	646,560
2016 - 2020	1,880,000	1,306,000	3,186,000
2021 - 2025	2,335,000	819,270	3,154,270
2026 - 2030	1,635,000	276,595	1,911,595
2031 - 2035	90,000	4,950	94,950
Totals	<u>\$ 7,615,000</u>	<u>\$ 4,115,954</u>	<u>\$ 11,730,954</u>

The District is required to maintain certain deposits to satisfy the provisions of the debt authorization. The required deposits are outlined in Section 10 and 11 of the debt authorization. The following describes these sections and the requirements:

Section 10 – Interest & Sinking Covenants - Series 2006

The District is required to deposit and credit to the Interest and Sinking Fund prior to each principal, interest payment or redemption date from the available pledged revenues an amount equal to one hundred percent (100%) of the amount required to fully pay the interest on and the principal of the prior lien obligations then coming due and payable. At September 30, 2010, the following is reported:

Amount Required	\$ -0-
Amount Available	<u>36,500</u>
Excess (Deficiency)	<u>\$ 36,500</u>

Section 11 – Reserve Covenants - Series 2006

The District shall deposit and credit to the 2006 Reserve Fund amounts required to maintain the balance in the 2006 Reserve Fund in an amount equal to \$ 389,408, which is the lesser of (1) 10 percent of the stated principal amount of the bonds, (2) 1.25 percent of the average annual debt service requirements on the bonds, or (3) maximum annual debt service requirements on the bonds. At September 30, 2010, the following is reported:

Amount Required	\$ 389,408
Amount Available	<u>406,222</u>
Excess (Deficiency)	<u>\$ 16,814</u>

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

E. Long - Term Obligations (Continued)

Section 10 – Interest & Sinking Covenants - Series 2008

The District is required to deposit and credit to the Interest and Sinking Fund prior to each principal, interest payment or redemption date from the available pledged revenues an amount equal to one hundred percent (100%) of the amount required to fully pay the interest on and the principal of the prior lien obligations then coming due and payable. At September 30, 2010, the following is reported

Amount Required	\$	-0-
Amount Available		<u>8,186</u>
Excess (Deficiency)	\$	<u>8,186</u>

Section 11 – Reserve Covenants - Series 2008

The District shall deposit and credit to the 2008 Reserve Fund amounts required to maintain the balance in the 2008 Reserve Fund in an amount equal to \$ 242,045, which is the lesser of (1) 10 percent of the stated principal amount of the bonds, (2) 1.25 percent of the average annual debt service requirements on the bonds, or (3) maximum annual debt service requirements on the bonds. At September 30, 2010, the following is reported:

Amount Required	\$	242,045
Amount Available		<u>265,811</u>
Excess (Deficiency)	\$	<u>23,766</u>

Section 10 – Interest & Sinking Covenants - Series 2009

The District is required to deposit and credit to the Interest and Sinking Fund prior to each principal, interest payment or redemption date from the available pledged revenues an amount equal to one hundred percent (100%) of the amount required to fully pay the interest on and the principal of the prior lien obligations then coming due and payable. At September 30, 2010, the following is reported

Amount Required	\$	-0-
Amount Available		<u>6,983</u>
Excess (Deficiency)	\$	<u>6,983</u>

Section 11 – Reserve Covenants - Series 2009

The District shall deposit and credit to the 2009 Reserve Fund amounts required to maintain the balance in the 2010 Reserve Fund in an amount equal to \$ 100,395, which is the lesser of (1) 10 percent of the stated principal amount of the bonds, (2) 1.25 percent of the average annual debt service requirements on the bonds, or (3) maximum annual debt service requirements on the bonds. At September 30, 2010, the following is reported:

Amount Required	\$	100,395
Amount Available		<u>100,804</u>
Excess (Deficiency)	\$	<u>409</u>

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

F. Customer Deposits

The District requires each new customer to pay \$100, which is held as a refundable deposit to secure payment of the customer's water bill. At September 30, 2010, the District's obligation totaled \$ 402,442.

G. Litigation

The District does not appear to be involved in any litigation as of September 30, 2010.

H. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. During fiscal year 2010, the District purchased commercial insurance to cover these liabilities. There were no significant reductions in coverage in the past fiscal year, and there were no settlements exceeding insurance coverage for each of the past three fiscal years.

I. Freshwater Supply District Agreements – Water and Sanitary Sewer Service

The District has entered into service agreements with the following freshwater supply districts:

Denton County Freshwater Supply District No. 8A

Denton County Freshwater Supply District No. 8B

Denton County Freshwater Supply District No. 9

Denton County Freshwater Supply District No. 10

Denton County Freshwater Supply District No. 11A

Denton County Freshwater Supply District No. 11B

Each freshwater district maintains a separate contract with the District, so specific terms vary per respective contract. Under the terms of these agreements, the District agrees to read each water meter of each retail customer of the freshwater districts one time every month and render a statement to each retail customer for the amount due the freshwater district for water service, sewer service, and solid waste collection, including initial deposits. In addition, the District will collect the amount due for water and wastewater service and remit to the freshwater districts the funds collected at least once per month.

The freshwater districts also agreed to pay the District for installation, maintenance or repair of the water delivery system and for items not specifically covered in the agreement. The charges are limited to the District's actual and direct expenses, plus an additional fifteen percent (15%) overhead charge, allocated to client districts on a pro-rata basis based on the number of active equivalent single family connections contained in each freshwater district. Additionally, freshwater districts will pay to Mustang thirty percent (30%) of any disconnection, re-connection fees or return check fee charged by the District related to disconnections or re-connections necessitated by a District customer's failure to timely pay for water and/or wastewater services.

At various dates in the future, beginning October 1, 2011, contract provisions call for the freshwater districts to convey to the District all right, title and interest to all water distribution and storage facilities and sanitary sewer collection facilities, including land, easements and rights of way that comprise the freshwater district system and serve the freshwater district certified area that have been acquired by the freshwater districts with the proceeds of its outstanding bonds. Any portion not acquired with proceeds of outstanding bonds shall be leased to the District in accordance with contract provisions.

MUSTANG SPECIAL UTILITY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
YEAR ENDED SEPTEMBER 30, 2010

J. Joint Agreements

The District has entered into equity agreements with the Upper Trinity Regional Water District (UTRWD) to provide the District with water resources into the future. Additionally, agreements have been executed for construction of additional water treatment and distribution services. There is also an agreement for shared costs of a wastewater treatment facility presently in use. The District's agreements require monthly service contract payments to the UTRWD. Amounts paid to the UTRWD for wastewater capacity are capitalized, and appear on the Statement of Net Assets as "Equity Buy-in Fees, Net". During the year, the District received from Developers \$ 5,000 as a capital contribution toward these wastewater capacity fees and \$ 170,994 of receivables were written off due to a development that was not completed.

K. Forbearance of Receivables

On September 30, 2010 the District entered into a forbearance agreement with Valencia on the Lake Water Control and Improvement District ("Valencia"). The agreement called for extending the due date of multiple payments that Valencia was to pay the District for the purchase of CCN in 2005. Valencia will make four payments totaling \$ 168,924 plus interest, with the final payment being on March 31, 2012. The District does not believe any amount beyond what is set forth in the forbearance agreement will be collected and, therefore, have expensed the remaining \$ 61,970 as bad debt.

L. Prior Period Adjustments

The \$ 118,378 decrease in beginning net assets represents amounts due to Upper Trinity Regional Water District at the end of the previous fiscal year. This amount was paid in the current year, but should have been expensed in the prior year and reflected in the financial statements as a liability at year end.

OTHER SUPPLEMENTARY INFORMATION

MUSTANG SPECIAL UTILITY DISTRICT
ENTERPRISE FUND
BUDGETARY COMPARISON SCHEDULE
YEAR ENDED SEPTEMBER 30, 2010

	Budgeted Amounts		Actual	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Water/Wastewater Sales	\$ 3,838,478	\$ 3,279,000	\$ 3,338,626	\$ 59,626
Customer Charges/Fees	1,164,460	1,081,000	1,134,975	53,975
Miscellaneous Income	10,000	900	23,101	22,201
Interest Income	19,000	18,450	26,714	8,264
Total Revenues	\$ 5,031,938	\$ 4,379,350	\$ 4,523,416	\$ 144,066
EXPENSES				
Payroll	\$ 856,503	\$ 769,129	\$ 756,843	\$ 12,286
Water Distribution System	2,844,017	2,589,043	2,260,955	328,088
Other Operating Costs	267,250	233,700	214,036	19,664
Professional and Legal Fees	292,750	142,562	109,688	32,874
Insurance	161,269	152,210	150,700	1,510
Amortization	-	-	425,420	(425,420)
Depreciation	-	-	1,115,651	(1,115,651)
Interest	536,979	536,151	585,126	(48,975)
Bad Debt - Sale of CCN	-	-	61,970	(61,970)
Total Expenses	\$ 4,958,768	\$ 4,422,795	\$ 5,680,389	\$ (1,257,594)
Change in Net Assets				
Before Capital Contributions	\$ 73,170	\$ (43,445)	\$ (1,156,973)	\$ (1,113,528)
CAPITAL CONTRIBUTIONS				
Wastewater Capacity Fee Refunded to Developers	\$ -	\$ -	\$ (165,994)	\$ (165,994)
Total Capital Contributions	\$ -	\$ -	\$ (165,994)	\$ (165,994)
Change in Net Assets	\$ 73,170	\$ (43,445)	\$ (1,322,967)	\$ (1,279,522)
Net Assets - Beginning (October 1)	22,229,403	22,229,403	22,229,403	-
Prior Period Adjustments	-	-	(118,378)	(118,378)
Net Assets - Beginning Adjusted (October 1)	22,229,403	22,229,403	22,111,025	(118,378)
Net Assets - Ending (September 30)	\$ 22,302,573	\$ 22,185,958	\$ 20,788,058	\$ (1,397,900)

TEXAS SUPPLEMENTARY INFORMATION (TSI)

MUSTANG SPECIAL UTILITY DISTRICT
SUPPLEMENTARY SCHEDULES INCLUDED WITHIN THIS REPORT
YEAR ENDED SEPTEMBER 30, 2010

<u>Exhibit ID</u>	<u>Exhibit Title</u>	<u>Page #</u>
	Independent Auditor's Report on Supplementary Schedules	35
TSI-1	Services and Rates	36
TSI-2	Enterprise Fund Expenditures	38
TSI-3	Temporary Investments	39
TSI-5	Long-Term Debt Service Requirements by Years	40
TSI-6	Changes in Long-Term Bonded Debt	44
TSI-7	Comparative Schedule of Revenues and Expenses Enterprise Fund - Five Years	45
TSI-8	Board Members, Key Personnel and Consultants	46

The following schedules are not applicable to this District.

H. Analysis of Taxes Levied and Receivable

RUTHERFORD,
TAYLOR &
COMPANY, P.C.
Certified Public Accountants

2802 Washington Street

Greenville, Texas 75401

(903) 455-6252

Fax (903) 455-6667

INDEPENDENT AUDITOR'S REPORT
ON SUPPLEMENTARY SCHEDULES

Board of Directors
Mustang Special Utility District
7985 FM 2931
Aubrey, TX 76227

Members of the Board:

In our opinion, the accompanying information is stated accurately in all material respects in relation to the basic financial statements, taken as a whole, of the Mustang Special Utility District for the year ended September 30, 2010, which are covered by our opinion presented in the first section of this report.

The accompanying information is supplementary to the basic financial statements and is not essential for a fair presentation of financial position, results of operations or cash flows.

Our audit, which was made for the purpose of forming opinions on the basic financial statements taken as a whole, included such tests of the accounting records, from which the supplementary information was compiled, and such other auditing procedures as we considered necessary in the circumstances.

February 8, 2011
Greenville, Texas

MUSTANG SPECIAL UTILITY DISTRICT
SERVICES AND RATES
YEAR ENDED SEPTEMBER 30, 2010

1. Services provided by the District:

<u>X</u>	Retail Water	<u>X</u>	Wholesale Water	___	Drainage
<u>X</u>	Retail Wastewater	___	Wholesale Wastewater	___	Irrigation
___	Parks/Recreation	___	Fire Protection	___	Security
___	Solid Waste/Garbage	___	Flood Control	___	Roads

X Participates in joint venture, regional system and/or wastewater service (other than emergency interconnect)
 ___ Other (specify): ___

2. Retail Rates Based on 5/8" Meter:

Most prevalent type of meter (if not a 5/8"): ___

	Minimum Charge	Minimum Usage	Flat Rate Y/N	Rate per 1000 Gallons Over Minimum	Usage Levels
WATER:	\$ <u>25.00</u>	<u>-0-</u>	<u>N</u>	\$ <u>2.43</u>	<u>-0-</u> to <u>1,000</u>
				\$ <u>2.66</u>	<u>1,000</u> to <u>3,000</u>
				\$ <u>3.30</u>	<u>3,000</u> to <u>6,000</u>
				\$ <u>3.64</u>	<u>6,000</u> to <u>9,000</u>
				\$ <u>3.99</u>	<u>9,000</u> to <u>12,000</u>
				\$ <u>4.34</u>	<u>12,000</u> to <u>15,000</u>
				\$ <u>4.91</u>	<u>15,000</u> to <u>20,000</u>
				\$ <u>5.49</u>	<u>20,000</u> to <u>25,000</u>
				\$ <u>9.41</u>	<u>25,000</u> to <u>unlimited</u>
WASTEWATER:	\$ <u>32.00</u>	<u>-0-</u>	<u>Y</u>	\$ <u> </u>	<u>-0-</u> to <u>8,000</u>
	\$ <u>36.00</u>	<u>-0-</u>	<u>Y</u>	\$ <u> </u>	<u>8,001</u> to <u>unlimited</u>

District employs winter averaging for wastewater usage? ___ Yes X No

Total charges per 10,000 gallons usage: Water \$ 57.56 Wastewater \$ 36.00

MUSTANG SPECIAL UTILITY DISTRICT
SERVICES AND RATES
YEAR ENDED SEPTEMBER 30, 2010

b. Water and Wastewater Retail Connections:

Meter Size	Total Connections	Active Connections	ESFC Factor	Active ESFCs
Unmetered	<u>20</u>	<u>0</u>	x 1.0	<u>0</u>
≤ 3/4"	<u>3,549</u>	<u>3,549</u>	x 1.0	<u>3,549</u>
1"	<u>58</u>	<u>58</u>	x 2.5	<u>145</u>
1 1/2"	<u>2</u>	<u>2</u>	x 5.0	<u>10</u>
2"	<u>34</u>	<u>34</u>	x 8.0	<u>272</u>
3"	<u>2</u>	<u>2</u>	x 15.0	<u>30</u>
4"	<u>1</u>	<u>1</u>	x 25.0	<u>25</u>
Total Water	<u>3,668</u>	<u>3,648</u>		
Total Wastewater	<u>1,109</u>	<u>1,109</u>	x 1.0	<u>1,109</u>

3. Total water consumption (rounded to the nearest 1,000) during the fiscal year:

Gallons pumped into system:	<u>449,266,364</u>
Gallons billed to customers:	<u>394,233,147</u>
Water Accountability (Water Loss):	<u>12.25%</u>

4. Standby Fees: District does not levy standby fees.

5. Location of District:

County(ies) in which district is located. Denton

Is the District located entirely in one county? Yes X No

Is the District located within a city? Entirely _____ Partly X Not at all _____

City(ies) in which district is located. Krugerville, Aubrey, Cross Roads, Pilot Point, Oak Point

Is the District located within a city's extra territorial jurisdiction (ETJ)?
Entirely _____ Partly X Not at all _____

ETJ's in which district is located. Krugerville, Aubrey, Cross Roads, Pilot Point, Oak Point, Little Elm, Frisco, Prosper

Is the general membership of the Board appointed by an office outside the district?

Yes _____ No X

If Yes, by whom? n/a