

DIRECTORS & OFFICERS

Virgil W. Davis, Chair

Retired Director, Electronic Programs,
University Research Foundation, Inc.

Clarence M. Ebert

General Manager & Vice-President,
Stainless Steel Fabricating Co.

Thomas E. Cooke, Vice Chair

Retired Trial Attorney,
Cooke Lamanna Smith & Cogswell

Sandra L. Stone

Retired Secondary School Educator

Richard W. Cox, Secretary

Retired Insurance Agent

Donald G. Weaver

Retired Professional Civil Engineer

Donna J. Severidt, Treasurer

Retired Computer Consultant &
Manager

Paul D. Williamsen

Retired Scheduling Supervisor,
United Technologies Chemical
Systems

Arturo R. Gabaldón, President

Community Water Company

VOLUNTEER BOARD

CONSULTANTS & OTHER MANAGEMENT

Glen Barnes

Retired Procurement Manager

John Struve

Retired VP Finance,
Wayne St College

Pierre Y. Hanhart

Controller & Assistant Treasurer
Community Water Company

Thomas J. Six

Retired Chief Financial Officer,
Ameritech Information System

Rob Meyer

Certified Public Accountant

Kenneth M. Taylor, Jr

Brigadier General, USAF, Retired

Michael R. Millikin

Retired General Manager
Telephone and Data System

Carol Yarborough

Realtor, Long Realty

As of March 31, 2017

Community Water Company of Green Valley

1501 South La Cañada Drive, Green Valley, AZ 85622

(520) 625-8409

Communitywater.com

2016

Annual Report



SAFE • LOCAL • SUSTAINABLE

Community Water Company of Green Valley (Consolidated)

To the Members of Community Water Company of Green Valley,

Customers of the Green Valley division of the Arizona Water Company decided to acquire local control of our water utility and organized Community Water Company of Green Valley in 1975. On June 10, 1977, the change of ownership was completed, and Community Water Company began providing reliable and safe water delivery service. Today our community, after much growth is nearly built out, and proudly, Community Water continues to deliver reliable water service.

As we look to the future, we would like to share a thought on safety. Community Water's existence depends on a well-trained staff working in a safe environment. Hence, our staff continually updates our safety programs to secure a safe work environment, and regular staff participation in safety related training is key to low accident rates and maintaining reliable delivery of our drinking water.

A top concern of most customers appears to be the sustainability of our local water supply – is there enough water? Community Water is committed to developing a sustainable water supply. Our local water supply is not sustainable as long as the source aquifer continues to decline. Even though it can be decades before we feel the impact, it is important to invest in solutions for future generations to capitalize upon. In that regard, Project Renew was started in 2007 to bring renewable water supplies to the Green Valley-Sahuarita area. It has the approval of the Bureau of Reclamation and development is at no cost to our members. We have acquired pipeline rights-of-way, and have installed segments of pipeline in the Town of Sahuarita at Sahuarita Road and Nogales Highway, and under the Pima Mine Road Bridge; and under I-19 at Pima Mine Road.

Sustainability requires diligence in the monitoring of our water quality. Community Water continues delivery of water that meets or surpasses all applicable health and safety measures. We conduct all required tests to check water quality and report our test results each June. Our Water Quality Report is available on our website. Please visit our office for a paper copy.

The Arizona Department of Environment Quality (ADEQ) has established a sulfate mitigation order with a local mine. This order includes two

action levels for sulfate in our drinking water; increased monitoring at 135 ppm and other action at 250 ppm. Community Water's highest sulfate level as reported in our June 2016 Water Quality Report is 52.6 ppm. A Community Advisory Group (CAG) meets to receive updates on the local mine's efforts and the current sampling results. The CAG meetings are open to the public, and the location, date and time are published in the local newspaper. Community Water participates in the CAG meetings and provides feedback to ADEQ.

Financial sustainability is also important for the safe and reliable delivery of our drinking water. We continue to focus on superb water delivery while reducing operating and maintenance costs where appropriate. Current rates for water delivery were approved by the Arizona Corporation Commission in 2016. Rate increases are required to generate the necessary revenues that support financial sustainability. This rate case was an important step in providing sufficient revenues to cover expenses, maintain funds for scheduled equipment maintenance, repair unexpected equipment breakage, and develop sufficient reserves to support appropriate borrowing of funds to make appropriate system upgrades.

Community Water had 12,611 active residential units connected to the water delivery system at year-end 2016, compared with 12,551 at year-end 2015. Commercial customers had a slight increase to 378, from 374 a year ago. The amount of water pumped from the aquifer in 2016 was 2,342 acre-feet, an increase of 3% from the prior year's 2,268 acre-feet. Total rainfall of 18 inches in 2016 was high when compared to the average over the past decade, yet it was a decrease from the record rainfall of 22 inches in 2015. The steady introduction and installation of water efficient washing machines, toilets, and showerheads has been determined to be the major contributor to water conservation over the past decade, both here in Green Valley and nationwide. In general, we anticipate water usage to continue declining into the early 2020s.

Customer satisfaction with Community Water remains high based on our December 2016 survey. Please congratulate our employees for their exemplary service. They are the heart of Community Water, and their excellent stewardship has resulted in exceptional customer service while providing a reliable and robust water delivery system.

Community Water is pleased that our Round-Up program continues to function well and is providing limited assistance to our water utility


customers in need. Round-Up is a program that rounds up water bills to the next whole dollar; and pools the round up dollars for assistance to our water utility customers. Our Round-Up program is administered by the Salvation Army. Community Water's Round-Up program is voluntary for our customers. Round-Up applications are available at our office or on our website.

We are grateful and indebted to our volunteer directors and board consultants for lending their knowledge and assistance to working on our local water issues. Their service adds value, and we continue to be delighted with the expertise of those serving. Also, their participation in representing Community Water at the various water-related meetings make it possible for Community Water to be more effective in local water issues.

Community Water is proud of its annual support of providing water to the MedianGreen Project over the past seven years. This water contribution supports the mission of the MedianGreen Project to replant and beautify the public road medians in Green Valley; reflecting the pride we take in our community.

Our annual meeting of members is on Thursday, April 27, 2017, at 9:30 a.m., in the GVR East Center, at 7 South Abrego Drive, Green Valley, AZ. Registration begins at 9:00 a.m. We look forward to seeing you at our annual meeting.

Sincerely,

Virgil W. Davis
Chair of the Board

Arturo R. Gabaldón
President

March 31, 2017

Community Water Company of Green Valley

(An Arizona nonprofit corporation with members operating a water utility regulated as a public service corporation by the Arizona Corporation Commission)

[Http://www.communitywater.com](http://www.communitywater.com)

**Supplemental Consolidating Abbreviated Financial Statements
As of December 31, 2016 (in Thousands)**

Balance Sheet	Consolidation				
	CWC	SICAN	Trust	Adjustment	Consolidated
Assets					
Current assets	\$ 3,407	\$ 9	\$ 437	\$ -	\$ 3,853
Utility plant	24,971	-	-	-	24,971
Central Arizona Project (CAP)	2,035	-	-	-	2,035
Other assets	1,073	198	114	(861)	524
Total assets	\$ 31,486	\$ 207	\$ 551	\$ (861)	\$ 31,383
Liabilities and net assets					
Current liabilities	\$ 836	\$ -	\$ 1	\$ -	\$ 837
Long-term debt	2,933	-	-	-	2,933
Deferred credits	7,160	-	2	-	7,162
Contributions in-aid-of construction	10,714	-	-	-	10,714
Net assets	9,843	207	548	(861)	9,737
Total liabilities and net assets	\$ 31,486	\$ 207	\$ 551	\$ (861)	\$ 31,383
Statement of revenues and expenses					
Operating revenues	\$ 4,041	\$ 8	\$ 25	\$ (4)	\$ 4,070
Operating expenses					
Operations	1,947	5	21	(4)	1,969
Maintenance	400	-	-	-	400
Depreciation and amortization	580	-	6	-	586
Taxes - other	497	-	-	-	497
Total operating expenses	3,424	5	27	(4)	3,452
Excess of oper. revenues over expenses	617	3	(2)	-	618
Other revenues (expenses)	(147)	(13)	-	-	(160)
Excess of revenues over expenses	\$ 470	\$ (10)	\$ (2)	\$ -	\$ 458
Statement of cash flow					
Cash flow from operating activities					
Excess of revenues over expenses	\$ 470	\$ (10)	\$ (2)	\$ -	\$ 458
Depreciation and amortization	811	-	6	-	817
Net other changes	(174)	9	(13)	(1)	(179)
Net cash provided by (to) oper. activities	1,107	(1)	(9)	(1)	1,096
Cash flow from investing activities					
Capital expenditures	(864)	-	-	-	(864)
CAP capital charges	(71)	-	-	-	(71)
Net other investing activities	(463)	-	-	-	(463)
Net cash used in investing activities	(1,398)	-	-	-	(1,398)
Cash flow from financing activities					
Net change in long-term debt	(92)	-	-	-	(92)
Net other financing activities	119	-	-	-	119
Net cash provided by fin. activities	27	-	-	-	27
Net change in cash and cash equivalents	\$ (264)	\$ (1)	\$ (9)	\$ (1)	\$ (275)

**Report of Independent Auditors
To the Board of Directors and Members of
Community Water Company of Green Valley
(An Arizona nonprofit corporation with members):**

We have audited the accompanying consolidated financial statements of Community Water Company of Green Valley, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of revenues and expenses, net assets, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Community Water Company of Green Valley as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the consolidated basic financial statements as a whole. The Supplemental Consolidating Abbreviated Financial Statements are presented for purposes of additional analysis and are not a required part of the consolidated basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

The Letter to the Members, 2016 Financial Highlights, and Directors & Officers and Volunteer Board Consultants & Other Management listings are presented for purposes of additional analysis and are not a required part of the consolidated basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the consolidated basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.



ULLMANN & COMPANY

Certified Public Accountants
Phoenix, Arizona

March 17, 2017

Consolidated
For the years ended December
(In

Assets

	<u>2016</u>	Restated <u>2015</u>
Current assets		
Cash and cash equivalents	\$ 1,462	\$ 1,737
Securities available-for-sale, at market	1,932	1,460
Accounts receivable, less allowance for doubtful accounts of \$1,000	387	281
Materials and supplies	38	39
Deferred tax assets- current	0	2
Prepayments	34	43
Total current assets	<u>3,853</u>	<u>3,562</u>
Utility plant		
Plant in service, at cost	44,680	44,108
Construction work in progress	4	2
	<u>44,684</u>	<u>44,110</u>
Less accumulated depreciation	19,713	18,618
Total utility plant	<u>24,971</u>	<u>25,492</u>
Investment in LLC	197	209
Deferred charges		
Central Arizona Project (CAP)	2,035	1,963
Right-of-way (ROW) use permits	112	118
Other	215	126
Total deferred charges	<u>2,362</u>	<u>2,207</u>
Total assets	<u>\$ 31,383</u>	<u>\$ 31,470</u>

Balance Sheets
31, 2016 and 2015
Thousands)

Liabilities and Net Assets

	<u>2016</u>	Restated <u>2015</u>
Current liabilities		
Accounts payable (A/P)	\$ 334	\$ 82
Current maturities of long-term debt	98	93
Accrued taxes	113	111
Other liabilities	292	304
Total current liabilities	<u>837</u>	<u>590</u>
Long-term debt, net	2,933	3,022
Deferred credits		
Refundable advances for construction	6,804	6,865
Deferred tax liability-noncurrent	1	1
Mark-to-market value of interest rate swap	208	275
Other	149	283
Total deferred credits	<u>7,162</u>	<u>7,424</u>
Contributions in-aid-of construction (CIAC), net	10,714	11,221
Total liabilities	<u>21,646</u>	<u>22,257</u>
Net assets		
Accumulated surplus	9,952	9,494
Accumulated other comprehensive income	(215)	(281)
Total net assets	<u>9,737</u>	<u>9,213</u>
Total net assets and liabilities	<u>\$ 31,383</u>	<u>\$ 31,470</u>

Consolidated Statements of Revenues and Expenses
For the years ended December 31, 2016 and 2015
(In Thousands)

	<u>2016</u>	<u>2015</u>
Operating revenues	\$ 4,070	\$ 3,778
Operating expenses		
Operations	1,969	1,877
Maintenance	400	349
Depreciation and amortization	586	840
Taxes - other	497	486
Total operating expenses	3,452	3,552
Excess of operating revenues over operating expenses	618	226
Other revenues (expenses)		
Passthrough expense investment in LLC	(12)	(19)
Interest income	17	14
Contributions for ROW use permits	0	3
Interest expense	(188)	(169)
Other income, net	24	27
Total other revenues (expenses)	(159)	(144)
Income before income tax	459	82
Income tax		
Current tax expense	0	(3)
Deferred tax (expense) benefit	(1)	1
Total income tax	(1)	(2)
Excess of revenues over expenses	458	80
Other comprehensive income, net of tax:		
Unrealized (loss) gain on securities	(1)	13
Unrealized loss on mark-to-market value of interest swap	67	(52)
Total other comprehensive income	66	(39)
Total comprehensive income	\$ 524	\$ 41

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

Consolidated Statements of Net Assets
For the years ended December 31, 2016 and 2015
(In Thousands)

	Accumulated surplus	Accumulated other comprehensive income	Memberships	Total net assets
December 31, 2014	\$ 9,366	\$ (242)	\$ 48	\$ 9,172
Net assets				
December 31, 2015				
Comprehensive income	80	(39)	0	41
December 31, 2015				
Net assets	9,446	(281)	48	9,213
December 31, 2016				
Comprehensive income	458	66	0	524
December 31, 2016				
Net assets	<u>\$ 9,904</u>	<u>\$ (215)</u>	<u>\$ 48</u>	<u>\$ 9,737</u>

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

Consolidated Statements of Cash Flow
For the years ended December 31, 2016 and 2015
(In Thousands)

	2016	2015
Excess of revenues over expenses	\$ 458	\$ 80
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities		
Depreciation and amortization	586	840
Depreciation and amortization included in operations and maintenance expense	231	166
Other noncash income and expense	0	(2)
Changes included in:		
Investment in LLC	12	19
Interest receivable	(1)	(1)
Accounts receivable	(106)	(11)
Materials and supplies	1	0
Deferred tax	2	(1)
Prepayments	9	9
ROW use permits	0	(3)
Other deferred charges	(142)	(57)
Accounts payable	275	(6)
Accrued taxes	2	0
Other current liabilities	(231)	35
Total adjustments	638	988
Net cash provided by operating activities	1,096	1,068
Cash flow from investing activities		
Capital expenditures	(864)	(1,619)
Proceeds from maturities of securities available-for-sale	1,485	1,965
Purchase of securities available-for-sale	(1,956)	(1,653)
Capital charges for CAP	(72)	(64)
Proceeds from sale of capital	9	382
Investment in ROW use permits	0	(2)
Net cash used in investing activities	(1,398)	(991)
Cash flow from financing activities		
Proceeds from long-term debt	0	832
Repayment of long-term debt	(92)	(66)
Proceeds from refundable advances and CIAC	267	165
Repayment of refundable advances	(148)	(163)
Proceeds from contributions for ROW use permits	0	3
Net cash provided by financing activities	27	771
Net (decrease) increase in cash and cash equivalents	(275)	848
Cash and cash equivalents at beginning of year	1,737	889
Cash and cash equivalents at end of year	\$ 1,462	\$ 1,737
Non cash investing activities		
A/P purchases of utility plant	\$ 23	\$ 0



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS:

Community Water Company of Green Valley was incorporated in 1975 as an Arizona nonprofit corporation with members. It purchased an existing water utility business from Arizona Water Company and began operation of the water utility in 1977. The water utility is a regulated public service corporation that delivers water to residential and commercial customers in a southern Arizona active adult community.

These consolidated financial statements include the accounts of all entities in which Community Water Company of Green Valley has a controlling financial interest. In 2011, Community Water Company of Green Valley established a wholly-owned subsidiary corporation named SICAN, Inc. ("SICAN") for the purpose of business investments. In 2012, Community Water Company of Green Valley created a variable interest entity named Community Water Company of Green Valley ROW Trust ("Trust") in which Community Water Company of Green Valley is the trustor and the beneficiary, and SICAN is the Trustee. The entity holds and manages right-of-ways required for Project Renew's construction.

Generally accepted accounting principles in the United States of America (US GAAP) view the economic substance of the trust arrangement as giving Community Water Company of Green Valley a controlling financial interest in the Trust and therefore require that Community Water Company of Green Valley (CWC) consolidate the Trust's financial results into the consolidated financial statements.

The accompanying consolidated financial statements present the results of consolidating CWC, SICAN, and the Trust (collectively referred to as CWC Consolidated).

All significant intercompany accounts and transactions have been eliminated in consolidation.

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

2. SIGNIFICANT ACCOUNTING POLICIES:

Maintenance of Accounting Records - CWC, SICAN, and Trust maintain their accounting records on the accrual basis of accounting in which revenue is recognized when earned and expenses are recognized when the obligation has been incurred. CWC maintains its records in accordance with the Uniform System of Accounts prescribed for Class A water utilities by the National Association of Regulatory Utility Commissioners.

Cash and Cash Equivalents - CWC Consolidated considers cash in banks and all highly liquid investments purchased with a maturity of three months or less to be cash equivalents for purposes of reporting cash flows.

Securities Available-for-Sale - CWC Consolidated accounts for its investment securities in accordance with FASB ASC 320-10-45 which provides that CWC Consolidated classify investments in securities as either trading securities, securities to be held to maturity or securities available-for-sale. CWC Consolidated has classified all investments as securities available-for-sale. Securities available-for-sale consists of U.S. Government investments, mortgage-backed securities, and certificates of deposits. These securities are recorded at fair value with any unrealized gains and losses being reflected as a separate component of Net Assets. Gains (losses) on the sale of securities available-for-sale are determined using the specific identification method.

Accounts Receivable - CWC Consolidated accounts receivable consists primarily of balances due by regulated utility customers which were billed on a monthly cycle basis. Credit is extended based on the guidelines of the applicable regulators and generally, collateral is not required.

Allowance for Doubtful Accounts - Allowances for uncollectible accounts are maintained for estimated probable losses resulting from CWC's inability to collect receivables from customers. Accounts that are outstanding longer than the payment terms are considered past due, and the allowance for doubtful accounts is computed based on an analysis of collectability of accounts receivable at the balance sheet date. For 2016 and 2015, there was an allowance of \$1,000. SICAN and Trust did not have allowances for uncollectible accounts for 2016 and 2015.

2. SIGNIFICANT ACCOUNTING POLICIES (continued):

Materials and Supply Inventory - Inventory is stated at the lower of cost or market. Cost is determined on a weighted average basis.

Utility Plant - Utility plant is stated at original cost and consists of contract costs, labor, material and allowances for indirect costs. The cost of maintenance, repairs, and minor renewals is charged to expense in the year incurred. Depreciation and amortization expense is provided for on the straight-line basis utilizing the following annual rates based on the estimated useful lives of the asset. The depreciation rates and plant in service balances by major classes of depreciable assets are as follows:

	Depreciation Rate (in Percent)	Balance At December 31, 2016 (In Thousands)	Balance At December 31, 2015 (In Thousands)
Utility Plant	2.00 to 12.50	\$43,138	\$42,632
Computer Equipment	20.00	680	651
Backhoe	5.00	149	149
Vehicles	20.00	542	505
Land	N/A	171	171
Total		\$44,680	\$44,108

Deferred Charges - Intangible assets (CAP and ROW use permits) are reviewed for impairment when circumstances indicate the carrying amount of an asset may not be recoverable. Impairment is recognized if the sum of undiscounted estimated future cash flows expected to result from the use of the asset is less than the carrying value. When an impairment loss is recognized, the asset's carrying value is reduced to its estimated fair value.

The CAP represents the cumulative annual capital charges (including legal and other administrative fees) for a Municipal and Industrial (M&I) subcontract. The CAP allocation costs will be amortized on a straight-line basis over a specific number of years, when appropriate (see also NOTE 5-Deferred Charges).

The Trust holds Right-of-ways (ROW) that are initially measured based on their fair values and are being amortized on a straight-line basis over the life of the ROW, and are stated at cost net of accumulated amortization.

2. SIGNIFICANT ACCOUNTING POLICIES (continued):

Refundable Advances and Contributions for Construction - The cost of constructing certain expansions to utility plant has been advanced or contributed to CWC by the owners of the property served by the expansions. CWC repays advances by refunding to the owners specified percentages of the annual water revenue which CWC derives from the expansions. These repayments continue until the advances are fully repaid or until the expiration of an agreed-upon repayment term. Contributions for construction are not repaid. Further, if the repayment term of an advance expires before an advance is fully repaid the unpaid balance is reclassified as contributions in-aid-of construction. Amounts classified as contributions in-aid-of construction are amortized on a straight-line basis utilizing the plant composite rate set by the Arizona Corporation Commission. The rate in effect for 2016 and 2015 was 3.92% and 3.98% respectively.

Refundable advances for construction are non-interest bearing. As of December 31, 2016 and 2015, CWC's refundable advances for construction specify repayment rates up to 20% of applicable annual water revenues and the majority of these contracts contain remaining repayment terms up to 15 years.

Accumulated Surplus – Accumulated Surplus consists of member revenues from sales of service and nonmember sources less current and prior periods' expenses.

Revenue Recognition - CWC's operating revenues are generated through sales of water to residential and commercial customers in the Green Valley Sahuarita area. Revenue consists of monthly cycle customer billings for water service at rates authorized by the Arizona Corporation Commission. Revenue from metered accounts includes unbilled amounts based on the estimated usage from the latest meter reading to the end of the accounting period.

Comprehensive Income - Other comprehensive income consists of available-for-sale securities' net unrealized holding gains and losses and the recognition of the value of the interest rate swap.

2. SIGNIFICANT ACCOUNTING POLICIES (continued):

Income Taxes - CWC is an Internal Revenue Code (IRC) Section 501(a) organization, exempt from taxes by application of IRC Section 501(c)(12) for CWC's operations.

SICAN and Trust are not exempt from income taxes. Income taxes are recognized for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the bases of certain assets and liabilities for financial and tax reporting. The deferred taxes represent the future tax return consequences of those differences, which will either be deductible or taxable when the assets and liabilities are recovered or settled.

Use of Estimates - The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions. The estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. They also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Concentration of Credit Risk - Financial instruments that potentially subject CWC Consolidated to concentrations of credit risk consist principally of temporary cash investments and cash equivalents. CWC Consolidated places its temporary cash investments with financial institutions and limits the amount of credit exposure to any one financial institution since they are insured by the Federal Deposit Insurance Corporation or Securities Investor Protection Corporation. Concentrations of credit risk with respect to cash equivalents are limited due to the diversification of the investments. As of December 31, 2016 and 2015, CWC Consolidated had no significant concentrations of risk.

3. SECURITIES AVAILABLE-FOR-SALE, AT MARKET:

The carrying amounts of investment securities available-for-sale are as follows:

	At December 31, 2016 (In Thousands)		
	Cost	Unrealized (Losses)	Fair Value
Certificates of Deposit with maturities within one year	\$ 1,147	\$ 0	\$ 1,147
Certificates of Deposit with maturities of 1-5 years	658	0	658
Mortgage Backed Securities U.S.	134	(7)	127
Total	\$ 1,939	\$ (7)	\$ 1,932

	At December 31, 2015 (In Thousands)		
	Cost	Unrealized (Losses)	Fair Value
Certificates of Deposit with maturities within one year	\$ 803	\$ 0	\$ 803
Certificates of Deposit with maturities of 1-5 years	454	0	454
Mortgage Backed Securities U.S.	209	(6)	203
Total	\$ 1,466	\$ (6)	\$ 1,460

Expected maturities will differ from contractual maturities since issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

4. SICAN'S INVESTMENT IN LLC:

SICAN has an investment in JPAR LLC ("JPAR"), a development company that is recognized at book value. This investment was funded from nonmember nonutility income. The following data reflects the book value items related to SICAN's investment in JPAR. SICAN's cumulative interest in JPAR's book value is as follows:

SICAN's Cumulative Interest in JPAR	Balance at December 31, 2016 (In Thousands)	Balance at December 31, 2015 (In Thousands)
SICAN Capital Contribution in JPAR	\$ 340	\$ 340
Cumulative Share of Net Loss	(143)	(131)
Book Value	\$ 197	\$ 209

Net losses are due to a timing difference because JPAR is in the development phase of operations, and losses are expected until construction is complete. JPAR's financial results can be summarized as follows:

JPAR Financial Summary	Balance at December 31, 2016 (In Thousands)	Balance at December 31, 2015 (In Thousands)
Total Assets	\$ 4,843	\$ 3,417
Total Liabilities	0	35
Total Equity	\$ 4,843	\$ 3,382
Revenues	\$ 0	\$ 0
Expenses	171	202
Net Loss	\$ (171)	\$ (202)

SICAN's share of net loss for the year is calculated using the weighted average capital accounts during the year. During the year ended December 31, 2016 and 2015, SICAN's allocated loss was 7% and 10% respectively, which represented net loss of around \$12,000 and \$20,000. Although SICAN owns less than 20% of the profit and loss percentages of JPAR at December 31, 2016, CWC Consolidated accounts for the investment using the equity method since SICAN is the managing member of JPAR and has significant influence over JPAR's operations.

5. DEFERRED CHARGES:

At December 31, 2016, Central Arizona Water Conservation District policy allows subcontract holders to recover the cumulative capital charges paid, if they relinquish or transfer their subcontract and have not drawn CAP water. The policy was modified in 2016 to exclude the recovery of cumulative capital charges for relinquishment or transfer after December 1, 2017, regardless of having drawn CAP water.

As of December 31, 2016, CWC has not drawn CAP water. CAP deferred charges were \$71,450 and \$64,305 in 2016 and 2015, respectively, bringing its total to \$2,035,209. Included in this amount is \$1,880,254 in cumulative capital charges for the 2,858 acre feet allocation. As of December 31, 2016, this asset is not considered impaired.

Trust's ROW use permits consist of the following:

	Balance at December 31, 2016 (In Thousands)	Balance at December 31, 2015 (In Thousands)
ROW use permits	\$ 129	\$ 129
Less: accumulated amortization	(19)	(13)
Net ROW in service	\$ 110	\$ 116
Land application in progress	2	2
Total ROW, net	\$ 112	\$ 118

ROW was funded from nonmember nonutility income. Total amortization expense amounted to \$5,689 and \$10,889 for the years ended December 31, 2016 and 2015, respectively. Trust's ROWs acquired during the years ended December 31, 2016, and 2015 totaled \$0 and \$2,000 respectively, bringing the cumulative total to \$128,530, net of permits disposed during 2015. These ROWs will be amortized over periods ranging from 10 years to 50 years. The schedule on the right, relates to the estimated amortization expense for ROWs.

	At Year End December 31 (In Thousands)
2017	\$ 6
2018	6
2019	6
2020	6
2021	6
Total	\$ 30

Other deferred charges include stored water credits with the Arizona Department of Water Resources, rate case expenses and advance land lease rental.

6. LONG-TERM DEBT (LTD):

On November 5, 2014, the Arizona Corporation Commission approved a \$3,320,000, 15-year debt instrument with Compass Bank and Compass Mortgage Corporation (CB).

The note to CB matures on November 14, 2029, when the remaining unpaid balance is due in full. It is CWC's intent to extend the maturity of this note. Future maturities of LTD outstanding at December 31, 2016, based on the terms of the signed commitment are as follows:

	At Year End December 31, 2016 (In Thousands)
2017	\$ 98
2018	104
2019	109
2020	117
2021	124
2022-2026	736
2027-2029	1,787
Long Term Debt (LTD)	3,075
Unamortized issuance cost	44
LTD, less unamortized debt issuance cost	3,031
Current portion of LTD	98
Total LTD, less current portion	\$ 2,933

CB has first Deed of Trust on CWC's utility plant and the utility's revenues.

CWC's current debt agreement contains various covenants and requires CWC to maintain a water utility operations' debt service ratio of at least 1.2 as of the end of any year. The ratio was 5.1 and 4.8 at December 31, 2016 and 2015, respectively.

Long-term debt monthly payments equal to the accrued interest on the note commenced December 14, 2014. Monthly principal and interest payments of \$22,730 commenced April 14, 2015. Interest accrues at a variable rate of LIBOR plus 2.7%.

The outstanding long-term balances of LTD were \$3,075,445 and \$3,167,673 at December 31, 2016 and December 31, 2015, respectively.

7. LONG-TERM DEBT (LTD)- CHANGE IN ACCOUNTING PRINCIPLE:

In 2016, CWC retroactively adopted the requirements in FASB ASC 835-30 to present debt issuance costs as a reduction of the carrying amount of the debt rather than as an asset. LTD as of December 31, 2015, was previously reported on the balance sheet as \$3,167,673, with the associated \$52,502 unamortized debt issuance costs included in other assets. Amortization of the debt issuance costs is reported as interest expense in the income statement for both years with no adjustment.

8. MARK-TO-MARKET VALUE OF INTEREST RATE SWAP:

On November 14, 2014, CWC entered into an interest rate swap agreement with Compass Bank which CWC designated as a hedge against the variability in future interest payments due on \$3,234,208. CWC will pay Compass Bank 2.98%; in return, Compass Bank will pay LIBOR rate to CWC. The terms of the swap agreement effectively convert the variable rate interest payments due on the note to a fixed rate of 5.68% through maturity on November 14, 2029.

The Company is exposed to interest rate risk associated with the Company's floating rate debt. The Company entered into an interest rate swap to manage interest rate risk and adjust the interest rate profile of the Company's debt to achieve a target mix of floating and fixed rate debt. Any unrealized gains and losses as a result of the derivative will be presented as Other Comprehensive Income. In 2016 and 2015, CWC recognized \$66,983 and \$52,039 respectively as unrealized gains and loss, for a cumulative \$207,585 at December 31, 2016.

9. INCOME TAX:

As a 501(c)(12), CWC was not subject to income tax in 2016 and 2015. SICAN and Trust incurred the following income tax for 2016 and 2015:

	At December 31, 2016		
	SICAN	Trust	Total
Current			
Federal	\$ 0	\$ 0	\$ 0
State	50	0	50
Total Current Tax Expense	50	0	50
Deferred			
Federal	438	379	817
State	136	71	207
Total Deferred Tax (Benefit)	574	450	1,024
Income Tax Expense	\$ 624	\$ 450	\$ 1,074

9. INCOME TAX (Continued):

	At December 31, 2015		
	SICAN	Trust	Total
Current			
Federal	\$ 741	\$ 1,592	\$ 2,333
State	310	187	497
Total Current Tax Expense	1,051	1,779	2,830
Deferred			
Federal	(274)	(193)	(467)
State	(87)	(43)	(130)
Total Deferred Tax Expense	(361)	(236)	(597)
Income Tax Expense	\$ 690	\$ 1,543	\$ 2,233

Deferred taxes are recognized for temporary differences between the bases of assets and liabilities for financial statements and income tax purposes. The differences relate primarily to accrual to cash differences and the amortization lives of intangible assets.

For SICAN, a valuation allowance of \$28,312 is not recognized as a deferred tax asset at December 31, 2016, since the future benefit from accrual to cash differences from the Investment in JPAR are not expected to be realized due to expected changes in profit and loss allocations in future years. The valuation increased by \$1,614 during the year ended December 31, 2016.

The components of the net deferred tax asset (liability) at December 31, 2016 and December 31, 2015 are as follows:

	At December 31, 2016		
	SICAN	Trust	Total
Deferred Tax Asset			
Current	\$ 8	\$ 0	\$ 8
Noncurrent	0	1,974	1,974
Total Deferred Tax Asset	8	1,974	1,982
Deferred Tax Liability			
Current	0	(1,372)	(1,372)
Noncurrent	0	(1,176)	(1,176)
Total Deferred Tax Liability	0	(2,548)	(2,548)
Net Deferred Tax Asset (Liability)	\$ 8	\$ (574)	\$ (566)

9. INCOME TAX (Continued):

	At December 31, 2015		
	SICAN	Trust	Total
<u>Deferred Tax Asset</u>			
Current	\$ 582	\$1,444	\$2,026
Total Deferred Tax Asset	582	1,444	2,026
<u>Deferred Tax Liability</u>			
Noncurrent	0	(1,568)	(1,568)
Total Deferred Tax Liability	0	(1,568)	(1,568)
Net Deferred Tax Asset (Liability)	\$ 582	\$ (124)	\$ 458

10. SUPPLEMENTAL CASH FLOW INFORMATION:

CWC, SICAN, and Trust engaged in the following transactions:

	For the Year 2016 (In Thousands)	For the Year 2015 (In Thousands)
CWC Expired Refundable Advances for Constructions	\$112	\$464
CWC Interest Paid	\$180	\$155
SICAN Income Taxes Paid	\$2	\$0
Trust Income Taxes Paid	\$0	\$1

11. RETIREMENT PLAN:

CWC has defined contribution retirement plans which cover substantially all employees who worked more than 1000 hours in each year. Under the provisions of these plans, during 2015 and 2016, a contribution equal to 10% to 18% of qualified employees' salaries and wages is contributed by CWC to the Retirement Plans for investment by the plan trustees.

Qualified employees become fully vested in the employer's contributions after five years of eligible service, as defined in the plan. CWC recorded expenses for these contributions of \$140,656 and \$132,345 for the years ended December 31, 2016 and 2015, respectively.

Under the terms of the 401(k) plan and 401(k) Roth plan, qualified employees can contribute to the plan.

12. FAIR VALUE MEASUREMENTS:

FASB ASC 820, Fair Value Measurements and Disclosures, (ASC 820) establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest

12. FAIR VALUE MEASUREMENTS (continued):

priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

The three levels of the fair value hierarchy are described as follows:

Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that CWC Consolidated has the ability to access.

Level 2: Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability;
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

The level 2 input must be observable for substantially the full-term of the asset or liability if the asset or liability has a specified (contractual) term.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2016 and 2015.

Securities Available-for-Sale – Certificates of Deposits: The fair values of available-for-sale Certificates of Deposits are based on quoted market prices for those or similar investments.

Mark-to-Market Value of Interest Rate Swap: The fair value of mark-to-market swap interest is based on the current and present value of projected 1-month LIBOR rates.

12. FAIR VALUE MEASUREMENTS (continued):

Securities Available-for-Sale – Mortgage-Backed Securities: The fair values of available-for-sale securities are based on quoted market prices for those or similar investments.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair value. Furthermore, although CWC believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. SICAN and Trust did not hold securities in 2016 and 2015.

The following table sets forth by level, within the fair value hierarchy, CWC's assets and liabilities at fair value:

	Balance at December 31, 2016 (In Thousands)	Balance at December 31, 2015 (In Thousands)
Level 1		
Securities Available-for-Sale		
Certificates of Deposits	\$ 1,805	\$ 1,257
Securities Available-for-Sale		
Mortgage Backed Securities	127	203
Total Assets	\$ 1,932	\$ 1,460
	Balance at	Balance at
	December 31, 2016	December 31, 2015
	(In Thousands)	(In Thousands)
Level 2		
Liabilities – Mark-to-Market		
Value of Interest Rate Swap	\$ 208	\$ 275

13. SALES TAXES:

Some transactions require CWC to collect sales tax from our customers. These taxes which totaled \$258,441 and \$235,445 in 2016 and 2015, respectively, are included in Operating Revenues.

14. SUBSEQUENT EVENTS:

Management has evaluated subsequent events through March 17, 2017, the date on which the financial statements were available to be issued.

There were no subsequent events that required adjustment to the financial statements or additional disclosures.

2016 Financial Highlights (Consolidated) in \$Millions

