

DIRECTORS & OFFICERS

Virgil W. Davis, Chair

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

Thomas E. Cooke, Vice Chair

Retired Trial Attorney,
Cooke Lamanna Smith & Cogswell

Richard W. Cox, Secretary

Retired Insurance Agent

Donna J. Severidt, Treasurer

Retired Computer Consultant &
Manager

Arturo R. Gabaldón, President

Community Water Company

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

Sandra L. Stone
Retired Secondary School Educator

Donald G. Weaver
Retired Professional Civil Engineer

Paul D. Williamsen
Retired Scheduling Supervisor,
United Technologies Chemical
Systems

VOLUNTEER BOARD

CONSULTANTS & OTHER MANAGEMENT

Mike Atherton
Retired Medical Doctor

Glen Barnes
Retired Procurement Manager

Pierre Y. Hanhart
Controller & Assistant Treasurer
Community Water Company

Rob Meyer
Certified Public Accountant

Michael R. Millikin
Retired General Manager
Telephone and Data System

Kenneth M. Taylor, Jr
Brigadier General, USAF, Retired

Carol Yarborough
Realtor, Long Realty

As of March 30, 2018

Community Water Company of Green Valley
1501 South La Cañada Drive, Green Valley, AZ 85622
(520) 625-8409
Communitywater.com

2017 Annual Report



SAFE • LOCAL • SUSTAINABLE

Community Water Company of Green Valley (Consolidated)



SAFE • LOCAL • SUSTAINABLE

To the Members of
Community Water Company
of Green Valley,

Community Water is committed to its mission of reliable water delivery. Our strengths include an excellent team of highly skilled water professionals and board directors, a robust water delivery system, an excellent financial position, and a reputation as a professional water utility. We take pride in our safety record, and our outreach efforts to keep you better informed of the local water issues.

As we look to the future, we would like to share a thought on the sustainability of our local water supply – is there enough water? Our local water supply is not sustainable if the source aquifer continues to decline. Even though it can be decades before we feel the impact, it is critical to invest in solutions for future generations to capitalize upon. Community Water is committed to developing a sustainable water supply and joined with Rosemont Copper Company to develop Project Renews in 2007. Project Renews will 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. In 2017, we connected to the Central Arizona Project pipeline and extended Project Renews under I-19 at Pima Mine Road; also, we have completed the acquisition of the Project Renews pipeline rights-of-way and have installed segments of pipe under the Pima Mine Road Bridge and under the Nogales Highway intersection with Sahuarita 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 at <http://www.communitywater.com/wqr.pdf>. Please visit our office for a paper copy.

Based on our December 2017 survey, customer satisfaction with Community Water remains high; this is attributed to the outstanding work by our well-trained staff. Our existence depends on their working in a safe environment. Hence, our team 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.

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 2017 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 essential for the safe and reliable delivery of our drinking water. We continue to focus on excellent 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 and are an essential step in providing sufficient revenues to cover expenses, maintain funds for scheduled equipment maintenance, repair unexpected equipment breakage, and develop reserves to support borrowing to make appropriate system upgrades.

Community Water had 12,677 active residential units connected to the water delivery system at year-end 2017, compared with 12,611 at year-end 2016. Commercial customers had a slight increase to 385, from 378 a year ago. The amount of water pumped from the aquifer in 2017 was 2,403 acre-feet, an increase of 2.6% from the prior year's 2,342 acre-feet. Total 2017 rainfall of fewer than 9 inches was below the average of the past decade, and a significant decrease from the record rainfall of 22 inches in 2015.

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 various water-related meetings enables Community Water to be effective in local water issues.

Community Water is proud of its annual support of providing water over the past eight years to the MedianGreen Project. 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.

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 roundup 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.

Our annual meeting of members is on Thursday, April 26, 2018, 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

April 11, 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, 2017 (in Thousands)**

Balance Sheet	Consolidation				
	CWC	SICAN	Trust	Adjustment	Consolidated
Assets					
Current assets	\$ 3,861	\$ 13	\$ 447	\$ -	\$ 4,321
Utility plant	24,747	-	-	-	24,747
Central Arizona Project (CAP)	-	-	-	-	-
Other assets	1,061	187	107	(861)	494
Total assets	\$ 29,669	\$ 200	\$ 554	\$ (861)	\$ 29,562
Liabilities and net assets					
Current liabilities	\$ 602	\$ 1	\$ -	\$ -	\$ 603
Long-term debt	2,837	-	-	-	2,837
Deferred credits	7,385	-	2	-	7,387
Contributions in-aid-of construction	10,306	-	-	-	10,306
Net assets	8,539	199	552	(861)	8,429
Total liabilities and net assets	\$ 29,669	\$ 200	\$ 554	\$ (861)	\$ 29,562
Statement of revenues and expenses					
Operating revenues	\$ 4,593	\$ 8	\$ 29	\$ (3)	\$ 4,627
Operating expenses					
Operations	1,955	4	19	(3)	1,975
Maintenance	423	-	-	-	423
Depreciation and amortization	715	-	6	-	721
Taxes - other	540	-	-	-	540
Total operating expenses	3,633	4	25	(3)	3,659
Excess of oper. revenues over expenses	960	4	4	-	968
Other revenues (expenses)	(248)	(12)	-	-	(260)
Excess of revenues over expenses	\$ 712	\$ (8)	\$ 4	\$ -	\$ 708
Statement of cash flow					
Cash flow from operating activities					
Excess of revenues over expenses	\$ 712	\$ (8)	\$ 4	\$ -	\$ 708
Depreciation and amortization	926	-	6	-	932
Net changes	(317)	13	3	(1)	(302)
Net cash provided by (to) oper. activities	1,321	5	13	(1)	1,338
Cash flow from investing activities					
Capital expenditures	(1,230)	-	-	-	(1,230)
Net other investing activities	(593)	-	-	-	(593)
Net cash used in investing activities	(1,823)	-	-	-	(1,823)
Cash flow from financing activities					
Net change in long-term debt	(98)	-	-	-	(98)
Net other financing activities	433	-	-	-	433
Net cash provided by fin. activities	335	-	-	-	335
Net change in cash and cash equivalents	\$ (167)	\$ 5	\$ 13	\$ (1)	\$ (150)

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, 2017 and 2016, 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, 2017 and 2016, 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.

Correction of Error

As discussed in *Note 14* to the consolidated financial statements, certain errors resulting in overstatement of amounts previously reported for deferred assets as of December 31, 2015, were discovered by management of the Company during the current year. Accordingly, amounts reported for deferred assets and expenses have been restated in the 2016 consolidated financial statements now presented, and an adjustment has been made to net assets as of December 31, 2015, to correct the error. Our opinion is not modified with respect to that matter.

Report on Supplementary Information

Our audits were 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, 2017 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
April 11, 2018

Consolidated
For the years ended December
(In

Balance Sheets
31, 2017 and 2016
Thousands)

Assets	<u>2017</u>	Restated <u>2016</u>
Current assets		
Cash and cash equivalents	\$ 1,312	\$ 1,462
Securities available-for-sale, at market	2,544	1,932
Accounts receivable, less allowance for doubtful accounts of \$1,000	390	387
Materials and supplies	42	38
Prepayments	33	34
Total current assets	<u>4,321</u>	<u>3,853</u>
Utility plant		
Plant in service, at cost	45,783	44,680
Construction work in progress	15	4
	<u>45,798</u>	<u>44,684</u>
Less accumulated depreciation	21,051	19,713
Total utility plant	<u>24,747</u>	<u>24,971</u>
Investment in LLC	187	197
Deferred charges		
Right-of-way (ROW) use permits	106	112
Other	201	193
Total deferred charges	<u>307</u>	<u>305</u>
Total assets	<u>\$ 29,562</u>	<u>\$ 29,326</u>

Liabilities and Net Assets	<u>2017</u>	Restated <u>2016</u>
Current liabilities		
Accounts payable (A/P)	\$ 94	\$ 334
Current maturities of long-term debt	104	98
Accrued taxes	116	113
Other liabilities	289	292
Total current liabilities	<u>603</u>	<u>837</u>
Long-term debt, net	2,837	2,934
Deferred credits		
Refundable advances for construction	6,948	6,804
Deferred tax liability-noncurrent	0	1
Mark-to-market value of interest rate swap	168	208
Other	271	149
Total deferred credits	<u>7,387</u>	<u>7,162</u>
Contributions in-aid-of construction (CIAC), net	<u>10,306</u>	<u>10,714</u>
Total liabilities	<u>21,133</u>	<u>21,647</u>
Net assets		
Appropriated Accumulated Surplus	63	0
Other Accumulated Surplus and Membership	8,539	7,894
Accumulated other comprehensive income	(173)	(215)
Total net assets	<u>8,429</u>	<u>7,679</u>
Total net assets and liabilities	<u>\$ 29,562</u>	<u>\$ 29,326</u>

The accompanying notes are an integral

part of the consolidated financial statements.

Consolidated Statements of Revenues and Expenses
For the years ended December 31, 2017 and 2016
(In Thousands)

	2017	Restated 2016
Operating revenues	\$ 4,627	\$ 4,070
Operating expenses		
Operations	1,975	1,970
Maintenance	423	400
Depreciation and amortization	721	586
Taxes - other	540	497
Total operating expenses	<u>3,659</u>	<u>3,453</u>
Excess of operating revenues over operating expenses	<u>968</u>	<u>617</u>
Other revenues (expenses)		
Passthrough expense investment in LLC	(10)	(12)
Interest income	22	17
Interest expense	(182)	(188)
Other expenses, net	(88)	(47)
Total other revenues (expenses)	<u>(258)</u>	<u>(230)</u>
Income before income tax	<u>710</u>	<u>387</u>
Income tax		
Current tax expense	(1)	0
Deferred tax (expense) benefit	(1)	(1)
Total income tax	<u>(2)</u>	<u>(1)</u>
Excess of revenues over expenses	<u>708</u>	<u>386</u>
Other comprehensive income, net of tax:		
Unrealized (loss) gain on securities	2	(1)
Unrealized gain on mark-to-market value of interest swap	40	67
Total other comprehensive income	<u>42</u>	<u>66</u>
Total comprehensive income	<u>\$ 750</u>	<u>\$ 452</u>

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

Consolidated Statements of Net Assets
For the years ended December 31, 2017 and 2016
(In Thousands)

	Appropriated accumulated surplus	Other accumulated Surplus and membership	Accumulated other comprehensive income	Total net assets
12/31/2015 net assets, as previously reported	\$ 0	\$9,494	\$(281)	\$9,213
Prior period adjustment	0	(1,986)	0	(1,986)
12/31/2015 net assets, as restated	0	7,508	(281)	7,227
12/31/2016 comprehensive income	0	386	66	452
12/31/2016 net assets, as restated	0	7,894	(215)	7,679
12/31/2017 comprehensive income	<u>63</u>	<u>645</u>	<u>42</u>	<u>750</u>
12/31/2017 net assets	<u>\$63</u>	<u>\$8,539</u>	<u>\$(173)</u>	<u>\$8,429</u>

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

Consolidated Statements of Cash Flow
For the years ended December 31, 2017 and 2016
(In Thousands)



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

	2017	Restated 2016
Excess of revenues over expenses	\$ <u>708</u>	\$ <u>386</u>
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities		
Depreciation and amortization	721	586
Depreciation and amortization included in operations and maintenance expense	210	231
Other noncash income and expense		
Changes included in:		
Investment in LLC	10	12
Interest receivable	(3)	(1)
Accounts receivable	(3)	(106)
Materials and supplies	(5)	1
Deferred tax	1	2
Prepayments	2	9
Other deferred charges	(48)	(142)
Accounts payable	(251)	275
Accrued taxes	3	2
Other current liabilities	(7)	(231)
Total adjustments	<u>630</u>	<u>638</u>
Net cash provided by operating activities	<u>1,338</u>	<u>1,024</u>
Cash flow from investing activities		
Capital expenditures	(1,230)	(864)
Proceeds from maturities of securities available-for-sale	2,357	1,485
Purchase of securities available-for-sale	(2,964)	(1,956)
Proceeds from sale of capital	14	9
Net cash used in investing activities	<u>(1,823)</u>	<u>(1,326)</u>
Cash flow from financing activities		
Repayment of long-term debt	(98)	(92)
Proceeds from refundable advances and CIAC	593	267
Repayment of refundable advances	(160)	(148)
Net cash provided by financing activities	<u>335</u>	<u>27</u>
Net decrease in cash and cash equivalents	<u>(150)</u>	<u>(275)</u>
Cash and cash equivalents at beginning of year	<u>1,462</u>	1,737
Cash and cash equivalents at end of year	<u>\$ 1,312</u>	<u>\$ 1,462</u>
Non cash investing activities		
A/P purchases of utility plant	<u>\$ 14</u>	<u>\$ 25</u>

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

1. NATURE OF OPERATIONS:

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

Accounting principles generally accepted in the United States of America (US GAAP) view the economic substance of the trust arrangement as giving CWC a controlling financial interest in the Trust. Therefore it requires that 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.

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, which are US GAAP for the water utility industry.

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 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 from 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 2017 and 2016, there was an allowance of \$1,000. Balances are written off when considered uncollectible. SICAN and Trust did not have allowances for uncollectible accounts for 2017 and 2016.

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 assets. 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, 2017 (In Thousands)	Balance At December 31, 2016 (In Thousands)
Utility Plant	2.00 to 12.50	\$44,201	\$43,138
Computer Equipment	20.00	715	680
Backhoe	5.00	149	149
Vehicles	20.00	547	542
Land	N/A	171	171
Total		\$45,783	\$44,680

Deferred Charges - Intangible assets (Right-of-way (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 Trust holds Right-of-ways 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.

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

2. SIGNIFICANT ACCOUNTING POLICIES (continued):

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 2017 and 2016 was 3.92%.

Refundable advances for construction are non-interest bearing. As of December 31, 2017 and 2016, CWC's refundable advances for construction specify repayment rates up to 20% of applicable annual water revenues and most of these contracts contain remaining repayment terms up to 15 years.

Accumulated Surplus – Accumulated Surplus consists of member revenues from sales of water service and nonmember revenues minus current and prior periods' expenses. Appropriated accumulated surplus is allocated to members on the basis of business with CWC.

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.

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

2. SIGNIFICANT ACCOUNTING POLICIES (continued):

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 concerning cash equivalents are limited due to the diversification of the investments. As of December 31, 2017 and 2016, 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, 2017 (In Thousands)		
	Cost	Unrealized (Losses)	Fair Value
Certificates of Deposit with maturities within one year	\$ 2,469	\$ 0	\$ 2,469
Mortgage Backed Securities U.S.	79	(4)	75
Total	\$ 2,548	\$ (4)	\$ 2,544

	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

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 by 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:

	Balance at December 31, 2017 (In Thousands)	Balance at December 31, 2016 (In Thousands)
SICAN's Cumulative Interest in JPAR		
SICAN Capital Contribution in JPAR	\$ 340	\$ 340
Cumulative Share of Net Loss	(153)	(143)
Book Value	<u>\$ 187</u>	<u>\$ 197</u>

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:

	Balance at December 31, 2017 (In Thousands)	Balance at December 31, 2016 (In Thousands)
JPAR Financial Summary		
Total Assets	\$ 5,821	\$ 4,843
Total Liabilities	295	0
Total Equity	\$ 5,526	\$ 4,843
Revenues	\$ 0	\$ 0
Expenses	188	171
Net Loss	<u>\$ (188)</u>	<u>\$ (171)</u>

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, 2017 and 2016, SICAN's allocated loss was 5% and 7%, respectively, which represented net loss of around \$10,000 and \$12,000 respectively. Although SICAN owns less than 20% of the profit and loss percentages of JPAR at December 31, 2017, 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:

Trust's ROW use permits consist of the following:

	Balance at December 31, 2017 (In Thousands)	Balance at December 31, 2016 (In Thousands)
ROW use permits	\$ 129	\$ 129
Less: accumulated amortization	(25)	(19)
Net ROW in service	<u>\$ 104</u>	<u>\$ 110</u>
Land application in progress	2	2
Total ROW, net	<u>\$ 106</u>	<u>\$ 112</u>

ROWs were funded from nonmember nonutility income. Total amortization expense amounted to \$5,703 and \$5,689 for the years ended December 31, 2017 and 2016, respectively.

At December 31, 2017 and 2016, Trust had \$128,530 in ROW permits. These ROWs will be amortized over periods ranging from 10 years to 50 years. The schedule on the right relates to the estimated future amortization expense for ROWs.

	At Year End December 31 (In Thousands)
2018	\$ 6
2019	6
2020	6
2021	6
2022	5
Total	<u>\$ 29</u>

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. CWC intends to extend the maturity of this note. Future maturities of LTD outstanding at December 31, 2017, based on the terms of the signed commitment are as follows:

6. LONG-TERM DEBT (LTD) Continued:

	At Year End December 31, 2017 (In Thousands)
2018	\$ 104
2019	109
2020	117
2021	124
2022	131
2023-2027	779
2028-2029	1,613
	<u>2,977</u>
Less unamortized debt issuance cost	<u>36</u>
LTD, less unamortized debt issuance cost	2,941
Current portion of LTD	(104)
Total LTD, less current portion	<u>\$ 2,837</u>

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 operation's debt service ratio of at least 1.2 as of the end of any year. The ratio was 6.36 and 4.87 at December 31, 2017 and 2016, 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 \$2,977,247 and \$3,075,445 at December 31, 2017 and December 31, 2016, 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 2017 and 2016, CWC recognized \$39,927 and \$66,983 as unrealized gains, for a cumulative loss of \$167,657 at December 31, 2017.

9. INCOME TAX:

As a 501(c)(12), CWC was not subject to income tax in 2017 and 2016. SICAN and Trust incurred the following income tax for 2017 and 2016:

	Year Ended December 31, 2017		
	SICAN	Trust	Total
Current			
Federal	\$ 520	\$ 0	\$ 520
State	173	0	173
Total Current Tax Expense	<u>\$ 693</u>	<u>\$ 0</u>	<u>\$ 693</u>
Deferred			
Federal	\$ (28)	605	577
State	0	200	200
Total Deferred Tax (Benefit)	<u>\$ (28)</u>	<u>805</u>	<u>777</u>
Income Tax Expense	<u>\$ 665</u>	<u>\$ 805</u>	<u>\$ 1,470</u>
	Year Ended December 31, 2016		
	SICAN	Trust	Total
Current			
State	\$ 50	\$ 0	\$ 50
Total Current Tax Expense	<u>50</u>	<u>0</u>	<u>50</u>
Deferred			
Federal	438	379	817
State	136	71	207
Total Deferred Tax Expense	<u>574</u>	<u>450</u>	<u>1,024</u>
Income Tax Expense	<u>\$ 624</u>	<u>\$ 450</u>	<u>\$ 1,074</u>

9. INCOME TAX (Continued):

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 \$39,547 is not recognized as a deferred tax asset at December 31, 2017, 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 \$11,235 during the year ended December 31, 2017.

The components of the net deferred tax asset (liability) at December 31, 2017 and December 31, 2016 are as follows:

	At December 31, 2017		
	SICAN	Trust	Total
<u>Deferred Tax Asset</u>			
Noncurrent	\$ 36	\$ 433	\$ 469
Total Deferred Tax Asset	36	433	469
<u>Deferred Tax Liability</u>			
Noncurrent	0	(1,812)	(1,812)
Total Deferred Tax Liability	0	(1,812)	(1,812)
Net Deferred Tax Asset (Liability)	\$ 36	\$ (1,379)	\$ (1,343)
	At December 31, 2016		
	SICAN	Trust	Total
<u>Deferred Tax Asset</u>			
Current	\$ 8	\$ 0	\$ 8
Noncurrent	0	1,974	1,974
Total Deferred Tax Asset	8	1,974	1,982
<u>Deferred Tax Liability</u>			
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)

10. SUPPLEMENTAL CASH FLOW INFORMATION:

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

	For the Year 2017 (In Thousands)	For the Year 2016 (In Thousands)
CWC Expired Refundable Advances for Constructions	\$156	\$112
CWC Interest Paid	\$174	\$180
SICAN Income Taxes Paid	\$0	\$2

11. RETIREMENT PLANS:

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 2016 and 2017, 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 plans. CWC recorded expenses for these contributions of \$151,371 and \$140,656 for the years ended December 31, 2017 and 2016, 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, 2017 and 2016.

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 2017 and 2016.

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

	Balance at December 31, 2017 (In Thousands)	Balance at December 31, 2016 (In Thousands)
Level 1		
Securities Available-for-Sale Certificates of Deposits	\$ 2,469	\$ 1,805
Securities Available-for-Sale Mortgage-Backed Securities	75	127
Total Assets	\$ 2,544	\$ 1,932
	Balance at December 31, 2017 (In Thousands)	Balance at December 31, 2016 (In Thousands)
Level 2		
Liabilities – Mark-to-Market Value of Interest Rate Swap	\$ 168	\$ 208

13. SALES TAXES:

Some transactions require CWC to collect sales tax from our customers. These taxes, which totaled \$293,169 and \$258,041 in 2017 and 2016, respectively, are included in Operating Revenues.

14. PRIOR PERIOD ADJUSTMENT:

During the year ended December 31, 2017, Management reviewed the Municipal and Industrial subcontract between CWC and Central Arizona Water Conservation District (CAWCD) and recognized the CAP capital charges (including legal and other administrative fees) in the year incurred in *Other expenses, net* rather than presenting them as Deferred Charges – *Central Arizona Project* (for CAP Capital Charges) and *Deferred - Other* (for related legal expenses) from 1993 to 2016.

14. PRIOR PERIOD ADJUSTMENT (continued):

Accordingly, the December 31, 2015 accumulated surplus of net assets balance has been decreased by \$1,986,026 and applicable 2016 amounts have been restated in these financial statements. Following is a summary of the line items from the 2016 financial statements that were restated (in thousands).

	Previously Reported	Adjustment	Restated Amount
Central Arizona Project (CAP)	2,035	(2,035)	0
Other	215	(22)	193
Total Deferred Charges	2,362	(2,057)	305
Total Assets	31,383	(2,057)	29,326
Accumulated Surplus	9,952	(2,057)	7,895
Total Net Assets	9,737	(2,057)	7,680
Total Net Assets and Liabilities	31,383	(2,057)	29,326
Operations (Expenses)	1,969	72	2,041
Total Operating Expenses	3,452	72	3,524
Excess of Revenues over Expenses	458	(72)	386

CAP Capital Charges are based on agreements between the CAWCD and the Bureau of Reclamation and are to be billed to sub-contract holders between 1993 and 2046. Based on CWC's allocation of 2,858 AF of CAP water, CWC's proportionate share of CAP Capital Charges through December 31, 2017, is approximately \$4,025,650. As of December 31, 2017, the CAWCD had elected to subsidize portions of the annual CAP Capital Charges and accordingly, at December 31, 2017, total CAP Capital Charges paid and recognized by CWC is \$1,978,397. The difference between CAP Capital Charges paid and recognized, and the amount previously presented as deferred charges mostly represents legal and other administrative fees.

15. SUBSEQUENT EVENTS:

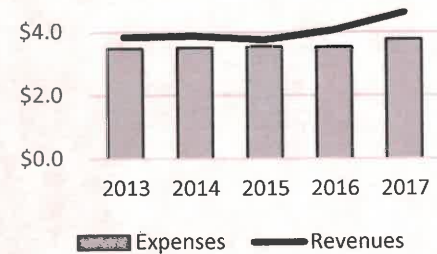
Management has evaluated subsequent events through April 11, 2018, the date on which the financial statements were available to be issued.

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

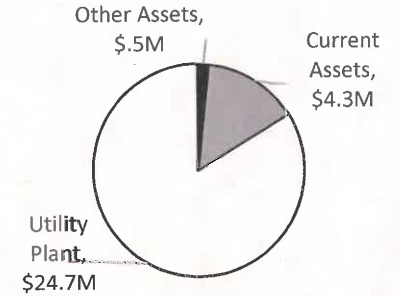


2017 Financial Highlights (Consolidated) in \$Millions

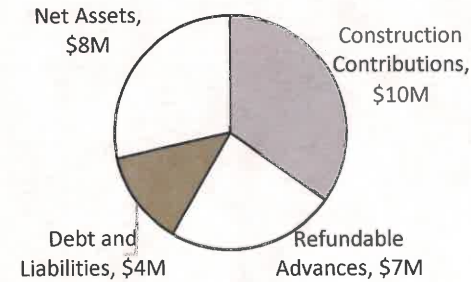
Revenues & Expenses



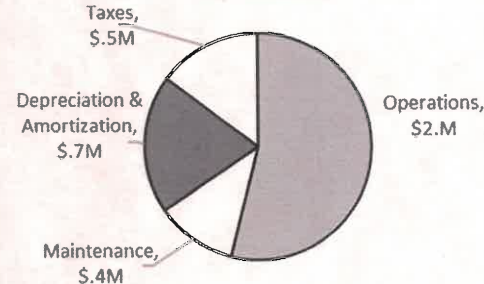
Assets



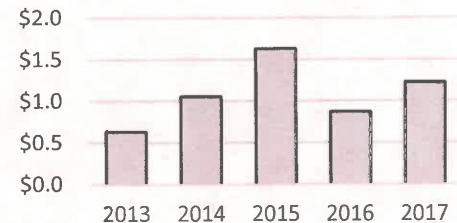
Liabilities & Net Assets



Expenses



Capital Expenditures



Acre-Foot Consumption & Units Served

