

2004

Annual Report



Community Water Company of Green Valley

**To The Members. . . .
of Community Water Company of Green Valley,
(an Arizona Nonprofit Corporation):**

Community Water Company of Green Valley is a non-profit Arizona Cooperative (Co-op) that has earned its members' respect and pride by successfully providing reliable supply and delivery of drinking water to its members for 28 years. Our operations personnel have designed and managed the construction of an excellent water distribution system that is well maintained. Expansion of our service area and prudent management of our financial reserves has enabled us to avoid rate increases for 18 years. We continue to retain a highly skilled service staff, moral is high and turn over is low.

2004 was a year of strategic planning and self evaluation. Early in the year we began the process of developing a mission statement to help guide our decision making process.

Our mission is . . . to reliably deliver drinking water to our customers (that meets all regulated standards) and to maintain a current and future water supply for our customers.

A set of guiding values was also adopted that recognizes the needs of our members, our customers, our employees and the business and governmental environment that we live in. Company personnel and members of the Board of Directors are working to develop and prepare plans in support of our mission. These plans address negotiations with local mining interests, utilization of our Central Arizona Project (CAP) water allocation, evaluation of risks to our water supply, development of required arsenic treatment facilities, financial planning and long range water system improvements. These are on-going issues that will require continuing efforts by your Co-op.

Water Quality - Arsenic

The US EPA has lowered the arsenic standards from 50 parts per billion (ppb) to 10 ppb, and your Co-op is required to be in compliance by January 23, 2006. The two wells on the east side of our service area have arsenic levels of 12 ppb and 14 ppb and therefore require treatment. Your Co-op expects to have these arsenic treatment facilities completed by the summer of 2005. A third well will require replacement because the sulfate contamination interferes with economical methods of treatment for arsenic. The total cost of a replacement well, new transmission lines and a possible arsenic treatment facility is not yet available. The arsenic treatment process alone is expensive. Initial capital costs approach \$1 million per well. These costs will be met with long term debt that will be paid for by rate increases.

Water Quality - Sulfates

Our two wells closest to the Phelps Dodge mine tailings pond are contaminated with levels of sulfates and total dissolved solids that exceed US EPA guidance. Your Co-op is working to resolve this problem. Independent studies have shown that high levels of sulfates are considered an aesthetic problem including taste, odors and buildup of deposits on water fixtures. Health effects are considered minimal in that a transitory laxative effect may occur in some people. The EPA has not regulated these contaminants, but has provided recommendations for acceptable sulfate levels. The option to treat the water for sulfates is economically unfeasible. A temporary solution has been reached with Phelps Dodge in which our Co-op will borrow three of their wells for the remainder of this year. A longer term solution is to procure two replacement wells. A permanent solution has not been determined. Your Co-op considers this a serious issue and has made progress to correct the situation and is committed to keeping our customers informed.

Central Arizona Project (CAP)

Your Co-op currently procures all of its water from the Santa Cruz aquifer. The water in this aquifer flows from the south to the north. The major alternative source of renewable water supplies to our area is the CAP of which we currently have an allocation of 1,337 acre feet. The CAP currently extends to Pima Mine Road. The US government has recently approved a water settlement act that grants your Co-op an additional allocation of 1,521 acre feet. This additional allocation will cost approximately \$860,000. This is a valuable resource to our members, and your Co-op is evaluating how to best use this resource in the future.

Rate Increases & Debts

Your Co-op will be seeking a rate increase in 2005 to support our efforts described above. The rate increase will be determined when we know the final costs of replacement wells and Phelps Dodge's participation. The rate increase is estimated between 25% to 30%, average bills could increase from \$16.50 to \$21.50 per month beginning in late 2006. Prior to any rate increases there will be a series of public meetings. Your Co-op is committed to keeping its customers informed throughout the process. Your Co-op will maintain cash flows for construction of arsenic treatment facilities and replacement wells with a \$4 million line of credit, that has been approved by the Arizona Corporation Commission in January 2005.

Growth

A total of 678 new users were added to our water system in 2004. Major developments are on-going in the north side of our service area near Duval Mine Road and in the Las Campanas subdivision. Almost \$1 million of physical plant has been added to our system in the last year by these developments. Your Co-op updated its long range water system improvement plan in 2005. The projections presented in this plan indicate that growth within our service area will continue for several years.

People Who Serve You

Special thanks to the staff of your Co-op who represent us in our community. Their skills are highly valued and their participation in the success of our Co-op is appreciated.

Special thanks are also extended to our board members who volunteer their time and technical skills in support of our Co-op. The board members contribute countless hours in research and evaluation in technical areas of this highly regulated industry. Their concerted efforts have successfully guided our Co-op for 28 years.

As we look into the future we see continuing challenges to our water supply, rate increases and higher regulatory standards. However we also see opportunities to make a positive difference in our community.

The annual meeting of members is scheduled for Tuesday, April 26, 2005 at 10:00 A.M., with registration beginning at 9:30 A.M. at the Green Valley Public Library. We encourage you to attend and look forward to seeing you there.

John R. McCandless
Chairman of the Board

Arturo R. Gabaldón
General Manager

April 11, 2005

**Report of Independent Auditors
To the Board of Directors and Members of
Community Water Company of Green Valley**

We have audited the accompanying balance sheets of Community Water Company of Green Valley as of December 31, 2004 and 2003, and the related statements of revenues and expenses, membership interest, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the 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, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**ULLMANN & COMPANY, P.C.
Certified Public Accountants**

February 4, 2005

Balance Sheets

Assets

	<u>2004</u>	<u>2003</u>
Utility plant:		
Plant in service, at cost	\$19,274,328	\$17,891,237
Construction work-in-progress	<u>96,754</u>	<u>146,737</u>
	19,371,082	18,037,974
Less accumulated depreciation	<u>6,111,969</u>	<u>5,795,269</u>
Total utility plant	<u>13,259,113</u>	<u>12,242,705</u>
Current assets:		
Cash and cash equivalents	1,796,640	1,864,810
Securities available-for-sale, at market	5,828	114,285
Accounts receivable, less allowance for doubtful accounts of \$3,200 in 2004 and 2003	196,923	187,209
Materials and supplies	36,829	39,348
Prepayments and deposits	<u>20,458</u>	<u>23,430</u>
Total current assets	<u>2,056,678</u>	<u>2,229,082</u>
Deferred charges:		
Central Arizona Project capital charges	422,492	382,382
Other	<u>67,411</u>	<u>60,367</u>
Total deferred charges	<u>489,903</u>	<u>442,749</u>
	 <u>\$15,805,694</u>	 <u>\$14,914,536</u>

As of December 31, 2004 and 2003

Membership Interest and Liabilities

	<u>2004</u>	<u>2003</u>
Membership interest:		
Memberships and contributions	\$ 48,010	\$ 48,010
Accumulated surplus	7,511,369	7,335,550
Accumulated other comprehensive income	<u>171</u>	<u>12,360</u>
Total membership interest	<u>7,559,550</u>	<u>7,395,920</u>
Long-term debt	<u>400,000</u>	<u>433,333</u>
Current liabilities:		
Current maturities of long-term debt	33,333	33,333
Accounts payable	159,571	69,096
Accrued taxes	73,107	70,706
Other liabilities	<u>114,174</u>	<u>147,978</u>
Total current liabilities	<u>380,185</u>	<u>321,113</u>
Deferred credits:		
Refundable advances for construction	6,027,439	5,377,007
Other	<u>48,717</u>	<u>33,823</u>
Total deferred credits	<u>6,076,156</u>	<u>5,410,830</u>
Contributions in-aid-of construction, net	<u>1,389,803</u>	<u>1,353,340</u>
	<u>\$15,805,694</u>	<u>\$14,914,536</u>

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

Statements of Revenues and Expenses
For the years ended December 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating revenues	<u>\$2,277,270</u>	<u>\$2,179,866</u>
Operating expenses:		
Operations	1,265,176	1,224,378
Maintenance	172,072	113,374
Depreciation and amortization	408,253	373,428
Taxes - other	<u>282,465</u>	<u>272,950</u>
Total operating expenses	<u>2,127,966</u>	<u>1,984,130</u>
Excess of operating revenues over operating expenses	<u>149,304</u>	<u>195,736</u>
Other revenues (expenses):		
Interest expense	(22,662)	(23,326)
Interest income	20,723	21,228
Other income, net	<u>28,454</u>	<u>14,146</u>
Total other revenues (expenses)	<u>26,515</u>	<u>12,048</u>
Excess of revenues over expenses	<u>\$ 175,819</u>	<u>\$ 207,784</u>

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

Statements of Membership Interest
For the years ended December 31, 2004 and 2003

	Comprehensive Income	Accumulated Surplus	Accumulated Other Comprehensive Income	Memberships and Contributions	Total Membership Interest
December 31, 2002 Membership Interest		\$7,127,766	\$14,436	\$48,010	\$7,190,212
Excess of revenues over expenses	\$207,784	207,784			207,784
Net adjustments to unrealized holding losses on securities available-for-sale	(2,076)		(2,076)		(2,076)
December 31, 2003 Comprehensive Income	<u>\$205,708</u>				
December 31, 2003 Membership Interest		7,335,550	12,360	48,010	7,395,920
Excess of revenues over expenses	\$175,819	175,819			175,819
Net adjustments to unrealized holding losses on securities available-for-sale	(12,189)		(12,189)		(12,189)
December 31, 2004 Comprehensive Income	<u>\$163,630</u>				
December 31, 2004 Membership Interest		<u>\$7,511,369</u>	<u>\$171</u>	<u>\$48,010</u>	<u>\$7,559,550</u>

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

Statements of Cash Flows

(Decrease) Increase in Cash and Cash Equivalents

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities:		
Cash received from customers	\$2,296,010	\$2,186,110
Cash paid for operating and maintenance expenses	(1,409,910)	(1,366,748)
Taxes paid	(280,064)	(270,161)
Interest paid	(22,662)	(21,518)
Interest received	<u>20,723</u>	<u>21,228</u>
Net cash provided by operating activities	<u>604,097</u>	<u>548,911</u>
Cash flows used in investing activities:		
Capital expenditures	(1,441,572)	(1,530,934)
Proceeds from sale of capital assets	-	16,100
Proceeds from maturities of securities available-for-sale	96,268	2,686
Central Arizona Project capital charges	<u>(40,110)</u>	<u>(46,126)</u>
Net cash used in investing activities	<u>(1,385,414)</u>	<u>(1,558,274)</u>
Cash flows from financing activities:		
Proceeds from long-term debt	-	500,000
Repayment of long-term debt	(33,333)	(33,334)
Proceeds from refundable advances and contributions in-aid-of construction	824,989	1,823,401
Repayments of refundable advances for construction	<u>(78,509)</u>	<u>(85,164)</u>
Net cash provided by financing activities	<u>713,147</u>	<u>2,204,903</u>
Net increase (decrease) in cash and cash equivalents	(68,170)	1,195,540
Cash and cash equivalents at beginning of year	<u>1,864,810</u>	<u>669,270</u>
Cash and cash equivalents at end of year	<u>\$1,796,640</u>	<u>\$1,864,810</u>
Non Cash Investing Activities:		
Accounts payable purchases of utility plant	<u>\$93,147</u>	<u>\$28,280</u>

For the years ended December 31, 2004 and 2003

**Reconciliation of Excess of Revenues Over Expenses
to Net Cash Provided by Operating Activities**

	<u>2004</u>	<u>2003</u>
Excess of revenues over expenses	<u>\$175,819</u>	<u>\$207,784</u>
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Depreciation and amortization	408,253	373,428
Depreciation and amortization included in operations and maintenance expense	57,280	54,878
Increase in accounts receivable	(9,714)	(7,902)
Decrease (increase) in materials and supplies	2,519	(1,182)
Decrease (increase) in prepayments and deposit	2,972	(4,041)
Increase in other deferred charges	(9,998)	-
Increase in accounts payable	25,608	12,414
Increase in accrued taxes	2,401	2,789
Decrease in other current liabilities	(33,804)	(13,524)
Net decrease in other deferred credits less amount attributable to amortization	<u>(17,239)</u>	<u>(75,733)</u>
Total adjustments	<u>428,278</u>	<u>341,127</u>
Net cash provided by operating activities	<u>\$604,097</u>	<u>\$548,911</u>

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

Notes to Financial Statements

1. NATURE OF OPERATIONS:

Community Water Company of Green Valley (the "Company"), an Arizona nonprofit corporation, member owned co-op, incorporated in 1975 by the water users of Green Valley and began operations in 1977. The Company provides utility service through the sale of water to residential and commercial customers in a southern Arizona active adult community.

2. SIGNIFICANT ACCOUNTING POLICIES:

Maintenance of Accounting Records - The Company maintains its accounting records substantially in accordance with the Uniform System of Accounts prescribed for Class A water utilities by the National Association of Regulatory Utility Commissioners.

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 balances of major classes of depreciable assets are as follows:

	Depreciation Rate	Balance <u>12/31/04</u>	Balance <u>12/31/03</u>
Utility Plant.....	2.49%	\$18,514,137	\$17,149,354
Computer Equipment...	12.50%	236,984	237,238
Backhoe.....	6.25%	107,179	107,179
Vehicles.....	16.67%	302,374	283,812
Land.....	N/A	<u>113,654</u>	<u>113,654</u>
Total.....		<u>\$19,274,328</u>	<u>\$17,891,237</u>

2. SIGNIFICANT ACCOUNTING POLICIES (continued):

Cash and Cash Equivalents - The Company 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.

Investment Securities - The Company accounts for its investment securities in accordance with Statement of Financial Accounting Standards No. 115 which provides that the Company classify investments in securities as either trading securities, securities to be held to maturity or securities available-for-sale. The Company has classified all investments as securities available-for-sale. Securities available-for-sale consists of U.S. Government investments and mortgage backed securities. Such securities are recorded at fair value with any unrealized gains and losses being reflected as a separate component of membership interest. Gains and losses on the sale of securities available-for-sale are determined using the specific identification method.

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

Revenue Recognition - The Company's operating revenues are generated through sales of water to residential and commercial customers in the Green Valley 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 entirely of net unrealized holding gains and losses on securities available-for-sale.

Income Taxes - The Company is an Internal Revenue Code (IRC) Section 501(a) organization, exempt from taxes by application of IRC Section 501(c)(12).

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. SIGNIFICANT ACCOUNTING POLICIES (continued):

Refundable Advances and Contributions for Construction - The cost of constructing certain expansions to utility plant has been advanced to the Company by the owners of the property served by the expansions. The Company repays these advances by refunding to the owners specified percentages of the annual water revenue which the Company derives from the expansions. These repayments continue until the advances are fully repaid or until the expiration of an agreed-upon repayment term. If the repayment term 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 annual utility plant rate.

Refundable advances for construction are non-interest-bearing. As of December 31, 2004 and 2003 the Company'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.

3. LONG-TERM DEBT:

On January 5, 2003, the Company entered into a long-term debt agreement consisting of a note to Bank One for \$500,000. The note is payable in monthly principal installments of \$2,778 plus interest at .50% per annum in excess of Bank One prime rate. The Bank One prime rate was 5.25% and 4% at December 31, 2004 and 2003, respectively. The note is collateralized by a first position deed of trust on all of the Company's assets and revenues.

Future maturities of this long-term debt, based on the terms of the signed commitment, are as follows:

2005	\$	33,333
2006		33,333
2007		<u>366,667</u>
		<u>\$433,333</u>

3. LONG-TERM DEBT (continued):

In January 2005, the Arizona Corporation Commission approved a non-revolving line of credit of up to \$4,000,000 for the Company to finance capital expenditures for new water treatment facilities and to refinance the existing note with Bank One. Bank One has extended a line of credit with monthly payments of interest only at the variable Bank One prime rate, with an option to fix the interest rate at 30, 60 or 90-day LIBOR plus 200 basis points. The line of credit matures 18 months from the initial date of funding, at which time it will be converted to a term loan.

4. INVESTMENT SECURITIES:

The carrying amounts of investment securities as shown in the balance sheets of the Company are as follows:

Securities available-for-sale December 31, 2004	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgaged Backed Securities U.S.	\$5,657	\$181	\$10	\$5,828
	<u>\$5,657</u>	<u>\$181</u>	<u>\$10</u>	<u>\$5,828</u>

Securities available-for-sale December 31, 2003	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government Investments	\$92,320	\$12,055	-	\$104,375
Mortgaged Backed Securities	9,605	322	\$17	9,910
	<u>\$101,925</u>	<u>\$12,377</u>	<u>\$17</u>	<u>\$114,285</u>

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.

5. RETIREMENT PLAN:

The Company has defined contribution retirement plans which cover substantially all full-time employees. Under the provisions of these plans, 10% to 15% of qualified employees' salaries and wages are contributed by the Company to the Retirement Plans for investment by the plan trustees. The Company recorded expenses for these contributions of \$89,890 and \$98,926 for the years ended December 31, 2004 and 2003, respectively.

Under the terms of the 401(k) plan, qualified employees can contribute up to 10% of their salaries and wages. Qualified employees become fully vested in five years of eligible service, as defined in the plan.

6. COMMITMENTS:

The Company has subcontracted to accept up to 1,337 acre-feet of water annually from the Central Arizona Project (CAP). In addition, the Company has committed to accept an additional 1,521 acre-feet if and when such allocation is awarded. As of December 31, 2004, the additional allocation has been approved by federal legislation. However, the CAP has not yet been allocated to the Company. Management estimates that when the allocation is awarded the Company will be liable for approximately \$860,000 to the CAP for capital charges. The CAP was declared complete during 1993. The Company incurred municipal & industrial water service capital charges of \$40,110 and \$46,126 for the years ended December 31, 2004 and 2003, respectively. The Company is currently studying several available options for the use of its allocations and cannot yet estimate the costs it will incur to utilize water from the CAP.

7. DEFERRED CHARGES:

Advance payments relating to future water allocation from Central Arizona Project will be amortized to expense when usage occurs. Other deferred charges include stored water credits with the Arizona Department of Water Resources and advance land lease rental. The water credits will be expensed when used and land rental is amortized over the period of the lease.

DIRECTORS & OFFICERS

J. R. McCandless, Chairman of the Board

Lt. Colonel, USMC, Retired

Roy H. Erichsen, Vice-Chairman

Retired Chief Executive Officer and President,
H.G.E., Inc. Engineers/Planners

Robert W. Liddell, Secretary

Retired R&D Manager
Calgon Division, Merck & Company, Inc.

Virgil W. Davis, Assistant Secretary

Retired Director, Electronic Programs
University Research Foundation, Inc.

Warren H. Engelland

Retired Vice President, Cargill, Inc.

Grant E. McMartin

Retired Partner, White, McMartin & Anderson, Attorneys

Roger L. Rogge

Retired Manager of Operations, Ford Forestry Center,
Michigan Technological University

Kenneth M. Taylor, Jr.

Brigadier General, USAF, Retired

OTHER OFFICERS & CONSULTANTS

Arturo R. Gabaldón, General Manager

Community Water Company of Green Valley

Margo Turner, Controller & Assistant Treasurer

Community Water Company of Green Valley

Robert A. Lembcke, Consultant

Retired Director and VP of Mfg, Peck, Inc.

Don E. Singleton, Consultant

Retired Staff Engineer, IBM Development Laboratory

Our Mission . . .

is to reliably deliver drinking water
to our customers
(that meets all regulated standards),
and to maintain a current and future water supply
for our customers.

Our Guiding Values

To be good stewards of our members' trust and economic values;

To provide responsible, professional service to our customers;

To promote a safe work environment and to encourage the
continued development of a highly skilled staff;

To advocate for responsible local & regional development and
management of water resources;

To seek prudent acquisition opportunities for the benefit of our
members and community; and

To be civic minded.