

**WESTERN HEIGHTS  
WATER COMPANY**

**Financial Statements  
with  
Independent Auditors' Report**

**For the Years Ended  
December 31, 2017 and 2016**

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## Independent Auditors' Report

To the Board of Directors  
Western Heights Water Company

### Report on Financial Statements

We have audited the accompanying financial statements of Western Heights Water Company which comprise the statements of financial position as of December 31, 2017 and 2016, and the related statements of operations, changes in stockholders' equity 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 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 financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Western Heights Water Company as of December 31, 2017 and 2016, and the results of operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## Report on Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The plant and equipment and accumulated depreciation and organization data supplementary information are presented for purposes of additional analysis and are not a required part of the financial statements. The schedule of plant and equipment and accumulated depreciation 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 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 organization data has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

*Lowell & Spafford*

March 21, 2018

**FINANCIAL STATEMENTS**

WESTERN HEIGHTS WATER COMPANY

Balance Sheets

December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 2,364,331	\$ 2,566,294
Certificates of deposit	106,531	105,802
Accounts receivable	332,740	257,215
Inventories	103,969	111,806
Prepaid expenses	<u>103,994</u>	<u>56,681</u>
Total current assets	<u>3,011,565</u>	<u>3,097,798</u>
<b>Property and equipment</b>		
Land	344,242	344,242
Water rights	247,754	247,754
Wells and water distribution system	14,428,409	14,097,764
Buildings and equipment	<u>921,943</u>	<u>920,859</u>
	15,942,348	15,610,619
Less: Accumulated depreciation	<u>8,514,418</u>	<u>8,055,503</u>
	7,427,930	7,555,116
Construction in progress	<u>837,679</u>	<u>180,933</u>
	<u>8,265,609</u>	<u>7,736,049</u>
Total assets	<u>\$ 11,277,174</u>	<u>\$ 10,833,847</u>



	<u>2017</u>	<u>2016</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 292,912	\$ 36,705
Accrued liabilities	43,983	41,449
Customer deposits	21,510	32,747
Developer deposits	<u>152,419</u>	<u>152,419</u>
Total current liabilities	<u>510,824</u>	<u>263,320</u>
<b>Stockholders' equity</b>		
Capital stock, par value \$ 40; authorized 5,000 shares; issued and outstanding 3,445 and 3,443 shares, respectively	137,520	137,440
Paid-in capital	1,644,451	1,638,631
Retained earnings and contributed capital	<u>8,984,379</u>	<u>8,794,456</u>
Total stockholders' equity	<u>10,766,350</u>	<u>10,570,527</u>
Total liabilities and stockholders' equity	<u>\$ 11,277,174</u>	<u>\$ 10,833,847</u>

*The accompanying notes are an integral part of these financial statements.*

**WESTERN HEIGHTS WATER COMPANY**

**Statements of Operations**

**For the Years Ended December 31, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
<b>Revenue</b>		
Water sales		
Basic charges	\$ 499,349	\$ 489,951
Water usage	<u>1,472,571</u>	<u>1,256,342</u>
Total revenue from water sales	<u>1,971,920</u>	<u>1,746,293</u>
<b>Operating expenses</b>		
Wages	221,033	186,484
Payroll taxes	20,664	17,068
Employee benefits	59,676	57,552
Power	228,472	214,579
Repairs and maintenance	229,123	203,782
Mobile equipment usage, net	(13,654)	(1,590)
Depreciation	450,652	458,222
Purchased water	257,337	232,184
Water analysis	7,241	3,332
Engineering	71,476	9,768
Licenses and permits	6,599	10,583
Insurance	19,559	35,350
Property taxes	7,232	5,134
Employee expenses	345	825
Supplies and miscellaneous	<u>8,309</u>	<u>4,756</u>
Total operating expenses	<u>1,574,064</u>	<u>1,438,029</u>
Gross profit	<u>397,856</u>	<u>308,264</u>
<b>General and administrative expenses</b>		
Office salaries	241,088	189,248
Payroll taxes	19,560	15,118
Employee benefits	65,742	65,988
Directors' fees	16,150	10,700
Office expenses	90,065	66,383
Communication	8,521	7,264
Professional fees	87,053	21,538
Depreciation	8,262	9,392

	<u>2017</u>	<u>2016</u>
<b>General and administrative expenses (Continued)</b>		
Insurance	1,389	2,778
Employee expenses	155	892
Licenses and permits	30,414	4,853
Miscellaneous	<u>2,763</u>	<u>3,834</u>
Total general and administrative expenses	<u>571,162</u>	<u>397,988</u>
<b>Income (loss) from operations</b>	<u>(173,306)</u>	<u>(89,724)</u>
<b>Other income</b>		
Meter connections	74,557	215,012
Stock transfer fees	9,200	14,500
Interest income	5,469	3,625
Miscellaneous	46,971	46,753
Assessment	227,832	228,525
Charges for improvements	<u>-</u>	<u>18,912</u>
	<u>364,029</u>	<u>527,327</u>
Income before provision for income taxes	190,723	437,603
Provision for income taxes	<u>800</u>	<u>800</u>
Net income	<u>\$ 189,923</u>	<u>\$ 436,803</u>

*The accompanying notes are an integral part of these financial statements.*

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**WESTERN HEIGHTS WATER COMPANY**

**Statements of Changes in Stockholders' Equity**

**For the Years Ended December 31, 2017 and 2016**

	Capital Stock	Paid in Capital	Retained Earnings and Contributed Capital	Total
Balance, January 1, 2016	\$ 137,160	\$ 1,621,036	\$ 8,357,653	\$ 10,115,849
Net income	-	-	436,803	436,803
Stock purchased	280	17,595	-	17,875
Balance, December 31, 2016	137,440	1,638,631	8,794,456	10,570,527
Net income	-	-	189,923	189,923
Stock purchased	80	5,820	-	5,900
Balance, December 31, 2017	\$ 137,520	\$ 1,644,451	\$ 8,984,379	\$ 10,766,350

*The accompanying notes are an integral part of these financial statements.*

**WESTERN HEIGHTS WATER COMPANY**

**Statements of Cash Flows**

**For the Years Ended December 31, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
<b>Cash flows from operating activities</b>		
Net income	\$ 189,923	\$ 436,803
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	458,915	467,614
Loss on disposal of fixed assets	-	426
(Increase) decrease in:		
Receivables	(75,525)	(20,799)
Inventories	7,837	(4,214)
Prepaid expenses	(47,313)	(11,240)
Increase (decrease) in:		
Accounts payable	256,207	19,381
Accrued liabilities	2,534	2,104
Customer and developer deposits	<u>(11,237)</u>	<u>8,000</u>
 Net cash provided by operating activities	 <u>781,341</u>	 <u>898,075</u>
 <b>Cash flows from investing activities</b>		
Purchase and construction of property and equipment	(988,475)	(284,729)
Purchase of certificates of deposit	(211,334)	(210,080)
Proceeds from redemption of certificates of deposit	<u>210,605</u>	<u>209,556</u>
 Net cash used in investing activities	 <u>(989,204)</u>	 <u>(285,253)</u>

	<u>2017</u>	<u>2016</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of stock	\$ <u>5,900</u>	\$ <u>17,875</u>
Net cash provided by (used in) financing activities	<u>5,900</u>	<u>17,875</u>
Net increase (decrease) in cash	(201,963)	630,697
<b>Cash and cash equivalents</b>		
Balance, beginning of year	<u>2,566,294</u>	<u>1,935,597</u>
Balance, end of year	<u>\$ 2,364,331</u>	<u>\$ 2,566,294</u>
<b>Supplemental cash flows information</b>		
Income taxes paid	\$ 800	\$ 800

*The accompanying notes are an integral part of these financial statements.*

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# WESTERN HEIGHTS WATER COMPANY

## Notes to Financial Statements

### 1. Nature of Business and Significant Accounting Policies

Western Heights Water Company (the Company) is a mutual water company operating for the purpose of supplying water to its stockholders. The stockholders of the Company are located in San Bernardino County, California.

The preparation of these financial statements requires management to make estimates and assumptions. Those estimates and assumptions affect the reported amounts of assets, liabilities, revenues, and expenses, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Management also determines the accounting policies to be used in the preparation of financial statements. A description of the significant accounting policies employed in the preparation of these financial statements follows:

#### Cash and Cash Equivalents

For purposes of the statement of cash flows, the Company considers cash and all highly liquid investments available for current use with an initial maturity of three months or less to be cash equivalents.

#### Accounts Receivable

Accounts receivable are primarily from water sales to customers. The Company has not accrued an allowance for bad debts because all amounts are expected to be collected in full within one year. Unbilled water sales are stated at the amount estimated by management based on historical experience from the dates of the most recent meter readings in late November and mid-December through the end of the year.

#### Inventories

Inventories are stated at the lower of cost or market and consist primarily of parts and materials. Cost is determined using the first-in, first-out method.

#### Property and Equipment

Property and equipment are stated at cost. Certain water rights are carried at 1964 appraisal values. The Company generally capitalizes purchases in excess of \$1,000 with useful lives that exceed one year and uses the straight-line method of depreciation over the following estimated useful lives of the assets:

Land improvements	7 to 20 years
Buildings and improvements	10 to 35 years
Wells	10 to 35 years
Reservoirs and flood control	7 to 35 years
Domestic pipes, pumps, boosters and motors system	5 to 40 years
Telemetry system	20 to 25 years
Tools & equipment	5 to 12 years
Office equipment	3 to 12 years
Mobile equipment	5 to 7 years

# WESTERN HEIGHTS WATER COMPANY

## Notes to Financial Statements

### 1. Nature of Business and Significant Accounting Policies (Continued)

#### Property and Equipment (Continued)

The cost of property and equipment retired or otherwise disposed of and the accumulated depreciation thereon are eliminated from the asset and related accumulated depreciation accounts, and the resulting difference, after giving effect to any proceeds from sales, is recognized as gain or loss on the sale. Maintenance and repairs are charged to expense as incurred. Replacements and improvements, which extend the life of an asset are capitalized.

Water rights acquired at the inception of the Company are reported at cost and water rights acquired with the expansion of the service area during the years 1959 through 1964 are reported at appraised value of \$100 per acre-foot.

#### Income Taxes

The Company is organized and operates as a mutual water company exempt from federal income taxes under code section 501(c)(12) of the Internal Revenue Code, as long as at least 85% or more of its income is derived from the sale of water to stockholders and is used to provide water to those stockholders. For state income tax purposes, the Company is taxed as a regular corporation, except that net income on water service is treated as a deduction for tax purposes.

Management believes that all of the positions taken by the Company in its federal and state income tax returns are more likely than not to be sustained upon examination. The Company's tax returns are subject to examination by the Internal Revenue Service and the California Franchise Tax Board, generally for three years and four years, respectively, after they are filed.

### 2. Accounts Receivable

Water sales accounts receivable consists of the following:

	<u>2017</u>	<u>2016</u>
Billed amounts	\$ 197,773	\$ 157,207
Unbilled amounts	134,417	99,258
Other receivable	<u>550</u>	<u>750</u>
	<u>\$ 332,740</u>	<u>\$ 257,215</u>

## WESTERN HEIGHTS WATER COMPANY

### Notes to Financial Statements

#### 3. Certificates of Deposit

The Company holds certificates of deposit as follows:

	<u>2017</u>	<u>2016</u>
<u>Certificates of Deposit</u>		
Bank of America	\$ 1,000	\$ 1,000
Capital Source Bank	<u>105,531</u>	<u>104,802</u>
	<u>\$ 106,531</u>	<u>\$ 105,802</u>

#### 4. Property and Equipment

Property and equipment consists of the following as of December 31, 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Water Rights		
At cost	\$ 129,890	\$ 129,890
At appraised value	<u>117,864</u>	<u>117,864</u>
	247,754	247,754
Land	344,242	344,242
Wells	2,482,300	2,482,300
Water distribution system	11,946,109	11,615,464
Buildings and paving	347,299	347,299
Water system equipment	465,445	465,445
Office equipment	<u>109,199</u>	<u>108,115</u>
	15,942,348	15,610,619
Less accumulated depreciation	<u>8,514,418</u>	<u>8,055,503</u>
	7,427,930	7,555,116
Construction in progress	<u>837,679</u>	<u>180,933</u>
	<u>\$ 8,265,609</u>	<u>\$ 7,736,049</u>

Construction in progress at December 31, 2017 consists of costs incurred for eleven projects. There are no significant additional funds committed to these projects at December 31, 2017.

#### 5. Compensated Absences

Employees of the Company are entitled to paid vacation and sick leave depending on the job classification, length of service, and other factors. The amounts accrued at December 31, 2017 and 2016 are \$43,042 and \$40,335, respectively.

# WESTERN HEIGHTS WATER COMPANY

## Notes to Financial Statements

### 6. Line-of-Credit

The Company has two lines of credit with Community Bank in the amounts of \$500,000 and \$200,000, expiring on August 1, 2018 and June 1, 2017, respectively. The \$500,000 line of credit was considered paid off by the bank on October 25, 2016. The lines are secured by substantially all assets of the Company and bear interest at the bank's index rate plus .50% (5.00% at December 31, 2017). There are no outstanding balances as of December 31, 2017.

### 7. Water Service Agreement

An agreement was executed with a developer in connection with water services to one of the Company's service areas. Terms of the agreement include conveying to the Company a well site of not less than two acres and paying for the cost of installation of a one-million-gallon reservoir to be constructed when the area is developed. During 2001, three acres were acquired by the Company in the water service area and as a result the Company meets the minimum five acre requirement of the City of Redlands for the well and reservoir site. However, as of December 31, 2017, construction had not begun.

### 8. Pension Plan

The Company contributes to a defined contribution pension plan for all eligible employees. An employee becomes eligible after completion of 1,000 hours and one year of service. The employer's maximum contribution was 6.0% of the participating employee's gross wages or salary for the years ended December 31, 2017 and 2016. The employee's maximum contribution is limited to \$18,500 or \$24,000 if the employee is over age 50. Company contributions for the years ended December 31, 2017 and 2016 are \$26,073 and \$24,240, respectively.

### 9. Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and trade accounts receivables. The Company maintains its cash with several financial institutions, which at times during the year exceeded the Federal Deposit Insurance Corporation's insurance limit. At yearend, the Company has \$1,578,030 in deposits in excess of FDIC insurance limits.

The Company's accounts receivable are primarily from stockholders/customers located in the Yucaipa and Redlands area of San Bernardino County, California. The Company's risk related to customer receivables is minimal due to its ability to discontinue water services.

### 10. Subsequent Events

Events or transactions that occurred after December 31, 2017 up through March 21, 2018, the date the Company's financial statements were available for issuance, were reviewed for subsequent event accounting and disclosure. During this period the Company does not believe it had any material subsequent events.

**SUPPLEMENTAL INFORMATION**

WESTERN HEIGHTS WATER COMPANY

Plant and Equipment and Accumulated Depreciation

December 31, 2017

	Plant and Equipment			Balance <u>12-31-17</u>
	Balance <u>01-01-17</u>	<u>Additions</u>	<u>Deletions</u>	
Land	\$ 344,242	\$ -	\$ -	\$ 344,242
Shop and storage building	247,918	-	-	247,918
Office building	92,366	-	-	92,366
Water rights	247,754	-	-	247,754
Wells	2,482,300	-	-	2,482,300
Domestic pipeline system (meters)	7,547,875	330,645	-	7,878,520
Telemetry system	221,059	-	-	221,059
Pumps, boosters, and motors	320,860	-	-	320,860
Reservoirs	3,397,903	-	-	3,397,903
Flood control project	54,479	-	-	54,479
Miscellaneous improvements	73,291	-	-	73,291
Paving - parking and well	7,014	-	-	7,014
Mobile equipment	398,046	-	-	398,046
Tools and equipment	67,400	-	-	67,400
Office equipment	3,936	-	-	3,936
Computer hardware and software	104,176	1,084	-	105,260
	<u>104,176</u>	<u>1,084</u>	<u>-</u>	<u>105,260</u>
Total assets	<u>\$ 15,610,619</u>	<u>\$ 331,729</u>	<u>\$ -</u>	<u>\$ 15,942,348</u>

Accumulated Depreciation				Net Book Value
Balance 01-01-17	Additions	Deletions	Balance 12-31-17	
\$ -	\$ -	\$ -	\$ -	\$ 344,242
162,499	8,817	-	171,316	76,602
57,557	3,258	-	60,815	31,551
-	-	-	-	247,754
1,600,511	107,331	-	1,707,842	774,458
3,991,078	185,576	-	4,176,654	3,701,866
127,372	7,006	-	134,378	86,681
232,190	7,795	-	239,985	80,875
1,215,697	125,443	-	1,341,140	2,056,763
52,465	86	-	52,551	1,928
68,906	748	-	69,654	3,637
7,014	-	-	7,014	-
377,498	7,416	-	384,914	13,132
66,710	437	-	67,147	253
3,217	719	-	3,936	-
92,789	4,283	-	97,072	8,188
<u>\$ 8,055,503</u>	<u>\$ 458,915</u>	<u>\$ -</u>	<u>\$ 8,514,418</u>	<u>\$ 7,427,930</u>

## WESTERN HEIGHTS WATER COMPANY

### Organization Data

December 31, 2017

#### **Date and State of Incorporation:**

The Company was originally organized February 17, 1912, under the general laws of the State of California, as Yucaipa Water Company No. 2. Authorized capital stock was 1,000 shares of \$100 par value stock. Subsequent amendment of the Articles of Incorporation changed the authorized capital stock to 5,000 shares of \$40 par value stock.

#### **Nature of Business:**

The Company is a mutual water company serving only stockholders of the Company.

#### **Date of Annual Meeting:**

March 21, 2018

#### **Duration of Charter:**

Perpetual

#### **Date of Exemption Letter:**

November 10, 1938

#### **Officers and Directors:**

Robert J. Zappia, M.D.

President

Timothy Green

Vice President

Nicole Sufficool

Secretary/Treasurer

Duane J. Burk

Director

John R. Dahlke

Director

Benjamin G. Kelly

Director