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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

Governing Board
Sheep Creek Water Company
Phelan, California

We have performed the procedures described in Schedule A, which were agreed to by Sheep Creek Water Company (the specified parties), on the financial health for the period ended December 31, 2019. The management of Sheep Creek Water Company (the System) is responsible for providing finance and accounting data use for evaluating and compiling specific exhibits as of December 31, 2019, as they relate to Compliance Order No. 05-13-18 R-002A1 Source Capacity Violation issued by the State Water Board. The sufficiency of these procedures is solely the responsibility of the Sheep Creek Water Company. Consequently, we make no representation regarding the sufficiency of the procedures referred to below either for the purpose for which this report has been requested or for any other purpose.

The procedures and associated findings are described in *Schedule A*.

This engagement to apply agreed-upon procedures was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an audit or review, the objective of Sheep Creek Water Company, which would be the expression of an opinion or conclusion, respectively, on the financial statements of as of December 31, 2019. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and is not intended to be and should not be used by anyone other than these specified parties. This report relates only to the State Water Board directive per Section 116530 of the California Health and Safety Code, and items specified above and does not extend to any financial statements of Sheep Creek Water Company, taken as a whole.



Brea, California
August 25, 2020

Schedule A

The following procedures were completed over the Sheep Creek Water Company per Section 116530 of the California Health and Safety Code.

1. Overall evaluation of the financial health of the System using the past five years Accountant's Compilation Report Balance Sheet and Statement of Income and Expenses.

Results

- a. Worksheet presented below demonstrates the system's ability to maintain consistent fee structures that are fiscally sound to manage operating expenses. For the five-year period from 2015 through 2019, revenues increased by 66% compared with expenses by 59%. Actual water consumption to fees collect is showing reduced water usage of 83% over the same five-year period. Additionally, during 2018 the system implemented a Tier rate structure that has improved fiscal health while enhancing responsible water usage.
- b. Cash on hand ratios shows the System has maintained a range of 45 days to 251 days at December 31 date for the five years (2015 to 2019). Additionally, the system has met current payments to vendors on a timely basis.
- c. Additionally, working capital ratio has remained positive over the years. Only one situation was noted when unusual legal costs were paid by installments.

Summarized below are the past five fiscal years ended December 31:

	2019	2018	2017	2016	2015
Cash	\$ 282,176	\$ 449,371	\$ 592,015	\$ 296,629	\$ 89,012
Accounts receivable	230,724	25,962	149,940	44,864	113,693
Inventory	121,509	116,972	99,531	90,737	84,015
Other Assets	222	27,852	21,926	19,787	22,576
Total Current Assets	<u>634,631</u>	<u>620,157</u>	<u>863,412</u>	<u>452,017</u>	<u>309,296</u>
Property and Equipment	12,020,121	11,779,704	10,651,005	10,491,235	10,264,992
Less: Accumulated Depreciation	(5,963,007)	(5,681,816)	(5,525,773)	(5,287,175)	(5,025,021)
Total Assets	<u>\$ 6,691,745</u>	<u>\$ 6,718,045</u>	<u>\$ 5,988,644</u>	<u>\$ 5,656,077</u>	<u>\$ 5,549,267</u>
Day of cash on hand	92	173	251	137	45
Current Liabilities	\$ 26,748	\$ 20,506	\$ 27,463	\$ 18,960	\$ 37,648
Long-Term Liabilities	476,416	614,130	388,078	410,756	274,199
Total Liabilities	<u>503,164</u>	<u>634,636</u>	<u>415,541</u>	<u>429,716</u>	<u>311,847</u>
Shareholder Equity	9,763,738	9,731,144	9,234,982	9,012,100	8,989,030
Retained Earnings	(3,575,157)	(3,647,735)	(3,661,879)	(3,785,739)	(3,751,610)
Total Shareholder Equity	<u>6,188,581</u>	<u>6,083,409</u>	<u>5,573,103</u>	<u>5,226,361</u>	<u>5,237,420</u>
Total Liabilities and Shareholder Equity	<u>\$ 6,691,745</u>	<u>\$ 6,718,045</u>	<u>\$ 5,988,644</u>	<u>\$ 5,656,077</u>	<u>\$ 5,549,267</u>
Income					
Water Sales	\$ 1,283,819	\$ 1,054,592	\$ 932,810	\$ 877,459	\$ 767,227
Other income	10,672	14,855	7,374	4,833	7,384
Total Income	<u>1,294,491</u>	<u>1,069,447</u>	<u>940,184</u>	<u>882,292</u>	<u>774,611</u>
Expenses					
Operating expenses (excluding Depreciation)	1,117,852	945,962	860,454	790,435	726,571
Depreciation	283,506	245,841	255,928	262,155	265,443
Other expenses	1,730	821	869	800	800
Total Expenses	<u>1,403,088</u>	<u>1,192,624</u>	<u>1,117,251</u>	<u>1,053,390</u>	<u>992,814</u>
Net Income (Loss)	<u>\$ (108,597)</u>	<u>\$ (123,177)</u>	<u>\$ (177,067)</u>	<u>\$ (171,098)</u>	<u>\$ (218,203)</u>

2. Evaluation of management and outstanding debt along with impending debt because of the order.

Results

- a. Over the past five years, debt service coverage ratios have averaged above 1.10% (net income over debt payments), and all debt payments have been made in accordance with terms. The debt service payment have been for skip loader from CCH industrial for \$ 91,388 (five years starting in 2016 at 3%), Vehicles loans ranging from \$22,830 to \$52,050 (2 or 3 year terms at 4% to 5%) and Shareholder loans ranging from \$80,000 to \$400,000 (five-year terms at 5% to 6.5%.All Shareholder loans were entered into for specific projects designated by the Board of Directors.
- b. In June 2020, the System entered into a Single Advance Term Promissory Note with average interest rate of 2.4% currently in an amount not to exceed \$410,000 to refinance the Shareholder loans into one payment. Payments will begin on July 2020 over four years at approximately \$8,900 monthly.
- c. In June 2020, the System entered into a Multiple Advance Term Promissory Note with a variable rate at under a Converted Term Loan with 3 different Tranches starting June 20, 2021, not to exceed \$4,000,000. Payment will begin following the first June 20, 2021, date over a 20-year period. The Multiple advances will correspond to the project order dates for Wells #12, #13,#14 and #15 (starting in 2021 to 2023).

3. Evaluation of financed documentation and demonstration of how funding (new proposed fee structure) with be obtained throughout the loan terms for repayment.

Results

- a. As noted above, the system obtained a \$4 million Multiple Advance Term Promissory Note with term flexible to meet the installation of four wells as outlined in the order.
- b. The system has the following 2 options showing detailed schedules to repay the new funding over a 20-year period. The System has not conducted a vote as of this report to determine which option will be implemented.

Overall increased rates are comparable to other water agencies when comparing base fee and water usage fees combined.

Project cost per meter service (Base Rate)

<u>Option 1</u>									
Loan Amount	Term Years	Interest Rate	Monthly P&I	Monthly Cost per	Total Cost per Meter	Cost per Day	Estimated Monthly Revenue	Estimated Annual Revenue	Estimated 20 YR Term Revenue
\$ 4,000,000.00	20	4.25%	\$ 25,000	\$ 21.01	\$ 5,042.02	\$ 0.69	\$ 25,000.00	\$ 300,000.00	\$ 6,000,000.00

Option 2

Project cost per Share (Assessment)- including collection cost

Loan Amount	Term Years	Interest Rate	Monthly P&I Payment	Annual Assessment Cost per Share	Total Cost per Share	Cost per Day	Estimated Annual Revenue	Estimated 20 YR Term Revenue	
\$ 4,000,000.00	20	4.25%	\$ 25,000	\$ 39.07	\$ 781.41	\$ 0.11 per share	\$ 312,563.56	\$ 6,251,271.13	
								Includes Assessment Collection Cost	

4. Review calculations for expected increase in operational expenses for additional wells outlined in the order.

2020	Well 11 Actual Production- Gal	SCE Billing	MWA Fees	Well Maintenance	Total Well 11 Cost to Run	per HCF Pumped	
JAN	\$ -	\$ 211.89	\$ -	\$ -	\$ 211.89	\$ -	
FEB	180,788.00	1,720.55	360.58	181.27	2,262.40	9.36	Installation of new controls & Testing
MAR	72,700.00	1,527.25	145.00	72.89	1,745.14	17.96	
APR	399,000.00	2,045.30	795.80	400.07	3,241.16	6.08	
MAY	548,900.00	1,739.96	1,094.77	550.37	3,385.10	4.61	
JUNE	1,890,700.00	6,018.74	3,770.96	1,895.76	11,685.45	4.62	Installation of new SCADA Controls & Testing
JUL	2,439,594.00	6,331.00	4,865.71	2,446.12	13,642.83	4.18	
AUG		-	-	-	-	-	
SEP		-	-	-	-	-	
OCT		-	-	-	-	-	
NOV		-	-	-	-	-	
DEC		-	-	-	-	-	
	\$ 5,531,682.00	\$ 19,594.69	\$ 11,032.81	5,546.47	\$ 36,173.97	\$ 4.89	

Average cost per of water from Well 11 during normal full-time operating conditions - \$4.47 per HCF / \$1,947 per Acre Foot

*Average cost to run Well 11 when well is not being used for full time operation is much higher due to the electrical demand cost when the well is first turned on for the billing period

Results:

- a. The system has project cost for Wells #12, #13 and #14 using the recent implemented Well #10 as a standard to estimate future additional operating costs. Assuming the new wells along with well #11 produce what well #11 produced last year, the estimated usage would be approximately 40-acre feet. Estimated cost to produce is \$1,947 per acre foot. The 40-acre feet could be divided between wells #11, #12, and #13. During non-drought years, wells #11, #12, and #13 would have minimal use since the Wrightwood Well Field will supply the needed water and is much more cost effect to operate.
- b. Based on assumed operating usage the anticipated additional cost would range from \$19,470 to \$77,880 (usage ranging from 10 to 40-acre feet). Additional operating usage costs will be managed by the proposed rate structure being implemented in 2020.

5. Evaluation of management and status of the System's reserve funds

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Assessment	\$ 93,276	\$ 231,668	\$ 229,196	\$ 978	\$ 986
Capital Improvements	98,739	22,585	9,585	9,561	4,543
System upgrades	37,004	19,615	37,681	18,054	27,552
Wells	34,481	70,419	184,063	185,144	27,118
Total	<u>\$ 263,500</u>	<u>\$ 344,287</u>	<u>\$ 460,525</u>	<u>\$ 213,737</u>	<u>\$ 60,199</u>

Percentage increase **39%** Overall net increase during the past five years

Results:

Reserve accounts have been verified for the past five years. The system has implemented additional funding priority using the Tiers 1,2,and 3 beginning in 2018 (shown below) and will make adjustments to the table below to designated additional funding for reserves to meet the financial covenant in accordance with Multiple Advance Term Promissory Note.

Month	Total Usage	Tier 1 Usage	Tier 2 Usage Well 11	Tier 3 Usage Overage	Month
JAN	12,480.62	7,242.21	2,506.00	2,732.41	JAN
FEB	10,979.96	6,266.14	2,672.00	2,041.82	FEB
MAR	10,326.75	5,639.45	3,225.00	1,462.30	MAR
APR	16,381.09	10,952.85	2,500.00	2,928.24	APR
MAY	17,288.19	11,097.04	3,200.00	2,991.16	MAY
JUNE	19,468.72	11,360.44	3,800.00	4,308.28	JUNE
JUL	24,332.53	13,345.80	3,950.00	7,036.73	JUL
AUG	24,571.73	13,269.07	3,900.00	7,402.66	AUG
SEP	21,868.39	12,256.22	3,763.00	5,849.17	SEP
OCT	19,743.60	12,541.29	3,250.00	3,952.31	OCT
NOV	13,907.07	9,951.45	1,500.00	2,455.62	NOV
DEC	12,938.87	8,990.84	1,350.00	2,598.03	DEC
TOTAL	204,287.52	122,912.80	35,616.00	45,758.72	TOTAL

Monthly Deposits

Total Well Maintenance	Tier 2 & 3- \$1.46 MWA Fees	Tier 3-\$2.00 Improvement	Tier 3-\$1.13 Assessment	System Upgrade	Well 11 \$5.00 Assessment
\$ 3,120.16	\$ 3,658.76	\$ 5,464.82	\$ 3,087.62	\$ 3,750.00	\$ -
2,744.99	3,901.12	4,083.64	2,307.26	3,750.00	-
2,581.69	4,708.50	2,924.59	1,652.39	3,750.00	-
6,809.39	3,650.00	5,856.48	3,308.91	3,750.00	-
7,417.63	4,672.00	5,982.31	3,380.01	3,750.00	-
8,921.32	5,548.00	8,616.56	4,868.36	3,750.00	-
11,576.50	5,767.00	14,073.46	7,951.50	3,750.00	-
11,794.26	5,694.00	14,805.32	8,365.01	3,750.00	-
10,273.18	5,493.98	5,849.17	6,609.56	3,750.00	5,970.00
8,537.06	4,745.00	7,904.62	4,466.11	3,750.00	5,950.00
5,454.58	2,190.00	4,911.25	2,774.85	3,750.00	5,950.00
5,208.73	1,971.00	5,196.06	2,935.77	3,750.00	5,925.00
\$ 84,439.48	\$ 51,999.36	\$ 85,668.28	\$ 51,707.36	\$ 45,000.00	\$ 23,795.00

Well Account

Capital Improvement Account

Assessment Account

System Upgrade Account

6. Provide a summarized conclusion on the overall current and anticipated financial health

Results:

- a. For the current financial health, the System has demonstrated over the past 5 years to be fiscally responsible for managing overall operations which includes maintaining cash flows, working capital, collections of receivables, and meeting debt obligations while providing members demand for quality water.
- b. As for the anticipated financial health, the System has worked diligently to secure the required flexible funding for additional water capacity, refinanced existing shareholder loans under lower rates, established funding option that are comparable in current market fee structures and project a multi-year budget that demonstrates adherence to future operations.