

PALOMINO LAKES MUTUAL WATER COMPANY

FINANCIAL STATEMENTS

YEAR ENDED MARCH 31, 2018

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Mark R. McDonell

Certified Public Accountant

Member American Institute of Certified Public Accountants

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

To the Board of Directors and Members of
Palomino Lakes Mutual Water Company
Cloverdale, California

I have reviewed the accompanying financial statements of Palomino Lakes Mutual Water Company (a non-profit mutual benefit corporation), which comprise the balance sheet as of March 31, 2018, and the related statements of revenues and expenses and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management's financial data and making inquiries of entity management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I do not express such an opinion.

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.

Accountant's Responsibility

My responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require me to perform procedures to obtain limited assurance as a basis for reporting whether I am aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I believe that the results of my procedures provide a reasonable basis for my conclusion.

Accountant's Conclusion

Based on my review, I am not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Management has omitted supplementary information about future major repairs and replacements of common property that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a required part of the basic financial statements, is required by the Financial Accounting Standards Board, who considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context.



Santa Rosa, California
September 20, 2018

PALOMINO LAKES MUTUAL WATER COMPANY
BALANCE SHEET
March 31, 2018

ASSETS

| | |
|--|--------------------|
| Cash for operations | \$21,959 |
| Accounts receivable | 2,284 |
| | 24,243 |
| | |
| Water system property and equipment, net | 1,045,424 |
| Land easements | 350,000 |
| Cash reserves for: | |
| Future repairs and replacements | 92,282 |
| Debt repayment | 37,522 |
| | \$1,549,471 |
| TOTAL ASSETS | \$1,549,471 |

LIABILITIES AND NET ASSETS

Liabilities

| | |
|--|----------------|
| Current portion of long-term debt | \$27,000 |
| Accounts payable | 1,881 |
| | 28,881 |
| | |
| Long-term debt, net of current portion | 912,120 |
| Total liabilities | 941,001 |

Members' equity

| | |
|---------------------------------|---------|
| Undesignated | 478,666 |
| Designated for: | |
| Future repairs and replacements | 92,282 |
| Debt repayment | 37,522 |
| | 608,470 |

| | |
|---|--------------------|
| TOTAL LIABILITIES AND NET ASSETS | \$1,549,471 |
|---|--------------------|

See accompanying notes and independent accountant's report.

PALOMINO LAKES MUTUAL WATER COMPANY
STATEMENT OF REVENUES AND EXPENSES
Year Ended March 31, 2018

REVENUES

| | |
|--|----------------|
| Member assessments for repayment of long-term debt | \$68,821 |
| Water use charges | 57,690 |
| Member assessments for future repairs and replacements | 28,771 |
| Other income | 1,981 |
| Total revenues | <u>157,263</u> |

EXPENSES

| | |
|---|----------------|
| Depreciation | 49,535 |
| Interest | 40,524 |
| Water system specialist | 22,153 |
| Repairs and maintenance | 16,775 |
| Electric utilities | 10,989 |
| Bookkeeping | 7,495 |
| Water control system monitoring service | 5,081 |
| Miscellaneous | 4,252 |
| Professional fees | 3,232 |
| Water testing | 2,426 |
| Water Resources Control Board fees | 1,517 |
| Chlorination | 1,428 |
| Meter reading | 1,212 |
| Insurance | 902 |
| Total expenses | <u>167,521</u> |

DEFICIENCY OF REVENUES OVER EXPENSES (10,258)

BEGINNING MEMBERS' EQUITY 618,728

ENDING MEMBERS' EQUITY \$608,470

See accompanying notes and independent accountant's report.

PALOMINO LAKES MUTUAL WATER COMPANY
STATEMENT OF CASH FLOWS
Year Ended March 31, 2018

| | |
|--|------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | |
| Deficiency of revenues over expenses | (\$10,258) |
| Adjustments to reconcile deficiency of revenues over expenses to net cash from operating activities: | |
| Depreciation | 49,535 |
| Accounts receivable | 590 |
| Accounts payable | (561) |
| Net cash from operating activities | 39,306 |
| CASH FLOWS FROM FINANCING ACTIVITIES | |
| Payments of long-term debt | (24,395) |
| Net cash from financing activities | (24,395) |
| CHANGE IN CASH | 14,911 |
| BEGINNING CASH | 136,852 |
| ENDING CASH | \$151,763 |
| SUMMARY OF CASH ACCOUNTS | |
| Cash for operations | \$21,959 |
| Cash reserves for: | |
| Future repairs and replacements | 92,282 |
| Debt repayment | 37,522 |
| | \$151,763 |
| SUPPLEMENTAL CASH FLOW DISCLOSURES | |
| Interest payments | \$40,524 |
| Income tax payments | \$ - |

See accompanying notes and independent accountant's report.

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2018

Note 1. Organization

Palomino Lakes Mutual Water Company (the Water Company) is incorporated in the State of California as a non-profit mutual benefit corporation. It is responsible for the operation and maintenance of a residential water system serving the Palomino Lakes community in Cloverdale, California which consists of 115 properties, including 108 homes.

Note 2. Summary Of Significant Accounting Policies

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America. Consequently, revenues and gains are recognized when earned, and expenses and losses are recognized when incurred.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Subsequent events

The financial statements for the year ended March 31, 2018 were evaluated for subsequent events through September 20, 2018, the date the financial statements were available to be issued.

Bank Accounts

Assessments are deposited into the Water Company's operating bank account unless designated for future repairs and replacements or debt repayment in which case the assessments are deposited into the applicable reserve account. The Water Company's lender, United States Department of Agriculture, specifies the debt repayment reserve level that must be maintained.

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2018

Note 2. Summary Of Significant Accounting Policies (continued)

Accounts Receivable

Accounts receivable are reported at net realizable value, management's estimate of the amount that will ultimately be collected. Uncollectible receivables are charged to operations using the allowance method. The allowance for doubtful accounts is based on the identification of potentially uncollectible accounts, the level of delinquent accounts based on contractual terms, and historical collection experience. Accounts are delinquent after one monthly billing cycle. When efforts to collect delinquent receivables fail, the receivables are written off. Management believes receivables at March 31, 2018 will be fully collected. Accordingly, no allowance for doubtful receivables was recorded.

Land Easements

The Water Company has right-of-way land easements permitting it to install, maintain and operate its well and water mains. The land easements are carried at cost and carrying value is assessed for impairment annually, or more frequently if circumstances require (i.e., carrying value is impaired if it exceeds fair value). Fair value is estimated by discounting future cash flows in conjunction with land easements use. Impaired land easements are written down to fair value.

Water System Property and Equipment

Costs of water system property and equipment in excess of \$2,000 are capitalized and depreciated using the straight-line method over the estimated useful lives of depreciable assets: 25 years for water system property, 5 years for equipment.

Members' Equity

Members' equity presented in the accompanying financial statements represents the excess, or residual, of assets over liabilities. The Water Company board may designate, or set aside, a portion of members' equity as reserves for specific purposes. As of March 31, 2018, it had established reserves for (1) future repairs and replacements and (2) debt repayment.

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2018

Note 2. Summary Of Significant Accounting Policies (continued)

Income Taxes

The Water Company is exempt from federal income taxes under Section 501(c)(12) of the Internal Revenue Code and from state franchise taxes under a similar section of the California Revenue and Taxation Code. Once filed, annual information returns are subject to audit for up to three years by the federal government, and four years by the state government.

Note 3. Components of Water System Property and Equipment

| | |
|--|-------------|
| Water system property | \$1,769,075 |
| Equipment | |
| Laptop computers | 3,483 |
| Freewave radio | 2,484 |
| | 1,775,042 |
| Less accumulated depreciation | (729,618) |
| Water system property and equipment, net | 1,045,424 |

Note 4. Long-Term Debt

The Water Company has three United States Department of Agriculture Rural Development loans:

| Terms | Balance as of March 31, 2018 |
|--|---------------------------------|
| Monthly payments of \$3,689 including interest at 4.00%. | \$848,906 |
| Monthly payments of \$364 including interest at 4.00%. | 83,696 |
| Monthly payments of \$1,357 including interest at 5.00%. | 6,518 |
| | \$939,120 |

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2018

Note 4. Long-Term Debt (continued)

The loans are secured by the Water Company's assets including its land easements, water system property and equipment, and future revenues. The loans include a covenant requiring the Water Company to maintain a debt service coverage ratio of not less than 1.10 to 1.00 (i.e., net income plus depreciation and interest expense to debt service payments due within the year).

Annual maturities of long-term debt at March 31, 2018:

| | |
|------------|------------------|
| 2019 | \$27,000 |
| 2020 | 18,000 |
| 2021 | 12,000 |
| 2022 | 13,000 |
| 2023 | 13,000 |
| Thereafter | 856,120 |
| | <u>\$939,120</u> |

At the time these financial statements were issued, the Water Company was evaluating borrowing of up to \$350,000 for water system improvements.

Note 5. Related Party Transaction

A Palomino Lakes community member provides certain operational services (e.g., meter reading). Fees paid for the year ended March 31, 2018 totaled approximately \$1,700.

Note 6. Future Major Repairs and Replacements

The Water Company's governing documents require assessments collected for future major repairs and replacements to be held in a separate bank account. Assessments collected are not based on a rigorous study of remaining useful lives of water system property and costs of future major repairs and replacements. Amounts accumulated may vary from actual expenditures and the variations may be material. If additional funds are needed, the Water Company board has the right to increase assessments or delay major repairs and replacements until funds are available.