

**PALOMINO LAKES MUTUAL WATER  
COMPANY**

**FINANCIAL STATEMENTS**

**YEARS ENDED MARCH 31, 2020 AND 2019**

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## **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 sheets as of March 31, 2020 and 2019, and the related statements of revenues and expenses and cash flows for the years 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 engagements 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**

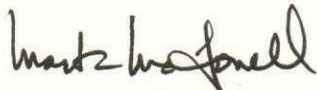
Based on my reviews, except for the issue noted in the Known Departure From Accounting Principles Generally Accepted in the United States of America paragraph, I am not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

## **Known Departure From Accounting Principles Generally Accepted in the United States of America**

As disclosed in these financial statements' Note 2 (Revenue Recognition and Departure from Generally Accepted Accounting Principles), the Water Company's revenue recognition policies for its fiscal year ended March 31, 2020 do not conform to generally accepted accounting principles in the United States of America. A recently issued accounting standard established new requirements for revenue recognition that apply to the Water Company's fiscal year ended March 31, 2020. Generally accepted accounting principles in the United States of America now require the Water Company to record a liability (deferred revenue) until its assessments for loan repayments, capital projects, and other special items are expended for their designated purposes at which point the Water Company has satisfied its performances obligations and revenue should be recognized. But the Water Company continues to account for assessments revenue from loan repayments, capital projects, and other special items as it has prior to its fiscal year ended March 31, 2020, specifically by recognizing revenue as the assessments are collected. This approach tends to recognize the Water Company's revenue before it is earned by understating its deferred revenue liability. The effect of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows has not been determined.

### **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the information about future major repairs and replacements on page 12 be presented to supplement the basic financial statements. Such 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. The information is the responsibility of management. I have not audited, reviewed, or compiled the required supplementary information and do not express an opinion, a conclusion, nor provide any assurance on it.



Santa Rosa, California

July 27, 2020

**PALOMINO LAKES MUTUAL WATER COMPANY**

**BALANCE SHEETS**

**March 31, 2020 and 2019**

	<u>2020</u>	<u>2019</u>
<b>ASSETS</b>		
Cash for operations	\$32,142	\$17,778
Accounts receivable	3,470	3,739
Other current assets	6,142	5,310
Total current assets	<u>41,754</u>	<u>26,827</u>
Water system property and equipment, net	1,361,541	1,061,332
Land easements	387,000	387,000
Cash reserves for:		
Future repairs and replacements	132,695	56,024
Debt repayment	46,301	41,436
Regulatory reserve	25,025	25,000
<b>TOTAL ASSETS</b>	<u><u>\$1,994,316</u></u>	<u><u>\$1,597,619</u></u>
<b>LIABILITIES AND MEMBERS' EQUITY</b>		
<b>Liabilities</b>		
Current portion of long-term debt	\$19,000	\$12,000
Accounts payable	6,152	2,719
Total current liabilities	<u>25,152</u>	<u>14,719</u>
Long-term debt, net of current portion	1,236,442	909,059
Easement acquisition commitment	30,505	31,082
<b>Total liabilities</b>	<u>1,292,099</u>	<u>954,860</u>
<b>Members' equity</b>		
Undesignated	498,196	520,299
Designated for:		
Future repairs and replacements	132,695	56,024
Debt repayment	46,301	41,436
Regulatory reserve	25,025	25,000
<b>Total members' equity</b>	<u>702,217</u>	<u>642,759</u>
<b>TOTAL LIABILITIES AND MEMBERS' EQUITY</b>	<u><u>\$1,994,316</u></u>	<u><u>\$1,597,619</u></u>

See accompanying notes and independent accountant's report.

**PALOMINO LAKES MUTUAL WATER COMPANY**  
**STATEMENTS OF REVENUES AND EXPENSES**  
**Years Ended March 31, 2020 and 2019**

	2020	2019
<b>REVENUES</b>		
Member assessments for repayment of long-term debt	\$92,400	\$92,982
Water use charges	61,230	56,759
Special assessment	45,200	-
Member assessments for future repairs and replacements	28,519	28,728
Other income	2,707	2,466
Total revenues	230,056	180,935
<b>EXPENSES</b>		
Depreciation and amortization	50,605	49,252
Interest	36,623	37,172
Water system specialist	27,690	23,745
Repairs and maintenance	16,289	492
Electric utilities	11,652	10,044
Bookkeeping	9,895	7,500
Insurance	5,150	5,076
Professional fees	3,964	4,457
Water control system monitoring service	3,648	3,952
Miscellaneous	2,057	4,237
Water testing	1,665	4,522
Water Resources Control Board fees	1,060	916
Meter reading	300	625
Total expenses	170,598	151,990
<b>EXCESS OF REVENUES OVER EXPENSES</b>	59,458	28,945
<b>BEGINNING MEMBERS' EQUITY</b>	642,759	613,814
<b>ENDING MEMBERS' EQUITY</b>	\$702,217	\$642,759

See accompanying notes and independent accountant's report.

**PALOMINO LAKES MUTUAL WATER COMPANY**  
**STATEMENTS OF CASH FLOWS**  
**Years Ended March 31, 2020 and 2019**

	2020	2019
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Excess of revenues over expenses	\$59,458	\$28,945
Adjustments to reconcile excess of revenues over expenses to net cash from operating activities:		
Depreciation and amortization	50,605	49,252
Accounts receivable	269	(1,455)
Other current assets	(832)	(5,311)
Accounts payable	3,433	838
Easement acquisition commitment	(432)	(430)
Net cash from operating activities	112,501	71,839
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of water system property and equipment	(350,459)	(64,801)
Easement acquisition	(500)	(502)
Net cash from investing activities	(350,959)	(65,303)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from long-term debt	350,000	-
Payments of long-term debt	(15,617)	(18,061)
Net cash from financing activities	334,383	(18,061)
<b>CHANGE IN CASH</b>	95,925	(11,525)
<b>BEGINNING CASH</b>	140,238	151,763
<b>ENDING CASH</b>	\$236,163	\$140,238
<b>SUMMARY OF CASH ACCOUNTS</b>		
Cash for operations	\$32,142	\$17,778
Cash reserves for:		
Future repairs and replacements	132,695	56,024
Debt repayment	46,301	41,436
Regulatory reserve	25,025	25,000
	\$236,163	\$140,238
<b>SUPPLEMENTAL CASH FLOW DISCLOSURES</b>		
Interest payments	\$42,546	\$37,172
Income tax payments	\$ -	\$ -

See accompanying notes and independent accountant's report.

**PALOMINO LAKES MUTUAL WATER COMPANY**  
**NOTES TO FINANCIAL STATEMENTS**  
**Years Ended March 31, 2020 and 2019**

**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 except for the issue noted in Note 2 (Revenue Recognition and Departure from Generally Accepted Accounting Principles). Otherwise, 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.

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.

Subsequent events

The financial statements were evaluated for subsequent events through July 27, 2020, the date the financial statements were available to be issued.



**PALOMINO LAKES MUTUAL WATER COMPANY**  
**NOTES TO FINANCIAL STATEMENTS**  
**Year Ended March 31, 2020 and 2019**

**Note 2. Summary Of Significant Accounting Policies (continued)**

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.

Revenue Recognition and Departure from Generally Accepted Accounting Principles

A recently issued accounting standard established new requirements for revenue recognition that apply to the Water Company's fiscal year ended March 31, 2020. The new standard requires revenue to be recognized through five steps consisting of identifying a contract with a customer, identifying the performance obligations in the contract, determining the transaction price, allocating the transaction price to performance obligations, and recognizing revenue as performance obligations are satisfied.

The Water Company's revenue recognition policies do not conform to generally accepted accounting principles in the United States of America for its fiscal year ended March 31, 2020. Generally accepted accounting principles in the United States of America now require the Water Company to record a liability (deferred revenue) until its assessments for loan repayments, capital projects, and other special items are expended for their designated purposes at which point the Water Company has satisfied its performance obligations and revenue should be recognized. But the Water Company continues to account for assessments revenue from loan repayments, capital projects, and other special items as it has prior to its fiscal year ended March 31, 2020, specifically by recognizing revenue as the assessments are collected. The effect of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows has not been determined.

As for water usage assessments, the Water Company's performance obligation is satisfied ratably as it meets the water needs of its customers over the assessment period. The Water Company has consistently applied this policy and it conforms to generally accepted accounting principles in the United States of America for the fiscal years ended March 31, 2020 and 2019.

Assessments are billed quarterly and generally collected within one month. Late fees and interest may be charged on all accounts thirty days or more past due.

**PALOMINO LAKES MUTUAL WATER COMPANY**  
**NOTES TO FINANCIAL STATEMENTS**  
**Years Ended March 31, 2020 and 2019**

**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, 2020 and 2019 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 all of its facilities including well, water mains, water tank sites, and plant building. 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, 2020 and 2019, it had established reserves for (1) future repairs and replacements, (2) debt repayment, and (3) regulatory requirements.

**PALOMINO LAKES MUTUAL WATER COMPANY**  
**NOTES TO FINANCIAL STATEMENTS**  
**Years Ended March 31, 2020 and 2019**

**Note 3. Components of Water System Property and Equipment**

	March 31,	
	2020	2019
Water system property	\$2,184,337	\$1,769,075
Water system improvement project in progress	-	64,801
Equipment		
Laptop computers	3,483	3,483
Freewave radio	2,484	2,484
	<u>2,190,304</u>	<u>1,839,843</u>
Less accumulated depreciation	<u>(828,763)</u>	<u>(778,511)</u>
Water system property and equipment, net	<u><u>1,361,541</u></u>	<u><u>1,061,332</u></u>

**Note 4. Long-Term Debt**

The Water Company has the following United States Department of Agriculture Rural Development sponsored loans:

Terms	Balance as of	
	March 31, 2020	March 31, 2019
Monthly payments of \$3,689 including interest at 4.00%.	\$827,470	\$838,402
Monthly payments of \$364 including interest at 4.00%.	81,576	82,657
Monthly payments of \$1,736 including interest at 4.25%.		
Principal balance	349,546	-
Unamortized debt issuance costs	(3,150)	-
	<u>\$1,255,442</u>	<u>\$921,059</u>

Debt issuance costs are amortized to interest expense over the term of the loan.

**PALOMINO LAKES MUTUAL WATER COMPANY**  
**NOTES TO FINANCIAL STATEMENTS**  
**Years Ended March 31, 2020 and 2019**

**Note 4. Long-Term Debt (continued)**

The Water Company's loans are secured by its 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 divided by debt service payments due within the year).

Interest incurred for years ended March 31, 2020 and 2019 has been recorded as follows:

	Year Ended March 31,	
	2020	2019
Interest expense	\$36,623	\$37,172
Construction period interest capitalized in cost of water system property	5,923	-
	\$42,546	\$37,172

Annual maturities of long-term debt are as follows:

	Year ending March 31,
2021	\$19,000
2022	20,000
2023	21,000
2024	22,000
2025	23,000
Thereafter	1,150,442
	\$1,255,442

**PALOMINO LAKES MUTUAL WATER COMPANY**  
**NOTES TO FINANCIAL STATEMENTS**  
**Years Ended March 31, 2020 and 2019**

**Note 5. Easement Acquisition Commitment**

The Water Company has a commitment to acquire a land easement from a member. Consideration consists of an initial \$2,500 payment in 2013 and additional consideration through 2063 as follows: (a) annual payments of \$400, (b) partial reimbursement of the member's yearly property taxes, and (c) up to 60,000 gallons of water per quarter at no charge. The estimated discounted cash flow cost to acquire the easement, \$37,000, assumes quarterly water use of 25,000 gallons; however, higher water use/easement cost is reasonably possible.

**Note 6. Related Party Transaction**

A Palomino Lakes community member provides certain operational services (e.g., meter reading). Fees paid for the years ended March 31, 2020 and 2019 totaled approximately \$8,000 and \$1,200, respectively.

**Note 7. Special Assessment**

The special assessment reported in the year ended March 31, 2020 was collected to pay water tank construction cost overruns (Tank 2 project) as well as a feasibility study for an upcoming backup power generator project.

**Note 8. Future Major Repairs and Replacements**

The Water Company's Board of Directors has studied the estimated useful lives and replacement costs of the water system's major components in order to plan for future major repairs and replacements. Actual expenditures may vary from estimated future expenditures and therefore amounts collected for future major repairs and replacements may not be adequate to meet future needs and the variations may be material. The Water Company's governing documents require assessments collected for future major repairs and replacements to be held in a separate bank account. If additional funds are needed, the Water Company Board of Directors has the right to increase assessments or delay major repairs and replacements until funds are available as discussed in the Required Supplementary Information on page 12.

**REQUIRED SUPPLEMENTARY INFORMATION**

**PALOMINO LAKES MUTUAL WATER COMPANY  
REQUIRED SUPPLEMENTARY INFORMATION  
FUTURE MAJOR REPAIRS AND REPLACEMENTS  
March 31, 2020**

The Water Company's Board of Directors has reviewed the system to estimate the remaining useful lives of major components and the replacement costs using the actual amounts from the recent "Tank #2" project and discussions with licensed contractors. Estimated current replacement costs will almost certainly be lower than the actual costs incurred at the time of replacement, due to inflation effects and tariffs on steel and other components. The costs that are less than \$50,000 will most likely be covered within the budgets of the Water Company's "Capital Improvement Fund (CIF)", but funding the larger items will require a special assessment before those replacement projects can commence. Due to the nature of our system, it is not expected that a loan will be sought to finance any of the items below, although that could be done if the Board chose to do all the replacements at once (See \* below). Amounts are rounded to the nearest thousand dollars.

<u>Components</u>	<u>Estimated Remaining Useful Life</u>	<u>Estimated Current Replacement Cost</u>
Treatment Building Paint and Roof	10 yrs	\$2,000
3 20-HP water pumps	10 yrs	\$5,000 each
Redwood Tanks at site 1	5 yrs**	\$200,000
Redwood Tank at site 2	7 yrs **	\$200,000
In-street valve sets (7)	n/a***	\$15,000 each

\*If a loan were obtained, the quarterly fixed fees for the community would have to be raised, and additional loan reserves would be required. At this time, it is still possible for the Water Company to get 30-year fixed loans secured entirely from cash flow.

\*\*As these tanks are vulnerable to earthquakes, it is possible that both of them could fail at the same time. However, as each of these tanks are paired with a steel tank, the Board could decide to delay replacing them no matter when they failed.

\*\*\*These valve sets are all frozen in their open position. While it would be very helpful to replace them now, they do not hamper system operation and do not incur any regulatory issues. They can be replaced individually at a time of our choosing, when available CIF funding permits.