

**PALOMINO LAKES MUTUAL WATER
COMPANY**

FINANCIAL STATEMENTS

YEAR ENDED MARCH 31, 2021

TABLE OF CONTENTS

INDEPENDENT ACCOUNTANT'S REVIEW REPORT	1 - 2
FINANCIAL STATEMENTS	
Balance Sheet	3
Statement of Revenues and Expenses	4
Statement of Cash Flows	5
Notes to Financial Statements	6 – 12
REQUIRED SUPPLEMENTARY INFORMATION	
Future Major Repairs and Replacements	13

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, 2021, 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

Accounting principles generally accepted in the United States of America require that the information about future major repairs and replacements on page 13 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.

A handwritten signature in black ink, appearing to read "Mark Maxwell". The signature is written in a cursive style with a large initial "M".

Santa Rosa, California
July 13, 2021

PALOMINO LAKES MUTUAL WATER COMPANY
BALANCE SHEET
March 31, 2021

ASSETS

Cash for operations	\$53,709
Accounts receivable	5,597
Total current assets	<u>59,306</u>
Water system property and equipment, net	1,534,911
Land easements	387,000
Cash reserves:	
Future repairs and replacements reserve	155,604
Loan reserves	51,166
Regulatory reserve	25,025
TOTAL ASSETS	<u><u>\$2,213,012</u></u>

LIABILITIES AND MEMBERS' EQUITY

Liabilities

Current portion of long-term debt	\$19,000
Accounts payable	15,127
Total current liabilities	<u>34,127</u>
Long-term debt, net of current portion	1,218,652
Assessments received in advance for:	
Future repairs and replacements	155,604
Debt repayment	40,014
Easement acquisition commitment	29,926
Total liabilities	<u>1,478,323</u>
Members' equity	<u>734,689</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	<u><u>\$2,213,012</u></u>

See accompanying notes and independent accountant's report.

PALOMINO LAKES MUTUAL WATER COMPANY
STATEMENT OF REVENUES AND EXPENSES
Year Ended March 31, 2021

REVENUES

Special assessment	\$203,014
Water use charges	83,592
Member assessments for repayment of long-term debt	74,329
Member assessments for future repairs and replacements	28,354
Other income	3,955
Total revenues	<u>393,244</u>

EXPENSES

Depreciation and amortization	66,582
Interest	49,939
Water system specialist	24,412
Electric utilities	14,284
Bookkeeping	12,110
Insurance	7,373
Repairs and maintenance	6,707
Professional fees	3,163
Water control system monitoring service	3,726
Miscellaneous	2,365
Water testing	2,430
Water Resources Control Board fees	746
Meter reading	450
Total expenses	<u>194,287</u>

EXCESS OF REVENUES OVER EXPENSES 198,957

BEGINNING MEMBERS' EQUITY (See Note 2, revenue recognition) 535,732

ENDING MEMBERS' EQUITY \$734,689

See accompanying notes and independent accountant's report.

PALOMINO LAKES MUTUAL WATER COMPANY
STATEMENT OF CASH FLOWS
Year Ended March 31, 2021

CASH FLOWS FROM OPERATING ACTIVITIES

Excess of revenues over expenses	\$198,957
Adjustments to reconcile excess of revenues over expenses to net cash from operating activities:	
Depreciation and amortization	66,582
Accounts receivable	(2,127)
Other current assets	6,142
Accounts payable	8,975
Assessments received in advance	29,133
Easement acquisition commitment	(432)
Net cash from operating activities	307,230

CASH FLOWS FROM INVESTING ACTIVITIES

Purchases of water system property and equipment	(239,599)
Easement acquisition	(500)
Net cash from investing activities	(240,099)

CASH FLOWS FROM FINANCING ACTIVITIES

Payments of long-term debt	(17,790)
Net cash from financing activities	(17,790)

CHANGE IN CASH

49,341

BEGINNING CASH

236,163

ENDING CASH

\$285,504

SUMMARY OF CASH ACCOUNTS

Cash for operations	\$53,709
Cash reserves:	
Future repairs and replacements reserve	155,604
Loan reserves	51,166
Regulatory reserve	25,025
	\$285,504

SUPPLEMENTAL CASH FLOW DISCLOSURES

Interest payments	\$49,939
Income tax payments	\$ -

See accompanying notes and independent accountant's report.

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2021

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. 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.

Bank Accounts

Assessments are deposited into the Water Company's operating bank account unless designated for future repairs and replacements in which case the assessments are deposited into the future repairs and replacements reserve account. Additional reserves are specified by regulations and the Water Company's lender, United States Department of Agriculture.

The Water Company maintains cash balances with one commercial bank in the United States. Balances up to \$250,000 are federally-insured. The Water Company had uninsured balances of \$35,504 as of March 31, 2021.

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2021

Note 2. Summary Of Significant Accounting Policies (continued)

Subsequent events

The financial statements were evaluated for subsequent events through July 13, 2021, the date the financial statements were available to be issued.

Revenue Recognition

As of April 1, 2020, the Water Company adopted new revenue recognition policies to conform to recent changes to generally accepted accounting principles in the United States of America. These principles require 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 recognizes revenue from water usage assessments ratably as it meets the water needs of its customers over the assessment period. It recognizes revenue from assessments for loan repayments, capital projects, and other special items as earned by recording a liability (assessments received in advance) until expended for the designated purpose at which point the Water Company has satisfied its performance obligation and revenue is recognized.

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

The Water Company adopted the new revenue recognition policies by adjusting members' equity at March 31, 2020 as follows:

Members' equity at March 31, 2020, as previously reported	\$702,217
Adjustment	<u>(\$166,485)</u>
Members' equity at March 31, 2020, as adjusted	<u><u>\$535,732</u></u>

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2021

Note 2. Summary Of Significant Accounting Policies (continued)

Revenue Recognition (continued)

The effects of the new revenue recognition policies on the Water Company's financial statements for the year ended March 31, 2021 are summarized as follows:

	Amounts That Would Have Been Reported	Effects of New Policies	As Reported Under New Policies
<i>Balance Sheet</i>			
<i>Liabilities</i>			
Assessments received in advance for:			
Future repairs and replacements	\$ -	\$155,604	\$155,604
Debt repayment	-	40,014	40,014
Members' equity	930,307	(195,618)	734,689
<i>Statement of Revenues and Expenses</i>			
<i>Revenues</i>			
Special assessment	226,000	(22,986)	203,014
Member assessments for future repairs and replacements	29,838	(1,484)	28,354
Member assessments for repayment of long-term debt	78,992	(4,663)	74,329
<i>Statements of Revenues and Expenses and Cash Flows</i>			
Excess of revenues over expenses	228,090	(29,133)	198,957
<i>Statement of Cash Flows</i>			
Adjustments to reconcile excess of revenues over expenses to net cash from operating activities:			
Assessments received in advance	-	29,133	29,133

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2021

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 one month after billing. When efforts to collect delinquent receivables fail, the receivables are written off. Management believes receivables at March 31, 2021 will be fully collected. Accordingly, no allowance for doubtful receivables was recorded. Accounts receivable as of the beginning and ending of the year ended March 31, 2021 were \$5,597 and \$3,470, respectively.

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.

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2021

Note 3. Components of Water System Property and Equipment

Water system property	\$2,423,955
Equipment	
Laptop computers	3,483
Freewave radio	2,484
	2,429,922
Less accumulated depreciation	(895,011)
Water system property and equipment, net	1,534,911

Note 4. Long-Term Debt

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

<u>Terms</u>	
Monthly payments of \$3,689 including interest at 4.00%.	\$816,093
Monthly payments of \$364 including interest at 4.00%.	80,450
Monthly payments of \$1,736 including interest at 4.25%.	
Principal balance	344,154
Unamortized debt issuance costs	(3,045)
	\$1,237,652

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

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2021

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 year ended March 31, 2021 was \$49,939.

Annual maturities of long-term debt are as follows:

<u>Year ending March 31,</u>	
2022	\$19,000
2023	20,000
2024	21,000
2025	22,000
2026	23,000
Thereafter	1,132,652
	<u>\$1,237,652</u>

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.

PALOMINO LAKES MUTUAL WATER COMPANY
NOTES TO FINANCIAL STATEMENTS
Year Ended March 31, 2021

Note 6. Related Party Transaction

A Palomino Lakes community member provides certain operational services (e.g., meter reading). Fees paid for the year ended March 31, 2021 totaled approximately \$3,300.

Note 7. Special Assessment

Special assessment in the year ended March 31, 2021 was collected to pay for a backup power generator project.

Note 8. Subsequent Event

The State Water Board recently notified the Water Company of the severe drought conditions, of pending reductions in the availability to fully use its water right during the drought, and the requirement for weekly reporting of system usage. The Water Company is in compliance with all these directives, and has budgeted for reduced revenues as a consequence of the curtailed allowed usage.

Note 9. 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 13.

REQUIRED SUPPLEMENTARY INFORMATION

**PALOMINO LAKES MUTUAL WATER COMPANY
REQUIRED SUPPLEMENTARY INFORMATION
FUTURE MAJOR REPAIRS AND REPLACEMENTS
March 31, 2021**

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 Tank at site 1	10 yrs**	\$200,000
Redwood Tank at site 2	10 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.