

**RANCHO PAUMA MUTUAL
WATER COMPANY
AUDIT REPORT
For the Fiscal Year Ended
October 31, 2017**



RANCHO PAUMA MUTUAL WATER COMPANY

For the Fiscal Year Ended October 31, 2017

Table of Contents

	<u>Page</u>
Independent Auditors' Report	1
Basic Financial Statements:	
Statement of Financial Position	2
Statement of Activities	3
Statement of Cash Flows	4
Statement of Functional Expenses.....	5
Notes to Financial Statements	6



INDEPENDENT AUDITORS' REPORT

Board of Directors
Rancho Pauma Mutual Water Company
Pauma Valley, California

We have audited the accompanying financial statements of Rancho Pauma Mutual Water Company, (a California mutual benefit corporation) which comprise the statement of financial position as of October 31, 2017, and the related statements of activities, cash flows, and functional expenses for the year 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit 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 Rancho Pauma Mutual Water Company as of October 31, 2017, and the changes in its shareholders' equity and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Murrieta, California
January 29, 2018

RANCHO PAUMA MUTUAL WATER COMPANY

Statement of Financial Position

October 31, 2017

ASSETS

Cash and cash equivalents	\$	441,185
Investments		250,000
Accounts receivable, net of allowance		252,438
Prepaid expenses		14,779
Capital assets:		
Non-depreciable assets		297,179
Depreciable assets		4,868,387
Less accumulated depreciation		<u>(3,154,512)</u>
Total Assets	\$	<u>2,969,456</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Liabilities

Accounts payable	\$	84,545
Unearned revenue		<u>2,313</u>
Total Liabilities		<u>86,858</u>

Shareholders' Equity

Capital stock, \$1 par value, 2,000 shares authorized		
1,104 shares issued and outstanding		1,104
Paid in capital		620,505
Unrestricted net assets		
Designated for reservoir repairs		275,000
Undesignated		<u>1,985,989</u>
Total unrestricted net assets		<u>2,260,989</u>
Total Shareholders' Equity		<u>2,882,598</u>
Total Liabilities and Shareholders' Equity	\$	<u>2,969,456</u>

RANCHO PAUMA MUTUAL WATER COMPANY

Statement of Activities

For the Fiscal Year Ended October 31, 2017

REVENUES, GAINS, AND OTHER SUPPORT

Revenues

Water sales	\$ 1,429,559
Electrical energy charges	230,375
Meter service charges	395,594
Vacant lot charges	7,920

Other Revenues and Gains

Administrative fees	4,071
Stock transfer charges	1,145
Investment income (loss)	<u>(3,190)</u>

Total Revenues, Gains, and Other Support	<u>2,065,474</u>
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EXPENSES

Program services	
Water services	1,409,891
Supporting services	
Management and general	<u>268,607</u>

Total Expenses	<u>1,678,498</u>
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Change in Net Assets, Before Provision for Income Taxes	386,976
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Estimate paid for income taxes (Note 1. L.)	<u>(24,410)</u>
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Change in Shareholders' Equity	362,566
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Shareholders' Equity, November 1, 2016	<u>2,520,032</u>
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Shareholders' Equity, October 31, 2017	<u>\$ 2,882,598</u>
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RANCHO PAUMA MUTUAL WATER COMPANY

Statement of Cash Flows

For the Fiscal Year Ended October 31, 2017

CASH FLOWS FROM OPERATING ACTIVITIES

Change in shareholders' equity	\$	362,566
Adjustments to reconcile increase (decrease) in shareholders' equity to net cash provided (used) by operating activities		
Depreciation expense		202,269
(Increase) decrease in operating assets:		
Accounts receivable		(62,597)
Prepaid expenses		(947)
Increase (decrease) in operating liabilities:		
Accounts payable		(40,306)
Accrued taxes payable		(23,309)
Unearned revenues		(13)
Net cash provided (used) by operating activities		<u>437,663</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Purchase of equipment		(450,887)
Purchase of certificates of deposit		<u>(250,000)</u>
Net cash provided (used) by investing activities		<u>(700,887)</u>
Net increase (decrease) in cash		(263,224)
Beginning cash and cash equivalents, November 1, 2016		<u>704,409</u>
Ending cash and cash equivalents, October 31, 2017	\$	<u><u>441,185</u></u>

RANCHO PAUMA MUTUAL WATER COMPANY*Statement of Functional Expenses**For the Fiscal Year Ended October 31, 2017*

	Program Services	Supporting Services	Total
	<u>Water Services</u>	<u>Management and General</u>	<u>Expenses</u>
Water purchases	\$ 845,671	\$ -	\$ 845,671
Management fees	160,898	147,635	308,533
Depreciation	202,269	-	202,269
Repairs and maintenance	94,714	6,561	101,275
Outside services	85,299	6,074	91,373
Professional services	-	74,620	74,620
Insurance	-	13,320	13,320
Truck expense	12,520	-	12,520
Office expense	-	7,777	7,777
Licenses and permits	7,132	-	7,132
Taxes	-	3,117	3,117
Telephone	-	3,095	3,095
Postage	-	2,819	2,819
Conferences	1,388	-	1,388
Uniforms	-	1,339	1,339
Rent	-	1,200	1,200
Dues & subscriptions	-	1,050	1,050
Totals	<u>\$ 1,409,891</u>	<u>\$ 268,607</u>	<u>\$ 1,678,498</u>

RANCHO PAUMA MUTUAL WATER COMPANY

Notes to Financial Statements

October 31, 2017

NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES

A. Nature of Activities

Rancho Pauma Mutual Water Company (the “Company”) is a shareholder owned mutual water company formed in 1956 by the residents of Pauma Valley, pursuant to the laws of the State of California. The Company provides water utility services with local water taken from wells in the Pauma Valley to its shareholders which covers approximately 1,325 acres. The Company is governed by a Board of Directors consisting of five directors elected by the Company's shareholders. Operating revenue is comprised mostly of water sales.

B. Basis of Accounting

The Company's policy is to prepare its financial statements on the accrual basis of accounting and accordingly reflect all significant receivables, payables, and other liabilities under this method. This means that revenues are recorded when earned, rather than when received, and expenses are recorded when incurred, not when they are paid. This conforms to generally accepted accounting principles as prescribed by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), and the American Institute of Certified Public Accountants (AICPA).

C. Basis of Presentation

The Company reports information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

Unrestricted: These net assets represent expendable funds for operations that are not otherwise limited by donor restrictions. These generally result from revenues generated by receiving contributions, providing services, and receiving interest from investments. These net assets also include expendable funds that are designated by the board, but do not meet the criteria to be classified as temporarily restricted.

Temporarily Restricted: The Company reports gifts of cash and other assets as temporarily restricted when they are received with donor stipulations that limit the use of the donated asset. The specific donor imposed restrictions are often contingent upon specific performance of a future event or a specific passage of time before the Company may spend the funds.

Permanently Restricted: These net assets are subject to irrevocable donor restrictions requiring that the assets be maintained in perpetuity usually for the purpose of generating investment income to fund current operations.

At October 31, 2017, the Company had only unrestricted net assets.

D. Cash and Cash Equivalents

The Company considers cash on hand, deposits, certificates of deposits with maturity of 90 days or less, and investments in actively traded mutual funds to be cash and cash equivalents. Investments in short term corporate and government bond mutual funds are carried at fair value and classified as cash equivalents. Realized gains or losses are calculated using the specific-identification method. Unrealized gains and losses represent the change in the fair market value of the individual investments for the year or since the acquisition date if acquired during the year and are recorded as a component of unrestricted net assets.

RANCHO PAUMA MUTUAL WATER COMPANY

Notes to Financial Statements

October 31, 2017

NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES (continued)

E. Investments

The Company considers certificates of deposits and other holdings with maturity greater than 90 days to be classified as investments. It is the policy of the Company that funds in surplus of immediate requirements shall be invested with the objectives, in priority order: a) insuring preservation of principal; b) maintaining adequate liquidity of investments to meet operating requirements; and c) maximizing returns subject to this investment policy.

F. Allowance for Doubtful Accounts

The Company's accounts receivable consist of balances due from its customers. The Company has the right of lien and foreclosure on customers' properties, and accordingly, the risk of non collection is low. However, when these remedies appear inadequate, the Company provides for estimated losses based upon prior experience and management's assessment of the collectability of existing specific accounts. Accounts receivable is presented net of allowance for doubtful accounts of \$4,000 for the year ended October 31, 2017.

G. Prepaid Expenses

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses.

H. Capital Assets

Any expenditures made that improve or extend the life of property and equipment, regardless of dollar value, are capitalized and recorded as additions to capital assets. Maintenance and repair costs are charged to expense as incurred. Donated property is recorded at the estimated fair value at the date of the donation. Depreciation is computed using the straight-line method over the estimated useful life of the related assets are as follows:

<u>Asset Class</u>	<u>Class Life</u>
Machinery & equipment	5 to 20 years
Reservoirs	10 to 50 years
Pipelines	15 to 40 years
Wells and related equipment	10 to 15 years
Buildings	7 to 39 years

I. Fair Value Measurements

In accordance with fair value measurements, the Company categorizes its assets and liabilities measured at fair value into a three-level hierarchy based on the priority of the inputs to the valuation technique used to determine fair value. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used in the determination of the fair value measurement fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement.

RANCHO PAUMA MUTUAL WATER COMPANY

Notes to Financial Statements

October 31, 2017

NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES (continued)

I. Fair Value Measurements (continued)

Financial assets and liabilities recorded on the balance sheet are categorized based on the inputs to the valuation techniques as follows:

Level 1 – Inputs that reflect unadjusted quoted prices in active markets for identical investments, such as stocks, corporate and government bonds. The Company has the ability to access the holding and quoted prices as of the measurement date.

Level 2 – Inputs, other than quoted prices, that are observable for the asset or liability either directly or indirectly, including inputs from markets that are not considered to be active.

Level 3 – Inputs that are unobservable. Unobservable inputs reflect the Company's own assumptions about the factors market participants would use in pricing an investment, and is based on the best information available in the circumstances.

J. Concentration of Risk

Cash and cash equivalents at times may exceed insured limits. Cash and cash equivalents in excess of FDIC and similar insurance coverage amounts are subject to the usual banking risks of funds in excess of those limits. Investments are subject to the usual market risks. As of October 31, 2017, no cash was exposed to custodial banking risk.

K. Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses during the reporting period. Significant estimates include the lives used for depreciation of property and equipment and allocation of costs between the various programs and expense categories. Actual results could differ from those estimates.

L. Income Taxes

The Company is a non-profit entity exempt from the payment of income taxes on activities related to its exempt purposes under Internal Revenue Code Section 501(c)12. However, the Company is not exempt from paying income taxes in California. Also, the Company is subject to taxes on unrelated business income due to unrelated dividend income. Accordingly, an estimate for income taxes has been paid in the amount of \$24,410. Management has determined that all income tax positions are more likely than not of being sustained upon potential audit or examination; therefore, no disclosures of uncertain income tax positions are required. The Company files information returns in the U.S. federal jurisdiction, and the state of California. The statute of limitations for federal and California state tax purposes is generally three and four years, respectively.

RANCHO PAUMA MUTUAL WATER COMPANY

Notes to Financial Statements

October 31, 2017

NOTE 2 - CASH AND INVESTMENTS

Cash and investments are reported at fair value and consisted of the following at October 31, 2017:

	<u>Carrying value/ Fair value</u>
Cash and cash equivalents	
Deposits	
Cash on hand and in banks	\$ 431,147
Fixed income bond mutual funds:	
Short term bond mutual fund - Vanguard*	6,047
Intermediate term bond mutual fund - Harbor Fund*	3,991
Total mutual funds	<u>10,038</u>
Total Cash and Cash Equivalents	<u>\$ 441,185</u>
Investments	
Certificates of deposit:	
First Internet Bank (12-month CD)	\$ 150,000
First Internet Bank (24-month CD)	100,000
Total Investments	<u>\$ 250,000</u>

* Considered cash equivalents as of October 31, 2017

Maturities of investments held at October 31, 2017, consisted of the following:

	<u>Fair Value</u>	<u>Maturity</u>	
		<u>Less Than One Year</u>	<u>One Year Through Five Years</u>
Investment maturities:			
First Internet Bank (12-month CD)	\$ 150,000	\$ 150,000	\$ -
First Internet Bank (24-month CD)	100,000	-	100,000
Total	<u>\$ 250,000</u>	<u>\$ 150,000</u>	<u>\$ 100,000</u>

RANCHO PAUMA MUTUAL WATER COMPANY

Notes to Financial Statements

October 31, 2017

NOTE 2 – CASH AND INVESTMENTS (continued)

The Company's elected fair value input method of cash and investments held at October 31, 2017, consisted of:

	Elected Input Technique			
	Total	Level 1	Level 2	Level 3
Mutual Funds:				
Short term bond fund - Vanguard	\$ 6,047	\$ 6,047	\$ -	\$ -
Intermediate term bond fund - Harbor Fund	3,991	3,991	-	-
Total cash equivalents carried at fair value	\$ 10,038	\$ 10,038	\$ -	\$ -
Certificates of deposit:				
First Internet Bank (12-month CD)	\$ 150,000	\$ 150,000	\$ -	\$ -
First Internet Bank (24-month CD)	100,000	100,000	-	-
Total investments carried at fair value	\$ 250,000	\$ 250,000	\$ -	\$ -

Investment income consisted of the following for the year ended October 31, 2017:

Interest, dividends and capital gain distributions	\$ 4,881
Realized gains (losses)	2,151
Unrealized gains (losses)	(10,222)
Total investment income	<u>\$ (3,190)</u>

NOTE 3 – ACCOUNTS RECEIVABLE

Accounts receivable, net of allowance for doubtful accounts, at October 31, 2017, consisted of the following:

User fees receivable	\$ 253,934
Due from other agencies	2,504
Allowance for doubtful accounts	(4,000)
Total	<u>\$ 252,438</u>

RANCHO PAUMA MUTUAL WATER COMPANY

Notes to Financial Statements

October 31, 2017

NOTE 4 – CAPITAL ASSETS

Capital assets consisted of the following as of October 31, 2017:

	Balance, November 1, 2016	Additions	Retirements	Balance, October 31, 2017
Capital assets not being depreciated:				
Land	\$ 5,175	\$ -	\$ -	\$ 5,175
Construction in Progress	-	266,787	-	266,787
Easements and rights	20,453	4,764	-	25,217
Total capital assets not being depreciated	<u>25,628</u>	<u>271,551</u>	<u>-</u>	<u>297,179</u>
Capital assets being depreciated:				
Machinery & equipment	433,116	4,514	32,667	404,963
Reservoirs	228,245	-	-	228,245
Pipelines	413,242	-	-	413,242
Wells and related equipment	3,497,006	174,822	-	3,671,828
Buildings	150,109	-	-	150,109
Total capital assets being depreciated	<u>4,721,718</u>	<u>179,336</u>	<u>32,667</u>	<u>4,868,387</u>
Accumulated depreciation for:				
Machinery & equipment	(293,521)	(44,387)	(32,667)	(305,241)
Reservoirs	(192,409)	(8,941)	-	(201,350)
Pipelines	(226,508)	(6,173)	-	(232,681)
Wells and related equipment	(2,177,048)	(137,202)	-	(2,314,250)
Buildings	(95,424)	(5,566)	-	(100,990)
Total accumulated depreciation	<u>(2,984,910)</u>	<u>(202,269)</u>	<u>(32,667)</u>	<u>(3,154,512)</u>
Total capital assets being depreciated, net	<u>1,736,808</u>	<u>(22,933)</u>	<u>-</u>	<u>1,713,875</u>
Capital assets, net	<u>\$ 1,762,436</u>	<u>\$ 248,618</u>	<u>\$ -</u>	<u>\$ 2,011,054</u>

Depreciation expense for the year ended October 31, 2017, was \$202,269. This amount is fully allocated to program expense function as it relates entirely to program assets.

NOTE 5 – CONCENTRATION OF REVENUES

During the year ended October 31, 2017, the Company received approximately 11.9% of its total revenues from the Pauma Valley Country Club, and approximately 42.6% of its total revenues is generated from agricultural users.

NOTE 6 – MANAGEMENT SERVICES

The Company shares office space and employees with the Pauma Valley Community Services District, a municipal entity. By agreement between the two entities, all employees are on payroll of the District, and the Company reimburses the District for its share of all services. The Company has no employee related or post-retirement benefits. The Company paid management fees to Pauma Valley Community Services District in the amount of \$308,533 for the year ended October 31, 2017.

RANCHO PAUMA MUTUAL WATER COMPANY

Notes to Financial Statements

October 31, 2017

NOTE 7 - DESIGNATED NET ASSETS

The Board of Directors has voted to set aside funds for the future repair and maintenance costs of the Company's water reservoir. These funds are considered unrestricted and designated, and are presented on the Statement of Financial Position. For the year ended October 31, 2017, total designated funds were \$275,000.

NOTE 8 - SUBSEQUENT EVENTS

Events subsequent to October 31, 2017 have been evaluated through January 29, 2018, the date at which the Company's audited financial statements were available to be issued.