



AUDITED FINANCIAL STATEMENTS

For the Years Ended December 31, 2012 and 2011

EGAN & EGAN
Certified Public Accountants

LINCOLN AVENUE WATER COMPANY

DECEMBER 31, 2012 AND 2011

INDEPENDENT AUDITORS' REPORT

AND

FINANCIAL STATEMENTS

LINCOLN AVENUE WATER COMPANY

CONTENTS

	<u>PAGE</u>
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENTS	
Balance sheets	2
Statements of income	3
Statements of stockholders' equity	4
Statements of cash flows	5
Notes to financial statements	6
SUPPLEMENTARY SCHEDULE	
Schedules I - Distribution, General and Administrative expenses	10

EGAN & EGAN
CERTIFIED PUBLIC ACCOUNTANTS
20910 MARTINEZ ST.
WOODLAND HILLS, CALIFORNIA 91364
(877) EGAN 4 US EGANCPA.COM

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Lincoln Avenue Water Company

We have audited the balance sheets of Lincoln Avenue Water Company as of December 31, 2012 and 2011, and the related statements of income, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, the financial statements referred to above present fairly, in all material respects, the financial position of Lincoln Avenue Water Company as of December 31, 2012 and 2011 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information presented on page 10 for the years ended December 31, 2012 and 2011 are presented for purposes of additional analysis and is not required as part of the basic financial statements. Such supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Egan & Egan

April 15, 2013

MEMBER OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

LINCOLN AVENUE WATER COMPANY

BALANCE SHEETS

DECEMBER 30, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current Assets		
Cash	\$ 1,598,990	1,610,889
Accounts receivable	423,906	419,109
Other receivables	203,909	172,137
Material and supplies	148,745	77,631
Prepaid expenses	52,705	41,096
Total current assets	<u>2,428,255</u>	<u>2,320,862</u>
Utility plant and equipment, net	10,279,015	10,094,643
Water rights, net	8	8
Other assets	<u>4,650</u>	<u>5,892</u>
	<u>\$ 12,711,928</u>	<u>12,421,405</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities		
Accounts payable	\$ 172,106	299,518
Accrued liabilities	153,187	178,309
Customer deposits	222,980	212,090
Other deposits	7,780	25,011
Total current liabilities	<u>556,053</u>	<u>714,928</u>
Stockholders' equity		
Common stock, appurtenant, 20,000 shares authorized	200,613	199,683
Common stock, nonappurtenant, 20,000 shares authorized	28,860	29,790
Retained earnings	11,926,402	11,477,004
Total stockholders' equity	<u>12,155,875</u>	<u>11,706,477</u>
	<u>\$ 12,711,928</u>	<u>12,421,405</u>

The accompanying notes are an integral part of these financial statements.

LINCOLN AVENUE WATER COMPANY

STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
OPERATING REVENUES		
Water sales	\$ 2,938,605	2,627,406
Water service charge	1,555,542	1,491,594
Water quality cost reimbursement	803,155	665,771
Late fees and other charges	93,430	94,116
Total operating revenues	<u>5,390,732</u>	<u>4,878,887</u>
OPERATING EXPENSES		
Distribution	3,216,424	2,667,306
General	707,883	689,039
Administrative	605,669	583,896
Depreciation	460,937	464,073
Total operating expenses	<u>4,990,913</u>	<u>4,404,314</u>
Income from operations	<u>399,819</u>	<u>474,573</u>
OTHER REVENUES (EXPENSES)		
Stock transfer and lost certificate fees	19,950	19,755
Rental income	1,200	1,200
Interest income	736	1,808
Miscellaneous income	27,693	52,289
Interest expense	-	(1,338)
Total other revenues (expenses)	<u>49,579</u>	<u>73,714</u>
Net income	<u>\$ 449,398</u>	<u>548,287</u>

The accompanying notes are an integral part of these financial statements.

LINCOLN AVENUE WATER COMPANY
STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>Common Stock</u> <u>Appurtenant</u>		<u>Common Stock</u> <u>Non-Appurtenant</u>		<u>Retained</u> <u>Earnings</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	
At January 1, 2010	3,005	198,653	3,082	30,820	\$ 10,928,717
Share split					
Transfer of shares	103	1,030	(103)	(1,030)	
Net income					<u>548,287</u>
Balance, December 31, 2011	<u>3,108</u>	<u>199,683</u>	<u>2,979</u>	<u>29,790</u>	<u>11,477,004</u>
Share split					
Transfer of shares	93	930	(93)	(930)	
Net income					<u>449,398</u>
Balance, December 31, 2012	<u><u>3,201</u></u>	<u><u>200,613</u></u>	<u><u>2,886</u></u>	<u><u>28,860</u></u>	<u><u>\$ 11,926,402</u></u>

The accompanying notes are an integral part of these financial statements.

LINCOLN AVENUE WATER COMPANY

STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ <u>449,398</u>	<u>548,287</u>
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	460,937	464,073
Changes in assets and liabilities:		
Receivables	(36,569)	(17,880)
Materials and supplies	(71,114)	58,590
Prepaid expenses	(11,609)	9,004
Accounts payable	(127,412)	19,747
Accrued liabilities	(25,122)	31,318
Deposits	(6,339)	15,990
Deferred income	-	-
Total adjustments	<u>182,772</u>	<u>580,842</u>
Net cash provided by operating activities	<u>632,170</u>	<u>1,129,129</u>
NET CASH USED BY INVESTING ACTIVITIES		
Purchases of utility plant	<u>(645,311)</u>	<u>(546,689)</u>
CASH USED BY FINANCING ACTIVITIES		
Increase in other assets	<u>1,242</u>	<u>3,097</u>
Net cash provided by financing activities	<u>1,242</u>	<u>3,097</u>
Net (decrease) increase in cash	(11,899)	585,537
CASH, Beginning of year	<u>1,610,889</u>	<u>1,025,352</u>
CASH, End of year	\$ <u><u>1,598,990</u></u>	<u><u>1,610,889</u></u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
CASH PAID DURING THE YEAR FOR:		
Interest	\$ <u><u>-</u></u>	<u><u>-</u></u>
Income taxes	\$ <u><u>800</u></u>	<u><u>800</u></u>

The accompanying notes are an integral part of these financial statements.

LINCOLN AVENUE WATER COMPANY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Nature of Operations - The Lincoln Avenue Water Company (“the Company”) is a non-profit mutual water company pursuant to Section 501(c)(12) of the Internal Revenue Code. The Company was incorporated in 1896 to provide water to residents of certain parts of Altadena, and an unincorporated area of the County of Los Angeles, California. As a mutual-owned water utility, its shareholders are the recipients of water from its distribution system.

(b) Cash - The Company considers cash and short-term investments of three months or less to be cash. The Company has combined balances in checking, savings and certificate of deposit accounts maintained in financial institutions that may be above FDIC insured limits per institution. The Board of Directors and Management does not believe that the amounts on deposit are at risk.

(c) Accounts Receivable - Management has determined that no allowance for bad debts is required at December 31, 2012 and 2011.

(d) Materials and Supplies - Materials and supplies are used for the maintenance of pipes and pumping equipment, and are stated at the lower of cost or market, using the first-in, first-out method. Materials and supplies include pipes, supplies and meters.

(e) Depreciation - Depreciation is calculated over estimated useful lives using the straight-line method as follows:

Furniture and fixtures	5	-	10
Vehicles and equipment	3	-	10
Wells, tunnels and reservoirs	10	-	70
Water distribution systems	20	-	50
Buildings and improvements	10	-	15

The cost of additions and betterments, which benefit future periods, are capitalized. The cost of repairs and maintenance are expensed as incurred.

The Company reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by Management in performing this assessment include current operating results, trends and prospects, the manner in which the property is used, and the effects of obsolescence, demand, competition, and other economic factors.

(f) Income Taxes - The Lincoln Avenue Water Company is organized as a capital stock mutual water company and is exempt from Federal income tax pursuant to Section 501 (c)(12) of the Internal Revenue Code.

LINCOLN AVENUE WATER COMPANY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

(g) Estimates - The preparation of financial statements in conformity with 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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(h) Revenues- Water sales are billed on a monthly cyclical basis. Estimated unbilled water revenue through December 31, 2012 and 2011 has been accrued at year-end.

(i) Reclassifications - The prior year's presentation contains reclassifications to conform to the current year's presentation.

(j) Water rights - Water rights of \$138,401 before amortization represent surface and groundwater rights.

(k) Fair value of financial instruments - The fair value of the Company's operating assets and liabilities approximate their carrying value.

(l) Concentration of credit risk - The accounts receivable are due from individuals and business located in a specific geographic area. The collection of these receivables may be impacted by economic conditions in this area.

(m) Contingencies - Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

(n) Subsequent events - The Company has evaluated subsequent events through the date at which the financial statements were available to be issued. No material subsequent events required disclosure

LINCOLN AVENUE WATER COMPANY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE 2 - UTILITY PLANT

Utility plant consists of:

	<u>2012</u>	<u>2011</u>
Land	\$ 16,897	16,897
Buildings and improvements	854,914	783,497
Reservoirs, roads and sumps	5,409,379	5,403,511
Pipelines	7,874,059	7,424,349
Treatment plants	896,617	896,617
Wells	570,502	570,502
Pumping, booster and chlorinator plants	513,254	463,995
Machinery and tools	404,955	404,955
Automobiles and trucks	374,289	369,289
Furniture, fixtures and equipment	341,326	328,476
In progress	<u>258,328</u>	<u>207,673</u>
Total property, plant and equipment	17,514,520	16,869,761
Less: accumulated depreciation	<u>(7,235,505)</u>	<u>(6,775,118)</u>
Net property, plant and equipment	<u>\$ 10,279,015</u>	<u>10,094,643</u>

The Company's surface water treatment plant transmission system sustained major damage from the Station fire in 2009. The damage was exacerbated by subsequent heavy rains and water and mud flows. Management estimated that 90% of the total surface water treatment plant transmission system was damaged or destroyed. The system is not operational and will not be operable until the repairs are made. During the year ended December 31, 2009, the Company recorded a valuation reserve related to the net book value of the treatment plant in the accompanying statement of income, other revenues (expenses). The Company has experienced regulatory delays relating to the approval of the plant reconstruction. The Company anticipates the approvals will be obtained in the near future and the plant will be restored to operations. In the event the Company can not restore the surface water transmission system to operational status, additional imported water will need to be purchased at rates which are higher than the Company's cost to treat and pump its own water.

NOTE 3 - SOURCE OF SUPPLY

The Company purchases a portion of its water from an imported water supplier. This supplier can unilaterally increase the price of its water while curtailing the amount of water delivered. A significant decrease in this delivery would adversely affect the Company's operation. The Company entered into an agreement with a local municipality to lease water rights in order to secure its access to water. The agreement will require the Company to pay eight quarterly payments of \$275,000 through December 31, 2013.

The Company obtains the balance of its water from local deep wells. This water must meet Federal and State drinking water standards. This water does not meet these standards at this time and must be treated to remove contaminants. Under an agreement with Cal Tech/NASA the company is reimbursed for the cost of treating this ground water. In the event this agreement did not exist the Company would be required to purchase additional imported water.

LINCOLN AVENUE WATER COMPANY

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2012 AND 2011

NOTE 4 - PROVISION FOR INCOME TAXES

The Company is subject to California tax on its unrelated business income. The provision for income taxes was \$800 for each of the years ended December 31, 2012 and 2011, respectively.

NOTE 5 - RETIREMENT PLAN

The Company maintains a profit sharing plan covering eligible employees. Employees are vested at 20% each year. Annual contributions to the plan are at the discretion of the Board of Directors and are limited to a percentage of eligible employee compensation under relevant Internal Revenue Code sections. For the years ended December 31, 2012 and 2011, the Company contributed \$42,000 and \$40,000 each year to the plan, respectively.

The Company sponsors a 401(k) for eligible employees providing pre-tax salary deferrals. The Company does not match the employee's contribution.

NOTE 6 - CONTINGENCIES AND COMMITMENTS

The Company is the subject of certain claims and assessments arising from the normal course of its operations. Management of the Company does not expect that the outcome of these matters will materially affect the financial position of the Company.

The Company has certain operating leases for equipment requiring future lease payments as follows:

<u>Year Ending</u> <u>December 31,</u>		
2013	\$	3,463
2014		3,463
2015		<u>2,309</u>
	\$	<u><u>9,235</u></u>

SUPPLEMENTARY SCHEDULE

LINCOLN AVENUE WATER COMPANY

DISTRIBUTION, GENERAL AND ADMINISTRATIVE EXPENSES

FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
DISTRIBUTION SYSTEM EXPENSES		
Auto and truck expense	\$ 61,988	42,239
Imported water purchases	546,662	1,192,760
Special water lease	1,100,000	91,667
Miscellaneous	6,995	3,067
Outside labor	84,675	53,947
Repairs	2,280	30,127
Salaries	459,540	412,325
Supplies	91,298	74,038
Utilities	302,358	269,612
Water quality compliance	560,628	497,524
Total distribution system expenses	<u>3,216,424</u>	<u>2,667,306</u>
GENERAL EXPENSES		
Business taxes and licenses	31,077	23,222
Directors' fees and expenses	42,926	40,059
Insurance	322,651	304,388
Legal and professional	22,768	31,456
Membership dues	11,170	14,658
Miscellaneous	(677)	(105)
Payroll taxes	73,942	69,390
Retirement plan	42,000	40,000
Property taxes	162,026	165,971
Total general expenses	<u>707,883</u>	<u>689,039</u>
ADMINISTRATIVE EXPENSES		
Computer billing, hardware and software	20,030	16,016
Miscellaneous	45,445	47,795
Office outside services	33,615	20,335
Postage	27,187	29,329
Repairs and maintenance	4,780	7,071
Salaries	450,975	438,577
Supplies	5,803	8,481
Utilities	17,834	16,292
Total administrative expenses	<u>605,669</u>	<u>583,896</u>
Total	<u>\$ 4,529,976</u>	<u>3,940,241</u>