



**Financial Audit of Erskine Creek Water Company  
Financial Statements  
For the Year Ended December 31, 2017**

**Utility Audit, Finance and Compliance Branch**  
May 24, 2019



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**Thanks to:**

**Angie Williams, Raymond Yin, Sharmin Wellington, and Aaron Louie**

**Audit of Financial Statements of  
Erskine Creek Water Company  
For the Year Ended December 31, 2017**

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**PUBLIC UTILITIES COMMISSION**

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



## **Report of Independent Auditors**

Nicholas Silicz, President  
Erskine Creek Water Company  
PO Box 656  
Lake Isabella, California 93240

### **Report on the Financial Statements**

The Utility Audit, Finance, and Compliance Branch (UAFCB) of the California Public Utilities Commission (Commission) has audited the accompanying financial statements of Erskine Creek Water Company (ECWC), which are comprised of the balance sheet as of December 31, 2017, and the related statement of income, retained earnings and cash flows for the year then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

ECWC's management is responsible for the preparation and fair presentation of the financial statements presented in the 2017 annual reports filed with the Commission. The Commission requires that the statements be in accordance with the accounting requirements of the Commission as set forth in the Uniform System of Accounts (USOA) for Water Utilities, as described in Note 1 in the Notes to the Financial Statements attached herein. Management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

### **Auditor's Responsibility**

The responsibility of the UAFCB is to express an opinion on ECWC's financial statements based on our audit. The audit was conducted 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 from 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 auditor's 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 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.

### **Basis for Qualified Opinion**

Due to the lack of supporting documentation and historical information on Retained Earnings and Accounts Receivable – Customers, UAFCB could not attest to these balances as of December 31, 2017. Therefore, UAFCB does not express an opinion on the balances of Retained Earnings and Accounts Receivable – Customers as of December 31, 2017.

### **Qualified Opinion**

In our opinion, except for the balances of Retained Earnings and Accounts Receivable – Customers as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Erskine Creek Water Company as of December 31, 2017, and the results of its operations and its cash flows for the year then ended, in accordance with the accounting requirements of the Commission as set forth in the USOA for Water Utilities, described in Note 1.

### **Basis of Accounting**

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements of ECWC were originally prepared on the basis of the accounting requirements of the California Public Utilities Commission as set forth in the USOA for Water Utilities, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### **Use of Report**

The report is intended solely for the information and use by the Commission and Erskine Creek Water Company. It should not be used by anyone other than the specified parties.

*Raymond Yin*

Raymond Yin, CPA  
Program and Project Supervisor  
Utility Audit, Finance, and Compliance Branch

## Balance Sheets

		<b>As of December 31, for the Year</b>	
		<b>2017</b>	<b>2016<sup>1</sup></b>
<b>ASSETS</b>			
<b>UTILITY PLANT</b>			
Water Plant in Service (Note 1)	\$1,357,761	\$1,302,924	
Construction Work in Progress	22,309	16,769	
Accumulated Depreciation of Water Plant (Note 1)	(607,182)	(580,965)	
<b>Net Utility Plant</b>	\$772,888	\$738,728	
 <b>CURRENT AND ACCRUED ASSETS</b>			
Cash	168,762	187,187	
Accounts Receivable – Customers (Note 1)	70,891	68,248	
Materials and Supplies	4,170	4,170	
Other Current Assets	7,425	3,928	
<b>Total Current and Accrued Assets</b>	251,248	263,533	
<b>Total Assets</b>	\$1,024,136	\$1,002,261	
 <b>CAPITALIZATION AND LIABILITIES</b>			
<b>CORPORATE CAPITAL AND SURPLUS</b>			
Common Stock	\$26,700	\$26,700	
Other Paid-in Capital	164,427	164,427	
Retained Earnings (Note 1)	489,710	486,187	
<b>Total Capitalization</b>	680,837	677,314	
 <b>LONG TERM DEBT</b>			
Long-term Debt (Note 1)	208,083	0	
 <b>CURRENT AND ACCRUED LIABILITIES</b>			
Accounts Payable	43,995	35,241	
Short-term Notes Payable	2,084	202,703	
Customer Deposits	21,926	19,557	
Accrued Taxes	0	0	
Other Current Liabilities	3,236	9,644	
<b>Net current and accrued liabilities</b>	71,241	267,145	
 <b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>			
Contributions in Aid of Construction (Note 1)	107,914	99,394	
Accumulated Amortization of Contributions (Note 1)	(43,939)	(41,592)	
<b>Net Contributions in Aid of Construction</b>	63,975	57,802	
<b>Total Capitalization and Liabilities</b>	\$1,024,136	\$1,002,261	

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*

<sup>1</sup> The amounts for the year ended December 31, 2016, were reported by ECWC. These amounts have not been audited by UAFCB.

## Income Statement

	<b>For the Year of</b>	
	<b>2017</b>	<b>2016<sup>2</sup></b>
<b>OPERATING REVENUES</b>		
Fire Protection Revenue	\$1,929	\$479
Metered Revenue	655,233	654,417
Other Water Revenue	7,490	0
<b>Total Operating Revenues</b> (Note 1)	664,652	654,896
<b>OPERATING EXPENSES</b>		
<b>Plant Operation and Maintenance Expenses</b>		
Power	54,192	50,720
Other Volume Related Expense	7,089	196
Employee Labor	94,074	90,356
Materials	37,145	32,960
Contract Work	2,734	12,234
Transportation Expenses	26,182	26,093
Other Plant Maintenance Expenses	5,368	2,302
<b>Total Plant Operation and Maintenance Expense</b>	226,784	214,861
<b>Administrative and General Expenses</b>		
Office Salaries	84,846	74,822
Management Salaries	65,958	68,100
Employee Pensions and Benefits	48,779	73,875
Uncollectible Accounts Expense	5,356	3,521
Office Services and Rentals (Note 2)	32,960	31,556
Office Supplies and Expenses	30,635	36,273
Professional Services	3,650	14,450
Insurance (Note 2)	16,875	26,477
Regulatory Commission Expense	20,909	920
General Expenses	15,679	17,512
<b>Total Administrative and General Expenses</b>	325,647	347,506
<b>Total Operating Expenses</b>	552,431	562,367
Depreciation Expense (Note 1)	29,670	26,477
Taxes Other Than Income Taxes	35,693	38,139
State Corporate Income Tax Expense	800	800
Federal Corporate Income Tax	0	1,000
<b>Total Operating Revenue Deductions</b>	618,594	628,783
<b>Total Utility Operating Income</b>	46,058	26,113
Non-utility Income	9	7,848
Miscellaneous Non-utility Expense	(3,881)	(1,000)
Interest Expense	(16,726)	(17,155)
<b>Total Other Income and Deductions</b>	(20,598)	(10,307)
<b>Net Income</b>	\$25,460	\$15,806

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*

<sup>2</sup> The amounts for the year ended December 31, 2016, were reported by ECWC. These amounts have not been audited by UAFCB.

## Statements of Retained Earnings

	<b>For the Year of</b>	
	<b>2017<sup>3</sup></b>	<b>2016<sup>4</sup></b>
<b>Retained Earnings, Beginning of Year</b>	\$486,187	\$470,381
<b>CREDITS:</b>		
Net Income	25,460	15,806
<b>Total Credits</b>	25,460	15,806
<b>DEBITS:</b>		
UAFCB Adjustment to Short-term Notes Payables	(10,744)	0
UAFCB Adjustment to Office Supplies and Expenses	(2,801)	0
UAFCB Adjustment to Non-utility Income	(5,234)	0
UAFCB Adjustment to General Expense	(3,158)	0
<b>Total Debits</b>	(21,937)	0
<b>Retained Earnings, End of Year</b>	\$489,710	\$486,187

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*

<sup>3</sup> The Retained Earnings balances were not audited but were the results of UAFCB compiled audit adjustments and Net Income (Loss) for 2017. UAFCB could not attest to the accuracy of the Retained Earnings balances due to lack of historical information on the account.

<sup>4</sup> The amounts for the year ended December 31, 2016, were reported by ECWC. These amounts have not been audited by UAFCB.



## Statements of Cash Flows

	<b>For the Year of</b>	
	<b>2017</b>	<b>2016<sup>5</sup></b>
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>		
Net Income (Loss)	\$25,460	\$15,806
<b>Adjustments to Reconcile Net Income to Cash</b>		
<b>Provided by Operating Activities</b>		
Depreciation and Amortization <sup>6</sup>	26,217	26,167
Decrease (Increase) in Accounts Receivable - Customers	(2,643)	(10,142)
Decrease (Increase) in Other Current Assets	(3,497)	(174)
Increase (Decrease) in Accounts Payable	8,754	15,819
Increase (Decrease) in Customer Deposits	2,369	(443)
Increase (Decrease) in Accrued Taxes	0	(5,593)
Increase (Decrease) in Short-term Notes Payables	(200,619)	(2,944)
Increase (Decrease) in Other Current Liabilities	(6,408)	2,880
<b>Net Cash Provided by Operating Activities</b>	<b>(150,367)</b>	<b>41,376</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Net Plant Deletions (Additions) – Water Plant in Service	(54,837)	(12,314)
Net Plant Deletions (Additions) – Construction Work in Progress	(5,540)	(16,769)
Increase (Decrease) in Contributions in Aid of Construction	8,520	39,275
Decrease (Increase) in Accumulated Amortization of Contributions	(2,347)	(41,592)
UAFCB Cumulative Adjustments to Retained Earnings <sup>7</sup>	(21,937)	0
<b>Net Cash Used for Investing Activities</b>	<b>(76,141)</b>	<b>(31,400)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Increase (Decrease) in Long-term Debt	208,083	0
<b>Net Cash Used for Financing Activities</b>	<b>208,083</b>	<b>0</b>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(18,425)</b>	<b>9,976</b>
<b>CASH AT BEGINNING OF YEAR</b>	<b>187,187</b>	<b>177,211</b>
<b>CASH AT END OF YEAR</b>	<b>\$168,762</b>	<b>\$187,187</b>

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*

<sup>5</sup> The amounts for the year ended December 31, 2016, were reported by ECWC. These amounts have not been audited by UAFCB.

<sup>6</sup> For the purpose of Statements of Cash Flows, UAFCB included (\$26,217) of Depreciation of Water Plants from the depreciation expense for the Year 2017.

<sup>7</sup> For the Year 2017, the total UAFCB credit adjustment of (\$21,937) to Retained Earnings represented the cumulative effect of UAFCB's adjustments to the Retained Earnings for the Year 2017.

## Notes to Financial Statements

### (1) Summary of Significant Accounting Policies

Erskine Creek Water Company (ECWC) was incorporated on March 3, 1952. ECWC is a Class C water utility with about 1,136 active service connections located in Lake Isabella, California. ECWC provides fire protection and metered water services in this location.

The financial statements of ECWC were prepared on the basis of accounting set forth in the Uniform System of Accounts (USOA) for Water Utilities adopted and prescribed by the Commission, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under that basis of accounting, certain transactions, such as adjustments of certain estimated operating expenses related to prior years and gains on the sale of property rights, would have been recorded directly in the statements of retained earnings. Accounting principles generally accepted in the United States of America would require such transactions to be recorded in the statement of income.

The Statements of Cash Flows are not required by the Commission when ECWC files its Annual Reports with the Commission. Therefore, the accompanying Statements of Cash Flows were compiled by UAFCB based on the audited financial information of ECWC Balance Sheets and Income Statements.

#### (a) Appendices

The accompanying Appendices are an integral part of the financial statements. Appendix A presents the net financial impact resulting from UAFCB's audit adjustments for the year ended 2017. Appendix B presents UAFCB detail audit adjustments for the year ended 2017.

#### (b) Water Plant in Service

Utility plant should be recorded at the original cost when it is initially constructed or purchased. Retired utility plants should be removed from utility plant accounts at cost and charged against accumulated depreciation.

#### (c) Depreciation of Water Plant

Depreciation was computed on a straight-line composite rate of 2.2% (equivalent to depreciating the plant assets over approximately 45 years) in order to depreciate all plant assets for ratemaking purposes and reporting the depreciation expense in ECWC's Annual Reports filed with the Commission. The Commission's Standard Practice (SP) U-04-SM, Paragraph 22, specifies that the annual composite depreciation rate should normally fall within the range of 2.0% to 3.5%.

#### (d) Accounts Receivable – Customers

UAFCB could not attest to the accuracy of the Accounts Receivable – Customers balance due to the lack of supporting documentation. Expressing an opinion on the Accounts Receivable – Customers balance as of December 31, 2017, would require

appropriate and sufficient documentation from the utility. However, the balance of this account is not material enough to warrant a disclaimer or an adverse opinion for the ECWC's financial statements as a whole. Due to this limitation, we cannot and do not express an opinion on the balance of Accounts Receivable – Customers as of December 31, 2017.

**(e) Long-term Debts**

ECWC entered into a ten-year promissory note agreement with its President on December 15, 2015, for \$205,647 due on December 15, 2026, with an interest rate of 8.25%. ECWC is required to make monthly installments of \$1,650. As of December 31, 2017, the promissory note had an ending balance of \$199,229. ECWC did not obtain the Commission's prior approval for the long-term debt as required per the Public Utilities (PU) Code, Section 818. PU Code, Section 818 states, in part, that *"no public utility may issue stocks and stock certificates, or other evidence of interest or ownership, or bonds, notes, or other evidences of indebtedness payable at periods of more than 12 months after the date thereof unless, in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue."*

ECWC entered into a three-year purchase agreement on December 15, 2017, with Jim Burke Ford for \$18,277, for a new truck. The final payment is due November 15, 2020, at an interest rate of 5.5% and the monthly payments are \$553.15. As of December 31, 2017, the loan balance was \$17,376.

**(f) Retained Earnings**

UAFCB could not attest to the accuracy of the Retained Earnings balance due to the lack of historical information. Expressing an opinion on the Retained Earnings balance as of December 31, 2017, would require auditing the Retained Earnings from the inception of the company. Due to the limitations of our audit scope, we cannot and do not express an opinion on the Retained Earnings balance as of December 31, 2017.

**(g) Contributions in Aid of Construction (CIAC) and Accumulated Depreciation of CIAC**

CIAC represents nonrefundable contributions of cash or property received from various parties for purposes of constructing additions to utility plant. Depreciation applicable to such contributed plant is charged against the CIAC account rather than to depreciation expense until the amount applicable to such properties has been completely amortized.

**(h) Revenues**

ECWC primarily obtained its water revenues from fire protection and metered services. Based on tariffs approved by the Commission, ECWC billed its customers on a bi-monthly basis.

**(2) Related and/or Affiliated Party Transactions**

ECWC's general ledger included expenses relating to transactions with affiliated parties. Specifically, ECWC had the following related-party transactions:

- (a) ECWC leased its office space from its company's president.
- (b) ECWC improperly recorded medical expenses for an employee who did not work for the utility but worked for Nicholas Construction, Inc. that was owned by ECWC's President.
- (c) ECWC periodically hired Nicholas Construction, Inc. to perform construction-related services.
- (d) ECWC entered into a promissory note agreement with its own President on December 15, 2015, for \$205,647, which is due on December 15, 2026, with an interest rate of 8.25%. ECWC is required to make monthly scheduled payments of \$1,650. As of December 31, 2017, the promissory note ending balance was \$199,229.

**(3) Annual Reports**

Per California Public Utilities Code, Sections 581, 582, and 584, ECWC is required to file an annual report with the Commission every year. For the year being audited, ECWC has complied with these requirements.

## Appendix A

### Summary of Net Financial Impact Resulting from UAFCB's Audit Adjustments for Year 2017

The following is a summary of net financial impact resulting from UAFCB's audit adjustments for Year 2017.

Audit Adj. No.	Annual Report				Description	For the Year 2017	
	Sch.	Line	Col.	Acct No.		Debit	Credit
<b><u>Net Financial Impact on Balance Sheets Items:</u></b>							
9	A	36	c	174	Other Current Assets	\$3,497	
5,6,7,9	A	6	c	215	Retained Earnings	21,937	
1,2	A	13	c	224	Long-term Debt		\$190,236
3,8	A	17	b	231	Accounts Payable	919	
1,2,7	A	18	c	232	Short-term Notes Payable	197,423	
<b><u>Net Financial Impact on Income Statements Items:</u></b>							
5	B	16	c	426	Miscellaneous Non-utility Expense	\$2,548	
4	B-2	9	b	630	Employee Labor	2,100	
4	B-2	11	b	650	Contract Work		\$4,300
4	B-2	18	b	670	Office Salaries	2,200	
5	B-2	20	b	674	Employee Pensions and Benefits		13,292
6	B-2	17	b	681	Office Supplies and Expenses		2,801
3, 7	B-2	25	b	684	Insurance		22,878
8,9	B-2	26	b	688	Regulatory Commission Expense	16,192	
9	B-2	27	b	689	General Expenses		13,309

## Appendix B

### Summary of Audit Adjustments for Year 2017

Audit Adj. No.	Annual Report				Description	For the Year 2017	
	Sch.	Line	Col.	Acct. No.		Debit	Credit
1	A	18	c	232	Short-term Notes Payable	\$196,037	
	A	13	c	224	Long-term Debt <i>To reclassify Promissory Notes from Short-term Notes Payable.</i>		\$196,037
2	A	13	c	224	Long-term Debt	\$5,801	
	A	18	c	232	Short-term Notes Payable <i>To reclassify the current portion of the Long-term Debt to Short-term Notes Payable.</i>		\$5,801
3	A	17	c	231	Accounts Payable	\$10,457	
	B-2	25	b	684	Insurance <i>To reverse a journal entry that incorrectly recorded 2018 expense into 2017 Annual Report.</i>		\$10,457
4	B-2	9	b	630	Employee Labor	\$2,100	
	B-2	18	b	670	Office Salaries	2,200	
	B-2	11	b	650	Contract Work <i>To reclassify Contract Work to agree with the audited amount.</i>		\$4,300
5	A	6	c	215	Retained Earnings	\$10,744	
	B	16	c	426	Miscellaneous Non-utility Expense	2,548	
	B-2	20	b	674	Employee Pensions and Benefits <i>To reclassify Employee Pensions and Benefits to agree with the audited amount.</i>		\$13,292
6	A	6	c	215	Retained Earnings	\$2,801	
	B-2	23	b	681	Office Supplies and Expenses <i>To adjust Office Supplies and Expenses to agree with the audited amount.</i>		\$2,801
7	A	6	c	215	Retained Earnings	\$5,234	
	A	18	c	232	Short-term Notes Payable	7,187	
	B-2	25	b	684	Insurance <i>To reclassify Insurance Expense to agree with the audited amount.</i>		\$12,421

Financial Audit of Erskine Creek Water Company Financial Statements  
For the Year Ended December 31, 2017

Audit Adj. No.	Annual Report				Description	For the Year 2017	
	Sch.	Line	Col.	Acct. No.		Debit	Credit
8	B-2	26	b	688	Regulatory Commission Expense	\$9,538	
	A	17	c	231	Accounts Payable <i>To reclassify Regulatory Commission Expense to agree with the audited amount.</i>		\$9,538
9	B-2	26	b	688	Regulatory Commission Expense	\$6,654	
	A	36	c	174	Other Current Assets	3,497	
	A	6	c	215	Retained Earnings	3,158	
	B-2	27	b	689	General Expenses <i>To reclassify General Expenses to agree with the audited amount.</i>		\$13,309