

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

August 3, 2020

Mr. Martin Mills, President
PureSource Water, Inc.
P.O. Box 1958
Aptos, CA 95001

Dear Mr. Mills:

Final Report Transmittal Letter—Review of PureSource Water, Inc.’s Annual Report for the period of January 1, 2019 through December 31, 2019

The Utility Audits Branch of the California Public Utilities Commission has completed its review of PureSource Water, Inc.’s (PSW) regulatory basis financial statements in the 2019 Annual Report filed with the CPUC, which comprise of the balance sheet as of December 31, 2019, and related statements of income and retained earnings. The final review report is enclosed.

We issued a draft review report on July 15, 2020. PSW did not provide a written response, therefore we are issuing the report as final. We will post the final review report on our website at <https://www.cpuc.ca.gov/utilityaudits/>.

We appreciate PSW’s assistance and cooperation during the engagement. If you have any questions regarding this report, please contact Raymond Yin, Program and Projects Supervisor, at (415) 703-1818.

Sincerely,

Angie Williams

Angie Williams, Director
Utility Audits, Risk and Compliance Division

cc: Ms. Jennifer Young, PureSource Water, Inc.
Ms. Alice Stebbins, Executive Director, CPUC
Mr. Lucian Filler, Deputy Executive Director, CPUC
Ms. Masha Vorobyova, Assistant Director, UAB
Mr. Bruce Berry, Program Manager, Water Division
Mr. Raymond Yin, Program and Project Supervisor, UBA
Ms. Khusbindar Kaur, Senior Management Auditor, UAB
Ms. Sharmin Wellington, Public Utilities Regulatory Analyst V, UAB
Mr. Sam Niepoth, Staff Services Management Auditor, UAB



REVIEW OF FINANCIAL STATEMENTS

PureSource Water, Inc.

For the Year Ended December 31, 2019

Utility Audits, Risk and Compliance Division
Utility Audits Branch
August 3, 2020



MEMBERS OF THE TEAM

Angie Williams, Director

Masha Vorobyova, Assistant Director

**Raymond Yin, CPA
Supervisor**

**Khusbindar Kaur, CPA
Lead**

**Sharmin Wellington, CPA
Staff**

**Sam Niepoth
Staff**

**A digital copy of this report can be found at:
<http://www.cpuc.ca.gov/utilityaudits/>**

**You can contact our office at:
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EXECUTIVE SUMMARY

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a review of the financial statements of PureSource Water, Inc. (PSW) as of December 31, 2019, pursuant to Public Utilities (PU) Code, Sections 314.5, 314.6, 581, 582, and 584 that provide the CPUC the statutory authority to review or audit the books and records of the regulated utilities. We conducted this review in accordance with the standards prescribed under “Review of Financial Statements” in the Generally Accepted Government Auditing Standards (GAGAS).

PSW was incorporated in California on April 26, 2001. PSW is a Class D water utility and serves approximately 79 unmetered customers located in the Rio del Mar Lodge Sites in the City of Santa Cruz, in Santa Cruz County of California. As a regulated water utility, PSW is required to prepare its financial statements on accrual basis of accounting set forth in the Uniform System of Accounts (USOA) adopted in Decision (D.) 16-11-006 by the CPUC on November 16, 2016, which is a comprehensive basis of accounting other than the generally accepted accounting principles in the United States of America.

The purpose of this review was to obtain limited assurance as a basis for reporting whether we were aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the USOA. In conjunction with our review of the financial statements, UAB also reviewed, for regulatory purposes, whether PSW complied with the following:

- a) PU Code Section 818 regarding obtaining CPUC’s approval before incurring any long-term debts.
- b) Timely filing of the 2019 Annual Report as required by the Water Division Memorandum dated January 7, 2020.

Based on our review, we are not aware of any material modifications that should be made to PSW’s financial statements in order for them to be in accordance with the accounting framework established in the USOA. For the review period, UAB did not note any noncompliance with PU Code Section 818. In addition, PSW has timely filed its 2019 Annual Report in compliance with the CPUC directive from the Water Division.

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

Mr. Martin Mills, President
PureSource Water, Inc.
P.O. Box 1958
Aptos, CA 95001

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the financial statements of PureSource Water, Inc. (PSW), which comprise the balance sheet as of December 31, 2019, and the related income statement and statement of retained earnings for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of PSW's 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, UAB does not express such an opinion.

Management's Responsibility for the Financial Statements

PSW's management is responsible for the preparation and fair presentation of its 2019 financial statements in accordance with the accounting framework established under CPUC's Uniform System of Accounts (USOA) for Water Utilities. PSW's management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of its 2019 financial statements that are free from material misstatement, whether due to fraud or error. In addition, PSW's management is responsible for the development of its policies and procedures to ensure full compliance with applicable regulations and CPUC directives.

Accountant's Responsibility

UAB's responsibility is to conduct the review engagement in accordance with the standards applicable to reviews of financial statements promulgated by the Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with the accounting framework of the USOA. For regulatory purposes, UAB also reviewed whether PSW complied with PU Code Section 818 to obtain its long-term debts, and whether PSW timely filed its 2019 Annual Report as required by CPUC's Water Division. We believe that the results of our procedures provide a reasonable basis for our conclusion.

Accountant's Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the accounting framework of the USOA. For the review period, UAB did not note any noncompliance with PU Code Section 818. In addition, PSW has timely filed its 2019 Annual Report in compliance with the CPUC directive from the Water Division.

Basis of Accounting

For regulatory purposes, the CPUC adopted, through Decision (D.) 16-11-006 on November 16, 2016, the updated USOA, which is a comprehensive basis of accounting other than the generally accepted accounting principles (GAAP) in the United States of America. The CPUC requires all water and sewer

utilities to prepare their financial statements in accordance with the accounting framework of the USOA. PSW's financial statements were prepared based on this regulatory requirement.

We draw attention to Notes to the Financial Statements, in which we described the basis of accounting as well as the accounting differences between GAAP and the USOA. Our conclusion is not modified with respect to this matter.

Views of Responsible Official

We issued a draft review report on July 15, 2020. PSW did not provide a written response. We are issuing the report as final.

Restricted Use of This Review Report

This review report is intended solely for the information and use by the CPUC and the management of PSW. It is not intended to be used and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

Angie Williams

Angie Williams, Director
Utility Audits, Risk and Compliance Division

REVIEWED FINANCIAL STATEMENTS

PureSource Water, Inc.
BALANCE SHEET (AS REVIEWED)
As of December 31, 2019

ASSETS	
UTILITY PLANT	
Water Plant in Service (Excluding SDWBA/SRF, Grant Funds)	\$103,822
Water Plant in Service - SDWBA/SRF	120,111
Water Plant in Service - Grant Funds	218,710
Accumulated Depreciation of Water Plant	(31,755)
Accumulated Amortization of SDWBA/SRF loan	(120,111)
Accumulated Depreciation of Water Plant - Grant Funds	(47,682)
Net Utility Plant	<u>243,095</u>
CURRENT AND ACCRUED ASSETS	
Cash	2,959
Accounts Receivable - Customers	4,950
Total Current and Accrued Assets	<u>7,909</u>
Total Assets	<u><u>251,004</u></u>
CAPITALIZATION AND LIABILITIES	
CORPORATE CAPITAL AND SURPLUS	
Common Stock (Corporations only)	-
Retained Earnings	20,182
Total Capitalization	<u>20,182</u>
CURRENT AND ACCRUED LIABILITIES	
Accounts Payable	1,189
Taxes Accrued	1,124
Total Current and Accrued Liabilities	<u>2,313</u>
CONTRIBUTIONS IN AID OF CONSTRUCTION	
Contributions in Aid of Construction	281,189
Accumulated Amortization of Contributions (negative number)	(52,680)
Total Contributions in Aid of Construction	<u>228,509</u>
Total Equity and Liabilities	<u><u>251,004</u></u>

(See independent accountant's review report and accompanying notes.)

PureSource Water, Inc.
INCOME STATEMENT (AS REVIEWED)
For Year Ended December 31, 2019

OPERATING REVENUES

Unmetered Water Revenue	96,932
Other Water Revenue	1,833
Total Operating Revenues	98,765

OPERATING EXPENSES

Plant Operation and Maintenance Expenses

Purchased Water	2,192
Power	9,866
Materials	5,173
Contract Work	13,488
Transportation Expense	3,496
Total Plant Operation and Maintenance Expenses	34,215

Administrative and General Expenses

Management Salaries	39,960
Employee Pensions and Benefits	2,400
Office Services and Rentals	1,263
Office Supplies and Expenses	2,696
Professional Services	1,798
Insurance	3,102
Regulatory Commission Expense	1,189
General Expenses	757
Net Administrative and General Expenses	53,165

Total Operating Expenses

87,380

Depreciation Expense	3,101
Taxes Other Than Income Taxes	5,672
State Corporate Income Tax Expense	800
Total Operating Revenue Deductions	96,953

Total Utility Operating Income (Loss)

1,812

OTHER INCOME AND DEDUCTIONS

Non-Utility Income	3
Miscellaneous Non-Utility Expense	(19)
Total Other Income and Deductions	(16)

Net Income (Loss)

1,796

(See independent accountant's review report and accompanying notes.)

PureSource Water, Inc.
STATEMENT OF RETAINED EARNINGS
For Year Ended December 31, 2019

Retained Earnings, Beginning of Year	\$18,386
CREDITS:	
Net Income	1,796
Total Credits	<u>1,796</u>
DEBITS:	
Debits	0
Total Debits	<u>(0)</u>
Retained Earnings, End of Year	<u><u>\$20,182</u></u>

(See independent accountant's review report and accompanying notes.)

PureSource Water, Inc.

NOTES TO THE FINANCIAL STATEMENTS

Regulated water utilities are required to prepare their financial statements on Accrual basis of accounting set forth in the Uniform System of Accounts (USOA) for Water Utilities adopted in Decision (D.) 16-11-006 by the CPUC on November 16, 2016, which is a comprehensive basis of accounting other than the generally accepted accounting principles (GAAP) in the United States of America. The following describes certain differences in accounting treatments between GAAP and USOA, the company's current accounting practices, and its compliance with applicable regulation and CPUC directives.

1. Purpose of Financial Information and Targeted Audience

The objective of preparing financial statements in accordance with GAAP is to provide information that is useful in making decisions about providing resources to the entity. Users of the financial information include existing and potential investors, lenders, and other creditors.

The purpose of using USOA to prepare financial statements is to have the utilities provide financial transparency of their water operations on a consistent basis. The primary user of the financial information is the CPUC for ratemaking and other compliance purposes.

2. Property, Plant, and Equipment

The USOA distinguishes the plant assets for water operations (i.e., Account 101, Water Plant in Service) from those for non-water operations (i.e., Account 121, Non-Water Utility Property and Other Assets), for ratemaking purposes.

(1) Depreciation Methodology

GAAP allows entities to elect a depreciation methodology of their choices, such as straight-line, double-declining balance, or sum-of-the-years digits depreciation method.

USOA requires utilities to use the "Straight-line remaining life method." "Remaining life" implies that estimates of future life and salvage value will be re-evaluated periodically and that depreciation rates will be adjusted to reflect any changes in estimates. Water utilities are required to comply with the CPUC's Standard Practice (SP) U-4-SM and SP U-4-M when determining depreciation accruals. Specifically, for the water plant with over \$100,000, the utility must maintain separate depreciation reserve by different plant accounts in accordance with Appendix B1 of SP U-4-SM; for the water plant under \$100,000, if the utility elects not to separate or maintain the depreciation reserve by accounts, it is appropriate to develop a composite value for remaining life for the entire plant in accordance with Appendix B2 or B3 of SP U-4-SM. The USOA suggested that all utilities maintain a separate accumulated depreciation subaccount for each depreciable plant account; and it is mandatory for water utilities having more than 500 customers.¹ The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs.

¹ D.16.11-006 dated November 10, 2016, General Accounting Instructions 4 on Page B14.

(2) Asset Retirement

USOA requires that the water plant be recorded at the original cost. In USOA's depreciation schedule, the difference between the estimated cost of removal and the salvage value is included in the depreciable base to obtain the annual depreciation expense. When retiring an asset, the cost of removal will reduce the balance of Account 108, Accumulated Depreciation of Water Plant, while the cash received from the salvage value or sale price will increase the balance of Account 108, Accumulated Depreciation of Water Plant. The gain or loss from the asset retirement that is recognized under GAAP is accumulated in Account 108, Accumulated Depreciation of Water Plant under USOA.

The Annual Report reflected total Water Plant in Service (WPIS) of \$442,643 which included Grant Funded plant of \$218,710 and Safe Drinking Water Bond Act funded plant of \$120,111.

3. Cash for Restricted Use

Under GAAP, if the restricted funds are considered to offset the current liability, the funds may be included as current asset classification. If the funds are set aside for use in the near future for the liquidation of long-term debts, payments to sinking funds, then the funds should be classified to non-current assets. If unsure of the timing of the use, the restricted cash can be classified as Other Assets.

Under USOA, the restricted funds are recorded to Account 132, Cash—Special Deposits, which should include cash amounts set aside from general corporate funds, deposited in a separate account with fiscal agents or others, and designated for a special use. A separate subaccount shall be maintained for each designated special use. Interest earned from this account shall be credited to Account 421, Non-Utility Income.

4. Contribution in Aid of Construction (CIAC)

CIAC account records non-refundable contributions of cash, land, or other property donated to the water utility to assist it in constructing, extending, or relocating its water system. The funds can be from governmental agencies and others. The balances in this account shall be written off over the period of its estimated service life by charging to Account 272, Accumulated Amortization of Contributions instead of a Depreciation Expense account, with contra credits to the appropriate subaccount of Account 108, Accumulated Depreciation of Water Plant.

(1) Facilities Fees

Facilities Fees are fees collected from ratepayers for the purpose of recovering a certain amount of revenue to offset certain facilities or improvements that are required to serve additional customers. Ordering Paragraph (OP) 3 of D.91-04-068 granted authority to Class C and D water utilities, and to districts of Class A and B water utilities with 2,000 or fewer service connections, to institute facilities fees as a part of their requests for a general increase in rates. Through Resolution W-4110, the CPUC granted authority to all Class D water utilities to file generic tariffs to charge fees for new connections for the purpose of generating funds to build a new plant or replace deteriorated plant. Facilities fees received by a water utility shall be deposited in Account 132, Cash—Special Deposits, and credited to Account 253, Other Credits. At the time these fees are used for water plant improvements, Account 101, Water Plant in Service shall be debited and Account 132, Cash—Special Deposits credited. Concurrently, Account 253, Other Credits shall be debited and Account

265.7, All Other Contributions in Aid of Construction credited. The annual depreciation and amortization of the facilities fees plant additions shall be debited to Account 272, Accumulated Amortization of Contributions, and credited to Account 108.3, Accumulated Depreciation of Water Plant–Other. The use of facilities fees should be in compliance with SP U-28-W.

The Annual Report reflected CIAC of \$281,189 of which \$218,710 is attributed to Grant funded water plant.

5. Safe Drinking Water Bond Act (SDWBA) Loans

SDWBA loans are low-interest loans from the California Department of Water Resources (DWR) to assist water utilities to fund for materials and services used on DWR-approved construction projects. SDWBA loans are repaid through surcharges on customer water bills. Although the accounting treatment of SDWBA loans is similar to GAAP, the USOA requires water utilities to follow the special accounting procedures below:

Water utilities must obtain the CPUC’s written approval prior to obtaining a SDWBA loan and instituting a SDWBA surcharge to its ratepayers. Any SDWBA surcharge collected from ratepayers shall be deposited monthly to Account 132, Cash–Special Deposits. The periodical payment of the SDWBA loans and related interest expenses shall be made from this special deposit account.

Plant assets funded by a SDWBA loan are booked in Account 101.1, Water Plant in Service–SDWBA, and are not depreciable. The principal of a SDWBA loan is amortized through the charges to Account 407, SDWBA Loan Amortization Expense, with contra credits to Account 108.1, Accumulated Amortization of SDWBA Loan, over the life of the SDWBA loan.

The Annual Report reflected Safe Drinking Water Bond Act funded plant of \$120,111 and it has been fully amortized as of the period ending December 31, 2019.

6. Authorized Costs and Revenues

Under GAAP, regulated entities record recoverable costs authorized by the regulator as Regulatory Assets and amortize them over a period of time. Likewise, authorized revenues for future repayment are recorded as Regulatory Liabilities.

USOA requires water utilities to record authorized costs that are to be amortized over future periods as an asset in Account 180, Deferred Charges. Similarly, authorized revenues for future repayment are recorded as liabilities in Account 253, Other Credits.

7. Water Utility Users Fee

PU Code, Sections 401 through 410 authorized the CPUC to set a fee annually to water utilities to cover the costs incurred by the CPUC in regulating them. USOA requires water utilities to credit regular operating revenue accounts with amounts of User Fees billed to customers and charge Account 688, Regulatory Commission Expense, with fees paid to the CPUC.²

² D.16.11-006 dated November 10, 2016, General Accounting Instructions 9 on Pages B18 and B19. Review of PureSource Water, Inc. For the Year Ended December 31, 2019

The Annual Report reflected Regulatory Commission Expense of \$1,189 which is attributed to CPUC Users Fee.

8. Form of Financial Statements³

(1) Balance Sheet

Unlike the financial statements of other industries, the financial statements of regulated water utilities present the water plant as the first major caption on the asset side of the balance sheet, and capitalization is first on the liability side. Current assets and current liabilities are relegated to a comparatively unimportant position in the center of the balance sheet, rather than being placed prominently as in statements for non-regulated industries.

(2) Income Statement

The form of Income Statement reflects the classification of revenues and expenses in ratemaking. Operating revenues and expenses are referred to as “above the line” because they are allowable in ratemaking, and the result of deducting total operating expenses from total operating revenues is the operating income. Other Income and Deductions are referred to as “below the line” because they are applied after operating income and are not allowable in ratemaking. The “below the line” items include interest revenue, dividend income, other revenues that are from non-water utility operations and/or non-water utility properties, expenses that are unrelated to water utility operations, and interest expense (the interest expense is recovered through the authorized rate of return). The concept of “above the line” revenues and expenses being allowable in ratemaking affects the form of the income statement, the classification of revenues and expenses, and decisions of management in incurring expenses.

9. Exclusion of Statement of Cash Flows

Financial Accounting Standards Board specifies in its Statement of Financial Accounting Standards No. 95 that a Statement of Cash Flows is part of a complete set of financial statements under GAAP. However, Codification of Statements on Auditing Standards AU-C Section 800.A35 states, in part, that, “Special purpose financial statements may not include a statement of cash flows....” Since the USOA is an accounting framework other than GAAP for regulatory purposes, the Statement of Cash Flows is not required by the CPUC and therefore excluded from this review report.

10. Compliance filing of 2019 Annual Report with the CPUC

PU Code, Sections 581, 582, and 584, and the CPUC’s directive (i.e., Water Division’s annual memorandum to water and sewer utilities) require all regulated water and sewer IOUs to file an Annual Report with the CPUC every year. For the year being reviewed, PSW has complied with these requirements.

³ Regulated Utilities Manual—A Service for Regulated Utilities by Deloitte & Touché USA LLP, pages 36-37.