

## PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

October 20, 2020

Mr. Robert Ukestad, Owner  
West San Martin Water Works, Inc.  
1005 Highland Avenue  
San Martin, CA 95046

Dear Mr. Ukestad:

**Final Report Transmittal Letter—Review of West San Martin Water Works' 2019 Annual Report for the period of January 1, 2019 through December 31, 2019**

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) has completed its review of West San Martin Water Works, Inc.'s (WSMWW) regulatory basis financial statements in the 2019 Annual Report filed with the CPUC, which comprise the balance sheet as of December 31, 2019, and related statement(s) of income. The final review report is enclosed.

WSMWW's response to the draft report findings and our evaluation of the response are incorporated into this final report. We will post the final review report on our website at <https://www.cpuc.ca.gov/utilityaudits/>.

Please provide a Corrective Action Plan (CAP) addressing the findings and recommendations by December 4, 2020. The CAP should include specific steps and target dates to correct the findings identified. Please submit the CAP to the Utility Audits Branch at [UtilityAudits@cpuc.ca.gov](mailto:UtilityAudits@cpuc.ca.gov), with a copy to Bruce DeBerry, Program Manager of Water Division, at [Bruce.DeBerry@cpuc.ca.gov](mailto:Bruce.DeBerry@cpuc.ca.gov).

We appreciate WSMWW's assistance and cooperation during the engagement, and your willingness to implement corrective actions. If you have any questions regarding this report, please contact Raymond Yin, Program and Project Supervisor, at (415) 703-1818.

Sincerely,

*Angie Williams*

Angie Williams, Director  
Utility Audits, Risk and Compliance Division

Mr. Robert Ukestad, President  
West San Martin Water Works, Inc.  
October 20, 2020  
Page 2

**cc:** Mr. Brian Ukestad, President, WSMWW  
Ms. Rachel Peterson, Acting Executive Director, CPUC  
Mr. Saul Gomez, Deputy Executive Director, Office of the Commission, 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, UAB  
Ms. Khusbindar Kaur, Senior Management Auditor, UAB  
Ms. Sharmin Wellington, Public Utilities Regulatory Analyst V, UAB



# REVIEW OF FINANCIAL STATEMENTS

West San Martin Water Works, Inc.

For the Year Ended December 31, 2019

Utility Audits, Risk and Compliance Division  
Utility Audits Branch  
October 20, 2020



## **MEMBERS OF THE TEAM**

**Angie Williams, Director**

**Masha Vorobyova, Assistant Director**

**Raymond Yin, CPA  
Supervisor**

**Khusbindar Kaur, CPA  
Lead**

**Sharmin Wellington, CPA  
Staff**

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

You can contact our office at:  
California Public Utilities Commission  
Utility Audits, Risk and Compliance Division  
400 R Street, Suite 221  
Sacramento, CA 95811

# TABLE OF CONTENTS

---

EXECUTIVE SUMMARY.....	1
INDEPENDENT ACCOUNTANT’S REVIEW REPORT.....	3
REVIEWED FINANCIAL STATEMENTS .....	5
Balance Sheet (As Reviewed).....	5
Income Statement (As Reviewed).....	6
Statement of Changes in Shareholder’s Equity (As Compiled ) .....	7
Notes to Financial Statements.....	8
APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS.....	13
APPENDIX B—WSMWW’S RESPONSE.....	20
APPENDIX C—UAB’S EVALUATION OF WSMWW’S RESPONSE .....	21

# EXECUTIVE SUMMARY

---

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a review of the financial statements of West San Martin Water Works, Inc. (WSMWW) as of December 31, 2019, pursuant to Public Utilities (PU) Code, Sections 314.5, 314.6, 581, 582, and 584 that provides 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 Engagements in the Generally Accepted Government Auditing Standards (GAGAS).

WSMWW was incorporated in California on November 22, 1967. WSMWW is a Class D water utility that serves 304 metered customers and 21 fire protection and hydrant customers. WSMWW serves San Martin, an unincorporated area south of Morgan Hill, Santa Clara County, California. As a regulated water utility, WSMWW 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 WSMWW 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 WSMWW's revised 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; and WSMWW filed its 2019 Annual Report timely in compliance with the CPUC directive from the Water Division. However, UAB identified seven material misstatements in WSMWW's Annual Report originally filed with the CPUC's Water Division, as described in the Appendix A—Review Findings and Recommendations. These findings are summarized below:

- Finding 1: WSMWW incorrectly reported \$108,423 of restricted cash for Facilities Fees as general cash in Account 131—Cash, instead of reporting it in Account 132—Cash—Special Deposits.
- Finding 2: WSMWW did not report \$7,021 of Users Fee collected from its customers and remitted to the CPUC as Other Water Revenue in Account 480 and Regulatory Commission Expense in Account 688.
- Finding 3: WSMWW incorrectly reported \$28,109 of pump tax surcharge collected from customers as Miscellaneous Non-Utility Income in Account 421, instead of reporting it as Other Metered Revenue in Account 470.5.

- Finding 4: WSMWW did not use Account 206–Subchapter S Corporation Accumulated Adjustments Account to report changes in ownership equity. As a result, Account 206–Subchapter S Corporation Accumulated Adjustments Account is understated by \$462,664 and Account 215–Retained Earnings and Account 211–Other Paid-in Capital accounts are overstated by \$44,570 and 418,094, respectively.
- Finding 5: WSMWW did not timely write off significantly past due accounts receivable totaling \$16,000. As a result, Account 141–Accounts Receivable and Account 143–Accumulated Provision for Uncollectible Accounts were overstated by \$16,000.
- Finding 6: WSMWW did not properly report balances for expired Advances for Construction contracts totaling \$40,278. As a result, Account 252–Advances for Construction is overstated and Account 265–Contributions in Aid of Construction is understated by \$40,278.
- Finding 7: WSMWW improperly reported taxes incurred by its shareholders as utility expenses totaling \$25,247. As a result, Account 410–Federal Corporate Income Tax Expense is overstated by \$18,250; Account 409–State Corporate Income Tax Expense is overstated by \$6,997; and Account 236–Taxes Accrued is overstated by \$25,247.

UAB discussed the above findings and recommendations with WSMWW at the exit conference on August 14, 2020. WSMWW concurred with the review results and agreed to post UAB’s proposed adjusting entries to correct the misstatements identified above. On August 20, 2020, WSMWW submitted its revised financial statements to the UAB to correct the material misstatements described in Appendix A of this report. UAB is not aware of any further material modifications that should be made to the revised financial statements.

# INDEPENDENT ACCOUNTANT'S REVIEW REPORT

---

Mr. Robert Ukestad, Owner  
West San Martin Water Works, Inc  
1005 Highland Avenue  
San Martin, CA 95046

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the financial statements of West San Martin Water Works, Inc. (WSMWW), which comprise the balance sheet as of December 31, 2019, and the related income statement for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of WSMWW'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***

WSMWW'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. WSMWW'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, WSMWW'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 engagements 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 WSMWW complied with PU Code Section 818 to obtain its long-term debts, and whether WSMWW timely filed its 2019 Annual Report as required by CPUC's Water Division. We believe that our review provides 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. However, UAB identified seven material misstatements in WSMWW's Annual Report originally filed with the CPUC's Water Division, as described in the Appendix A—Review Findings and Recommendations. These misstatements have been corrected in the accompanying financial statements.

For the review period, UAB did not note any noncompliance with PU Code Section 818. In addition, WSMWW 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. WSMWW'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***

On September 18, 2020, UAB provided a draft review report to WSMWW for comments. On October 2, 2020, WSMWW provided its comments to UAB, agreeing with the audit results and recommendations but expressing disagreement with the CPUC's requirements regarding Finding 7. WSMWW's comments are included in Appendix B of this report. UAB's evaluations of those comments are in Appendix C of this report. The review findings and recommendations presented in this report remain unchanged and represent our final determination of this review engagement.

### ***Other Matter - Submission of a Corrective Action Plan***

WSMWW's management should submit a corrective action plan to the UAB at [UtilityAudits@cpuc.ca.gov](mailto:UtilityAudits@cpuc.ca.gov), with a copy to Bruce DeBerry, Program Manager of Water Division, at [Bruce.DeBerry@cpuc.ca.gov](mailto:Bruce.DeBerry@cpuc.ca.gov) by December 4, 2020. The corrective action plan should address how WSMWW will implement the recommendations and provide the timing of incorporating UAB's review adjustments to WSMWW's books and records. If WSMWW is unable to implement UAB's recommendations, the corrective action plan should state the reason(s) for not being able to implement any of the recommendations. WSMWW should use the amounts reviewed by the UAB as presented in this report as the basis to file its 2020 Annual Report with the CPUC.

### ***Restricted Use of This Review Report***

This review report is intended solely for the information and use by the CPUC and the management of WSMWW. 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

---

West San Martin Water Works, Inc.  
**Balance Sheet (As Reviewed)**  
As of December 31, 2019

<b>ASSETS</b>	
<b>UTILITY PLANT</b>	
Water Plant in Service	\$2,279,246
Water Plant Acquisition Adjustments	7,986
Accumulated Depreciation of Water Plant	<u>(1,548,826)</u>
<b>Net Utility Plant</b>	738,406
<b>CURRENT AND ACCRUED ASSETS</b>	
Cash	361,297
Cash–Special Deposits	108,423
Accounts Receivable	42,627
Materials and Supplies	8,483
Other Current Assets	<u>6,622</u>
<b>Total Current and Accrued Assets</b>	527,452
<b>Total Assets</b>	<u><u>\$1,265,858</u></u>
<b>CAPITALIZATION AND LIABILITIES</b>	
<b>CORPORATE CAPITAL AND SURPLUS</b>	
Common Stock	\$15,794
Subchapter S Corporation Accumulated Adjustments Account	<u>563,365</u>
<b>Total Capitalization</b>	579,159
<b>CURRENT AND ACCRUED LIABILITIES</b>	
Accounts Payable	28,049
Customer Deposits	<u>7,220</u>
<b>Total Current and Accrued Liabilities</b>	35,269
<b>DEFERRED CREDITS</b>	
Advances for Construction	109,810
Other Credits	105,723
Accumulated Deferred Income Taxes–Accelerated Tax Depreciation	<u>67,881</u>
<b>Total Deferred Credits</b>	283,414
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>	
Contributions in Aid of Construction	1,494,421
Accumulated Amortization of Contributions	<u>(1,126,405)</u>
<b>Net Contributions in Aid of Construction</b>	368,016
<b>Total Equity and Liabilities</b>	<u><u>\$1,265,858</u></u>

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

West San Martin Water Works, Inc.  
**Income Statement (As Reviewed)**  
For Year Ended December 31, 2019

<b>OPERATING REVENUES</b>	
Unmetered Water Revenue	\$5,822
Fire Protection Revenue	3,770
Metered Water Revenue	554,719
Other Water Revenue	7,021
<b>Total Operating Revenue</b>	<u>571,332</u>
<b>OPERATING EXPENSES</b>	
<b>Plant Operation and Maintenance Expenses</b>	
Power	70,775
Other Volume Related Expenses	152,196
Employee Labor	50,250
Materials	3,810
Contract Work	20,647
Transportation Expenses	1,972
Other Plant Maintenance Expenses	3,587
<b>Total Plant Operation and Maintenance Expenses</b>	<u>303,237</u>
<b>Administrative and General Expenses</b>	
Management Salaries	60,000
Employee Pensions and Benefits	11,025
Office Services and Rentals	16,875
Office Supplies and Expenses	10,144
Professional Services	21,344
Insurance	6,382
Regulatory Commission Expense	7,807
General Expenses	3,575
<b>Net Administrative and General Expenses</b>	<u>137,152</u>
<b>Total Operating Expenses</b>	<u>440,389</u>
Depreciation Expense	17,101
Taxes Other Than Income Taxes	18,749
State Corporate Income Tax Expense	1,430
<b>Total Operating Revenue Deductions</b>	<u>477,669</u>
<b>Total Utility Operating Income</b>	93,663
<b>OTHER INCOME AND DEDUCTIONS</b>	
Non-Utility Income	430
Miscellaneous Non-Utility Expense	(189)
Interest Expense	(1)
<b>Total Other Income and Deductions</b>	<u>240</u>
<b>Net Income</b>	<u><u>\$93,903</u></u>

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

West San Martin Water Works, Inc  
Statement of Changes in Shareholder's Equity (As Compiled <sup>1</sup>)  
For Year Ended December 31, 2019

Stockholders' Equity, Beginning of Year	\$519,123
<b>CREDITS:</b>	
Net Income	93,903
<b>Total Credits</b>	<u>93,903</u>
<b>DEBITS:</b>	
Dividend Distribution	(33,867)
<b>Total Debits</b>	<u>(33,867)</u>
<b>Stockholder's Equity, End of Year</b>	<u><u>\$579,159</u></u>

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

---

<sup>1</sup> UAB compiled the Statement of Changes in Stockholders' Equity based on the reviewed Balance Sheet and Income Statement, and other relevant financial data.

# West San Martin Water Works, Inc.

## Notes to 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 describe 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 "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.<sup>2</sup> The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs.

---

<sup>2</sup> D.16.11-006 dated November 10, 2016, General Accounting Instructions 4 on Page B14.

West San Martin Water Works, Inc. (WSMWW) computes depreciation on a composite depreciation rate of 2.76%. The CPUC's SP U-04-SM, Paragraph 22, specifies that the annual composite rate generally falls within the range of 2.0% and 3.5%.

## **(2) Asset Retirement**

USOA requires that 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.

WSMWW did not retire any assets during 2019.

## **(3) Sale and Acquisition of Properties**

Under GAAP, entities recognize gain or loss from disposal of properties and recognize goodwill or gain from a bargain purchase of other entities' segment or properties.

Under USOA, no goodwill or gain is recognized from the sale or acquisition of a water system or unit, unless it is approved by the CPUC's decision. When the utility sells or purchases the water system or unit, the utility shall first record the transaction into a temperate Account 104, Water Plant Purchased or Sold. Within six months from the date of sale or date of acquisition, the utility shall file with the CPUC for approval of the proposed journal entries to clear this account. The difference between the net original cost of the assets acquired and the cost to the acquiring utility shall be charged or credited to Account 114, Water Plant Acquisition Adjustments.

WSMWW did not sell or acquire any properties in 2019.

## **3. Inventory**

GAAP allows entities to use different methodologies, such as average cost, first-in-first-out, and last-in-first-out, for the valuation of inventory, which includes cost components of raw materials, work-in-process, and finished goods, etc.

Under USOA, the inventory includes meters, materials and supplies. If identifiable, the inventory should be recorded at original cost, which includes transportation charges, sales and use taxes and other directly assignable costs. Items of small value whose original cost cannot be readily determined shall be recorded at current prices. Scrap materials shall be carried in inventory at estimated scrap value.

## **4. 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 to 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.

WSMWW had a restricted cash balance of \$108,423; however, the restricted cash was comingled with its general cash and reported in Account 131 in the Annual Report originally filed with the CPUC’s Water Division. WSMWW provided its revised Annual Report on August 20, 2020, which reflected the correct balances in Account 131–Cash and Account 132–Cash Special Deposits.

## **5. Advances for Construction**

Under USOA, the advances for construction are similar to a loan for the construction work under GAAP. The construction contract must comply with the Main Extension Rule specified in the CPUC’s SP U-17-W. Among other things, one of the requirements is “*Advance Main Extension Contracts would run for 40 years, with refunds at 2 ½ percent per year.*”

WSMWW did not timely evaluate Advances for Construction contracts. Advances for Construction balance reported in the Annual Report originally filed with the CPUC incorrectly included balances for expired contracts. Balances for expired contracts should be reported as Contributions in Aid of Construction. As a result, Account 252–Advances for Construction is overstated by \$40,278 and Account 265–Contributions in Aid of Construction is understated by the same amount. However, in the revised financial statements provided on August 20, 2020, WSMWW corrected these misstatements.

## **6. 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.

## **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 CPUC Expense, with fees paid to the CPUC.<sup>3</sup>

WSMWW omitted CPUC Users Fee from its original 2019 Annual Report, causing Account 688—Regulatory Commission Expense and Account 480—Other Water Revenues to be understated by \$7,021. However, WSMWW provided its revised Annual Report on August 20, 2020, which correctly reflected the CPUC Users Fee.

## **8. Form of Financial Statements<sup>4</sup>**

### **(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 affect the form of the income statement, the classification of revenues and expenses, and decisions of management in incurring expenses.

---

<sup>3</sup> D.16.11-006 dated November 10, 2016, General Accounting Instructions 9 on Pages B18 and B19.

<sup>4</sup> Regulated Utilities Manual—A Service for Regulated Utilities by Deloitte & Touché USA LLP, pages 36-37.



## **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 purpose, the Statement of Cash Flows is not required 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, WSMWW has complied with these requirements.

# APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS

---

## **Finding 1: Improper reporting of Cash–Special Deposits**

### **Condition:**

In the Annual Report originally filed with the CPUC’s Water Division on May 26, 2020, WSMWW incorrectly recorded and reported Facilities Fees totaling \$108,423 as Cash in Account 131 rather than in Account 132-Cash-Special Deposits. The USOA requires that restricted cash should be reported in Account 132–Cash–Special Deposits. As a result, Account 131–Cash was overstated by \$108,423 and Account 132–Cash–Special Deposits was understated by the same amount. However, in the revised financial statements submitted on August 20, 2020, WSMWW corrected these misstatements.

### **Criteria:**

The USOA states, in part, that:

#### 10. Facilities Fees

C. When facilities fees are received by a water utility, the amount received shall be deposited in Account 132–Cash-Special deposits and credited to Account 253–Other Credits. Interest earned on these fees shall be debited to Account 132-Cash-Special Deposits and credited to Account 421–Non-Utility Income.

### **Cause:**

WSMWW stated it was not aware of the USOA requirement that unspent Facilities Fees should be reported as restricted cash. WSMWW lacked procedures to ensure its compliance with the USOA accounting requirements.

### **Effect:**

Inaccurate reporting of Cash, and Cash–Special Deposits, distorts WSMWW’s financial position as of December 31, 2019, which could impact decision-makers.

### **Recommendations:**

WSMWW should establish and implement monitoring policies and procedures to ensure adherence to the USOA accounting requirements. For the Facilities Fees collected from its customers but not yet spent, WSMWW should record and report them as Cash–Special Deposits.

## **Finding 2: Improper reporting of CPUC Users Fee**

### **Condition:**

In the Annual Report originally filed with the CPUC’s Water Division, WSMWW treated CPUC Users Fee totaling \$7,021 collected from its customers and remitted to the CPUC as a pass-through activity without reporting the revenue and expenses associated with the collections and remission of the Users Fee. As a result, both Account 480–Other Water Revenue and Account 688–Regulatory Commission Expense were understated by \$7,021. However, in the revised financial statements submitted on August 20, 2020, WSMWW corrected these misstatements.

**Criteria:**

The USOA states, in part, that:

## 9. Water Utility Users Fee

B. Water utilities will credit regular operating revenue accounts with amounts billed to customers and charge account 688, Regulatory Commission Expense, with fees paid to the Commission.

**Cause:**

WSMWW stated it was not aware of the USOA requirement that CPUC Users Fee collected from its customers should be reported as Other Water Revenue and Users Fee remitted to the CPUC should be reported as Regulatory Commission Expense. WSMWW lacked procedures to ensure its compliance with the USOA accounting requirements.

**Effect:**

Inaccurate reporting of Other Water Revenue in Account 480 and Regulatory Commission Expense in Account 688 in the Annual Report, which may be used during WSMWW's General Rate Case (GRC) application review process, could potentially impact the water rates for WSMWW.

**Recommendations:**

WSMWW should establish and implement policies and procedures to ensure adherence to the USOA accounting requirements. It should also record and report the CPUC Users Fee as Other Water Revenue and Regulatory Commission Expense.

**Finding 3: Improper reporting of pump tax surcharge****Condition:**

In the Annual Report originally filed with the CPUC's Water Division, WSMWW incorrectly reported Pump Tax Surcharge applicable to metered customers totaling \$28,109 as Miscellaneous Non-Utility Income. However, the USOA requires that surcharge revenues approved by the CPUC relevant to metered customers should be reported in a Metered Water Revenue subaccount. As a result, Miscellaneous Non-Utility Income in Account 421 was overstated by \$28,109 and Other Metered Revenue in Account 470.5 was understated by the same amount. However, in the revised financial statements submitted on August 20, 2020, WSMWW corrected these misstatements.

**Criteria:**

USOA states, in part, that:

## 470. Metered Water Revenue

A. This account shall include all revenue from metered water service. Surcharge revenues approved by the Commission applicable to metered customers shall be recorded in this account. Separate subaccounts shall be maintained for each type of surcharge approved by the Commission unless otherwise authorized or directed by the Commission.

**Cause:**

WSMWW stated it was unaware surcharges applicable to metered water customers should be reported as Metered Water Revenue. WSMWW lacked procedures to ensure its compliance with the USOA accounting requirements.

**Effect:**

Inaccurate reporting of Metered Revenue in the Annual Report, which may be used during WSMWW's GRC application process, could potentially impact water rates for WSMWW's ratepayers.

**Recommendations:**

WSMWW should establish and implement policies and procedures to ensure adherence to the USOA accounting requirements. It should also record and report the CPUC approved surcharge applicable to metered water customers in a separate subaccount under Account 470–Metered Water Revenue.

**Finding 4: Improper reporting of changes in ownership equity****Condition:**

In the Annual Report originally filed with the CPUC's Water Division, WSMWW incorrectly used Account 215–Retained Earnings and Account 211–Other Paid-in Capital to report changes in its ownership equity and paid-in capital not derived from earnings. WSMWW changed its status from a C Corporation to an S Corporation in 2017. According to the USOA, Account 206–Subchapter S Corporation Accumulated Adjustments Account should be used by S Corporations for the reporting of changes in its ownership equity and all paid-in-capital. As a result, Account 206–Subchapter S Corporation Accumulated Adjustments Account is understated by \$462,664 and Account 215–Retained Earnings and Account 211–Other Paid-in Capital accounts are overstated by \$44,570 and 418,094, respectively. However, in the revised financial statements submitted on August 20, 2020, WSMWW corrected these misstatements.

**Criteria:**

USOA states, in part, that:

**206. Subchapter S Corporation Accumulated Adjustments Account**

- A. This account shall be used by Subchapter S Corporations for the reporting of changes in its ownership equity.
- B. This account shall include all paid-in-capital not derived from earnings.
- C. This account shall be credited with:
  - 1. Net income.
  - 2. Accounting adjustments not properly attributable to the current period.
- D. This account shall be charged with:
  - 1. Net loss.
  - 2. Accounting adjustments not properly attributable to the current period.
  - 3. Dividends.

**211. Other Paid-in Capital (for corporations only)**

- A. This account shall include all non-Subchapter S Corporation's paid-in capital not derived from earnings. It shall include such items as premiums and discounts related

to the issuance of capital stock, donations to the utility of its capital stock, credits arising from the forgiveness of debt of the utility; credits arising out of a reorganization of the utility, or in connection with its recapitalization.

#### 215. Retained Earnings (for corporations only)

- A. This account shall reflect corporate earnings retained in the business.
- B. The account shall be credited with:
  - 1. Net income.
  - 2. Accounting adjustments not properly attributable to the current period.
- C. The account shall be charged with:
  - 1. Net losses.
  - 2. Accounting adjustments not properly attributable to the current period.
  - 3. Dividends.

#### **Cause:**

After changing its tax status from a C Corporation to a Subchapter S Corporation, WSMWW did not implement any monitoring policies and procedures to ensure its compliance with the USOA accounting requirements relating to the use of proper accounts for reporting changes in ownership equity.

#### **Effect:**

Inaccurate reporting of Subchapter S Corporation Accumulated Adjustments Account, Retained Earnings, and Other Paid-in Capital account balances distorted WSMWW's financial position as of December 31, 2019, which could impact decision-makers.

#### **Recommendations:**

WSMWW should establish and implement policies and procedures to ensure proper reporting in compliance with USOA accounting requirements. It should also ensure that Account 206–Subchapter S Corporation Accumulated Adjustments Account is used to report changes in ownership equity as required by the USOA. A separate subaccount should be maintained in its general ledger to track the balances of equity derived from earnings as a C Corporation and a Subchapter S Corporation.

#### **Finding 5: Collectability of accounts receivable was not timely analyzed**

#### **Condition:**

WSMWW did not timely write off significantly past due accounts receivable totaling \$16,000. WSMWW's Aged Accounts Receivable report showed that \$16,245 of accounts receivable have been outstanding since July 2018. In 2017, WSMWW recorded an estimated \$16,000 in Account 143–Accumulated Provision for Uncollectible Accounts to cover estimated losses on accounts receivable; however, it did not write off any existing accounts receivable as of December 31, 2019. Because the aged accounts receivable has been outstanding for more than two years, it should be written off. As a result, Account 141–Accounts Receivable and Account 143–Accumulated Provision for Uncollectible Accounts were overstated by \$16,000 in the Annual Report originally filed with the CPUC's Water Division. However, in the revised financial statements submitted on August 20, 2020, WSMWW corrected these misstatements.

**Criteria:**

USOA states, in part, that:

143. Accumulated Provision for Uncollectible Accounts

A. This account shall be used by those utilities desiring to maintain a valuation reserve for uncollectible accounts, instead of writing off bad debts directly as they are incurred.

B. This account shall be credited with amounts to cover estimated losses on accounts receivable, with concurrent charges to Account 676, Uncollectible Accounts Expense.

C. This account also shall be credited with collections on accounts receivable previously written off as uncollectible.

D. This account shall be charged, and Account 141, Accounts Receivable-Customers, shall be credited with amounts determined to be uncollectible.

**Cause:**

WSMWW lacked monitoring procedures to ensure accounts receivables are evaluated timely to identify and write off uncollectible receivables.

**Effect:**

Inaccurate reporting of Accounts Receivable and Accumulated Provision for Uncollectible Accounts distorted WSMWW's financial position as of December 31, 2019.

**Recommendation:**

WSMWW should establish and implement monitoring procedures to evaluate its aged accounts receivable at least annually and timely write off uncollectible accounts.

**Finding 6: Advances for Construction contracts were not timely analyzed**

**Condition:**

In the Annual Report originally filed with the CPUC's Water Division, WSMWW did not properly report balances for expired Advances for Construction contracts totaling \$40,278. The original 2019 Annual Report reported a balance of \$150,088 in the Advances for Construction Account. The Utility informed the UAB that only one Advance for Construction was outstanding with a balance of \$109,810 as of December 31, 2019. Therefore, the balance in Advances for Construction account should be \$109,810. WSMWW explained that the remaining balance in Advances for Construction account is from expired contracts that should be reclassified as Contributions in Aid of Construction. As a result, Account 252-Advances for Construction is overstated by \$40,278 and Account 265-Contributions in Aid of Construction is understated by the same amount. However, in the revised financial statements submitted on August 20, 2020, WSMWW corrected these misstatements.

**Criteria:**

USOA states, in part, that:

252. Advances for Construction

- A. This account shall include construction advances from subdividers and others, which are subject to refund in accordance with the provisions of the utility's water main extension rules.
- B. Any balances in this account representing the unrefunded balances of expired contracts, or discounts resulting from termination of contracts in accordance with the utility's water main extension rules, shall be transferred to Account 265, Contributions in Aid of Construction.

**Cause:**

WSMWW has not implemented monitoring procedures that require the utility to regularly analyze Advances of Construction contracts to ensure that balances for expired contracts or terminated contracts are reclassified as Contributions in Aid of Construction.

**Effect:**

Inaccurate reporting of Advances for Construction and Contributions in Aid of Construction distorted WSMWW's financial position as of December 31, 2019.

**Recommendations:**

WSMWW should establish and implement policies and procedures to ensure that it re-evaluates the contracts for Advances for Construction annually and reclassifies any unrefunded balance for expired or terminated advances to Contributions in Aid of Construction.

**Finding 7: Improper reporting of corporate income taxes**

**Condition:**

WSMWW incorrectly reported \$25,247 State and Federal income taxes in its 2019 Annual Report originally filed with the CPUC's Water Division. WSMWW is structured as an S Corporation. S Corporations do not directly pay income taxes. Instead, shareholders of an S Corporation are liable for income taxes on their allocated share of the income. According to the Utility personnel, the corporate income taxes reported in the Annual Report are the taxes incurred by WSMWW's shareholders for the income generated by WSMWW as an S Corporation. Because there is no corporate tax incurred by WSMWW directly, the Utility should not report any corporate income tax expense. As a result, Account 410—Federal Corporate Income Tax Expense is overstated by \$18,250; Account 409—State Corporate Income Tax Expense is overstated by \$6,997; and Account 236—Taxes Accrued is overstated by \$25,247 in the Annual Report originally filed with the CPUC's Water Division. However, in the revised financial statements submitted on August 20, 2020, WSMWW corrected these misstatements.

**Criteria:**

The USOA states, in part, that:

- 410. Federal Corporate Income Tax Expense
  - A. This account will be used only by incorporated water utilities.

CPUC Decision 20-07-036, at page 3 states, in part, that:

[i]t has consistently been this Commission's practice to view utilities as separate from their affiliates for ratemaking purposes. As a result, rates will include allowances only for expenses the utility itself pays... Because there is no corporate tax incurred by [a S Corporation], there is no need for a tax allowance in rates.

**Cause:**

WSMWW lacked monitoring procedures in place to ensure that it complied with the CPUC directives by reporting only the income tax expenses directly incurred by WSMWW.

**Effect:**

Inaccurate reporting of State Corporate Income Tax Expense (Account 409) and Federal Corporate Income Tax Expense (Account 410) in the Annual Report, which may be used during WSMWW's GRC application review process, could potentially impact the water rates for WSMWW. Inaccurate reporting of Accrued Taxes (Account 236), improperly distorted WSMWW's financial position as of December 31, 2019.

**Recommendations:**

WSMWW should establish and implement monitoring policies and procedures to ensure its compliance with the CPUC directives and only report income tax expenses directly incurred by the WSMWW in its Annual Report.



## APPENDIX B—WSMWW'S RESPONSE

---

WSMWW submitted the following response to UAB's draft report via email on October 2, 2020:

To whom it may concern:

West San Martin Water Works, Inc. thanks the Commission for bringing to our attention the adjustments needed in the 2019 Annual Report. We have accepted and corrected all matters the Commission have referenced in their report and will follow their recommendations going forward. Regarding Finding No. 7, we have corrected the amount of State and Federal income taxes that is reported on the 2019 Annual Report; however, we do not agree with the Commission's rule regarding S-Corporations not being able to report State and Federal income taxes. We request the Commission to review and make changes to its regulations regarding the reporting of State and Federal income taxes for S-Corporations.

Sincerely,  
Brian Ukestad, President  
West San Martin Water Works, Inc.

## APPENDIX C—UAB'S EVALUATION OF WSMWW'S RESPONSE

---

WSMWW submitted its response to UAB's draft report on October 2, 2020. The response has been incorporated into our final report. In evaluating WSMWW's response, we noted that WSMWW agreed to follow the recommendations for all findings. However, we noted that WSMWW disagrees with the CPUC's requirements regarding Finding 7. UAB's evaluation of WSMWW's response regarding Finding 7 is presented below.

### **Finding 7: Improper reporting of corporate income taxes**

While WSMWW has corrected the misstatement relating to Federal and State Corporate Income Taxes, WSMWW stated that it does not agree with the CPUC's rule regarding S Corporations not being able to report State and Federal income taxes in the Annual Report and requested that the CPUC review and make changes to its regulations regarding the reporting of State and Federal income taxes for S Corporations.

UAB appreciates WSMWW's willingness to correct the misstatements in its 2019 Annual Report and implement UAB's recommendations. However, CPUC's decision regarding the tax treatment for S Corporations adopted in D.20-07-036 is a legal CPUC directive that all regulated utilities in California must comply with. Therefore, UAB's finding and recommendation in this regard remain unchanged.