PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

Transmitted via e-mail

January 25, 2021

Mr. William G. Hay Jr., President
Point Arena Water Works, Inc.
P.O. Box 205
Point Arena, CA 95468

Dear Mr. Hay:

Final Report Transmittal Letter—Review of Point Arena Water Works, Inc.'s 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 Point Arena Water Works, Inc.'s (PAWW) 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 statements of income and retained earnings. The final review report is enclosed.

PAWW's response to the draft report findings is incorporated into this final report. PAWW agreed with the review findings. 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 March 11, 2021. 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, with a copy to Bruce DeBerry, Program Manager of Water Division, at Bruce.DeBerry@cpuc.ca.gov.

We appreciate PAWW'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

cc: Carla Sigman, Office Manager, Point Arena Water Works, Inc.
Marino Rodriguez, Consultant for Point Arena Water Works, Inc.
Rachel Peterson, Executive Director, CPUC
Saul Gomez, Deputy Executive Director, Office of the Commission, CPUC
Lucian Filler, Deputy Executive Director, CPUC
Masha Vorobyova, Assistant Director, UAB
Bruce DeBerry, Program Manager, Water Division
Raymond Yin, Program and Project Supervisor, UAB
Khusbindar Kaur, Senior Management Auditor, UAB
Sharmin Wellington, Public Utilities Regulatory Analyst V, UAB
Sam Niepoth, Staff Services Management Auditor, UAB

REVIEW OF FINANCIAL STATEMENTS

Point Arena Water Works, Inc.

For the Year Ended December 31, 2019

Utility Audits, Risk and Compliance Division
Utility Audits Branch
January 25, 2021

MEMBERS OF THE TEAM

Angie Williams, Director

Masha Vorobyova, Assistant Director

Raymond Yin, CPA
Program and Project 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:
California Public Utilities Commission
Utility Audits, Risk and Compliance Division
400 R Street, Suite 221
Sacramento, CA 95811

Table of Contents

EXECUTIVE SUMMARY

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a review of the financial statements of Point Arena Water Works, Inc. (PAWW) 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 the Generally Accepted Government Auditing Standards (GAGAS).

PAWW was incorporated in California on February 2, 1984. PAWW is a Class D water utility with 206 active service connections. PAWW serves approximately 206 metered customers and provides service to the City of Point Arena and vicinity, and Whiskey Shoals Subdivision in Mendocino County, California. As a regulated water utility, PAWW is required to prepare its financial statements on the 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 PAWW 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 PAWW's revised financial statements in order for them to be in accordance with the accounting framework established in the USOA. For the review period, PAWW timely filed its 2019 Annual Report in compliance with the CPUC directive from the Water Division. However, PAWW did not comply with PU Code Section 818 to obtain its long-term debts. UAB identified eight material misstatements and internal control deficiencies in PAWW's Annual Report originally filed with the CPUC's Water Division, as described in Appendix A–Review Findings and Recommendations. These findings are summarized below:

- Finding 1: PAWW did not obtain CPUC's approval prior to incurring its reported Long-Term Debt of $311,302 in accordance with PU Code Section 818. PAWW incurred its Long-Term Debt resulting from services rendered to PAWW by two affiliated companies (Bed-Rock Products Inc. and X-Bar Ranch) from 2005 through 2019.

- Finding 2: PAWW's Accounts Payable reflected amounts owed to its owner for office rent expenses incurred in 2011 and 2012, totaling $10,782. According to the USOA guidelines, Account 231–Accounts Payable should reflect amounts payable by the Utility within one year. Amounts payable more than one year from the date of issue should be recorded as

Long-Term Debt. As a result, Account 231–Accounts Payable was overstated by $10,782, and Account 224–Long-Term Debt was understated by the same amount.

- Finding 3: PAWW recorded prior year revenues of $12,024 in Account 421–Non-Utility Income and prior-year expenses of $40,070 in Account 426–Miscellaneous Non-Utility Expense in the current year. The recording errors occurred because PAWW did not use the accrual basis of accounting to record all revenues and expenses in the correct accounting period.

- Finding 4: PAWW incorrectly recorded late fees of $3,315 collected from water service customers in Account 421–Non-Utility Income. CPUC's Standard Practice U-28-W requires that late fees be recorded as Other Water Revenue. As a result, Account 421–Non–Utility Income was overstated by $3,315 and Account 480–Other Water Revenue was understated by the same amount.

- Finding 5: PAWW improperly recorded and reported CPUC Users Fee and did not timely remit a portion of CPUC Users Fee. During the review of PAWW's collection and remittance of CPUC Users Fee, UAB noted that Account 231–Accounts Payable was understated by $7,954 and Account 236–Accrued Taxes was overstated by the same amount; and Account 480–Other Water Revenue and Account 688–Regulatory Commission Expense were understated by $4,086. In addition, the liability for CPUC Users Fee as of December 31, 2019 included Users Fee for the year 2018 totaling $3,874 that was not timely remitted to the CPUC. PU Code Section 433 requires utilities to remit Users Fee to the CPUC at least annually. As a result, PAWW did not comply with the CPUC directives.

- Finding 6: PAWW incorrectly recorded reimbursement totaling $4,145 for power expense owed to PAWW by an affiliated company, Bed-Rock Products Inc., in Account 174–Other Current Assets instead of Account 142–Receivables from Affiliated Companies, as required by the USOA. Therefore, PAWW overstated the Other Current Assets by $4,145 and understated the Receivables from Affiliated Companies by the same amount. In addition, PAWW's accounting practice was to record amounts due to its affiliated companies as Accounts Payable instead of recording them as Payables to Affiliated Companies in its Annual Report as prescribed by the USOA.

- Finding 7: PAWW did not maintain adequate documentation to support the reported balances in the Accumulated Depreciation and Contribution in Aid of Construction accounts.

- Finding 8: PAWW does not have any formal written service agreements between the related entities – Bed Rock Products, Inc., and X-Bar Ranch – for services they provide, which can expose the PAWW to unnecessary liability and legal disputes. In addition, PAWW did not record its revenues and associated receivables timely or monthly as customers were being billed in its general ledger as required by the USOA.

UAB discussed the results of the review with PAWW at the exit conference on November 17, 2020. PAWW concurred with the review results and agreed to post UAB's proposed adjusting entries. PAWW submitted its revised financial statements to UAB to correct the material misstatements described in Appendix A of this report on December 10, 2020. UAB provided a draft review report to PAWW for comments on January 5, 2021. PAWW submitted its comments on January 19, 2021, agreeing to implement UAB's recommendations. PAWW's response is included in Appendix B of this report. UAB appreciates PAWW's assistance and cooperation during the engagement, and willingness to implement corrective actions. The review findings and recommendations presented in this report represent our final determination of this review engagement.

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

Mr. William G. Hay Jr., President
Point Arena Water Works, Inc.
P.O. BOX 205
Point Arena, CA 95468

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the financial statements of Point Arena Water Works, Inc. (PAWW), 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 PAWW'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

PAWW'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. PAWW'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, PAWW'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 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 PAWW complied with PU Code Section 818 to obtain its long-term debts and whether PAWW 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. However, UAB identified eight material misstatements in PAWW's Annual Report originally filed with the CPUC's Water Division, as described in the Appendix A– Review Findings and Recommendations.

For the review period, PAWW timely filed its 2019 Annual Report in compliance with the CPUC directive from the Water Division. However, PAWW did not comply with PU Code Section 818 to obtain its long-term debts.

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. PAWW'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 Officials

UAB discussed the results of the review with PAWW at the exit conference on November 17, 2020. PAWW concurred with the review results and agreed to post UAB's proposed adjusting entries. PAWW submitted its revised financial statements to UAB to correct the material misstatements described in Appendix A of this report on December 10, 2020. UAB provided a draft review report to PAWW for comments on January 5, 2021. PAWW submitted its comments on January 19, 2021, agreeing to implement UAB's recommendations. PAWW's response is included in Appendix B of this report. UAB appreciates PAWW's assistance and cooperation during the engagement, and willingness to implement corrective actions. The review findings and recommendations presented in this report represent our final determination of this review engagement.

Other Matter - Submission of a Corrective Action Plan

PAWW's management should submit a corrective action plan to the UAB at UtilityAudits@cpuc.ca.gov, with a copy to Bruce DeBerry, Program Manager of Water Division, at Bruce.DeBerry@cpuc.ca.gov by March 11, 2021. The corrective action plan should address how PAWW will implement the recommendations and provide the timing of incorporating UAB's review adjustments to PAWW's books and records. If PAWW 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. PAWW 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 PAWW. 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

Point Arena Water Works, Inc.
Balance Sheet (As Reviewed)
As of December 31, 2019

ASSETS	
UTILITY PLANT	
Water Plant in Service	$1,807,611
Accumulated Depreciation of Water Plant	(868,130)
Net Utility Plant	939,481
CURRENT AND ACCRUED ASSETS	
Cash	14,845
Cash - Special Deposit	5,121
Accounts Receivable - Customers	28,109
Receivables from Affiliated Companies	4,145
Other Current Assets	18,148
Deferred Charges	94,042
Total Current and Accrued Assets	164,410
Total Assets	$1,103,891
CAPITALIZATION AND LIABILITIES	
CORPORATE CAPITAL AND SURPLUS	
Common Stock	$120,000
Other Paid-in Capital	48,865
Retained Earnings	23,289
Total Capitalization	192,154
LONG-TERM DEBT	
Long-Term Debt	311,302
CURRENT AND ACCRUED LIABILITIES	
Accounts Payable	9,225
Customer Deposits	3,738
Taxes Accrued	24,627
Interest Accrued	52,393
Total Current and Accrued Liabilities	89,983
DEFERRED CREDITS	
Advances for Construction	32,423
Other Credits	5,000
Accumulated Deferred Income Taxes - Other	17,899
Total Deferred Credits	55,322
CONTRIBUTIONS IN AID OF CONSTRUCTION	
Contributions in Aid of Construction	932,199
Accumulated Amortization of Contributions	(477,069)
Net Contributions in Aid of Construction	455,130
Total Equity and Liabilities	$1,103,891

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

Point Arena Water Works, Inc.
Income Statement (As Reviewed)
For Year Ended December 31, 2019

OPERATING REVENUES	
Metered Water Revenue	$322,565
Other Water Revenue	9,231
Total Operating Revenue	331,796
OPERATING EXPENSES	
Plant Operation and Maintenance Expenses	
Power	20,640
Other Volume Related Expenses	483
Employee Labor	15,370
Materials	8,006
Contract Work	29,226
Transportation Expenses	15,910
Other Plant Maintenance Expenses	30,049
Total Plant Operation and Maintenance Expenses	119,684
Administrative and General Expenses	
Management Salaries	85,041
Uncollectible Accounts Expense	881
Office Services and Rentals	9,288
Office Supplies and Expenses	9,877
Professional Services	43,824
Insurance	7,276
Regulatory Commission Expense	10,374
General Expenses	8,465
Net Administrative and General Expenses	175,026
Total Operating Expenses	294,710
Depreciation Expense	10,229
Taxes Other Than Income Taxes	14,360
State Corporate Income Tax Expense	800
Total Operating Revenue Deductions	320,099
Total Utility Operating Income (Loss)	11,697
OTHER INCOME AND DEDUCTIONS	
Non-Utility Income	2
Miscellaneous Non-Utility Expense	(421)
Interest Expense (excluding SDWBA)	(22,329)
Total Other Income and Deductions	(22,748)
Net Income (Loss)	($11,051)

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

Point Arena Water Works, Inc.
Statement of Retained Earnings (As Compiled [1])
For Year Ended December 31, 2019

Retained Earnings, Beginning of Year	$62,386
CREDITS:	
Net Income	0
UAB Adjustment to Non-Utility Income	12,024
Total Credits	12,024
DEBITS:	
Net Loss	(11,051)
UAB Adjustment to Miscellaneous Non-utility expense	(40,070)
Total Debits	(51,121)
Retained Earnings, End of Year	$23,289

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

[1] UAB compiled the Statement of Retained Earnings based on the reviewed Balance Sheet and Income Statement, and other relevant financial data.

Point Arena 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 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 "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.[2] The utility must obtain prior written approval from the CPUC for any practice that deviates from the aforementioned SPs.

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

PAWW used two different depreciation methodology to report its depreciable assets on the Annual Report. PAWW used the straight-line remaining life method to calculate its depreciation expense for the Water Plant in Service funded by PAWW while using the composite rate method of 1.95% to amortize its Contributions in Aid of Construction assets.

In addition, PAWW reported Water Plant in Service of $1,807,611 on its Annual Report; however, PAWW could not identify or provide a detailed listing of $820,473 contributed plant reported in Account 265–Contributions in Aid of Construction.

(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.

PAWW did not retire assets during the review period per the Annual Report.

(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's 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.

PAWW did not dispose of its properties or acquire other entities' segment or properties during the review period.

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 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.

PAWW reported restricted Cash – Special Deposits of $5,121, which is attributed to facilities fees.

4. 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."

PAWW reported Advances for Construction of $32,423 of this $31,187 was attributed to Bed Rock Products, Inc. (Affiliated Company) from 1994. The balance of $1,236 was attributed to the Cypress Meadows Project, which was collected in 2019.

5. 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 Deprecation 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.

PAWW reported WPIS of $1,807,611 in its 2019 Annual Report; however, PAWW could not identify or provide a detailed listing to support $820,473 of its contributed plant assets reported in the Contributions in Aid of Construction account.

(2) Government Grants

Funds received from a governmental funding agency shall be deposited in Account 132, Cash–Special Deposits and credited to Account 265.1, Contributions in Aid of Construction–Government Grant Proceeds. When the Grant Funds were used, the utility shall credit Account 132, Cash–Special Deposits, and debit the appropriate plant asset account. The use of grant funds should be in compliance with the funding agencies' requirements. For the depreciable portion of the grant-funded properties, the annual depreciation and amortization of the Grant Funds shall be debited to Account 272, Accumulated Amortization of Contributions, and credit to Account 108.2, Accumulated Depreciation of Water Plant–Grant Funds. For the non-depreciable portion of the funded properties, when the properties are retired, the costs shall be credited to the appropriate plant account and charged to Account 265.1, Contributions in Aid of Construction–Government Grant Proceeds in order to eliminate any credit balance in the grant fund account applicable thereto.

PAWW did not report CIAC attributed to Government Grants.

6. Long-Term Debt

Water utilities are required to obtain prior authorization from the CPUC before incurring any long-term debt. PU Code Section 818, states 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, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the Commission, the money, property, or labor to be procured or paid for by the issue is reasonably required for the purposes specified in the order, and that, except as otherwise permitted in the order in the case of bonds, notes, or other evidences of indebtedness, such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

PAWW did not obtain CPUC's approval prior to incurring its Long-term Debt of $311,302 in accordance with PU Code, Section 818. PAWW compounded its interest expense at a rate of 24% annually or 2% monthly on the prior months' interest accrued and principal amount.

7. 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.

The Garcia River flooded in 2017, which is about 250 feet south of PAWW's Garcia River Well. Debris caught in the willows near PAWW's well site caused deposition of a large gravel bar, which caused the floodwaters to create a trench approximately 206 feet long and 30 feet wide on average toward PAWW's well site. PAWW recorded long-term debt of $90,418 from its affiliated companies for repairs due to the Garcia River flood. The repairs were performed by PAWW's affiliated companies.

PAWW filed Advice Letter 78 to recover expenses recorded in its Catastrophic Event Memorandum Account (CEMA) due to the Garcia River flood. The CPUC subject all bills to a one-time surcharge of $124,484 to be collected at the rate of $17.92 per customer per month over a period of 36 months from the effective date of Advice Letter No. 78 (April 26, 2018) and/or terminated upon the full amortization or recovery of the CEMA. PAWW was authorized to transfer the balance of $124,484 from the CEMA to a balancing account for recovery. PAWW reported a CEMA collection of $40,331 during 2019.

8. 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 charged Account 688, Regulatory Commission Expense, with fees paid to the CPUC.[3]

PAWW incorrectly recorded CPUC Users Fee of $7,954 in Account 236–Accrued Taxes, instead of Account 231–Accounts Payable. This caused PAWW's noncompliance with the USOA. In addition, the Users Fee of $4,086 was not recorded in Account 480-Other Water Revenues and Account 688–Regulatory Commission Expense.

9. Affiliate Transactions

Affiliate companies are all entities, including any holding companies that are under direct or indirect common ownership or control with a water utility regulated by the CPUC. Water utilities are required to comply with the rules specified in D.10-10-019 and SP U-21-W for all the transactions with its affiliates.

Rule 12 of SP U-21-W states, in part, that, "Water Utility shall file with the Commission each year a report which includes a summary of all transactions between Water Utility and its affiliated companies for the previous calendar year…."

PAWW's Long-term Debt of $311,302 is entirely comprised of related or affiliated transactions. These transactions and associated costs primarily resulted from equipment rentals from its affiliated companies that are commonly used in the water utility industry. There were no service agreements between the related entities for services provided by Bed-Rock Products, Inc., and X-Bar Ranch to the Utility. In addition, these related entities' transactions were not disclosed on the Annual Report in their prescribed accounts.

[3] D.16.11-006 dated November 10, 2016, General Accounting Instructions 9 on Pages B18 and B19.

10. Form of Financial Statements [4]

(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.

11. 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.

12. 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, PAWW has complied with these requirements.

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

APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS

Finding 1: CPUC's Approval for Long-Term Debt Was Not Obtained

Condition:
PAWW did not obtain CPUC's approval prior to incurring its reported Long-Term Debt totaling $311,302, as required by PU Code Section 818. PAWW incurred its Long-Term Debt resulting from services rendered to PAWW by two affiliated companies (Bed-Rock Products Inc. and X-Bar Ranch) from 2005 through 2019.

Criteria:
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 evidence 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.

USOA states that:

> 224. Long-Term Debt
>
> A. This account shall include all notes, conditional sales contracts, or other evidence of indebtedness payable more than one year from the date of issue.
>
> B. A separate subaccount shall be maintained for each obligation outstanding.
>
> Note: Prior authorization must be obtained from this Commission before any long-term indebtedness may be incurred by the utility. (Public Utilities Code, Section 818.)

Cause:
PAWW lacks policies and procedures to ensure liabilities payable more than one year from the date of issuance adheres to the CPUC directives.

Effect:
Noncompliance with CPUC's directives could expose PAWW to undue liability.

Recommendations:
PAWW should immediately file an advice letter with the CPUC's Water Division to seek the CPUC's approval for its long-term debts and follow Water Division's guidance accordingly. PAWW should develop and implement policies and procedures to ensure compliance with the requirements specified under PU Code Section 818 by obtaining CPUC's approval before incurring any long-term debt.

Finding 2: Inaccurate Reporting of Accounts Payable and Long-Term Debt

Condition:
PAWW's Accounts Payable reflected amounts it owed to its owner for office rent expenses incurred in 2011 and 2012 totaling $10,782. According to the USOA guidelines, Account 231–Accounts Payable should reflect amounts payable by the Utility within one year. Amounts payable more than one year from the date of issue should be recorded as Long-Term Debt. As a result, Account 231–Accounts Payable was overstated by $10,782 and Account 224–Long-Term Debt was understated by the same amount. PAWW corrected these misstatements in its revised financial statements submitted to UAB on December 10, 2020.

Criteria:
USOA states, in part, that:

> 231. Accounts Payable
> This account shall include all amounts payable by the utility within one year, which is not provided for in other accounts.
>
> 224. Long-Term Debt
> A. This account shall include all notes, conditional sales contracts or other evidence of indebtedness payable more than one year from the date of issue.
>
> B. A separate subaccount shall be maintained for each obligation outstanding.
>
> Note: Prior authorization must be obtained from this Commission before any long-term indebtedness may be incurred by the utility. (Public Utilities Code, Section 818).

Cause:
PAWW lacks policies and procedures over its financial reporting to ensure that the balance reported in Account 231–Accounts Payable reflects amounts payable by PAWW within one year and balance payable more than one year from issuance was reported in Account 224–Long-Term Debt.

Effect:
Inaccurate reporting of Accounts Payable has distorted PAWW's financial position as of December 31, 2019, and lowered PAWW's liquidity ratio, which could raise concerns for decision-makers about PAWW's ability to meet its current obligations.

Recommendation:
PAWW should develop and implement policies and procedures over its Accounts Payable and Long-Term Debt to ensure amounts recorded in these accounts accurately reflect PAWW's short-term and long-term obligations.

Finding 3: Prior Year Revenues and Expenses Recorded in Current Year

Condition:
PAWW recorded prior year revenues of $12,024 in Account 421–Non-Utility Income and prior-year expenses of $40,070 in Account 426–Miscellaneous Non-Utility Expense in the current year. The recording errors occurred because PAWW did not use the accrual basis of accounting to record all

revenues and expenses in the correct accounting period. PAWW corrected these misstatements in its revised financial statements submitted to UAB on December 10, 2020.

Criteria:
USOA states, in part, that:

> 2. General Accounting Instructions
>
> A. The books of account of all water utilities shall be kept by the double entry method, on an accrual basis. Each utility shall post its accounts monthly and shall close its books at the end of each calendar year.

Cause:
PAWW lacks adequate review procedures over its financial reporting process to ensure revenues and expenses are recorded in the proper periods using the accrual basis of accounting.

Effect:
Noncompliance with CPUC's directives could cause the financial statements to be materially misstated, which could impact the water tariff rates determined during the general rate case.

Recommendation:
PAWW should develop and implement a record review process to ensure that all revenues and expenses are recorded using the accrual basis of accounting in the correct accounting period.

Finding 4: Water Revenue Late Fees

Condition:
PAWW incorrectly recorded late fees of $3,315 collected from water service customers in Account 421–Non-Utility Income. CPUC's Standard Practice U-28-W requires that late fees be recorded as Other Water Revenue. As a result, Account 421–Non–Utility Income was overstated by $3,315 and Account 480–Other Water Revenue was understated by the same amount. PAWW corrected these misstatements in its revised financial statements submitted to UAB on December 10, 2020.

Criteria:
Standard Practice U-28-W states, in part, that:

> **Late Payment Charge:**
> Late payment charges may be imposed when the customer doesn't pay the bill within 19 days of it being mailed (see Public Utilities Code Section 779.1)… Resolution W-4035, April 9, 1997, authorizes Ponderosa Water Company and all Class C and D water utilities to charge a late payment charge of $5.00 after they file an advice letter and tariff describing the charge… These funds should be booked as Other Utility Revenues.

USOA states, in part, that:

> **480. Other Water Revenue**
> This account shall include revenue from water operations other than the delivery of water or provision of fire protection. This account shall be appropriately subdivided.

Items

Fees for changing, temporarily shutting off or reconnecting services.
Maintenance of appliances or repair of piping on customers' premises Rental income from water property.

Cause:
PAWW lacks accounting policies and procedures to ensure compliance with CPUC's directives, including the USOA, and to ensure water revenues are properly classified and accurately reported.

Effect:
Improper reporting of late fees can cause financial statements to be materially misstated, which could impact the water tariff rates during the general rate case.

Recommendation:
PAWW should develop and implement accounting policies and procedures that comply with the USOA requirements and ensure that all revenues are properly classified and accurately recorded.

Finding 5: Reporting Errors and Untimely Remittance of CPUC's Users Fee

Condition:
PAWW improperly recorded and reported CPUC Users Fee and did not timely remit a portion of CPUC Users Fee. During the review of PAWW's collection and remittance of CPUC Users Fee, UAB noted that Account 231–Accounts Payable was understated by $7,954 and Account 236–Accrued Taxes was overstated by the same amount; and Account 480–Other Water Revenue and Account 688–Regulatory Commission Expense were understated by $4,086 as follows:

- PAWW incorrectly recorded the liability for CPUC Users Fee totaling $7,954 payable to the CPUC in Account 236–Accrued Taxes instead of Account 231–Accounts Payable. As a result, Accounts Payable was understated by $7,954 and Account 236–Accrued Taxes was overstated by the same amount. In addition, the liability for CPUC Users Fee as of December 31, 2019 included Users Fee for the year 2018 totaling $3,874 that was not timely remitted to the CPUC. PU Code Section 433 requires utilities to remit Users Fee to the CPUC at least annually. As a result, PAWW did not comply with the CPUC directives.

- PAWW did not properly record Users Fee totaling $4,086 attributed to the year 2019 in Account 480–Other Water Revenue and Account 688–Regulatory Commission Expense, as required by the USOA. Consequently, both accounts were understated by $4,086.

PAWW corrected these misstatements in its revised financial statements submitted to UAB on December 10, 2020.

Criteria:
USOA states, in part, that:

> **9. Water Utility Users Fee**
> Public Utilities Code Sections 401 through 415 provide that the Commission shall annually set a fee to be paid by water utilities to cover the costs incurred by the Commission in regulating them. A percentage of gross revenues is added to customer bills and paid by the water companies to the Commission.

A. Class A water utilities pay a percentage of gross revenues quarterly; Class B, C, and D water utilities pay a designated amount, based on gross revenues, on January 15 of the following year. Sales of water for resale and Interdepartmental water sales should be excluded from gross revenues when computing the 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.

231. Accounts Payable
This account shall include all amounts payable by the utility within one year, which is not provided for in other accounts.

Resolution M-4839 states, in part, that:

(e) For every public utility with annual gross intrastate revenues of seven hundred fifty thousand dollars ($750,000) or less, the Commission shall annually establish uniform fees to be paid by each such public utility, if the revenues collected thereby are consistent with paragraph (2) of subdivision (a) and subdivision (c).

PU Code Section 433 states that:

Except as provided in Section 404, every public utility subject to Section 431 shall make payment of the required fee in accordance with the following schedule:

(a) Every public utility with annual gross intrastate revenues of seven hundred fifty thousand dollars ($750,000) or less shall make payment of the fee to the commission on an annual basis on or before January 15.

(b) Every other public utility not subject to subdivision (a) shall make payment of the fee to the commission on a quarterly basis between the first and 15th days of July, October, January, and April.

Cause:
PAWW lacks accounting and reporting policies and procedures to ensure compliance with CPUC's directives, including the accounting requirements specified in the USOA.

Effect:
Inaccurate reporting of Taxes Accrued, Other Water Revenues, and Regulatory Commission Expense balances distorted PAWW's financial position as of December 31, 2019, which could impact the water tariff rates during the general rate case.

Recommendation:
PAWW should establish and implement accounting and reporting policies and procedures relating to recording and reporting of CPUC Users Fee to ensure compliance with the CPUC's directives and USOA requirements.

Finding 6: Misclassification of Related Party Receivables and Payables

Condition:
PAWW incorrectly recorded a reimbursement totaling $4,145 for power expense owed to PAWW by an affiliated company, Bed-Rock Products Inc., in Account 174–Other Current Assets instead of Account 142–Receivables from Affiliated Companies, as required by the USOA. Therefore, PAWW overstated the Other Current Assets by $4,145 and understated the Receivables from Affiliated Companies by the same amount. PAWW corrected these misstatements in its revised financial statements submitted to UAB on December 10, 2020.

In addition, while reviewing PAWW's related party transactions, we noted that PAWW's accounting practice was to record amounts due to its affiliated companies as Accounts Payable instead of recording them as Payables to Affiliated Companies in its Annual Report as prescribed by USOA.

Criteria:
USOA states, in part, that:

> **142. Receivables from Affiliated Companies**
> This account shall include the debit balances subject to current settlement in open accounts with affiliated companies, and notes and drafts which affiliated companies are liable, and which mature and are expected to be paid in full no later than one year from date of issuance, together with interest thereon. Items which do not bear a specified due date, but which have been carried for more than 90 days and items which are not paid within 90 dates from due date shall be transferred to Account 123, Investments by Affiliated Companies.

Cause:
PAWW lacks accounting policies and procedures to ensure receivables from affiliated companies were recorded in Account 142–Receivables from Affiliated Companies and amounts due to affiliated companies were recorded as Payables to Affiliated Companies, as required by the USOA.

Effect:
Inaccurate reporting of Accounts Receivable distorted PAWW's financial position as of December 31, 2019, which could impact the water tariff rates determined during the general rate case.

Recommendation:
PAWW should establish and implement accounting policies and procedures to ensure PAWW complies with the CPUC directives and USOA requirements for reporting its affiliated transactions on its annual reports.

Finding 7: Internal Control Weaknesses over Record Retention

Condition:
PAWW lacked adequate record retention protocols, which led to unsupported information reported in its Annual Report. While reconciling account balances reported in PAWW's Annual Report with its accounting records, UAB noted the PAWW did not maintain adequate documentation to support the reported balances in the Accumulated Depreciation and Contribution in Aid of Construction (CIAC) accounts as follows:

- PAWW was unable to provide documentation to support Accumulated Depreciation totaling $69,987. PAWW reported Accumulated Depreciation of $868,130 in its Annual Report, but the Depreciation Schedules only supported partial Accumulated Depreciation totaling $798,143. PAWW prepared the Depreciation Schedules in 2016 with data from prior years' tax returns and Annual Reports going back to the year 1996. However, PAWW did not update its accumulated depreciation balance shown in its Depreciation Schedules to reflect the accumulated depreciation balances reported in prior years' Annual Reports.

- PAWW was unable to provide a detailed list identifying $820,473 of the total $932,199 Contributions in Aid of Construction (CIAC) assets due to lack of adequate record retention. As a result, PAWW used inconsistent depreciation methodologies to depreciate its assets. PAWW used the straight-line remaining life method to calculate its depreciation expense for the WPIS funded by PAWW, while using the composite rate method to amortize its CIAC assets.

Criteria:
USOA states, in part, that:

> **2. General Accounting Instructions**
> A. The books of account of all water utilities shall be kept by the double entry method, on an accrual basis. Each utility shall post its accounts monthly and shall close its books at the end of each calendar year.
>
> B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction."
>
> **4. Depreciation**
> A. Depreciation charges shall be computed using the straight-line remaining life method (see definition (17)), and composite depreciation rates (see definition (4)). The rates shall be reviewed periodically and adjusted as required, so that the depreciation accrual will bear a reasonable relationship to the remaining life, the estimated net future salvage, costs of plant in service, and to the balance of accumulated depreciation accrued in prior periods.

Cause:
PAWW stated that the cause of the variance in Accumulated Depreciation was due to the depreciation schedules being prepared in 2016 in its attempt to better track depreciation going forward. In addition, PAWW lacked record retention policies and procedures for its assets to ensure assets were properly identified, recorded, and safeguarded.

Effect:
Inadequate record-keeping can cause inaccurate financial information to be reported in the financial statements, potentially impacting the water rates for PAWW's ratepayers determined during PAWW's general rate case.

Recommendation:
PAWW should develop and implement record retention policies and procedures for its assets to ensure it retains accurate asset balances and their associated depreciation.

Finding 8: Internal Control Weaknesses Over Financial Reporting

Condition:
The UAB noted the following weaknesses in internal controls over PAWW's financial reporting:

- While reviewing PAWW's affiliated party transactions, we noted that PAWW had no formal written service agreements between the related entities – Bed Rock Products Inc. and X-Bar Ranch – for services rendered, which could expose PAWW to unnecessary liability and legal disputes.

- While reviewing PAWW's operating revenues, we noted that PAWW did not record its revenues and associated receivables timely or monthly as customers were being billed in its general ledger, as required by the USOA. Instead, PAWW recorded a single journal entry (JE 005) to record operating revenues and corresponding Accounts Receivables at year-end.

Criteria:
USOA states, in part, that:

> **2. General Accounting Instructions**
> A. The books of account of all water utilities shall be kept by the double entry method, on an accrual basis. Each utility shall post its accounts monthly and shall close its books at the end of each calendar year.
>
> B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction."

Good internal and prudent business practices require companies to formalize all major business agreements in writing to minimize liabilities and legal disputes.

Cause:
PAWW lacks policies and procedures to ensure that all major business agreements are formalized in writing. In addition, PAWW lacks policies and procedures to ensure its revenues were recorded timely or monthly as required by the USOA guidelines.

Effect:
Noncompliance with CPUC's directives could cause the financial statements to be materially misstated, which could impact the water tariff rates determined during the general rate case.

Recommendations:
PAWW should establish written policies and implement procedures requiring all major business agreements to be formalized in writing. PAWW should also establish and implement policies and

procedures to record monthly all revenue, receivables, and affiliated transactions to ensure compliance with the CPUC's directives and USOA requirements.

APPENDIX B—PAWW'S RESPONSE

Point Arena Water Works, Inc.
PO Box 205
Point Arena, CA 95468
(707) 882-1696 phone
(707) 882-3258 fax
paww@mcn.org

January 18, 2021

Sharmin Wellington, CPA
California Public Utilities Commission
Utility Audits Branch
400 R Street, Suite #221
Sacramento, CA 95811

Dear Sharmin;

"Point Arena Water Works, Inc. (PAWW) 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. 1, PAWW was not aware that approval of long-term debt was needed for unpaid invoices that were past a year overdue and were for general maintenance and repairs of the water system, not capital improvements. PAWW will prepare an advice letter with the CPUC to for the approval of this long-term debt.

Regarding Finding No. 7, PAWW's previous accountant had maintained records of CIAC but sadly they passed away suddenly and the records of CIAC were not able to be recovered. Going forward PAWW will maintain a record of all CIAC put in place.

Regarding all other findings, PAWW will follow the recommendations of the CPUC."

Sincerely;

William G. Hay, Jr.

William G. Hay Jr.
President