

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

January 25, 2021

Mr. Robert Berry, President
Yerba Buena Water Company
P. O. Box 3829
Paso Robles, CA 93447

Dear Mr. Berry:

Final Report Transmittal Letter—Review of Yerba Buena Water Company’s 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 Yerba Buena Water Company’s (YBWC) 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 for the year then ended. The final review report is enclosed.

YBWC’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 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 YBWC’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 Berry, President
Yerba Buena Water Company
January 25, 2021
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cc: Christian Aldinger, CPA, Peasley, Aldinger & O’Bymachow, An Accountancy Corporation
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



REVIEW OF FINANCIAL STATEMENTS

Yerba Buena Water Company

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**

**Justin Kessler, 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

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EXECUTIVE SUMMARY

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a review of the financial statements of Yerba Buena Water Company (YBWC) 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).

YBWC was incorporated in California on August 23, 1947. YBWC is a Class D water utility that serves 245 metered customers. YBWC's service area is located approximately 15 miles north of Malibu in Ventura County, California. As a regulated water utility, YBWC 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 YBWC 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 YBWC's revised financial statements in order for them to be in accordance with the accounting framework established in the USOA. For the review period, YBWC filed its 2019 Annual Report timely in compliance with the CPUC directive from the Water Division. However, UAB noted that YBWC did not comply with PU Code Section 818 because YBWC incurred a long-term obligation without obtaining CPUC's authorization. UAB identified four material misstatements in YBWC's Annual Report originally filed with the CPUC's Water Division, as described in the Appendix A—Review Findings and Recommendations. In addition, UAB noted one significant deficiency in YBWC's internal control that came to our attention during the review. These findings are summarized below:

- Finding 1: YBWC incorrectly reported \$69,500 of compensation paid to a contractor in Account 630—Employee Labor. The compensation to the contractor included \$5,000 compensation for legal consulting services and \$64,500 compensation for repair and maintenance services.
- Finding 2: YBWC incorrectly reported \$54,000 of consulting services as Management Salaries and \$11,900 of external bookkeeping services as Office Salaries instead of reporting them as Professional Services in the Annual Report.

- Finding 3: YBWC improperly classified long-term advances totaling \$443,503 from its parent company, Crowne Pointe Estates, as Accounts Payable in Account 231 instead of Long-Term Debt in Account 224. In addition, YBWC did not request the CPUC's authorization prior to obtaining these long-term advances from its parent company, as required by PU Code 818.
- Finding 4: YBWC incorrectly accounted for contracted billing services totaling \$5,000 in Account 678—Office Services and Rentals, instead of in Account 682—Professional Services.
- Finding 5: YBWC does not have formalized agreements for services provided by its affiliated companies, including cash advances from its parent company, which is inconsistent with prudent business practices.

UAB discussed the above findings and recommendations with YBWC at the exit conference on October 16, 2020. YBWC concurred with the review results and agreed to post UAB's proposed adjusting entries. On October 16, 2020, YBWC 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. UAB provided a draft review report to YBWC for comments on December 29, 2020. YBWC submitted its comments on January 8, 2021, agreeing to implement UAB's recommendations, but expressed some concerns about them. YBWC's response is included in Appendix B of this report. UAB's evaluation of YBWC's response is included in Appendix C of this report. The review findings and recommendations presented in this report represent our final determination of this review engagement.

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

Mr. Robert Berry, President
Yerba Buena Water Company
P.O. Box 3829
Paso Robles, CA 93447

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the financial statements of Yerba Buena Water Company (YBWC), 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 YBWC'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

YBWC'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. YBWC'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, YBWC'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 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 YBWC complied with PU Code Section 818 to obtain its long-term debts, and whether YBWC 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 four material misstatements in YBWC'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, YBWC timely filed its 2019 Annual Report in compliance with the CPUC directive from the Water Division. However, UAB noted that YBWC did not comply with PU Code Section 818 because YBWC incurred a long-term obligation without obtaining CPUC's authorization.

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. YBWC'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

UAB discussed the above findings and recommendations with YBWC at the exit conference on October 16, 2020. YBWC concurred with the review results and agreed to post UAB's proposed adjusting entries. On October 16, 2020, YBWC 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. UAB provided a draft review report to YBWC for comments on December 29, 2020. YBWC submitted its comments on January 8, 2021, agreeing to implement UAB's recommendations, but expressed some concerns about them. YBWC's response is included in Appendix B of this report. UAB's evaluation of YBWC's response is included in Appendix C of this report. 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

YBWC'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 YBWC will implement the recommendations and provide the timing of incorporating UAB's review adjustments to YBWC's books and records. If YBWC 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. YBWC 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 YBWC. 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

Yerba Buena Water Company Balance Sheet (As Reviewed) As of December 31, 2019

ASSETS	
UTILITY PLANT	
Water Plant in Service	\$1,524,191
Accumulated Depreciation of Water Plant	(741,146)
Net Utility Plant	<u>783,045</u>
CURRENT AND ACCRUED ASSETS	
Cash	31,586
Special Deposits	1,257
Accounts Receivable	12,783
Other Current Assets	125,407
Total Current and Accrued Assets	<u>171,033</u>
Total Assets	<u><u>\$954,078</u></u>
CAPITALIZATION AND LIABILITIES	
CORPORATE CAPITAL AND SURPLUS	
Common Stock	\$26,000
Other Paid-in Capital	385,319
Retained Earnings	(282,009)
Total Capitalization	<u>129,310</u>
LONG-TERM DEBT	
Long-Term Debt	443,503
CURRENT AND ACCRUED LIABILITIES	
Accounts Payable	38,544
Customer Deposits	4,554
Total Current and Accrued Liabilities	<u>43,098</u>
CONTRIBUTIONS IN AID OF CONSTRUCTION	
Contributions in Aid of Construction	579,220
Accumulated Amortization of Contributions	(241,053)
Net Contributions in Aid of Construction	<u>338,167</u>
Total Equity and Liabilities	<u><u>\$954,078</u></u>

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

Yerba Buena Water Company
Income Statement (As Reviewed)
 For Year Ended December 31, 2019

OPERATING REVENUES	
Metered Water Revenue	\$359,943
Other Water Revenue	715
Total Operating Revenue	<u>360,658</u>
OPERATING EXPENSES	
Plant Operation and Maintenance Expenses	
Power	16,908
Other Volume Related Expenses	3,572
Materials	286
Contract Work	108,996
Transportation Expenses	6,382
Other Plant Maintenance Expenses	141,056
Total Plant Operation and Maintenance Expenses	<u>277,200</u>
Administrative and General Expenses	
Office Services and Rentals	7,601
Office Supplies and Expenses	15,278
Professional Services	84,454
Insurance	6,296
Regulatory Commission Expense	4,554
General Expenses	689
Net Administrative and General Expenses	<u>118,872</u>
Total Operating Expenses	396,072
Depreciation Expense	23,631
Taxes Other Than Income Taxes	12,233
State Corporate Income Tax Expense	800
Total Operating Revenue Deductions	<u>432,736</u>
Total Utility Operating Loss	(72,078)
Net Loss	<u><u>(\$72,078)</u></u>

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

Yerba Buena Water Company
Statement of Retained Earnings (As Reviewed)
For Year Ended December 31, 2019

Retained Earnings, Beginning of Year	(\$209,931)
DEBITS:	
Net Loss	<u>(72,078)</u>
Total Credits	(72,078)
Retained Earnings, End of Year	<u>(\$282,009)</u>

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

Yerba Buena Water Company

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.¹ The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs.

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

Yerba Buena Water Company (YBWC) computes depreciation on a straight-line remaining life of method.

(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.

YBWC did not retire any assets during the review period.

(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.

YBWC did not sell or acquire any properties during the review period.

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.

YBWC did not report any inventory in its 2019 Annual Report.

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.

YBWC had a restricted cash balance of \$1,257 recorded in Account 132–Cash–Special Deposits in its 2019 Annual Report.

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.”

YBWC did not report any Advances for Construction in its 2019 Annual Report.

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.

YBWC reported a balance of \$1,257 for unspent facilities fees in Account 253–Other Credits and Account 132–Cash–Special Deposits.

7. 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.

YBWC has an outstanding unsecured long-term advance from its parent company, Crown Pointe Estates totaling \$443,503. Crown Pointe Estates advanced YBWC a total of \$204,447 prior to 2015 and an additional \$191,218 during 2015 and 2016. The purpose of these advances from Crown Pointe Estates was to ensure that YBWC timely paid its contractors and vendors and avoid cash shortages. In addition, YBWC has an additional payable to Crown Pointe Estates totaling \$47,838 for repair services provided in 2019. These advances are unsecured long-term payables to its affiliated company. YBWC does not incur any interest charges on these advances and it has not encumbered any of its utility properties as a result of these transactions.

As noted in Finding 2, YBWC incorrectly classified the long-term advances from its parent company as Accounts Payable in Account 231 instead of reporting the long-term advances as Long-Term Debt in Account 224 in its original Annual Report. In addition, YBWC did not comply with PU Code Section 818 because it did not obtain CPUC's authorization prior to incurring the long-term obligation.

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 charge Account 688, Regulatory CPUC Expense, with fees paid to the CPUC.²

YBWC correctly included CPUC Users Fee in Account 688–Regulatory Commission Expense and Account 470–Metered Water Revenue.

² D.16.11-006 dated November 10, 2016, General Accounting Instructions 9 on Pages B18 and B19.

9. Form of Financial Statements ³

(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.

10. 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.

11. 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, YBWC has complied with these requirements.

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

APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS

Finding 1: Improper Reporting of Compensation Paid to Non-Utility Employees

Condition:

YBWC improperly recorded \$69,500 of compensation paid to a contractor in Account 630—Employee Labor in the Annual Report originally filed with the CPUC’s Water Division on June 12, 2020. The compensation to the contractor included \$5,000 for legal consulting services and \$64,500 for repair and maintenance services. According to the USOA, legal consulting services should be reported as Professional Services, while repair and maintenance services provided by non-utility employees should be reported as Contract Work. As a result, Account 630—Employee Labor was overstated by \$69,500, Account 682—Professional Services was understated by \$5,000 and Account 650—Contract Work was understated by \$64,500. YBWC corrected these misstatements in its revised financial statements submitted to UAB on October 16, 2020.

Criteria:

The USOA states, in part, that:

630. Employee Labor

This account shall include the wages of all employees whose time is utilized in the operation, repair, and maintenance of the water system.

650. Contract Work

This account shall include the cost of all repair and maintenance work not performed by water company employees.

682. Professional Services

This account shall include the fee of independent accountants, engineers, lawyers, and similar professional consultants.

Cause:

YBWC lacks adequate monitoring procedures to ensure the compensation for individuals not employed by the Utility were recorded as Contract Work or Professional Services in accordance with the USOA accounting requirements.

Effect:

Improper classification of Contract Work and Professional Services expenses distorted YBWC’s 2019 income statement and resulted in inaccurate reporting in the Annual Report. Inconsistent classification of expenses reduces the comparability of financial statements among small water utilities.

Recommendations:

YBWC should establish and implement monitoring policies and procedures to ensure adherence to the USOA accounting requirements. YBWC should record and report expenses pertaining to services provided by non-employees as Contract Work and Professional Services expenses as required.

Finding 2: Improper Reporting of Professional Services**Condition:**

YBWC incorrectly reported \$54,000 consulting services as Management Salaries and \$11,900 of external bookkeeping services as Office Salaries instead of reporting them as Professional Services in the Annual Report originally filed with the CPUC's Water Division on June 12, 2020. According to the USOA, fees for consultants and bookkeepers who are not employed by the utility should be reported as Professional Services. As a result, Account 671—Management Salaries was overstated by \$54,000, Account 670—Office Salaries was overstated by \$11,900 and Account 682—Professional Services was understated by \$65,900. YBWC corrected these misstatements in its revised financial statements submitted to UAB on October 16, 2020.

Criteria:

The USOA states, in part, that:

682. Professional Services

This account shall include the fee of independent accountants, engineers, lawyers, and similar professional consultants.

670. Office Salaries

This account shall include the salaries of all employees whose time is utilized in billing, collecting, record keeping, or general office work.

671. Management Salaries

This account shall include the portion of salaries of managers, owners, partners or principal stockholders of a utility, chargeable to utility operations.

Cause:

YBWC lacks adequate monitoring procedures to ensure the compensation for individuals not employed by the utility for consulting and bookkeeping services were recorded as Professional Services in accordance with the USOA accounting requirements.

Effect:

Improper classification of Contract Work and Professional Services expenses distorted YBWC's 2019 income statement and resulted in inaccurate reporting in the Annual Report. Inconsistent classification of expenses reduces the comparability of financial statements among small water utilities.

Recommendations:

YBWC should establish and implement monitoring policies and procedures to ensure adherence to the USOA accounting requirements. YBWC should record and report expenses pertaining to services provided by non-employees as Contract Work and Professional Services expenses as applicable.

Finding 3: Misclassification of Long-Term Obligations and Noncompliance with PU Code Section 818**Condition:**

YBWC improperly classified long-term advances totaling \$443,503 from its parent company, Crowne Pointe Estates, as Accounts Payable in Account 231, in its Annual Report originally filed

with the CPUC's Water Division on June 12, 2020. According to the USOA, Account 231—Accounts Payable should only include payables by the utility that are due within one year. Crowne Point Estates advanced YBWC a total of \$204,447 prior to 2015 and an additional \$191,218 during 2015 and 2016. YBWC has an additional payable to Crown Pointe Estates totaling \$47,838 for repair services provided in 2019, which is not expected to be paid within a year. These advances are unsecured long-term obligations payable to YBWC's parent company. As a result, Account 231—Accounts Payable was overstated by \$443,503 and Account 224—Long-Term Debt was understated by the same amount. YBWC corrected these misstatements in its revised financial statements submitted to UAB on October 16, 2020.

In addition, YBWC did not obtain the CPUC's authorization prior to obtaining these long-term advances from its parent company, as required by PU Code, Section 818.

Criteria:

The USOA states, in part, that:

231. Accounts Payable

This account shall include all amounts payable to 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 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.)

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.

Cause:

YBWC lacks adequate policies and procedures to ensure that obligations payable more than one year from the date of issue are properly classified as Long-Term Debt in Account 224. YBWC also lacks adequate policies and procedures to ensure compliance of requirements specified in PU Code Section 818 for obtaining long-term obligations.

Effect:

Inaccurate reporting of Long-Term Debt as Accounts Payable distorted YBWC's financial position as of December 31, 2019, which could cause decision-makers to incorrectly perceive that the Utility may be unable to meet its current financial obligations. In addition, YBWC's noncompliance with PU Code Section 818 for obtaining CPUC's authorization prior to incurring long-term debts could expose YBWC to undue liability.

Recommendations:

YBWC should establish and implement policies and procedures to ensure adherence to the USOA accounting requirements relating to Accounts Payable and Long-Term Debt. YBWC should implement policies and procedures to ensure that CPUC's approval is obtained prior to incurring any long-term indebtedness. In addition, YBWC should immediately file an Advice Letter to seek authorization to recognize the portion of Accounts Payable that is owed to Crown Point Estates as an unsecured long-term advance from an affiliate.

Finding 4: Professional Services Incorrectly Accounted for as Office Services and Rentals**Condition:**

YBWC incorrectly reported contracted billing services totaling \$5,000 as Office Services and Rentals in Account 678 instead of Professional Services in Account 682, in its Annual Report originally filed with the CPUC's Water Division on June 12, 2020. YBWC corrected these misstatements in its revised financial statements submitted to the UAB on October 16, 2020.

Criteria:

USOA states, in part, that:

678. Office Services and Rentals

Items

Computer and/or Billing Machine Credit Reports
 Payments to Service Bureaus Commissions to Others
 Office Equipment Rentals For Collecting Bills
 Other Services

682. Professional Services

This account shall include the fee of independent accountants, engineers, lawyers, and similar professional consultants.

Cause:

YBWC lacked adequate monitoring procedures and a review process to ensure the contracted billing service expenses are accurately reported as Professional Services in Account 682 as required by the USOA.

Effect:

Improper reporting of Professional Services and Office Services and Rentals expenses distorted YBWC's 2019 income statement and resulted in inaccurate reporting in the Annual Report. Inconsistent classification of expenses reduces the comparability of financial statements among small water utilities.

Recommendations:

YBWC should establish and implement monitoring and review procedures to ensure reporting errors are detected and the Annual Report adheres to the USOA accounting requirements. YBWC should record and report its contracted billing service expenses in Account 682–Professional Services.

Finding 5: Lack of Formalized Agreements**Condition:**

YBWC did not have a formalized protocol for cash advances and services provided by its affiliated companies, which is inconsistent with prudent business practices. While reviewing YBWC's affiliated transactions, we noted that YBWC's parent company Crown Point Estates provided services to repair damages caused to YBWC's water plant by the Woolsey Fire in November 2018. The terms of these services were not formalized in a written agreement. In addition, Crown Point Estates has provided long-term advances to YBWC totaling \$443,503 since 2005; however, the terms of these long-term advances are not formalized in a written agreement. Lack of written contracts to document major business agreements can expose YBWC to unnecessary liabilities and legal disputes.

Criteria:

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

Cause:

YBWC lacks adequate internal controls to ensure that all major business agreements are formalized in writing.

Effect:

The lack of formalized agreements can expose YBWC to unnecessary liabilities or legal disputes.

Recommendations:

YBWC should establish written policies and implement procedures which would require that all major business agreements get formalized in writing.

APPENDIX B—YBWC'S RESPONSE

Yerba Buena Water Company

P.O. Box 3829 • Paso Robles, CA 93447

January 8, 2021

Angie Williams, Director
Utility Audits, Risk and Compliance Division
Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Re: Draft Review Report for the review of Yerba Buena Water Company's Annual Report
for the period of January 1, 2019 through December 31, 2019

Dear Ms. Williams,

YBWC is submitting written comments concerning the Draft Review Report for the review of YBWC's Annual Report for the 2019 year.

Findings 1, 2 & 4:

YBWC does not have any actual employees. As a small company, YBWC has used outside services to perform the functions that employees would normally perform. A large company with a full staff of actual employees would allocate payroll to the Employee Labor, Management Salaries and Office Salaries Accounts. In the GRC process the outside services have historically been assigned to the account to where the employee wages would have been charged. This has been done to aid in the understandability of the YBWC Operations and Summary of Earnings.

YBWC understands the Uniform System of Accounts specifies that only "actual" wages be included in Account 630-Employee Labor, Account-670 Office Salaries and Account 671-Management Salaries.

YBWC has made the UAB's recommended adjustments related to Findings 1, 2 & 4 in the revised 2019 Annual Report submitted at the time of the exit conference and will in the future years classify expenses consistent with UAB's findings.

YBWC expresses its concern that in future GRC's, CPUC Staff Analysts may have issues with how the normal labor functions are presented in the Summary of Earnings.

Finding 3:

In accordance with the recommendations of UAB, YBWC filed AL. No. 56 on December 4, 2020 to request CPUC authority to consider the Accounts Payable that is more than one year old to be a liability properly included in Account No. 224-Long Term Debt.

Angie Williams, Director
January 8, 2021
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YBWC wants to also respond to the finding with several clarifications:


- a) These obligations that were originally due to YBWC vendors still carry the same terms even after CPE bought the obligations from the vendors. Simply put, for these Accounts Payables on YBWC books, the original vendor (or CPE who acquired the A/P) never agreed to any change in terms and furthermore did not consent to a change in classification from Accounts Payable to "Long-Term" Debt. YBWC agrees that it is improbable that these Accounts Payable will be paid within the next year.
- b) YBWC did not borrow funds or obtain Long-Term debt contrary to the requirements specified in PU Code Section 818. YBWC responds to this finding in the Review Report by restating that although these payables are more than one year old and probably won't be paid within one year, these payables don't meet the normal accounting criteria to be Long-Term Debt. YBWC did not receive funds nor encumber any of its assets.

As previously stated, YBWC has complied with UAB's recommendations and filed an Advice Letter to request authority to recognize these unpaid payables as Long-Term Debt.

Finding 5:

YBWC recognizes the benefits of documenting and formalizing major business agreements and will establish a policy to formalize major business agreements.

Sincerely,


Robert M. Berry
President
Yerba Buena Water Company

APPENDIX C—UAB'S EVALUATION OF YBWC'S RESPONSE

YBWC submitted its response to UAB's draft report on January 8, 2021. The response has been incorporated into Appendix B of this report. In evaluating YBWC's response, we noted that YBWC has agreed to implement our recommendations. However, YBWC expressed concerns relating to the findings as follows:

Finding 1: Improper Reporting of Compensation Paid to Non-Utility Employees

Finding 2: Improper Reporting of Professional Services

Finding 4: Professional Services Incorrectly Accounted for as Office Services and Rentals

YBWC has made UAB's recommended adjustments in the revised 2019 Annual Report and will prospectively classify those expenses consistent with UAB's findings and recommendations. However, YBWC expressed concerns about UAB's recommended classification of those expenses during future GRC application process. YBWC stated that historically expenses for outside services had been assigned as employee labor expenses and YBWC is concerned that CPUC may have an issue with how the labor functions are presented in the Summary of Earnings during future GRC process.

UAB appreciates that YBWC has taken steps to remediate these findings. UAB conducted the review engagement in accordance with GAGAS to determine whether YBWC's Annual Report was presented in accordance with the accounting framework of the USOA. UAB's Findings 1, 2, and 4 are consistent with the USOA accounting requirements. Therefore, UAB's findings and recommendations remain unchanged.

Finding 3: Misclassification of Long-Term Obligations and Noncompliance with PU Code Section 818

UAB appreciates that YBWC has implemented UAB's recommendation and filed an Advice Letter with the Water Division to request CPUC's authorization to recognize the long-term advances due to its parent company, Crowne Pointe Estates, as Long-Term Liabilities. YBWC stated that although these liabilities will not be paid within one year, YBWC believes that these liabilities do not meet the typical accounting criteria to be considered Long-Term Debt. YBWC acknowledged that a significant portion of YBWC's advances from its parent company has been outstanding for over 15 years. The USOA specifies that short-term liabilities are payable not more than one year from the date of issuance or creation. In addition, the USOA specifies that debt payable more than one year from the date of issue should be classified as Long-Term Debt. UAB reiterates that Crowne Pointe Estates has provided several advances to YBWC since 2005 to payoff liabilities YBWC owed to its vendors. Since a significant portion of these advances have been outstanding for over 15 years, it meets the criterion of long-term debt (i.e., debt payable at periods of more than 12 months). Therefore, UAB's finding is consistent with the statutory requirement specified in PU Code Section 818 and the USOA accounting requirements. UAB's finding and recommendation remains unchanged.

Finding 5: Lack of Formalized Agreements

YBWC agreed with UAB's finding and recommendation.