STATE OF CALIFORNIA GAVIN NEWSOM, *Governor*

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

Transmitted via e-mail

February 2, 2021

Ms. Jennifer Merchant
Chief Executive Officer
The Sea Ranch Water Company
P. O. Box 16
The Sea Ranch, CA 95497

Dear Ms. Merchant:

Final Report Transmittal Letter—Review of The Sea Ranch 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 The Sea Ranch Water Company (TSRWC) 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.

TSRWC'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 19, 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 TSRWC'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: Ellen A. Buechner, Director of Financial Services and Human Resources, TSRWC
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
Rimple Bhatti, Associate Management Auditor, UAB

REVIEW OF FINANCIAL STATEMENTS

The Sea Ranch Water Company

For the Year Ended December 31, 2019

Utility Audits, Risk and Compliance Division
Utility Audits Branch
February 2, 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

Rimple Bhatti, 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 The Sea Ranch Water Company (TSRWC) as of December 31, 2019, pursuant to Public Utilities (PU) Code Sections 314.5, 314.6, 581, 582, and 584 that provide the CPUC the statutory authority to review or audit the books and records of the regulated utilities. We conducted this review in accordance with the standards prescribed under Review Engagements in the Generally Accepted Government Auditing Standards (GAGAS).

TSRWC was incorporated in California on October 9, 1964. TSRWC is a Class C water utility with 1,868 metered water service connections and two irrigation service connections in the Sea Ranch area. TSRWC headquarters is located approximately seven miles southeast of Gualala in Sonoma County. TSRWC is a wholly owned subsidiary of The Sea Ranch Association (TSRA), a non-profit mutual benefit corporation. The majority of TSRWC's customers are voting members of TSRA, but TSRWC also serves customers that are not members of the TSRA. As a regulated water utility, TSRWC 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 TSRWC 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 TSRWC's revised financial statements in order for them to be in accordance with the accounting framework established in the USOA. For the review period, UAB did not note any noncompliance with PU Code Section 818; and TSRWC filed its 2019 Annual Report timely in compliance with the CPUC directive from the Water Division. UAB identified four material misstatements in TSRWC's Annual Report originally filed with the CPUC's Water Division, as described in the Appendix A–Review Findings and Recommendations. These findings are summarized below:

- Finding 1: TSRWC incorrectly reported $59,796 of outstanding reimbursements due from the County of Sonoma for operating the County's wastewater treatment facilities in Account 141–Accounts Receivable–Customers instead of Account 174–Other Current Assets.

- Finding 2: TSRWC did not record $58,340 of deferred income tax liabilities originated in 2018. As a result, the reported Taxes Accrued in Account 236 was overstated by $58,340 and Accumulated Deferred Income Taxes–Accelerated Tax Depreciation in Account 282 was understated by the same amount.

- Finding 3: TSRWC treated $30,806 CPUC Users Fee collected from its customers and remitted to the CPUC as a pass-through activity without reporting the revenue and expenses associated with the collections and remittance of the CPUC Users Fee. As a result, Account 480–Other Water Revenue and Account 688–Regulatory Commission Expense were each understated by $30,806.

- Finding 4: TSRWC incorrectly recorded $13,606 of Plant Replacement Fees surcharge billed to its customers in November 2019 as operating revenues. As a result, Account 253–Other Credits and Account 132–Cash–Special Deposits were understated by $13,606 and Account 470–Metered Water Revenue and Account 131–Cash were both overstated by the same amount.

UAB discussed the above findings and recommendations with TSRWC at the exit conference on December 29, 2020. TSRWC concurred with the review results and agreed to post UAB's proposed adjusting entries. On December 30, 2020, TSRWC 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 TSRWC for comments on January 20, 2021. TSRWC submitted its comments on January 25, 2021, agreeing to implement UAB's recommendations. The review findings and recommendations presented in this report represent our final determination of this review engagement.

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

Ms. Jennifer Merchant
Chief Executive Officer
The Sea Ranch Water Company
P. O. Box 16
The Sea Ranch, CA 95497

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the financial statements of The Sea Ranch Water Company (TSRWC), which comprise the balance sheet as of December 31, 2019, 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 TSRWC'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

TSRWC'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. TSRWC'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, TSRWC's management is responsible for the development of its policies and procedures to ensure full compliance with applicable regulations and CPUC directives.

Accountant's Responsibility

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

Accountant's Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the accounting framework of the USOA. However, UAB identified four material misstatements in TSRWC's Annual Report originally filed with the CPUC's Water Division, as described in the Appendix A–Review Findings and Recommendations. These misstatements have been corrected in the accompanying financial statements.

For the review period, UAB did not note any noncompliance with PU Code Section 818. In addition, TSRWC has timely filed its 2019 Annual Report in compliance with the CPUC directive from the Water Division.

Basis of Accounting

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

We conducted an exit conference on December 29, 2020 and discussed our review results with TSRWC management and its consultants. TSRWC's management concurred with UAB's findings and agreed to make appropriate adjusting journal entries. On December 30, 2020, TSRWC submitted its revised financial statements to the UAB to correct the material misstatements described in Appendix A of this report. At the exit conference, we also stated the final report will include the views of responsible officials. UAB provided a draft review report to TSRWC for comments on January 20, 2021. TSRWC submitted its comments on January 25, 2021, agreeing to implement UAB's recommendations. 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

TSRWC'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 19, 2021. The corrective action plan should address how TSRWC will implement the recommendations and provide the timing of incorporating UAB's review adjustments to TSRWC's books and records. If TSRWC 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. TSRWC 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 TSRWC. 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

The Sea Ranch Water Company
Balance Sheet (As Reviewed)
As of December 31, 2019

ASSETS	
UTILITY PLANT	
Water Plant in Service	$19,309,982
Construction Work in Progress	19,982
Accumulated Depreciation of Water Plant	(6,555,723)
Net Utility Plant	12,774,241
CURRENT AND ACCRUED ASSETS	
Cash	568,773
Cash–Special Deposits	1,777,847
Accounts Receivable	240,400
Other Current Assets	91,106
Total Current and Accrued Assets	2,678,126
Deferred Charges	179,703
Total Assets and Other Debits	$15,632,070
CAPITALIZATION AND LIABILITIES	
CORPORATE CAPITAL AND SURPLUS	
Common Stock	$145,900
Other Paid-in Capital	505,514
Retained Earnings	3,262,600
Total Capitalization	3,914,014
Long-Term Debt	6,217,321
CURRENT AND ACCRUED LIABILITIES	
Payables to Affiliated Companies	96,418
Accounts Payable	4,865
Short-Term Notes Payable	206,334
Taxes Accrued	2,118
Interest Accrued	27,728
Other Current Liabilities	35,319
Total Current and Accrued Liabilities	372,782
DEFERRED CREDITS	
Other Credits	60,738
Accumulated Deferred Income Taxes – Accel. Tax Depreciation	615,304
Total Deferred Credits	676,042
CONTRIBUTIONS IN AID OF CONSTRUCTION	
Contributions in Aid of Construction	9,163,514
Accumulated Amortization of Contributions	(4,711,603)
Net Contributions in Aid of Construction	4,451,911
Total Equity and Liabilities	$15,632,070

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

The Sea Ranch Water Company
Income Statement (As Reviewed)
For Year Ended December 31, 2019

OPERATING REVENUES	
Irrigation Revenue	$4,321
Metered Water Revenue	2,335,041
Other Water Revenue	37,142
Total Operating Revenue	2,376,504
OPERATING EXPENSES	
Plant Operation and Maintenance Expenses	
Power	62,960
Other Volume Related Expenses	19,015
Employee Labor	282,928
Materials	5,913
Contract Work	23,317
Transportation Expenses	16,199
Other Plant Maintenance Expenses	95,557
Total Plant Operation and Maintenance Expenses	505,889
Administrative and General Expenses	
Office Salaries	53,749
Management Salaries	204,554
Employee Pensions and Benefits	106,005
Office Services and Rentals	23,349
Office Supplies and Expenses	67,987
Professional Services	22,412
Insurance	137,134
Regulatory Commission Expense	33,378
General Expenses	87,423
Net Administrative and General Expenses	735,991
Total Operating Expenses	1,241,880
Depreciation Expense	229,078
Taxes Other Than Income Taxes	92,669
State Corporate Income Tax Expense	43,920
Federal Corporate Income Tax Expense	95,112
Total Operating Revenue Deductions	1,702,659
Total Utility Operating Income	673,845
OTHER INCOME AND DEDUCTIONS	
Non-Utility Income	22,705
Interest Expense	(352,354)
Total Other Income and Deductions	(329,649)
Net Income	$344,196

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

The Sea Ranch Water Company
Statement of Retained Earnings (As Reviewed)
For Year Ended December 31, 2019

Retained Earnings, Beginning of Year	$2,918,404
CREDITS:	
Net Income	344,196
Total Credits	344,196
DEBITS:	
Debits	0
Total Debits	
Retained Earnings, End of Year	$3,262,600

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

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

TSRWC computes depreciation using the straight-line remaining life method.

---

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

(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.

TSRWC retired fully depreciated water plant with a book cost of $71,549 during 2019. The cost of removal totaling $10,565 relating to the asset retirement was recorded as a reduction to the balance of Account 180, Accumulated Depreciation of Water Plant.

(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.

TSRWC did not sell or acquire any properties in 2019.

3. Inventory

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

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

TSRWC 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.

TSRWC reported a restricted cash balance of $1,777,847 in the 2019 Annual Report.

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) Contributed Assets
TSRWC's prior owner and the developer of The Sea Ranch Community contributed certain assets (reservoir, water mains, hydrants, pipes, services, and pumping equipment) to the TSRWC. These assets have a balance of $6,383,198 as of December 31, 2019. These assets are included on the balance sheet in the Water Plant in Service account, with an offsetting entry to the CIAC liability account. These contributed assets have a related accumulated amortization totaling $3,933,326 as of December 31, 2019.

(2) Replacement Reserve Fund

In addition to the developer contributed assets, TSRWC assesses a Plant Replacement Fees surcharge to its customers' bill for the purpose of funding a Replacement Reserve Fund. The Plant Replacement Fees are treated as CIAC. The RRF is restricted for the purpose of repairing and replacing components of the water system as they wear out or are damaged. Amounts expended from RRF to replace water system components are capitalized in the Water Plant in Service account and are offset as a credit to the CIAC account. There is no sunset clause on the authorized RRF surcharges. As of December 31, 2019, the CIAC-RRF account had a balance of $2,780,316 and a related accumulated amortization totaling $778,277.

Unspent Plant Replacement Fees are deposited in Account 132, Cash–Special Deposits and credited to Account 253, Other Credits. As of December 31, 2019, $60,738 of unspent Plant Replacement Fees were reported as Other Credits.

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.

On February 25, 2010, the CPUC authorized TSRWC to obtain debt financing of $7,500,000 to fund its water plant infrastructure capital improvements. On October 23, 2012, TSRWC entered into an agreement with Rabobank for a loan of $7,500,000 to finance its water plant construction project. The unpaid principal balance of the loan bears interest at a rate equal to the one-month LIBOR plus 2.500% per annum. As of December 31, 2019, the loan had an outstanding principal of $6,423,804. The current and long-term portions of the debt as of December 31, 2019, are $206,334 and $6,217,321, respectively.

7. Water Utility Users Fee

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

TSRWC omitted the CPUC Users Fee from its original 2019 Annual Report, causing Account 688–Regulatory Commission Expense and Account 480–Other Water Revenue to be understated by $30,806. However, TSRWC provided its revised Annual Report on December 30, 2020, which correctly reflected the CPUC Users Fee.

8. 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…."

TSRWC is a wholly owned subsidiary of The Sea Ranch Association (TSRA). TSRA provides administrative, payroll, and other services to TSRWC. These TSRA expenditures are billed to TSRWC monthly and paid by the TSRWC in the subsequent month. During the year ended December 31, 2019, TSRWC paid the TSRA $1,179,318 those services. The outstanding balance

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

owed to the TSRA as of December 31, 2019, was $96,418 and reported as Payables to Affiliated Companies in the 2019 Annual Report.

TSRWC rented office space from the Association for $17,232 during 2019. The terms of the lease are renewed annually.

TSRWC subleased a portion of solar equipment from TSRA through June 30, 2019. Total lease expense charged to the TSRWC amounted to $13,986 for the year ended December 31, 2019.

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 the 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 purposes, 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, TSRWC 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: Misclassification of Non-Water Service Receivables

Condition:
TSRWC incorrectly reported $59,796 of outstanding reimbursements due from the County of Sonoma for operating the County's wastewater treatment facilities in Account 141–Accounts Receivable–Customers in the Annual Report filed with the CPUC's Water Division on March 27, 2020. Receivables other than from customers for water service should have been accounted for in Account 174–Other Current Assets. As a result, Account 141–Accounts Receivable–Customers and Account 174–Other Current Assets were each overstated by $59,796. However, TSRWC corrected these misstatements in its revised financial statements submitted to UAB on December 30, 2020.

Criteria:
The USOA states, in part, that:

> **141. Accounts Receivable-Customers**
> This account shall include amounts due from customers for water service.
> Note: Accounts receivable other than from customers for water service shall be included in account 174, Other Current Assets, or in account 121, Non-Water Utility Property and Other Assets, as appropriate.
>
> **174. Other Current Assets**
> A. This account shall include prepayment of rents, taxes, insurance and similar expenses for which payment have been made in advance of the period to which they apply. As the periods covered by such prepayments expire, this account shall be credited and the proper operating expense or other accounts shall be charged with the amounts applicable to the current period.
>
> B. This account shall include the book cost of all notes receivable and accounts receivable, other than from customers for water service, maturing or collectible within one year.

Cause:
TSRWC's accounting policy to record receivables other than from customers for water service in Account 141–Accounts Receivable–Customers did not conform with the USOA requirements. TSRWC lacks monitoring procedures over financial reporting to ensure that non-trade receivables are properly classified as Other Current Assets as required by the USOA.

Effect:
Improper reporting of Accounts Receivable and Other Current Assets distorted TSRWC's financial position as of December 31, 2019. Inconsistent classification of current assets reduces the comparability of financial statements among small water utilities.

Recommendations:
TSRWC should revise its accounting policies and procedures to ensure TSRWC records and reports non-trade receivables in Account 174–Other Current Assets. TSRWC should develop and implement monitoring procedures to ensure that account balances are classified using the guidelines specified in the USOA.

Finding 2: Deferred Income Tax Liability Reporting Error

Condition:
TSRWC did not record $58,340 of deferred income tax liability originating in 2018. TSRWC did not calculate and post adjusting journal entries to reduce Taxes Accrued by the amount of deferred income taxes based on the difference between straight-line book depreciation and accelerated tax depreciation. As a result, Taxes Accrued in Account 236 was overstated by $58,340 and Accumulated Deferred Income Taxes–Accelerated Tax Depreciation in Account 282 was understated by the same amount. However, TSRWC corrected these misstatements in its revised financial statements submitted to UAB on December 30, 2020.

Criteria:
USOA states, in part, that:

> **282. Accumulated Deferred Income Taxes – Accelerated Tax Depreciation**
> A. Account 282 shall be credited and Account 236, Taxes Accrued, shall be charged with the difference between the federal income tax expense based on tax basis, straight-line method of depreciation and the tax liability resulting from use of accelerated tax depreciation.

Cause:
TSRWC stated that it did not have actual tax information available to record deferred income taxes in its Annual Report at the time of its filing. TSRWC lacks monitoring procedures over its financial reporting process to ensure proper estimate of deferred income tax liability arising from the difference between the book depreciation and tax depreciation when the actual tax depreciation was unknown at the time the Annual Report was submitted.

Effect:
Inaccurate reporting of Accumulated Deferred Income Taxes–Accelerated Tax Depreciation and Taxes Accrued distorted TSRWC's financial position as of December 31, 2019. Overstatement of accrued taxes can improperly understate TSRWC's available working capital during the General Rate Case (GRC) process, resulting in higher water rates for the ratepayers.

Recommendation:
TSRWC should establish and implement monitoring procedures over its financial reporting to ensure proper estimate and reporting of Taxes Accrued.

Finding 3: CPUC Users Fee Reporting Error

Condition:
TSRWC treated $30,806 CPUC Users Fee collected from its customers and remitted to the CPUC as a pass-through activity without reporting the revenue and expense associated with the collection and remittance of the CPUC Users Fee in the Annual Report originally filed with the CPUC's Water

Division on March 27, 2020. As a result, Account 480–Other Water Revenue and Account 688–Regulatory Commission Expense were understated by $30,806. However, TSRWC corrected these misstatements in its revised financial statements submitted to UAB on December 30, 2020.

Criteria:
The USOA states, in part, that:

> **9. Water Utility Users Fee**
> Water utilities will credit regular operating revenue accounts with amounts billed to customers and charge account 688, Regulatory Commission Expense, with fees paid to the Commission.

Cause:
TSRWC accounting policy to treat CPUC Users Fee as a pass-through activity does not conform with the USOA requirements. TSRWC lacks monitoring procedures over its financial reporting to ensure that the CPUC Users Fee were reported as operating revenue and Regulatory Commission Expense in the Annual Report as required by the USOA.

Effect:
Inaccurate reporting of Regulatory Commission Expense and operating revenue in the Annual Report, which may be used during TSRWC's GRC application process, could potentially impact water rates for TSRWC's ratepayers.

Recommendation:
TSRWC should establish and implement monitoring procedures over its financial reporting to ensure proper accounting and reporting of CPUC Users Fee based on CPUC's USOA guidelines.

Finding 4: Improper Recording of Plant Replacement Fees Surcharge

Condition:
TSRWC incorrectly recorded $13,606 of Plant Replacement Fees surcharge billed to its customers in November 2019 as operating revenue. Plant Replacement Fees should have been treated as Contributions in Aid of Construction as mandated by the USOA. As a result, Account 253–Other Credits and Account 132–Cash–Special Deposits were understated by $13,606 and Account 47–Metered Water Revenue and Account 131–Cash were overstated by the same amount. However, TSRWC corrected these misstatements in its revised financial statements submitted to UAB on December 30, 2020.

Criteria:
USOA states, in part, that:

> **265. Contributions in Aid of Construction**
>
> A. This account shall include:
> 1. All non-refundable contributions of cash, land or other property received by the utility in connection with the construction or extension of its water system.

Cause:
TSRWC incorrectly recorded plant replacement fees surcharge as operating revenue due to an isolated clerical error. TSRWC lacked adequate monitoring procedures over its accounting process to prevent and detect clerical errors.

Effect:
Improper reporting of Metered Water Revenue in the Annual Report, which may be used during TSRWC's GRC application process, could potentially impact water rates for TSRWC's ratepayers. Misclassification of restricted cash and Plant Replacement Fees Surcharge can result in TSRWC spending restricted cash for unintended purposes.

Recommendation:
TSRWC should establish and implement monitoring procedures to minimize inadvertent clerical errors.

APPENDIX B—TSRWC'S RESPONSE

The Sea Ranch
Water Company

707-785-2411 / Fax: 707-785-9756

January 25, 2021

State of California
Public Utilities Commission
Attn: Mr. Raymond Yin and Ms. Khusbindar Kaur
505 Van Ness Avenue
San Francisco CA 94102

Delivered via email

Dear Mr. Yin and Ms. Kaur:

The Sea Ranch Water Company wishes to thank the staff of the Utility Audits Branch for a positive experience during the recent review of the company's Annual Report for 2019. We have thoroughly reviewed the Draft Report provided to us on January 20, 2021 and have no concerns, corrections, or suggested changes to its content.

The Sea Ranch Water Company thanks the Commission for bringing to our attention the adjustments needed in the 2019 Annual Report. We have corrected all matters the Commission has referenced in their report and will follow their recommendations going forward.

Very truly yours,

Ellen A. Buechner
Chief Financial Officer
The Sea Ranch Water Company, Inc.

35600 Verdant View Drive / P.O. Box 16 / The Sea Ranch, California 95497-0016