



# REVIEW OF FINANCIAL STATEMENTS

## Cypress Ridge Sewer Company

For the Year Ended December 31, 2020

Utility Audits, Risk and Compliance Division  
Utility Audits Branch  
April 26, 2022



## **MEMBERS OF THE TEAM**

**Angie Williams, Director**

**Masha Vorobyova, Assistant Director**

**Raymond Yin, CPA  
Program and Project Supervisor**

**Khusbindar Kaur, CPA  
Lead**

**Tir Saephan, Auditor**

A digital copy of this report can be found at:  
[Audit Reports by Industry \(ca.gov\)](#)

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

## PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

April 26, 2022

Mr. Charles M. Baker, President  
Cypress Ridge Sewer Company  
P.O. Box 745  
Grover Beach, CA 93483

Dear Mr. Baker:

**Final Report Transmittal Letter—Review of Cypress Ridge Sewer Company’s 2020 Annual Report for the year ended December 31, 2020**

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) has completed its review of Cypress Ridge Sewer Company’s (CRSC) regulatory basis financial statements in the 2020 Annual Report filed with the CPUC, which comprise the balance sheet as of December 31, 2020, and related statement of income. The final review report is enclosed.

We issued the draft review report on March 30, 2022. CRSC notified us via email on April 14, 2022, that it had no comments to the draft review report. Therefore, we are issuing the report as final. We will post the final review report on our website at [Audit Reports by Industry \(ca.gov\)](https://www.cpuc.ca.gov/Audit-Reports-by-Industry).

Please provide a Corrective Action Plan (CAP) addressing the findings and recommendations by June 10, 2022. The CAP should include specific steps and target dates to correct the findings identified. Please submit the CAP to the Utility Audits Branch at [UtilityAudits@cpuc.ca.gov](mailto:UtilityAudits@cpuc.ca.gov), with a copy to Bruce DeBerry, Program Manager of Water Division, at [Bruce.DeBerry@cpuc.ca.gov](mailto:Bruce.DeBerry@cpuc.ca.gov).

We appreciate CRSC’s assistance and cooperation during the engagement. 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: on next page

Mr. Charles M. Baker, President  
Cypress Ridge Sewer Company  
April 26, 2022  
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cc: Eric Sweeney, Chief Plant Operator, CRSC  
Rachel Peterson, Executive Director, CPUC  
Kristin Stauffacher, Deputy Executive Director, Office of the Commission, CPUC  
Terence Shia, Director, Water Division, CPUC  
Masha Vorobyova, Assistant Director, UAB, CPUC  
Bruce Berry, Program Manager, Water Division, CPUC  
Raymond Yin, Program and Project Supervisor, UAB, CPUC  
Khusbindar Kaur, Senior Management Auditor, UAB, CPUC  
Tir Saephan, Staff Services Management Auditor, UAB, CPUC

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## EXECUTIVE SUMMARY

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The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a review of the financial statements of Cypress Ridge Sewer Company (CRSC) as of December 31, 2020, pursuant to Public Utilities (PU) Code Sections 314.5, 314.6, 581, 582, and 584 that provides the CPUC the statutory authority to review or audit the books and records of the regulated utilities. We conducted this review in accordance with the standards prescribed under Review of Financial Statements in the Generally Accepted Government Auditing Standards (GAGAS).

Incorporated in California on April 11, 2008, CRSC is a Class D investor-owned sewer utility with 386 active customer service connections<sup>1</sup>. CRSC's service area is located near the town of Arroyo Grande in San Luis Obispo County of California. As a regulated sewer utility, CRSC 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 CRSC 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 2020 Annual Report as required by the Water Division Memorandum dated January 26, 2021.

Based on our review, we are not aware of any material modifications that should be made to CRSC'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 CRSC filed its 2020 Annual Report timely in compliance with the CPUC directive from the Water Division. However, UAB identified three material misstatements and a noncompliance with CPUC directives in CRSC'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: CRSC has neither implemented a reduction in rates, nor refunded its ratepayers the overbilled revenues, resulting from removing \$37,910 of federal and state income tax allowance from its revenue requirement as required by D.20-07-036, dated July 17, 2020.
- Finding 2: CRSC incorrectly used Account 215—Retained Earnings and Account 211—Other Paid-in Capital to report changes in ownership equity and other paid-in capital not derived from earnings. CRSC is an S Corporation, and the USOA requires S Corporations to use Account 206—Subchapter S Corporation Accumulated Adjustments Account for reporting changes in ownership equity and all paid-in capital. As a result, CRSC overstated Account

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<sup>1</sup> CRSC's 2020 Annual Report, Schedule I—Number of Active Service Connections, Page 19.

211–Other Paid-in Capital by \$626,724 and understated Account 206–Subchapter S Corporation Accumulated Adjustments Account, and Account 215–Retained Earnings accounts by \$390,077 and \$236,647, respectively.

- Finding 3: CRSC incorrectly reported the net overcollection of customer surcharges totaling \$6,716 as a credit against Account 141–Accounts Receivable–Customers. In Resolutions W-4946 and W-4968, the CPUC authorized CRSC to transfer the excess labor costs to a balancing account and recover them through surcharges. The net overcollection of surcharges should have been recorded as a liability in Account 253–Other Credits. As a result, CRSC understated both Accounts Receivable and Other Credits by \$6,716.
- Finding 4: CRSC misclassified \$2,683 of expenses for chlorine used for water treatment as Materials in Account 640 instead of reporting the expenses as Other Volume Related Expenses in Account 618. As a result, CRSC understated Account 618–Other Volume Related Expenses by \$2,683 and overstated Account 640–Materials by the same amount.

UAB discussed the above findings with CRSC’s management during fieldwork. CRSC’s management concurred with the findings and agreed to post UAB’s proposed adjusting journal entries to correct the misstatements identified above. CRSC submitted its revised financial statements to the UAB to correct the material misstatements described in Appendix A of this report on February 28, 2022. UAB further discussed these findings with CRSC’s management and its accountant at the exit conference on March 7, 2022, and CRSC concurred with the review results. UAB is not aware of any further material modifications that should be made to the accompanying financial statements. We issued the draft review report on March 30, 2022. CRSC responded via email on April 14, 2022, indicating that it had no comments to the draft review report.



# INDEPENDENT ACCOUNTANT'S REVIEW REPORT

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Mr. Charles M. Baker, President  
Cypress Ridge Sewer Company  
P.O. Box 745  
Grover Beach, CA 93483

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the accompanying financial statements of Cypress Ridge Sewer Company (CRSC), which comprise the balance sheet as of December 31, 2020, 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 CRSC'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***

CRSC's management is responsible for the preparation and fair presentation of its 2020 financial statements in accordance with the accounting framework established under CPUC's Uniform System of Accounts (USOA) for Water Utilities. CRSC's management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of its 2020 financial statements that are free from material misstatement, whether due to fraud or error. In addition, CRSC's management is responsible for the development of its policies and procedures to ensure full compliance with applicable regulations and CPUC directives.

## ***Accountant's Responsibility***

UAB's responsibility is to conduct the review engagement in accordance with the standards applicable to reviews of financial statements promulgated by the Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with the accounting framework of the USOA. For regulatory purposes, UAB also reviewed whether CRSC complied with PU Code Section 818 to obtain its long-term debts, and whether CRSC timely filed its 2020 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 three material misstatements in CRSC's Annual Report originally filed with CPUC's Water Division, as described in the Appendix A—Review Findings and Recommendations. These misstatements have been corrected in the accompanying financial statements. UAB also identified a noncompliance with CPUC Decision (D.) 20-07-036 as described in Appendix A—Review Findings and Recommendations.

For the review period, UAB did not note any noncompliance with PU Code Section 818. In addition, CRSC has timely filed its 2020 Annual Report in compliance with the CPUC directive from the Water Division.



***Basis of Accounting***

For regulatory purposes, the CPUC adopted, through 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. CRSC's financial statements were prepared based on this regulatory requirement.

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

***Views of Responsible Official***

We discussed our review results and findings with CRSC management during fieldwork. CRSC's management concurred with UAB's findings and agreed to make appropriate adjusting journal entries to its accounting records to correct the material misstatements. CRSC submitted its revised financial statements to the UAB to correct the material misstatements on February 28, 2022. UAB further discussed these findings with CRSC's management and its accountant at the exit conference on March 7, 2022, and CRSC concurred with the review results. At the exit conference, we also stated that the final report will include the views of responsible officials. We issued the draft review report on March 30, 2022. CRSC responded via email on April 14, 2022, indicating that it had no comments to the draft review report.

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

CRSC's management should submit a corrective action plan (CAP) to the UAB at [UtilityAudits@cpuc.ca.gov](mailto:UtilityAudits@cpuc.ca.gov), with a copy to Bruce DeBerry, Program Manager of Water Division, at [Bruce.DeBerry@cpuc.ca.gov](mailto:Bruce.DeBerry@cpuc.ca.gov) by June 10, 2022. The CAP should address how CRSC will implement the recommendations. If CRSC is unable to implement UAB's recommendations, the CAP should state the reason(s) for not being able to implement any of the recommendations. CRSC should use the amounts reviewed by the UAB as presented in this report as the basis to file its 2021 Annual Report with the CPUC.

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

The purpose of this report is to summarize the results of the review mandated by PU Code Section 314.5. Accordingly, this review report is intended solely for the information and use by the CPUC and the management of CRSC, and it is not suitable for any other purpose. It is not intended to be used and should not be used by anyone other than the specified parties. This restriction is not intended to limit distribution of the final report, which is a matter of public record and will be available on the CPUC website at [Audit Reports by Industry \(ca.gov\)](https://www.cpuc.ca.gov/Audit-Reports-by-Industry).

*Angie Williams*

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Angie Williams, Director  
Utility Audits, Risk and Compliance Division

## REVIEWED FINANCIAL STATEMENTS

### Cypress Ridge Sewer Company Balance Sheet (As Reviewed) As of December 31, 2020

<b>ASSETS</b>	
<b>UTILITY PLANT</b>	
Sewer Plant in Service	\$5,266,581
Accumulated Depreciation of Sewer Plant	<u>(2,755,410)</u>
<b>Net Utility Plant</b>	<u>2,511,171</u>
<b>CURRENT AND ACCRUED ASSETS</b>	
Cash	79,116
Materials and Supplies	8,900
Other Current Assets	<u>8,433</u>
<b>Total Current and Accrued Assets</b>	<u>96,449</u>
<b>Total Assets</b>	<u><u>\$2,607,620</u></u>
<b>CAPITALIZATION AND LIABILITIES</b>	
<b>CORPORATE CAPITAL AND SURPLUS</b>	
Subchapter S Corporation Accumulated Adjustments Account	<u>\$390,077</u>
<b>Total Capitalization</b>	<u>390,077</u>
<b>CURRENT AND ACCRUED LIABILITIES</b>	
Accounts Payable	17,247
Taxes Accrued	70
Other Current Liabilities	<u>10,324</u>
<b>Total Current and Accrued Liabilities</b>	<u>27,641</u>
<b>DEFERRED CREDITS</b>	
Other Credits	<u>5,122</u>
<b>Total Deferred Credits</b>	<u>5,122</u>
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>	
Contributions in Aid of Construction	4,814,500
Accumulated Amortization of Contributions	<u>(2,629,720)</u>
<b>Net Contributions in Aid of Construction</b>	<u>2,184,780</u>
<b>Total Equity and Liabilities</b>	<u><u>\$2,607,620</u></u>

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

**Cypress Ridge Sewer Company**  
**Income Statement (As Reviewed)**  
For Year Ended December 31, 2020

<b>OPERATING REVENUES</b>	
Unmetered Water Revenue	\$575,503
<b>Total Operating Revenue</b>	<u>575,503</u>
<b>OPERATING EXPENSES</b>	
<b>Plant Operation and Maintenance Expenses</b>	
Power	32,807
Other Volume Related Expenses	9,509
Employee Labor	201,921
Materials	30,913
Contract Work	55,025
Transportation Expenses	3,148
Other Plant Maintenance Expenses	1,570
<b>Total Plant Operation and Maintenance Expenses</b>	<u>334,893</u>
<b>Administrative and General Expenses</b>	
Management Salaries	10,000
Employee Pensions and Benefits	15,857
Uncollectible Accounts Expense	945
Office Services and Rentals	10,167
Office Supplies and Expenses	1,318
Professional Services	48,213
Insurance	19,310
Regulatory Commission Expense	7,164
General Expenses	22,263
<b>Net Administrative and General Expenses</b>	<u>135,237</u>
<b>Total Operating Expenses</b>	470,130
Depreciation Expense	14,436
Taxes Other Than Income Taxes	17,462
State Corporate Income Tax Expense	856
<b>Total Operating Revenue Deductions</b>	<u>502,884</u>
<b>Total Utility Operating Income</b>	72,619
<b>OTHER INCOME AND DEDUCTIONS</b>	
Interest Expense	6
<b>Total Other Income and Deductions</b>	<u>(6)</u>
<b>Net Income</b>	<u><u>\$72,613</u></u>

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

Cypress Ridge Sewer Company  
**Statement of Changes in Shareholders' Equity (As Compiled <sup>2</sup>)**  
 For Year Ended December 31, 2020

<b>Stockholder's Equity, Beginning of Year</b>	\$295,779
<b>CREDITS:</b>	
Net Income	72,613
CRSC's Adjustments to Taxes Accrued	21,685
<b>Total Credits</b>	94,298
<b>DEBITS:</b>	
Debits	0
<b>Total Debits</b>	0
<b>Stockholder's Equity, End of Year</b>	\$390,077

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

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<sup>2</sup> UAB compiled the Statement of Changes in Shareholder's Equity based on the reviewed Balance Sheet and Income Statement, and other relevant financial data.

# Cypress Ridge Sewer Company

## Notes to Financial Statements

Incorporated in California on April 11, 2008, CRSC is a Class D investor-owned sewer utility with 386 active customer service connections<sup>3</sup>. CRSC's service area is located near the town of Arroyo Grande in San Luis Obispo County of California.

### Significant Accounting Policies

As a regulated sewer utility, CRSC 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 (GAAP) in the United States of America. The followings 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 sewer 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

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<sup>3</sup> CRSC's 2020 Annual Report, Schedule I—Number of Active Service Connections, Page 19.

remaining life for the entire plant in accordance with Appendix B2 or B3 of SP U-4-SM. The USOA suggested that all utilities maintain a separate accumulated depreciation subaccount for each depreciable plant account; and it is mandatory for water utilities having more than 500 customers.<sup>4</sup> The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs. Sewer utilities are required to comply with the same requirements as the water utilities.

Cypress Ridge Sewer Company (CRSC) utilizes the straight-line remaining life method for each class of asset as prescribed in SP U-4-SM to determine depreciation accruals.

## **(2) Asset Retirement**

USOA requires that water plant be recorded at 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.

CRSC did not retire any assets 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.

CRSC reported an inventory balance of \$8,900 as of December 31, 2020, in Account 151–Materials and Supplies.

## **4. Contribution in Aid of Construction (CIAC)**

CIAC account records non-refundable contributions of cash, land or other property donated to the sewer utility to assist it in constructing or extending, its sewer 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 Sewer Plant.

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



CRSC report a balance of \$4,814,500 in Account 265—CIAC and \$2,484,129 in Account 272—Accumulated Amortization of Contributions. The CIAC account largely consists of Sewer Treatment Plant and Sewer Mains funded by a developer.

## 5. 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 sewer 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.

In its 2020 Annual Report originally filed with the CPUC’s Water Division, CRSC netted \$6,716 of overcollection from customer surcharges against Account 141—Accounts Receivable instead of reporting the overcollection as Other Credits in Account 253. On February 28, 2022, CRSC submitted a revised Annual Report to the CPUC and corrected this misstatement.

## 6. Sewer Utility Users Fee

PU Code, Sections 401 through 410 authorized the CPUC to set a fee annually to sewer utilities to cover the costs incurred by the CPUC in regulating them. USOA requires sewer 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.<sup>5</sup>

CRSC correctly recorded CPUC Users Fee in Account 688—Regulatory Commission Expense and operating revenues.

## 7. Form of Financial Statements<sup>6</sup>

### (1) Balance Sheet

Unlike the financial statements of other industries, the financial statements of regulated sewer utilities present the sewer 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

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<sup>5</sup> D.16.11-006 dated November 10, 2016, General Accounting Instructions 9 on Pages B18 and B19.

<sup>6</sup> Regulated Utilities Manual—A Service for Regulated Utilities by Deloitte & Touché USA LLP, pages 36-37.

income, other revenues that are from non-sewer utility operations and/or non-sewer utility properties, expenses that are unrelated to sewer 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.

## **8. 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.

## **9. Compliance filing of 2020 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, CRSC has complied with these requirements.

## APPENDIX A—REVIEW OF FINDINGS AND RECOMMENDATIONS

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### **Finding 1: Noncompliance with Rate Reduction and Refunds**

#### **Condition:**

CRSC has neither implemented a reduction in rates, nor refunded its ratepayers the overbilled revenues, resulting from removing \$37,910 of federal and state income tax allowance from its revenue requirement as required by D.20-07-036, dated July 17, 2020. CPUC authorized a general rate increase to CRSC in Resolution W-5187, dated March 28, 2019, which incorrectly included recovery of state and federal income tax expenses in determining the sewer rates, although CRSC does not pay income taxes as an S Corporation. On August 17, 2020, CRSC filed an advice letter to implement the required rate reduction; however, the CPUC's Water Division subsequently rejected the Advice Letter because the calculated rate adjustments and refunds to customers included in the Advice Letter were not in compliance with D.20-07-036. On December 9, 2020, CRSC filed a petition for modification of D.20-07-036 to contest the calculation of the amount of refund it owes to its ratepayers. As of April 26, 2022, CRSC has not implemented the rate reduction or issued the refunds to its ratepayers as required by D.20-07-036.

#### **Criteria:**

Ordering Paragraph 3 of D.20-07-036 states that:

Cypress shall file an Advice Letter within 60 days to implement the reduction in rates resulting from removing the income tax allowance from its revenue requirement and to refund the revenue collected from including an income tax allowance in rates. Cypress shall implement the refund as a credit to new rates over twelve months.

#### **Cause:**

CRSC has not implemented a reduction in its rates or refunded its ratepayers as required by D.20-07-036, because it is contesting the refund amount. CRSC has filed a petition for modification of D.20-07-036 and the case is pending on a resolution from the CPUC.

#### **Effect:**

As a result of not implementing a rate reduction as required by D.20-07-036 and issuing the refunds to its ratepayers, CRSC has continued charging its customers higher sewer rates than it should.

#### **Recommendation:**

CRSC must implement the required rate reduction as required by D.20-07-036 and refund all overcollections to its ratepayers.

### **Finding 2: Incorrect Reporting of Ownership Equity and Other Paid-in Capital**

#### **Condition:**

CRSC incorrectly used Account 215—Retained Earnings and Account 211—Other Paid-in Capital to report changes in ownership equity and other paid-in capital not derived from earnings in the Annual Report originally filed with the CPUC's Water Division on March 24, 2021. CRSC is an S Corporation and the USOA requires S Corporations to use Account 206—Subchapter S Corporation Accumulated Adjustments Account for reporting changes in ownership equity and

other paid-in capital. Therefore, CRSC overstated Account 211–Other Paid-in Capital by \$626,724 and understated Account 206–Subchapter S Corporation Accumulated Adjustments Account, and Account 215–Retained Earnings accounts by \$390,077 and \$236,647, respectively. CRSC corrected these misstatements in its revised Annual Report submitted to the CPUC on February 28, 2022.

**Criteria:**

The USOA states, in part, that:

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

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

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

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

**Cause:**

CRSC lacks effective monitoring procedures to ensure its compliance with USOA accounting requirements relating to the use of proper accounts for recording and reporting changes in ownership equity.

**Effect:**

Inaccurate reporting of Subchapter S Corporation Accumulated Adjustments Account and Retained Earnings account balances distorted CRSC's financial position as of December 31, 2020, which could mislead decision-makers about CRSC's tax structure and its responsibility for corporate income taxes.

**Recommendations:**

CRSC should establish and implement monitoring procedures to ensure that it timely identifies changes in regulatory accounting and reporting requirements. It should use Account 206—Subchapter S Corporation Accumulated Adjustments Account to record and report changes in its ownership equity as required by the USOA. CRSC should also maintain a separate subaccount in its general ledger to track and distinguish the balances of equity derived from earnings and other paid-in capital not derived from earnings.

**Finding 3: Inaccurate Reporting of Over-Collected Surcharges****Condition:**

CRSC incorrectly reported the net overcollection of customer surcharges totaling \$6,716 as a credit against Account 141—Accounts Receivable—Customers in the Annual Report originally filed with the CPUC’s Water Division on March 24, 2021. In Resolutions W-4946 and W-4968, the CPUC authorized CRSC to transfer the excess labor costs to a balancing account and recover them through surcharges. The net overcollection of surcharges should have been recorded as a liability in Account 253—Other Credits. As a result, CRSC understated both Account 141—Accounts Receivable and Account 253—Other Credits by \$6,716. CRSC corrected these misstatements in its revised Annual Report submitted to the CPUC on February 28, 2022.

**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.

**253. Other Credits**

This account shall include advance billings, unamortized premium on debt, items in suspense and other credit items not provided for in other accounts. This account shall also include specific revenues (Revenue Balancing Account) that the Commission has authorized the utilities to record for future repayment.

**Cause:**

CRSC lacks effective monitoring procedures over its accounting and reporting process to ensure that overcollection of customer surcharges are recorded as Other Credits in Account 253.

**Effect:**

Inaccurate reporting of Accounts Receivable and Other Credits distorted CRSC’s financial position as of December 31, 2020.

**Recommendations:**

CRSC should obtain authorization from the CPUC’s Water Division to refund the overcollection to its ratepayers. CRSC should also improve its monitoring procedures over its accounting and reporting process to ensure amounts reported in its Annual Reports are accurate and complete.

**Finding 4: Misclassification of Non-Volume Related Expenses****Condition:**

CRSC misclassified \$2,683 of expenses for chlorine used for water treatment as Materials in Account 640 instead of reporting the expenses as Other Volume Related Expenses in Account 618 in the 2020 Annual Report originally filed with the CPUC's Water Division on March 24, 2021. As a result, CRSC understated Account 618—Other Volume Related Expenses by \$2,683 and overstated Account 640—Materials by the same amount. CRSC corrected these misstatements in its revised Annual Report submitted to the CPUC on February 28, 2022.

**Criteria:**

The USOA states, in part, that:

**640. Materials**

This account shall include all materials and supplies used in operation and maintenance of the water system, other than repair and maintenance materials charged to Account 650, Contract Work and chemicals charged to Account 618, Other Volume Related Expenses.

**618. Other Volume Related Expenses**

This account shall include all other expenses related to the volume of water used.

## Items

Ground water replenishment charges.  
Chemicals used in water treatment.  
Water rights leases based on volume.

**Cause:**

CRSC lacks effective review and oversight procedures over its accounting and recording process to accurately classify expenses.

**Effect:**

CRSC's misclassification of expenses reduces the comparability of its financial statements with other small water utilities. Consistent financial presentation among small water utilities aids decision makers in analyzing the performance and financial position of CRSC relative to other sewer utilities in California.

**Recommendation:**

CRSC should strengthen its review and oversight procedures over its accounting and recording process to ensure that expenses are accurately classified.