



REVIEW OF FINANCIAL STATEMENTS

Keene Water System

For the Year Ended December 31, 2021

Utility Audits, Risk and Compliance Division
Utility Audits Branch
May 15, 2023



MEMBERS OF THE TEAM

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

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PUBLIC UTILITIES COMMISSION

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Transmitted via e-mail

May 15, 2023

Ms. Barbara Orr
Director – Financial Reporting
Union Pacific Railroad Company for Keene Water System
1400 Douglas Street, Stop 1820
Omaha, NE 68179

Dear Ms. Orr:

Final Report Transmittal Letter—Review of Keene Water System’s Annual Report for the Year Ended December 31, 2021

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) has completed its review of Keene Water System’s (KWS) regulatory basis financial statements in the Annual Report filed with the CPUC, which comprise the balance sheet as of December 31, 2021, and related statements of income, and retained earnings. The final review report is enclosed.

UAB provided a draft review report to KWS for comments on April 12, 2023. KWS submitted its comments via email on April 26, 2023. KWS’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 [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 29, 2023. The CAP should include specific steps and target dates to correct the findings identified. Please submit the CAP 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.

We appreciate KWS’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: See next page

Ms. Barbara Orr
Director – Financial Reporting
Keene Water System
May 15, 2023
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cc: Brian Jeter, Director, Finance, Union Pacific Railroad Company
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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 Keene Water System (KWS) as of December 31, 2021, 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 standards applicable to reviews of financial statements prescribed by the generally accepted government auditing standards (GAGAS), except for obtaining an external peer review. UAB was unable to obtain an external peer review timely due to delays caused by the COVID-19 pandemic. However, this does not affect UAB's adherence to all other GAGAS requirements and our conclusion on this review engagement is not modified with respect to this matter.

KWS is a Class D water utility and provides metered water service to 24 active residential service connections and two active commercial service connections.¹ KWS's service territory is located in the communities of Keene and Woodford in Kern County, California.² KWS is an internal operating unit of Union Pacific Railroad Company (Union Pacific). As a regulated water utility, KWS 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 10, 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 KWS 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 2021 Annual Report as required by the Water Division Memorandum dated January 20, 2022.

Based on our review, we are not aware of any material modifications that should be made to KWS's revised financial statements in order for them to be in accordance with the accounting framework prescribed by the USOA. For the review period, UAB did not note any noncompliance with PU Code Section 818; and KWS filed its 2021 Annual Report timely in compliance with the CPUC directive from the Water Division. However, UAB identified four material misstatements in KWS'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: KWS incorrectly recorded and reported \$6,513,007 fundings provided by Union Pacific to cover KWS's past operations in Account 241—Other Current Liabilities in its 2021 Annual Report. Since KWS is an internal operating unit of Union Pacific and the \$6,513,007 recorded in Other Current Liabilities does not meet the criteria of Other Current Liabilities as defined by the USOA, KWS agreed that it is more appropriate to reclassify the \$6,513,007 to Account 253—Other Credits in the Annual Report. As a result, KWS

¹ KWS's 2021 Annual Report, Schedule I—Service Connections at End of Year, Page 19.

² CPUC D.06-07-034, Page 2.

overstated Account 241–Other Current Liabilities by \$6,513,007 and understated Account 253–Other Credits by the same amount.

- Finding 2: KWS did not bill its customers using the most updated tariff rates approved by the CPUC. As a result, KWS underbilled its ratepayers and understated its revenue in Account 470–Metered Water Revenue and Account 462–Fire Protection and Hydrant Revenue by \$7,214 and \$13,722, respectively; and overstated Retained Earnings by \$20,937 in its 2021 Annual Report.
- Finding 3: KWS understated Account 650–Contract Work by \$14,000 in its 2021 Annual Report. Due to a recording error, Union Pacific, inadvertently missed charging some invoices to KWS’s cost accumulation number to identify the expenses related to KWS. As a result, KWS understated both Account 650–Contract Work and Account 253–Other Credits by \$14,000.
- Finding 4: KWS did not accrue \$1,464 of CPUC Users Fee expenses and related liabilities incurred in 2021 but were paid in 2022 in its 2021 Annual Report. As a result, KWS understated both Account 688–Regulatory Commission Expense and Account 231–Accounts Payable by \$1,464. Additionally, KWS failed to timely remit its 2021 CPUC Users Fee to the CPUC, resulting in a non-compliance with PU Code Sections 431 and 433, and CPUC’s directives specified in Resolution M-4841 and CPUC Water Division’s Memorandum dated July 23, 2020.

UAB discussed the above findings and recommendations with KWS during fieldwork. KWS’s agreed to post UAB’s proposed adjusting entries to correct the misstatements identified above. UAB further discussed these findings with KWS’s management at the exit conference on March 3, 2023. At the exit conference, UAB also stated that the final report will include the views of responsible officials. KWS submitted its revised financial statements to the CPUC’s Water Division on March 27, 2023, 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 issued a draft review report to KWS for comments on April 12, 2023. KWS submitted its comments via email on April 26, 2023. KWS’s response to the findings is presented in Appendix B of this report. In its response, KWS stated it has applied the adjusting journal entries to correct the misstatements described in Appendix A of this report; however, KWS does not consider the misstatements to be material. UAB’s evaluation of KWS’s response is presented in Appendix C of this report. The review findings and recommendations presented in this report remain unchanged and represent our final determination of this review engagement.

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

Barbara Orr

Director – Financial Reporting

Union Pacific Railroad Company for Keene Water System

1400 Douglas Street, Stop 1820

Omaha, NE 68179

Report on the Financial Statements

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the accompanying financial statements of Keene Water System (KWS), which comprise the balance sheet as of December 31, 2021, and the related statements of income and retained earnings for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of KWS'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

KWS's management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting framework prescribed by CPUC's Uniform System of Accounts (USOA) for Water Utilities; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. In addition, KWS'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 prescribed by the USOA. UAB conducted this review in compliance with the auditing standards of GAGAS, except for obtaining an external peer review within the required timeframe as discussed in the succeeding paragraph. We believe that the results of our procedures provide a reasonable basis for our conclusion.

UAB was unable to obtain an external peer review timely due to delays caused by the COVID-19 pandemic. However, this does not affect UAB's adherence to all other GAGAS requirements and our conclusion on this review engagement is not modified with respect to this matter.

We are required to be independent of KWS and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our reviews.

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 prescribed by the USOA.

Basis of Accounting

For regulatory purposes, the CPUC adopted, through Decision (D.) 16-11-006 on November 10, 2016, the updated USOA, which is a comprehensive regulatory basis of accounting framework 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 prescribed by the USOA. KWS's financial statements were prepared based on this regulatory requirement.

We draw attention to the 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.

Emphasis of Matter – Correction of Material Misstatements

As discussed in Notes 3, 4, 5, and 6, UAB identified four material misstatements in KWS's 2021 Annual Report originally filed with CPUC's Water Division on March 22, 2022. These misstatements have been corrected in the accompanying financial statements. Our conclusion is not modified with respect to this matter.

Other Matter– Views of Responsible Official

We discussed our review results and findings with KWS during fieldwork. UAB further discussed these findings with KWS's management at the exit conference on March 3, 2023. At the exit conference, UAB also stated that the final report will include the views of responsible officials. KWS's management agreed to make appropriate adjusting journal entries to its accounting records to correct the material misstatements described in Appendix A of this report. KWS submitted its revised financial statements to the CPUC's Water Division on March 27, 2023, to correct the material misstatements in each account as described in Appendix A of this report. UAB is not aware of any material modifications that should be made to the accompanying financial statements.

UAB issued a draft review report to KWS for comments on April 12, 2023. KWS submitted its comments via email on April 26, 2023. KWS's response to the findings is presented in Appendix B of this report. In its response, KWS stated it has applied the adjusting journal entries to correct the misstatements described in Appendix A of this report; however, KWS does not consider the misstatements to be material. UAB's evaluation of KWS's response is presented in Appendix C of this report. The review findings and recommendations presented in this report remain unchanged and represent our final determination of this review engagement.

Other Matter–Submission of a Corrective Action Plan

KWS's management should submit a corrective action plan (CAP) to UAB at UtilityAudits@cpuc.ca.gov, with a copy to Bruce DeBerry, Program Manager of Water Division, at Bruce.DeBerry@cpuc.ca.gov by June 29, 2023. The CAP should address how KWS will implement the recommendations. If KWS is unable to implement UAB's recommendations, the CAP should state the reason(s) for not being able to implement recommendations. KWS should use the amounts reviewed by UAB as presented in this report as the basis to file its 2022 Annual Report with the CPUC.

Report on Other Regulatory Requirements

For regulatory purposes, UAB also reviewed whether KWS complied with PU Code Section 818 to obtain its long-term debts, and whether KWS timely filed its 2021 Annual Report as required by CPUC's Water Division. For the review period, UAB did not note any noncompliance with PU

Code Section 818; and KWS timely filed its 2021 Annual Report in compliance with the CPUC directive from the Water Division.

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 KWS, 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 this report, which is a matter of public record and will be available on the CPUC's website at [Audit Reports by Industry \(ca.gov\)](https://www.cpuc.ca.gov/Audit-Reports-by-Industry).

Angie Williams

Angie Williams, Director
Utility Audits, Risk and Compliance Division

Sacramento, CA
May 15, 2023

REVIEWED FINANCIAL STATEMENTS

Keene Water System Balance Sheet (As Reviewed) As of December 31, 2021

ASSETS	
UTILITY PLANT (Note 2)	
Water Plant in Service	\$1,911,166
Accumulated Depreciation of Water Plant	(654,089)
Net Utility Plant	<u>1,257,077</u>
CURRENT AND ACCRUED ASSETS	
Accounts Receivable	9,771
Total Current and Accrued Assets	<u>9,771</u>
Total Assets	<u><u>\$1,266,848</u></u>
CAPITALIZATION AND LIABILITIES	
CORPORATE CAPITAL AND SURPLUS	
Retained Earnings	(\$5,261,665)
Total Capitalization	<u>(5,261,665)</u>
Current and Accrued Liabilities	
Accounts Payable	1,464
Customer Deposits	42
Total Current and Accrued Liabilities	<u>1,506</u>
Current and Accrued Liabilities	
Other Credits (Note 3)	6,527,007
Total Equity and Liabilities	<u><u>\$1,266,848</u></u>

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

Keene Water System
Income Statement (As Reviewed)
 For Year Ended December 31, 2021

OPERATING REVENUES	
Fire Protection Revenue (Note 4) ³	\$18,692
Metered Water Revenue (Note 4)	104,639
Total Operating Revenue	123,331
 OPERATING EXPENSES	
Plant Operation and Maintenance Expenses	
Purchased Water	19,043
Contract Work (Note 5)	33,393
Transportation Expense	387,673
Total Plant Operation and Maintenance Expenses	440,109
 Administrative and General Expenses	
Regulatory Commission Expense (Note 6)	1,464
Net Administrative and General Expenses	1,464
Total Operating Expenses	441,573
 Depreciation Expense	47,779
Total Operating Revenue Deductions	489,352
 Net Loss	(\$366,021)

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

³ A \$1 rounding difference was noted between the revised Annual Report and KWS's underlying accounting records.

Keene Water System
Statement of Retained Earnings (As Compiled ⁴)
 For Year Ended December 31, 2021

Retained Earnings, Beginning of Year	(\$4,874,708)
CREDITS:	
Total Credits	0
DEBITS:	
Net Loss	366,021
UAB Adjustment Fire Protection and Hydrant Revenue	13,722
UAB Adjustment to Metered Water Revenue	7,214
Total Debits	386,957
Retained Earnings, End of Year	(\$5,261,665)

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

⁴ UAB compiled the Statement of Retained Earnings based on the reviewed Balance Sheet and Income Statement, and other relevant financial data.

Keene Water System

Notes to Financial Statements

KWS is a Class D water utility and provides metered water service to 24 active residential and service connections and two active commercial service connections.⁵ KWS's service territory is located in the communities of Keene and Woodford in Kern County, California.⁶ KWS is an internal operating unit of Union Pacific.

Significant Accounting Policies

The financial statements of KWS were prepared on the basis of accounting set forth in the Uniform System of Accounts (USOA) for Water Utilities. Regulated water utilities are required to prepare their financial statements on accrual basis of accounting set forth in the USOA adopted in Decision (D.) 16-11-006 by the CPUC on November 10, 2016, which is a comprehensive regulatory basis of accounting framework 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 the 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.

The 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

⁵ KWS's 2021 Annual Report, Schedule I—Service Connections at End of Year, Page 19.

⁶ CPUC D.06-07-034, Page 2.

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.⁷ The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs.

KWS computes depreciation on a straight-line composite rate of 2.5 percent, which falls within industry average.

(2) Asset Retirement

The USOA requires that water plant be recorded at original cost. In the 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 the USOA.

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

KWS did not acquire or sell any utility property during the review period.

3. Funding for Past Operations

Since 2006, KWS has been annually incurring operating deficits. As of December 31, 2021, KWS's total operating deficit totaled \$6,527,007. KWS is an internal operating unit of Union Pacific. Union Pacific provides additional funding to cover KWS's operations each year.

KWS incorrectly recorded and reported \$6,513,007 of funding from Union Pacific between 2006 and 2021 to cover KWS's operations as Other Current Liabilities in Account 241 in its 2021 Annual Report originally filed with the CPUC's Water Division on March 22, 2022. Since KWS is an

⁷ D.16.11-006 dated November 10, 2016, General Accounting Instructions 4 on Page B14.

internal operating unit of Union Pacific and the \$6,513,007 recorded in Other Current Liabilities does not meet the criteria of Other Current Liabilities as defined by the USOA, KWS agreed that it is more appropriate to reclassify the \$6,513,007 to Account 253—Other Credits in the Annual Report. As a result, KWS overstated Account 241—Other Current Liabilities by \$6,513,007 and understated Account 253—Other Credits by the same amount. KWS incorporated UAB's proposed adjustments and corrected the noted misstatements in its revised 2021 Annual Report submitted to the CPUC's Water Division on March 27, 2023.

Additionally, Note 5 below describes another material misstatement impacting Account 253—Other Credits.

4. Water Revenue

KWS did not bill its customers the tariff rates authorized by the CPUC. As a result, KWS underbilled its ratepayers and understated its revenue in Account 470—Metered Water Revenue and Account 462—Fire Protection and Hydrant Revenue by \$7,214 and \$13,722, respectively, in its 2021 Annual Report originally filed with the CPUC's Water Division on March 22, 2022. However, KWS incorporated UAB's proposed adjustments and corrected the noted misstatements in its revised 2021 Annual Report submitted to the CPUC's Water Division on March 27, 2023.

5. Operating Expense

Union Pacific, KWS's parent company, inadvertently did not record some invoices to KWS's cost accumulation number to identify the expenses as KWS's expenses. As a result, KWS understated both Account 650—Contract Work and Account 253—Other Credits by \$14,000. KWS incorporated UAB's proposed adjustments and corrected the noted misstatements in its revised 2021 Annual Report submitted to the CPUC's Water Division on March 27, 2023.

6. 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. The 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.⁸

KWS did not accrue \$1,464 of CPUC Users Fee expenses and related liabilities incurred in 2021 but were paid in 2022 in its Annual Report originally filed with the CPUC's Water Division on March 22, 2022. As a result, KWS understated both Account 688—Regulatory Commission Expense and Account 231—Accounts Payable by \$1,464.

In addition, KWS failed to timely remit its 2021 CPUC Users Fee to the CPUC and thus did not comply with PU Code Sections 431 and 433, and CPUC's directives specified in Resolution M-4841 and CPUC Water Division's Memorandum dated July 23, 2020.

7. Form of Financial Statements⁹

⁸ D.16.11-006 dated November 10, 2016, General Accounting Instructions 9 on Pages B18 and B19.

⁹ Regulated Utilities Manual—A Service for Regulated Utilities by Deloitte & Touche USA LLP, pages 36-37.

(1) Balance Sheet

Unlike the financial statements of other industries, the financial statements of regulated water utilities present the water plant as the first major caption on the asset side of the balance sheet, and capitalization is first on the liability side. Current assets and current liabilities are relegated to a comparatively unimportant position in the center of the balance sheet, rather than being placed prominently as in statements for non-regulated industries.

(2) Income Statement

The form of Income Statement reflects the classification of revenues and expenses in ratemaking. Operating revenues and expenses are referred to as “above the line” because they are allowable in ratemaking, and the result of deducting total operating expenses from total operating revenues is the operating income. Other Income and Deductions are referred to as “below the line” because they are applied after operating income and are not allowable in ratemaking. The “below the line” items include interest revenue, dividend income, other revenues that are from non-water utility operations and/or non-water utility properties, expenses that are unrelated to water utility operations, and interest expense (the interest expense is recovered through the authorized rate of return). The concept of “above the line” revenues and expenses being allowable in ratemaking affects the form of the income statement, the classification of revenues and expenses, and decisions of management in incurring expenses.

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 2021 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, KWS has complied with these requirements.

APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS

Finding 1: Incorrect Recording and Reporting of Other Current Liabilities

Condition:

KWS incorrectly recorded and reported \$6,513,007 fundings provided by Union Pacific to cover KWS's past operations in Account 241—Other Current Liabilities in its Annual Report originally filed with the CPUC's Water Division on March 22, 2022. Since KWS is an internal operating unit of Union Pacific and the \$6,513,007 recorded in Other Current Liabilities does not meet the criteria of Other Current Liabilities as defined by the USOA, KWS agreed that it is more appropriate to reclassify the \$6,513,007 to Account 253—Other Credits in the Annual Report. As a result, KWS overstated Account 241—Other Current Liabilities by \$6,513,007 and understated Account 253—Other Credits by the same amount.

UAB proposed, and KWS agreed and incorporated, the following adjusting journal entry to correct the misstatement identified above:

AJE No.	Acct No.	Description	DR	CR
1	241	Other Current Liabilities	\$6,513,007	
	253	Other Credits		\$6,513,007
		<i>To reclassify fundings that KWS received to cover its operating deficit from Union Pacific as Other Credits.</i>		

KWS applied this adjusting journal entry and corrected these material misstatements in its revised 2021 Annual Report to the CPUC's Water Division on March 27, 2023.

Criteria:

The USOA states, in part, that:

241. Other Current Liabilities

A. This account shall include all current and accrued liabilities not provided for elsewhere.

B. Include herein pension accruals prior to the time they are transmitted to the trustee, accruals of vacation pay, etc.

C. A separate subaccount shall be maintained for each class of liability.

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:

KWS lacks monitoring and review procedures to ensure that only liabilities payable within one year are reported as Other Current Liabilities in Account 241.

Effect:

Inaccurate reporting of Other Credits and Other Current Liabilities distorted KWS financial position as of December 31, 2021, and reduced the comparability of KWS's 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 KWS relative to other small water utilities in California.

Recommendation:

KWS should establish and implement review and monitoring policies and procedures to ensure that only liabilities payable within one year are reported as Other Current Liabilities in Account 241.

Finding 2: Incorrect Tariff Rates Billed**Condition:**

KWS underbilled its ratepayers and understated its revenue in Account 470–Metered Water Revenue and Account 462–Fire Protection and Hydrant Revenue by \$7,214 and \$13,722, respectively, in its Annual Report originally filed with the CPUC's Water Division on March 22, 2022. KWS did not properly charge its customers using the most updated tariff rates approved by the CPUC in Advice Letter (AL) 18, effective December 20, 2018. The following table summarizes the discrepancies between the water rates KWS billed its customers and the tariff rates approved by the CPUC in AL 18:

Description	Billed Water Rates	Rates per Tariff Book	Variance Over/(Under) Billed
Service Charge			
5/8 Inch Meters	\$96.95	\$104.71	(\$7.76)
3/4 Inch Meters	145.43	157.07	(11.64)
2 Inch Meters	145.43	837.66	(692.23)
Rate Base Charge			
2 Inch Meters	95.75	510.00	(414.25)
Quantity Rate			
Usage, per 1,000 gallons	9.22	9.95	(0.73)

As a result, KWS understated Account 470–Metered Water Revenue and Account 462–Fire Protection and Hydrant Revenue by \$7,214 and \$13,722, respectively; and overstated Retained Earnings by \$20,937.

UAB proposed the following adjusting entry to correct the misstatement identified above:

AJE No.	Acct. No.	Description	DR	CR
2	215	Retained Earnings	\$20,936	
	462	Fire Protection and Hydrant Revenue		\$13,722
	470	Metered Water Revenue		7,214
<i>To record underbilled revenues due to use of incorrect tariff rates.</i>				

KWS has incorporated this adjusting journal entry and corrected these material misstatements in its revised 2021 Annual Report to the CPUC's Water Division on March 27, 2023.

Criteria:

SP U-8-W states, in part, that:

C. Tariffs Generally

8. The Utility's tariffs or tariff book includes the entire body of rates, tolls, rentals, charges, classifications and rules of a public Utility. No regulated Utility can charge for any utility service that is not described and approved by the Commission in its tariffs. A tariff schedule describes and sets rates for a specific utility service.

Cause:

KWS lacks adequate monitoring and review procedures over its billing process to ensure that ratepayers are billed at the most updated tariff rates approved by the CPUC.

Effect:

KWS underbilled its customers and under-reported its revenue in its 2021 Annual Report. Inaccurate reporting of Operating Revenue in the Annual Report, which may be used during the KWS's General Rate Case (GRC) application review process, could potentially impact the water rates for KWS's ratepayers.

Recommendation:

KWS should strengthen its monitoring and review procedures over its billing process to ensure that ratepayers are billed at the most updated tariff rates approved by the CPUC.

Finding 3: Misstatement of Contract Work

Condition:

KWS understated Account 650—Contract Work by \$14,000 in its Annual Report originally filed with the CPUC's Water Division on March 22, 2022. Due to a recording error, Union Pacific inadvertently missed charging some invoices to KWS's cost accumulation number to identify the expenses related to KWS. As a result, KWS understated both Account 650—Contract Work and Account 253—Other Credits by \$14,000.

UAB proposed the following adjusting entry to correct the misstatement identified above:

AJE No.	Acct. No.	Description	DR	CR
3	650	Contract Work	\$14,000	
	253	Other Credits		\$14,000
		<i>To record omitted Contract Work expense and related liability.</i>		

KWS has incorporated this adjusting journal entry and corrected these material misstatements in its revised 2021 Annual Report to the CPUC's Water Division on March 27, 2023.

Criteria:

The USOA states, in part, that:

650. Contract Work

This account shall include the cost of all repair and maintenance work not performed by water company employees. Examples of such expenses are pump repairs, repairs of water system leaks by local plumbers, painting of tanks by painting contractors, and testing of water by laboratories. This account shall include materials that are part of a contract price if the cost of such materials is not separately stated, and incidental operation and maintenance expenses not chargeable to accounts 630 or 640.

Cause:

KWS lacks monitoring and review procedures over its accounting and reporting process to ensure its operating expenses are recorded completely and accurately.

Effect:

Inaccurate reporting of Contract Work in the Annual Report, which may be used during KWS's GRC application review process, could impact water rates for KWS's ratepayers. Inaccurate reporting of Other Credits reduces the comparability of KWS's 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 KWS relative to other small water utilities in California.

Recommendation:

KWS should establish and implement monitoring and review procedures to ensure that operating expenses are accurately accounted for in accordance with the accounting requirements of the USOA.

Finding 4: Unrecorded CPUC Users Fee and Related Liabilities

Condition:

KWS did not accrue \$1,464 of CPUC Users Fee expenses and related liabilities incurred in 2021 and paid in 2022 in its Annual Report originally filed with the CPUC's Water Division on March 22, 2022. As a result, KWS understated both Account 688—Regulatory Commission Expense and Account 231—Accounts Payable by \$1,464.

Additionally, KWS failed to timely remit its 2021 CPUC Users Fee to the CPUC, resulting in a non-compliance with PU Code Sections 431 and 433, and CPUC's directives specified in Resolution M-4841 and CPUC Water Division's Memorandum dated July 23, 2020. PU Code Section 433(a) requires that "Every public utility with annual gross intrastate revenues of seven hundred fifty thousand dollars (\$750,000) or less shall make payment of the fee to the commission on an annual basis on or before January 15." PU Code Section 431 requires the CPUC to annually determine the Users Fee. Resolution M-4841 established the Users Fee effective October 1, 2020. CPUC Water Division's Memorandum dated July 23, 2020, directs all regulated water and sewer utilities to implement the authorized CPUC Users Fee. KWS did not remit its CPUC Users Fee until October 26, 2022.

UAB proposed the following adjusting entry to correct the misstatement identified above:

AJE No.	Acct. No.	Description	DR	CR
4	688	Regulatory Commission Expense	\$1,464	
	231	Accounts Payable		\$1,464
		<i>To record unaccrued CPUC Users Fee expense and related liability.</i>		

KWS has incorporated this adjusting journal entry and corrected these material misstatements in its revised 2021 Annual Report to the CPUC's Water Division on March 27, 2023.

Criteria:

The USOA states, in part, that:

2. General Accounting Instructions

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

PU Code Section 433 states that:

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

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

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

Cause:

KWS lacks monitoring and review procedures to ensure that expenses and liabilities are accurately recorded and reported in its Annual Report. KWS also lacks policies and procedures to ensure that CPUC Users Fee is timely remitted to the CPUC.

Effect:

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

Inaccurate reporting of Accounts Payable in Account 231 distorted KWS's financial position as of December 31, 2021, and reduced the comparability of KWS's financial statements with other small water utilities. Consistent presentation among small water utilities aids decision makers in analyzing the performance and financial position of KWS relative to other small water utilities in California.

Recommendations:

KWS should implement monitoring and review procedures to ensure that expenses and liabilities are accurately recorded and reported in its Annual Report. KWS should also establish and implement policies and procedures to ensure that CPUC Users Fee is timely remitted to the CPUC.

APPENDIX B—UTILITY'S RESPONSE

Keene Water System
2021 Annual Report Review Written Response

Finding 1

We agree the amounts classified in Other Current Liabilities in Account 241 in the Annual Report will not be cleared within one-year. The amount was moved to Account 253 – Other Credits. We do not consider the move from short-term to long-term to be materially misleading as, based on the financials, it was obvious that this account was the offset for the annual operating deficits.

Finding 2, 3, & 4

The correcting journal entries have been made; however, we do not consider the revenue and expense adjustments, which increasing the net loss by 1%, to be material as Keene Water Systems has already been incurring annual operating deficits since 2006 as noted in the audit report.

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

We appreciate KWS's comments submitted on April 26, 2023. In its response, KWS stated that it has applied adjusting journal entries to correct the misstatement described in Appendix A of this report. We appreciate KWS's willingness to correct the misstatements noted by us during the review. KWS also commented on the materiality issue we described in each finding in Appendix A. We address KWS's comments below.

Finding 1

KWS stated that it does not consider reclassifying the fundings provided by Union Pacific to cover KWS's past operations from Account 241—Other Current Liabilities to Account 253—Other Credits to be materially misleading. KWS also stated that it is obvious, based on the financial statements, this balance is an offset for the annual operating deficits. UAB disagrees with KWS's position. Reporting the accumulated balance of the past operations as Other Current Liabilities is misleading because the Other Current Liabilities account should only report liabilities that are payable within one year. KWS has received these fundings from Union Pacific Railroad Company to cover its past operations since 2006. Recording the accumulation of these fundings as Other Current Liabilities in the financial statements is inappropriate because it implies that KWS is obligated to repay the \$6,513,007 to Union Pacific within the following year. In addition, UAB reiterates that KWS is an internal operating unit of Union Pacific and the \$6,513,007 recorded in Other Current Liabilities does not meet the criteria of Other Current Liabilities as defined by the USOA. Therefore, this finding remains unchanged.

Findings 2, 3, and 4

KWS stated that it does not consider the revenue or expense adjustments, which increased the net loss by one percent, to be material to KWS. UAB disagrees with KWS's position. We determine the materiality of a misstatement not based solely on a percentage of net income or net loss. Rather, we consider both quantitative and qualitative measures, including but not limited to the cumulative effect that the misstatement could impact the decision of a user of the financial statements, and a regulated utility's compliance with specific CPUC directives such as those mandated by the USOA. A misstatement is considered material if it could reasonably be expected to influence the decisions that the primary users of general-purpose financial statements make based on those financial statements, which provide financial information about a specific entity. A material misstatement is information in the financial statements that is sufficiently incorrect that it may impact the economic decisions of someone relying on those statements. We determined that the misstatements described in Findings 2, 3, and 4 in Appendix A of this report are material. Therefore, these findings remain unchanged.