



REVIEW OF FINANCIAL STATEMENTS

Mecchi Water Service, LLC

For the Year Ended December 31, 2021

Utility Audits, Risk and Compliance Division
Utility Audits Branch
May 31, 2023



MEMBERS OF THE TEAM

Angie Williams, Director

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PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

May 31, 2023

Mr. Gary Ledesma, Owner
Mecchi Water Service LLC
1367 Tofts Drive
San Jose, CA 95131

Dear Mr. Ledesma:

Final Report Transmittal Letter— Review of Mecchi Water Service, LLC'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 Mecchi Water Service, LLC's (MWS) regulatory basis financial statements in the 2021 Annual Report filed with the CPUC, which comprise the balance sheet as of December 31, 2021, and related statements of income and proprietary capital. The final review report is enclosed.

UAB provided a draft report to MWS for comments on March 28, 2023. MWS responded via email on April 7, 2023, that it had no comments regarding the draft 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 July 17, 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 MWS'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

Mr. Gary Ledesma, Owner
Mecchi Water Service, LLC
May 31, 2023
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cc: Rachel Peterson, Executive Director, CPUC
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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 Mecchi Water Service, LLC (MWS) 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.

MWS is a Class D water utility with 30 active flat rate customer service connections.¹ MWS's service territory is located approximately three-quarter mile north of San Martin in Santa Clara County, California. MWS registered as a limited liability company (LLC) in California on February 17, 2021,² and operates as a partnership. Prior to registering as an LLC, MWS operated as Mecchi Water Company. CPUC Decision (D.) 42487, dated February 8, 1949, declared MWS's water system as a public utility. As a regulated water utility, MWS is required to prepare its financial statements on accrual basis of accounting set forth in the Uniform System of Accounts (USOA) adopted in 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 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 MWS 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, except for the balances of the Water Plant in Service and Accumulated Depreciation of Water Plant accounts, we are not aware of any material modifications that should be made to MWS's revised financial statements in order for them to be in accordance with the accounting framework prescribed by the USOA. MWS did not retain any documentation to substantiate the balances of \$66,530 and \$42,566 for Account 101–Water Plant in Service and Account 108–Accumulated Depreciation of Water Plant, respectively, in its 2021 Annual Report. Therefore, UAB is unable to verify the accuracy of the reported balances of Water Plant in Service and Accumulated Depreciation of Water Plant.

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

² MWS's 2021 Annual Report, General Information, Page 4.

For the review period, UAB did not note any noncompliance with PU Code Section 818. In addition, MWS timely filed its 2021 Annual Report as required by the directives from the CPUC's Water Division.

UAB identified five material misstatements in MWS's 2021 Annual Report originally filed with the CPUC's Water Division and a noncompliance with the USOA requirements as described in Appendix A—Review Findings and Recommendations. These findings are summarized below:

- Finding 1: MWS did not retain any documentation to substantiate the balances of \$66,530 and \$42,566 for Account 101—Water Plant in Service and Account 108—Accumulated Depreciation of Water Plant, respectively, in its 2021 Annual Report. Due to the lack of supporting documentation, UAB is unable to verify the accuracy of the reported balances for these accounts.
- Finding 2: MWS did not report \$6,698 of outstanding liabilities as of December 31, 2021, in its 2021 Annual Report. Specifically, MWS did not accrue \$383 of late fees incurred in 2021; \$231 of professional services expenditure incurred in 2021; \$3,220 of outstanding liabilities incurred for CPUC Users fees incurred prior to 2021; and \$2,864 of expenses related to ground water production incurred prior to 2021.
- Finding 3: MWS understated Account 141—Accounts Receivable and Account 218—Proprietary Capital by \$1,090 and \$1,063, respectively; and overstated Account 460—Unmetered Water Revenue and Account 676—Uncollectible Account Expense by \$1,280 and \$1,307, respectively. The account balances that MWS reported in its originally filed 2021 Annual Report did not agree with MWS underlying accounting records such as the Billing Register and Accounts Receivable Aging Report.
- Finding 4: MWS overstated Account 688—Regulatory Commission Expense and Account 218—Proprietary Capital by \$553 and \$1,244, respectively; and understated Account 480—Other Water Revenue and Account 231—Accounts Payables by \$254 and \$437, respectively, in its 2021 Annual Report. The misstatements occurred because MWS did not report \$254 of CPUC Users Fee it billed to its customers during 2021, incorrectly reported \$990 of prior year CPUC Users Fee paid in 2021 as Regulatory Commission Expense in its 2021 Annual Report, and did not accrue \$437 of CPUC Users Fee due to the CPUC as of December 31, 2021.

In addition, MWS did not bill its customers for the CPUC Users Fee surcharge between January and May 2021. MWS also failed to timely remit its CPUC Users Fee to the CPUC in compliance with PU Code Sections 431 and 433.

- Finding 5: MWS misreported its cumulative net deficit from operations in the amount of \$944 in Account 206—Subchapter S Corporation Accumulated Adjustments Accounts instead of reporting it in Account 218—Proprietary Capital in its 2021 Annual Report. MWS is a partnership and should have recorded and reported any changes in its ownership equity in Account 218—Proprietary Capital instead of Account 206 – Subchapter S Corporation Accumulated Adjustments Account.

- Finding 6: MWS did not maintain its accounting records as required by the USOA. Specifically, MWS did not record all of its transactions using the double entry method, nor using accrual basis of accounting to record and report all account balances. In addition, MWS did not maintain a general ledger or a working trial balance to support the balances reported in the Annual Report under the review period.

UAB discussed the above findings with MWS during fieldwork. MWS's management concurred with the findings and agreed to make appropriate adjusting journal entries to correct the misstatements identified above. MWS submitted its revised financial statements to the CPUC's Water Division on March 15, 2023, to correct the material misstatements in each account, except for Water Plant in Service and Accumulated Depreciation of Water Plant, as described in Appendix A of this report. UAB further discussed these findings with MWS's management at the exit conference on March 28, 2023, and MWS concurred with the review results. Except for the reported balances of Water Plant in Service and Accumulated Depreciation of Water Plant accounts, UAB is not aware of any material modifications that should be made to the accompanying financial statements. UAB provided a draft review report to MWS for comments on March 28, 2023. MWS responded via email on April 7, 2023, that it had no comments regarding the draft report. The review findings and recommendations presented in this report represent our final determination of this review engagement.

INDEPENDENT ACCOUNTANT'S REVIEW REPORT

Gary Ledesma, Owner
Mecchi Water Service, LLC
1367 Tofts Drive
San Jose, CA 95131

Report on the Financial Statements

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

MWS'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, MWS'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 MWS and to meet our other ethical responsibilities, in accordance with relevant ethical requirements related to our reviews.

Basis for Qualified Conclusion

As noted in Note 2 of the accompanying financial statements, MWS could not provide sufficient supporting documents to substantiate the balances of \$66,530 and \$42,566 for Water Plant in Service and Accumulated Depreciation of Water Plant, respectively, presented in the accompanying

financial statements. Due to the lack of supporting documentation, UAB is unable to verify the accuracy of the reported balances for these accounts. The effects of this departure from the USOA accounting requirements on MWS's financial position has not yet been determined by its management.

Qualified Conclusion

Based on our review, except for the effects of the matters described in the Basis for Qualified Conclusion paragraph, 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 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. MWS's accompanying 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 2, 3, 4, 5, and 6, UAB identified five material misstatements in MWS's 2021 Annual Report originally filed with CPUC's Water Division on March 1, 2022. Except for the misstatements related to Water Plant in Service and Accumulated Depreciation of Water Plant accounts as disclosed in Notes 2, MWS corrected four of the five material misstatements in the accompanying financial statements. As discussed in Note 2 to the Financial Statements, UAB does not express a conclusion on the reported balances of Water Plant in Service and Accumulated Depreciation of Water Plant as of December 31, 2021, in the accompanying financial statements. However, our conclusion to the rest of the accompanying financial statements is not modified with respect to this matter.

Other Matter– Views of Responsible Official

We discussed our review results and findings with MWS during fieldwork. MWS's management concurred with the findings and agreed to make appropriate adjusting journal entries to correct the material misstatements described in Appendix A of this report. MWS submitted its revised financial statements to the CPUC's Water Division on March 15, 2023, to correct the material misstatements in each account, except for Water Plant in Service and Accumulated Depreciation of Water Plant, as described in Appendix A of this report. UAB further discussed these findings with MWS's management at the exit conference on March 28, 2023, and MWS concurred with the review results. Except for the reported balances of Water Plant in Service and Accumulated Depreciation of Water Plant accounts, UAB is not aware of any material modifications that should be made to the accompanying financial statements.

UAB provided a draft review report to MWS for comments on March 28, 2023. MWS responded via email on April 7, 2023, that it had no comments regarding the draft report. The review findings

and recommendations presented in this report represent our final determination of this review engagement.

Other Matter–Submission of a Corrective Action Plan

MWS’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 July 17, 2023. The CAP should address how MWS will implement the recommendations and provide the timing of incorporating UAB’s review adjustments to MWS’s books and records. If MWS is unable to implement UAB’s recommendations, the CAP should state the reason(s) for not being able to implement any of the recommendations. MWS 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 MWS complied with PU Code Section 818 to obtain its long-term debts, and whether MWS 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. In addition, MWS has timely filed its 2021 Annual Report in compliance with the CPUC directive from the Water Division. However, as described in Finding 6 in Appendix A of this report, MWS did not maintain its accounting system as required by the USOA.

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 MWS, 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 31, 2023

REVIEWED FINANCIAL STATEMENTS

Mecchi Water Service Balance Sheet (As Reviewed)

As of December 31, 2021

ASSETS	
UTILITY PLANT	
Water Plant in Service (Note 2)	\$66,530
Accumulated Depreciation of Water Plant (Note 2)	(42,566)
Net Utility Plant	<u>23,964</u>
CURRENT AND ACCRUED ASSETS	
Cash	1,375
Accounts Receivable—Customers (Note 4)	1,090
Total Current and Accrued Assets	<u>2,465</u>
Total Assets and Other Debits	<u><u>\$26,429</u></u>
PROPRIETARY CAPITAL	
Proprietary Capital (Note 3)	(\$6,989)
Total Proprietary Capital	<u>(6,989)</u>
CURRENT AND ACCRUED LIABILITIES	
Accounts Payable (Note 5)	33,050
Taxes Accrued	368
Total Current and Accrued Liabilities	<u>33,418</u>
Total Equity and Liabilities	<u><u>\$26,429</u></u>

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

Mecchi Water Service
Income Statement (As Reviewed)
 For Year Ended December 31, 2021

OPERATING REVENUES	
Unmetered Water Revenue (Note 4)	\$30,553
Other Water Revenue (Note 6)	254
Total Operating Revenue	30,807
OPERATING EXPENSES	
Plant Operation and Maintenance Expenses	
Power	3,227
Other Volume Related Expenses	8,135
Contract Work	23,847
Transportation Expense	70
Other Plant Maintenance Expenses	207
Total Plant Operation and Maintenance Expenses	35,486
Administrative and General Expenses	
Office Services and Rentals	278
Office Supplies and Expenses	251
Professional Services	4,008
Regulatory Commission Expense	437
General Expenses	350
Net Administrative and General Expenses	5,324
Total Operating Expenses	40,810
Depreciation Expense	1,671
State Corporate Income Tax Expense	800
Miscellaneous Non-Utility Expense	383
Total Operating Revenue Deductions	43,664
Net Loss	(\$12,857)

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

Mecchi Water Service
Statement of Proprietary Capital (As Compiled ³)
 For Year Ended December 31, 2021

Proprietary Capital, Beginning of Year ⁴	\$10,178
CREDITS:	
Additional Investments During the Year	8,600
UAB Adjustment to Accounts Receivable	1,090
UAB Adjustment to Unmetered Water Revenue	1,280
UAB Adjustment to Professional Services	231
UAB Adjustment to Miscellaneous Non-Utility Expense	383
Total Credits	11,584
DEBITS:	
Net Loss	12,857
UAB Adjustment to Uncollectible Accounts Expense	123
UAB Adjustment to Accounts Payable	7,135
UAB Adjustment to Other Water Revenue	254
UAB Adjustment to Regulatory Commission Expense	553
MWS Prior period adjustment to Accounts Payable ⁵	7,829
Total Debits	28,751
Proprietary Capital, End of Year	(\$6,989)

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

³ UAB compiled the Statement of Proprietary Capital based on the reviewed Balance Sheet and Income Statement, and other relevant financial data.

⁴ MWS reported this beginning balance in Subchapter S Corporation Accumulated Adjustments Account; however, UAB has determined that MWS operated as a partnership and should report its equity in the Proprietary Capital account.

⁵ MWS recorded an adjustment for Accounts Payable that was not reported in the prior year (2020) Annual Report.

Mecchi Water Service

Notes to Financial Statements

MWS is a Class D water utility with 30 active flat rate customer service connections.⁶ MWS's service territory is located approximately three-quarter mile north of San Martin in Santa Clara County, California. MWS registered as a limited liability company (LLC) in California on February 17, 2021,⁷ and operates as a partnership. Prior to registering as an LLC, MWS operated as Mecchi Water Company. CPUC Decision (D.) 42487, dated February 8, 1949, declared MWS's water system as a public utility.

Significant Accounting Policies

The financial statements of MWS 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 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 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

⁶ MWS's 2021 Annual Report, Schedule I–Service Connections at End of Year, Page 19.

⁷ MWS's 2021 Annual Report, General Information, Page 4.

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.⁸ The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs.

MWS computes depreciation on a composite depreciation rate of 2.5 percent, which falls within industry average.

MWS did not retain any documentation to substantiate the balances of \$66,530 and \$42,566 for Account 101–Water Plant in Service and Account 108–Accumulated Depreciation of Water Plant, respectively, in its 2021 Annual Report originally filed with the CPUC’s Water Division on March 1, 2022. Due to the lack of supporting documentation, UAB is unable to verify the accuracy of the reported balances for these accounts.

(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.

MWS 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.

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

⁸ D.16.11-006 dated November 10, 2016, General Accounting Instructions 4 on Page B14.

3. Proprietary Capital

MWS misreported its cumulative net deficit from operations in the amount of \$944 in Account 206–Subchapter S Corporation Accumulated Adjustments Account instead of reporting it in Account 218–Proprietary Capital in its 2021 Annual Report originally filed with the CPUC’s Water Division on March 1, 2022. MWS is a partnership and should have recorded and reported any changes in its ownership equity in Account 218–Proprietary Capital. As a result, MWS understated Account 206–Subchapter S Corporation Accumulated Adjustments Account by \$944 and overstated Account 218–Proprietary Capital by the same amount. However, MWS incorporated UAB’s proposed adjustment and corrected these misstatements in its revised Annual Report submitted to the CPUC’s Water Division on March 15, 2023.

4. Accounts Receivable, Revenues, and Uncollectible Account Expense

MWS understated Account 141–Accounts Receivable and Account 218–Proprietary Capital by \$1,090 and \$1,063, respectively; and overstated Account 460–Unmetered Water Revenue and Account 676–Uncollectible Account Expense by \$1,280 and \$1,307, respectively. The account balances that MWS reported in its originally filed Annual Report did not agree with MWS underlying accounting records such as the Billing Register and Accounts Receivable Aging Report. However, MWS incorporated UAB’s proposed adjustment and corrected these misstatements in its revised Annual Report submitted to the CPUC’s Water Division on March 15, 2023.

5. Accounts Payable and Operating Expense

MWS did not report \$6,698 of outstanding liabilities as of December 31, 2021, in its 2021 Annual Report originally filed with the CPUC’s Water Division on March 1, 2022 as described below:

- MWS did not accrue \$383 of late fees incurred in 2021.
- MWS did not accrue \$231 of expenditures incurred in 2021 for professional services.
- MWS did not accrue \$3,220 of outstanding liabilities for CPUC Users Fees incurred prior to 2021.
- MWS did not accrue \$2,864 of expenses related to ground water production costs incurred prior to 2021.

As a result, MWS understated Account 231–Accounts Payable, Account 426–Miscellaneous Non-Utility Expense, and Account 682–Professional Services by \$6,698, \$383, and \$231, respectively; and overstated Account 218–Proprietary Capital by \$6,084. However, MWS incorporated UAB’s proposed adjustment and corrected these misstatements in its revised Annual Report submitted to the CPUC’s Water Division on March 15, 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.⁹

MWS did not report \$254 of CPUC Users Fee it billed to its customers during 2021. Also, MWS incorrectly reported \$990 of prior year CPUC Users Fee paid in 2021 as Regulatory Commission Expense in its 2021 Annual Report. Moreover, MWS did not accrue \$437 of CPUC Users Fee due to the CPUC as of December 31, 2021.

In addition, MWS did not bill its customers for the CPUC Users Fee surcharge between January and May 2021. MWS also failed to timely remit its CPUC Users Fee to the CPUC in compliance with PU Code Section 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 Statements¹⁰

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

¹⁰ Regulated Utilities Manual—A Service for Regulated Utilities by Deloitte & Touché USA LLP, pages 36-37.

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, MWS has complied with these requirements.

APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS

Finding 1: Lack of Supporting Documentation

Condition:

MWS did not retain any documentation to substantiate the balances of \$66,530 and \$42,566 for Account 101—Water Plant in Service and Account 108—Accumulated Depreciation of Water Plant, respectively, in its 2021 Annual Report originally filed with the CPUC’s Water Division on March 1, 2022. Due to the lack of supporting documentation, UAB is unable to verify the accuracy of the reported balances for these accounts.

Criteria:

The USOA states, in part, that:

General Accounting Instructions 2

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

B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction.

101. Water Plant in Service

A. This account shall include the original cost of all water plant owned and used by the utility in providing water service. The following subaccounts should be maintained, if applicable:

101.1 Water Plant in Service - SDWBA

101.2 Water Plant in Service - Grant Funds

101.3 Water Plant in Service – Other

B. This account is the control account for plant accounts 301 through 379.

108. Accumulated Depreciation of Water Plant

A. This account shall reflect the depreciation and amortization accumulated on plant used in water utility service. The following subaccounts should be maintained, if applicable:

108.1 Accumulated Amortization of SDWBA

108.2 Accumulated Depreciation of Water Plant - Grant Funds

108.3 Accumulated Depreciation of Water Plant - Other

Cause:

MWS lacks policies and procedures to ensure that it retains source documentation to support the balances of Water Plant in Service and Accumulated Depreciation in its 2021 Annual Report.

Effect:

Due to the lack of supporting documentation, UAB is unable to verify the accuracy of the reported balances of Account 101–Water Plant in Service and Account 108–Accumulated Depreciation of Water Plant. Inaccurately reported balances of Water Plant in Service and Accumulated Depreciation of Water Plant could potentially impact MWS’s rate base and water rates for MWS’s ratepayers during MWS’s General Rate Case (GRC) application review process.

Recommendation:

MWS should establish and implement accounting policies and procedures to ensure that source documentations are properly retained and readily available to support account balances reported in its Annual Report.

Finding 2: Omitted Liabilities and Expenses**Condition:**

MWS did not report \$6,698 of outstanding liabilities as of December 31, 2021, in its 2021 Annual Report originally filed with the CPUC’s Water Division on March 1, 2022. MWS’s underlying accounting records showed that it did not accrue the following liabilities:

<u>Description</u>	<u>Overstatement/(Understatement)</u>			
	<u>Acct 231</u>	<u>Acct 426</u>	<u>Acct 682</u>	<u>Acct 218</u>
MWS did not accrue \$383 of late fees it incurred in 2021 for past due invoices related to ground water production.	(383)	(383)		
MWS did not accrue \$231 of expenditures incurred in 2021 for professional services.	(231)		(231)	
MWS did not accrued \$3,220 of outstanding liabilities for CPUC Users fees incurred prior to 2021.	(3,220)			\$3,220
MWS did not accrue \$2,864 of expenses related to ground water production costs incurred prior to 2021.	(2,864)			2,864
Total	(6,698)	(383)	(231)	6,084

As a result, MWS understated Account 231–Accounts Payable, Account 426–Miscellaneous Non-Utility Expense, and Account 682–Professional Services by \$6,698, \$383, and \$231, respectively; and overstated Account 218–Proprietary Capital by \$6,084.

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

AJE No.	Acct. No.	Description	DR	CR
1	218	Proprietary Capital	\$6,084	
	426	Miscellaneous Non-Utility Expense	383	
	682	Professional Services	231	
	231	Accounts Payable		\$6,698
		<i>To adjust liabilities and expenses to agree with the company's underlining records.</i>		

MWS incorporated this adjusting journal entry and corrected this misstatement in its revised 2021 Annual Report submitted to the CPUC's Water Division on March 15, 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.

B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction.

231. Accounts Payable

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

Cause:

MWS lacks policies and procedures over its accounting and reporting process to ensure that liabilities and expenses are recorded accurately and completely in the year incurred.

Effect:

Inaccurate reporting of Miscellaneous Non-Utility Expense in Account 426, and Professional Services in Account 682 in the Annual Report, which may be used during MWS's GRC application review process, could potentially impact the water rates for MWS's ratepayers.

Inaccurate reporting of Accounts Payable (Account 231) distorted MWS's financial position as of December 31, 2021, misstated its available working capital, and reduced the comparability of MWS'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 MWS relative to other small water utilities in California.

Recommendation:

MWS should establish and implement policies and procedures over its accounting and reporting process to ensure that liabilities and expenses are recorded accurately and completely in the year incurred.

Finding 3: Misstated Assets, Revenues, and Expenses**Condition:**

MWS understated Account 141—Accounts Receivable and Account 218—Proprietary Capital by \$1,090 and \$1,063, respectively; and overstated Account 460—Unmetered Water Revenue and Account 676—Uncollectible Account Expense by \$1,280 and \$1,307, respectively, in its 2021 Annual Report originally filed with the CPUC’s Water Division on March 1, 2022, due to the following accounting errors:

Description	Overstated/(Understated)			
	Acct 141	Acct 460	Acct 676	Acct 218
MWS did not report any Accounts Receivable in its Annual Report while its Accounts Receivable Aging Report showed an Accounts Receivable balance of \$1,090 as of December 31, 2021.	(\$1,090)			(\$1,090)
MWS reported \$31,833 of Unmetered Water Revenue in its 2021 Annual Report instead of reporting \$30,553 as recorded in its 2021 Billing Register, resulting in an overstatement of \$1,280. MWS’s accounting records also showed that MWS reported revenues in its Annual Report using cash basis of accounting instead of accrual basis of account as required by the USOA.		\$1,280		(1,280)
MWS reported \$1,307 of Uncollectible Accounts Expense in Account 676 in its 2021 Annual Report. However, MWS did not write off any Accounts Receivable in 2021 and MWS expects to be able to collect all outstanding receivables from its ratepayers.			\$1,307	1,307
	<u>(\$1,090)</u>	<u>\$1,280</u>	<u>\$1,307</u>	<u>(\$1,063)</u>

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

AJE No.	Acct. No.	Description	DR	CR
2	141	Accounts Receivable - Customers	\$1,090	
	460	Unmetered Water Revenue	1,280	
	218	Proprietary Capital		\$1,063
	676	Uncollectible Accounts Expense		1,307
		<i>To adjust the reported balances of Accounts Receivable, Unmetered Water Revenue, and Uncollectible Accounts Expense to agree with MWS's Billing Registers and Accounts Receivable Aging Report.</i>		

MWS incorporated this adjusting journal entry and corrected this misstatement in its revised 2021 Annual Report submitted to the CPUC's Water Division on March 15, 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.

B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction.

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.

Cause:

MWS lacks policies and procedures over its accounting and reporting process to ensure that revenues and accounts receivables reported in its 2021 Annual Report are accurate as supported by its underlying accounting records. MWS also lacks review and monitoring procedures to ensure that only bad debts that are directly written off are reported as Uncollectible Accounts Expense in Account 676.

Effect:

Inaccurate reporting of Unmetered Water Revenue in Account 460 and Uncollectible Accounts Expense in Account 676 in its 2021 Annual Report, which may be used during MWS's GRC application review process, could potentially impact the water rates for MWS's ratepayers.

In addition, inaccurate reporting of Accounts Receivable in Account 141 distorted MWS's financial position as of December 31, 2021, understated its available working capital, and reduced the comparability of MWS'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 MWS relative to other small water utilities in California.

Recommendations:

MWS should establish and implement policies and procedures over its accounting and reporting process to ensure that revenues and accounts receivables reported in its Annual Report are accurate as recorded in its underlying accounting records. MWS should also implement review and monitoring procedures to ensure that only bad debts that are directly written off are reported as Uncollectible Accounts Expense in Account 676.

Finding 4: Misreported CPUC Users Fee**Condition:**

MWS overstated Account 688—Regulatory Commission Expense and Account 218—Proprietary Capital by \$553 and \$1,244, respectively; and understated Account 480—Other Water Revenue and Account 231—Accounts Payables by \$254, and \$437, respectively, in its 2021 Annual Report originally filed with the CPUC's Water Division on March 1, 2022, due to the following accounting errors:

Description	Overstatement/(Understatement)			
	Acct 231	Acct 480	Acct 688	Acct 218
MWS did not report \$254 of CPUC Users Fee it billed to its customers during 2021.		(\$254)		\$254
MWS incorrectly reported \$990 of prior year CPUC Users Fee paid in 2021 as Regulatory Commission Expense in 2021.			\$990	990
MWS did not accrue \$437 of CPUC Users Fee due to the CPUC as of December 31, 2021.	(\$437)		(437)	
Total	(\$437)	(\$254)	\$553	\$1,244

In addition, MWS did not bill its customers for the CPUC Users Fee surcharge between January and May 2021. MWS also failed to timely remit its CPUC Users Fee to the CPUC in compliance with PU Section 431 and 433, and CPUC's directives specified in Resolution M-4841 and CPUC Water Division's Memorandum dated July 23, 2020.

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

AJE No.	Acct. No.	Description	DR	CR
3	218	Proprietary Capital	\$1,244	
	231	Accounts Payable		\$437
	480	Other Water Revenue		254
	688	Regulatory Commission Expense		553
		<i>To adjust revenue, expense, and liabilities related to CPUC Users Fee to agree with MWS's underlining records.</i>		

MWS incorporated this adjusting journal entry and corrected this misstatement in its revised 2021 Annual Report submitted to the CPUC's Water Division on March 15, 2023.

Criteria:

The USOA states, in part, that:

9. Water Utility Users Fee

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

B. Water utilities will credit regular operating revenue accounts with amounts billed to customers and charge account 688, Regulatory Commission Expense, with fees paid to the Commission.

231. Accounts Payable

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

480. Other Water Revenue

This account shall include revenue from water operations other than the delivery of water or provision of fire protection. This account shall be appropriately subdivided.

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

688. Regulatory Commission Expense

A. This account shall include all expenses (except salaries of regular utility employees) incurred by the utility in connection with formal matters before regulatory commissions.

B. Amounts of regulatory commission expense which, by direction of the commission is to be spread over future periods shall be charged to Account 180,

Deferred Charges and amortized by charges to Account 688, Regulatory Commission Expense.

PU Code Section 433(a) states 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.

CPUC Resolution M-4841 established the Users Fee effective October 1, 2020.

CPUC Water Division's Memorandum dated July 23, 2020, direct all regulated water and sewer utilities to implement the authorized CPUC Users Fee.

Cause:

MWS lacks monitoring and review procedures over its accounting and reporting process to ensure that all transactions related to CPUC Users Fee is accurately recorded and reported in its Annual Reports. MWS also lacks monitoring procedures to ensure that CPUC Users Fee is timely remitted to the CPUC.

Effect:

Inaccurate reporting of Accounts Payable (Account 231) distorted MWS's financial position as of December 31, 2021, and overstated its available working capital, which could impact the water rates for its ratepayers during its GRC application review process. In addition, inaccurate reporting of Other Water Revenue and Operating Expenses in the Annual Report, which may be used during MWS's GRC application review process, could also potentially impact the water rates for MWS's ratepayers.

Recommendations:

MWS should establish and implement policies and procedures over its accounting and reporting process to ensure that all transactions related to CPUC Users Fee are accurately recorded and reported in its Annual Reports. MWS should also establish and implement monitoring procedures to ensure that CPUC Users Fee is timely remitted to the CPUC.

Finding 5: Misclassified Ownership Equity

Condition:

MWS misreported its cumulative net deficit from operations in the amount of \$944 in Account 206—Subchapter S Corporation Accumulated Adjustments Account instead of reporting it in Account 218—Proprietary Capital in its 2021 Annual Report originally filed with the CPUC's Water Division on March 1, 2022. The USOA mandates that Account 218—Proprietary Capital should be used for reporting changes in ownership equity of a sole proprietor, or partners, in an unincorporated water utility. MWS is a partnership and should have recorded and reported any changes in its ownership equity in Account 218—Proprietary Capital. As a result, MWS understated Account 206—Subchapter S Corporation Accumulated Adjustments Accounts by \$944 and overstated Account 218—Proprietary Capital by the same amount.

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

AJE No.	Acct. No.	Description	DR	CR
4	218	Proprietary Capital	\$944	
	206	Subchapter S Corporation Accumulated Adjustments Account <i>To reclassify MWS's ownership equity to the proper account in compliance with the accounting requirements of the USOA.</i>		\$944

MWS incorporated this adjusting journal entry and corrected this misstatement in its revised 2021 Annual Report submitted to the CPUC's Water Division on March 15, 2023.

Criteria:

The USOA states, in part, that:

218. Proprietary Capital (for proprietorships and partnerships only)

- A. This account shall be credited with the investment of a sole proprietor, or partners, in an unincorporated water utility.
- B. A separate subaccount shall be maintained for each partner.
- C. At the end of each calendar year the net income or loss for the year shall be entered in this account.
- D. Accounting adjustments not properly attributable to operations of the current period shall be charged or credited to this account.
- E. All withdrawals from the business by the owner or partners other than as compensation for services performed shall be charged to subaccount 218.1, Proprietary Drawings. This subaccount shall be closed into Account 218 at the end of each accounting period.

Note: Amounts designated by a non-corporate owner or partner as a "salary", representing fair and reasonable compensation for services performed, shall be charged to operating expense account 671, Management Salaries, or to water plant accounts when appropriate. If clearing accounts are used, the owner's or partners' salaries will initially be charged to Account 900.1, Payroll Clearing, pending distribution.

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.

Cause:

MWS 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 Proprietary Capital account balances distorted MWS's financial position as of December 31, 2021, which could mislead decision-makers about MWS's tax structure.

Recommendations:

MWS should establish and implement monitoring procedures over its accounting and reporting process to ensure that it timely identifies changes in regulatory accounting and reporting requirements. MWS should use Account 218—Proprietary Capital to record and report changes in its ownership equity as required by the USOA.

Finding 6: Noncompliance with USOA Accounting Requirements**Condition:**

During the review, UAB noted the following deficiencies in MWS's accounting system and noncompliance with the accounting requirements of the USOA in MWS's accounting:

- MWS did not record all of its transactions using the double entry method.
- MWS did not use accrual basis of accounting to record and report all account balances.
- MWS did not maintain a general ledger or a working trial balance to support the balances reported in the Annual Report. Instead, MWS relied on bank statements, vendor statements and invoices as supporting documents.

General Accounting Instruction 2 of the USOA requires utilities to maintain their accounting records on an accrual basis of accounting using double entry method.

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.

B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction.

Cause:

MWS lacks an effective and efficient accounting system to ensure that its accounting transactions are accurately and completely recorded in its books and reported in its Annual Reports.

Effect:

Lack of an effective and efficient accounting system results in noncompliance with the USOA accounting requirements. It can also result in material misstatements in MWS's financial reporting.

Recommendation:

MWS should establish and implement an effective and efficient accounting system to ensure that its accounting transactions are accurately and completely recorded and reported, and that it complies with the accounting requirements of the USOA.