



REVIEW OF FINANCIAL STATEMENTS

Sonoma Springs Water Company

For the Year Ended December 31, 2022

Utility Audits, Risk and Compliance Division
Utility Audits Branch
February 29, 2024



MEMBERS OF THE TEAM

Angie Williams, Director

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You can contact our office at:
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PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

February 29, 2024

Sean Wadsworth
Managing Partner
Sonoma Springs Water Company
1651 Warm Springs Road
Glen Ellen, CA 95442

Dear Sean Wadsworth:

Final Report Transmittal Letter—Review of Sonoma Springs Water Company’s Annual Report for the Year Ended December 31, 2022

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) has completed its review of Sonoma Springs Water Company’s (SSWC) regulatory basis financial statements in the 2022 Annual Report filed with the CPUC, which comprise the balance sheet as of December 31, 2022, and related statements of income and retained earnings. The final review report is enclosed.

UAB provided a draft review report to SSWC for comments on February 13, 2024. SSWC responded via email on February 21, 2024, 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/AuditReportsbyIndustry).

Please provide a Corrective Action Plan (CAP) addressing the findings and recommendations by April 15, 2024. The CAP should include specific steps SSWC will take to address UAB’s findings and recommendations and a target date for implementing each specific corrective action. Please submit SSWC’s 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 SSWC 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

Sean Wadsworth
Managing Partner
Sonoma Springs Water Company
February 29, 2024
Page 2

cc: Rachel Peterson, Executive Director, CPUC
Kristin Stauffacher, Deputy Executive Director, Office of the Commission, CPUC
Terence Shia, Director, Water Division, CPUC
Masha Vorobyova, Assistant Director, UAB, CPUC
Bruce DeBerry, Program Manager, Water Division, CPUC
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TABLE OF CONTENTS

EXECUTIVE SUMMARY.....	1
INDEPENDENT ACCOUNTANT’S REVIEW REPORT.....	4
REVIEWED FINANCIAL STATEMENTS	7
Balance Sheet (As Reviewed).....	7
Income Statement (As Reviewed).....	8
Statement of Retained Earnings (As Compiled).....	9
Notes to Financial Statements.....	10
APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS.....	15

EXECUTIVE SUMMARY

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a review of the financial statements of Sonoma Springs Water Company¹ (SSWC) as of December 31, 2022, pursuant to Public Utilities (PU) Code sections 314.5, 314.6, 581, 582, and 584 that provide 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).

SSWC, a Class D water utility, serves approximately 21 metered customers² in Glenn Ellen in Sonoma County, California.³ As a regulated water utility, SSWC 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 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 USOA. In conjunction with our review of the financial statements, UAB also reviewed, for regulatory purposes, whether SSWC:

- a) complied with PU Code section 818 regarding obtaining CPUC's approval before incurring any long-term debts;
- b) complied with PU Code sections 431 and 433, and CPUC directives regarding CPUC Users Fee requirements; and
- c) timely filed its 2022 Annual Report as required by CPUC Water Division's Memorandum dated February 6, 2023.

Based on our review, except for the balance of Retained Earnings, we are not aware of any material modifications that should be made to SSWC's revised financial statements in order for them to be in accordance with the accounting framework prescribed by USOA. SSWC's ending Retained Earnings balance of \$22,341 presented in the accompanying financial statements is materially misstated due to significant errors in SSWC's historical accounting records. Without performing an in-depth review of SSWC's historical accounting records since its inception, UAB is unable to determine the cumulative effect of these misstatements on SSWC's financial position as of December 31, 2022.

¹ Sonoma Spring Water Company is the trade name of Sonoma Springs, LLC. Sonoma Springs, LLC was organized as a limited liability company on February 4, 2016, in California and is a wholly owned subsidiary of Well Within, LLC.

² SSWC's December 2022 Billing Register.

³ Resolution W-5141, Page 2.

For the regulatory compliance components identified above for the review period, our review determined that SSWC:

- a) complied with PU Code section 818 regarding obtaining CPUC's approval before incurring any long-term debts;
- b) complied with PU Code sections 431 and 433 and CPUC directive regarding CPUC Users Fee requirements; and
- c) complied with CPUC directive from the Water Division and timely filed its 2022 Annual Report on March 15, 2023.

During the review, UAB identified five findings, including four material misstatements in SSWC's 2022 Annual Report originally filed with CPUC's Water Division, and one noncompliance with regulatory requirements. These findings are described in Appendix A—Review Findings and Recommendations and summarized below:

- Finding 1: SSWC's reported Retained Earnings of \$12,825 is materially misstated in its 2022 Annual Report due to significant errors in SCWC's Annual Report.
- Finding 2: SSWC understated Account 101—Water Plant in Service, Account 108—Accumulated Depreciation of Water Plant, Account 215—Retained Earnings, and Account 403—Depreciation Expense by \$49,804, \$43,847, \$7,091, and \$1,134, respectively, in its 2022 Annual Report. SSWC did not record and report the original cost, the related accumulated depreciation, and depreciation of the water plant system acquired in 2015, in addition to capital improvement expenditures incurred in 2019.
- Finding 3: SSWC understated Account 141—Accounts Receivable—Customers and Account 215—Retained Earnings by \$3,560 and \$3,592, respectively; and overstated Account 470—Metered Water Revenue by \$32 in its 2022 Annual Report. Our review of SSWC's accounting records disclosed that SSWC used cash basis of accounting instead of accrual basis of accounting as required by USOA accounting requirements.
- Finding 4: SSWC overstated Account 682—Professional Services by \$324 and understated Account 650—Contract Work by the same amount in its 2022 Annual Report due to various misclassification errors.
- Finding 5: Our review disclosed deficiencies in SSWC's accounting system which constitutes a noncompliance with USOA accounting requirements. SSWC's General Ledger and Working Trial Balance were incomplete and inaccurate. Furthermore, SSWC incorrectly used cash basis of accounting instead of accrual basis of accounting to record and report its accounting transactions.

UAB discussed the above findings with SSWC's management during fieldwork and at the exit conference on February 1, 2024. SSWC's management concurred with the findings and agreed to make appropriate adjusting journal entries to correct the misstatements identified above. SSWC submitted its revised financial statements to CPUC's Water Division on February 5, 2024, to correct the material misstatements in each account, except for Retained Earnings, as described in Appendix

A of this report. Except for the reported balance of Retained Earnings, UAB is not aware of any further material modifications that should be made to the accompanying financial statements.

UAB provided a draft review report to SSWC for comments on February 13, 2024. SSWC responded on February 21, 2024, 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

Sean Wadsworth
Managing Partner
Sonoma Springs Water Company
1651 Warm Springs Road
Glen Ellen, CA 95442

Report on the Financial Statements

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the accompanying financial statements of Sonoma Springs Water Company (SSWC), which comprise the balance sheet as of December 31, 2022, and statements of income statement and retained earnings for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of SSWC'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

SSWC'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, SSWC'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 USOA. We believe that the results of our procedures provide a reasonable basis for our conclusion.

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

Basis for Qualified Conclusion

As disclosed in Note 4 of the accompanying financial statements, SSWC's ending Retained Earnings balance of \$22,341 presented in the accompanying financial statements is materially misstated due to significant errors in SSWC's historical accounting records. The effect of this departure from USOA accounting requirements on SSWC'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 the accounting framework prescribed by USOA.

Basis of Accounting

For regulatory purposes, 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. CPUC requires all water and sewer utilities to prepare their financial statements in accordance with the accounting framework prescribed by USOA.

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

Emphasis of Matter—Correction of Material Misstatements

As discussed in Notes 2 through 5, UAB identified four material misstatements in SSWC's 2022 Annual Report originally filed with CPUC's Water Division on March 15, 2023. Except for the misstatement related to the Retained Earnings account as described in Note 4, those misstatements have been corrected in the accompanying financial statements. As discussed in Note 4 to the financial statements, UAB does not express a conclusion on the reported balance of Retained Earnings as of December 31, 2022, in the accompanying financial statements. However, our conclusion to the rest of the accompanying financials statements is not modified with respect to this matter.

Other Matter—Views of Responsible Official

We discussed our review results with SSWC's management during fieldwork and at the exit conference on February 1, 2024. SSWC's management concurred with the findings and agreed to make appropriate adjusting journal entries to its accounting records to correct the material misstatements described in Appendix A of this report. SSWC submitted its revised financial statements to CPUC's Water Division on February 5, 2024, to correct the material misstatements in each account, except for Retained Earnings as described in Appendix A of this report. At the exit conference, we also stated that the final report will include the views of responsible officials. Except for the reported balance of the Retained Earnings account, UAB is not aware of any material modifications that should be made to the accompanying financial statements.

UAB provided a draft review report to SSWC for comments on February 13, 2024. SSWC responded on February 21, 2024, 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

SSWC'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 April 15, 2024. The CAP should include specific steps SSWC will take to address UAB's findings and recommendations and a target date for implementing each specific corrective action. If SSWC is unable to implement UAB's recommendations, the CAP

should state the reasons for not being able to implement any of the recommendations. SSWC should use the amounts reviewed by UAB as presented in this report as the basis to file its 2023 Annual Report CPUC.

Report on Other Regulatory Requirements

For regulatory purposes, UAB also reviewed whether SSWC:

- a) complied with PU Code section 818 regarding obtaining CPUC's approval before incurring any long-term debts;
- b) complied with PU Code sections 431 and 433, and CPUC directives regarding CPUC Users Fee requirements; and
- c) timely filed its 2022 Annual Report as required by CPUC Water Division's Memorandum dated February 6, 2023.

For the regulatory compliance components identified above for the review period, our review determined that SSWC:

- a) complied with PU Code section 818 regarding obtaining CPUC's approval before incurring any long-term debts;
- b) complied with PU Code sections 431 and 433 and CPUC directive regarding CPUC Users Fee requirements; and
- c) complied with CPUC directive from the Water Division and timely filed its 2022 Annual Report on March 15, 2023.

Furthermore, as described in Finding 5 in Appendix A of this report, SSWC did not maintain its accounting system as required by 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 CPUC and the management of SSWC, 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 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
February 29, 2024

REVIEWED FINANCIAL STATEMENTS

Sonoma Springs Water Company Balance Sheet (As Reviewed)

As of December 31, 2022

ASSETS	
UTILITY PLANT	
Water Plant in Service (Note 2)	\$49,804
Accumulated Depreciation of Water Plant (Note 2)	(43,847)
Net Utility Plant	<u>5,957</u>
CURRENT AND ACCRUED ASSETS	
Cash	2,824
Accounts Receivable (Note 3)	3,560
Receivables from Affiliated Companies (Note 7)	10,000
Total Current and Accrued Assets	<u>16,384</u>
Total Assets	<u><u>\$22,341</u></u>
CORPORATE CAPITAL AND SURPLUS	
Retained Earnings (Note 4)	\$22,341
Total Corporate Capital and Retained Earnings	<u>22,341</u>
Total Liabilities and Other Credits	<u><u>\$22,341</u></u>

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

Sonoma Springs Water Company
Income Statement (As Reviewed)
 For Year Ended December 31, 2022

OPERATING REVENUES	
Metered Water Revenue	\$16,878
Total Operating Revenue	16,878
OPERATING EXPENSES (Note 5)	
Plant Operation and Maintenance Expenses	
Power	3,600
Materials	87
Contract Work	6,033
Total Plant Operation and Maintenance Expenses	9,720
Administrative and General Expenses	
Management Salaries	1,800
Regulatory Commission Expense	1,072
General Expenses	820
Net Administrative and General Expenses	3,692
Total Operating Expenses	13,412
Depreciation Expense	1,134
Total Operating Revenue Deductions	14,546
Net Income	\$2,332

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

Sonoma Springs Water Company
Statement of Retained Earnings (As Compiled ⁴)
 For Year Ended December 31, 2022

Retained Earnings, Beginning of Year	\$9,327
 CREDITS:	
Net Income	2,332
UAB Adjustment to Water Plant in Service	49,804
UAB Adjustment to Depreciation Expense	1,134
UAB Adjustment to Accounts Receivable	3,560
UAB Adjustment to Metered Water Revenue	32
Total Credits	56,862
 DEBITS:	
UAB Adjustment to Accumulated Depreciation	43,847
UAB Rounding Adjustment	1
Total Debits	43,848
Retained Earnings, End of Year	\$22,341

(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.

Sonoma Springs Water Company

Notes to Financial Statements

SSWC, a Class D water utility, serves approximately 21 metered customers⁵ in Glenn Ellen in Sonoma County, California.⁶

Significant Accounting Policies

The financial statements of SSWC 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 USOA adopted in Decision (D.) 16-11-006 by CPUC on November 10, 2016, which is a comprehensive basis of accounting other than the generally accepted accounting principles (GAAP) in the United States of America. The following describes certain differences in accounting treatments between GAAP and USOA, the company's current accounting practices, and its compliance with applicable regulation and CPUC directives.

1. Purpose of Financial Information and Targeted Audience

The objective of preparing financial statements in accordance with GAAP is to provide information that is useful in making decisions about providing resources to the entity. Users of the financial information include existing and potential investors, lenders, and other creditors.

The purpose of using 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 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 CPUC's Standard Practice (SP) U-4-SM and SP U-4-M when determining depreciation accruals. Specifically, for the water plant with over \$100,000, the utility must maintain separate depreciation reserve by different plant accounts in accordance with Appendix B1 of SP U-4-SM; for the water plant under \$100,000, if the utility elects not to separate or

⁵ SSWC's December 2022 Billing Register.

⁶ Resolution W-5141, Page 2.

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 CPUC for any practice deviates from the aforementioned SPs.

SSWC utilizes a composite rate of 2.4 percent for each class of depreciable asset as prescribed in SP U-4-SM to determine depreciation accruals.

(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.

SSWC 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 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 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.

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

SSWC understated Account 101–Water Plant in Service, Account 108–Accumulated Depreciation and Account 403–Depreciation Expense by \$49,804, 43,847 and \$1,134 respectively. SSWC did not record and report the original cost, the related accumulated depreciation and depreciation of the water plant system it acquired in 2015 and capital improvement expenditures it incurred in 2019. However, SSWC incorporated UAB's proposed adjustments and corrected the noted misstatements in its revised 2022 Annual Report submitted to CPUC's Water Division on February 5, 2024.

3. Accounts Receivable

SSWC did not report \$3,560 of outstanding Accounts Receivable in its 2022 Annual Report originally filed with CPUC's Water Division on March 15, 2023. SSWC reported its Accounts Receivable using cash basis of accounting instead of accrual basis of accounting as required by the

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

USOA. As a result, SSWC understated Account 141–Accounts Receivable–Customers and Account 215–Retained Earnings by \$3,560 each. However, SSWC incorporated UAB’s proposed adjustments and corrected the noted misstatements in its revised 2022 Annual Report submitted to CPUC’s Water Division on February 5, 2024.

4. Retained Earnings

SSWC’s reported balance of \$9,327 in Account 215–Retained Earnings is materially misstated in its 2022 Annual Report originally filed with CPUC’s Water Division on March 15, 2023, due to errors in SSWC’s historical accounting records. The beginning balances of Retained Earnings shown in SSWC’s Annual Reports for the respective years did not agree with the preceding years’ ending balances as described below:

- SSWC’s reported beginning balance of \$4,156 in its Retained Earnings account in its 2021 Annual Report did not agree with the prior year ending balance of \$3,316.
- SSWC’s reported beginning balance of \$3,042 in its Retained Earnings account in its 2020 Annual Report did not agree with the prior year ending balance of \$5,588.
- SSWC’s reported beginning balance of \$2,067 in its Retained Earnings account in its 2018 Annual Report did not agree with the prior year ending balance of \$3,372.

Furthermore, SSWC understated Retained Earnings in its 2022 Annual Report by \$9,516 as a result of cumulative accounting errors and omissions described in Notes 2 and 3 to the Financial Statements.

SSWC’s management has yet to determine the cumulative effect of these misstatements on SSWC’s Retained Earnings account balance as of December 31, 2022. Without performing an in-depth review of SSWC’s historical accounting records, the cumulative impact of the noted accounting errors on SSWC’s Retained Earnings Account cannot be determined. Determining the cumulative impact on the balance of Retained Earnings as of December 31, 2022, would require UAB to obtain additional information and perform extensive analyses going beyond the scope of this engagement.

5. Operating Expenses

SSWC overstated Account 682–Professional Services by \$324 and understated 650–Contract Work by the same amount in its 2022 Annual Report originally filed with CPUC’s Water Division on March 15, 2023.

However, SSWC incorporated UAB’s proposed adjustments and corrected the noted misstatements in its revised 2022 Annual Report submitted to CPUC’s Water Division on February 5, 2024.

6. Water Utility Users Fee

PU Code sections 401 through 410 authorized CPUC to set a fee annually to water utilities to cover the costs incurred by 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 CPUC.⁸

SSWC correctly recorded CPUC Users Fee in Account 688 – Regulatory Commission Expense, and Operating Revenues; and timely remitted its CPUC Users Fee for 2022.

7. Affiliate Transactions

Affiliate companies are all entities, including any holding companies, that are under direct or indirect common ownership or control with a water utility regulated by CPUC. Water utilities are required to comply with the rules specified in D.10-10-019 and SP U-21-W for all the transactions with its affiliates.

Rule 12 of SP U-21-W states, in part, that, “Water Utility shall file with the Commission each year a report which includes a summary of all transactions between Water Utility and its affiliated companies for the previous calendar year....”

SSWC reported a \$10,000 loan to Morton Warm Springs, its affiliate company, in Account 142–Receivables from Affiliated Companies. The loan was initiated in November 2022 as a temporary loan and should be paid withing one year.

8. Form of Financial Statements⁹

(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.

SSWC did not comply with the applicable accounting requirements of the USOA. SSWC did not record all transactions related to Water Plant in Service and the annual depreciation expenses for its

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 & Touché USA LLP, pages 36-37.

water plant. Further, it incorrectly used the cash basis of accounting instead of accrual basis of account to record and report its accounting transactions.

9. 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.

10. Compliance filing of 2022 Annual Report with CPUC

PU Code sections 581, 582, and 584, and 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 CPUC every year. For the year being reviewed, SSWC has complied with these requirements.

APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS

Finding 1: Materially Misstated Retained Earnings

Condition:

SSWC's reported Retained Earnings of \$12,825 is materially misstated in its 2022 Annual Report originally filed with CPUC's Water Division on March 15, 2023. Our review of SSWC's accounting records disclosed the following accounting errors:

- Our review of SSWC's Annual Reports from 2017 through 2022 disclosed that SSWC did not accurately carry over its cumulative balances of Retained Earnings from year to year. The beginning balances of Retained Earnings shown in SSWC's Annual Reports for the respective years did not agree with the preceding years' ending balances as shown below:

Annual Report for Year Ended:	Prior Year Ending Balance	Beginning Balance	Variance
December 31, 2018	\$3,372	\$2,067	\$1,305
December 31, 2019	3,619	3,619	0
December 31, 2020	5,588	3,042	2,546
December 31, 2021	3,316	4,156	(840)
December 31, 2022	9,327	9,327	0

- SSWC understated its Retained Earnings reported in its 2022 Annual Report by \$9,516 as a result of cumulative accounting errors and omissions described in Findings 1 through 3.

SSWC's management has yet to determine the cumulative effect of these misstatements on SSWC's financial position as of December 31, 2022. Without performing an in-depth review of SSWC's historical accounting records, the cumulative impact of the noted accounting errors on SSWC's financial position cannot be determined. Determining the cumulative impact on the SSWC's financial position December 31, 2022, would require us to obtain additional information and perform extensive analyses going beyond the scope of this engagement.

Criteria:

General Accounting Instructions 2 of the USOA states, in part, that:

215. Retained Earnings (for corporations only)

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

2. Accounting adjustments not properly attributable to the current period.
3. Dividends.

Cause:

SSWC lacks monitoring and review procedures for its accounting and reporting process to ensure that changes in its ownership equity are accurately recorded and reported in Account 215–Retained Earnings as required by USOA.

Effect:

SSWC’s management has yet to determine the cumulative effect of this departure from USOA’s accounting requirements on SSWC’s financial position as of December 31, 2022.

Inaccurate reporting of Account 215–Retained Earnings distorted SSWC’s financial position as of December 31, 2022, and reduced the comparability of SSWC’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 SSWC relative to other small water utilities in California.

Recommendation:

SSWC should establish and implement review procedures for its accounting and reporting process to ensure changes in its ownership equity are accurately recorded and reported in Account 215–Retained Earnings in compliance with USOA accounting requirements.

Finding 2: Omitted Water Plant in Service, Accumulated Depreciation, and Depreciation Expense

SSWC understated Account 101–Water Plant in Service, Account 108–Accumulated Depreciation of Water Plant, Account 215–Retained Earnings, and Account 403–Depreciation Expense by \$49,804, \$43,847, \$7,091, and \$1,134, respectively, in its 2022 Annual Report originally filed with CPUC’s Water Division on March 15, 2023. Our review of SSWC’s accounting records disclosed the following accounting errors:

Description	Overstated/(Understated)			
	Acct 101	Acct 108	Acct 215	Acct 403
SSWC did not record and report the original cost, the related accumulated depreciation, and depreciation expense of the water plant system it acquired in 2015.	(\$45,954)	(\$43,550)	(\$3,439)	(\$1,035)
SSWC did not record and report capital improvement expenditures it incurred in 2019. SSWC also omitted reporting accumulated depreciation and depreciation expense related to these capital improvement expenditures.	(3,850)	(297)	(3,652)	(99)
Total	<u>(\$49,804)</u>	<u>(\$43,847)</u>	<u>(\$7,091)</u>	<u>(\$1,134)</u>

UAB proposed, and SSWC agreed and incorporated, the following adjusting entry to correct the misstatements identified above:

Adj No.	Acct No.	Description	DR	CR
1	101	Water Plant in Service	\$49,804	
	403	Depreciation Expense	1,134	
	108	Accumulated Depreciation of Water Plant		\$43,847
	215	Retained Earnings		7,091

To record omitted activities related to SSWC's Water Plant in Service.

SSWC applied this adjusting journal entry to correct its books and submitted a revised 2022 Annual Report to CPUC's Water Division on February 5, 2024.

Criteria:

The USOA states, in part, that:

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

B. This account shall be credited with:

1. Amounts concurrently charged to account 403, Depreciation Expense, representing currently accruing depreciation of water plant (other than contributed water plant).

403. Depreciation Expense

This account shall be charged with that portion of the depreciation accrual credited to Account 108, Accumulated Depreciation of Water Plant, applicable to all classes of depreciable water plant except plant represented by contributions in aid of construction. Depreciation shall be accrued on a straight-line remaining life basis. Use of a single composite depreciation rate applied to all depreciable plant is permissible for water utilities with annual revenues of \$ 100,000 or less.

General Accounting Instructions**4. Depreciation**

A. Depreciation charges shall be computed using the straight-line remaining life method (see definition (17)), and composite depreciation rates (see definition (4)).

Cause:

SSWC lacks monitoring and review procedures for its accounting and reporting process to ensure Water Plant in Service and related depreciation, including water plant acquisitions and additions, are accurately recorded in its books and reported in its Annual Reports.

Effect:

Inaccurate reporting of Water Plant in Service, Accumulated Depreciation of Water Plant, and Depreciation Expense in the Annual Report, which may be used during SSWC's General Rate Case (GRC) application review process, could potentially impact the water rates for SSWC's ratepayers.

Recommendation:

SSWC should establish and implement monitoring and review procedures for its accounting and reporting process to ensure that all Water Plant in Service and related depreciation, including water plant acquisitions and additions, are accurately recorded and reported.

Finding 3: Omitted Accounts Receivable**Condition:**

SSWC understated Account 141—Accounts Receivable—Customers and Account 215—Retained Earnings by \$3,560 and \$3,592, respectively, and overstated Account 470—Metered Water Revenue by \$32, in its 2022 Annual Report originally filed with CPUC's Water Division on March 15, 2023. Our review of SSWC's accounting records disclosed that SSWC used cash basis of accounting instead of accrual basis of accounting as required by USOA accounting requirements.

Specifically, SSWC's reported accounts balances were misstated as follows:

Description	Overstated/(Understated)		
	Acct 141	Acct 215	Acct 470
SSWC incorrectly reported \$3,592 of Metered Water Revenue earned in 2021 as revenues in 2022		(\$3,592)	\$3,592
SSWC did not accrue \$3,560 as of December 31, 2022, of receivables and revenues earned in 2022.	(3,560)		(3,560)
Total	<u>(\$3,560)</u>	<u>(\$3,592)</u>	<u>\$32</u>

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

Adj. No.	Acct. No.	Description	DR	CR
2	141	Accounts Receivable	\$3,560	
	470	Metered Water Revenue	32	
	215	Retained Earnings		\$3,592
		<i>To accrue Accounts Receivable and Operating Revenues earned in 2022</i>		

SSWC applied this adjusting journal entry to correct its books and submitted a revised 2022 Annual Report to CPUC's Water Division on February 5, 2024.

Criteria:

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.

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.

470. Metered Water Revenue

A. This account shall include all revenue from metered water service. Surcharge revenues approved by the omission applicable to metered customers shall be recorded in this account. Separate subaccounts shall be maintained for each type of surcharge approved by the Commission unless otherwise authorized or directed by the Commission.

Cause:

SSWC used cash basis of accounting to record and report revenues and accounts receivable. SSWC lacks review and monitoring procedures to ensure that revenues and accounts receivables are recorded and reported using accrual basis of accounting as required by USOA.

Effect:

Inaccurate reporting of Accounts Receivable in Account 141 distorted SSWC's financial position as of December 31, 2022, misstated its available working capital, and reduced the comparability of SSWC'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 SSWC relative to other small water utilities in California.

Inaccurate reporting of Operating Revenue in the Annual Report, which may be used during SSWC's GRC application review process, could potentially impact water rates for SSWC's ratepayers.

Recommendation:

LCWC should establish and implement monitoring and review procedures for its accounting and reporting process to ensure that Accounts Receivable–Customers, and Operating Revenue are properly accounted for in compliance with the accounting requirements of the USOA.

Finding 4: Misclassification of Operating Expenses

Condition:

SSWC overstated Account 682–Professional Services by \$324 and understated Account 650– Contract Work by \$324 in its 2022 Annual Report dated March 15, 2023, due to misclassification of operating expenses as outlined below:

Description	Overstated/(Understated)	
	Acct 650	Acct 682
SSWC misclassified \$1,800 of Management Salaries as Professional Service	\$1,800	(\$1,800)
SSWC misclassified \$324 of Contract Work as Professional Services	(2,124)	2,124
Total	(\$324)	\$324

UAB proposed, and SSWC agreed and incorporated, the following adjusting entry to correct the misstatements identified above:

Adj No.	Acct No.	Description	DR	CR
3	650	Contract Work	\$324	
	682	Professional Services		\$,324
		<i>To reclassify incorrectly recorded Operating Expenses to proper accounts.</i>		

SSWC applied this adjusting journal entry to correct its books and submitted a revised 2022 Annual Report to CPUC's Water Division on February 5, 2024.

Criteria:

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. The following subaccounts shall be used, if applicable

650.1 Contract Water Quality and Testing Work

650.2 Other Contract Work

671. Management Salaries

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

B. No portion of such salaries shall be allocated to other expense accounts even though the owner or manager may perform other duties (e.g., billing, collecting, and maintenance) in addition to managing the utility.

C. Drawings by partners or owners of non-corporate utilities in addition to amounts designated as “salaries” for operating the utility shall be charged to subaccount 218.1, Proprietary Drawings.

D. The portion of salaries of managers, owners, partners or principal stockholders assignable to utility plant construction shall be charged to Account 101 or Account 105 as appropriate. Also see Account 900.1 Payroll Clearing.

682. Professional Services

This account shall include the fees of independent accountants, engineers, lawyers, and similar professional consultants. This account shall be kept in a manner that will permit ready analysis of charges.

Cause:

SSWC lacks monitoring and review procedures for its accounting and recording process to ensure that Management Salaries and Contract works are accurately recorded and reported in its 2022 Annual Report.

Effect:

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

Recommendation:

SSWC should establish and implement monitoring and review procedures for its accounting and recording process to ensure that Management Salaries and Contract work are accurately recorded and reported in its Annual Reports.

Finding 5: Noncompliance with USOA Accounting Requirements**Condition:**

Our review disclosed deficiencies in SSWC's accounting system which constitutes a noncompliance with USOA accounting requirements.

- SSWC's General Ledger and Working Trial Balance were incomplete and inaccurate because SSWC did not record all transactions related to Water Plant in Service and the annual depreciation expenses for its water plant.
- SSWC incorrectly used cash basis of accounting instead of accrual basis of accounting to record and report its accounting transactions.

Criteria:

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:

SSWC lacks policies, and monitoring and review procedures for its accounting system to ensure that its accounting transactions are accurately and completely recorded in its accounting system and reported in its Annual Reports using accrual basis of accounting.

Effect:

Lack of policies, and monitoring and review procedures for its accounting system results in noncompliance with the USOA accounting requirements. It can also result in material misstatements in SSWC's financial reporting. Inaccurate and materially misstated financial information in SSWC's Annual Reports, which may be used during SSWC's GRC application review process, could potentially impact water rates for SSWC's ratepayers.

Recommendation:

SSWC should establish and implement policies and procedures for its accounting system to ensure that its financial data are accurately and completely recorded in its accounting system and reported in its Annual Reports using accrual basis of accounting.