California Public Utilities Commission
Division of Water and Audits

Financial Audit of

Lukins Brothers Water Company
U-142-W

Financial Statements

For the Years Ended December 31, 2010, 2009 and 2008

March 1, 2012

**The following Commission Staff contributed to the completion of this audit report:
Kayode Kajopaiye, Bernard Ayanruoh, Fred Tamse, and Joyce de Rossett**

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Independent Auditor's Report

The Utility Audit, Finance and Compliance (Staff, UAFCB) of the California Public Utilities Commission (CPUC, Commission) has audited the accompanying balance sheets of LUKINS Brothers Water Company (LUKINS) as of December 31, 2010, 2009, and 2008, and the related income statements, statements of retained earnings, and statements of cash flows for the years then ended. LUKINS' management is responsible for:

1. Completeness and correctness of the financial statements presented in the 2010, 2009 and 2008 annual reports filed with the Commission.
2. Conformity with accounting requirements of the Commission as set forth in the Uniform System of Accounts (USOA) for Class C water utilities, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

The responsibility of the UAFCB is to express an opinion on LUKINS' financial statements as a whole based on its audit.

The audit was conducted in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Accordingly, the audit included examining, on a test basis, evidence concerning LUKINS' compliance with the Commission's accounting and reporting requirements, and performing such procedures as we considered necessary in the circumstances. The UAFCB believes that its audit provides a reasonable basis for an opinion.

In our opinion, except for the material noncompliance related with certain account balances as described in the Notes to Financial Statements, the financial statements referred to above presents fairly, in all material respects, the financial position of LUKINS as of December 31, 2010, 2009, and 2008, and the results of its operations and its cash flows for the years then ended, in compliance with the aforementioned accounting requirements.

The report is intended solely for the information and use by the Commission and LUKINS. It should not be used by anyone other than the specified parties.

Kayode Kajopaiye, Chief
Utility Audit, Finance and Compliance Branch

Balance Sheets

	As of December 31 for the Year		
	2010	2009	2008
ASSETS			
UTILITY PLANT			
Water Plant in Service	$ 849,265	$ 825,425	$ 821,725
Accumulated Depreciation of Water Plant	(653,527)	(638,574)	(624,159)
Construction Work in Progress	14,255	0	0
Net Utility Plant	209,993	186,851	197,566
CURRENT AND ACCRUED ASSETS			
Cash	9,935	16,034	(24,924)
Accounts Receivable – Customers	8,399	15,714	3,645
Materials and Supplies	730	0	0
Other Current Assets – Employee Loans	1,615	500	0
Capital Asset Clearing Account	2,912	2,912	2,798
Total Current and Accrued Assets	23,591	35,160	(18,481)
Total Assets	$ 233,584	$ 222,011	$ 179,085
CAPITALIZATION AND LIABILITIES			
CORPORATE CAPITAL AND SURPLUS			
Common Stock	$ 25,000	$ 25,000	$ 25,000
Retained Earnings	(630,560)	(625,621)	(614,415)
Other Paid in Capital	559,184	0	0
Total Corporate Capital and Retained Earnings	(46,376)	(600,621)	(589,415)
LONG-TERM DEBT			
Long-Term Debt	43,232	602,416	603,298
CURRENT AND ACCRUED LIABILITIES			
Accounts Payable	185,914	175,393	141,834
Short-term Notes Payable	0	1,836	3,386
Accrued Taxes	27,886	2,816	2,093
Unearned Water Revenue	0	0	6,796
Other Current Liabilities	22,928	35,421	4,342
Total Current and Accrued Liabilities	236,728	215,466	158,451
DEFERRED CREDITS:			
Advances for Construction	0	4,750	6,750
Total Capitalization and Liabilities	$ 233,584	$ 222,011	$ 179,085

(The accompanying notes are an integral part of these Financial Statements.)

Income Statements

	For the Year Ended		
	2010	2009	2008
OPERATING REVENUES			
Unmetered Water Revenue	$447,802	$368,822	$239,010
Fire Protection Revenue	2,701	2,701	2,052
Metered Water Revenue	20,360	18,924	17,153
Other Water Revenue	1,265	6,816	5,887
Total Operating Revenues	472,128	397,263	264,102
OPERATING EXPENSES			
Plant Operation and Maintenance Expenses			
Power Purchase	25,237	25,414	30,931
Employee Labor	52,320	1,020	0
Materials	10,283	5,375	6,573
Contract Work	54,204	112,094	109,153
Transportation Expenses	7,671	5,133	6,857
Other Plant Maintenance Expenses	9,142	9,413	8,022
Total Plant Operation and Maintenance	158,856	158,448	161,535
Administrative and General Expenses			
Office Salaries	85,497	61,020	55,406
Management Salaries	47,000	40,769	40,000
Employee Pensions and Benefits	14,995	4,895	18,488
Office Services and Rentals	55,106	54,952	50,364
Office Supplies and Expenses	15,234	13,870	14,061
Professional Services	3,619	1,585	1,937
Insurance	14,729	11,345	9,760
Regulatory Commission Expense	0	423	0
General Expenses	8,768	4,761	6,914
Total Administrative and General Expenses	244,948	193,620	196,929
Depreciation Expense	15,694	14,959	14,297
Loss on Retirements of Plants	5,027	2,052	0
Taxes Other Than Income Taxes	36,396	18,991	21,108
State Corporate Income Tax Expense	834	800	800
Total Operating Revenue Deductions	461,755	388,869	394,669
Total Utility Operating Income (Loss)	10,374	8,393	(130,567)
Non-Utility Income	0	0	6,677
Non-Utility Expenses	15,431	15,656	11,241
Net Non-Utility Income (Loss)	(15,431)	(15,656)	(5,064)
Net Income (Loss)	($5,057)	($7,262)	($135,132)

(The accompanying notes are an integral part of these Financial Statements)

Statements of Retained Earnings

	For the Year Ended		
	2010	2009	2008
Retained Earnings, Beginning of Year	($625,621)	($614,415)	($462,459)
CREDITS:			
Net Income	0	0	0
Prior Period Adjustments to Plant in Service	0	0	12,800
Prior Period Adjustment to Depreciation Expenses	118	197	0
Total Credits	118	197	12,800
DEBITS:			
Net Loss	(5,057)	(7,262)	(135,132)
Prior Period Adjustment to Plant in Service		(4,140)	
Prior Period Adjustment to Depreciation Expenses	0	0	(29,625)
Total Debits	(5,057)	(11,402)	(164,757)
Retained Earnings, End of Year	($630,560)	($625,621)	($614,416)

(The accompanying notes are an integral part of these Financial Statements)

Statements of Cash Flows

	For the Year of		
	2010	2009	2008
CASH FLOW FROM OPERATING ACTIVITIES:			
Net Income (Loss)	($5,057)	($7,262)	($135,132)
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities –			
Depreciation and amortization	14,953	14,415	15,894
Undeposited Funds	0	0	3,029
Decrease (Increase) in Accounts Receivable	7,315	(12,069)	28,478
Decrease (Increase) in Materials and Supplies	(730)	0	0
Decrease (Increase) in Other Current Assets	(1,115)	(500)	0
Decrease (Increase) in Capital Asset Clearing Account	0	(114)	(2,796)
Increase (Decrease) in Accounts Payable	10,521	33,559	67,293
Increase (Decrease) in Accrued Taxes	25,071	722	1,926
Increase (Decrease) in Unearned Water Revenue	0	(6,796)	6,796
Increase (Decrease) in Other Current Liabilities	(12,493)	31,079	(363)
Increase (Decrease) in Advances for Construction	(4,750)	(2,000)	(3,337)
Net Cash Provided by Operating Activities	33,714	51,033	(18,212)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Increase (Decrease) in Net Plant Additions	(23,840)	(3,700)	15,228
Increase (Decrease) in Construction Work in Progress	(14,255)	0	0
Net Cash Used for Investing Activities	(38,095)	(3,700)	15,228
CASH FLOWS FROM FINANCING ACTIVITIES:			
Increase (Decrease) in Short-term Notes Payable	(1,836)	(1,550)	(562)
Increase (Decrease) in Long-Term Debt	(559,184)	(882)	382
Increase (Decrease) in Other Paid-in Capital	559,184	0	0
Increase (Decrease) in Adjustment to Retained Earnings	118	(3,943)	(16,825)
Net Cash Used for Financing Activities	(1,718)	(6,375)	(17,005)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(6.099)	40,958	(19,989)
CASH AT BEGINNING OF YEAR	16,034	(24,924)	(4,936)
CASH AT END OF YEAR	**$9,935**	**$16,034**	**($24,925)**

(The accompanying notes are an integral part of these Financial Statements)

Notes to Financial Statements

(1) Summary of Significant Accounting Policies

LUKINS Brothers Water Company (LUKINS) is owned by Danny G. Lukins (President) and Larry L. Lukins (Vice President). LUKINS was established on April 2, 1973. As of December 31, 2010, LUKINS has 932 service connections within the portion of Tahoe Valley area near State Route 89 and US Highway 50 in the City of South Lake Tahoe, California.

LUKINS has prepared the accompanying financial statements on the basis of accounting set forth in the Uniform System of Accounts for Water Utilities (for Classes B, C & D) adopted and prescribed by the California Public Utilities Commission (CPUC or Commission), which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under that basis of accounting, certain transactions, such as adjustments of certain operating expenses, revenues and depreciation related to prior years are recorded directly in the statements of retained earnings. Accounting principles generally accepted in the United States of America would require such transactions to be recorded in the income statements. A Statement of Cash Flows is not required by the Commission when LUKINS files its annual reports with the Commission. Therefore, the accompanying Statements of Cash Flows were compiled by the Commission staff based on the financial information in LUKINS' Balance Sheets and Income Statements.

(a) Utility Plant

Utility plant is recorded at original cost when it is first constructed or purchased. Plant retirements are removed from utility plant accounts at cost and charged against accumulated depreciation.

In 2009, LUKINS' Water Plant in Service has a difference of $1,754 between the General Ledger and the amount reported in the annual report. The difference was due to plant retirements in "Pumping Equipment and Services & Meter Installation" account recorded by LUKINS in the General Ledger but not reported in the annual report. Also in 2010, LUKINS' Water Plant in Service has a difference of $5,696 between the General Ledger and the amount reported in the annual report. The difference was due to inaccurate amounts recorded in several Plant in Service accounts totaling $5,696 which were reflected in the annual report but not recorded in the General Ledger. The table below summarizes the differences between the amounts recorded in the General Ledger and the amounts reported in the Annual Reports for the years 2008 - 2010.

Description	Annual Report	General Ledger	Difference
2008			
Water Plant in Service	$821,725	$821,725	0
2009			
Water Plant in Service	$827,179	$825,425	$1,754
2010			
Water Plant in Service	$854,960	$849,264	$5,696

LUKINS has agreed to revise its 2010 annual report to reflect a corrected Plant in Service balance after adjusting the 2010 records to include the adjustments noted for 2009 and 2010 in the table above.

(b) Depreciation

Standard Practice (SP) U-3-SM contains Commission guidelines on asset depreciation for small water utilities. Under SP U-3-SM, it is appropriate for small water utilities with less than $100,000 of total plant, to use a composite rate to calculate their depreciation expense. For larger water utilities (Class A, B & C) with plant assets of over $100,000, it is acceptable under Commission rules and more advantageous for the utilities to depreciate Plant in Service accounts by using individual assets lives and depreciation rates instead of a composite rate. Although LUKINS had a composite depreciation rate of 2.5% developed years back, the Company never used it nor computed depreciation expenses for capital assets installed prior to 2008. As a result, there were no depreciation expenses reported in LUKINS' annual reports for the years prior to 2008.

During the audit, UAFCB reviewed LUKINS' books and records and recommended the use of the individual assets and depreciation rates to calculate its depreciation expense instead of a composite rate. Since LUKINS' total plant was $843,000, using this methodology resulted in a higher depreciation expenses and is consistent with the Commission Standard Practice (SP) U-3-SM for water utilities with plant assets of over $100,000. UAFCB assisted LUKINS to set up depreciation schedules and templates for the computation of its depreciation expenses beginning with 2007. Subsequently, the Company prepared depreciation schedules for years 2008, 2009 & 2010 which included depreciation amounts, plant retirements and plant costs using the methodology recommended by UAFCB. The depreciation schedules also included depreciation rates and depreciation expenses for plant additions.

The table below shows the comparison of the calculations of depreciation expenses using a composite rate vs. individual asset lives and depreciation rate for each plant asset.

		2010	2009	2008
1	Gross Plant	$849,265	$825,425	$821,725
2	Accumulated Depreciation	-653,527	-638,574	-624,159
3	Net Plant	195,738	186,851	197,566
4	Composite Rate	2.5%	2.5%	2.5%
5	**Depreciation Expenses (by Composite Rate) – (Line 3 * Line 4)**	**4,893**	**4,671**	**4,939**
6	**Depreciation Expenses (by Individual Asset)[1]**	**15,694**	**14,959**	**14,297**
7	Difference (Line 6 less Line 5)	$10,801	$10,288	$9,358

[1] Depreciation methodology recommended by UAFCB

(c) Accumulated Depreciation

Since there were no depreciation expenses reported by LUKINS for the years prior to 2008, there were equally no reserve accounts established for accumulated depreciation during those years. However, for subsequent years, the Company did establish the reserve accounts for the same years it computed and recorded depreciation expenses on its books.

UAFCB provided LUKINS templates to help the Company compute its accumulated depreciation. Because LUKINS failed to recognize certain plant retirements in the Accumulated Depreciation account, differences existed between the amounts contained in the Depreciation Schedule and the amounts recorded in the General Ledger. The table below shows the differences.

	Depreciation Schedule	General Ledger	Difference
2008			
Accumulated Depreciation	$594,534	$624,159	$29,625
2009			
Accumulated Depreciation	$638,574	$609,146	$29,428
2010			
Accumulated Depreciation	$653,527	$624,217	$29,310

LUKINS has agreed to revise its 2010 annual report to reflect a corrected Accumulated Depreciation balance after adjusting the 2010 records to include the adjustments noted for 2008, 2009 and 2010 in the table above.

(d) Deferred Credits

As of December 31, 2006, LUKINS had refundable Advances for Construction balance of $10,362 from one customer. The Company refunded $275 in 2007, $3,337 in 2008, $2,000 in 2009, and $4,750 in 2010 (total of $10,362). As of December 31, 2010 the balance in the Advances for Construction account is zero.

(e) Revenues

LUKINS send bills to unmetered customers on an annual basis. Some customers elect to pay water bill annually in advance. Subsidiary accounts receivable ledger shows individual customer's advance payments. Metered customers are billed monthly for connection charges plus water usage.

The increase in LUKINS operating revenues resulted from the interim rate increase granted by the Commission in LUKINS' 2009 GRC. Unmetered Revenues increased by $79,000 in 2010. The Company computes its water revenues based on tariffs approved by the Commission.

(f) Contract Work

In Resolution W-4791 approved on October 15, 2009, LUKINS estimated that contract work in 2009 would cost $25,000. The company was ordered to hire its own employees to do maintenance work and to minimize dependence on contract work with Danny Lukins' private company. In 2010, LUKINS hired new employees to do the maintenance work. The Company's contract work for 2008, 2009 & 2010 were $109,153; $112,091, and $54,204 respectively. To comply with CPUC directives, Lukins hired one full time employee to handle most day to day maintenance, meter reading and line repairs. Lukins was able to reduce the amount of contract work by $57,000. Recorded expenses for contract work in 2010 were above the authorized amount in rates. Lukins attributes the increase to excessive amount of snow fall during the year, resulting in higher than normal costs for snow removal.

(g) Employee Labor

In Resolution W-4791, LUKINS estimated to spend $83,000 for two full employees. The Water Sewer Advisory Branch estimated $31,200 for one employee working ¾ of the time. The Resolution concluded that $31,200 was reasonable and should be adopted. It was expected that the employee labor costs would increase and the contract work expenses would decrease. However, labor costs recorded in 2010 was $53,320 from $0 in 2008. LUKINS hired 5 employees (one full time and 4 part time) in 2010 to work on water maintenance projects.

(h) Office Services and Rentals

In Resolution W-4791, LUKINS' estimated that its annual expenditure for lease of land was $48,000 annually. The Water & Sewer Advisory Branch estimated it to be $18,000 but subject to an independent appraiser finding. The Resolution adopted staff's estimate of $18,000 in rates with the provision that rates were subject to an up or down adjustment depending on the results of an independent appraisal that the Company was ordered to perform. LUKINS hired Lynn C. Barnett (a California Certified General Appraiser) to do the appraisal. Lynn C. Barnett submitted her appraisal report to the Water & Sewer Advisory Branch on February 10, 2010. She reported the annual market rental value of the property to be $43,500. Since the appraised rental market value of the property ($43,500) is higher than the amount adopted in rates ($18,000), the Company is entitled to file an advice letter for an upward adjustment in rates. On February 14, 2012, Lukins submitted an advice letter for an upward adjustment in rate for rent.

(2) Long-term Debt

Melvin L. Lukins (MLL) was the previous owner and father of Danny and Larry Lukins who are the current owners of LUKINS. Melvin L. Lukins and Sons Inc. was the construction company which completed contract work (water line repairs and maintenance) prior to 2000, when Danny G. Lukins General Engineering Contractor began handling contract work. As of December 31, 2010, LUKINS books showed a long-term debt balance of $559,184 as the amount owed by the LUKINS to MLL. The loan amount was not supported by a promissory note, carried no maturity date and 0% interest rate.

According to the Company, the $559,184 debt was for unpaid work performed for LUKINS by MLL Construction prior to 1998. During that time, MLL Construction handled all field services/maintenance for LUKINS.

The CPUC requires that all water utilities must seek the Commission's approval for any long-term notes payable before they are issued. Since LUKINS could not find documentation to support prior approval from the Commission, UAFCB concluded that LUKINS did not obtain Commission's approval before the long-term debt was issued.

In 2010, LUKINS cleared its long-term debt to MLL via an entry to Retained Earnings account. UAFCB believes that the adjustment should have been to the "Other Paid-in

Capital" account because it was a clearance of debt with no cash outlay or distribution of earnings to the stockholders LUKINS agreed with UAFCB and has made an entry to reclassify the amount to Other Paid-in Capital instead of to Retained Earnings.

(3) Distribution System Improvement Charge (DSIC)

Per Resolution No.W-4726, effective December 4, 2008, the Commission approved a DSIC rate increase of $169,840 for LUKINS, collectible from the Company's customers via a surcharge. The amount was to provide improvement and adequate water flow for fire protection. Specifically, the surcharge was for engineering design of water system rehabilitation. Funds from the DSIC are specifically stated not to go towards construction. LUKINS was required to open a separate bank account for receipts of DSIC funds and payments of infrastructure rehabilitation expenses. The DSIC surcharge collections were deposited into a separate Company's bank account with the Plumas Bank.

As of June 30, 2011, the total amount that LUKINS billed its customers to collect the DSIC surcharge amounted to $169,321. Of the $169,321 billed, LUKINS collected $169,082 in payments from customers. Out of this collection, LUKINS paid $107,882 for engineering design contract. By June 30, 2011, LUKINS should have $61,200 unexpended DSIC funds. However, the bank statement from the Plumas Bank showed a bank balance of only $44,628. UAFCB's reconciliation of the DSIC's funds received and recorded by LUKINS vs. the amounts deposited in Plumas Bank showed a difference of $16,572.

LUKINS claimed it deposited $16,810.64 in the Plumas Bank on September 30, 2011 to correct the short fall. UAFCB reviewed the Plumas Bank statement for the period ending September 30, 2011 and confirmed that LUKINS' did deposit the $16,810.64 as claimed.

(4) Retained Earnings

LUKINS' results of operations are cleared to Retained Earnings. No distributions from Retained Earnings were made by LUKINS during the record periods. However, in 2010, LUKINS cleared its long term debt to Melvin Lukins through Retained Earnings account. UFACB disagreed and recommended that LUKINS should establish "Other Paid-in Capital" account to record the clearance of LUKINS' long-term debt.

(5) Construction in Progress

LUKINS is in the process of constructing their new office building and upgrading the main operations yard. LUKINS' current office structure needs repair and does not meet the Americans with Disabilities Act (ADA) regulations. In 2010, the Company incurred construction costs amounting to $14,255 for building permits, installation fees, and upgrades required by the City of South Lake Tahoe and Tahoe Regional Planning Agencies. The expenditures were paid with revenues from operations.

(6) Annual Reports

In compliance with General Order 104 (A) LUKINS filed its 2008, 2009 and 2010 Annual Reports with the Commission as required. However, the Company revised the filed annual reports multiple times during the audit while working with UAFCB auditor. Lukins claimed to have submitted revised Annual Reports to the CPUC when requested to do so. To ensure the validity of the information considered during the audit, UAFCB requested LUKINS to provide revised annual report 2010 incorporating all the recommended adjustments by UAFCB for the audit years 2008, 2009 & 2010, including revisions to the Plant in Service accounts, depreciation, retirements of capital assets and other corrections. Lukins has agreed to submit a final revised 2010 Annual Report to incorporate UAFCB's recommendations from this audit.

(7) Comments and Corrections from Lukins

On February 9, 2012, UAFCB emailed a "draft" of the Financial Audit Report to Lukins for comments and corrections. On February 15, 2012, Lukins provided timely comments and corrections which have been incorporated in this final report.