



# Audit of Sewer Utilities

## Rolling Green Utilities, Inc. - Sewer

For the Year Ended December 31, 2017

Utility Audits Branch  
April 10, 2020



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**A digital copy of this report can be found at:  
<http://www.cpuc.ca.gov/utilityaudits/>**

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# EXECUTIVE SUMMARY

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The Utility Audits Branch (UAB), formerly known as the Utility Audit, Finance and Compliance Branch (UAFCB)<sup>1</sup>, is in the Utility Audits, Risk and Compliance Division (UARCD), which reports directly to the Executive Director of the California Public Utilities Commission (CPUC). Pursuant to PU Code, Sections 314.5, 314.6, 581, 582, and 584, the CPUC has statutory authority to inspect and audit the books and records of the utilities to ensure that ratepayers' money is well spent. PU Code Section 314.5 specifies that the CPUC shall inspect and audit the books and records for regulatory and tax purposes at least once every three years for utilities serving over 10,000 customers and at least once every five years for utilities serving 10,000 or fewer customers. PU Code Section 314.6(a) states that *"The commission may conduct financial and performance audits of any entity or program created by any order, decision, motion, settlement, or other action of the commission."*

Rolling Green Utilities, Inc. (RGU), which is comprised of Water and Sewer operations, was incorporated in California on March 29, 1965. RGU is a Class D Sewer utility with 285 active service connections. RGU serves approximately 285 unmetered customers in the Rolling Green Terrace Subdivision near Big Pine, Inyo County, California. As a regulated sewer utility, RGU is required to prepare its financial statements on accrual basis of accounting set forth in the Uniform System of Accounts (USOA) for Water Utilities adopted in Decision 85-04-076 that was subsequently updated in Decision 16-11-006 by the CPUC on November 16, 2016, which is a comprehensive basis of accounting other than the generally accepted accounting principles in the United States of America.

UAB conducted the audit of RGU's 2017 Annual Report filed with the CPUC in accordance with applicable PU Code, regulations, and CPUC's directives. The primary objectives of this audit are to ensure the fair presentation of the financial information in RGU's 2017 Annual Report and to determine whether RGU complied with the applicable regulations and CPUC's directives. The scope of our audit was limited to the financial information presented in RGU's 2017 Annual Report filed with the CPUC. In addition, UAB evaluated RGU's effectiveness of internal control over its accounting and reporting functions as it relates to the audit objectives.

Based on our audit, the following findings were identified:

- Finding 1: RGU lacks formal written policies and procedures for several operating processes.
- Finding 2: RGU does not have adequate segregation of duties relating to the accounting functions; the same employee could perform multiple accounting functions.
- Finding 3: RGU does not have an asset management system in place. RGU did not maintain a detail list of assets, including a description of the utility plant, plant original acquisition costs, funding source, deletion or retirement, useful life for each item, et cetera.
- Finding 4: RGU did not provide its asset depreciation schedule to UAB for review. UAB found that RGU did not follow the CPUC's Standard Practice U-4-SM to calculate the annual depreciation accrual, nor did it follow the USOA's requirements to report its depreciation.

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<sup>1</sup> Effective January 2020, Utility Audit, Finance and Compliance (UAFCB) was renamed to Utility Audits Branch (UAB).

- Finding 5: RGU used cash basis of accounting to record its transactions. The USOA mandates Utilities' books of accounts be kept on accrual basis of accounting. Cash basis of accounting recognizes certain expenses when paid rather than when they were incurred.
- Finding 6: UAB noted multiple misclassifications of expenses during the audit period.
- Finding 7: RGU did not provide sufficient, appropriate evidence to support the transactions recorded in its General Ledger (G/L).
- Finding 8: Material variances were noted between RGU's G/L, accounting records, and the Annual Report for numerous accounts.
- Finding 9: RGU overstated Account 460—Unmetered Sewer Revenue by \$1,456.

## **RESTRICTED USE OF THIS AUDIT REPORT**

This audit report is intended solely for the information and use by the CPUC and the management of RGU. It is not intended to be used and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

# AUDIT REPORT

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## BACKGROUND

The California Public Utilities Commission (CPUC) was established by Constitutional Amendment as the Railroad Commission in 1911. The Legislature passed the Public Utilities Act in 1912 to expand the CPUC's regulatory authority over natural gas, electric, telephone, and water companies as well as railroads and marine transportation companies. In 1946, the Railroad Commission was renamed the California Public Utilities Commission.<sup>2</sup> The California Public Utilities (PU) Code granted CPUC's regulatory authority over Investor-Owned Utilities (IOU) in California. The Utility Audits Branch (UAB), formerly known as the Utility Audit, Finance and Compliance Branch (UAFCB)<sup>3</sup>, is in the Utility Audits, Risk and Compliance Division (UARCD), which reports directly to the Executive Director of the CPUC. The UAB provides auditing, accounting, financial, and advisory services on regulated utilities and monitors compliance with laws and CPUC directives.

PU Code, Section 314.5(a) states, in part, that:

*The commission shall audit the books and records for regulatory and tax purposes ... (2) at least once every five years in the case of every electrical, gas, heat, telegraph, telephone, and water corporation serving 10,000 or fewer customers....*

In addition, PU Code, Section 314.6(a) states that, *"The commission may conduct financial and performance audits of any entity or program created by any order, decision, motion, settlement, or other action of the commission."* Regulated utilities are required to comply with PU Code Sections 581, 582 and 584 by timely submitting to the CPUC the requested documents in the form and detail prescribed by the CPUC.

On April 17, 1985, CPUC approved Decision 85-04-076 to update the Uniform System of Accounts (USOA), which is a basis of accounting other than the generally accepted accounting principles in the United States, for the regulated water and sewer IOUs in California. All regulated water utilities are required to comply with the accounting requirements specified in the USOA. Among other requirements, the USOA requires that *"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."*<sup>4</sup>

For the purpose of applying systems of accounts prescribed by the CPUC, regulated water utilities are divided into four classes based on the number of service connections as follows:

- Class A Utilities—having more than 10,000 service connections.
- Class B Utilities—having between 2,001 service connections and 10,000 service connections.
- Class C Utilities—having between 501 service connections and 2,000 service connections.
- Class D Utilities—having 500 service connections or less.

Classes B, C and D water utilities are commonly referred to as "Small Water Utilities."

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<sup>2</sup> <https://www.cpuc.ca.gov/history/>

<sup>3</sup> Effective January 2020, Utility Audit, Finance and Compliance Branch (UAFCB) was renamed to Utility Audits Branch (UAB).

<sup>4</sup> D.85-04-076, Page 10.

Rolling Green Utilities, Inc. (RGU), which is comprised of the Water and Sewer operations, was incorporated in California on March 29, 1965. RGU is a Class D sewer utility with 285 active service connections. RGU serves approximately 285 metered customers in the Rolling Green Terrace Subdivision near Big Pine, Inyo County, California. RGU also provides water services in the Rolling Green Terrace Subdivision near Big Pine, Inyo County, California. RGU tracks and records each operation's costs separately in its G/L.

## **OBJECTIVE AND SCOPE**

UAB conducted the audit of RGU's 2017 Annual Report filed with the CPUC in accordance with applicable PU Code, regulations, and CPUC's directives. The primary objectives of this audit are to ensure the fair presentation of the financial information in RGU's 2017 Annual Report and to determine whether RGU complied with the applicable regulations and CPUC's directives. The scope of our audit was the financial information presented in RGU's 2017 Annual Report filed with the CPUC. In addition, UAB evaluated RGU's effectiveness of internal control over its accounting and reporting functions as it relates to the audit objectives.

## **METHODOLOGY**

To determine RGU's compliance with the applicable regulations and CPUC directives in reporting the financial information in its 2017 Annual Report and to assess RGU's internal controls over its accounting and reporting, UAB obtained sufficient and appropriate evidence to achieve the audit objectives. The specific procedures performed during this audit included, but were not limited to, the following:

1. Obtained an understanding of the company's business operation and its accounting system.
2. Performed analytical procedures on the reported financial data to identify year-to-year trending and significant fluctuations of individual accounts over the past three-year period.
3. Assessed the company's internal controls through observation, inquiry, and documentation. Specific procedures included, but were not limited to:
  - Reviewed RGU's policies and procedures, and their implementation pertaining to accounting, recording, reporting, and record retention.
  - Discussed with key company personnel to obtain an understanding of RGU's internal control structure and operating environment.
  - Reviewed RGU's organization chart to evaluate segregation of duties, authorization and approval processes, performance monitoring and controls, and compliance with regulatory requirements and CPUC's directives.
4. Performed risk assessment and determined materiality level based on the auditor's understanding of the company's operations, the evaluation of its internal control, and UAB's financial analysis.
5. Determined the company's compliance with applicable regulations and CPUC's directives regarding timeliness of filing the Annual Report; compliance with USOA accounting requirements; treatments

of public grants, loans, utility plant, Facilities Fees, and Users Fee; disclosure and accounting treatment of affiliated transactions, etc.

6. Reviewed the list of utility plant assets, related invoices, purchase orders, work orders, and depreciation schedule to determine the existence, completeness, rights and valuation of utility plant.
7. Reconciled Sewer Plant in Service and depreciation expense balances shown in the Annual Reports to the general ledger (G/L) and depreciation schedules.
8. Reviewed the loan agreements and bank statements to determine the obligation, completeness, classification, and valuation of reported liabilities.
9. Determined the occurrence, completeness, accuracy, classification, and cutoff of the recorded expenditures by reviewing relevant supporting documents, such as purchase requisitions, cancelled checks, bank statements, invoices, contracts or agreements, and insurance policies, etc. Performed sample-testing as appropriate.
10. Determined the completeness, accuracy, and cutoff of the recorded revenues by reviewing the billing records and money received from ratepayers; and performed reasonableness tests of reported revenues based on the CPUC approved tariffs for the audit period.
11. Reconciled the amounts reported in the Annual Report to the underlying accounting records presented on the G/L and trial balance for the year ended December 31, 2017.
12. Determined that cash existed and was supported by bank statements and bank reconciliations. Determined that cash balance was properly classified (facilities fees, customers' deposits, contributions) in the financial statements and any restrictions on the use of the funds were properly disclosed.
13. Analyzed Common Stock and Other Paid-in Capital accounts by reviewing common stock certificates, par value, shares outstanding, and recalculated average share price.
14. Determined and disclosed if any related/affiliated party transactions per D.06-12-029.

## **AUDIT FINDINGS AND RECOMMENDATIONS**

The results of our audit of RGU's 2017 Annual Report are described below. The audited financial statements and UAB's Audit Adjustments are presented in the next section, titled "Audited Financial Statements."

### **Finding 1: RGU lacks formal written policies and procedures for several operating processes.**

#### **Condition:**

There were material weaknesses in the RGU's system of internal control over its operating processes, which present a reasonable possibility that material misstatements in RGU's Annual Report will not be



prevented or detected on a timely basis. RGU did not have formal written policies and procedures for the following:

- A. Record retention.
- B. Revenue recording and reporting, including recording and remittance procedures for surcharges collected.
- C. Recording and reporting cash disbursements.
- D. Payroll process.
- E. Inventory, recording, and reporting of Materials and Supplies.
- F. Asset acquisition, retirement, abandonment, and deletion due to obsolescence.
- G. Preparation, filing, and maintenance of annual reports filed or to be filed with the CPUC.

**Criteria:**

Good internal controls and prudent business practices require companies to establish proper written policies and procedures to carry out complex and routine operations.

**Cause:**

RGU has not developed written policies and procedures to govern its operating processes.

**Effect:**

The absence of formal written policies and procedures to govern RGU's business operations could result in inaccurate accounting records and mismanagement of its financial statements.

**Recommendations:**

RGU should establish written policies and procedures for the aforementioned areas to govern its business operations. In addition, RGU should provide a copy of its written policies and procedures to the UAB along with its corrective action plan.

**Finding 2: RGU does not have segregation of duties relating to the accounting functions.**

**Condition:**

RGU does not have adequate segregation of duties over key functions that should have been separated, such as opening mails, receiving and depositing cash, recording cash payments in the G/L, processing disbursements, and preparing bank reconciliations.

**Criteria:**

Good internal control practices dictate that key accounting functions should be properly segregated to prevent errors and fraud.

**Cause:**

RGU has not established an adequate system of internal controls over its accounting operations.

**Effect:**

A poor system of internal controls could result in inaccurate accounting records and misstatement of the financial statements.

**Recommendations:**

When possible, RGU should segregate the accounting functions performed by its employees to ensure checks and balances are in place and implemented to minimize errors or fraud. The same employee

should not perform more than one of the following functions: 1) receiving and depositing remittances, 2) preparing checks, 3) authorizing disbursements, 4) signing checks, 5) reconciling bank accounts and posting to G/L, and 6) initiating or preparing invoices, etc.

RGU should include in its corrective action plan to the UAB regarding its plan to establish and implement an adequate system of internal controls over its accounting and reporting functions.

**Finding 3: RGU does not have an asset management system in place.**

**Condition:**

RGU does not have an asset management system in place to identify assets owned, their depletion and useful lives. RGU did not maintain a detail list of assets, including a description of the plant, plant original acquisition data, funding source, deletion or retirement, useful life for each item, et cetera.

**Criteria:**

General Instructions 3.A and 4.A of the USOA states, in part, that:

*A. All water plants shall be recorded at original cost.*

*B. ...The rates shall be reviewed periodically and adjusted as required, so that the depreciation accrual will bear a reasonable relationship to the remaining life....*

**Cause:**

RGU has not established an adequate system of internal controls over its assets.

**Effect:**

A poor system of internal controls could result in the loss of assets undetected or inaccurate assets being reported.

**Recommendations:**

RGU should maintain adequate documentation to support its Sewer Plant in Service including depreciation and amortization schedules, and the related accounting records. RGU should also provide a detail list of its assets to UAB along with its corrective action plan.

**Finding 4: RGU did not provide its asset depreciation schedule to UAB for review.**

**Condition:**

RGU's depreciation calculation methodology did not comply with the USOA and CPUC's Standard Practice U-4-SM. Based on our review of Schedule A-2, Depreciation and Amortization Reserves of RGU's 2017 Annual Report, UAB noted that RGU used a single composite depreciation rate of 2.4 percent to calculate its annual depreciation expense. The USOA and CPUC's Standard Practice U-4-SM do not allow water utilities with annual revenue over \$100,000 to use the single composite rate methodology to calculate depreciation expense. In addition, RGU did not provide its asset depreciation schedule to support the accumulated depreciation reported in the Annual Report. As a result, UAB was unable to verify the accuracy of the reported depreciation expense of \$271 in Account 403 and the accumulated depreciation of sewer plants of \$161,136 in Account 108.

**Criteria:**

The General Instructions 2.B of the USOA states that:

*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.*

Under Account 403, Depreciation Expense, on Page B39, the USOA specifies, in part, that:

*...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....*

**Cause:**

RGU did not follow the USOA requirements to properly record and report its depreciation expense and did not maintain documentation to support Accumulated Depreciation reported in the Annual Report.

**Effect:**

Failure to follow the requirements of the USOA and CPUC's directives can result in reporting inaccurate financial information in the Annual Report, which may be used during RGU's General Rate Case (GRC) application review process and could potentially impact the sewer rates for RGU's ratepayers.

**Recommendations:**

RGU should follow the USOA requirements in recording and reporting its Depreciation Expense and Accumulated Depreciation of Sewer Plant. In addition, RGU should provide a copy of its depreciation schedule to UAB along with its corrective action plan.

**Finding 5: RGU did not record expenses using accrual basis of accounting**

**Condition:**

Transactions in Account 408—Taxes Other Than Income Taxes and Account 664—Other Plant Maintenance Expense were incorrectly recorded when paid, instead of when the expenses were incurred. The USOA mandates that the Utilities' books must be kept using accrual basis of accounting. The cash basis method recognizes certain expenses when paid rather than when they were incurred. As a result, Taxes Other Than Income Taxes was overstated by \$4,287 and Other Plant Maintenance Expense was overstated by \$3,040.

**Criteria:**

General Instructions 2.A of the USOA states that:

*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.*

**Cause:**

RGU did not use accrual basis of accounting to record its financial data.

**Effect:**

Because RGU did not use accrual basis of accounting, some accounts in the 2017 Annual Report were not accurately reported. In addition, misstated expenses in the Annual Report, which may be used during the RGU's GRC application review process, could potentially impact the sewer rates for RGU's ratepayers.

**Recommendation:**

RGU should comply with the accounting methodology prescribed by the USOA by using accrual basis of accounting to record its transactions.

**Finding 6: Misclassifications of Expenses****Condition:**

UAB noted multiple misclassifications of expenses during the audit period as follows:

- The expenses for Sewer Ponds Rental should have been recorded in Account 664—Other Plant Maintenance Expenses instead of Account 678—Office Services and Rentals.
- The expenses for SWRCB Permit Fee should have been recorded into Account 688—Regulatory Commission Expense instead of Account 689—General Expense.

As a result, Other Plant Maintenance Expenses account was understated by \$11,775; Office Services and Rentals was overstated by \$11,775; Regulatory Commission Expense was understated by \$4,849; and, General Expense was overstated by \$4,849.

**Criteria:**

The USOA defines the aforementioned accounts as follows:

*Account 664—Other Plant Maintenance Expense:*

*This account shall include all plant operation and maintenance expenses not related to volume of water, and not separately provided for in other accounts. Items: Well rental charges; Charges for the right to divert water from springs and streams; Cost of drilling nonproductive wells unless special accounting is ordered by the Commission; Telemetry.*

*Account 678—Office Services and Rentals:*

*Computer and/ or Billing Machine  
Credit Report  
Payments to Service Bureaus  
Commissions to others for collecting bills  
Office Equipment Rentals  
Other Services*

*Account 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 cases before regulatory commission. B. This account also shall include fees assessed against a utility for salaries and expenses of regulatory commissions. C. Amounts of regulatory commission expense which, by direction of the commission are to be spread over future periods shall be charged to account 180, Deferred Charges and amortized by charges to account 688, Regulatory Commission Expense.*

*Account 689—General Expense:*

*This account shall include all expenses not includible in other operating expense account. Item:*

*Advertising; Collection agency fees; Subscriptions; Water association dues.*

**Cause:**

RGU lacks adequate internal control over its accounting and reporting functions to ensure its expenses were recorded and reported accurately.

**Effect:**

Inaccurate reporting of Other Plant and Maintenance Expense, Office Services and Rentals, Regulatory Commission Expense, and General Expense in the Annual Report distorted RGU's Income Statement for the year ended December 31, 2017.

**Recommendation:**

RGU should establish proper internal controls to ensure its financial data are accurately recorded and reported.

**Finding 7: RGU did not provide sufficient, appropriate evidence for several accounts to support the transactions recorded in its G/L.**

**Condition:**

RGU did not provide adequate documentation such as invoices, receipts, contracts, asset listing, accounts receivable aging report, materials and supplies listing, stock certificates, and schedule of retained earnings to support the transactions recorded in the following accounts: Account 101—Sewer Plant in Service, Account 141—Accounts Receivable, Account 151—Materials and Supplies, Account 211—Other Paid-in Capital, and Account 215—Retained Earnings.

As a result, UAB was unable to verify the reported balances for Account 101—Sewer Plant in Service of \$190,820, Account 141—Accounts Receivable of \$13,274, Account 151—Materials and Supplies of \$1,050, Account 211—Other Paid-in Capital of \$40,598, and Account 215—Retained Earnings of \$30,444.

**Criteria:**

PU Code, Section 582 states, in part, that:

*Whenever required by the commission, every public utility shall deliver to the commission copies of any or all maps, profiles, contracts, agreements, franchises, reports, books, accounts, papers, and records in its possession or in any way relating to its property or affecting its business, and also a complete inventory of all its property in such form as the commission may direct.*

The USOA General Instructions 2.B states that:

*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:**

RGU did not comply with the USOA requirements to maintain sufficient supporting documents for its reported financial data in the 2017 Annual Report. RGU does not have control procedures to ensure documentation is retained to support transactions recorded in its books.

**Effect:**

Due to the lack of documentation to support account balances, UAB is unable to attest to the accuracy of assets and ownership equity reported on the RGU's Balance Sheet as of December 31, 2017.

**Recommendations:**

RGU should comply with all accounting requirements specified in the USOA and maintain proper supporting documents for its transactions. In addition, RGU should strengthen its internal controls to ensure all transactions booked in its G/L are adequately supported by proper documentation.

**Finding 8: Material variances were noted between RGU's G/L, accounting records, and the Annual Report for numerous accounts.****Condition:**

The UAB noted the following variances between the Annual Report and RGU's accounting records:

- Account 131—Cash: The December 2017 bank statements showed a cash balance of \$104,349 as of December 31, 2017. However, RGU reported \$76,478 in its 2017 Annual Report, resulting in an understatement of \$27,871.
- Account 201—Common Stock: CPUC Decision 69724 showed that RGU issued 5,430 shares of Common Stock with a par value of \$10. Advice Letter (AL) 31-W showed that the stocks purchased were allocated to the Water Utility and Sewer Utility at 67 percent and 33 percent, respectively. Therefore, the value of outstanding Common Stock allocated to the Sewer Utility is \$17,920 (5,430 \* \$10 \* 33%). However, RGU reported \$27,150 in its 2017 Annual Report, resulting in an overstatement of \$9,230 (\$27,150-\$17,920).
- Account 671—Management Salaries: The Payroll Summary for 2017 reflected \$14,448 of management salaries for the year ended December 31, 2017. However, RGU reported \$27,048 in its 2017 Annual Report, resulting in an understatement of \$12,600 (\$27,048 - \$14,448).
- Account 678—Office Services and Rentals: RGU's 2017 G/L showed \$16,670 of Office Services and Rental expenses for the year ended December 31, 2017. However, RGU reported \$18,161 in its 2017 Annual Report, resulting in an overstatement of \$1,491 (\$18,161 - \$16,670).

**Criteria:**

PU Code, Section 581 states that:

*Every public utility shall furnish to the commission in such form and detail as the commission prescribes all tabulations, computations, and all other information required by it to carry into effect any of the provisions of this part, and shall make specific answers to all questions submitted by the commission.*

*Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly each question propounded therein, and if it is unable to answer any question, it shall give a good and sufficient reason for such failure.*

PU Code, Section 582 states that:

*Whenever required by the commission, every public utility shall deliver to the commission copies of any or all maps, profiles, contracts, agreements, franchises, reports, books, accounts, papers, and records in its possession or in any way relating to its property or affecting its business, and also a complete inventory of all its property in such form as the commission may direct.*

**Cause:**

RGU does not conduct periodic reconciliation of its underlying accounting records relating to Cash, Common Stock, Management Salaries, and Office Services and Rentals to the Annual Report to ensure the accuracy of reported information.

**Effect:**

Inaccurate reporting of Cash (Account 131) and Common Stock (Account 201) distorted RGU's financial position as of December 31, 2017. Misstated expenses for Management Salaries (Account 671) and Office Services and Rentals (Account 678) in the Annual Report, which may use used during the RGU's GRC application review process, could potentially impact the sewer rates for RGU's ratepayers.

**Recommendation:**

RGU should conduct periodic reconciliation of accounting records to the Annual Reports to ensure the information reported is accurate.

**Finding 9: RGU had overstated its Unmetered Sewer Revenue.**

**Condition:**

RGU overstated Unmetered Sewer Revenue in Account 460 by \$1,456 based on UAB's review of the limited documentation available. UAB imputed the annual revenue based on the tariff rate times the number of customers serviced during the year 2017. UAB's imputed revenue was \$120,418, while the reported amount per the Annual Report was \$121,874.

**Criteria:**

General Instructions 2 in USOA for Class B, C, And D Water Utilities adopted in D.85-04-076 states, in part, that:

*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:**

RGU did not comply with the USOA requirements to maintain adequate documents to support the reported Unmetered Sewer Revenue in its 2017 Annual Report. RGU lacks proper internal controls to ensure that documentation to support account balances are properly maintained and readily available.

**Effect:**

Due to lack of supporting documents, UAB was unable to verify the accuracy of the reported Unmetered Sewer Revenue in RGU's 2017 Annual Report.

**Recommendations:**

RGU should comply with all accounting requirements specified in the USOA and maintain proper supporting documents for its transactions. In addition, RGU should strengthen its internal controls to ensure all transactions booked in its G/L are adequately supported by proper documentation.

## CONCLUSION

In conducting this audit, we obtained an understanding of RGU's internal controls, including any information system's controls that we considered significant within the context of our audit objective. We assessed whether those controls were properly designed, implemented, and operating effectively. Any deficiencies in internal control that were identified during this audit and determined to be significant within the context of our audit objective are included in this report.

RGU's management is responsible for the preparation and fair presentation of its 2017 Annual Report filed with the CPUC. The CPUC requires that the statements be in accordance with the accounting requirements as set forth in the USOA. RGU's management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of its 2017 Annual Report that are free from material misstatements, whether due to fraud or error. In addition, RGU's management is responsible for the development of its policies and procedures to ensure full compliance with applicable regulations and CPUC's directives.

We conducted our audit in accordance with the applicable PU Code, regulations, and CPUC's directives. We planned and performed the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings, audit adjustments and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings, audit adjustments, and recommendations presented in this report.

RGU's Management should submit an electronic copy of its corrective action plan to the UAB at [UtilityAudits@cpuc.ca.gov](mailto:UtilityAudits@cpuc.ca.gov), with a copy to Lucian Filler, Deputy Executive Director of CPUC, at [Lucian.Filler@cpuc.ca.gov](mailto:Lucian.Filler@cpuc.ca.gov), and Bruce DeBerry, Program Manager of Water Division, at [Bruce.DeBerry@cpuc.ca.gov](mailto:Bruce.DeBerry@cpuc.ca.gov) no later than May 25, 2020. The corrective action plan should address how RGU will implement the recommendations and provide the timing of incorporating UAB's audit adjustments to RGU's books and records. If RGU is unable to implement UAB's recommendations, the corrective action plan should state the reason(s) for not being able to implement any of the recommendations. RGU should use the audited amounts in UAB's audit report as the basis to file its 2019 Annual Report with the CPUC.



## VIEWS OF RESPONSIBLE OFFICIAL

On November 13, 2019, UAB provided a draft audit report to RGU and requested a written response for the findings. UAB made additional requests for written responses for the findings on February 18, 2020, January 15, 2020, and March 6, 2020. However, RGU's management did not provide a written response to the draft audit report as of the date of this report. RGU's management did not dispute the audit findings and recommendations during our exit meeting on November 25, 2019. The audit findings and recommendations presented in this report represent our final determination of this audit.

*Angie Williams*

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Angie Williams, Director  
Utility Audits, Risk and Compliance Division

cc: Alice Stebbins, Executive Director, CPUC  
Lucian Filler, Deputy Executive Director, CPUC  
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# AUDITED FINANCIAL STATEMENTS

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## RGU Sewer Company **BALANCE SHEET (AS AUDITED)** As of December 31, 2017

<b>ASSETS</b>	
<b>UTILITY PLANT</b>	
Sewer Plant in Service	\$190,820
Accumulated Depreciation of Sewer Plant	<u>(165,360)</u>
<b>Net Utility Plant</b>	25,460
<b>CURRENT AND ACCRUED ASSETS</b>	
Cash	104,349
Accounts Receivable—Customers	13,274
Materials and Supplies	<u>1,050</u>
<b>Total Current and Accrued Assets</b>	118,673
<b>Total Assets</b>	<u><u>\$144,133</u></u>
<b>CAPITALIZATION AND LIABILITIES</b>	
<b>CORPORATE CAPITAL AND SURPLUS</b>	
Common Stock	\$17,920
Other Paid-in Capital	40,598
Retained Earnings	<u>63,320</u>
<b>Total Capitalization</b>	121,838
<b>CURRENT AND ACCRUED LIABILITIES</b>	
Accounts Payable	<u>22,295</u>
<b>Total Current and Accrued Liabilities</b>	22,295
<b>Total Equity and Liabilities</b>	<u><u>\$144,133</u></u>

*(The accompanying Notes to Financial Statements are an integral part of these Financial Statements)*

RGU Sewer Company  
**INCOME STATEMENT (AS AUDITED)**  
For Year Ended December 31, 2017

<b>OPERATING REVENUES</b>	
Unmetered Sewer Revenue	\$120,418
Other Sewer Revenue	2,125
<b>Total Operating Revenue</b>	122,543
<b>OPERATING EXPENSES</b>	
<b>Plant Operation and Maintenance Expenses</b>	
Employee Labor	12,347
Materials	7,895
Contract Work	2,245
Transportation Expenses	15,670
Other Plant Maintenance Expenses	13,162
<b>Total Plant Operation and Maintenance Expenses</b>	51,319
<b>Administrative and General Expenses</b>	
Office Salaries	7,035
Management Salaries	14,448
Employee Pensions and Benefits	5,795
Uncollectible Accounts Expense	196
Office Services and Rentals	4,895
Office Supplies and Expenses	1,258
Professional Services	1,690
Insurance	7,739
Regulatory Commission Expense	6,974
General Expenses	240
<b>Net Administrative and General Expenses</b>	50,270
<b>Total Operating Expenses</b>	101,589
Depreciation Expense	4,495
Taxes Other Than Income Taxes	3,234
<b>Total Operating Revenue Deductions</b>	109,318
<b>Total Utility Operating Income (Loss)</b>	13,225
<b>OTHER INCOME AND DEDUCTIONS</b>	
Interest Expense	(284)
<b>Total Other Income and Deductions</b>	(284)
<b>Net Income (Loss)</b>	\$12,941

*(The accompanying Notes to Financial Statements are an integral part of these Financial Statements)*

RGU Sewer Company  
**STATEMENT OF RETAINED EARNINGS (AS COMPILED <sup>5</sup>)**  
 For Year Ended December 31, 2017

<b>Retained Earnings, Beginning of Year</b>	<b>\$33,240</b>
 <b>CREDITS:</b>	
Net Income	12,941
UAB Adjustment to Cash	27,871
UAB Adjustment to Common Stock	9,230
UAB Adjustment to Unmetered Sewer Revenue	1,456
<b>Total Credits</b>	<b>51,498</b>
 <b>DEBITS:</b>	
UAB Adjustment to Other Plant Maintenance Expense	(3,040)
UAB Adjustment to Management Salaries	(12,600)
UAB Adjustment to Office Services and Rentals	(1,491)
UAB Adjustment to Taxes Other Than Income Taxes	(4,287)
<b>Total Debits</b>	<b>(21,418)</b>
<b>Retained Earnings, End of Year</b>	<b>\$63,320</b>

*(The accompanying Notes to Financial Statements are an integral part of these Financial Statements)*

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<sup>5</sup> UAB compiled the Statement of Retained Earnings based on the audited Balance Sheet and Income Statement, and other relevant financial data.

# RGU SEWER COMPANY

## NOTES TO FINANCIAL STATEMENTS

Regulated sewer utilities are required to prepare their financial statements on accrual basis of accounting set forth in the Uniform System of Accounts (USOA) adopted in Decision (D.) 85-04-076 by the CPUC on April 17, 1985, which is a comprehensive basis of accounting other than the generally accepted accounting principles (GAAP) in the United States of America. The followings describe certain differences in accounting treatments between GAAP and USOA, RGU's current accounting practices, and its compliance with applicable regulation and CPUC's directives.

### 1. Purpose of Financial Information and Targeted Audience

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

The purpose of using USOA to prepare financial statements is to have the utilities provide financial transparency of their water and/or sewer operations on a consistent basis. The primary user of the financial information is the CPUC for ratemaking and other compliance purposes.

### 2. Property, Plant, and Equipment

The USOA distinguishes the plant assets for water operations (i.e., Account 101, Water Plant in Service) from those for non-water operations (i.e., Account 121, Non-Water Utility Property and Other Assets), for ratemaking purposes.

#### (1) Depreciation Methodology

GAAP allows entities to elect a depreciation methodology of their choices, such as straight-line, double-declining balance, or sum-of-the-years digits depreciation method.

USOA requires utilities to use the "Straight-line remaining life method." "Remaining life" implies that estimates of future life and salvage value will be re-evaluated periodically and that depreciation rates will be adjusted to reflect any changes in estimates. Water utilities are required to comply with the CPUC's Standard Practice (SP) U-4-SM and SP U-4-M when determining depreciation accruals. Specifically, for the water plant with over \$100,000, the utility must maintain separate depreciation reserve by different plant accounts in accordance with Appendix B1 of SP U-4-SM; for the water plant under \$100,000, if the utility elects not to separate or maintain the depreciation reserve by accounts, it is appropriate to develop a composite value for remaining life for the entire plant in accordance with Appendix B2 or B3 of SP U-4-SM. The USOA suggested that all utilities maintain a separate accumulated depreciation subaccount for each depreciable plant account; and, it is mandatory for water utilities having more than 500 customers.<sup>6</sup> The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs. Sewer utilities are required to comply with the same requirements as the water utilities.

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<sup>6</sup> D.16.11-006 dated November 10, 2016, General Accounting Instructions 4 on Page B14.

The depreciation expense was computed at a composite rate of 2.4 percent in order to depreciate all plant assets for ratemaking purposes and for reporting all the depreciation expense in RGU's Annual Reports filed with the CPUC. RGU could not provide supporting documents for the 2.4 percent composite rate it used to depreciate its plant assets.

## **(2) Asset Retirement**

USOA requires that water plant be recorded at the original cost. In USOA's depreciation schedule, the difference between the estimated cost of removal and the salvage value is included in the depreciable base to obtain the annual depreciation expense. When retiring an asset, the cost of removal will reduce the balance of Account 108, Accumulated Depreciation of Water Plant, while the cash received from the salvage value or sale price will increase the balance of Account 108, Accumulated Depreciation of Water Plant. The gain or loss from the asset retirement that is recognized under GAAP is accumulated in Account 108, Accumulated Depreciation of Water Plant under the USOA.

The utility plant is recorded at the original cost when first constructed or purchased. Retired utility plant assets are removed from utility plant accounts based on the estimated cost and charged against accumulated depreciation. RGU did not maintain a detail list of sewer plant assets. Even though UAB repeatedly requested the supporting documents for the sewer plant assets, RGU was unable to provide UAB with a detail list supporting the value of its sewer plant assets. UAB was unable to satisfy itself by other auditing procedures concerning the reported account balance of \$190,820 as of December 31, 2017. Therefore, UAB was unable to verify the accuracy of this account.

## **3. Inventory**

GAAP allows entities to use different methodologies, such as average cost, first-in-first-out, and last-in-first-out, for the valuation of inventory, which includes cost components of raw materials, work-in-process, and finished goods, etc.

Under USOA, the inventory includes meters, materials and supplies. If identifiable, the inventory should be recorded at original cost, which includes transportation charges, sales, and use taxes and other directly assignable costs. Items of small value whose original cost cannot be readily determined shall be recorded at current prices. Scrap materials shall be carried in inventory at estimated scrap value.

RGU could not provide sufficient, appropriate evidence such as invoices or receipts to support the transactions recorded in Account 151—Materials and Supplies. Due to the lack of sufficient supporting documents, UAB was unable to verify the reported account balance of \$1,050 as of December 31, 2017.

## **4. Sewer Utility Users Fee**

PU Code, Sections 401 through 410 authorized the CPUC to set a fee annually to sewer utilities to cover the costs incurred by the CPUC in regulating them. USOA requires sewer utilities to credit regular operating revenue accounts with amounts of Users Fee billed to customers and charge Account 688—Regulatory Commission Expense, with fees paid to the CPUC.<sup>7</sup>

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<sup>7</sup> D.85-04-076 dated April 17, 1985, General Accounting Instructions 9 on Page 16.

RGU included Sewer Utility Users Fee into the sewer services billings charged to its customers and recorded the total billed amounts as its operating revenue. Payments of Sewer Utility Users Fee to the CPUC should be recorded into the Regulatory Commission Expense account when payments are due. RGU should have credited Account 480—Other Sewer Revenue with \$2,125 of Users Fee billed to its customers and charged Account 688—Regulatory Commission Expense, with fees paid to the CPUC.

## 5. Form of Financial Statements <sup>8</sup>

### (1) Balance Sheet

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

### (2) Income Statement

The form of Income Statement reflects the classification of revenues and expenses in ratemaking. Operating revenues and expenses are referred to as “above the line” because they are allowable in ratemaking, and the result of deducting total operating expenses from total operating revenues is the operating income. Other Income and Deductions are referred to as “below the line” because they are applied after operating income and are not allowable in ratemaking. The “below the line” items include interest revenue, dividend 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 affect the form of the income statement, the classification of revenues and expenses, and decisions of management in incurring expenses.

RGU has complied with these requirements and presentation of the financial statements, which are comprised of the balance sheet as of December 31, 2017, and the related statements of income.

## 6. 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 purposes, the Statement of Cash Flows is not required and therefore excluded from this audit report.

## 7. Compliance filing of 2017 Annual Report with the 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

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<sup>8</sup> Regulated Utilities Manual—A Service for Regulated Utilities by Deloitte & Touché USA LLP, pages 36-37.

Report with the CPUC every year. For the year being audited, RGU has complied with these requirements.



## UAB'S AUDIT ADJUSTMENTS

### FOR THE YEAR ENDED DECEMBER 31, 2017

Audit Adj. No.	Annual Report				Description	Debit	Credit
	Sch.	Line	Col.	Acct No.			
1	B	6	c	403	Depreciation Expense	\$4,224	
	A	14	c	108	Accumulated Depreciation of Sewer Plant <i>To adjust Accumulated Depreciation of Sewer Plant and Depreciation Expense to agree with the audited amount.</i>		\$4,224
2	A	30	c	131	Cash	\$27,871	
	A	6	c	215	Retained Earnings <i>To adjust Cash to agree with the audited amount.</i>		\$27,871
3	A	2	c	201	Common Stock	\$9,230	
	A	6	c	215	Retained Earnings <i>To adjust Common Stock to agree with the audited amount.</i>		\$9,230
4	B-1	2	c	460	Unmetered Sewer Revenue	\$1,456	
	A	6	c	215	Retained Earnings <i>To adjust Unmetered Sewer Revenue to agree with the audited amount.</i>		\$1,456
5	A	6	c	215	Retained Earnings	\$3,040	
	B-2	13	c	664	Other Plant Maintenance Expense <i>To adjust Other Plant Maintenance Expense to agree with the audited amount</i>		\$3,040

## UAB'S AUDIT ADJUSTMENTS

### FOR THE YEAR ENDED DECEMBER 31, 2017

Audit Adj. No.	Annual Report				Description	Debit	Credit
	Sch.	Line	Col.	Acct No.			
6	A	6	c	215	Retained Earnings	\$12,600	
	B-2	19	c	671	Management Salaries <i>To adjust Management Salaries to agree with the audited amount.</i>		\$12,600
7	A	6	c	215	Retained Earnings	\$1,491	
	B-2	13	c	664	Other Plant Maintenance Expenses	11,775	
	B-2	22	c	678	Office Services and Rentals <i>To adjust Office Services and Rentals to agree with the audited amount and reclassify Sewer Ponds Rental Expense to Other Plant Maintenance Expenses.</i>		\$13,266
8	B-2	26	c	688	Regulatory Commission Expense	\$4,849	
	B-2	27	c	689	General Expenses <i>To reclassify SWRCB permit Fee to Regulatory Commission Expense.</i>		\$4,849
9	A	6	c	215	Retained Earnings	\$4,287	
	B	8	c	408	Taxes Other Than Income Taxes <i>To adjust Taxes Other Than Income Taxes to agree with the audited amount.</i>		\$4,287

# APPENDICES

## APPENDIX A—BALANCE SHEETS (AS REPORTED) <sup>9</sup>

	As of	
	12/31/2017	12/31/2016
<b>ASSETS</b>		
<b>UTILITY PLANT</b>		
Sewer Plant in Service	\$190,820	\$195,731
Accumulated Depreciation of Sewer Plant	(161,136)	(165,940)
<b>Net Utility Plant</b>	<u>29,684</u>	<u>29,791</u>
<b>CURRENT AND ACCRUED ASSETS</b>		
Cash	76,478	69,952
Accounts Receivable – Customers	13,274	9,255
Materials and Supplies	1,050	1,050
<b>Total Current and Accrued Assets</b>	<u>90,802</u>	<u>80,257</u>
<b>Total Assets</b>	<u>\$120,486</u>	<u>\$110,048</u>
<b>CAPITALIZATION AND LIABILITIES</b>		
<b>CORPORATE CAPITAL AND SURPLUS</b>		
Common Stock	\$27,150	\$27,150
Other Paid-in Capital	40,598	40,918
Retained Earnings	30,444	33,240
<b>Total Capitalization</b>	<u>98,192</u>	<u>101,308</u>
<b>CURRENT AND ACCRUED LIABILITIES</b>		
Accounts Payable	22,295	8,740
<b>Total Current and Accrued Liabilities</b>	<u>22,295</u>	<u>8,740</u>
<b>Total Equity and Liabilities</b>	<u>\$120,486</u>	<u>\$110,048</u>

<sup>9</sup> The reported amounts were derived directly from RGU’s 2016 and 2017 Annual Reports without modification. They contain rounding variances and do not represent the audited amounts. They are included here for disclosure purposes only.

## APPENDIX B—INCOME STATEMENTS (AS REPORTED) <sup>10</sup>

	For the Year of	
	2017	2016
<b>OPERATING REVENUES</b>		
Unmetered Sewer Revenue	\$121,874	\$117,006
Approved Total Surcharge Revenue PUC Fees	0	1,384
Other Sewer Revenue (PUC Fees)	2,125	0
<b>Total Operating Revenue</b>	123,999	118,390
<b>OPERATING EXPENSES</b>		
<b>Plant Operation and Maintenance Expenses</b>		
Employee Labor	\$12,347	\$9,714
Materials	7,895	5,308
Contract Work	2,245	3,420
Transportation Expenses	15,670	7,078
Other Plant Maintenance Expenses	4,427	5,642
<b>Total Plant Operation and Maintenance Expenses</b>	42,584	31,162
<b>Administrative and General Expenses</b>		
Office Salaries	7,035	5,981
Management Salaries	27,048	18,485
Employee Pensions and Benefits	5,795	4,938
Uncollectible Accounts Expense	196	1,564
Office Services and Rentals	18,161	15,508
Office Supplies and Expenses	1,258	1,015
Professional Services	1,690	1,765
Insurance	7,739	13,402
Regulatory Commission Expense	2,125	0
General Expenses	5,089	7,098
<b>Net Administrative and General Expenses</b>	76,136	69,756
<b>Total Operating Expenses</b>	118,720	100,917
Depreciation Expense	271	353
Taxes Other Than Income Taxes	7,521	10,405
State Corporate Income Tax Expense	0	800
Federal Corporate Income Tax Expense	0	584
<b>Total Operating Revenue Deductions</b>	126,511	113,060
<b>Total Utility Operating Income (Loss)</b>	(2,512)	5,331
<b>OTHER INCOME AND DEDUCTIONS</b>		
Non-Utility Income	0	(1,384)
Interest Expense	(284)	(635)
<b>Total Other Income and Deductions</b>	(284)	(2,019)
<b>Net Income (Loss)</b>	(\$2,796)	\$3,311

<sup>10</sup> The reported amounts were derived directly from RGU's 2016 and 2017 Annual Reports without modification. They contain rounding variances and do not represent the audited amounts. They are included here for disclosure purposes only.