Audit of Water Utilities

Del Oro Water Company–Paradise Pines District

For the Year Ended December 31, 2018

Utility Audits Branch
May 11, 2020

MEMBERS OF THE TEAM

Angie Williams, Director

Raymond Yin, CPA
Program and Project Supervisor

Khusbindar Kaur, CPA
Senior Management Auditor

Sharmin Wellington, CPA
Public Utilities Regulatory Analyst V

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

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The Utility Audits Branch (UAB), formerly known as the Utility Audit, Finance and Compliance Branch (UAFCB)[1], 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."*

Del Oro Water Company (DOWC) is a Class B water utility subject to the jurisdiction of the CPUC. DOWC provides water service to 19 districts throughout California, comprised of approximately 8,500 connections until November 2018 when connections declined to approximately 5,300 as a result of the California Camp Fire. DOWC was incorporated in the State of California on July 29, 1963. DOWC provides water service to the city of Ferndale in Humboldt County, the community of Johnson Park in Shasta County, a portion of the city of Bakersfield in Kern County, as well as Butte, Tulare, Colusa, and Tuolumne Counties. DOWC operates the Paradise Pines District (PPD) in an unincorporated area in Butte County. PPD had approximately 4,800 service connections before the California Camp Fire, which caused a decline of approximately 38 percent, or 1,824 service connections, of its total service connections in the PPD service area.

The UAB conducted the audit of PPD's 2018 Annual Report filed with the CPUC in accordance with applicable PU Codes, regulations, and CPUC's directives. The primary objectives of this audit are to ensure the fair presentation of the financial information in PPD's 2018 Annual Report and to determine whether PPD complied with the applicable regulations and CPUC's directives. The scope of our audit was limited to the financial information presented in PPD's 2018 Annual Report filed with the CPUC. In addition, UAB evaluated the effectiveness of PPD's 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: The current portion of PPD's long term debt was not reported in Account 232, Short-term Notes Payable, in the Annual Report. As a result, Long-term Debt in Account 224 was overstated by $165,471, while Short-term Notes Payable in Account 232 was understated by the same amount. In addition, PPD did not properly record transactions pertaining to the Safe Drinking Water Bonds Act (SDWBA) loan, resulting in understating the Other Credits in Account 253 by $913,686 in the Annual Report.

- Finding 2: PPD reported State Water Resource Control Board fees of $30,136 in Account 689–General Expense, instead of Account 688–Regulatory Commission Expense.

[1] Effective January 2020, Utility Audit, Finance and Compliance (UAFCB) was renamed to Utility Audits Branch (UAB).

- Finding 3: The Vice President's salary was improperly included in Account 670–Office Salaries, instead of in Account 671–Management Salaries.

- Finding 4: PPD failed to report SDWBA loan amortization in its designated account per the USOA guidelines.

- Finding 5: PPD commingled Irrigation Revenues with Metered Water Revenue in the 2018 Annual Report; this practice does not comply with the USOA guidelines. As a result, Account 465–Irrigation Revenue was understated by $4,173, while Account 470–Metered Water Revenue was overstated by the same amount

- Finding 6: PPD did not report CPUC Users Fee in its Annual Report, resulting in an understatement of $35,128 in Account 688–Regulatory Commission Expense.

- Finding 7: PPD did not report the SDWBA surcharge collected from its customers in its Annual Report, resulting in an understatement of Metered Water Revenue by $253,328.

- Finding 8: PPD has consistently paid dividends in excess of its cumulative retained earnings over the past several years, resulting in an accumulated deficit, or negative retained earnings balance, of ($532,239) as of December 31, 2018.

- Finding 9: PPD incorrectly classified and reported vacation and sick leave expenses as regular salaries instead of classifying and reporting them as Employee Pension and Benefits expenses.

RESTRICTED USE OF THIS AUDIT REPORT

This audit report is intended solely for the information and use by the CPUC and the management of PPD. 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

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.[2] 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)[3], 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 inspect and audit the books and records for regulatory and tax purposes as follows… (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 November 10, 2016, CPUC approved Decision (D.) 16-11-006 to update its 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 updated USOA, which became effective on January 1, 2018. 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."* [4]

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."

---

[2] https://www.cpuc.ca.gov/history/
[3] Effective January 2020, Utility Audit, Finance and Compliance (UAFCB) was renamed to Utility Audits Branch (UAB).
[4] D.16-11-006, Page B13.

Del Oro Water Company (DOWC) is a Class B water utility subject to the jurisdiction of the CPUC. DOWC provides water service to 19 districts throughout California, comprised of approximately 8,500 connections until November 2018 when connections declined to approximately 5,300 as a result of the California Camp Fire. DOWC was incorporated in the State of California on July 29, 1963. DOWC provides water service to the city of Ferndale in Humboldt County, the community of Johnson Park in Shasta County, a portion of the city of Bakersfield in Kern County, as well as Butte, Tulare, Colusa, and Tuolumne Counties. DOWC operates the Paradise Pines District (PPD) in an unincorporated area in Butte County. PPD had approximately 4,800 service connections before the California Camp Fire, which caused a decline of approximately 38 percent, or 1,824 service connections, of its total service connections in the PPD service area.

OBJECTIVE AND SCOPE

UAB conducted the audit of PPD's 2018 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 PPD's 2018 Annual Report and to determine whether PPD complied with the applicable regulations and CPUC's directives. The scope of our audit was the financial information presented in PPD's 2018 Annual Report filed with the CPUC. In addition, UAB evaluated the effectiveness of PPD's internal control over its accounting and reporting functions as it relates to the audit objectives.

METHODOLOGY

To determine PPD's compliance with the applicable regulations and CPUC's directives in reporting the financial information in its 2018 Annual Report and to assess PPD's internal controls over its accounting and reporting, the 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 trends 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 the company's policies and procedures, and their implementation pertaining to accounting, recording, reporting, and record retention.
   - Interviewed key company personnel to obtain an understanding of its internal control structure and operating environment.
   - Reviewed the company'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 the timeliness of filing the Annual Report; compliance with USOA accounting requirements; treatments of public grants, loans, utility plant, facility fees, and users fee; disclosure and accounting treatment of affiliated transactions, etc.

6. Reviewed the list of water plant assets, related invoices, purchase orders, work orders, and depreciation schedule to determine the existence, completeness, rights, and valuation of utility plant.

7. Reconciled Water Plant in Service and depreciation expense balances shown in the Annual Report to the general ledger (G/L) and depreciation schedules.

8. Reviewed lease agreements for new leases and determine whether leased assets were properly capitalized, and that related depreciation is determined using an appropriate method and asset's useful life.

9. Determined that amounts recorded as Water Plant Construction Work in Progress are for on-going and uncompleted construction-related projects.

10. Reviewed the loan agreements and bank statements to determine the obligation, completeness, classification, and valuation of reported liabilities related to the utility's operations.

11. Determined the occurrence, completeness, accuracy, classification, and cutoff of the recorded expenditures by reviewing relevant supporting documents, such as purchase requisitions, canceled checks, bank statements, invoices, contracts or agreements, and insurance policies, etc. Performed sample-testing as appropriate.

12. 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.

13. Reconciled the amounts reported in the Annual Report to the underlying accounting records presented on the general ledger and trial balance for the year ended December 31, 2018.

14. Determined that cash exist and is supported by bank statements and bank reconciliations. Determined that cash balance is properly classified (facilities fees, customer's deposits, contributions) in the financial statements and any restrictions on the use of the funds are properly disclosed.

15. Analyzed Common Stock and Other Paid-in Capital accounts by reviewing common stock certificates, par value, shares outstanding, and recalculated average share price.

16. Determined and disclosed if any related/affiliated party transactions per D.10-10-019.

17. Determined that contributions were used for intended construction purposes by reviewing the contribution agreement.

AUDIT FINDINGS AND RECOMMENDATIONS

The results of our audit of PPD's 2018 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: Long-term Debt Recording and Reporting Errors

Condition:
UAB noted the following deficiencies while reviewing PPD's long-term debt:

- PPD did not record the current portion of its long-term loan in the Short-term Notes Payable account. As a result, Long-term Debt in Account 224 was overstated by $165,471, while Short-term Notes Payable in Account 232 was understated by the same amount.
- PPD did not report the Safe Drinking Water Bonds Act (SDWBA) loan interest expense of $70,363 in its Annual Report for the period ending December 31, 2018.
- PPD improperly used G/L Account 253–State Revolving Fund Loan[5] to record its SDWBA loan transactions instead of using Account 224–Long-term Debt, Account 470.4–SDWBA Surcharge, Account 470.4–Safe Drinking Water Bond Surcharge, and Account 427–Interest Expense per the USOA guidelines. As a result, the reported Other Credits in Account 253 was overstated by $913,686, which is comprised of SDWBA Surcharge of $253,328 in Account 470.4, less SDWBA Interest Expense of $70,363 in Account 427, plus prior year cumulated effects of SDWBA loan of $730,721 ($253,328 - $70,363 + $730,721 = $913,686).

Criteria:
The USOA states, in part, that:

224. Long-term Debt
A. This account shall include all notes, conditional sales contracts or other evidences of indebtedness payable more than one year from date of issue.
B. A separate subaccount shall be maintained for each obligation outstanding.

232. Short-term Notes Payable
This account shall include the face value of all notes, or other similar evidences of indebtedness, payable on demand or within a period not exceeding one year from the date of issue.

253. Other Credits
This account shall include advance billings, unamortized premium on debt, items in suspense and other credit items not provided for in other accounts. This account shall also include specific revenues (Revenue Balancing Account) that the Commission has authorized the utilities to record for future repayment.

427. Interest Expense
To this account shall be charged all interest expense of the utility. The contra credits to entries in this account shall be divided among:
Account 237.1 Interest Accrued on Long-Term Debt
Account 237.2 Interest Accrued on SDWBA Loan

[5] PPD uses the description "State Revolving Fund Loan" for Account 253, which differs from the USOA account description for Account 253–Other Credits.

Account 237.3 Interest Accrued on Other Liabilities

Cause:
PPD does not have adequate internal controls over its financial reporting to ensure that the current portion of Long-term Debt payable within a year of the Balance Sheet date is classified as Short-term Debt. PPD also lacks internal control to ensure the transactions relating to SDWBA loans are properly recorded in its G/L, reported in the Annual Report, and supported by the SDWBA fiscal agent account bank statements. In addition, PPD did not reconcile the G/L amounts to the SDWBA loan amortization schedule. Furthermore, PPD does not have adequate internal controls to ensure that it adheres to the accounts prescribed by the USOA to record its transactions.

Effect:
Inaccurate reporting and misclassification of Long-term Debt balance distorted PPD's financial position as of December 31, 2018. The lack of adequate internal controls can impact the reliability and accuracy of the financial information and the effectiveness and efficiency of PPD's operations.

Recommendations:
PPD should ensure that the information reported in the Annual Report is accurate. PPD should conduct periodic reconciliations of the G/L amounts to the SDWBA loan amortization schedule. PPD should follow the USOA requirements for recording its transactions and ensure that the current portion of Long-term Debt is properly recorded as Short-term Notes Payable. PPD should ensure all interest expense is properly reported.

Finding 2: Misclassification of Regulatory Fees

Condition:
PPD recorded fees paid to the State Water Resource Control Board in Account 689–General Expense instead of Account 688–Regulatory Commission Expense. As a result, General Expense was overstated by $30,136, while Regulatory Commission Expense in Account 688 was understated by the same amount.

Criteria:
Regarding Regulatory Commission Expense, the USOA states, in part, that:

A. *This account shall include all expenses (except salaries of regular utility employees) incurred by the utility in connection with formal matters before regulatory commissions.*
B. *Amounts of regulatory commission expense which, by direction of the commission is to be spread over future periods shall be charged to Account 180, Deferred Charges and amortized by charges to Account 688, Regulatory Commission Expense.*

Cause:
PPD misinterpreted the USOA requirements, causing regulatory fees to be misclassified.

Effect:
Inaccurate reporting of Regulatory Commission Expense account balances distorted PPD's Income Statement for the year ended December 31, 2018.

Recommendation:
PPD should comply with the accounting requirements prescribed under the USOA and record fees paid to the State Water Resource Control Board in Account 688–Regulatory Commission Expense.

Finding 3: Management Salaries

Condition:
The salaries of DOWC's Vice President was recorded as Office Salaries in Account 670. His compensation should have been recorded as Management Salaries in Account 671 to commensurate with the job duties. As a result, expenses for Office Salaries were overstated by $108,671, while expenses for Management were understated by the same amount.

Criteria:
The USOA states, in part, the following:

> *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.*

Cause:
PPD misinterpreted the USOA requirements, causing misclassification of Management Salaries.

Effect:
Inaccurate reporting of Office Salaries and Management Salaries in the Annual Report distorted PPD's Income Statement for the year ended December 31, 2018.

Recommendation:
PPD should comply with the accounting requirements prescribed under the USOA and record its Vice President's compensation as Management Salaries.

Finding 4: SDWBA Loan Amortization

Condition:
PPD incorrectly reported the amortization of SDWBA loan as "Accumulated Amortization–Regional Project" in the Liabilities and Other Credits section of Schedule A (Balance Sheet) in the Annual Report. "Accumulated Amortization–Regional Project" is not a USOA-approved account. The USOA specifies that the principal amount of the SDWBA loans should be amortized through charges to Account 407, SDWBA Loan Amortization Expense, with contra credits to Account 108.1, Accumulated Amortization of SDWBA Loan, over the life of the loan. While PPD properly recorded the balance of Accumulated Amortization of SDWBA, PPD has been incorrectly recording the SDWBA Loan Amortization Expenses as a debit to the "Accumulated Amortization–Regional Project" account. As a result, SDWBA Loan Amortization Expense was understated by $92,697 and the "Accumulated Amortization–Regional Project" account was improperly used to report a debit balance of $370,788 in the Annual Report.

Criteria:
The USOA General Instruction 8 states in part:

E. Safe Drinking Water Bond Act financed plant will not be depreciated on the books of account through charges to Account 403, Depreciation Expense. Instead, the principal amount of the loan will be amortized through the charges to Account 407, SDWBA Loan Amortization Expense, with contra credits to Account 108.1, Accumulated Amortization of SDWBA Loan, over the life of the SDWBA loan. These amortization charges will not be included in cost of service for ratemaking purposes. The intent of these entries is to have an accumulated depreciation balance equal to the amount of plant financed through the loan, when the SDWBA loan is fully paid.

Cause:
PPD lacks adequate internal controls over financial reporting to ensure that the SDWBA loan amortizations are properly recorded in accordance with the guidelines prescribed by the USOA.

Effect:
Inaccurate reporting of the SDWBA Loan Amortization Expense in the Annual Report, which may be used during PPD's General Rate Case (GRC) application review process, could potentially impact water rates for PPD's ratepayers. Inaccurately including a non-USOA approved account, "Accumulated Amortization – Regional Project," in the Annual Report distorted the presentation of PPD's Balance Sheet as of December 31, 2018.

Recommendation:
PPD should follow the USOA guidelines for recording and reporting SDWBA loan amortization.

Finding 5: Misclassification of Irrigation Revenue

Condition:
PPD comingled Irrigation Revenue with Metered Water Revenue in the 2018 Annual Report; this practice does not comply with the USOA guidelines. As a result, Account 465–Irrigation Revenue was understated by $4,173, while Account 470–Metered Water Revenue was overstated by the same amount.

Criteria:
The USOA states in part:

465. Irrigation Revenue
This account shall include all revenue from irrigation service, under either metered or flat rate irrigation tariff schedule.

Cause:
PPD misinterpreted the USOA for recording its revenues causing irrigation revenue to be understated.

Effect:
Incorrectly reporting revenues in the Annual Report, which may be used during PPD's GRC application process, could potentially affect water rates for its ratepayers.

Recommendation:
PPD should comply with the accounting requirements prescribed under the USOA by recording and reporting its Irrigation Revenue in Account 465.

Finding 6: Understatement of Regulatory Commission Expense

Condition:
PPD collected CPUC Users Fee of $35,128 for the year ended December 31, 2018; but did not report it in the Annual Report. As a result, Account 688-Regulatory Commission Expense was understated by $35,128 and Account 480-Other Water Revenues were understated by the same amount.

Criteria:
The USOA General Instruction 9, states in part:

> *A. Class A water utilities pay a percentage of gross revenues quarterly; Class B, C, and D water utilities pay a designated amount, based on gross revenues, on January 15 of the following year. Sales of water for resale and Interdepartmental water sales should be excluded from gross revenues when computing the Water Utility Users fee.*
> *B. Water utilities will credit regular operating revenue accounts with amounts billed to customers and charge account 688, Regulatory Commission Expense, with fees paid to the Commission.*

Cause:
PPD management misinterpreted the accounting requirements of the USOA, resulting in the inaccurate recording and reporting of CPUC Users Fee attributable to the PPD district.

Effect:
Inaccurate reporting of Account 688–Regulatory Commission Expense and Account 480–Other Water Revenue distorted PPD's Income Statement for the year ended December 31, 2018.

Recommendation:
PPD should follow the USOA guidelines to record and report CPUC User Fee in all future filings of its Annual Reports with the CPUC.

Finding 7: Understatement of Revenue Attributable to SDWBA Surcharge

Condition:
PPD did not report $253,328 of SDWBA surcharge collected from its customers in Account 470.4, Metered Water Revenue–Safe Drinking Water Bond Surcharge.

Criteria:
The USOA General Instruction 8, states in part:

> *C. SDWBA loans will be repaid through surcharges on customer water bills. Surcharges will be separately shown on customer bills and credited to Account 470.4, Safe Drinking Water Bond Surcharge - Metered Revenue or Account 460.4, Safe Drinking Water Bond Surcharge - Unmetered Revenue.*
> *D. SDWBA surcharge collections will be deposited monthly with the designated fiscal agent. The funds on deposit with the fiscal agent will be reported in Account 132 Cash - Special Deposits.*
> *E. Safe Drinking Water Bond Act financed plant will not be depreciated on the books of account through charges to Account 403, Depreciation Expense. Instead, the principal amount of the loan will be amortized through the charges to Account 407, SDWBA Loan Amortization Expense, with contra credits to Account 108.1, Accumulated Amortization of SDWBA Loan, over the life of the SDWBA loan. These*

amortization charges will not be included in cost of service for ratemaking purposes. The intent of these entries is to have an accumulated depreciation balance equal to the amount of plant financed through the loan, when the SDWBA loan is fully paid.

Cause:
PPD management misinterpreted the USOA guidelines, resulting in PPD not recording revenue attributed to SDWBA surcharge in its Annual Report.

Effect:
Inaccurate reporting of Safe Drinking Water Bond Surcharge in the Annual Report, which may be used during PPD's GRC application review process, could potentially impact water rates for PPD's ratepayers.

Recommendation:
PPD should follow the USOA guidelines to record and report SDWBA surcharge in all future filings of its Annual Reports with the CPUC.

Finding 8: Paying Dividends Despite Having Accumulated Deficit

Condition:
PPD has consistently paid dividends in excess of its cumulative retained earnings over the past several years, resulting in an accumulated deficit, or negative retained earnings balance, of ($532,239) as of December 31, 2018.

Criteria:
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.*
>
> *211. Other Paid-in Capital (for corporations only)*
> *A. This account shall include all non-Subchapter S Corporation's paid-in capital not derived from earnings. It shall include such items as premiums and discounts related to the issuance of capital stock, donations to the utility of its capital stock, credits arising from the forgiveness of debt of the utility; credits arising out of a reorganization of the utility, or in connection with its recapitalization.*
> *B. Each type of paid-in capital shall be carried in a separate subaccount.*

Cause:
PPD failed to ensure it has positive retained earnings before declaring and paying a dividend.

Effect:
An accumulated deficit could hinder PPD's ability to meet its future financial obligations, while decreasing PPD's equity and increasing its reliance on debt financing. The continuous withdrawals via dividends in excess of net income could eventually reduce PPD's equity to zero.

Recommendation:
PPD should immediately stop declaring or paying any dividends due to its accumulated deficit. PPD could consider paying dividends when it has positive retained earnings.

Finding 9: Accrued vacation and sick leave expense were not properly classified as Employee Pensions and Benefits expense

Condition:
PPD classified and reported vacation and sick leave expenses as regular salaries instead of classifying and reporting them as Employee Pensions and Benefits expenses in Account 674.

Criteria:
The USOA states, in part:

> *674 - Employee Pensions and Benefits account shall include all accruals under employee pension plans to which the utility has irrevocably committed such funds, and payments for employee accident, sickness, hospital and death benefits, or insurance therefore. Include also expenses for medical, educational or recreational activities of employees.*

Cause:
PPD misinterpreted the USOA for recording its sick leave and vacation expenses causing Employee Pension and Benefits to be misstated.

Effect:
Incorrectly reporting expenses distorted PPD's Income Statement for the year ended December 31, 2018.

Recommendation:
PPD should comply with the accounting requirements prescribed under the USOA by recording and reporting accrued vacation and sick leave expenses as Employee Pensions and Benefits in Account 674.

CONCLUSION

In conducting this audit, we obtained an understanding of PPD's internal controls, including any information systems controls that we considered significant within the context of our audit objectives. 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 objectives are included in this report.

PPD's management is responsible for the preparation and fair presentation of its 2018 Annual Report filed with the CPUC. The CPUC requires that the statements be in accordance with the accounting requirements as set forth in CPUC's USOA. PPD's management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of its 2018 Annual Report that are free from material misstatements, whether due to fraud or error. In addition, PPD's management is responsible for the development of its policies and procedures to ensure full compliance with applicable regulations and CPUC 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.

PPD's management should submit an electronic copy of its corrective action plan to the UAB at UtilityAudits@cpuc.ca.gov, with a copy to Lucian Filler, Deputy Executive Director of CPUC, at Lucian.Filler@cpuc.ca.gov, and Bruce DeBerry, Program Manager of Water Division at Bruce.DeBerry@cpuc.ca.gov no later than June 25, 2020. The corrective action plan should address how PPD will implement the recommendations and provide the timing of incorporating UAB's audit adjustments to PPD's books and records. If PPD 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. PPD 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 April 22, 2020, UAB provided a draft audit report to PPD for comments. On May 5, 2020, PPD provided its comments to UAB, which are included in Appendix C of this report. UAB's evaluations of and rebuttals to those comments are in Appendix D of this report. Where appropriate, UAB modified its preliminary audit findings and recommendations. The audit findings and recommendations presented in this report represent our final determination of this audit.

Angie Williams

Angie Williams, Director
Utility Audits, Risk and Compliance Division

cc: Alice Stebbins, Executive Director, CPUC
Lucian Filler, Deputy Executive Director, CPUC
Bruce DeBerry, Program Manager, Water Division
Raymond Yin, Program and Project Supervisor, UAB
Khusbindar Kaur, Senior Management Auditor, UAB
Sharmin Wellington, Public Utilities Regulatory Analyst V, UAB

DEL ORO WATER COMPANY – PARADISE PINES DISTRICT

BALANCE SHEET (AS AUDITED)

As of December 31, 2018

ASSETS	
UTILITY PLANT	
Water Plant in Service (Note 2)	$9,365,889
Water Plant in Service - SDWBA (Note 6)	3,707,883
Construction Work in Progress - Water Plant	774,785
Accumulated Depreciation of Water Plant (Note 2)	(5,420,409)
Accumulated Amortization of SDWBA (Note 6)	(370,788)
Net Utility Plant	8,057,360
CURRENT AND ACCRUED ASSETS	
Cash (Note 4)	159,088
Cash – Special Deposit	78,009
Accounts Receivable – Customers	187,101
Receivables from Associated Companies	66,762
Materials and Supplies (Note 3)	7,157
Other Current Assets	172,391
Deferred Charges	162,473
Total Current and Accrued Assets	832,981
Total Assets	$8,890,341
LIABILITIES AND OTHER CREDITS	
SHAREHOLDERS' EQUITY	
Common Stock	$21,820
Other Paid-in Capital	5,255,066
Retained Earnings (Note 1)	10,659
Total Shareholders' Equity	5,287,545
LONG-TERM DEBT	
Long-Term Debt (Note 7)	2,764,815
CURRENT AND ACCRUED LIABILITIES	
Payables to Affiliated Companies	1,558
Accounts Payable	60,974
Short-term Notes Payable	165,471
Customer Deposits	24,042
Accrued Taxes	5,975
Other Current Liabilities	64,706
Total Current and Accrued Liabilities	322,726
DEFERRED CREDITS	
Advances for Construction	176,900
Other Credits	266,994
Total Deferred Credits	443,894
CONTRIBUTION IN AID OF CONSTRUCTION	
Contributions in Aid of Construction (Note 5)	1,788,920
Accumulated Amortization of Contributions	(1,717,559)
Net Contributions in Aid of Construction	71,361
Total Equity and Liabilities	$8,890,341

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

DEL ORO WATER COMPANY – PARADISE PINES DISTRICT
INCOME STATEMENT (AS AUDITED)
For Year Ended December 31, 2018

OPERATING REVENUES	
Metered Water Revenue	$2,210,437
Safe Drinking Water Bond Surcharge	253,328
Irrigation Water Revenue	4,173
Other Water Revenue	202,052
Total Operating Revenues	2,669,990
OPERATING EXPENSES	
Plant Operation and Maintenance Expenses	
Purchased Water	150,778
Power	285,434
Other Volume Related Expenses	2,696
Employee Labor	318,215
Materials	38,225
Contract Work	34,314
Transportation Expenses	85,625
Other Plant Maintenance Expenses	2,625
Total Plant Operation and Maintenance Expense	917,912
Administrative and General Expenses	
Office Salaries	241,430
Management Salaries	222,491
Employee Pensions and Benefits	151,529
Uncollectible Accounts Expense	1,009
Office Services and Rentals	68,439
Office Supplies and Expenses	143,528
Professional Services	15,049
Insurance	41,700
Regulatory Commission Expense (Note 9)	65,264
General Expenses	10,626
Total Administrative and General Expenses	961,065
Total Operating Expenses	1,878,977
Depreciation Expense (Note 2)	191,704
SDWBA/SRF Loan Amortization Expense	92,697
Taxes Other Than Income Taxes	71,818
State Corporate Income Tax Expense	800
Total Operating Revenue Deductions	2,235,996
Total Utility Operating Income	433,994
OTHER INCOME AND DEDUCTIONS	
Non-Utility Income	32,251
Miscellaneous Non-Utility Expense	(34,787)
Interest Expense	(70,363)
Total Other Income and Deductions	(72,899)
Net Income	$361,095

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

DEL ORO WATER COMPANY – PARADISE PINES DISTRICT
STATEMENT OF RETAINED EARNINGS (AS COMPILED[6])
For Year Ended December 31, 2018

Retained Earnings, Beginning of Year	**($528,066)**
CREDITS:	
Net Income	361,095
UAB Adjustment to Other Credits	730,721
UAB Adjustment to SWDBA Amortization	92,697
Total Credits	1,184,513
DEBITS:	
Dividend	(275,000)
UAB Adjustment to Accumulated Amortization of Regional Project	(370,788)
Total Debits	(645,788)
Retained Earnings, End of the Year	**$10,659**

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

[6] UAB compiled the Statement of Retained Earnings based on the audited Balance Sheet and Income Statement, and other relevant financial data.

DEL ORO WATER COMPANY – PARADISE PINES DISTRICT

NOTES TO FINANCIAL STATEMENTS

Regulated water utilities are required to prepare their financial statements on an accrual basis of accounting set forth in the Uniform System of Accounts (USOA) for Water Utilities adopted in Decision (D.) 16-11-006 by the California Public Utilities Commission (CPUC) on November 16, 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 USOA to prepare financial statements is to have the utilities provide financial transparency of their water operations on a consistent basis. The primary user of the financial information is the CPUC for ratemaking and other compliance purposes.

The State of California experienced one of its deadliest wildfires during November 2018 known as the California Camp Fire. PPD had approximately 4,800 service connections before the California Camp Fire, which caused a decline of approximately 38 percent, or 1,824 service connections, of its total service connections in the PPD service area. CPUC Resolution W-5193 approved a Lost Revenue Memorandum Account (LRMA) for DOWC to recoup $800,000 through a surcharge of $10.54 per customer per month for 12 months. Resolution W-5193 ordered that 78.4% of the recovery shall be allocated to PPD. The PPD was affected by the California Camp Fire which caused estimated assets impairment of $75,050 based on the book value of the assets. The impairment is primarily related to the PPD's water meters. DOWC is involved in a class action lawsuit against PG&E and is in litigation against its insurance company and agent for reimbursement due to the damages caused by the Camp Fire. The eventual recovery, if any, from PG&E and DPWC's insurance company is undeterminable as of the date of this report.

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

PPD utilizes the straight-line remaining life method for each class of assets to depreciate its assets for rate-making purposes and reporting the depreciation expenses in the Annual Report filed with the CPUC.

(2) Asset Retirement
USOA requires that the water plant be recorded at its 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 recorded in Account 108, Accumulated Depreciation of Water Plant under the USOA.

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.

4. Cash and Cash for Restricted Use

Under GAAP, if the restricted funds are considered to offset the current liability, the funds may be included as current asset classification. If the funds are set aside for use in the near future for the liquidation of long-term debts, payments to sinking funds, then the funds should be classified to non-current assets. If unsure of the timing of the use, the restricted cash can be classified as Other Assets.

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

Under USOA, the restricted funds are recorded to Account 132, Cash–Special Deposits, which should include cash amounts set aside from general corporate funds, deposited in a separate account with fiscal agents or others, and designated for special use. A separate subaccount shall be maintained for each designated special use. Interest earned from this account shall be credited to Account 421, Non-Utility Income.

5. Contributions in Aid of Construction (CIAC)

CIAC account records non-refundable contributions of cash, land or other property donated to the water utility to assist it in constructing, extending, or relocating its water system. The funds can be from governmental agencies and others. The balances in this account shall be written off over the period of its estimated service life by charging to Account 272, Accumulated Amortization of Contributions instead of a Deprecation Expense account, with contra credits to the appropriate subaccount of Account 108, Accumulated Depreciation of Water Plant.

6. Safe Drinking Water Bond Act (SDWBA) Loans

SDWBA loans are low-interest loans from the California Department of Water Resources (DWR) to assist water utilities to fund materials and services used on DWR-approved construction projects. SDWBA loans are repaid through surcharges on customer water bills. Although the accounting treatment of SDWBA loans is similar to GAAP, the USOA requires water utilities to follow the special accounting procedures below:

Water utilities must obtain the CPUC's written approval before obtaining an SDWBA loan and instituting an SDWBA surcharge to its ratepayers. Any SDWBA surcharge collected from ratepayers shall be deposited monthly to Account 132, Cash–Special Deposits. The periodical payment of the SDWBA loans and related interest expenses shall be made from this special deposit account.

Plant assets funded by an SDWBA loan are booked in Account 101.1, Water Plant in Service–SDWBA, and are not depreciable. The principal of an SDWBA loan should be amortized through the charges to Account 407, SDWBA Loan Amortization Expense, with contra credits to Account 108.1, Accumulated Amortization of SDWBA Loan, over the life of the SDWBA loan. PPD failed to report the loan amortization amount of $92,697 in Account 407, SDWBA Loan Amortization Expense. PPD failed to report SDWBA loan interest expense in Account 427. PPD financial statements reflected water plant in service funded by the Safe Drinking Water Bond Act of $3,707,883.

7. Long-Term Debt

Water utilities are required to obtain prior authorization from the CPUC before incurring any long-term debt. PU Code Section 818, states that,

> *No public utility may issue stocks and stock certificates, or other evidence of interest or ownership, or bonds, notes, or other evidences of indebtedness payable at periods of more than 12 months after the date thereof unless, in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property, or labor to be procured or paid for by the issue is reasonably required for the purposes specified in the order, and that, except as*

otherwise permitted in the order in the case of bonds, notes, or other evidences of indebtedness, such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

In D.08-05-032, the CPUC authorized the Safe Drinking Water State Revolving Fund Loan (SDWSRF) for the Regional Intertie Project for Lime Saddle, Magalia, and Paradise Pines Districts for $4,465,879. The CPUC subsequently authorized the increase of the SDWSRF loan in D.14-02-034 to $4,778,700. PPD was allotted approximately 78 percent of the loan proceeds $3,707,883.

8. Authorized Costs and Revenues

Under GAAP, regulated entities record recoverable costs authorized by the regulator as Regulatory Assets and amortize them over a period of time. Likewise, authorized revenues for future repayment are recorded as Regulatory Liabilities.

USOA requires water utilities to record authorized costs that are to be amortized over future periods as an asset in Account 180, Deferred Charges. Similarly, authorized revenues for future repayment are recorded as liabilities in Account 253, Other Credits.

9. Water Utility Users Fee

PU Code, Sections 431 and 433 authorized the CPUC to set a fee annually to water utilities to cover the costs incurred by the CPUC in regulating them. USOA requires water 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.[8]

PPD is not in compliance with the USOA guidelines regarding the treatment of CPUC Users Fee. PPD reported the CPUC Users Fee on its parent's 2018 Annual Report without allocating the fees collected to the districts. Therefore, fees collected and remitted to the CPUC of $31,005 were not reported in PPD's 2018 Annual Reports per the USOA guidelines.

10. 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 the 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….*"

PPD is a district within Del Oro Water Company, which is a subsidiary of Utility Management Services (UMS), Inc. PPD financial statements reflected Receivables from Affiliated Companies (UMS) of $66,762.

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

11. Form of Financial Statements [9]

(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 affect the form of the income statement, the classification of revenues and expenses, and decisions of management in incurring expenses.

12. 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.

13. Compliance filing of 2018 Annual Report with the CPUC

PU Code, Sections 581, 582, and 584, and the CPUC's directive (i.e., Water Division's annual memorandum to water and sewer utilities) require all regulated water and sewer utilities to file an Annual Report with the CPUC every year. For the year being audited, PPD has complied with these requirements.

---

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

UAB'S AUDIT ADJUSTMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

Audit Adj. No.	Annual Report Sch.	Line	Col.	Acct. No.	Description	Debit	Credit
1	A	13	c	224	Long-term Debt	$165,471	
	A	18	c	232	Short-term Notes Payables		$165,471
					To reclassify current portion of Long-term Debt to Short-term Notes Payables.		
2	B-2	26	b	688	Regulatory Commission Expense	$30,136	
	B-2	27	b	689	General Expense		$30,136
					To reclassify State Water Resources Control Board (SWRCB) fees to Regulatory Commission Expense.		
3	B-2	26	b	688	Regulatory Commission Expense	$35,128	
	B-1	26	b	480	Other Water Revenue		$35,128
					To record the CPUC Users Fee attributed to PPD revenues.		
4	B-1	17	b	470	Metered Water Revenue	$4,173	
	B-1	15	b	465	Irrigation Water Revenue		$4,173
					To record Irrigation Water Revenue in a separate account per the USOA requirements.		
5	A	27	c	253	Other Credits	$253,328	
	B-1	21	b	470.4	Safe Drinking Water Bond Surcharge		$253,328
					To record State Revolving Fund (SRF) surcharge collected per USOA requirements.		
6	B-2	19	b	671	Management Salaries	$108,671	
	B-2	18	b	670	Office Salaries		$108,671
					To reclassify the DOWC Vice President's compensation to Management Salaries.		
7	B	7	c	407	SDWBA Loan Amortization Expense	$92,697	
	A	6	c	215	Retained Earnings		$92,697
					To record SDWBA loan amortization per the USOA guidelines.		

UAB'S AUDIT ADJUSTMENTS (CONTINUES)

FOR THE YEAR ENDED DECEMBER 31, 2018

Audit Adj. No.	Annual Report			Acct.			
	Sch.	Line	Col.	No.	Description	Debit	Credit
8	A	6	c	215	Retained Earnings	$370,788	
	A		c		Accumulated Amortization of Regional Project		$370,788
					To record SDWBA loan amortization per the USOA guidelines.		
9	B	18	c	427	Interest Expense	$70,363	
	A	27	c	253	Other Credits		$70,363
					To record SDWBA loan interest expense per the USOA guidelines.		
10	A	27	c	253	Other Credits	$730,721	
	A	6	c	215	Retained Earnings		$730,721
					To reclassify SDWBA transactions incorrectly recorded in Account 253.		

APPENDIX A—BALANCE SHEETS (AS REPORTED) [10]

ASSETS	As of 12/31/2018	As of 12/31/2017
UTILITY PLANT		
Water Plant in Service	$9,365,889	$9,297,624
Water Plant in Service - Prop 50	3,707,883	3,707,883
Construction Work In Progress - Water Plant	774,785	71,101
Accumulated Depreciation of Water Plant	(5,420,409)	(5,221,568)
Accumulated Amortization of Prop 50	(370,788)	(278,091)
Net Utility Plant	8,057,360	7,576,949
CURRENT AND ACCRUED ASSETS		
Cash	159,088	257,466
Cash - Special Deposit	78,009	72,831
Accounts Receivable - Customers	187,101	101,654
Receivables from Associated Companies	66,762	79,826
Materials and Supplies	7,157	7,157
Other Current Assets	172,391	165,002
Deferred Charges	162,473	98,986
Total Current and Accrued Assets	832,981	782,922
Total Assets	$8,890,341	$8,359,871
CAPITALIZATION AND LIABILITIES		
CORPORATE CAPITAL AND SURPLUS		
Common Stock	$21,820	$21,820
Other Paid-in Capital	5,255,066	4,574,296
Retained Earnings	(532,239)	(528,066)
Total Corporate Capital and Surplus	4,744,647	4,068,050
LONG-TERM DEBT	2,930,286	3,105,841
CURRENT AND ACCRUED LIABILITIES		
Payables to Affiliated Companies	1,558	0
Accounts Payable	60,974	88,255
Short-term Notes Payable	0	0
Customer Deposits	24,042	44,626
Accrued Taxes	5,975	11,081
Other Current Liabilities	64,706	62,934
Total Current and Accrued Liabilities	157,255	206,896
DEFERRED CREDITS		
Advances for Construction	176,900	167,917
Other Credits	1,180,680	1,010,760
Total Deferred Credits	1,357,580	1,178,677
CONTRIBUTION IN AID OF CONSTRUCTION		
Contributions in Aid of Construction	1,788,920	1,788,920
Accumulated Amortization of Contributions	(1,717,559)	(1,710,422)
Net Contributions In Aid of Construction	71,361	78,498
Regional Project Amortization	(370,788)	(278,091)
Total Equity and Liabilities	$8,890,341	$8,359,871

[10] The reported amounts were derived directly from PPD's 2018 and 2017 Annual Reports. They do not represent the audited amounts. They are included here for disclosure purposes only.

APPENDIX B—INCOME STATEMENTS (AS REPORTED) [11]

	For the Year of	
	2018	2017
OPERATING REVENUES		
Metered Water Revenue	$2,214,610	$2,209,511
Other Water Revenue	166,924	137,578
Total Operating Revenues	2,381,534	2,347,089
OPERATING EXPENSES		
Plant Operation and Maintenance Expenses		
Purchased Water	150,778	198,370
Power	285,434	279,269
Other Volume Related Expenses	2,696	1,513
Employee Labor	318,215	306,467
Materials	38,225	41,386
Contract Work	34,314	40,800
Transportation Expenses	85,625	78,970
Other Plant Maintenance Expenses	2,625	4,114
Total Plant Operation and Maintenance Expenses	917,912	950,889
Administrative and General Expenses		
Office Salaries	350,101	348,416
Management Salaries	113,820	109,053
Employee Pensions and Benefits	151,529	135,715
Uncollectible Accounts Expense	1,009	5,654
Office Services and Rentals	68,439	71,411
Office Supplies and Expenses	143,528	149,063
Professional Services	15,049	11,277
Insurance	41,700	51,502
Regulatory Commission Expense	0	0
General Expenses	40,762	58,934
Total Administrative and General Expenses	925,937	941,025
Total Operating Expenses	1,843,849	1,891,914
Depreciation Expense	191,704	191,953
Taxes Other Than Income Taxes	71,818	91,131
State Corporate Income Tax Expense	800	800
Total Operating Revenue Deductions	2,108,171	2,175,798
Total Utility Operating Income	273,363	171,291
OTHER INCOME AND DEDUCTIONS		
Non-utility Income	32,251	33,955
Miscellaneous Non-utility Expense	(34,787)	(32,607)
Total Other Income and Deductions	(2,536)	1,348
Net Income	$270,827	$172,639

[11] The reported amounts were derived directly from PPD's 2018 and 2017 Annual Reports. They do not represent the audited amounts. They are included here for disclosure purposes only.

APPENDIX C—PPD'S RESPONSES

DEL ORO WATER COMPANY

DELIVERING NATURE'S PRECIOUS RESOURCE

May 5, 2020

Sharmin Wellington, CPA
California Public Utilities Commission
Utility Audits Branch
400 R Street, Suite #221
Sacramento, California 95811

Re: Draft Audit of Water Utilities Del Oro Water – Paradise Pines District

Dear Sharmin:

On April 24, 2020, we held our teleconference exit meeting regarding the audit of Paradise Pines District for the year ended December 31, 2018.

I am responding to the findings we discussed that day as follows:

Finding 1: Long-term Debt Recording and Reporting Errors
PPD agrees with Bullet Point 1 – and will reclassify current portion of Long-Term Debt to Short Term Payables. The correct amount of $165,471.

PPD disagrees with Bullet Point 2 correction – interest portion was posted in GL#253007
Correcting this posting should be:

253007 – SRF Regional Project Surchg	$34,621	Credit
215000 - Retained Earnings Prior	$34,621	Debit

PPD has posted the SDWBA Loan improperly from the beginning of the project. PPD started collecting the surcharge prior to starting the project as the project got delayed due to engineering issues. During the prior audit in 2012, CPUC auditors allow posting to continue into the SRF Regional Project Surchg GL #273007. PPD now realizes that they need to correct these posting and will do so.

Attached is the amortization schedule from the SDWBA Loan and PPD calculations for the current portion payable.

Finding 2: Misclassification of Regulatory Fees
PPD agrees with this finding.

Finding 3: Management Salaries
PPD does not agree with USOA findings. [redacted] is the CEO and owns 82.160% of the stock. [redacted] is CFO and owns 11.242% of the stock. [redacted] is the sole, acting manager, and ultimate decision maker, as any decision needs his approval before it can be carried out. [redacted]

DRAWER 5172 CHICO, CALIFORNIA 95927–WWW.DELOROWATER.COM

ARBUCKLE–BENBOW – BLACK BUTTE – BUZZTAIL– CALIFORNIA PINES – COUNTRY ESTATES – FERNDALE – JOHNSON PARK – LARKSPUR MEADOWS
LIME SADDLE– MAGALIA – METROPOLITAN – MT. LASSEN– PARADISE PINES – RIVER ISLAND – STIRLING BLUFFS – STRAWBERRY – TRAVER–TULARE

DEL ORO WATER COMPANY
DELIVERING NATURE'S PRECIOUS RESOURCE

Director of Corporate Accounting both fall under his direction and guidance and need his approval before acting on any operation of the utility.

As a line item expense for General Rates Cases and Public Relations, customers and analysts feel that management is an item that can be eliminated or reduced as an expense. [redacted] role with autonomy to make decisions in the future when [redacted] steps down would move him into the management classification. Right now, PPD feels his salary should remain in the Office Salary Account.

Finding 4: SDWBA Loan Amortization
PPD agrees with this finding as stated above regarding SDWBA postings.

Finding 5: Misclassification of Irrigation Revenue
PPD agrees with this finding.

Finding 6: Understatement of Regulatory Commission Expense
PPD will correct PUC User Fees to Revenue and expense. The correct amount including all utility service, surcharges, and DWSRF surcharges for 2018 is $35,128.49.

CPUC bills Del Oro Water quarterly for CPUC fees as the Class A's.

Finding 7: Understatement of Revenue Attributable to SDWBA Surcharge
PPD agrees with this finding as stated above regarding SDWBA postings.

Finding 8: Paying Dividends Despite having Accumulated Deficit
Dividends from the districts of Del Oro Water are paid to the parent company. Annually these amounts are reviewed by net income, capital improvement projects, and current cash availability of the districts. The parent company has never paid dividends to the stock owners. All dividends remain in the parent company to purchase small utility districts and invest in capital improvements for the smaller districts of Del Oro Water whether it is planned or an emergency.
Dividends are also reviewed by the combined annual financials of all its districts.

Finding 9: Accrued vacation and sick leave
PPD agrees with this finding.

After your review, if you have any further questions, please contact me.

Sincerely,

[redacted]
Director Corporate Accounting & Regulatory Affairs

Attachments

DRAWER 5172 CHICO, CALIFORNIA 95927–WWW.DELOROWATER.COM

ARBUCKLE– BENBOW – BLACK BUTTE– BUZZTAIL – CALIFORNIA PINES – COUNTRY ESTATES – FERNDALE – JOHNSON PARK – LARKSPUR MEADOWS
LIME SADDLE– MAGALIA – METROPOLITAN – MT. LASSEN – PARADISE PINES – RIVER ISLAND –STIRLING BLUFFS–STRAWBERRY – TRAVER–TULARE

(PPD representative's names and signature are intentionally redacted by UAB for privacy.)

APPENDIX D—UAB'S EVALUATION OF PPD'S RESPONSES

On May 5, 2020, Del Oro Water Company–Paradise Pines District (PPD) submitted its responses to Utility Audits Branch's (UAB) draft report dated April 22, 2020. The responses have been reviewed and incorporated into our final audit report. In evaluating PPD's responses, UAB noted that PPD only disagreed with UAB's Audit Findings 1 and 3. Therefore, UAB devoted its attention to addressing PPD's comments that disagreed with UAB's findings. Appendix C contains PPD's responses in its entirety. UAB's evaluation of PPD's comments is presented below.

Finding 1: Long-term Debt Recording and Reporting Errors

PPD agrees with Finding Bullet 1 and disagrees with Bullet 2 adjusting journal entry. PPD proposed Account 253007 for the adjusting journal entry.

UAB has revised its Finding 1 and related Audit Adjustments 9 and 10. PPD proposed an adjusting journal entry to debit Account 253007–SRF Regional Project Surcharge and credit Account 215000–Retained Earnings for $34,621. UAB evaluated PPD's comments and revised its audit adjustments by reclassifying the total SDWBA interest expense of $70,363 to Account 427 and crediting Account 253–Other Credit for $70,363, consisting of interest payments of $35,742 paid in June and $34,621 paid in December 2018, to reflect proper treatment of SDWBA loan interest per the USOA guidelines. In addition, UAB reclassified the SDWBA transaction amounts from Other Credits in Account 253 per the USOA guidelines.

Finding 2: Misclassification of Regulatory Fees

PPD agrees with this finding. PPD should implement UAB's recommendation for this finding.

Finding 3: Management Salaries

PPD disagrees with Finding 3. PPD stated that DOWC's Vice President is a minority shareholder and cannot make any operational decisions without the President's approval because the President exerts full control of operational decision making.

UAB disagrees with PPD's position. The USOA stipulates wages of managers, owners, or principal stockholders who perform any functions relating to the utility's operations shall be included as Management Salaries in Account 671. Although the Vice President cannot make operational decisions without the President's approval, the Vice President's wages should be recorded as Management Salaries in Account 671 because he is a shareholder with 11.242% ownership interest. PPD should implement UAB's recommendation for this finding.

For the reasons stated above, UAB's Finding 3 and related recommendations remain unchanged.

Finding 4: SDWBA Loan Amortization

PPD agrees with this finding. PPD should implement UAB's recommendation for this finding.

Finding 5: Misclassification of Irrigation Revenue

PPD agrees with this finding. PPD should implement UAB's recommendation for this finding.

Finding 6: Understatement of Regulatory Commission Expense

PPD agrees with this finding. UAB updated this finding to reflect the Users Fee collected by PPD. PPD should implement UAB's recommendation for this finding.

Finding 7: Understatement of Revenue Attributable to SDWBA Surcharge

PPD agrees with this finding. PPD should implement UAB's recommendation for this finding.

Finding 8: Paying Dividends Despite Having Accumulated Deficit

PPD agrees with this finding. PPD states the dividends are paid to the parent company and are used to invest in capital improvements for smaller districts. PPD should implement UAB's recommendation for this finding.

Finding 9: Accrued vacation and sick leave expense were not properly classified as Employee Pensions and Benefits expense

PPD agrees with this finding. PPD should implement UAB's recommendation for this finding.