



# REVIEW OF FINANCIAL STATEMENTS

## McMor Chlorination, Inc. – Sewer Operations

For the Year Ended December 31, 2020

Utility Audits, Risk and Compliance Division  
Utility Audits Branch  
November 7, 2022



## **MEMBERS OF THE TEAM**

**Angie Williams, Director**

**Masha Vorobyova, Assistant Director**

**Raymond Yin, CPA  
Program and Project Supervisor**

**Khusbindar Kaur, CPA  
Lead**

**Sam Niepoth  
Staff**

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You can contact our office at:  
California Public Utilities Commission  
Utility Audits, Risk and Compliance Division  
400 R Street, Suite 221  
Sacramento, CA 95811

## PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



Transmitted via e-mail

November 7, 2022

Mr. Dennis Gatson  
Chief Executive Officer  
McMor Chlorination, Inc.  
4700 District Boulevard  
Bakersfield, CA 93313

Dear Mr. Gatson:

**Final Report Transmittal Letter—Review of McMor Chlorination, Inc.’s Sewer Operations’  
Annual Report for the Year Ended December 31, 2020**

The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) has completed its review of McMor Chlorination, Inc.’s (McMor) sewer operations’ (McMor (Sewer)) regulatory basis financial statements in the 2020 Annual Report filed with the CPUC, which comprise the balance sheet as of December 31, 2020, and related statements of income, and retained earnings. The final review report is enclosed.

We issued the draft review report on September 30, 2022. McMor responded via email on October 13, 2022, that it had no comments to the draft report. Therefore, we are issuing the report as final. We will post the final review report on our website at [Audit Reports by Industry \(ca.gov\)](https://www.cpuc.ca.gov/AuditReports).

Please provide a Corrective Action Plan (CAP) addressing the findings and recommendations by December 22, 2022. The CAP should include specific steps and target dates to correct the findings identified. Please submit the CAP to the UAB at [UtilityAudits@cpuc.ca.gov](mailto:UtilityAudits@cpuc.ca.gov), with a copy to Bruce DeBerry, Program Manager of Water Division, at [Bruce.DeBerry@cpuc.ca.gov](mailto:Bruce.DeBerry@cpuc.ca.gov).

We appreciate McMor (Sewer)’s assistance and cooperation during the engagement, and your willingness to implement corrective actions. If you have any questions regarding this report, please contact Raymond Yin, Program and Project Supervisor, at (415) 703-1818.

Sincerely,

*Angie Williams*

Angie Williams, Director  
Utility Audits, Risk and Compliance Division

cc: See next page.

Mr. Dennis Gatson  
Chief Executive Officer  
McMor Chlorination, Inc.  
November 7, 2022  
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cc: Michael Stevenson, CPA, Barbich Hooper King Dill Hoffman, Accountancy Corporation  
Rachel Peterson, Executive Director, CPUC  
Kristin Stauffacher, Deputy Executive Director, Office of the Commission, CPUC  
Terence Shia, Director, Water Division, CPUC  
Masha Vorobyova, Assistant Director, UAB, CPUC  
Bruce Berry, Program Manager, Water Division, CPUC  
Raymond Yin, Program and Project Supervisor, UAB, CPUC  
Khusbindar Kaur, Senior Management Auditor, UAB, CPUC  
Sam Niepoth, Associate Management Auditor, UAB, CPUC

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## EXECUTIVE SUMMARY

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The Utility Audits Branch (UAB) of the California Public Utilities Commission (CPUC) conducted a review of the financial statements of McMor Chlorination, Inc.'s (McMor) sewer operations (McMor (Sewer)) as of December 31, 2020, pursuant to Public Utilities (PU) Code Sections 314.5, 314.6, 581, 582, and 584 that provide the CPUC the statutory authority to review or audit the books and records of the regulated utilities. We conducted this review in accordance with standards applicable to reviews of financial statements prescribed by the generally accepted government auditing standards (GAGAS), except for obtaining an external peer review. UAB was unable to obtain an external peer review timely due to delays caused by the COVID-19 pandemic. However, this does not affect UAB's adherence to all other GAGAS requirements and our conclusion on this review engagement is not modified with respect to this matter.

McMor, which is comprised of water and sewer operations, was incorporated in California on March 11, 2008. McMor acquired its water and sewer systems from the Sears Living Trust, as authorized by CPUC Decision (D.) 16-08-004, dated August 18, 2016. McMor (Sewer) is a sewer utility and serves approximately 19 unmetered sewer customers<sup>1</sup> near the town of Buttonwillow in Kern County, California.<sup>2</sup> As a regulated sewer utility, McMor (Sewer) is required to prepare its financial statements on accrual basis of accounting set forth in the Uniform System of Accounts (USOA) adopted in D.16-11-006 by the CPUC on November 10, 2016, which is a comprehensive regulatory basis of accounting framework other than the generally accepted accounting principles in the United States of America.

The purpose of this review was to obtain limited assurance as a basis for reporting whether we were aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the USOA. In conjunction with our review of the financial statements, UAB also reviewed, for regulatory purposes, whether McMor (Sewer) complied with the following:

- a) PU Code Section 818 regarding obtaining CPUC's approval before incurring any long-term debts.
- b) Timely filing of the 2020 Annual Report as required by the Water Division Memorandum dated January 26, 2021.

Based on our review, except for the balances of the Cash and Retained Earnings accounts, we are not aware of any material modifications that should be made to McMor (Sewer)'s revised financial statements in order for them to be in accordance with the accounting framework prescribed by the USOA. McMor (Sewer) has commingled its Cash and Operating Expense accounts with McMor's water operations since its inception. As a result, McMor (Sewer)'s Retained Earnings balance of \$50,195 and Cash balance of \$9,015 in the revised financial statements are materially misstated. McMor (Sewer)'s management has yet to determine the effects of this departure from the USOA accounting requirements on McMor (Sewer)'s financial position. Without performing an in-depth review of McMor's historical accounting records since its inception, UAB is unable to determine the effects of these misstatements on McMor (Sewer)'s financial position as of December 31, 2020.

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<sup>1</sup> McMor (Sewer) Billing Register for December 29, 2021.

<sup>2</sup> CPUC D.16-08-004, Page 1.

Determining the cumulative impact on the Cash and Retained Earnings balances as of December 31, 2020, would require UAB to go beyond the scope of this review.

For the review period, UAB did not note any noncompliance with PU Code Section 818; however, McMor (Sewer) did not file its 2020 Annual Report timely as required by the directives from the CPUC's Water Division, as described in Finding 12 below.

UAB identified 11 material misstatements in McMor (Sewer)'s Annual Report originally filed with the CPUC's Water Division and a noncompliance with a CPUC directive as described in the Appendix A – Review Findings and Recommendations. These findings are summarized below:

- Finding 1: McMor (Sewer) understated its Sewer Plant in Service (SPIS) balance in Account 101 by \$295,067 as of December 31, 2020, as a result of several accounting errors and omissions UAB identified during the review.
- Finding 2: McMor (Sewer) understated Account 108–Accumulated Depreciation of Sewer Plant and Account 403–Depreciation Expense by \$301,955 and \$8,107, respectively, and overstated Account 108.3–Accumulated Depreciation of Sewer Plant–Other by \$51,286 in its 2020 Annual Report as a result of several accounting errors and omissions UAB identified during the review.
- Finding 3: McMor (Sewer) reported the ending Retained Earnings balance of \$50,859 that is materially misstated in its 2020 Annual Report. McMor (Sewer) understated the Retained Earnings reported in its Annual Report by \$664 as a result of several accounting errors and omissions UAB identified during the review. McMor is also using inconsistent allocation methodologies to allocate operating expenses between its water and sewer operations.
- Finding 4: McMor (Sewer) materially misstated the ending cash balance of \$9,015 in Account 131–Cash in its 2020 Annual Report. McMor uses a joint bank account and commingles its Cash for its water and sewer operations. McMor has been allocating the Cash account balance between its water and sewer operations since its inception instead of keeping its cash receipts and cash disbursements separate for each operation.
- Finding 5: McMor (Sewer) misclassified \$143,237 of Unmetered Sewer Revenue as Other Sewer Revenue in its 2020 Annual Report. As a result, McMor (Sewer) understated Account 460–Unmetered Sewer Revenue by \$143,237 and overstated Account 480–Other Sewer Revenue by the same amount.
- Finding 6: McMor (Sewer) did not record the total of \$45,407 Sewer Plant Acquisition Adjustments allocated to its sewer operations at the time of the acquisition in November 2016. Additionally, McMor (Sewer) omitted recording \$18,164 of the related amortization expense between 2017 and 2020. As a result, McMor (Sewer) understated Account 426–Miscellaneous Non-Utility Expense and Account 114–Sewer Plant Acquisition Adjustments by \$4,541 and \$27,243, respectively.

McMor (Sewer) also incorrectly recorded \$86,766 of goodwill in Account 104–Sewer Plant Purchased or Sold related to the acquisition of its sewer plant. McMor (Sewer) amortized the goodwill by debiting Account 407–SDWBA Loan Amortization Expense and crediting

Account 108.1–Accumulated Amortization of SDWBA Loan. The USOA does not allow accounting for goodwill. As a result, McMor (Sewer) overstated Account 104–Sewer Plant Purchased or Sold, Account 108.1–Accumulated Amortization of SDWBA Loan, and Account 407–SDWBA Loan Amortization Expense by \$86,766, \$16,000, and \$4,000, respectively.

- Finding 7: McMor (Sewer) overstated Account 224–Long Term Debt and Account 427–Interest Expense by \$804 and \$1,558, respectively, and understated Account 232–Short-Term Notes Payable by \$18,061 in its 2020 Annual Report.
- Finding 8: McMor (Sewer) overstated its Operating Expense by \$14,756 in its 2020 Annual Report because (1) McMor applied inconsistent allocation methodologies to allocate expenses between its water and sewer operations; (2) McMor (Sewer) misclassified \$30,657 of payments made to its contractors as Materials in Account 640, instead of reporting it in Account 650–Contract Work; and (3) McMor (Sewer) did not provide any documentation to support the reported balance of \$18,326 in Account 688–Regulatory Commission Expense.
- Finding 9: McMor (Sewer) understated Account 141–Accounts Receivable–Customers, and Account 676–Uncollectible Accounts Expense by \$8,813 and \$5,009, respectively, in its 2020 Annual Report.
- Finding 10: McMor (Sewer) overstated Account 231–Accounts Payable and Account 664–Other Plant Maintenance Expenses by \$10,115 and \$9,697, respectively, in its 2020 Annual Report.
- Finding 11: McMor (Sewer) overstated Account 688–Regulatory Commission Expense by \$756 and understated Account 231–Accounts Payable by \$1,602 in its 2020 Annual Report.
- Finding 12: McMor (Sewer) did not comply with the CPUC’s Annual Report filing requirement of April 30, 2021. Instead, McMor (Sewer) filed its Annual Report on November 3, 2021.

UAB discussed the above findings with McMor (Sewer) during fieldwork. McMor (Sewer)’s management concurred with the findings and agreed to make appropriate adjusting journal entries to correct the misstatements identified above. McMor (Sewer) submitted its revised financial statements to UAB on August 11, 2022, to correct the material misstatements in each account, except for Cash and Retained Earnings, as described in Appendix A of this report. UAB further discussed these findings with McMor (Sewer)’s management at the exit conference on August 18, 2022, and McMor (Sewer) concurred with the review results. Except for the Cash and Retained Earnings accounts, UAB is not aware of any material modifications that should be made to the accompanying financial statements. UAB provided a draft review report to McMor for comments on September 30, 2022. McMor responded via email on October 13, 2022, that it had no comments regarding the draft report. The review findings and recommendations presented in this report represent our final determination of this review engagement.



## INDEPENDENT ACCOUNTANT'S REVIEW REPORT

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Dennis Gatson  
Chief Executive Officer  
McMor Chlorination, Inc.  
4700 District Boulevard  
Bakersfield, CA, 93313

### **Report on the Financial Statements**

The Utility Audits Branch (UAB) of the California Public Utility Commission (CPUC) has reviewed the accompanying financial statements of McMor Chlorination, Inc.'s (McMor) sewer operations (McMor (Sewer)), which comprise the balance sheet as of December 31, 2020, and the related statements of income and retained earnings for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of McMor (Sewer)'s management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, UAB does not express such an opinion.

#### ***Management's Responsibility for the Financial Statements***

McMor (Sewer)'s management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting framework prescribed by CPUC's Uniform System of Accounts (USOA) for Water Utilities; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of its financial statements that are free from material misstatement, whether due to fraud or error. In addition, McMor (Sewer)'s management is responsible for the development of its policies and procedures to ensure full compliance with applicable regulations and CPUC directives.

#### ***Accountant's Responsibility***

UAB's responsibility is to conduct the review engagement in accordance with the standards applicable to reviews of financial statements promulgated by the generally accepted government auditing standards (GAGAS) issued by the Comptroller General of the United States. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with the accounting framework prescribed by the USOA. UAB conducted this review in compliance with the auditing standards of GAGAS, except for obtaining an external peer review within the required timeframe as discussed in the succeeding paragraph. We believe that the results of our procedures provide a reasonable basis for our conclusion.

UAB was unable to obtain an external peer review timely due to delays caused by the COVID-19 pandemic. However, this does not affect UAB's adherence to all other GAGAS requirements and our conclusion on this review engagement is not modified with respect to this matter.

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

***Basis for Qualified Conclusion***

As noted in Notes 4 and 5 of these financial statements, McMor (Sewer) has been commingling its Cash and Operating Expense accounts with McMor’s water operations since its inception. As a result, McMor (Sewer)’s Retained Earnings balance of \$50,195 and Cash balance of \$9,015 in the accompanying financial statements are materially misstated. The effects of this departure from the USOA accounting requirements on McMor (Sewer)’s financial position has not been determined by its management.

***Qualified Conclusion***

Based on our review, except for the effects of the matters described in the Basis for Qualified Conclusion paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting framework prescribed by the USOA.

***Basis of Accounting***

For regulatory purposes, the CPUC adopted, through Decision (D.) 16-11-006 on November 10, 2016, the updated USOA, which is a comprehensive regulatory basis of accounting framework other than the generally accepted accounting principles (GAAP) in the United States of America. The CPUC requires all water and sewer utilities to prepare their financial statements in accordance with the accounting framework prescribed by the USOA. McMor (Sewer)’s financial statements were prepared based on this regulatory requirement.

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

***Emphasis of Matter – Correction of Material Misstatements***

As discussed in Notes 2 through 9 to the financial statements, UAB identified 11 material misstatements in McMor (Sewer)’s 2020 Annual Report originally filed with CPUC’s Water Division on November 3, 2021. These misstatements have been corrected in the accompanying financial statements. Our conclusion is not modified with respect to this matter.

***Other Matter – Views of Responsible Official***

We discussed our review results and findings with McMor (Sewer) during fieldwork. McMor (Sewer)’s management concurred with the findings and agreed to make appropriate adjusting journal entries to its accounting records to correct the material misstatements described in Appendix A of this report. McMor (Sewer) submitted its revised financial statements to UAB to correct the material misstatements in each account, except for Cash and Retained Earnings, as described in Appendix A of this report on August 11, 2022. UAB further discussed these findings with McMor (Sewer)’s management at the exit conference on August 18, 2022, and McMor (Sewer) concurred with the review results. Except for the Cash and Retained Earnings account, UAB is not aware of any material modifications that should be made to the accompanying financial statements. UAB provided a draft review report to McMor for comments on September 30, 2022. McMor responded via email on October 13, 2022, that it had no comments regarding the draft report. The review findings and recommendations presented in this report represent our final determination of this review engagement.

***Other Matter – Submission of a Corrective Action Plan***

McMor (Sewer)'s management should submit a corrective action plan (CAP) to UAB at [UtilityAudits@cpuc.ca.gov](mailto:UtilityAudits@cpuc.ca.gov), with a copy to Bruce DeBerry, Program Manager of Water Division, at [Bruce.DeBerry@cpuc.ca.gov](mailto:Bruce.DeBerry@cpuc.ca.gov) no later than December 22, 2022.. The CAP should address how McMor (Sewer) will implement the recommendations and provide the timing of incorporating UAB's review adjustments to McMor (Sewer)'s books and records. If McMor (Sewer) 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. McMor (Sewer) should use the amounts reviewed by UAB as presented in this report as the basis to file a revised 2021 Annual Report with the CPUC.

**Report on Other Regulatory Requirements**

For regulatory purposes, UAB also reviewed whether McMor (Sewer) complied with PU Code Section 818 to obtain its long-term debts, and whether McMor (Sewer) timely filed its 2020 Annual Report as required by CPUC's Water Division. For the review period, UAB did not note any noncompliance with PU Code Section 818. However, McMor (Sewer) is not in compliance with the CPUC's Annual Report filing requirement because it did not timely file its 2020 Annual Report. CPUC Water Division's Memo dated January 26, 2021, requires that all water and sewer utilities file their 2020 Annual Reports with the CPUC by April 30, 2021. McMor (Sewer) did not file its Annual Report until November 3, 2021, without obtaining the approval from the CPUC Water Division for a filing extension.

***Restricted Use of This Review Report***

The purpose of this report is to summarize the results of the review mandated by PU Code Section 314.5. Accordingly, this review report is intended solely for the information and use by the CPUC and the management of McMor (Sewer), and it is not suitable for any other purpose. It is not intended to be used and should not be used by anyone other than the specified parties. This restriction is not intended to limit distribution of this report, which is a matter of public record and will be available on the CPUC's website at [Audit Reports by Industry \(ca.gov\)](https://www.cpuc.ca.gov/Audit-Reports-by-Industry).

*Angie Williams*

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Angie Williams, Director  
Utility Audits, Risk and Compliance Division

Sacramento, CA  
November 7, 2022

## REVIEWED FINANCIAL STATEMENTS

### McMor Chlorination, Inc. (Sewer) Balance Sheet (As Reviewed) As of December 31, 2020

<b>ASSETS</b>	
<b>UTILITY PLANT</b>	
Sewer Plant in Service (Note 2)	\$405,346
Sewer Plant Acquisition Adjustments (Note 2)	27,243
Accumulated Depreciation of Sewer Plant (Note 2)	<u>(301,955)</u>
<b>Net Utility Plant</b>	<b>130,634</b>
<b>CURRENT AND ACCRUED ASSETS</b>	
Cash (Note 5)	9,015
Accounts Receivable–Customers	<u>15,726</u>
<b>Total Current and Accrued Assets</b>	<b>24,741</b>
<b>Total Assets and Other Debits</b>	<b><u>\$155,375</u></b>
<b>CAPITALIZATION AND LIABILITIES</b>	
<b>CORPORATE CAPITAL AND SURPLUS</b>	
Common Stock	\$268
Retained Earnings (Note 4)	<u>50,195</u>
<b>Total Capitalization</b>	<b>50,463</b>
<b>LONG-TERM DEBT</b>	
Long-Term Debt (Note 3)	85,249
<b>CURRENT AND ACCRUED LIABILITIES</b>	
Accounts Payable (Note 6)	1,602
Short-Term Notes Payable	<u>18,061</u>
<b>Total Current and Accrued Liabilities</b>	<b>19,663</b>
<b>Total Liabilities and Other Credits</b>	<b><u>\$155,375</u></b>

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

**McMor Chlorination, Inc. (Sewer)**  
**Income Statement (As Reviewed)**  
 For Year Ended December 31, 2020

<b>OPERATING REVENUES</b>	
Unmetered Sewer Revenue (Note 7)	\$143,237
Other Sewer Revenue (Note 7)	1,613
<b>Total Operating Revenue</b>	144,850
 <b>OPERATING EXPENSES (Note 8)</b>	
<b>Plant Operation and Maintenance Expenses</b>	
Power	28,652
Contract Work	47,254
Other Plant Maintenance Expenses	487
<b>Total Plant Operation and Maintenance Expenses</b>	76,393
 <b>Administrative and General Expenses</b>	
Uncollectible Accounts Expense	5,009
Professional Services	455
Regulatory Commission Expense	15,519
General Expenses	150
<b>Net Administrative and General Expenses</b>	21,133
<b>Total Operating Expenses</b>	97,526
Depreciation Expense	8,107
Taxes Other Than Income Taxes	1,409
<b>Total Operating Revenue Deductions</b>	107,042
<b>Total Utility Operating Loss</b>	37,808
 <b>OTHER INCOME AND DEDUCTIONS</b>	
Miscellaneous Non-Utility Expense	4,541
Interest Expense	5,985
<b>Total Other Income and Deductions</b>	10,526
<b>Net Income</b>	\$27,282

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

**McMor Chlorination, Inc. (Sewer)**  
**Statement of Retained Earnings (As Compiled <sup>3</sup>)**  
 For Year Ended December 31, 2020

<b>Retained Earnings, Beginning of Year</b>	\$32,059
<b>CREDITS:</b>	
Net Income	27,282
UAB Adjustment to Sewer Plant in Service	295,067
UAB Adjustment to Accumulated Amortization of SDWBA Loan	16,000
UAB Adjustment to Sewer Plant Acquisition Adjustments	31,784
UAB Adjustment to Interest Expense	1,558
UAB Adjustment to Materials	18,226
UAB Adjustment to Accounts Receivable–Customers	13,822
UAB Adjustment to Accounts Payable	10,115
<b>Total Credits</b>	413,854
<b>Debits:</b>	
UAB Adjustment to Accumulated Depreciation of Sewer Plant	242,562
UAB Adjustment to Sewer Plant Purchased or Sold	86,766
UAB Adjustment to SDWBA Loan Amortization Expense	4,000
UAB Adjustment to Long Term Debt	18,865
UAB Adjustment to Power	9,076
UAB Adjustment to Contract Work	7,113
UAB Adjustment to Regulatory Commission Expense	17,639
UAB Adjustment to Other Plant Maintenance Expenses	9,697
<b>Total Debits</b>	395,718
<b>Retained Earnings, End of Year</b>	\$50,195

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

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<sup>3</sup> UAB compiled the Statement of Retained Earnings based on the reviewed Balance Sheet and Income Statement, and other relevant financial data.

## **McMor Chlorination, Inc. (Sewer) Notes to Financial Statements**

McMor Chlorination Inc. (McMor), which is comprised of water and sewer operations, was incorporated in California on March 11, 2008. McMor acquired its water and sewer systems from the Sears Living Trust, as authorized by CPUC D.16-08-004, dated August 18, 2016. McMor’s sewer operations (McMor (Sewer)) is a Class D sewer utility and serves approximately 19 unmetered sewer customers<sup>4</sup> near the town of Buttonwillow in Kern County, California.<sup>5</sup>

### **Significant Accounting Policies**

The financial statements of McMor (Sewer) were prepared on the basis of accounting set forth in the Uniform System of Accounts (USOA) for Water Utilities. Regulated sewer utilities are required to prepare their financial statements on accrual basis of accounting set forth USOA adopted in Decision (D.) 16-11-006 by the CPUC on November 10, 2016, which is a comprehensive regulatory basis of accounting framework other than the generally accepted accounting principles (GAAP) in the United States of America. The followings describe certain differences in accounting treatments between GAAP and USOA, the company’s current accounting practices, and its compliance with applicable regulation and CPUC directives.

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

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

The purpose of using the USOA to prepare financial statements is to have the utilities provide financial transparency of their 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.

The USOA requires utilities to use “Straight-line remaining life method.” “Remaining life” implies that estimates of future life and salvage value will be re-evaluated periodically and that depreciation rates will be adjusted to reflect any changes in estimates. Water utilities are required to comply with the CPUC’s Standard Practice (SP) U-4-SM and SP U-4-M when determining depreciation accruals. Specifically, for the water plant with over \$100,000, the utility must

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<sup>4</sup> McMor (Sewer) Billing Register for December 29, 2021.

<sup>5</sup> CPUC D.16-08-004, Page 1.

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.

McMor (Sewer) did not carry over Accumulated Depreciation when it acquired its sewer system in 2017. McMor (Sewer) also incorrectly used an accelerated tax depreciation methodology and fully depreciated its net assets in 2017. UAB computed the depreciation using a composite depreciation rate of two percent, which is falls within industry average, to determined accumulated depreciation as of December 31, 2020. McMor (Sewer) also misclassified its accumulated depreciation in Account 108.3–Accumulated Depreciation of Sewer Plant–Other instead of reporting the Accumulated Depreciation in Account 108–Accumulated Depreciation of Sewer Plant. As a result, McMor (Sewer) understated Account 403–Depreciation Expense and Account 108–Accumulated Depreciation by \$8,107, and \$301,955, respectively, in its 2020 Annual Report; and overstated Account 108.3–Accumulated Depreciation of Sewer Plant–Other by \$51,286. However, McMor (Sewer) corrected these misstatements in its revised Annual Report submitted to the CPUC’s Water Division on August 11, 2022.

## **(2) Asset Retirement**

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

McMor (Sewer) did not retire any assets during the review period.

## **(3) Sale and Acquisition of Properties**

Under GAAP, entities recognize gain or loss from disposal of properties and recognize goodwill or gain from a bargain purchase of other entities’ segment or properties.

Under the USOA, no goodwill or gain is recognized from the sale or acquisition of a water system or unit, unless it’s approved by the CPUC’s decision. When the utility sells or purchases the water system or unit, the utility shall first record the transaction into a temperate Account 104, Water Plant Purchased or Sold. Within six months from the date of sale or date of acquisition, the utility shall file with the CPUC for approval of the proposed journal entries to clear this account. The difference between the net original cost of the assets acquired and the cost to the acquiring utility shall be charged or credited to Account 114, Water Plant Acquisition Adjustments.

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



As discussed in Findings 1 and 6 in Appendix A of this report, McMor (Sewer) has various accounting and reporting errors regarding sewer plant related accounts in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021. These accounting and reporting errors resulted in various misstatements in the following accounts. Therefore, UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting entries to correct the misstatements:

Adj. No.	Acct No.	Description	DR	CR
1	101	Water Plant in Service	\$295,067	
	215	Retained Earnings		\$295,067
4	108.1	Accumulated Amortization of SDWBA	\$16,000	
	114	Water Plant Acquisition Adjustments	27,243	
	215	Retained Earnings	42,982	
	426	Miscellaneous Non-Utility Expense	4,451	
	104	Water Plant Purchased or Sold		\$86,766
	407	SDWBA Loan Amortization Expense		4,000

McMor (Sewer) corrected the above misstatements by filing a revised 2020 Annual Report with the CPUC’s Water Division on August 11, 2022.

### 3. 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.16-08-004, the CPUC authorized McMor to enter into a ten-year loan agreement with Sears Living Trust to facilitate McMor’s acquisition of the water and sewer systems of Interstate 5 Utility Company, Inc. from the Sears Living Trust. The Decision authorized McMor to amortize the \$280,000 purchase price of the water and sewer systems at an interest rate of five percent.

As of December 31, 2020, McMor’s long-term debt allocation for its water and sewer systems were as follows:

<b>Description</b>	<b>McMor (Water)</b>	<b>McMor (Sewer)</b>	<b>Total</b>
Current Portion	\$13,036	\$18,061	\$31,097
Long-Term Portion	61,529	85,249	146,778
Total Outstanding Principle	<u>\$74,565</u>	<u>\$103,310</u>	<u>\$177,875</u>

The Long-Term Debt reported in McMor (Sewer)’s 2020 Annual Report did not agree with its loan amortization schedule and payment records. McMor (Sewer) did not classify the current portion of its Long-Term Debt as Short-Term Notes Payable. As a result, McMor (Sewer) understated Account 224–Long Term Debt, and Account 232–Short-Term Notes Payable by \$804, and \$18,061, respectively, as of December 31, 2020. McMor (Sewer) corrected this misstatement in its revised Annual Report submitted to the CPUC’s Water Division on August 11, 2022.

#### **4. Retained Earnings**

The reported Retained Earnings balance of \$50,195 as of December 31, 2020, in the accompanying financial statements are materially misstated. McMor (Sewer) reported a Retained Earnings balance of \$50,859 in its 2020 Annual Report. McMor (Sewer) understated the Retained Earnings reported in its 2020 Annual Report by \$664 due to various accounting errors and omissions that UAB identified during this review. McMor used inconsistent allocation methodologies to allocate Operating Expenses between its water and sewer operations. Although these noted errors have been corrected in the accompanying Income Statement for the year ended December 31, 2020, prior year expense allocation errors have not been corrected. McMor (Sewer)’s management has yet to determine the effects of this departure from the USOA accounting requirements on McMor (Sewer)’s financial position. Determining the cumulative effect on the Retained Earning balance as of December 31, 2020, would require UAB to go beyond the scope of this review. Therefore, we do not express a conclusion on the Retained Earning balance in the accompanying balance sheet as of December 31, 2020.

#### **5. Cash**

Cash account balance of \$9,015 in the accompanying financial statements is materially misstated. McMor uses a joint bank account for its water and sewer operations. McMor has been allocating the Cash account balance between its water and sewer operations since its inception instead of keeping its cash receipts and cash disbursements for each operation separate. This departure from the USOA materially impacts McMor (Sewer)’s Cash balance as of December 31, 2020. The effects of this departure from the USOA on McMor (Sewer)’s financial position have not been determined by its management. McMor (Sewer)’s management has yet to determine the effects of this departure from the USOA accounting requirements on McMor (Sewer)’s financial position. Determining the cumulative effect on the Cash balance as of December 31, 2020, would require UAB to go beyond the scope of this review. Therefore, we do not express a conclusion on the Cash balance in the accompanying Balance Sheet as of December 31, 2020.

## **6. Accounts Payable**

McMor (Sewer) overstated Account 231–Accounts Payable by \$10,115 in its 2020 Annual Report. McMor (Sewer) reported an Accounts Payable balance of \$10,115; however, McMor (Sewer)’s G/L and Accounts Payable Aging Report as of December 31, 2020, showed a balance of \$53,085. McMor (Sewer)’s underlying accounting records revealed that the entire liability balance that McMor (Sewer) reported in its Annual Report and recorded in its G/L is due to uncorrected accounting errors. As a result of these accounting errors, McMor (Sewer) overstated Account 231–Accounts Payable and Account 664–Other Plant Maintenance Expenses by \$10,115 and \$9,697, respectively. However, McMor (Sewer) corrected this misstatement in its revised Annual Report submitted to the CPUC’s Water Division on August 11, 2022.

## **7. Operating Revenues**

McMor (Sewer) generated approximately 99 percent of its Operating Revenues from unmetered sewer services. During our review, we noted various accounting and classification issues related to McMor (Sewer)’s Unmetered Sewer Revenues and its use of cash basis accounting instead of accrual basis accounting, as required by the accounting requirements of the USOA, when accounting for its revenues. As discussed in Finding 5 in Appendix A of this report, McMor (Sewer)’s revenue balances were materially misstated in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021. However, McMor (Sewer) agreed with and incorporated UAB’s proposed adjustments to correct the noted misstatements in its revised 2020 Annual Report submitted to the CPUC’s Water Division on August 11, 2022.

## **8. Operating Expenses**

McMor applied inconsistent allocation methodologies to allocate expenses between its water and sewer operations, which resulted in McMor (Sewer)’s Total Operating Expenses being understated by \$3,570 in its 2020 Annual Report originally filed with the CPUC’s Water Division. McMor (Sewer) could not provide any documentation to support the balance of \$18,326 in Account 688–Regulatory Commission Expense reported in its Annual Report. McMor (Sewer) also misclassified \$30,657 of payments made to its contractors as Materials in Account 640, instead of reporting it in Account 650–Contract Work. As a result, Operating Expenses were overstated by \$14,756. However, McMor (Sewer) corrected this misstatement in its revised 2020 Annual Report submitted to the CPUC’s Water Division on August 11, 2022.

## **9. Water Utility Users Fee**

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

During our review, we noted various accounting and reporting errors related to McMor (Sewer)’s CPUC Users Fee and its use of cash basis accounting instead of accrual basis accounting, as required by the accounting requirements of the USOA, when accounting for the collection and payments of

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<sup>7</sup> D.16.11-006 dated November 10, 2016, General Accounting Instructions 9 on Pages B18 and B19.

CPUC Users Fee. Finding 11 in Appendix A of this report describes the resulting misstatements in McMor (Sewer)'s 2020 Annual Report originally filed with the CPUC's Water Division on November 3, 2021. However, McMor (Sewer) agreed with and incorporated UAB's proposed adjustments to correct the noted misstatements in its revised 2020 Annual Report submitted to the CPUC's Water Division on August 11, 2022.

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

### (1) Balance Sheet

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

### (2) Income Statement

The form of Income Statement reflects the classification of revenues and expenses in ratemaking. Operating revenues and expenses are referred to as "above the line" because they are allowable in ratemaking, and the result of deducting total operating expenses from total operating revenues is the operating income. Other Income and Deductions are referred to as "below the line" because they are applied after operating income and are not allowable in ratemaking. The "below the line" items include interest revenue, dividend income, other revenues that are from non-water utility operations and/or non-water utility properties, expenses that are unrelated to water utility operations, and interest expense (the interest expense is recovered through the authorized rate of return). The concept of "above the line" revenues and expenses being allowable in ratemaking affects the form of the income statement, the classification of revenues and expenses, and decisions of management in incurring expenses.

McMor (Sewer) correctly complied with this requirement by presenting its financial statements in the form of a balance sheet and income statement.

## 11. Exclusion of Statement of Cash Flows

Financial Accounting Standards Board specifies in its Statement of Financial Accounting Standards No. 95 that a Statement of Cash Flows is part of a complete set of financial statements under GAAP. However, Codification of Statements on Auditing Standards AU-C Section 800.A35 states, in part, that, "*Special purpose financial statements may not include a statement of cash flows...*" Since the USOA is an accounting framework other than GAAP for regulatory purpose, the Statement of Cash Flows is not required and therefore excluded from this review report.

## 12. Compliance filing of 2020 Annual Report with the CPUC

PU Code, Sections 581, 582, and 584, and the CPUC's directive (i.e., Water Division's annual memorandum to water and sewer utilities) require all regulated water and sewer IOUs to file an Annual Report with the CPUC every year. For the year being reviewed, McMor (Sewer) is not in compliance with the CPUC's Annual Report filing requirement because it did not timely file its 2020

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

Annual Report. CPUC Water Division’s Memo dated January 26, 2021, requires that all water and sewer utilities file their 2020 Annual Reports with the CPUC by April 30, 2021. McMor (Sewer) did not file its Annual Report until November 3, 2021, without obtaining the approval from the CPUC Water Division for a filing extension.

## APPENDIX A—REVIEW FINDINGS AND RECOMMENDATIONS

### Finding 1: Understated Sewer Plant in Service

#### Condition:

McMor (Sewer) understated its Account 101—Sewer Plant in Service (SPIS) by \$295,067 in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021, due to the following accounting errors and omissions:

Description	Overstated/ (Understated)
McMor (Sewer) incorrectly reported its 2016 sewer system acquisition in its 2020 Annual Report and entirely omitted recording the acquisition in its General Ledger (G/L). McMor (Sewer) reported \$50,279 of SPIS in its Annual Report, representing the net book value of assets transferred to McMor (Sewer). However, McMor (Sewer) should have recorded and reported the original cost of the sewer system totaling \$373,696 in applicable plant accounts.	(\$323,417)
McMor (Sewer) erroneously added \$60,000 of goodwill to Account 301—Intangible Plant. The USOA does not allow inclusion of goodwill.	60,000
McMor (Sewer) did not report capital improvements totaling \$17,248 to its Sewer Treatment Plant in 2019 and 2020.	(17,248)
McMor (Sewer) did not report vehicles purchased for \$14,402 in 2017.	(14,402)
<b>Total</b>	<b><u>(\$295,067)</u></b>

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
1	101	Sewer Plant in Service (SPIS)	\$295,067	
	215	Retained Earnings		\$295,067
		<i>To adjust SPIS balance to agree with McMor (Sewer)’s records and to comply with the accounting requirements of the USOA.</i>		

McMor (Sewer) applied this adjusting journal entry to correct its books and submitted a revised 2020 Annual Report to the CPUC’s Water Division on August 11, 2022.

**Criteria:**

The USOA states, in part, that:

**104. Water Plant Purchased or Sold**

A. This account shall be temporarily charged with the cost and expenses incidental to acquisition of water systems acquired as operating units or systems. The account shall be temporarily credited with the selling price of water systems transferred to others.

B. Within six months from date of acquisition or sale of a water system the utility shall file with the Commission for approval proposed journal entries to clear this account.

Note A. In clearing this account, the original cost of acquired plant shall be charged to plant accounts, and accumulated depreciation shall be credited to account 108, Accumulated Depreciation of Water Plant. Any balance (representing the difference between the net original cost of the assets acquired and the cost to the acquiring utility) shall be charged or credited to account 114, Water Plant Acquisition Adjustments.

**101. Water Plant in Service**

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

101.1 Water Plant in Service – SDWBA

101.2 Water Plant in Service – Grant Funds

101.3 Water Plant in Service – Other

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

**Cause:**

McMor (Sewer) lacks monitoring and review procedures over its accounting and reporting process to ensure that transactions relating to its SPIS acquisitions and additions are accurately recorded in its books and reported in its Annual Reports.

**Effect:**

Inaccurate reporting of SPIS accounts in the Annual Report, which may be used during McMor (Sewer)'s General Rate Case (GRC) application review process, could potentially impact the sewer rates for McMor (Sewer)'s ratepayers.

**Recommendation:**

McMor (Sewer) should establish and implement monitoring and review procedures over its accounting and reporting process to ensure that SPIS acquisitions and additions are accurately recorded and reported.

**Finding 2: Understated Accumulated Depreciation****Condition:**

McMor (Sewer) understated Account 108–Accumulated Depreciation of Sewer Plant and Account 403–Depreciation Expense by \$301,955 and \$8,107, respectively, and overstated Account 108.3–Accumulated Depreciation of Sewer Plant–Other by \$51,286 in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021, due to accounting errors and omissions:

<b>Description</b>	<b>Overstated/(Understated)</b>		
	<b>Account 403</b>	<b>Account 108</b>	<b>Account 108.3</b>
McMor (Sewer) did not carry over \$270,416 of Accumulated Depreciation when it acquired its sewer system in 2016.		(\$270,416)	
In 2017, McMor (Sewer) recognized \$51,286 of Depreciation Expense using an accelerated tax depreciation methodology instead of using a depreciation methodology approved by the USOA, which yielded Depreciation Expense of \$7,762.		43,524	
McMor (Sewer) did not report any depreciation expense from 2018 to 2020 because it incorrectly fully depreciated its sewer plant in 2017 using an accelerated tax depreciation methodology. The USOA does not permit the use of accelerated depreciation methodology for regulatory purposes. As a result, McMor (Sewer) understated its Accumulated Depreciation and Depreciation Expense by \$23,777 and \$8,107, respectively, as of December 31, 2020.	(\$8,107)	(23,777)	
McMor (Sewer) incorrectly reported \$51,286 of Accumulated Depreciation of its sewer plant in Account 108.3–Accumulated Depreciation of Sewer Plant–Other instead reporting it in Account 108–Accumulated Depreciation of Sewer Plant.		(51,286)	\$51,286
<b>Total</b>	<b>(\$8,107)</b>	<b>(\$301,955)</b>	<b>\$51,286</b>

Although Depreciation Expense and Accumulated Depreciation were reported in McMor (Sewer)’s Annual Report, McMor (Sewer) did not record Accumulated Depreciation or Depreciation Expense in its G/L.



UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
2	108.3	Accumulated Depreciation of Sewer Plant–Other	\$51,286	
	215	Retained Earnings	242,562	
	403	Depreciation Expense	8,107	
	108	Accumulated Depreciation of Sewer Plant		\$301,955
		<i>To correct sewer plant assets' accumulated depreciation balance and current year depreciation expense to agree with the reviewed amounts.</i>		

McMor (Sewer) applied this adjusting journal entry to correct its books and submitted a revised 2020 Annual Report to the CPUC’s Water Division on August 11, 2022.

**Criteria:**

The USOA states in part, that:

**108. Accumulated Depreciation of Water Plant**

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

- 108.1 Accumulated Amortization of SDWBA
- 108.2 Accumulated Depreciation of Water Plant - Grant Funds
- 108.3 Accumulated Depreciation of Water Plant - Other

B. This account shall be credited with:

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

Note: Also see Account 104, Water Plant Purchased or Sold.

F. The utility is restricted in the use of this account to the purposes set forth above. It shall not transfer any portion to retained earnings or to other accounts without prior written authorization from this Commission.

Note: Refer to Paragraph 4, Accounting Instructions - Depreciation, for information on depreciation accruals and plant retirement procedures.

**403. Depreciation Expense**

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

Note A. See Accounting Instructions – Depreciation, Paragraph 4, for more detailed instructions on depreciation accounting.

### **General Accounting Instructions**

#### **4. Depreciation**

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

#### **Cause:**

McMor (Sewer) did not follow the accounting requirements of the USOA to account for its utility plant acquisition and to depreciate its assets. McMor (Sewer) lacks monitoring and review procedures over its accounting and reporting process to ensure its compliance with the accounting requirements of the USOA regarding utility plant acquisition and asset depreciation.

#### **Effect:**

Inaccurate reporting of the balances of the Depreciation and Amortization accounts in the 2020 Annual Report, which may be used during McMor (Sewer)'s GRC application review process, could potentially impact the sewer rates for McMor (Sewer)'s ratepayers.

#### **Recommendation:**

McMor (Sewer) should follow the accounting requirements of the USOA when accounting for any utility plant acquisitions and depreciating its assets. McMor (Sewer) should also establish and implement monitoring and review procedures over its accounting and reporting process to ensure that it complies with the accounting requirements of the USOA regarding utility plant acquisition and asset depreciation.

### **Finding 3: Materially Misstated of Retained Earnings**

#### **Condition:**

McMor (Sewer) reported the ending Retained Earnings balance of \$50,859 that is materially misstated in its 2020 Annual Report originally filed with the CPUC's Water Division on November 3, 2021. McMor (Sewer) overstated the Retained Earnings reported in its Annual Report by \$664 as a result of cumulative accounting errors and omissions as described throughout Appendix A. McMor also used inconsistent allocation methodologies to allocate operating expenses between its water and sewer operations although most of these expenses can be and should have been directly charged to either operation. Therefore, McMor should only allocate inextricable shared operating expenses between its water and sewer operations in rare circumstances. Since McMor (Sewer) used consistent accounting methodology in prior years, similar errors likely affected McMor (Sewer)'s Retained Earnings in prior years.

#### **Criteria:**

General Accounting Instructions 2 of the USOA 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.

#### **Cause:**

McMor (Sewer) lacks monitoring and review procedures to ensure that nonshared expenses are charged directly to its water or sewer operations. McMor (Sewer) also lacks procedures to

consistently and accurately allocate inextricable shared operating expenses between its water and sewer operations.

**Effect:**

McMor (Sewer)'s management has yet to determine the effects of this departure from the USOA accounting requirements on McMor (Sewer)'s financial position. Without performing an in-depth review of McMor (Sewer)'s historical accounting records since its inception, UAB is unable to determine the impact of prior year errors on McMor (Sewer)'s financial statements. Determining the cumulative impact on the Retained Earnings as of December 31, 2020, would require UAB to go beyond the scope of this review.

Misallocation of expenses between McMor's water and sewer operations in its Annual Report, which may be used during McMor (Sewer)'s GRC application review process, could potentially impact the sewer rates for McMor (Sewer)'s rates payers. Inaccurate reporting of Retained Earnings distorted McMor (Sewer)'s financial position as of December 31, 2020, which could impact decision makers.

**Recommendations:**

McMor should establish and implement monitoring and review procedures to ensure that nonshared expenses are charged directly to its water or sewer operations, and use consistent and accurate methodology to allocate inextricable shared expenses between its water and sewer operations.

**Finding 4: Cash Account Commingled Between Water and Sewer Operations**

**Condition:**

McMor (Sewer) materially misstated the ending cash balance of \$9,015 in Account 131–Cash in its 2020 Annual Report originally filed with the CPUC's Water Division on November 3, 2021. McMor uses a joint bank account and commingles its Cash for its water and sewer operations. McMor has been allocating the Cash account balance between its water and sewer operations since its inception instead of keeping its cash receipts and cash disbursements separately for each operation. Since McMor (Sewer) used the same joint bank account for its water and sewer operations since its inception, the same issue likely affected McMor (Sewer)'s Cash balance in prior years.

While reviewing McMor's Cash account, we also noted that McMor is not correctly performing its bank reconciliations. McMor uses QuickBooks bank reconciliation function, which requires the beginning of the period bank statement balance. For December 2020 reconciliation, the beginning bank statement balance in the QuickBooks Cash reconciliation did not agree with the actual bank statement.

McMor's G/L also includes a balance of \$79,893 in the Undeposited Funds account, which is not reported in the 2020 Annual Report. This amount is likely due to cumulative accounting errors of unreconciled items in the bank account.

**Criteria:**

General Accounting Instructions 2 of the USOA 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.

**Cause:**

McMor uses a joint bank account to handle cash transactions for both its water and sewer operations. It also lacks monitoring, review, and reconciliation procedures over its Cash account to ensure that (1) a separate Cash account is maintained for its water and sewer operations; (2) cash reconciliations are performed regularly, timely, and accurately; and (3) the Cash account balance is accurately reported in the Annual Reports.

**Effect:**

McMor (Sewer)’s management has yet to determine the effects of this departure from the USOA accounting requirements on McMor (Sewer)’s financial position. Without performing an in-depth review of McMor (Sewer)’s historical accounting records since its inception, UAB is unable determine the impact of prior year errors on McMor (Sewer)’s financial statements. Determining the cumulative impact on the Cash balance as of December 31, 2020, would require UAB to go beyond the scope of this review.

Inaccurate reporting of Cash distorted McMor (Sewer)’s financial position and available working capital as of December 31, 2020, which could potentially impact the sewer rates for McMor (Sewer)’s ratepayers during McMor (Sewer)’s GRC review process.

**Recommendations:**

McMor should use a separate bank account for its water and sewer operations to handle their respective cash transactions. McMor should also establish and implement monitoring, review, and reconciliation procedures over its Cash account to ensure that the Cash balance is properly accounted for in its books and accurately reported to the CPUC via its Annual Reports.

**Finding 5: Misclassified Unmetered Sewer Revenue**

**Condition:**

McMor (Sewer) misclassified \$143,237 of Unmetered Sewer Revenue as Other Sewer Revenue in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021. As a result, McMor understated Account 460–Unmetered Sewer Revenue by \$143,237 and overstated Account 480–Other Sewer Revenue by the same amount.

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
3	480	Other Sewer Revenue	\$143,237	
	460	Unmetered Sewer Revenue		\$143,237
		<i>To reclassify Unmetered Sewer Revenue incorrectly recorded and reported as Other Sewer Revenue</i>		

McMor (Sewer) applied these adjusting journal entries to correct its books and submitted a revised Annual Report to the CPUC’s Water Division on August 11, 2022.

**Criteria:**

The USOA States, in part, that:

**460. Unmetered Water Revenue**

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

**480. Other Water Revenue**

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

**Cause:**

McMor (Sewer) lacks monitoring and review procedures over its accounting and reporting process to ensure accurate classification of revenues.

**Effect:**

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

**Recommendation:**

McMor (Sewer) should establish and implement monitoring and review procedures over its accounting and reporting process to ensure that accurate classification of revenues.

**Finding 6: Inaccurate Reporting of Sewer Plant Acquisition Adjustments**

**Condition:**

McMor did not properly account for the acquisition of its water and sewer operations of Interstate 5 Utility Company, Inc. from the Sears Living Trust. In aggregate, McMor (Sewer) overstated Account 104–Water Plant Purchased or Sold, Account 108.1–Accumulated Amortization of SDWBA Loan, and Account 407–SDWBA Loan Amortization Expense by \$86,766, \$16,000, and \$4,000, respectively; and understated Account 114–Sewer Plant Acquisition Adjustments and Account 426–Miscellaneous Non-Utility Expense by \$27,243 and \$4,541, respectively.

McMor incorrectly reported \$78,182 that it paid above the net book value of the water and sewer system in 2016. USOA accounting instructions and CPUC D.16-08-004 required McMor to record the difference in purchase price and net book value in Account 114–Sewer Plant Acquisition Adjustment and amortize the balance in Account 426–Miscellaneous Non-Utility Expense over a ten-year period. Of the \$78,182 of Sewer Plant Acquisition Adjustment authorized by the CPUC, approximately \$45,407, or 58 percent, should be allocated to McMor's sewer operations based on the allocation of respective total value of the water and sewer system acquired by McMor. During the review, UAB noted the following accounting errors and omissions relating to the difference between the net book value and purchase price of the sewer system:

- McMor (Sewer) did not record the total of \$45,407 of Sewer Plant Acquisition Adjustments allocated to its sewer operations at the time of the acquisition in 2016. McMor (Sewer) also omitted \$18,164 ( $\$45,407 \div 10 \times 4$ ) of the related amortization expense between 2017 and 2020. As a result, McMor (Sewer) misstated the following accounts:

<b>Account</b>	<b>Overstated (Understated)</b>
Account 114–Sewer Plant Acquisition Adjustments	(\$27,243)
Account 426–Miscellaneous Non-Utility Expense	(4,541)

- McMor (Sewer) incorrectly recorded \$86,766 of goodwill in Account 104–Sewer Plant Purchased or Sold related to the acquisition of its sewer plant. Additionally, McMor (Sewer) amortized the goodwill by debiting Account 407–SDWBA Loan Amortization Expense and crediting Account 108.1–Accumulated Amortization of SDWBA Loan. Because the USOA does not allow accounting for goodwill, McMor (Sewer)’s Annual Report should not have included the \$86,766 of goodwill and the related amortization. As a result, McMor (Sewer) misstated the following accounts:

<b>Account</b>	<b>Overstated (Understated)</b>
Account 104–Sewer Plant Purchased or Sold	\$86,766
Account 108.1–Accumulated Amortization of SDWBA	16,000
Account 407–SDWBA Loan Amortization Expense	4,000

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
4	108.1	Accumulated Amortization of SDWBA	\$16,000	
	114	Sewer Plant Acquisition Adjustments	27,243	
	215	Retained Earnings	42,982	
	426	Miscellaneous Non-Utility Expense	4,541	
	104	Sewer Plant Purchased or Sold		\$86,766
	407	SDWBA Loan Amortization Expense		4,000
		<i>To remove goodwill and related amortization reported in the Annual Report and record Sewer Plant Acquisition Adjustments accumulated balance authorized by CPUC’s D.16-08-004 that was omitted in the 2020 Annual Report.</i>		

McMor (Sewer) applied this adjusting journal entry to correct its books and submitted a revised 2020 Annual Report to the CPUC’s Water Division on August 11, 2022.

**Criteria:**

The USOA states, in part, that:

**104. Water Plant Purchased or Sold**

A. This account shall be temporarily charged with the cost and expenses incidental to acquisition of water systems acquired as operating units or systems. The account shall be temporarily credited with the selling price of water systems transferred to others.

B. Within six months from date of acquisition or sale of a water system the utility shall file with the Commission for approval proposed journal entries to clear this account.

Note A. In clearing this account, the original cost of acquired plant shall be charged to plant accounts, and accumulated depreciation shall be credited to account 108, Accumulated Depreciation of Water Plant. Any balance (representing the difference between the net original cost of the assets acquired and the cost to the acquiring utility) shall be charged or credited to account 114, Water Plant Acquisition Adjustments.

Note B. When an existing water system or operating unit is acquired, the utility shall be obligated to obtain from the vendor all existing records, including records of plant construction dates and costs, and records of accumulated depreciation applicable to such properties.

**114. Water Plant Acquisition Adjustments**

A. This account shall include the difference between (1) the cost to the utility of water plant acquired as an operating unit or system by purchase, merger, or otherwise, and (2) the net of amounts distributed to the plant accounts, the accumulated depreciation account and other appropriate accounts.

B. No transfers shall be made from this account unless prior written authorization has been obtained from the Commission. If authorization is obtained to amortize the balance in this account, the contra charge shall be to Account 426, Miscellaneous Non-Utility Expense.

CPUC D.16-08-004 states, in part, that:

Since McMor is paying more than the recorded book value for the Interstate 5 Utility systems McMor should account for the difference in the purchase price amount through Account 114, the Water Plant Acquisition Account. The balance of \$78,182 should be amortized over a 10-year period through Account 426, Miscellaneous Non-Utility Expense, per the instructions provided in the Uniform System of Accounts.<sup>9</sup>

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<sup>9</sup> CPUC D.16-08-004, Page 8.

**Cause:**

McMor (Sewer) lacks monitoring and review procedures over its accounting for sewer plant acquisition to ensure its compliance with the accounting requirements specified in D.16-08-004 and the USOA.

**Effect:**

Inaccurate reporting of Accumulated Amortization of SDWBA Loan (Account 108.1), Sewer Plant Purchased or Sold (Account 104), SDWBA Loan Amortization Expense (Account 407), Sewer Plant Acquisition Adjustments (Account 114) and Miscellaneous Non-Utility Income (Account 426) distorted McMor (Sewer)’s financial position as of December 31, 2020; and could potentially impact the sewer rate for McMor (Sewer)’s ratepayers during the GRC review process.

**Recommendation:**

McMor (Sewer) should establish and implement monitoring and review procedures over its accounting for sewer plant acquisition to ensure compliance with the accounting requirements specified in D.16-08-004 and the USOA.

**Finding 7: Understatement of Short-Term and Long-Term Debt**

**Condition:**

McMor (Sewer) understated Account 232–Short-Term Notes Payable, Account 224–Long Term Debt and Account 427–Interest Expense by \$18,061, \$804, and \$1,558, respectively, in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021. Our review of McMor (Sewer)’s Long-Term Debt account revealed the following accounting errors:

<u>Description</u>	<u>Overstated/(Understated)</u>		
	<u>Account 224</u>	<u>Account 232</u>	<u>Account 427</u>
McMor (Sewer) reported a long-term debt balance of \$84,445 in its 2020 Annual Report. Its loan amortization schedule and payment records, only support a Long-Term Debt balance of \$103,310.	(\$18,865)		
McMor (Sewer) did not classify the current portion of its Long-Term Debt totaling \$18,061 as Short-Term Notes Payable.	\$18,061	(\$18,061)	
McMor did not accurately allocate Interest Expense between its water and sewer operations. McMor allocated 57 percent of total Interest Expense to its water operations and 43 percent of total Interest Expense to its sewer operations. however, 58 percent of the related long-term debt was allocated to its Sewer Plant in Service and 42 percent was allocated to its Water Plant in Service.			(\$1,558)
<b>Total</b>	<u><u>(\$804)</u></u>	<u><u>(\$18,061)</u></u>	<u><u>(\$1,558)</u></u>



Additionally, while reviewing McMor (Sewer)’s Long-Term Debt, we noted that McMor (Sewer) did not record its outstanding long-term debt as a liability in its G/L. Instead, McMor (Sewer) recorded both its interest and principal payments related to its long-term debt as an expenditure.

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
5	215	Retained Earnings	\$17,307	
	427	Interest Expense	1,558	
	224	Long-Term Debt		\$804
	232	Short-Term Notes Payable		18,061
<i>To correct the Long-Term Debt balance to agree with the loan agreement and loan payment schedule; to reclassify current portion of the Long-Term debt to Short-Term Notes Payable; and to adjust interest expense to reflect proper allocation of interest expense between the company’s water and sewer operations.</i>				

McMor (Sewer) applied this adjusting journal entry to correct its books and submitted a revised 2020 Annual Report to the CPUC’s Water Division on August 11, 2022.

**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

**Cause:**

McMor (Sewer) lacks monitoring and review procedures over the recording and reporting of long-term debt to ensure accuracy and compliance with the USOA accounting requirements and CPUC D.16-08-004.

**Effect:**

Understated Short-Term Notes Payable misstated McMor (Sewer)’s available working capital and short-term liquidity. Understated Long-Term Debt distorted McMor (Sewer)’s financial position as of December 31, 2020. Inaccurately reported Interest Expense reduces the comparability of McMor (Sewer)’s financial statements with other sewer utilities. Consistent financial presentation among sewer utilities aids decision makers in analyzing the performance and financial position of McMor (Sewer) relative to other sewer utilities in California.

**Recommendation:**

McMor (Sewer) should establish and implement monitoring and review procedures over the recording and reporting of long-term debt to ensure accuracy and compliance with the accounting requirements of the USOA.

**Finding 8: Overstated Operating Expenses**

**Condition:**

McMor (Sewer) overstated its Operating Expense by \$14,756 in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021, due to the following accounting errors:

- McMor applied inconsistent allocation methodologies to allocate expenses between its water and sewer operations. Additionally, while reviewing McMor’s supporting accounting records, we discovered that most of the operating expenses can be and should have been charged directly to either its sewer or water operations. Due to the incorrect and inconsistent allocation of operating expenses between its water and sewer operations, McMor (Sewer) misstated its operating expenses as follows:

<u>Account</u>	<u>Overstated/ (Understated)</u>
Account 640–Materials	(\$18,226)
Account 688–Regulatory Commission Expense	(1,533)
Account 615–Power	9,076
Account 650–Contract Work	7,113
<b>Total Operating Expense</b>	<b><u><u>(\$3,570)</u></u></b>

- McMor (Sewer) did not provide any documentation to support the balance of \$18,326 in Account 688– Regulatory Commission Expense reported in its Annual Report. As a result, Account 688–Regulatory Commission Expense is overstated by \$18,326.
- McMor (Sewer) misclassified \$30,657 of payments made to its contractors as Materials in Account 640, instead of reporting it as Contract Work in Account 650. As a result, McMor (Sewer) overstated Account 640–Materials by \$30,657 and understated Account 650–Contract Work by the same amount.

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
6	215	Retained Earnings	\$14,746	
	650	Contract Work	23,554	
	615	Power		\$9,076
	640	Materials		12,431
	688	Regulatory Commission Expense		16,793
		<i>To adjust Operating Expenses to reflect proper allocation between the company's water and sewer operations; to reclassify Contract Work expense incorrectly booked as Materials expense; and to remove unsubstantiated Regulatory Commission Expense.</i>		

McMor (Sewer) applied this adjusting journal entry to correct its books and submitted a revised 2020 Annual Report to the CPUC's Water Division on August 11, 2022.

**Criteria:**

The USOA states, in part, that:

**2. General Accounting Instructions**

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

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

C. Utilities may further subdivide any of the accounts provided that such subdivisions do not impair the integrity of the accounts, or they may maintain such additional accounts as are included in the Uniform System of Accounts for Class A Water Utilities.

**640. Materials**

This account shall include all materials and supplies used in operation and maintenance of the water system, other than repair and maintenance materials charged to Account 650, Contract Work and chemicals charged to Account 618, Other Volume Related Expenses.

**650. Contract Work**

This account shall include the cost of all repair and maintenance work not performed by water company employees. Examples of such expenses are pump repairs, repairs of water system leaks by local plumbers, painting of tanks by painting contractors, and testing of water by laboratories. This account shall include materials that are part

of a contract price if the cost of such materials is not separately stated, and incidental operation and maintenance expenses not chargeable to accounts 630 or 640.

**Cause:**

McMor lacks monitoring and review procedures over the accounting and reporting of its operating expenses to ensure that they are accurately charged to its water or sewer operations and properly reported in its Annual Reports for the water and sewer operations in accordance with the accounting requirements of the USOA.

**Effect:**

Inaccurate reporting of operating expenses in the Annual Report, which may be used during McMor (Sewer)’s GRC application review process, could potentially impact the sewer rates for McMor (Sewer)’s ratepayers.

**Recommendation:**

McMor should establish and implement monitoring and review procedures over its accounting and reporting of operating expense to ensure that expenses are accurately charged to its water or sewer operations and properly reported in its Annual Report for the water and sewer operations in accordance with the accounting requirements of the USOA.

**Finding 9: Understated Accounts Receivable**

**Condition:**

McMor (Sewer) understated Account 141–Accounts Receivable–Customers and Account 676–Uncollectible Accounts Expense by \$8,813 and \$5,009, respectively, in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021. These misstatements occurred because McMor (Sewer) used cash basis of accounting instead of accrual basis of accounting to record and report revenues and Accounts Receivable as required by the USOA. UAB noted the following omissions by McMor (Sewer):

Description	Account 141	Account 676
McMor (Sewer) did not accrue \$12,075 of Operating Revenues and Accounts Receivable earned during the December 2020 accounting period in its 2020 Annual Report. McMor (Sewer) also incorrectly reported \$12,075 of Operating Revenues earned in 2019 in its 2020 Annual Report.	(\$12,075)	
McMor (Sewer)’s G/L and Accounts Receivable Aging Report showed \$8,660 of Accounts Receivable from customers for its sewer operations; however, McMor (Sewer) only reported \$6,913 of Accounts Receivable in its 2020 Annual Report.	(1,747)	
McMor (Sewer) did not record or report \$5,009 of Uncollectible Accounts Expense resulting from a customer who filed for bankruptcy in 2020.	5,009	(\$5,009)
<b>Total</b>	<b>(\$8,813)</b>	<b>(\$5,009)</b>

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
7	141	Accounts Receivable–Customers	\$8,813	
	676	Uncollectible Accounts Expense	5,009	
	215	Retained Earnings		\$13,822
<i>To record the omitted Uncollectible Accounts Expense and Accounts Receivable in McMor (Sewer)'s 2020 Annual Report.</i>				

McMor (Sewer) applied this adjusting journal entry to correct its books and submitted a revised 2020 Annual Report to the CPUC’s Water Division on August 11, 2022.

**Criteria:**

The USOA states, in part, that:

**2. General Accounting Instructions**

- A. The books of account of all water utilities shall be kept by the double entry method, on an accrual basis. Each utility shall post its accounts monthly and shall close its books at the end of each calendar year.
- B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction.

**141. Accounts Receivable–Customers**

This account shall include amounts due from customers for water service.

Note: Accounts receivable other than from customers for water service shall be included in account 174, Other Current Assets, or in account 121, Non-Water Utility Property and Other Assets, as appropriate.

**Cause:**

McMor (Sewer) used cash basis of accounting to record and report its revenues and receivables. McMor (Sewer) lacks effective review and monitoring procedures to ensure that revenues are recorded and reported using accrual basis of accounting as required by the USOA.

**Effect:**

Inaccurate reporting of Accounts Receivable and Operating Revenue in its 2020 Annual Report, which may be used during McMor (Sewer)’s GRC application review process, could potentially impact the sewer rates for McMor (Sewer)’s ratepayers.

**Recommendations:**

McMor (Sewer) should update its accounting policy to ensure that revenues and receivables are recorded and reported using accrual basis of accounting. McMor (Sewer) should also establish and implement monitoring and review procedures over its accounting and reporting process to ensure compliance with the accounting requirements in the USOA.

**Finding 10: Inaccurate Recording and Reporting of Accounts Payable**

**Condition:**

McMor (Sewer) overstated Account 231–Accounts Payable by \$10,115 in its 2020 Annual Report originally filed with the CPUC’s Water Division on November 3, 2021. McMor (Sewer) reported an Accounts Payable balance of \$10,115 in its Annual Report; however, McMor (Sewer)’s G/L and Accounts Payable Aging Report showed a balance of \$53,085 as of December 31, 2020. Our review of McMor (Sewer)’s underlying accounting records revealed that the entire liability balance that McMor (Sewer) reported in its Annual Report and recorded in its G/L is due to uncorrected accounting errors. For example, McMor (Sewer) recorded and reported a duplicate accrual of an invoice for equipment used in its sewer treatment plant totaling \$9,697. McMor (Sewer) made the required payment to the vendor in December 2020 but did not correct the duplicate accrual in its accounting records. McMor (Sewer)’s accounting records also showed accounting errors in prior periods. For example, McMor (Sewer)’s Accounts Payable Aging Report showed liabilities owed to several other vendors, including a \$42,610 uncorrected accrual error in 2017. Although this balance was not reported in the Annual Report, McMor (Sewer)’s underlying accounting records relating to Accounts Payable are inaccurate. As a result of these accounting errors, McMor (Sewer) overstated Account 231–Accounts Payable and Account 664–Other Plant Maintenance Expenses by \$10,115 and \$9,697, respectively.

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting entries to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
8	231	Accounts Payable	\$10,115	
	215	Retained Earnings		\$418
	664	Other Plant Maintenance Expenses		9,697

*To adjust Accounts Payable to correct over-accrual errors.*

McMor (Sewer) applied these adjusting journal entries to correct its books and submitted a revised Annual Report to the CPUC’s Water Division on August 11, 2022.

**Criteria:**

The USOA states in part:

**2. General Accounting Instructions**

B. All books of account, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a

limited technical sense, but also all other records, reports, correspondence, memoranda and information useful in determining the facts regarding a transaction.

**231. Accounts Payable**

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

**Cause:**

McMor (Sewer) lacks monitoring and review procedures over its accounting and reporting process to prevent, detect, and timely correct accounting errors.

**Effect:**

Inaccurate reporting of Other Plant Maintenance Expenses in the Annual Report, which may be used during McMor (Sewer)’s GRC application review process, could potentially impact the sewer rates for McMor (Sewer)’s ratepayers. Inaccurate reporting of Accounts Payable (Account 231) distorted McMor (Sewer)’s financial position as of December 31, 2020, and understated its available working capital, which could impact the water rates for its ratepayers during its GRC review process.

**Recommendation:**

McMor (Sewer) should establish monitoring and review procedures over its accounting and reporting process to prevent, detect, and timely correct accounting errors.

**Finding 11: Inaccurate Recording of CPUC Users Fee**

**Condition:**

McMor (Sewer) understated Regulatory Commission Expense and Accounts Payable by \$756 and \$1,602, respectively, in its Annual Report originally filed with the CPUC’s Water Division on November 3, 2021. McMor (Sewer) incorrectly used cash basis of accounting to record and report CPUC Users Fee. McMor (Sewer) did not accrue \$1,602 of CPUC Users Fee incurred in 2020 but not paid until 2021. Additionally, McMor (Sewer) reported \$846 of CPUC Users Fee for 2019 in its 2020 Annual Report. As a result, McMor (Sewer) misstated the following accounts:

<u>Account</u>	<u>Overstated/ (Understated)</u>
Account 688–Regulatory Commission Expense	\$756
Account 231–Accounts Payable	(1,602)
Account 215–Retained Earnings	846

McMor (Sewer) also incorrectly recorded and reported the collection of \$1,613 CPUC Users Fee as a reduction to Power expense instead of reporting it as Other Sewer Revenue. As a result, McMor (Sewer) misstated the following accounts:

<u>Account</u>	<u>Overstated/ (Understated)</u>
Account 615–Power	(\$1,613)
Account 480–Other Sewer Revenue	(1,613)

UAB proposed, and McMor (Sewer) agreed and incorporated, the following adjusting journal entry to correct the misstatements identified above:

Adj. No.	Acct. No.	Description	DR	CR
9	215	Retained Earnings	\$846	
	615	Power	1,613	
	688	Regulatory Commission Expense	756	
	231	Accounts Payable		\$1,602
	480	Other Sewer Revenue		1,613
		<i>To adjust the CPUC Users Fee to agree with the company's records and to comply with the accounting requirements of the USOA.</i>		

McMor (Sewer) applied this adjusting journal entry to correct its books and submitted a revised 2020 Annual Report to the CPUC’s Water Division on August 11, 2022.

**Criteria:**

The USOA states, in part, that:

**General Accounting Instructions 2**

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

**9. Water Utility Users Fee**

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

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.

**615. Power**

This account shall include the cost of power and fuel used to operate pumps.

Note: Fuel and electricity used to heat and light offices shall be charged to Account 681, Office Supplies and Expense.



**480. Other Water Revenue**

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

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

**Cause:**

McMor (Sewer) lacks monitoring and review procedures over its accounting and reporting process to ensure compliance with the accounting requirements of the USOA.

**Effect:**

Inaccurate reporting of Accounts Payable (Account 231) distorted McMor (Sewer)'s financial position as of December 31, 2020, and understated its available working capital, which could impact the sewer rates for its ratepayers during its GRC review process. Inaccurate reporting of Other Sewer Revenue and Operating Expenses in the Annual Report, which may be used during McMor (Sewer)'s GRC review process, could also potentially impact the sewer rates for McMor (Sewer)'s ratepayers.

**Recommendation:**

McMor (Sewer) should establish and implement monitoring and review procedures to ensure compliance with the accounting requirements of the USOA.

**Finding 12: Late Filing of Annual Report**

**Condition:**

McMor (Sewer) did not comply with the CPUC's Annual Report filing requirement because it did not timely file its 2020 Annual Report. CPUC Water Division's Memo dated January 26, 2021, requires that all water and sewer utilities file their 2020 Annual Reports with the CPUC by April 30, 2021. McMor (Sewer) did not file its Annual Report until November 3, 2021, without obtaining the approval from the CPUC Water Division for a filing extension.

**Criteria:**

CPUC Water Division Memorandum dated January 26, 2021, requires that all water and sewer utilities regulated by the CPUC file their 2020 annual reports on or before April 30, 2021.

**Cause:**

McMor (Sewer) lacks monitoring and review procedures to ensure the timely filing of its 2020 Annual Report with the CPUC's Water Division.

**Effect:**

McMor (Sewer) did not comply with the filing requirements of the CPUC's Water Division regarding its 2020 Annual Report. Unavailability of the Annual Report in a timely manner could impact decision making by the CPUC's decision makers and the public.

**Recommendation:**

McMor (Sewer) should establish and implement monitoring and review procedures to ensure compliance with CPUC's Annual Report filing requirements.