



California Public Utilities Commission
Division of Water and Audits

Financial Audit of
Sereno Del Mar Water Company
Financial Statements
For the Years Ended December 31, 2011 and 2012

November 6, 2013



Acknowledgement

**The following Commission Staff contributed to the completion of this audit report:
Kayode Kajopaiye, Bernard Ayanruoh, Raymond Yin, and Beth Chia**

**Audit of Financial Statements of
Sereno Del Mar Water Company
For the Years Ended December 31, 2011 and 2012**

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PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



Independent Auditor's Report

The Utility Audit, Finance and Compliance Branch (UAFCB) of the California Public Utilities Commission (Commission) has audited the accompanying balance sheets of Sereno Del Mar Water Company (SDMWC) as of December 31, 2011 and 2012, and the related income statements for the years then ended. SDMWC's management is responsible for:

1. Completeness and accuracy of the financial statements presented in the 2011 and 2012 annual reports filed with the Commission.
2. Conformity with accounting requirements of the Commission as set forth in the Uniform System of Accounts for Class B, C and D water utilities, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

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

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

In our opinion, except for the balances of Contributions In Aid of Construction (CIAC) and Accumulated Amortization of Contributions as described in the following paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Sereno Del Mar Water Company as of December 31, 2011 and 2012, and the results of its operations and its cash flows for the years then ended, in compliance with the aforementioned accounting requirements.

Due to the lack of sufficient supporting documentation on the historical data of CIAC and Accumulated Amortization of Contributions, the UAFCB could not attest to the balances of these accounts as of December 31, 2011 and 2012. Therefore, UAFCB does not express any opinion on those balances.

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

Bernard Ayanruoh, CPA
Program and Project Supervisor
Utility Audit, Finance and Compliance Branch

**Audit of Financial Statements of
Sereno Del Mar Water Company
For the Years Ended December 31, 2011 and 2012**

Balance Sheets

	As of December 31 for the Year	
	2012	2011
ASSETS		
UTILITY PLANT		
Water Plant in Service (Note 1)	\$471,111	\$445,739
Safe Drinking Water Bond Act (SDWBA) Plant (Note 1)	250,000	250,000
Accumulated Depreciation of Water Plant (Note 1)	(215,164)	(203,386)
Accumulated Amortization of SDWBA Loan (Note 1)	<u>(121,998)</u>	<u>(109,471)</u>
Net Utility Plant	383,949	382,882
CURRENT AND ACCRUED ASSETS		
Cash	39,411	6,678
Special Accounts (Note 1)	25,837	80,802
Accounts Receivable – Customers	12,910	2,505
Receivables from Associated Companies	<u>0</u>	<u>7,500</u>
Total Current Assets	78,158	97,485
Total Assets	<u>\$462,107</u>	<u>\$480,367</u>
CAPITALIZATION AND LIABILITIES		
CORPORATE CAPITAL AND SURPLUS		
Common Stock	29,449	29,449
Other Paid-in Capital	75,000	42,000
Retained Earnings	<u>40,039</u>	<u>71,801</u>
Total Capitalization	144,488	143,250
LONG-TERM DEBT		
Long-Term Debt (Note 2)	128,002	140,529
CURRENT AND ACCRUED LIABILITIES		
Accounts Payable	0	773
Other Current Liabilities	<u>2,283</u>	<u>2,046</u>
Total Current and Accrued Liabilities	2,283	2,819
CONTRIBUTION IN AID OF CONSTRUCTION		
Contribution In Aid of Construction (Note 3)	259,276	259,229
Accumulated Amortization of Contributions (Note 3)	<u>(71,942)</u>	<u>(65,460)</u>
Net Contribution In Aid of Construction	<u>187,334</u>	<u>193,769</u>
Total Capitalization and Liabilities	<u>\$462,107</u>	<u>\$480,367</u>

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

Income Statements

	For the Year of	
	2012	2011
OPERATING REVENUES		
Metered Water Revenue (Note 1)	\$143,992	\$138,800
Approved Total Surcharge Revenue	11,205	11,189
Other Water Revenue	<u>16,920</u>	<u>10,020</u>
Total Operating Revenues	172,117	160,009
OPERATING EXPENSES		
Plant Operation and Maintenance Expenses		
Purchased Water	773	784
Power	7,477	6,401
Materials	374	49
Contract Work (Note 1)	85,954	70,830
Other Plant Maintenance Expenses	<u>21,469</u>	<u>5,767</u>
Total Plant Operation and Maintenance Expense	116,047	83,831
Administrative and General Expenses		
Office Services and Rentals (Note 1)	9,035	7,235
Office Supplies and Expenses (Note 1)	4,018	3,228
Professional Services (Note 1)	7,525	13,638
Insurance	2,553	2,951
Regulatory Commission Expense	1,049	2,018
General Expenses (Note 1)	<u>2,366</u>	<u>2,452</u>
Total Administrative and General Expenses	<u>26,546</u>	<u>31,522</u>
Total Operating Expenses	142,593	115,353
Depreciation Expense (Note 1)	5,296	4,663
SDWBA Loan Amortization Expenses (Note 1)	12,527	12,218
Taxes Other Than Income Taxes (Note 4)	5,068	6,726
State Corporate Income Tax Expense (Note 4)	<u>0</u>	<u>775</u>
Total Operating Revenue Deductions	165,484	139,735
Total Utility Operating Income	6,633	20,274
Interest Expense	<u>3,454</u>	<u>3,763</u>
Total Other Income and Deductions	3,454	3,763
Net Income	<u><u>\$3,179</u></u>	<u><u>\$16,511</u></u>

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

Statements of Retained Earnings

	For the Year of	
	2012	2011
Retained Earnings, Beginning of Year	\$71,801	(\$58,611)
CREDITS:		
Net Income	3,179	16,511
UAFCB Adjustment to Accumulated Depreciation of Water Plant and Accumulated Amortization of SDWBA Loan	150,065	154,893
UAFCB Adjustment to Accumulated Amortization of Contributions	71,942	65,460
UAFCB Adjustment to Contract Work	6,225	0
UAFCB Adjustment to Office Services and Rentals	750	0
UAFCB Adjustment to Office Supplies and Expenses	225	0
UAFCB Adjustment to Professional Services	300	0
UAFCB Adjustment to Depreciation Expense	2,001	1,368
UAFCB Adjustment to Interest Expense	10,950	4,669
UAFCB Adjustment to SDWBA Loan Amortization Expense	<u>15,980</u>	<u>23,970</u>
Total Credits	261,617	266,871
DEBITS:		
SDMWC Adjustment to Retained Earnings (Footnote 1)	(33,000)	0
UAFCB Cumulative Adjustment to Beginning Balance (Footnote 2)	(106,240)	0
UAFCB Adjustment to Depreciation Expense	(8,046)	(1,361)
UAFCB Adjustment to Contributions in Aid of Construction	<u>(146,093)</u>	<u>(135,098)</u>
Total Debits	(293,379)	(136,459)
Retained Earnings, End of Year	<u>\$40,039</u>	<u>\$71,801</u>

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

Statement of Retained Earnings Footnotes:

(1) SDMWC transferred \$33,000 from Retained Earnings to Other Paid-in Capital on January 1, 2012.

(2) This amount represents the cumulative adjustments to the reported beginning balance of Retained Earnings as of January 1, 2012. Detailed computation is shown below:

Retained Earnings as of 01/01/2012 – As Audited	\$71,801
Retained Earnings as of 01/01/2012 – As Reported	<u>(34,439)</u>
Variance – UAFCB Cumulative adjustments	<u>\$106,240</u>

Statements of Cash Flows

	For the Year of	
	2012	2011
CASH FLOW FROM OPERATING ACTIVITIES:		
Net Income (Loss)	\$3,179	\$16,511
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities		
Depreciation	5,296	4,663
SDWBA loan amortization expense	12,527	12,218
Decrease (Increase) in Special Accounts (Footnote 1)	54,965	(80,802)
Decrease (Increase) in Accounts Receivable (Footnote 2)	(10,405)	(2,505)
Decrease (Increase) in Receivables from Associated Companies (Footnote 3)	7,500	(7,500)
Increase (Decrease) in Accounts Payable (Footnote 4)	(773)	773
Increase (Decrease) in Other Current Liabilities (Footnote 5)	<u>237</u>	<u>(158,862)</u>
Net Cash Provided by Operating Activities	72,526	(215,504)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net Plant Additions	(25,372)	(6,904)
Increase (Decrease) in Accumulated Depreciation of Water Plant (Footnote 6)	6,482	(236,578)
Increase in Accumulated Amortization of SDWBA Loan (Footnote 7)	0	97,253
Increase in Contributions In Aid of Construction (Footnote 8)	47	128,474
Decrease in Accumulated Amortization of Constructions (Footnote 9)	<u>(6,482)</u>	<u>(65,460)</u>
Net Cash Used for Investing Activities	(25,325)	(83,215)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (Decrease) in Long-Term Debt (Footnote 5)	(12,527)	140,529
Increase (Decrease) in Other Paid In Capital (Footnote 10)	33,000	(25,000)
UAFCB Adjustments to Retained Earnings (Footnote 11)	<u>(34,941)</u>	<u>113,901</u>
Net Cash Used for Financing Activities	(14,468)	229,430
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	32,733	(69,289)
CASH AT BEGINNING OF YEAR	<u>6,678</u>	<u>75,967</u>
CASH AT END OF YEAR	<u>\$39,411</u>	<u>\$6,678</u>

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

Statement of Cash Flow Footnotes:

- (1) UAFCB reclassified the utility's facility fees of \$58,082 and \$8,129 from Cash account to Special Deposits account in 2011 and 2012, respectively, and adjusted for the Special Deposit account by including the California Trust Bank balance of \$22,720 and \$17,708 in 2011 and 2012, respectively.
- (2) UAFCB accrued \$2,505 and \$12,910 in Other Water Revenue account for the Carmet's share of treatment plant's operating and maintenance cost in 2011 and 2012, respectively.

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- (3) UAFCB adjusted the January 2012 payment to Russian River Utility for the operation and administration services of \$7,500 in 2011 and reversed the transaction in 2012.
- (4) UAFCB accrued the excess water delivered costs of \$773 in 2011 and none in 2012.
- (5) UAFCB reclassified \$146,676 from Current Liabilities account to Long-term Debt account and Accumulated Amortization of SDWBA Loan account in 2011. Cash flows changes in 2011 were outflow of \$158,862 and inflow of \$140,529 for Other Current Liabilities and Long-term Debt accounts, respectively. The cash flows change of \$12,527 in 2012 was due to the 2012 amortization expense of SDWBA loan.
- (6) UAFCB adjusted \$247,249 from the Accumulated Depreciation of Water Plant account in 2011 to Retained Earnings account, which caused cash an outflow of \$231,915 in 2011. The total cash flows change in 2011 was an outflow of \$236,578 (-\$231,915-depreciation expense of \$4,663).
- (7) UAFCB adjusted Accumulated Amortization of SDWBA loan balance of \$109,471 in 2011. The total cash flows change in 2011 was an inflow of \$97,253 (\$109,471-amortization expense of \$12,218).
- (8) UAFCB adjusted \$135,097 to the Contributions In Aid of Construction account in 2011, which has resulted a net cash inflow of \$128,474 for 2011.
- (9) UAFCB adjusted \$65,460 to the Accumulated Amortization of Contributions account in 2011 which has resulted a net cash outflow of \$65,460 for 2011.
- (10) On September 22, 2011, SDMWC disbursed \$25,000 dividend to shareholders. In January 1, 2012, SDMWC made a fund transfer of \$33,000 from Retained Earnings account to Other Paid-in Capital account.
- (11) UAFCB's adjustments to retained Earnings of \$113,901 and (\$42,441) for 2011 and 2012, respectively, did not include the net income of \$16,511 and \$3,179 for 2011 and 2012, respectively.

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

Notes to Financial Statements

(1) Summary of Significant Accounting Policies

Sereno Del Mar Water Company (SDMWC) was incorporated in the State of California on January 2, 1969. SDMWC is a Class D water utility serving 168 metered customers in Sereno Del Mar, Subdivisions I, II, III, Sonoma County, California. SDMWC is wholly owned by Russian River Utility Company (RRU). In its Decision (D.)99-10-005 dated October 7, 1999, the California Public Utilities Commission (Commission) authorized RRU to acquire SDMWC to continue SDMWC's existing service.

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

(a) Water Plant

Utility plant is recorded at original cost when it is first constructed or purchased. Retired utility plants were removed from utility plant accounts at cost and charged against accumulated depreciation.

(b) SDWBA Plant

SDMWC built a water treatment plant in 2001 for \$250,000 using the Safe Drinking Water Bond Act (SDWBA) loan from the State Department of Water Resources (DWR).

(c) Depreciation of Water Plant

Depreciation is computed on a straight-line composite rate of 2.5% (equivalent to depreciating the plant assets over 40 years) to depreciate all of its plant assets for ratemaking purpose and for reporting the depreciation expense in its Annual Reports filed with the Commission.

(d) Amortization of SDWBA Loan

The SDWBA loan of \$250,000 from DWR carries an interest rate of 2.5132% per annum. The loan has been amortized over 20 years beginning July 2002. The principal payment to the DWR was reported as SDWBA loan amortization expense.

(e) Special Accounts

The special account balances represent the cash balances collected by SDMWC via special surcharges from its customers. The purpose of the special surcharge was to fund the repayments of the SDWBA loan and facility fees assessment.

(f) Revenues

All SDMWC's customers are metered and billed on a monthly basis. SDMWC computed its water revenues and SDWBA loan surcharge revenues based on tariffs approved by the Commission.

SDMWC billed Carmet-By-The-Sea Water Company (Carmet) for the treatment and supply of potable water on a quarterly basis in accordance with the agreement executed in 2002.

(g) Allocated Operating Services Expenses

SDMWC paid monthly operating services fees of \$6,000 and \$7,500 in 2011 and 2012, respectively, to RRU for performing services in operation and maintenance of water system, providing office space and staff, office supplies, and civil engineer services. SDMWC allocated this monthly services fee to expenses of contract work, office services and rentals, office supplies and expenses, and professional services, respectively.

(h) General Expenses

SDMWC agreed to pay a sinking fund of \$1,500 annually to RRU for the purpose of reserving fund for major improvement at the treatment plant. SDMWC recorded this sinking fund payment in General Expenses account in 2011 and 2012.

(2) Long-term Debt

In May of 2000, SDMWC obtained a loan from the DWR to finance a treatment plant in compliance with the SDWBA. The original amount consists of a secured loan of \$250,000, which carries an annual interest rate of 2.5132% and to be amortized over 20 years. As of December 31, 2012, the loan has a principal balance of \$128,002.

(3) Contributions In Aid of Construction (CIAC) and Accumulated Amortization of Contributions

CIAC represents nonrefundable contributions of cash or property received from various parties for purposes of constructing additions to utility plant. Depreciation applicable to such contributed plant is charged against the CIAC account rather than to depreciation expense until the amount applicable to such properties has been completely amortized.

Due to the lack of sufficient supporting documentation on the historical data of CIAC and Accumulated Amortization of Contributions, the Commission staff could not attest to the balances of CIAC and Accumulated Amortization of Contributions as of December 31, 2011 and 2012. Therefore, UAFCB does not express an opinion on the accuracy of such

balances reported by SDMWC in its 2011 and 2012 Annual Reports filed with the Commission.

(4) Income Taxes

SDMWC was not liable for any income taxes to Federal or State governments because RRU filed consolidated tax returns with the Federal and State governments every year. SDMWC paid an estimated California Corporate Franchise Tax of \$775 to the California Franchise Tax Board in 2011.

(5) Annual Reports

Per California Public Utilities Code, Sections 581, 582, and 584, SDMWC is required to file an annual report with the Commission every year. For the years being audited, SDMWC has complied with these requirements.