



California Public Utilities Commission
Division of Water and Audits

**Financial Audit Report of
The Sea Ranch Water Company Inc.
Financial Statements
For the Years Ended December 31, 2012 and 2013**

U -126-W

October 19, 2015



Acknowledgement

**The following Commission Staff contributed to the completion of this audit report:
Kayode Kajopaiye, Bernard Ayanruoh, Vic Khai Duong, Joyce De Rossett and
Beverly Sligh**

**Audit of Financial Statements of
The Sea Ranch Water Company, Inc.
For the Years Ended December 31, 2012 and 2013**

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PUBLIC UTILITIES COMMISSION

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SAN FRANCISCO, CA 94102-3298

**Report of Independent Auditors****The Board of Directors****The Sea Ranch Water Company Inc. (TSRWC)****Report on the Financial Statements**

The Utility Audit, Finance and Compliance Branch (UAFCB) of the California Public Utilities Commission audited the accompanying financial statements of The Sea Ranch Water Company Inc., which comprise the balance sheets as of December 31, 2012 and 2013, and the related statements of income and the retained earnings for the years then ended, and prepared the cash flows and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

The Sea Ranch Water Company Inc.'s management is responsible for the preparation and fair presentation of the financial statements presented in the 2012 and 2013 annual reports filed with the Commission in accordance with the accounting requirements of the California Public Utilities Commission as set forth in the Uniform System of Accounts for Water Utilities, described in Note 1. Management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error.

Auditor's Responsibility

The responsibility of the UAFCB is to express an opinion on The Sea Ranch Water Company Inc.'s financial statements based on the 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.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Sea Ranch Water Company Inc. as of December 31, 2012 and 2013, and the results of its operations and its cash flows for the years then ended, in accordance with the accounting requirements of the California Public Utilities Commission as set forth in the Uniform System of Accounts for Water Utilities, described in Note 1.

Basis of Accounting

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared by The Sea Ranch Water Company Inc. on the basis of the accounting requirements of the California Public Utilities Commission as set forth in the Uniform System of Accounts for Water Utilities, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Use of Report

The report is intended solely for the information and use by the Commission and The Sea Ranch Water Company Inc. Based on TSRWC's request, the use of this report is also extended to its lender, Rabobank, so that TRSWC may remain in compliance with existing loan covenants. 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

Balance Sheets

	As of December 31 for the Year	
	2013	2012
ASSETS AND DEFERRED CHARGES		
UTILITY PLANT		
Water Plant in Service (Note 1)	\$17,080,106	\$10,195,301
Water Plant Construction Work in Progress (CWIP) (Note 1)	179,663	1,910,619
Accumulated Depreciation of Water Plant (Note 1)	<u>(4,539,205)</u>	<u>(4,229,274)</u>
Net Utility Plant	12,720,564	7,876,646
CURRENT AND ACCRUED ASSETS		
Cash	140,171	11,053
Special Accounts (Note 1)	2,153,996	6,538,411
Accounts Receivable - Customers	216,312	117,500
Other Current Assets	109,484	29,233
Total Current and Accrued Assets	<u>2,619,963</u>	<u>6,696,197</u>
Deferred Charges (Note 1)	311,794	342,166
Total Assets and Deferred Charges	<u>\$15,652,321</u>	<u>\$14,915,009</u>
LIABILITIES AND OTHER CREDITS		
CORPORATE CAPITAL AND SURPLUS		
Common Stock	145,900	145,900
Other Paid-in Capital	505,514	505,514
Retained Earnings	1,494,270	809,306
Total Corporate Capital and Retained Earnings	<u>2,145,684</u>	<u>1,460,720</u>
LONG-TERM DEBT		
Long-Term Debt (Note 2)	7,321,376	7,500,000
Advance from Associated Companies	23,677	73,460
Net Long-Term Debt	<u>7,345,053</u>	<u>7,573,460</u>
CURRENT AND ACCRUED LIABILITIES		
Accounts Payable	227,263	92,165
Short Term Notes Payable	153,905	200,000
Accrued Taxes	186,601	58,056
Payables To Associated Companies	100,770	85,443
Accrued Interest	17,155	24,783
Other Current Liabilities	234,923	86,203
Accumulated Deferred Income Taxes – Current (Note 5)	9,182	25,354
Total Current and Accrued Liabilities	<u>929,799</u>	<u>572,004</u>
DEFERRED CREDITS		
Other Credits – Deferred Revenue – Unused RRF (Note 4)	476,308	420,668
Accumulated Deferred Income Taxes – Other (Note 5)	<u>168,898</u>	<u>129,257</u>
Total Deferred Credits	645,206	549,925
CONTRIBUTION IN AID OF CONSTRUCTION		
Contribution In Aid of Construction (CIAC) (Note 3)	8,448,773	8,393,720
Accumulated Amortization of Contributions	<u>(3,862,194)</u>	<u>(3,634,820)</u>
Net Contribution In Aid of Construction	4,586,579	4,758,900
Total Liabilities and Other Credits	<u>\$15,652,321</u>	<u>\$14,915,009</u>

(The accompanying notes and summary of audit adjustments are an integral part of these Financial Statements)

Income Statements

	For the Year of	
	2013	2012
OPERATING REVENUES		
Irrigation Water Revenue	\$6,302	\$4,825
Metered Water Revenue	2,316,332	1,247,102
Other Water Revenue	3,383	10,753
Total Operating Revenues (Note 1)	<u>2,326,017</u>	<u>1,262,680</u>
OPERATING EXPENSES		
Plant Operation and Maintenance Expenses		
Purchased Water		
Power	43,843	42,992
Other Volume Related expenses	24,411	22,822
Employee Labor	233,699	192,113
Materials	4,568	2,880
Contract Work	66,598	27,463
Transportation Expenses	18,391	26,666
Other Plant Maintenance Expenses	39,713	38,227
Total Plant Operation and Maintenance Expense	<u>431,223</u>	<u>353,163</u>
Administrative and General Expenses		
Office Salaries	35,579	35,506
Management Salaries	129,430	134,156
Employee Pensions and Benefits	114,613	116,126
Uncollectible Accounts Expense/(Recovery)	1,366	402
Office Services and Rentals	25,508	22,037
Office Supplies and Expenses	37,829	25,822
Professional Services	19,993	35,049
Insurance	111,095	102,369
General Expenses	42,020	41,672
Regulatory Commission Expense	10,779	19,832
Total Administrative and General Expenses	<u>528,212</u>	<u>532,971</u>
Net Administrative and General Expenses	<u>528,212</u>	<u>532,971</u>
Total Operating Expenses (Note 1)	<u>959,435</u>	<u>886,134</u>
Depreciation Expense	131,347	32,783
State Corporate Income Taxes	100,640	28,480
Federal Corporate Income Taxes (Note 5 and 6)	352,861	97,789
Taxes Other Than Income Taxes	62,610	60,111
Total Operating Revenue Deductions	<u>1,606,893</u>	<u>1,105,297</u>
Total Utility Operating Income	<u>719,124</u>	<u>157,383</u>
Non-Utility Income	133,705	82,337
Interest Expense	(167,861)	(43,816)
Total Other Income and Deductions	<u>(34,156)</u>	<u>38,521</u>
Net Income (rounded)	<u>\$684,967</u>	<u>\$195,902</u>

(The accompanying notes and summary of audit adjustments are an integral part of these Financial Statements)

Statements of Retained Earnings

	For the Year of	
	2013	2012
Retained Earnings, Beginning of Year	\$809,306	\$613,404
CREDITS:		
Net Income (rounded)	684,967	195,902
UAFCB Adjustment to Accumulated Depreciation Water Plant	(3)	0
Total Credits	684,964	809,306
DEBITS:		
Dividends for the period	0	0
Total Debits	0	0
Retained Earnings, End of Year (rounded)	<u>\$1,494,270</u>	<u>\$809,306</u>

(The accompanying notes and summary of audit adjustments are an integral part of these Financial Statements)

Statements of Cash Flows

	For the Year of	
	2013	2012
CASH FLOW FROM OPERATING ACTIVITIES:		
Net Income (Loss)	\$684,967	\$195,902
Adjustments to Reconcile Net Income to Cash		
Provided by Operating Activities		
Depreciation	309,930	192,907
Decrease (Increase) in Accounts Receivable	(98,812)	(8,095)
Decrease (Increase) in Other Current Assets	(80,251)	1,837
Decrease (Increase) in Deferred Charges (Note 1)	30,372	(342,166)
Decrease (Increase) in Accum. Def. Income Taxes - Other	39,641	(43,770)
Decrease (Increase) in Accum. Def. Income Taxes - Current	(16,172)	25,354
Increase (Decrease) in Accounts Payable	135,098	(126,756)
Increase (Decrease) in Payables to Associated Companies	15,327	85,443
Increase (Decrease) in Accrued Taxes	128,545	58,056
Increase Other Current Liabilities	148,720	7,411
Increase (Decrease) in Other Credits - (RRF)	55,640	420,668
Net Cash Provided by Operating Activities	<u>1,353,005</u>	<u>466,791</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net Plant Additions (Note 1)	(6,884,805)	(230,824)
Decrease (Increase) in Special Accounts	4,384,415	(6,162,504)
Increase (Decrease) in Water Plant CWIP	1,730,957	(959,745)
Deferred CIAC RRF	0	(367,986)
Contributions in Aid of Construction	55,053	50,944
Accumulated Amort. of Contributions	(227,374)	(160,122)
Net Cash Used for Investing Activities	<u>(941,754)</u>	<u>(7,830,237)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (Decrease) in Short-Term Notes Payable	(46,095)	(200,000)
Increase (Decrease) in Accrued Interest	(7,628)	7,536
Increase (Decrease) in Long-Term Debt	(178,624)	7,500,000
Increase (Decrease) in Other Paid in Capital	0	(265,000)
Increase (Decrease) in Advances from Associated Companies	(49,783)	(92,981)
SWRC Adjustments to Retained Earnings – Dividends and others	(3)	0
Net Cash Used for Financing Activities	<u>(282,133)</u>	<u>6,949,555</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	129,118	(413,891)
CASH AT BEGINNING OF YEAR	<u>11,053</u>	<u>424,944</u>
CASH AT END OF YEAR	<u>\$140,171</u>	<u>\$11,053</u>

(The accompanying notes and summary of audit adjustments are an integral part of these Financial Statements)

Notes to Financial Statements

(1) Summary of Significant Accounting Policies

The Sea Ranch Water Company Inc. (TSRWC), a Class C water utility under the State of California Public Utilities Commission's (Commission) jurisdiction, is a fully-owned subsidiary of The Sea Ranch Association (TSRA). The majority of TSRWC's customers are voting members of TSRA. However, TSRWC remains a regulated water utility under the Commission's jurisdiction. TSRWC also serves other customers that are not members of TSRA. TSRWC water utility currently serves 1,849 metered customers and two irrigation customers in the Sea Ranch area, which is located approximately 7 miles southeast of Gualala in Sonoma County.

TSRWC has prepared the accompanying Balance Sheets, Income Statements, and Statements of Retained Earnings 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 and depreciation related to prior years are recorded directly in the statements of retained earnings. Accounting principles generally accepted in the United States of America would require such transactions to be recorded in the income statements. A Statement of Cash Flows is not required by the Commission when TSRWC files its annual reports with the Commission. Therefore, the accompanying Statements of Cash Flows were compiled by the UAFCB based on the financial information in TSRWC's Balance Sheets and Income Statements.

(a) Utility Plant

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

TSRWC has constructed a one million gallon reservoir/tank and accompanying infrastructure between 2010 and 2014. Some of this project's expenditures are initially recorded in Water Plant Construction Work in Progress (CWIP).

(b) Capitalized Interest

Interest costs incurred on debt used to construct fixed assets are capitalized as part of the overall cost of construction.

(c) Depreciation

Depreciation is computed on a straight-line basis to depreciate all of its plant assets for ratemaking purpose and for reporting the depreciation expense in its Annual Reports filed with the Commission. The composite rate is 2.40% for Year 2012 and 2.70% for Year 2013, respectively.

(d) Special Accounts

The special account represents funds earmarked for specific purposes. TSRWC special accounts are:

- Project construction account
- Project – construction reserve
- Facilities fees
- Reserve Replacement Fund (RRF)

(e) Deferred Charges

TSRWC's deferred charges consist primarily of financing costs for long-term debt and prepaid items such as insurance, rent and interest that are pending amortization for future period under the approval of the Commission that may be recovered through future surcharges.

(f) Revenues

All TSRWC's customers are metered and they are billed on a bi-monthly basis. TSRWC computes its water revenues based on tariffs approved by the Commission. TSRWC's revenues consist of:

- Irrigation
- Metered Water
- Other Revenues

(g) Allocated Administrative Expenses

The Sea Ranch Association (TSRA) bills TSRWC every month for the following expenses: Rent, Insurance, Payroll and Employee Pensions and Benefits. Except for executive and management costs, these corporate administrative expenses are being allocated to TSRWC based on number of employees for labor benefits and based on recovery of costs as analyzed every several years for rent. In total, \$1,148,278 had been charged by TSRA to TSRWC in 2013 and \$ 1,019,510 in 2012.

(2) Long-term Debts

As of December 31, 2013, TSRWC has the following Long-term Debts:

<u>Description</u>	<u>Outstanding Balance As of December 31, 2013</u>
Commercial Loan – Rabobank	\$7,321,376
Advances from Associated Companies	<u>\$23,677</u>
	<u>\$7,345,053</u>

(a) Rabo Bank Loan

On February 25, 2010, the Commission authorized TSRWC to obtain debt financing of \$7,500,000 to fund its water plant infrastructure capital improvements. On October 23, 2012, TSRWC entered into an agreement with Rabobank for a loan, up to \$7,500,000, to finance its water plant construction project. This loan carries an annual Libor interest rate of 2.5% during the construction period and is to be repaid within sixteen years.

(b) Advances from Associated Companies

Other long-term loan arrangements by TSRWC are notes payable to Sea Ranch Association for tank maintenance and meter service of \$23,677. The debt instrument was approved by the Commission on August 30, 2014 through Resolution W-4492 and has a monthly payment of \$1,520 consisting of principal and interest, with an interest rate of 4.02% to be paid through May 1, 2015.

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

CIAC represent 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.

The assets consist of water mains, hydrants, service and pumping equipment, pipes and are included in the classification of 'Utility Plant' on the balance sheet. Furthermore, the TSRA has contributed funding for the expedited removal and replacement of polybutylene pipes and a hydraulic model. Contribution in Aid of Construction is subject to amortization which reduces the carrying value of these contributed assets.

(4) Replacement Reserve Fund (RRF)

In addition to developer and TSRA contributed assets, contributions are made by customers for the purpose of funding a Replacement Reserve Fund (the "RRF"). The RRF is restricted for the purpose of repairing and replacing components of the water system as they wear out or are damaged. Amounts expended from RRF to replace water system components are capitalized in the Utility Plant assets account and are offset as a credit to the "Contributions in Aid of Construction – Structure and Plant account – RRF. There is no sunset clause on the authorized RRF surcharges.

(5) Deferred Income Taxes

TSRWC recorded deferred tax liability of \$154,611 for 2012 and \$178,080 for 2013, respectively. The deferred tax liability represents the difference between book income and taxable income resulting from the use of accelerated depreciation for tax purposes. The deferred tax liability will be amortized over the life of the depreciable asset's life. The current year tax provision is based on the corporation's actual tax filing expense.

(6) Income Taxes

TSRWC has federal income tax expenses of \$97,789 for 2012 and \$352,861 for 2013. The State income tax expenses were \$28,480 for 2012 and \$100,640 for 2013.

(7) Annual Reports

California Public Utilities Code Sections 581, 582, and 584 require utilities to file an annual report with the Commission every year. For the years being audited, TSRWC has complied with these requirements. Per General Order 24-C, TSRWC is required to report semi-annually activities related to its long term debt. However for the years audited, TSRWC did not comply with this General Order. According to TSRWC, the company was unaware of this reporting requirement but intends to fully comply in the future.