



**California Public Utilities Commission**  
*Division of Water and Audits*

**Financial Audit of**  
**California Utilities Service, Inc.**  
**Financial Statements**  
**For the Years Ended December 31, 2014 and 2015**

**December 28, 2016**



## **Acknowledgement**

**The following Commission Staff contributed to the completion of this audit report:  
Kayode Kajopaiye, Raymond Yin, and Khai Duong**

**Audit of Financial Statements of  
California Utilities Service, Inc.  
For the Years Ended December 31, 2014 and 2015**

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**PUBLIC UTILITIES COMMISSION**

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



## **Report of Independent Auditors**

Thomas R. Adcock, President  
California Utilities Service, Inc.  
P.O. Box 5100  
Salinas, CA 93915

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

The Utility Audit, Finance and Compliance Branch (UAFCB) of the California Public Utilities Commission (Commission) has audited the accompanying financial statements of California Utilities Service, Inc. (CUS), which are comprised of the balance sheets as of December 31, 2014 and 2015, and the related statements of income, retained earnings and cash flows for the years then ended, and the related notes to the financial statements.

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

CUS's management is responsible for the preparation and fair presentation of the financial statements presented in the 2014 and 2015 annual reports filed with the Commission. The Commission requires that the statements be in accordance with the accounting requirements of the Commission as set forth in the Uniform System of Accounts (USOA) for Water Utilities, as described in Note 1 to the Notes to the Financial Statements attached herein. 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 CUS's financial statements based on our audits. 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, except for the balances of Short-Term Debt and Retained Earnings as described in the following paragraphs, the financial statements referred to above present fairly, in all material respects, the financial position of California Utilities Service, Inc. as of December 31, 2014 and 2015, and the results of its operations and its cash flows for the years then ended, in accordance with the accounting requirements of the Commission as set forth in the USOA for Water Utilities, described in Note 1.

As described in Note 2, UAFCB does not express an opinion on the Short-Term Debt balances which are outstanding more than twelve (12) months due to CUS's non-compliance with Public Utilities Code, Section 818.

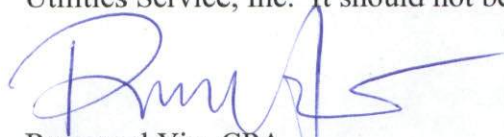
As described in Note 1, UAFCB does not express an opinion on the Retained Earnings account as of December 31, 2015 and 2014. Due to the lack of historical information, UAFCB could not attest to these balances.

### **Basis of Accounting**

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements of CUS were originally prepared on an accrual basis of accounting as required by the USOA or Generally Accepted Accounting Principles (GAAP) but do have some minor exceptions. The corrections on the reported financial statements were achieved via audit adjustments by the UAFCB.

### **Use of Report**

The report is intended solely for the information and use by the Commission and California Utilities Service, Inc. It should not be used by anyone other than the specified parties.



Raymond Yin, CPA  
Program and Project Supervisor  
Utility Audit, Finance and Compliance Branch

**Audit of Financial Statements of  
California Utilities Service, Inc.  
For the Years Ended December 31, 2014 and 2015**

**Balance Sheets**

	<b>As of December 31 for the Year</b>	
	<b>2015</b>	<b>2014</b>
<b>ASSETS</b>		
<b>UTILITY PLANT</b>		
Sewer Plant in Service (Note 1)	\$5,126,098	\$5,083,452
Sewer Plant held for future use	6,096	6,096
Construction Work in Progress – Sewer Plant	6,612	6,612
Accumulated Depreciation of Water Plant (Note 1)	<u>(3,652,233)</u>	<u>(3,457,792)</u>
<i>Net Utility Plant</i>	<b>\$1,486,573</b>	<b>\$1,638,368</b>
<b>CURRENT AND ACCRUED ASSETS</b>		
Cash	34,181	108,638
Accounts Receivable – Customers	18,605	3,636
Accumulated Provision for Uncollectible	(3,007)	(1,337)
Material and Supplies	2,645	2,450
Other Current Assets	47,132	43,915
Deferred Assets	<u>17,106</u>	<u>18,293</u>
<i>Total Current and Accrued Assets</i>	116,662	175,595
<b>Total Assets</b>	<b><u>\$1,603,235</u></b>	<b><u>\$1,813,963</u></b>
<b>CAPITALIZATION AND LIABILITIES</b>		
<b>CORPORATE CAPITAL AND SURPLUS</b>		
Common Stock	\$10,000	\$10,000
Retained Earnings (Note 1)	<u>28,006</u>	<u>(4,542)</u>
<i>Total Capitalization</i>	38,006	5,458
<b>LONG-TERM DEBT</b>		
Long Term Debt (Note 3)	0	96,862
<b>CURRENT AND ACCRUED LIABILITIES</b>		
Accounts Payable	140,311	331,357
Short-Term Note Payable (Note 2)	600,000	600,000
Customer Deposits	231	231
Accrued Taxes	21,991	13,842
Payable to Affiliated Companies	189,567	15,098
Other Current Liabilities	<u>58,498</u>	<u>57,412</u>
<i>Total Current and Accrued Liabilities</i>	1,010,598	1,017,940
<b>CONTRIBUTION IN AID OF CONSTRUCTION</b>		
Contribution in Aid of Construction (Note 4)	3,327,812	3,326,951
Accumulated Amortization of Contribution	<u>(2,883,390)</u>	<u>(2,752,724)</u>
<i>Net Contribution in Aid of Construction</i>	444,422	574,227
<b>OTHER CREDITS</b>		
Other Credits	430	430
Accumulated Deferred Income Taxes - ACRS	<u>109,779</u>	<u>119,046</u>
<i>Total Other Credits</i>	110,209	119,476
<b>Total Capitalization and Liabilities</b>	<b><u>\$1,603,235</u></b>	<b><u>\$1,813,963</u></b>

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*

## Income Statements

	<b>For the Year of</b>	
	<b>2015</b>	<b>2014</b>
<b>OPERATING REVENUES</b>		
Unmetered Sewer Revenue	<u>\$1,745,210</u>	<u>\$1,723,281</u>
<b>Total Operating Revenues</b> (Note 1)	1,745,210	1,723,281
<b>OPERATING EXPENSES</b>		
<b>Plant Operation and Maintenance Expenses</b>		
Power	73,453	71,592
Other Volume Related Expenses	1,733	3,512
Employee Labor	165,046	173,638
Materials	23,027	24,303
Contract Work	352,326	446,996
Transportation Expenses	182,179	197,418
Other Plant Maintenance Expenses	<u>60,153</u>	<u>63,549</u>
<b>Total Plant Operation and Maintenance Expense</b>	857,917	981,008
<b>Administrative and General Expenses</b>		
Office Salaries (Note 1)	107,724	105,988
Management Salaries	113,112	111,612
Employee Pensions and Benefits (Note 1)	162,341	155,243
Uncollectible Account Expense	1,670	1,337
Office Services and Rentals	13,405	13,854
Office Supplies and Expenses (Note 1)	48,033	47,717
Professional Services	93,191	63,303
Insurance	83,153	73,445
General Expenses	<u>6,141</u>	<u>18,751</u>
<b>Total Administrative and General Expenses</b>	<u>628,770</u>	<u>591,250</u>
<b>Total Operating Expenses</b>	1,486,687	1,572,258
Depreciation Expense (Note 1)	63,775	62,842
Taxes Other Than Income Taxes	82,260	87,562
State Corporate Income Tax Expense	2,950	800
Federal Corporate Income Tax Expense	<u>4,562</u>	<u>0</u>
<b>Total Operating Revenue Deductions</b>	1,640,234	1,723,462
<b>Total Utility Operating Income</b>	104,976	(181)
Non-Utility Income	18,673	9,447
Non-Utility Expense	(250)	0
Interest Expense	<u>(90,853)</u>	<u>(93,668)</u>
<b>Total Other Income and Deductions</b>	(72,430)	(84,221)
<b>Net Income</b>	<u>\$32,546</u>	<u>(\$84,402)</u>

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*

**Statements of Retained Earnings**

	For the Year of	
	2015	2014
<b>Retained Earnings, Beginning of Year</b>	(\$4,542)	\$79,860
<b>CREDITS:</b>		
UAFCB Rounding Adjustment	2	0
Net Income	<u>32,546</u>	<u>(84,402)</u>
<b>Total Credits</b>	32,548	(84,402)
<b>Retained Earnings, End of Year</b>	<u>\$28,006</u>	<u>(\$4,542)</u>

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*



## Statements of Cash Flows

	For the Year of	
	2015	2014
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>		
Net Income	\$32,546	(\$84,402)
<b>Adjustments to Reconcile Net Income to Cash Provided by Operating Activities</b>		
Depreciation and Amortization	63,775	62,842
Decrease in Special Accounts	0	7,443
Accumulated Provision for Uncollectible Accounts	1,670	(8,776)
Decrease (Increase) in Accounts Receivable - Customers	(14,968)	35,108
Decrease (Increase) in Material and Supplies	(195)	(212)
Decrease (Increase) in Other Current Assets	(3,217)	(9,420)
Decrease in Deferred Charges	1,187	16,678
Increase (Decrease) in Accounts Payable	(191,046)	186,552
Increase (Decrease) in Accrued Taxes	8,149	(29,930)
Increase (Decrease) in Other Current Liabilities	1,087	(6,770)
Decrease in Other Credits	(9,267)	(6,326)
<b>Net Cash Provided by Operating Activities</b>	<u>(110,279)</u>	<u>162,787</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Net Plant Additions	(42,646)	(5,756)
Increase in Contributions in Aid of Construction	<u>861</u>	<u>0</u>
<b>Net Cash Used for Investing Activities</b>	<u>(41,785)</u>	<u>(5,756)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Increase (Decrease) in Long-Term Debt	(96,862)	(94,250)
Increase (Decrease) in Payables to Associated Companies	<u>174,469</u>	<u>(17,727)</u>
<b>Net Cash Used for Financing Activities</b>	<u>77,607</u>	<u>(111,977)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<u>(74,457)</u>	<u>45,054</u>
<b>CASH AT BEGINNING OF YEAR</b>	<u>108,638</u>	<u>63,584</u>
<b>CASH AT END OF YEAR</b>	<u>\$34,181</u>	<u>\$108,638</u>

*(The accompanying notes and the appendices are an integral part of these Financial Statements)*

## Notes to Financial Statements

### **(1) Summary of Significant Accounting Policies**

California Utilities Service, Inc. (CUS) was incorporated in February of 1985. CUS is a sewer utility with approximately 1,115 connections in an incorporated area of Monterey County along Salinas-Monterey Highway 68.

The financial statements of CUS were prepared on an accrual basis of accounting as required by the Uniform System of Accounts (USOA) or Generally Accepted Accounting Principles (GAAP). The Statements of Retained Earnings and Statements of Cash Flows are not required by the Commission when CUS files its Annual Reports with the Commission. Therefore, the accompanying Statements of Retained Earnings and Statements of Cash Flows were compiled by UAFCB based on the audited financial information of CUS Balance Sheets and Income Statements.

#### **(a) Appendices**

The accompanying Appendices are an integral part of the financial statements. Appendix A and Appendix B present the net financial impact resulting from UAFCB's audit adjustments for Years 2015 and 2014, respectively. Appendix C and Appendix D summarize UAFCB's detailed audit adjustments for Years 2015 and 2014, respectively.

#### **(b) Water Plant in Service**

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

#### **(c) Retained Earnings**

UAFCB could not attest to the accuracy of the Retained Earnings balances due to the lack of historical information. Expressing an opinion on the Retained Earnings balances as of December 31, 2015 and 2014 would require auditing the Retained Earnings from the inception of the company. Due to limitation of our audit scope, we cannot express an opinion on those balances.

#### **(d) Depreciation of Water Plant**

Depreciation is computed using a straight-line composite rate of 3.927% to depreciate all of its plant assets for ratemaking purpose and for reporting the depreciation expense in its Annual Reports filed with the Commission.

**(e) Revenues**

CUS revenues are obtained from flat rate service to its customers on an annual basis. CUS computed its sewer revenues based on tariffs approved by the Commission.

**(f) Allocated Administrative Expenses**

CUS shares the same administrative office, office equipment, billing expenses, office salaries, employee pension & benefits and office utilities with its sister company, Alco Water Service (AWC). These costs are initially recorded in AWC books and subsequently allocated to CUS through an intercompany payable account. Allocated administrative costs were \$204,070.29 in 2015 and \$205,099.78 in 2014.

**(2) Short-Term Note**

In its 2014 and 2015 annual reports, CUS reported an on-demand note held by Tom R. Adcock. The note was issued on November 1, 2011 and is in the amount of \$600,000. The interest rate of the note is based on a composite of both the average of the 52 week CCC Bond Index and the "Bank Prime Loan Rate" Index (13.18%-16.545% in 2015, 12.195%-12.72% in 2014). Interest paid by CUS on the note was \$83,975 in 2015 and \$75,272.50 in 2014. Based on the economic conditions in the past few years, the prevailing interest rates during the audit period were in single digit. Therefore, the interest rates charged on this Short-Term Note seem to be high.

CUS correctly reported the note when issued as Short-Term Debt (USOA Account 232) but the note has been outstanding for more than twelve months in 2014 and 2015. Consequently, CUS should seek approval from the Commission to be in compliance with Public Utility Code (PUC), Section 818.

PUC Section 818 requires that a public utility, in addition to other requirements of law, to secure Commission approval to issue stocks, bonds, notes or other evidence of *indebtedness* payable at periods of more than twelve (12) months. PUC Section 818 also requires that the loan proceeds not to be used in whole or in part for operating expenses or charges against income.

CUS has not requested nor received Commission authorization for the note it reported in its 2014 and 2015 Annual Reports that has been outstanding for more than 12 months. To correct its omission and to comply with the requirements of PUC Section 818, CUS should file a Tier 3 Advice Letter with the Commission to seek authorization for the note. The filing must indicate the terms and conditions of the loan, the purpose of the use of proceeds, and if the utility assets were encumbered. CUS disagrees. The matter is referred to CPUC Legal Division.

**(3) Long Term Debt**

In its 2014 and 2015 annual reports, CUS reported Long-Term Debt (USOA Account 224) of \$96,862 and \$0, respectively, which is essentially a capital lease.

E.U Capital Ventures financed the construction of a sewer collection main and leased back the structure to CUS. The total payments exceed 90% of the asset value and the transaction

was properly classified as a capital lease and LTD. Capital leases do not need to be approved by the Commission.

**(4) Contributions In Aid of Construction (CIAC) and Accumulated Amortization**

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.

**(5) Annual Reports**

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

## Appendix A

### Summary of Net Financial Impact Resulting from UAFCB's Audit Adjustments for Year 2015

The following is a summary of net financial impact resulting from UAFCB's audit adjustments for Year 2015.

Audit Adj. No.	Annual Report				Description	For the Year 2015	
	Sch.	Line.	Col.	Acct No.		Debit	Credit
<b><u>Net Financial Impact on Balance Sheets Items:</u></b>							
1	A	14	4	131	Cash	\$7,445	
1	A	16	4	132	Special Accounts		\$7,445
2	A	19	4	143	Accumulated Provision for Uncollectible Accounts		1,670
3	A	35	4	236	Taxes Accrued	9,267	
<b><u>Net Financial Impact on Income Statements Items:</u></b>							
2	F	24	4	676	Uncollectible Accounts Expense	\$1,670	
3	F	39	4	421	Non-Utility Income		\$9,267

## Appendix B

### Summary of Net Financial Impact Resulting from UAFCB's Audit Adjustments for Year 2014

The following is a summary of net financial impact resulting from UAFCB's audit adjustments for Year 2014.

Audit Adj. No.	Annual Report				Description	For the Year 2014	
	Sch.	Line.	Col.	Acct No.		Debit	Credit
<b><u>Net Financial Impact on Balance Sheets Items</u></b>							
1	A	14	4	131	Cash	\$7,444	
1	A	16	4	132	Special Accounts		\$7,444
2	A	19	4	143	Accumulated Provision for Uncollectible Accounts		1,337
3	A	37	4	241	Payable to Associated Companies	8,453	
4, 5	A	45	4	272	Accumulated Amortization of Contributions	6,079,675	
4	A	44	4	271	Contribution in Aid of Construction		3,326,951
2, 6	A	46	4	282	Accumulated Deferred Income Taxes - ACRS		2,871,770
6	A	47	4	283	Accumulated Deferred Income Taxes - Other	119,046	
<b><u>Net Financial Impact on Income Statements Items:</u></b>							
3	F	23	4	674	Employee Pensions and Benefits		\$8,453
2	F	24	4	676	Uncollectible Account Expense	\$1,337	

## Appendix C

### Summary of Audit Adjustments for Year 2015

Audit Adj. No.	Annual Report				Description	Debit	Credit
	Sch.	Line	Col.	Acct No.			
1	A	14	4	131	Cash	\$7,445	
	A	16	4	132	Special Accounts		\$7,445
					<i>To correctly report Special Accounts and Cash.</i>		
2	F	24	4	676	Uncollectible Accounts Expense	\$1,670	
	A	19	4	143	Accumulated Provision for Uncollectible Accounts		\$1,670
					<i>To correctly report Accounts Receivable - Customers.</i>		
3	A	35	4	236	Taxes Accrued	\$9,267	
	F	39	4	421	Non-Utility Income		\$9,267
					<i>To correctly report Accrued Taxes.</i>		

## Appendix D

### Summary of Audit Adjustments for Year 2014

Audit Adj. No.	Annual Report				Description	Debit	Credit
	Sch.	Line.	Col.	Acct No.			
1	A	14	4	131	Cash	\$7,444	
	A	16	5	132	Special Accounts		\$7,444
					<i>To correctly report Special Accounts and Cash.</i>		
2	F	24	4	676	Uncollectible Account Expense	\$1,337	
	A	19	4	143	Accumulated Provision for Uncollectible Accounts		\$1,337
					<i>To correctly report Accounts Receivable - Customers</i>		
3	A	37	4	241	Payable to Associated Companies	\$8,453	
	F	23	4	674	Employee Pensions and Benefits		\$8,453
					<i>To correctly report Employee Pensions &amp; Benefits and Payable to Associated Companies.</i>		
4	A	45	4	272	Accumulated Amortization of Contributions	\$3,326,951	
	A	44	4	271	Contribution in Aid of Construction (CIAC)		\$3,326,951
					<i>To correct input errors of CIAC and related amortization by the company.</i>		
5	A	45	4	272	Accumulated Amortization of Contributions	\$2,752,724	
	A	46	4	282	Accumulated Deferred Income Taxes – ACRS Depreciation		\$2,752,724
					<i>To correct input errors of Accumulated Deferred Income Taxes – ACRS Depreciation by the company and Accumulated Amortization of Contributions.</i>		
6	A	47	4	283	Accumulated Deferred Income Taxes – Other	\$119,046	
	A	46	4	282	Accumulated Deferred Income Taxes – ACRS Depreciation		\$119,046
					<i>To correct input errors of Accumulated Deferred Income Taxes – ACRS Depreciation and Accumulated Deferred Income Taxes – Other by the company.</i>		