



Financial Audit of Nacimiento Water Company Financial Statements For the Year Ended December 31, 2017

Utility Audit, Finance and Compliance Branch
June 26, 2019



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Thanks to:

Angie Williams, Raymond Yin, Sharmin Wellington, and Aaron Louie

**Audit of Financial Statements of
Nacimiento Water Company
For the Year Ended December 31, 2017**

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PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



Report of Independent Auditors

Tim Bean, President
Nacimiento Water Company
2890 Saddle Way
Bradley, California 93426

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 Nacimiento Water Company (NWC), which are comprised of the balance sheet as of December 31, 2017, and the related statement of income, retained earnings and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

NWC's management is responsible for the preparation and fair presentation of the financial statements presented in the 2017 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 in 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 NWC's financial statements based on our 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 from 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 judgment, 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.

Basis for Qualified Opinion

Due to the lack of supporting documentation and/or historical information on the reported Long-term Debt, Retained Earnings, and Revenues as described in Note 1(e), (f), and (i) to the Audited Financial Statements, UAFCB could not attest to these balances as of December 31, 2017. Therefore, UAFCB does not express an opinion on the balances of Retained Earnings, Long-term Debt, and Revenues as of December 31, 2017.

Qualified Opinion

In our opinion, except for the balances of Retained Earnings, Long-term Debt, and Revenues as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Nacimiento Water Company as of December 31, 2017, and the results of its operations and its cash flows for the year then ended, in accordance with the accounting requirements of the Commission as set forth in the USOA 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 of NWC were originally prepared on the basis of the accounting requirements of the California Public Utilities Commission as set forth in the USOA 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 Nacimiento Water Company. It should not be used by anyone other than the specified parties.

Raymond Yin

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

Balance Sheets

		As of December 31, for the Year	
		2017	2016¹
ASSETS			
UTILITY PLANT			
Water Plant in Service (Note 1)	\$3,053,480	\$3,017,491	
Construction Work in Progress	167,894	116,486	
Accumulated Depreciation of Water Plant (Note 1)	(1,796,484)	(1,748,434)	
Net Utility Plant	\$1,424,890	\$1,385,543	
CURRENT AND ACCRUED ASSETS			
Cash	47,513	47,677	
Special Accounts (Note 1)	5,559	0	
Accounts Receivable – Customers	47,200	30,600	
Other Current Assets	2,324	2,000	
Deferred Charges	20,621	21,941	
Total Current and Accrued Assets	123,217	102,218	
Total Assets	\$1,548,107	\$1,487,761	
CAPITALIZATION AND LIABILITIES			
CORPORATE CAPITAL AND SURPLUS			
Common Stock	\$25,000	\$25,000	
Other Paid-in Capital (Note 1)	159,200	159,200	
Retained Earnings (Note 1)	(77,137)	(194,278)	
Total Capitalization	107,063	(10,078)	
LONG TERM DEBT			
Long-term Debt (Note 1)	220,756	0	
CURRENT AND ACCRUED LIABILITIES			
Accounts Payable	83,238	88,422	
Accrued Taxes	1,206	7,977	
Accrued Interest	89,673	0	
Other Current Liabilities	32,168	341,134	
Other Credits	62,678	62,624	
Net Current and Accrued Liabilities	268,963	500,157	
CONTRIBUTIONS IN AID OF CONSTRUCTION			
Contributions in Aid of Construction (Note 1)	2,278,193	2,278,193	
Accumulated Amortization of Contributions (Note 1)	(1,326,868)	(1,280,511)	
Net Contributions in Aid of Construction	951,325	997,682	
Total Capitalization and Liabilities	\$1,548,107	\$1,487,761	

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

¹ The amounts for the year ended December 31, 2016, were reported by NWC. These amounts have not been audited by UAFCB.

Income Statement

	For the Year of	
	2017	2016 ²
OPERATING REVENUES		
Unmetered Water Revenue	\$77	\$0
Fire Protection Revenue	176,249	151,717
Metered Revenue	495,055	454,321
Other Water Revenue	0	53
Total Operating Revenues (Note 1)	671,381	606,091
OPERATING EXPENSES		
Plant Operation and Maintenance Expenses		
Purchased Water	8,597	17,834
Power	35,574	35,844
Other Volume Related Expense	12,501	30,189
Employee Labor	154,063	117,809
Materials	62,685	52,216
Contract Work	7,305	4,454
Transportation Expenses	11,182	11,981
Other Plant Maintenance Expenses	7,209	8,365
Total Plant Operation and Maintenance Expense	299,116	278,692
Administrative and General Expenses		
Management Salaries	89,016	89,016
Employee Pensions and Benefits	49,188	53,205
Office Services and Rentals	900	900
Office Supplies and Expenses	12,609	16,462
Professional Services	12,103	30,476
Insurance	21,312	25,789
Regulatory Commission Expense	12,412	2,012
General Expenses	5,669	6,855
Total Administrative and General Expenses	203,209	224,715
Total Operating Expenses	502,325	503,407
Depreciation Expense (Note 1)	23,828	28,525
Taxes Other Than Income Taxes	25,330	21,468
State Corporate Income Tax Expense	800	807
Total Operating Revenue Deductions	552,283	554,207
Total Utility Operating Income	119,098	51,884
Non-utility Income	321	87
Interest Expense	(9,105)	(12,113)
Total Other Income and Deductions	(8,784)	(12,026)
Net Income	\$110,314	\$39,858

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

² The amounts for the year ended December 31, 2016, were reported by NWC. These amounts have not been audited by UAFCB.

Statements of Retained Earnings

	For the Year of	
	2017 ³	2016 ⁴
Retained Earnings, Beginning of Year	(\$194,278)	(\$234,134)
CREDITS:		
Net Income	110,314	39,858
UAFCB Adjustment to Accumulated Depreciation of Water Plant	5,454	0
UAFCB Adjustment to Accrued Taxes	9,427	0
UAFCB Adjustment to Other Current Liabilities	2,602	0
Total Credits	127,797	39,858
DEBITS:		
UAFCB Adjustment to Transportation Expense	(2,601)	0
UAFCB Adjustment to Office Supplies and Expenses	(1,290)	0
UAFCB Adjustment to Other Current Assets	(1,917)	0
UAFCB Adjustment to Accumulated Depreciation of Water Plant	(4,847)	0
UAFCB Adjustment to Annual Report Error ⁵	(1)	(2)
Total Debits	(10,656)	(2)
Retained Earnings, End of Year	(\$77,137)	(\$194,278)

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

³ The Retained Earnings balances were not audited but were the results of UAFCB compiled audit adjustments and Net Income (Loss) for 2017. UAFCB could not attest to the accuracy of the Retained Earnings balances due to lack of historical information on the account.

⁴ The amounts for the year ended December 31, 2016, were reported by NWC. These amounts have not been audited by UAFCB

⁵ NWC Annual Reports included an immaterial rounding variance of \$1 for 2017 and \$2 for 2016. Refer to Note (1)(b) on Page 5 for further details.

Statements of Cash Flows

	For the Year of	
	2017	2016 ⁶
CASH FLOW FROM OPERATING ACTIVITIES:		
Net Income (Loss)	\$110,314	\$39,858
Adjustments to Reconcile Net Income to Cash		
Provided by Operating Activities		
Depreciation and Amortization ⁷	48,050	74,882
Decrease (Increase) in Special Accounts	(5,559)	0
Decrease (Increase) in Accounts Receivable - Customers	(16,600)	1,088
Decrease (Increase) in Other Current Assets	(324)	(1,200)
Decrease (Increase) in Deferred Charges	1,320	1,320
Increase (Decrease) in Accounts Payable	(5,184)	12,559
Increase (Decrease) in Accrued Taxes	(6,771)	(2,862)
Increase (Decrease) in Accrued Interest	89,673	0
Increase (Decrease) in Other Current Liabilities	(308,966)	6,498
Increase (Decrease) in Other Credits	54	35
Net Cash Provided by Operating Activities	(93,993)	132,178
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net Plant Deletions (Additions) – Water Plant in Service	(35,989)	(9,715)
Net Plant Deletions (Additions) – Construction Work in Progress	(51,408)	(25,396)
Increase (Decrease) in Contributions in Aid of Construction	0	0
Decrease (Increase) in Accumulated Amortization of Contributions	(46,357)	(46,357)
UAFCB Cumulative Adjustments to Retained Earnings ⁸	6,827	(2)
Net Cash Used for Investing Activities	(126,927)	(81,470)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase (Decrease) in Long-term Debt	220,756	0
Net Cash Used for Financing Activities	220,756	0
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(164)	50,709
CASH AT BEGINNING OF YEAR	47,677	(3,031)
CASH AT END OF YEAR	\$47,513	\$47,677

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

⁶ The amounts for the year ended December 31, 2016, were reported by NWC. These amounts have not been audited by UAFCB.

⁷ For the purpose of the Statements of Cash Flows, UAFCB included (\$48,050) of Depreciation of Water Plants from the depreciation expense for the Year 2017.

⁸ For the Year 2017, the total UAFCB credit adjustment of \$6,827 to Retained Earnings represented the cumulative effect of UAFCB's adjustments to the Retained Earnings for the Year 2017 and \$2 adjustment due to the rounding variance in NWC's 2016 Annual Report. Refer to Note (1)(b) on Page 5 for further details.

Notes to Financial Statements

(1) Summary of Significant Accounting Policies

Nacimiento Water Company (NWC) was incorporated on June 25, 1969. NWC is a Class C water utility with about 645 metered customers in its service territory of 25 miles northwest of Paso Robles, San Luis Obispo County. NWC provides service to the community of Oak Shores, which is adjacent to Lake Nacimiento. NWC provides fire protection and metered water services in this location.

The financial statements of NWC were prepared on the basis of accounting set forth in the Uniform System of Accounts (USOA) for 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 estimated operating expenses related to prior years and gains on the sale of property rights, would have been 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 statement of income.

The Statements of Cash Flows are not required by the Commission when NWC files its Annual Reports with the Commission. Therefore, the accompanying Statements of Cash Flows were compiled by UAFCB based on the audited financial information of NWC Balance Sheets and Income Statements.

(a) Appendices

The accompanying Appendices are an integral part of the financial statements. Appendix A presents the net financial impact resulting from UAFCB's audit adjustments for the year ended 2017. Appendix B presents UAFCB detail audit adjustments for the year ended 2017.

(b) Water Plant in Service

Utility plant should be recorded at the original cost when it is initially constructed or purchased. Retired utility plants should be removed from utility plant accounts at cost and charged against accumulated depreciation. NWC retained \$1 each on its books for two retired vehicles.

(c) Depreciation and Accumulated Depreciation of Water Plant

Depreciation was computed on a straight-line weighted average composite rate of 2.3% (equivalent to depreciating the plant assets over approximately 45 years) in order to depreciate all plant assets for ratemaking purposes and reporting the depreciation expense in NWC's Annual Reports filed with the Commission. The Commission's Standard Practice (SP) U-04-SM, Paragraph 22, specifies that the annual composite depreciation rate should normally fall within the range of 2.0% to 3.5%.

(d) Special Accounts

NWC failed to record the Facilities Fees of \$5,559 collected in 2017 under a separate and/or segregated bank account. NWC failed to comply with General Order 96-B and SP U-28-W,

which states, in part, that *“All fees collected must be kept in a segregated bank account and credited to contributions in aid of construction (CIAC) at the time the fees are spent for additional plant.”*

(e) Long-term Debts

NWC entered into three different shareholder loans with the initial balances of \$136,616, \$56,100, and \$34,899 in 2000, 2014, and 2015, respectively. NWC was unable to provide the formal written agreement to support these amounts. In addition, NWC did not obtain the Commission’s prior approval for these long-term debt as required per the Public Utilities (PU) Code, Section 818. PU Code, Section 818 states, in part, 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.”*

(f) Retained Earnings

UAFCB could not attest to the accuracy of the Retained Earnings balance due to the lack of historical information. Expressing an opinion on the Retained Earnings balance as of December 31, 2017, would require auditing the Retained Earnings from the inception of the company. Due to the limitations of our audit scope, we cannot and do not express an opinion on the Retained Earnings balance as of December 31, 2017.

(g) Other Paid-in Capital

UAFCB could not attest to the accuracy of the Other Paid-in Capital balance due to the lack of historical information. NWC was unable to provide adequate documentation to support this amount.

(h) Contributions in Aid of Construction (CIAC) and Accumulated Depreciation of CIAC

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.

(i) Revenues

NWC primarily obtained its water revenues from fire protection and metered services based on tariffs approved by the Commission. NWC billed its customers either on an annual or quarterly basis. NWC did not follow full accrual basis of accounting as mandated by the USOA for recording its revenue, instead NWC recognized revenue when payments were received and not when customers were billed for services. NWC could not provide UAFCB the supporting documents for the reported Revenue for the audit period. Therefore, we cannot and do not express an opinion on the Revenue balance as of December 31, 2017.

(2) Compliance Filing of Annual Report

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

Appendix A

Summary of Net Financial Impact Resulting from UAFCB's Audit Adjustments for Year 2017

The following is a summary of net financial impact resulting from UAFCB's audit adjustments for Year 2017.

Audit Adj. No.	Annual Report				Description	For the Year 2017	
	Sch.	Line	Col.	Acct No.		Debit	Credit
<u>Net Financial Impact on Balance Sheets Items:</u>							
1, 11	A	11	C	108	Accumulated Depreciation of Water Plant	\$607	
2	A	27	C	131	Cash		\$5,559
2	A	29	C	132	Special Accounts	5,559	
8, 9	A	34	C	174	Other Current Assets	2,324	
1, 3, 4, 6, 7, 9, 11	A	44	C	215	Retained earnings		6,828
4	A	53	C	224	Long-term Debt		220,756
4, 5, 10	A	57	C	231	Accounts Payables		18,532
3	A	61	C	236	Accrued Taxes	9,427	
4	A	62	C	237	Accrued Interest		89,673
4	A	63	C	241	Other Current Liabilities	319,534	
<u>Net Financial Impact on Income Statements Items:</u>							
5	B	12	C	427	Interest Expense	\$2,602	
6	B-2	8	B	660	Transportation Expense		\$2,601
7	B-2	17	B	681	Office Supplies and Expense		1,786
8	B-2	19	B	684	Insurance Expense		611
9, 10	B-2	20	B	688	Regulatory Commission Expense	5,797	
7	B-2	21	B	689	General Expenses	496	

Appendix B

Summary of Audit Adjustments for Year 2017

Audit Adj. No.	Annual Report				Description	For the Year 2017	
	Sch.	Line	Col.	Acct. No.		Debit	Credit
1	A	11	c	108	Accumulated Depreciation of Water Plant	\$5,454	
	A	44	c	215	Retained Earnings <i>To reclassify Insurance payment for a fully depreciated asset.</i>		\$5,454
2	A	29	c	132	Special Accounts	\$5,559	
	A	27	c	131	Cash <i>To reclassify Facility Fees collected to the proper account.</i>		\$5,559
3	A	61	c	236	Accrued Taxes	\$9,427	
	A	44	c	215	Retained Earnings <i>To reclassify Accrued Taxes to agree with the audited amount</i>		\$9,427
4	A	63	c	241	Other Current Liabilities	\$319,534	
	A	57	c	231	Accounts Payables		\$6,503
	A	44	c	215	Retained Earnings		2,602
	A	62	c	237	Accrued Interest		89,673
	A	53	c	224	Long-term Debt <i>To reclassify Other Current Liabilities to agree with the audited amount.</i>		220,756
5	B	12	c	427	Interest Expense	\$2,602	
	A	57	c	231	Accounts Payables <i>To adjust Interest Expense to agree with the audited amount.</i>		\$2,602
6	A	44	c	215	Retained Earnings	\$2,601	
	B-2	8	b	660	Transportation Expense <i>To reclassify Transportation Expense to agree with the audited amount.</i>		\$2,601
7	A	44	c	215	Retained Earnings	\$1,290	
	B-2	21	b	689	General Expenses	496	
	B-2	17	b	681	Office Supplies and Expense <i>To adjust Office Supplies and Expense to agree with the audited amount.</i>		\$1,786

Financial Audit of Nacimiento Water Company Financial Statements
For the Year Ended December 31, 2017

Audit Adj. No.	Annual Report				Description	For the Year 2017	
	Sch.	Line	Col.	Acct. No.		Debit	Credit
8	A	34	c	174	Other Current Assets	\$611	
	B-2	19	b	684	Insurance Expense <i>To adjust Insurance Expense to agree with the audited amount.</i>		\$611
9	A	34	c	174	Other Current Assets	\$1,713	
	A	44	c	215	Retained Earnings	1,917	
	B-2	20	b	688	Regulatory Commission Expense <i>To reclassify the reported Regulatory Commission Expense to agree with the audited amount.</i>		\$3,630
10	B-2	20	b	688	Regulatory Commission Expense	\$9,427	
	A	57	c	231	Accounts Payables <i>To adjust Regulatory Commission Expense to agree with the audited amount.</i>		\$9,427
11	A	44	c	215	Retained Earnings	\$4,847	
	A	22	c	108	Accumulated Depreciation of Water Plant <i>To adjust Accumulated Depreciation of Water Plant to agree with the audited amount.</i>		\$4,847