



Audit of Water Utilities

Rogina Water Company

For the Year Ended December 31, 2018

Utility Audits Branch
May 5, 2020



MEMBERS OF THE TEAM

Angie Williams, Director

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

**Khusbindar Kaur, CPA
Senior Management Auditor**

**Sharmin Wellington, CPA
Public Utilities Regulatory Analyst V**

**Rimplejeet Bhatti
Associate Management Auditor**

**Sam Niepoth
Staff Services Management Auditor**

**A digital copy of this report can be found at:
<http://www.cpuc.ca.gov/utilityaudits/>**

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EXECUTIVE SUMMARY

The Utility Audits Branch (UAB), formerly known as the Utility Audit, Finance and Compliance Branch (UAFCB)¹, is in the Utility Audits, Risk and Compliance Division (UARCD), which reports directly to the Executive Director of the California Public Utilities Commission (CPUC). Pursuant to California Public Utilities (PU) Code, Sections 314.5, 314.6, 581, 582, and 584, the CPUC has statutory authority to inspect and audit the books and records of the utilities to ensure that ratepayers' money is well spent. PU Code Section 314.5 specifies that the CPUC shall inspect and audit the books and records for regulatory and tax purposes at least once every three years for utilities serving over 10,000 customers and at least once every five years for utilities serving 10,000 or fewer customers. PU Code Section 314.6(a) states that *“the Commission may conduct financial and performance audits of any entity or program created by any order, decision, motion, settlement, or other action of the Commission.”*

Rogina Water Company (RWC) provides water service in the town of Talmage and vicinity, three miles east of the city of Ukiah, in Mendocino County in California. RWC serves 977 domestic customers, 13 irrigation customers, 3 fire lines, and 141 hydrants. As a regulated water utility, RWC is required to prepare its financial statements on an accrual basis of accounting as set forth in the Uniform System of Accounts (USOA) for Water Utilities that was adopted in Decision (D.) 16-11-006 by the CPUC on November 16, 2016. The USOA is a comprehensive basis of accounting other than the generally accepted accounting principles in the United States of America.

The UAB conducted the audit of RWC's 2018 Annual Report filed with the CPUC in accordance with applicable PU Codes, regulations, and CPUC's directives. The primary objectives of this audit were to ensure the fair presentation of the financial information in RWC's 2018 Annual Report and to determine whether RWC complied with the applicable regulations and CPUC's directives. The scope of our audit was limited to the financial information presented in RWC's 2018 Annual Report filed with the CPUC. In addition, UAB evaluated the effectiveness of the RWC's internal control over its accounting and reporting functions as it relates to the audit objectives.

Based on our audit, the following findings were identified:

- Finding 1: There are material weaknesses in RWC's system of internal control over financial reporting, which present a reasonable possibility that material misstatements in RWC's Annual Report will not be prevented or detected in a timely manner.
- Finding 2: RWC reported an estimated value of \$9,500 for Materials and Supplies in the Annual Report instead of the actual cost.
- Finding 3: RWC incorrectly recorded \$28,483 of Facilities Fees as Cash in Account 131 instead of as Cash-Special Deposit in Account 132. RWC also incorrectly recorded \$24,910 of unspent Facilities Fees as Customer Deposits in Account 233 instead of as Other Credits in Account 253. In addition, RWC reported a \$3,114 deposit for Facilities Fees as a reduction to Cash in Account 131 instead of as Other Credits in Account 253.

¹ Effective January 2020, Utility Audit, Finance and Compliance (UAFCB) was renamed to Utility Audits Branch (UAB).

- Finding 4: RWC incorrectly reported \$79,571 of deferred income tax liability resulting from accelerated tax depreciation in Account 283, Accumulated Deferred Income Tax Liability, instead of Account 282, Accumulated Deferred Income Taxes—Accelerated Tax Depreciation.
- Finding 5: RWC incorrectly reported \$57,179 of the current portion of its long-term debt in Account 224, Long-Term Debt, instead of reporting it in Account 232, Short-Term Notes Payable.
- Finding 6: RWC did not report the revenues and expenses associated with the collections and remittance of Users Fees from July to December 2018, resulting in both Account 480—Other Water Revenue and Account 688—Regulatory Commission Expense being understated by \$7,408.
- Finding 7: RWC was unable to provide documentation to support ownership equity reported in the Annual Report. Therefore, we were unable to determine the accuracy of the Common Stock and Other Paid-in Capital balance reported in the Annual Report.
- Finding 8: RWC did not prorate property tax payments to the correct accounting year. As a result, the expense for Account 408, Taxes Other Than Income Taxes, was understated by \$297, while and Account 174, Other Current Assets, was understated by \$7,310 in the Annual Report.
- Finding 9: RWC was unable to provide adequate documentation to support \$67,331 of \$361,836 Contributions in Aid of Construction (CIA) balance reported in Account 265 in the Annual Report. Therefore, we are unable to determine the accuracy of the CIAC balance reported in the Annual Report.
- Finding 10: RWC incorrectly recorded \$7,350 of office rental expense as Office Supplies and Expenses in Account 681, instead of as Office Services and Rentals expenses in Account 678. RWC also improperly charged \$2,648 of food purchases as operating expenses during the audit period.
- Finding 11: RWC incorrectly classified and reported \$8,636 of vacation and sick leave expenses as regular salaries instead of classifying and reporting the expenses in Account 674, Employee Pensions and Benefits.
- Finding 12: The Depreciation Expense, Account 403, and Accumulated Depreciation of Water Plant, Account 108, reported in the Annual Report were not supported by RWC’s depreciation schedule and accounting records. As a result, Depreciation Expense and Accumulated Depreciation of Water Plant were understated by \$6,446 and \$27,485, respectively.

RESTRICTED USE OF THIS AUDIT REPORT

This audit report is intended solely for the information and use by the CPUC and the management of RWC. It is not intended to be used and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDIT REPORT

BACKGROUND

The California Public Utilities Commission (CPUC) was established by Constitutional Amendment as the Railroad Commission in 1911. The Legislature passed the Public Utilities Act in 1912 to expand the CPUC's regulatory authority over natural gas, electric, telephone, and water companies as well as railroads and marine transportation companies. In 1946, the Railroad Commission was renamed the California Public Utilities Commission.² The California Public Utilities (PU) Code granted CPUC's regulatory authority over Investor-Owned Utilities (IOU) in California. The Utility Audits Branch (UAB), formerly known as Utility Audit Finance, and Compliance Branch (UAFCB)³, is in the Utility Audits, Risk and Compliance Division (UARCD), which reports directly to the Executive Director of the CPUC. The UAB provides auditing, accounting, financial, and advisory services on regulated utilities and monitors compliance with laws and CPUC directives.

PU Code, Section 314.5(a) states, in part, that:

*The commission shall inspect and audit the books and records for regulatory and tax purposes as follows...
(2) every electrical, gas, heat, telegraph, telephone, and water corporation serving 10,000 or fewer customers at least once every five years.*

In addition, PU Code, Section 314.6(a) states, *"The commission may conduct financial and performance audits of any entity or program created by any order, decision, motion, settlement, or other action of the commission."* Regulated utilities are required to comply with PU Code Sections 581, 582, and 584 by timely submitting to the CPUC the requested documents in the form and detail prescribed by the CPUC.

On November 10, 2016, CPUC approved Decision (D.) 16-11-006 to update its Uniform System of Accounts (USOA), which is a basis of accounting other than the generally accepted accounting principles in the United States, for the regulated water and sewer IOUs in California. All regulated water utilities are required to comply with the accounting requirements specified in the updated USOA, which became effective on January 1, 2018. Among other requirements, the USOA requires that *"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."*⁴

For the purpose of applying systems of accounts prescribed by the CPUC, regulated water utilities are divided into four classes based on the number of service connections as follows:

- Class A Utilities—having more than 10,000 service connections.
- Class B Utilities—having between 2,001 service connections and 10,000 service connections.
- Class C Utilities—having between 501 service connections and 2,000 service connections.
- Class D Utilities—having 500 service connections or less.

Classes B, C, and D water utilities are commonly referred to as "Small Water Utilities."

² <https://www.cpuc.ca.gov/history/>

³ Effective January 2020, Utility Audit, Finance and Compliance (UAFCB) was renamed to Utility Audits Branch (UAB).

⁴ D.16-11-006, Page B13.

Rogina Water Company (RWC) was incorporated in 1947 and provides water service in the town of Talmage and vicinity, three miles east of the city of Ukiah, in Mendocino County in California. RWC has accumulated a franchise area that has grown to a system that has five wells, which serves 977 domestic customers, 13 irrigation customers, 3 fire lines and 141 hydrants. As a regulated Class C water utility, RWC is required to comply with CPUC's USOA for Class B, C, and D water utilities.

OBJECTIVE AND SCOPE

UAB conducted the audit of RWC's 2018 Annual Report filed with the CPUC in accordance with applicable PU Codes, regulations, and CPUC's directives. The primary objectives of this audit are to ensure the fair presentation of the financial information in RWC's 2018 Annual Report and to determine whether RWC complied with the applicable regulations and CPUC's directives. The scope of our audit was the financial information presented in RWC's 2018 Annual Report filed with the CPUC. In addition, UAB evaluated the effectiveness of the RWC's internal control over its accounting and reporting functions as it relates to the audit objectives.

METHODOLOGY

The UAB obtained sufficient and appropriate evidence to determine RWC's compliance with the applicable regulations and CPUC directives in reporting the financial information in its 2018 Annual Report and assessed whether key internal controls over financial reporting are designed, implemented and operating effectively. The specific procedures performed during this audit included, but were not limited to, the following:

1. Obtained an understanding of the RWC's business operation and its accounting system.
2. Performed analytical procedures on the reported financial data to identify significant fluctuations of individual accounts from the prior year to the current year.
3. Assessed whether the Utility's internal controls are designed, implemented, and operating effectively through observation, inquiry, and documentation. Specific procedures included, but were not limited to:
 - Review of the company's policies and procedures, and their implementation pertaining to accounting, recording, reporting, and record retention.
 - Inquiries with key company personnel.
 - Review of the company's organization chart to evaluate segregation of duties, authorization and approval processes, performance monitoring and controls, and compliance with regulatory requirements and CPUC's directives.
4. Performed risk assessment and determined materiality level based on the auditor's understanding of the company's operations, the evaluation of its internal control, and UAB's financial analysis.
5. Determined the company's compliance with applicable regulations and CPUC's directives regarding the timeliness of filing the Annual Report; compliance with USOA accounting requirements; treatments of public grants, loans, utility plant, Facilities Fees, and Users Fee; disclosure and accounting treatment of affiliated transactions, etc.

6. Reconciled the amounts reported in the Annual Report to the underlying accounting records presented on the general ledger (G/L) and trial balance for the year ended December 31, 2018.
7. Reviewed the list of water plant assets and toured RWC's facilities to ensure the physical existence, completeness, rights and valuation of utility plant.
8. Reconciled Water Plant in Service and depreciation expense balances shown in the Annual Reports to the G/L and reviewed the depreciation calculation.
9. Determined that cash exists and is supported by bank statements and bank reconciliations. Determined that cash balance is properly classified (facilities fees, customer's deposits, contributions) in the financial statements and any restrictions on the use of the funds are properly disclosed.
10. Reconciled the accounts receivables reported in the Annual Report and the trial balance to underlying accounting records such as Accounts Receivable Detail Report by Customer.
11. Analyzed Common Stock account by reviewing common stock certificates, par value, and shares outstanding.
12. Performed a search for unrecorded liabilities by sampling subsequent cash disbursements made in 2019 and verifying whether the disbursements should have been reported as an expense during the 2018 accounting period.
13. Determined that contributions were used for intended construction purposes by reviewing the contribution agreement.
14. Recalculated accumulated amortization of Contributions in Aid of Construction to verify the accuracy of the amortization reported in the Annual Report.
15. Determined the occurrence, completeness, accuracy, classification, and cutoff of the recorded expenditures by reviewing relevant supporting documents, such as canceled checks, bank statements, invoices, contracts or agreements, and insurance policies. Performed sample-testing as appropriate.
16. Determined the completeness, accuracy, and cutoff of the recorded revenues by reviewing the billing records and money received from ratepayers; and performing reasonableness tests of reported revenues based on the CPUC approved tariffs for the audit period.
17. Recalculated payroll taxes to verify that payroll tax expense and related liabilities were properly reported in the Annual Report.

AUDIT FINDINGS AND RECOMMENDATIONS

The results of our audit of RWC's 2018 Annual Report are described below. The audited financial statements and UAB's Audit Adjustments are presented in the next section, titled "Audited Financial Statements."

Finding 1: Internal Control Deficiencies

Condition:

UAB identified the following material weaknesses in the RWC's system of internal control over its financial reporting, which present a reasonable possibility that material misstatements in RWC's Annual Report will not be prevented or detected on a timely basis:

- a. RWC does not have formal written policies and procedures for the following:
 - Record retention.
 - Revenue recording and reporting including recording and remittance procedures for surcharges collected.
 - Recording and reporting cash disbursements.
 - Payroll process.
 - Inventory, recording, and reporting of Materials and Supplies.
 - Asset acquisition, retirement, abandonment, and deletion due to obsolescence.
- b. RWC does not have a written rental agreement to rent its office space.
- c. Employee timecards were not properly completed. Timecards were not signed by the employees or supervisors and did not specify the pay periods.
- d. RWC did not use the chart of accounts required by the Uniform System of Accounts to record transactions in its accounting records. RWC used its own general ledger (G/L) accounting numbering system. For example, RWC recorded taxes payable in G/L account 3635; however, the USOA requires that all taxes accrued or payable by the utility, including payroll taxes, should be recorded as Taxes Accrued in Account 236.

Criteria:

The USOA states, in part, that:

1. General Accounting Instructions

B. The Uniform System of Accounts contained herein was prescribed for Class B, C, and D Water Utilities, effective January 1, 2018, by California Public Utilities Commission Decision No. 16-11-006. A separate Uniform System of Account for Class A Water Utilities has been prescribed by the California Public Utilities Commission.

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.

Good internal controls and prudent business practices require RWC to:

- Establish written policies and procedures to carry out complex and routine operations.
- Reconcile account balances to underlying accounting records to ensure that errors are detected and corrected timely.

- Implement a review process to ensure that errors in financial recording and reporting are detected and corrected timely.
- Perform periodic inventory counts to place an accurate value on the materials and supplies reported in the Annual Report.
- Establish and implement procedures that require all employees to use timesheets to track total hours worked. Timesheets can be used to support wages and salaries paid to employees.
- Formalize all major business agreements, including office space rental agreement, in writing to minimize liabilities and legal disputes.

Cause:

Due to the size of the company and lack of staff resources, RWC does not have an adequate internal control structure in place.

Effect:

The lack of internal controls can impact the reliability and accuracy of RWC's Annual Report and the effectiveness and efficiency of RWC's operations.

Recommendations:

- (1) RWC should establish written policies and implement procedures to ensure that:
 - Accounting transactions are timely reviewed for accuracy and completeness and recorded in conformity with the USOA.
 - All expenses incurred and/or revenues earned during the reporting period are properly recorded and reported using accrual basis of accounting.
 - Periodic inventory counts of materials and supplies are conducted to ensure physical existence and accuracy.
 - Employee timesheets for every pay period are properly filled, signed and dated by the respective employees, and verified and signed off by two duly authorized company officials.
- (2) Formalize all major business agreements, including office space rental agreement, in writing.
- (3) Establish a Chart of Accounts based on the USOA to record accounting transactions.

Finding 2: Inadequate Controls over Materials and Supplies

Condition:

RWC did not perform inventory counts of assets reported as Materials and Supplies in Account 151. Instead of reporting the actual cost in the Annual Report, RWC reported an estimated value of \$9,500 for Materials and Supplies. RWC also did not maintain a list of materials and supplies on hand showing the description, quantity, and costs of the items.

Criteria:

The USOA states, in part, that:

151. Materials and Supplies

A. This account shall include the cost of materials and supplies on hand, purchased for use in plant construction or repair work.

D. Inventories of materials and supplies shall be taken at least annually, and the necessary adjustments shall be made to bring this account into agreement with the actual quantities on hand.

Cause:

RWC does not have procedures in place to perform periodic inventory counts of assets reported as Materials and Supplies. RWC did not maintain records to support the amounts recorded in the Materials and Supplies account.

Effect:

UAB was unable to determine the accuracy of the reported ending balance of Materials and Supplies in the Annual Report due to the lack of supporting documentation to verify the amount. Consequently, the balance of Materials and Supplies as of December 31, 2018, in the Annual Report could be materially misstated.

Recommendations:

RWC should:

- Maintain sufficient and appropriate evidence to support the amounts recorded on the financial statements.
- Perform, at a minimum, annual physical inventory counts and update its inventory records accordingly.
- Tag and track high-value inventory items; this will help to ensure that inventory is correctly valued, and amounts are accurately recorded on the financial statements.

Finding 3: Facilities Fees Reporting Deficiencies

Condition:

UAB noted the following deficiencies while reviewing RWC's collection of Facilities Fees:

- RWC incorrectly recorded collection of Facilities Fees as Cash in Account 131, instead of as Cash–Special Deposit in Account 132. The USOA requires that cash designated for a special use should be classified as Cash–Special Deposits. Since the Facilities Fees are restricted for the use of water plant improvements, they should have been recorded as Cash–Special Deposits. Consequently, Cash in Account 131 was overstated by \$28,483, while Cash–Special Deposits in Account 132 was understated by the same amount.
- RWC incorrectly recorded a balance of \$24,910 for Facilities Fees as Customer Deposits in Account 233 instead of as Other Credits in Account 253.
- RWC incorrectly recorded a \$3,114 deposit for Facilities Fees. RWC incorrectly recorded the deposit as a reduction (credit) to Account 141 by using an account description of Accounts Receivables–Facilities Fees, resulting in an abnormal credit balance for Accounts Receivable. During its year-end closing process, RWC corrected the abnormal Accounts Receivable balance by increasing (debiting) Accounts Receivable while incorrectly reducing (crediting) Cash–Time Deposit, in Account 131. As a result, both Cash in Account 131 and Other Credits were understated by \$3,114.

Criteria:

The USOA states, in part, that:

10. Facilities Fees

A. Facilities fees are available for Class B, C, and D water utilities. These fees are also available to Class A water utility districts that serve less than 2,000 service connections.

B. Eligible utilities may file an advice letter to institute a facilities fee schedule.

C. When facilities fees are received by a water utility, the amount received shall be deposited in Account 132 – Cash-Special deposits and credited to Account 253 – Deferred Credits. Interest earned on these fees shall be debited to Account 132- Cash-Special Deposits and credited to Account 421 – Non-Utility Income.

132. Cash - Special Deposit

This account shall include cash amounts set aside from general corporate funds, and deposited in a separate account with fiscal agents or others, and designated for a special use. A separate subaccount shall be maintained for each designated special use.

Cause:

RWC does not have adequate internal controls in place to ensure that account balances for Facilities Fee and Cash are properly reported in the Annual Report.

Effect:

Inaccurate reporting of Cash, Cash–Special Deposits, and Other Credits account balances distorted RWC’s financial position as of December 31, 2018.

Recommendation:

RWC should ensure that all account balances, including but not limited to Cash–Special Deposit, are properly reported in the Annual Report to comply with the USOA requirements.

Finding 4: Accumulated Deferred Income Taxes Reporting Deficiencies**Condition:**

RWC incorrectly reported \$79,571 of deferred income tax liability resulting from accelerated tax depreciation in Account 283, Accumulated Deferred Income Tax Liability, instead of Account 282, Accumulated Deferred Income Taxes–Accelerated Tax Depreciation.

Criteria:

The USOA states, in part, that:

283. Accumulated Deferred Income Tax Liability

This account shall reflect the balance of deferred income tax liabilities recorded in accordance with GAAP (resulting from both flow-through and normalized treatment of temporary tax differences). For enterprises that have not yet adopted FASB Accounting Standards Update 2015-17 – Income Taxes (Topic 740): Balance Sheet Classifications of Deferred Taxes, deferred income tax liabilities that are classified as current liabilities may also be recorded in this account."

282. Accumulated Deferred Income Taxes – Accelerated Tax Depreciation

A. Account 282 shall be credited and Account 236, Taxes Accrued, shall be charged with the difference between the federal income tax expense based on tax basis, straight-line method of depreciation and the tax liability resulting from use of accelerated tax depreciation.

B. Account 282 shall be debited and Account 236, Taxes Accrued shall be credited when the tax liability based on the use of accelerated tax depreciation exceeds the federal income tax expense based on tax basis, straight-line method of depreciation.

Cause:

RWC does not have adequate internal controls in place to ensure that the amount reported in Accumulated Deferred Income Taxes – Accelerated Tax Depreciation was properly calculated and reported in the Annual Report.

Effect:

Inaccurate reporting of Accumulated Deferred Income Tax Liability and Accumulated Deferred Income Taxes–Accelerated Tax Depreciation balances distorted RWC’s Annual Report.

Recommendation:

RWC should ensure that deferred income tax liability resulting from accelerated tax depreciation should be properly recorded in Account 282, Accumulated Deferred Income Tax Taxes–Accelerated Tax Depreciation.

Finding 5: Misclassification of Long-Term Debt

Condition:

RWC incorrectly reported the current portion of its long-term debt in Account 224, Long-Term Debt. The current portion of the long-term debt should be recorded in Account 232, Short-Term Notes Payable because the principal that will be due for payment within one year of the balance sheet date. As a result, Long-Term Debt was overstated by \$57,179, while the Short-Term Notes Payable was understated by the same amount.

Criteria:

The USOA states, in part, the following:

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. Note: Prior authorization must be obtained from this Commission before any long-term indebtedness may be incurred by the utility. (Public Utilities Code, Section 818.)

230. Payables to Affiliated Companies

A. This account shall include amounts owed to affiliated companies on notes, drafts, acceptances, or other similar evidence of indebtedness, and open accounts payable on demand or not more than one year from date of

issue or creation. Note: The records supporting the entries to this account shall be so kept that the utility can furnish complete information concerning each note, draft, acceptance, indebtedness, or other open account.

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:

RWC does not have adequate controls over financial reporting to ensure that payable dues within a year of the balance sheet date are properly classified as Short-Term Notes Payable.

Effect:

Misclassification of Long-Term Debt and Short-Term Notes Payable distorted RWC's financial position as of December 31, 2018.

Recommendation:

RWC should adhere to the USOA guidelines and reclassify the current portion of its Long-Term Debt as Short-Term Notes Payable.

Finding 6: CPUC Users Fee Reporting Deficiencies

Condition:

RWC treated CPUC Users Fee collected from its customers and remitted to the CPUC between July through December 2018 as a pass-through activity without reporting the revenue and expenses associated with the collections and remittance of the Users Fee. As a result, bother Account 480—Other Water Revenue and Account 688—Regulatory Commission Expense were understated by \$7,408.

Criteria:

The USOA states, in part, that:

Water utilities will credit regular operating revenue accounts with amounts billed to customers and charge account 688, Regulatory Compliance Expense, with fees paid to the Commission.

Cause:

RWC changed its billing system in July 2018. The new billing system treated CPUC Users Fee as a pass-through activity without reporting the revenues and expenses associated with the collections and remittance of the Users Fee.

Effect:

Inaccurate reporting of Other Water Revenue (Account 480) and Regulatory Compliance Expense (Account 688) in the Annual Report, which may be used during RWC's General Rate Case (GRC) application review process, could potentially impact the water rates for RWC's ratepayers.

Recommendation:

RWC should comply with the USOA guidelines to record and report CPUC Users Fee in its Annual Reports.

Finding 7: Lack of Supporting Documentation for Ownership Equity

Condition:

RWC was unable to provide adequate documentation to support the ownership equity reported in the Annual Report. RWC reported \$156,000 of Common Stock and (66,446) of Other Paid-in Capital in the Annual Report. UAB reviewed CPUC D.71401, approved on October 11, 1966, that showed that the RWC issued 1,565 shares of its \$100 par value capital stock, in exchange for assets valued at \$156,559. At the time of stock issuance, RWC's Common Stock was \$156,500 (1,565 shares × \$100 par value per share) and the Other in Paid Capital was \$59 (\$156,559 value of assets - \$156,500 Common Stocks). RWC was unable to provide any other documentation to support the \$500 reduction in Common Stock (\$156,000 - \$156,500) and \$66,505 reduction in Other Paid in Capital ((66,446) - \$59).

Criteria:

The USOA states, in part, that:

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.

201. Common Stock

A. This account shall be credited with the total par value or stated value of common stock outstanding. B. Premiums related to the issue of common stock shall be carried in a separate subaccount of Account 211, Other Paid in Capital.

206. Subchapter S Corporation Accumulated Adjustments Account

A. This account shall be used by Subchapter S Corporations for the reporting of changes in its ownership equity.

B. This account shall include all paid-in-capital not derived from earnings.

C. This account shall be credited with:

1. Net income.

2. Accounting adjustments not properly attributable to the current period.

Cause:

RWC lacks adequate internal controls over its financial reporting system to ensure that proper and adequate documentation is maintained to support the reported ownership equity balances.

Effect:

UAB is unable to determine the accuracy of the Common Stock and Other Paid in Capital balance reported in the Annual Report due to the lack of supporting documentation to verify the amount. Consequently, the balance of Common Stock and Other Paid in Capital balance reported in the Annual Report could be materially misstated.

Recommendation:

RWC should ensure that adequate documentation is maintained to support account balances reported in the Annual Report.

Finding 8: Property Tax Prepayment Reporting Deficiency

Condition:

RWC did not properly prorate property tax payments to the correct accounting year. In 2017, RWC paid \$7,607 of property taxes for the period of January 2018 through June 2018 and incorrectly recorded the payment as an expense in the accounting period ending on December 31, 2017, instead of recording the expense in the accounting period ending on December 31, 2018. Additionally, in 2018 RWC paid \$7,310 of property taxes for the period of January 2019 through June 2019 and recorded it as an expense, instead of reporting it as a prepayment, as of December 31, 2018. As a result, the expense account for Taxes Other Than Income Taxes (Account 408) was understated by \$297 and Other Current Asset (Account 174) was understated by \$7,310.

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.

174. Other Current Assets

A. This account shall include prepayment of rents, taxes, insurance and similar expenses for which payment have been made in advance of the period to which they apply. As the periods covered by such prepayments expire, this account shall be credited, and the proper operating expense or other accounts shall be charged with the amounts applicable to the current period.

Cause:

RWC lacks internal controls over its financial reporting to ensure that account balances are properly reported in the correct accounts for the proper period.

Effect:

Inaccurate reporting of property taxes in the Annual Report, which may be used during RWC's GRC application review process, could potentially impact the water rates for RWC's ratepayers.

Recommendations:

RWC should:

- Ensure that all account balances are properly reported in the Annual Report
- Use the accrual basis of accounting to comply with the USOA.

Finding 9: Contributions in Aid of Construction (CIAC) – Lack of Supporting Documentation

Condition:

During our review of the CIAC, we noted the following deficiencies:

- RWC was unable to provide any documentation to support \$30,258 of \$361,836 of CIAC reported in the Annual Report.

- RWC was unable to provide adequate documentation to support a reclassification of expired Advances for Construction contracts as CIAC. In December 2016, RWC posted a journal entry to reclassify a balance of \$54,331 for expired Advances for Construction as CIAC. RWC provided a payment schedule that showed that \$17,066 of \$54,331 reclassification was for an Advance for Construction contract that was canceled in October 2011. The RWC was unable to provide any documentation to support the remaining \$37,265 balance of Advance in Construction that was reclassified as CIAC.

As a result, we are unable to verify the accuracy of the reported CIAC at the amount of \$67,523.

Criteria:

The USOA states, in part, that:

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.

5. Contributions in Aid of Construction

Non-refundable contributions of cash or plant facilities donated to the water utility to assist it in constructing, extending or relocating its water facilities shall be credited to an appropriate subaccount of Account 265, Contributions in Aid of Construction. (See Account 265 for description of items includible in this account.)

Balances in this account representing contributions of depreciable plant shall be written off over a period equal to the estimated service life of the property involved by charges to an appropriate subaccount of Account 272, Accumulated Amortization of Contributions (instead of to account 403, Depreciation Expense), with contra credits to and credit to an appropriate subaccount of Account 108, Accumulated Depreciation of Water Plant. The charges to this account shall continue until such time as the balance in this account applicable to such properties has been completely amortized. The balance in the account applicable to non-depreciable property shall remain unchanged until such time as the property is sold or otherwise retired. At time of retirement of non-depreciable property, which was acquired by grant funds, the costs thereof shall be credited to the appropriate plant account and charged to this account in order to eliminate any credit balance in the grant account applicable thereto. The net salvage realized on the retirement of grant-funded property shall be recorded as a credit to the appropriate subaccount of Accumulated Depreciation of Water Plant.

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

Cause:

RWC lacks adequate internal controls over its financial reporting system to ensure that proper and adequate documentation is maintained to support the balance of CIAC reported in the Annual Report.

Effect:

UAB is unable to determine the accuracy of the CIAC balance reported in the Annual Report due to the lack of supporting documentation to verify the amount. Consequently, the balance of CIAC reported in the Annual Report could be materially misstated.

Recommendation:

RWC should ensure that proper and adequate documentation is maintained and readily available to support account balances reported in the Annual Report.

Finding 10: Incorrectly Recorded Office Rental Expense and Food Costs

Condition:

UAB noted the following issues while reviewing RWC’s operating expenses:

- The RWC incorrectly recorded \$7,350 of office rental expense as Office Supplies and Expenses in Account 681 instead of recording it as the Office Services and Rentals expenses in Account 678.
- RWC improperly charged \$2,648 food purchases to operating expense Account 689, General Expenses. When we inquired with the RWC about the purpose of these food purchases, RWC stated that the food was provided during the company’s board meetings. However, the dates of the food purchases did not match the dates of the board meetings. Therefore, RWC’s claim is unsupported and we have no evidence that these food purchases relate to water utility operations. Therefore, General Expenses in Account 689 was overstated by \$2,648, while the Miscellaneous Non-Utility Expenses in Account 426 were understated by the same amount. UAB reclassified the \$2,648 to Miscellaneous Non-Utility Expense in Account 426 to reflect the audit finding.

Criteria:

The USOA states, in part:

678. Office Services and Rentals Items:

*Computer and/ or Billing Machine Credit Reports
Payments to Service Bureaus Commissions to Others
Office Equipment Rentals For Collecting Bills
Other Services"*

681 Office Supplies and Expense

This account shall include the cost of office supplies and expenses, including printing, stationery, general accounting supplies, repair, maintenance and telephone, utilities, and other office expenses

689. General Expense

This account shall include all expenses not includible in other operating expense accounts. General expenses include advertising, subscriptions, collection agency fees and Water Association dues.

Cause:

RWC does not have proper and adequate internal controls in place over its financial reporting to ensure that operating expenses are allowable and reported in the correct accounts.

Effect:

Inaccurate reporting of operating expenses in the Annual Report, which may be used during RWC's GRC application review process, could potentially impact the water rates for RWC's ratepayers.

Recommendation:

RWC should ensure that all expenses are allowable and properly reported in the Annual Report to comply with the USOA requirements.

Finding 11: Misclassification of Vacation and Sick Pay**Condition:**

RWC classified and reported vacation and sick leave expenses as regular salaries instead of classifying and reporting them as Employee Pension and Benefits expenses. The misclassification resulted in an understatement of Employee Pension and Benefits expenses by \$8,636, and overstatements of Employee Labor and Office Salaries by \$5,320 and \$3,315 respectively.

Criteria:

Regarding Account 674—Employee Pensions and Benefits, the USOA states, in part, that:

This account shall include all accruals under employee pension plans to which the utility has irrevocably committed such funds and payments for employee accident, sickness, hospital and death benefits, or insurance therefore. Include also expenses for medical, educational or recreational activities of employees.

Cause:

RWC did comply with the USOA accounting requirements.

Effect:

Inaccurate reporting of Employee Pensions and Benefits, Employee Labor, Office Salaries, and Management Salaries account balances distorted RWC's Income Statement presentation for the year ended December 31, 2018.

Recommendation:

RWC should classify accrued vacation and sick leave expenses as Employee Pension and Benefits per the USOA guidelines.

Finding 12: Accumulated Depreciation Reporting Deficiencies**Condition:**

UAB noted the following deficiencies while reviewing RWC's depreciation calculations for Water Plant in Service:

- RWC did not properly report accumulated depreciation and depreciation expense relating to Water Plant. RWC's depreciation schedule showed that the current year depreciation using the straight-line method for all water plant was \$72,721. Of this amount, \$5,278 of the depreciation was allocable to water plant acquired using CIAC funding. Therefore, the

current year Depreciation Expense in Account 403 should have been \$67,443 (\$72,721 - \$5,278). However, RWC only reported \$60,997 of Depreciation Expense. As a result, Depreciation Expense was understated by \$6,446 (\$67,443 - \$60,997).

- RWC reported \$1,551,952 of Accumulated Depreciation of Water Plant in Account 108. Based on the review of RWC's Depreciation Schedule and Accumulated Amortization of Contributions Schedule, UAB noted that the Accumulated Depreciation of Water Plant balance as of December should have been \$1,579,437. As a result, the Accumulated Depreciation of Water Plant balance in Account 108 was understated by \$27,485 (\$1,579,437 - \$1,551,952).
- RWC used two separate methodologies to depreciate its Water Plant in Service. The Water Plant in Service that RWC acquired with its own funds were depreciated using a straight-line depreciation method, while Water Plant in Service acquired using CIAC funds were depreciated using a composite rate of 3.24 percent.

Criteria:

The USOA states, in part:

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).

2. Amounts concurrently charged to Account 265, Accumulated Amortization of Contributions, representing amortization of contributed water plant.

3. Salvage value, sales price, insurance settlements and other amounts recovered from plant retired.

4. Amounts representing the balance of accumulated depreciation and amortization of water plant acquired from others.

C. A separate subaccount, Account 108.1, Accumulated Amortization of SDWBA Loan, shall be maintained for utilities with Safe Drinking Water Bond Act loans.

D. This account shall be charged with:

1. Original cost of depreciable water plant retired.

2. Cost of removal of plant retired.

Cause:

RWC used an inconsistent methodology to depreciate its assets.

Effect:

Inaccurate reporting of Accumulated Depreciation of Water Plant distorted RWC's financial position as of December 31, 2018. Inaccurate reporting of Accumulated Depreciation of Water

Plant and Depreciation Expense, which may be used during RWC's GRC application review process, could potentially impact water rates for RWC ratepayers.

Recommendation:

RWC should apply one depreciation methodology to all of its depreciable assets during the same accounting period.

CONCLUSION

In conducting this audit, we obtained an understanding of RWC's internal controls, including any information systems controls that we considered significant within the context of our audit objective. We assessed whether those controls were properly designed, implemented, and operating effectively. Any deficiencies in internal control that were identified during this audit and determined to be significant within the context of our audit objective are included in this report.

RWC's management is responsible for the preparation and fair presentation of its 2018 Annual Report filed with the CPUC. The CPUC requires that the statements be in accordance with the accounting requirements as set forth in CPUC's USOA. RWC's management is also responsible for the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of its 2018 Annual Report that are free from material misstatements, whether due to fraud or error. In addition, RWC's management is responsible for the development of its policies and procedures to ensure full compliance with applicable regulations and CPUC directives.

We conducted our audit in accordance with the applicable PU Code, regulations, and CPUC's directives. We planned and performed the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings, audit adjustments, and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings, audit adjustments, and recommendations presented in this report.

RWC Management should submit an electronic copy of its corrective action plan to UAB at UtilityAudits@cpuc.ca.gov, with a copy to Lucian Filler, Deputy Executive Director of CPUC, at Lucian.Filler@cpuc.ca.gov, and Bruce DeBerry, Program Manager of Water Division, at Bruce.DeBerry@cpuc.ca.gov no later than June 22, 2020. The corrective action plan should address how RWC will implement the recommendations and provide the timing of incorporating UAB's audit adjustments to RWC books and records. If RWC 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. RWC should use the audited amounts in UAB's audit report as the basis to file its 2019 Annual Report with the CPUC.

VIEWS OF RESPONSIBLE OFFICIAL

On April 17, 2020, UAB provided a draft audit report to RWC for comments. On May 4, 2020, RWC provided its comments to UAB, which are included in Appendix C of this report. UAB's evaluations of and rebuttals to those comments are in Appendix D of this report. Where

appropriate, UAB modified its preliminary audit findings and recommendations. The audit findings and recommendations presented in this report represent our final determination of this audit.

Angie Williams

Angie Williams, Director
Utility Audits, Risk and Compliance Division

cc: Alice Stebbins, Executive Director, CPUC
Lucian Filler, Deputy Executive Director, CPUC
Bruce DeBerry, Program Manager, Water Division
Raymond Yin, Program and Project Supervisor, UAB
Khusbindar Kaur, Senior Management Auditor, UAB
Sharmin Wellington, Public Utilities Regulatory Analyst V, UAB
Rimplejeet Bhatti, Associate Management Auditor, UAB
Sam Niepoth, Staff Services Management Auditor, UAB

AUDITED FINANCIAL STATEMENTS

Rogina Water Company **BALANCE SHEET (AS AUDITED)** As of December 31, 2018

ASSETS	
UTILITY PLANT	
Water Plant in Service (Note 2)	\$2,986,067
Accumulated Depreciation of Water Plant (Note 2)	(1,579,437)
Net Utility Plant	<u>1,406,630</u>
CURRENT AND ACCRUED ASSETS	
Cash	228,967
Cash – Special Deposit (Note 4)	31,266
Accounts Receivable – Customers	57,775
Materials and Supplies (Note 3)	9,500
Other Current Assets	12,837
Deferred Charges	348
Total Current and Accrued Assets	<u>340,693</u>
Total Assets	<u><u>\$1,747,323</u></u>
LIABILITIES AND OTHER CREDITS	
CORPORATE CAPITAL AND SURPLUS	
Common Stocks	\$156,000
Other Paid-in Capital	(66,446)
Retained Earnings (Note 8)	1,128,896
Total Corporate Capital and Retained Earnings	<u>1,218,450</u>
LONG TERM DEBT	
Long Term Debt	55,596
CURRENT AND ACCRUED LIABILITIES	
Accounts Payable	22,511
Short Term Notes Payable	57,179
Customer Deposits	2,160
Accrued Taxes	39,255
Interest Accrued	564
Total Current and Accrued Liabilities	<u>121,669</u>
DEFERRED CREDITS	
Advances for Construction (Note 5)	6,854
Other Credits	28,024
Accumulated Deferred Income Taxes - Accel. Tax Depreciation	79,571
Total Deferred Credits	<u>114,449</u>
CONTRIBUTION IN AID OF CONSTRUCTION	
Contributions in Aid of Construction (Note 6)	361,836
Accumulated Amortization of Contributions	(124,677)
Net Contributions in Aid of Construction	<u>237,159</u>
Total Equity and Liabilities	<u><u>\$1,747,323</u></u>

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

Rogina Water Company
INCOME STATEMENT (AS AUDITED)
For Year Ended December 31, 2018

OPERATING REVENUES	
Fire Protection and Hydrant Revenue	\$1,582
Irrigation Revenue	24,233
Metered Water Revenue	851,968
Other Water Revenue	11,233
Total Operating Revenues	<u>889,016</u>
OPERATING EXPENSES	
Plant Operation and Maintenance Expenses	
Purchased Water	18,800
Power	108,613
Other Volume Related Expenses	3,645
Employee Labor	80,992
Materials	19,477
Contract Work	34,257
Transportation Expenses	16,669
Other Plant Maintenance Expenses	6,578
Total Plant Operation and Maintenance Expense	<u>289,031</u>
Administrative and General Expenses	
Office Salaries	32,213
Management Salaries	72,625
Employee Pensions and Benefits	57,370
Uncollectible Accounts Expense	2,895
Office Services and Rentals	16,496
Office Supplies and Expenses	32,622
Professional Services	28,264
Insurance	19,236
Regulatory Commission Expense (Note 7)	22,172
General Expenses	9,244
Total Administrative and General Expenses	<u>293,137</u>
Total Operating Expenses	582,168
Depreciation Expense (Note 2)	67,443
Taxes Other Than Income Taxes	33,022
State Corporate Income Tax Expense	17,169
Federal Corporate Income Tax Expense	37,180
Total Operating Revenue Deductions	<u>736,982</u>
Total Utility Operating Income	152,034
OTHER INCOME AND DEDUCTIONS	
Non-Utility Income	(258)
Miscellaneous Non-Utility Expense	7,796
Interest Expense (excluding SDWBA)	11,369
Total Other Income and Deductions	<u>18,907</u>
Net Income	<u><u>\$133,127</u></u>

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

Rogina Water Company
STATEMENT OF CHANGES IN RETAINED EARNINGS (AS COMPILED ⁵)
 For Year Ended December 31, 2018

Retained Earnings, Beginning of Year	\$1,009,201
CREDITS:	
Net Income	133,127
UAB Adjustment to Cash - Special Deposit	28,483
UAB Adjustment to Other Current Asset	7,311
UAB Adjustment to Long Term Debt	57,179
UAB Adjustment to Customer Deposits	24,910
UAB Adjustment to Accumulated Deferred Income Tax Liabilities	79,571
UAB Adjustment to Miscellaneous Non-Utility Expense	2,648
UAB Adjustment to Operating Expenses	11,502
Total Credits	344,731
DEBITS:	
UAB Adjustment to Accumulated Depreciation	(27,485)
UAB Adjustment to Cash	(25,369)
UAB Adjustment to Short Term Notes Payable	(57,179)
UAB Adjustment to Other Credits	(28,024)
UAB Adjustment to Accumulated Deferred Income Taxes - Accel. Tax Depreciation	(79,571)
UCB Adjustment to Other Water Revenue	(7,408)
Total Debits	(225,036)
Retained Earnings, End of Year	\$1,128,896

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

⁵ UAB compiled the Statement of Retained Earnings based on the audited Balance Sheet and Income State, and other relevant financial data. UAB could not attest to the accuracy of the Retained Earnings balance due to the lack of historical information. Attesting to the accuracy of Retained Earnings balance as of December 31, 2018, would require auditing the Retained Earnings from the inception of the company. Due to the limitations of our audit scope, we do not attest to the accuracy of retained earnings.

ROGINA WATER COMPANY

NOTES TO FINANCIAL STATEMENTS

Regulated water utilities are required to prepare their financial statements on accrual basis of accounting set forth in the Uniform System of Accounts (USOA) for Water Utilities adopted in Decision (D.) 16-11-006 by the California Public Utilities Commission (CPUC) on November 16, 2016, which is a comprehensive basis of accounting other than the generally accepted accounting principles (GAAP) in the United States of America. The following describes 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 USOA to prepare financial statements is to have the utilities provide financial transparency of their water 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.

USOA requires utilities to use the "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 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 with more than 500 customers.⁶ The utility must obtain prior written approval from the CPUC for any practice deviates from the aforementioned SPs.

RWC used two separate methodologies to depreciate its Water Plant in Service. The Water Plant in Service that RWC acquired with its own funds were depreciated using a straight-line depreciation

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

method, while Water Plant in Service acquired using Contributions in Aid of Construction (CIAC) funds were depreciated using a composite rate of 3.24 percent. The CPUC's SP U-04-SM, Paragraph 22, specifies that the annual composite depreciation rate generally falls within the range of 2.0 percent to 3.5 percent. UAB noted that the 2018 depreciation expense was understated by \$6,446 and accumulated depreciation was understated by \$27,485. Refer to Finding 12.

(2) Asset Retirement

USOA requires that the water plant be recorded at the original cost. In USOA's depreciation schedule, the difference between the estimated cost of removal and the salvage value is included into 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 recorded in Account 108, Accumulated Depreciation of Water Plant under the USOA.

(3) Water Plant Acquisition Adjustments

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 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 temporary 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 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.

3. Inventory

GAAP allows entities to use different methodologies, such as average cost, first-in-first-out, and last-in-first-out, for the valuation of inventory, which includes cost components of raw materials, work-in-process, and finished goods, etc.

Under USOA, the inventory includes meters, materials and supplies. If identifiable, the inventory should be recorded at original cost, which includes transportation charges, sales and use taxes and other directly assignable costs. Items of small value whose original cost cannot be readily determined shall be recorded at current prices. Scrap materials shall be carried in inventory at estimated scrap value.

The RWC reported an estimated balance of \$9,500 in the materials and supplies accounts, instead of reporting the account balance at actual cost.

4. Cash for Restricted Use

Under GAAP, if the restricted funds are considered to offset the current liability, the funds may be included as current asset classification. If the funds are set aside for use in the near future for the liquidation of long-term debts, payments to sinking funds, then the funds should be classified to non-current assets. If unsure about the timing of the use, the restricted cash can be classified to Other Assets.

Under USOA, the restricted funds are recorded to Account 132, Cash–Special Deposits, which should include cash amounts set aside from general corporate funds, deposited in a separate account with fiscal agents or others, and designated for a special use. A separate subaccount shall be maintained for each designated special use. Interest earned from this account shall be credited to Account 421, Non-Utility Income.

The RWC incorrectly recorded \$28,483 collection of Facilities Fees as unrestricted Cash. The Facilities Fees are restricted for water plant improvements. Refer to Finding 3.

5. Advances for Construction

Under USOA, the advances for construction is similar to a loan for the construction work under GAAP. The construction contract must comply with the Main Extension Rule specified in the CPUC’s SP U-17-W. Among other things, one of the requirements is “Advance Main Extension Contracts would run for 40 years, with refunds at 2 ½ percent per year.”

As of December 31, 2018, the RWC reported a balance of \$6,854 for Advances for Construction.

6. Contribution in Aid of Construction (CIAC)

CIAC account records non-refundable contributions of cash, land or other property donated to the water utility to assist it in constructing, extending, or relocating its water system. The funds can be from governmental agencies and others. The balances in this account shall be written off over the period of its estimated service life by charging to Account 272, Accumulated Amortization of Contributions instead of a Depreciation Expense account, with contra credits to the appropriate subaccount of Account 108, Accumulated Depreciation of Water Plant.

The RWC reported a balance of \$361,836 for CIAC; however, the RWC was unable to provide any documentation to support \$67,523 of the balance of CIAC. Refer to Finding 9.

(1) Facilities Fees

Facilities Fees are fees collected from ratepayers for the purpose of recovering a certain amount of revenue to offset certain facilities or improvements that are required to serve additional customers. Ordering Paragraph (OP) 3 of D.91-04-068 granted authority to Class C and D water utilities, and to districts of Class A and B water utilities with 2,000 or fewer service connections, to institute facilities fees as a part of their requests for a general increase in rates. Through Resolution W-4110, the CPUC granted authority to all Class D water utilities to file generic tariffs to charge fees for new connections for the purpose of generating funds to build new plant or replace deteriorated plant. Facilities fees received by a water utility shall be deposited in Account 132, Cash–Special Deposits and credited to Account 253, Other Credits. At the time these fees are used for water plant improvements, Account 101, Water Plant in Service shall be debited and Account 132, Cash–Special Deposits credited. Concurrently, Account 253, Other Credits shall be debited and Account 265.7, All Other Contributions in Aid of Construction credited. The annual depreciation and amortization of the facilities fees plant additions shall be debited to Account 272, Accumulated Amortization of Contributions, and credited to Account 108.3, Accumulated Depreciation of Water Plant–Other. The use of facilities fees should be in compliance with SP U-28-W.

7. Water Utility Users Fee

PU Code, Sections 431 and 433 authorized the CPUC to set a fee annually to water utilities to cover the costs incurred by the CPUC in regulating them. USOA requires water utilities to credit regular operating revenue accounts with amounts of Users Fee billed to customers and charge Account 688, Regulatory Commission Expense, with fees paid to the CPUC.⁷

RWC is not in compliance with the USOA guidelines regarding the treatment of CPUC Users Fee because RWC treated the CPUC Users Fee as a pass-through activity. RWC understated its Regulatory Commission Expense by \$7,408 in the Annual Report.

8. Retained Earnings

UAB compiled the Statement of Retained Earnings based on the audited Balance Sheet and Income Statement, and other relevant financial data. UAB could not attest to the accuracy of Retained Earnings balance due to a lack of historical information on them. Attesting to the accuracy of Retained Earnings balance as of December 31, 2018, would require auditing the Retained Earnings from the inception of the company. Due to the limitations of our audit scope, we do not attest to the accuracy of retained earnings.

9. Accumulated Deferred Income Taxes – Accelerated Tax Depreciation

Accumulated Deferred Income Taxes—Accelerated Tax Depreciation account records the difference between the federal income tax expense based on a tax basis, straight-line method of depreciation and the tax liability resulting from the use of accelerated tax depreciation. For the year ended December 31, 2018, RWC reported a balance of \$79,571 for Accumulated Deferred Income Taxes—Accelerated Tax Depreciation.

The 2018 Federal Tax Law (2018 Tax Cuts and Jobs Act) significantly reduced the federal tax rate for businesses from 35 percent to 21 percent for the tax year beginning January 1, 2018. Existing authorized utility water rates for water service are based on the current federal rate of 35 percent. RWC is not tracking the impact on Commission-jurisdiction revenue requirement caused by changes in the business tax rate and other potential tax code change from the 2018 Federal Tax Law.

10. Form of Financial Statements⁸

(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.

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

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

(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 income statement, the classification of revenues and expenses, and decisions of management in incurring expenses.

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 purposes, the Statement of Cash Flows is not required and therefore excluded from this audit report.

12. Compliance filing of 2018 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 utilities to file an Annual Report with the CPUC every year. For the year being audited, RWC complied with these requirements.

UAB'S AUDIT ADJUSTMENTS

FOR THE YEAR ENDED DECEMBER 31, 2018

Audit Adj. No.	Annual Report			Acct. No.	Description	Debit	Credit
	Sch.	Line	Col.				
1	A	1	b	132	Cash-Special Deposits	\$28,483	
	A	30	c	131	Cash <i>To reclassify Facilities Fees as Cash Special Deposits</i>		\$28,483
2	A	19	c	233	Customer Deposits	\$24,910	
	A	27	c	253	Other Credits <i>To reclassify deposit relating to Facilities Fees to the other credits</i>		\$24,910
3	A	3	b	131	Cash	\$3,114	
	A	27	c	253	Other Credits <i>To reclassify deposit relating to Facilities Fees to the other credits</i>		\$3,114
4	A	30	c	283	Accumulated Deferred Income Tax Liabilities	\$79,571	
	A	29	c	282	Accumulated Deferred Income Tax - Accel. Tax Depreciation <i>To adjust for Accumulated Deferred Income Tax being recorded in the wrong account.</i>		\$79,571
5	B	6	c	403	Depreciation Expense	\$6,446	
	A	6	c	215	Retained Earnings	21,039	
	A	14	c	108	Accumulated Depreciation <i>To record accumulated depreciation and depreciation expense.</i>		\$27,485
6	A	13	e	224	Long-Term Debt	\$57,179	
	A	18	e	232	Short-Term Note Payable <i>To remove the incorrectly reported portion of Long-Term Debt to Short-Term Note Payable.</i>		\$57,179

Audit Adj. No.	Annual Report			Acct. No.	Description	Debit	Credit
	Sch.	Line	Col.				
7	B-2	26	b	688	Regulatory Commission Expense	\$7,408	
	B-1	26	b	480	Other Water Revenue <i>To reclassify regulatory commission expense as other water revenue</i>		\$7,408
8	A	36	c	174	Other Current Assets	\$7,311	
	B	8	c	408	Taxes Other Than Income Taxes	296	
	A	6	c	215	Retained Earnings <i>To adjust for misallocation of property taxes.</i>		\$7,607
9	B-2	39	b	678	Office Services and Rentals	\$7,350	
	B-2	40	b	681	Office Supplies and Expense <i>To reclassify the portion of Office Rent that was reported as Office Supplies and Expense</i>		\$7,350
10	B	16	c	426	Miscellaneous Non-Utility Expense	\$2,648	
	B	27	b	689	General Expenses <i>To reclassify expenses relating to meals to Miscellaneous Non-Utility Expense</i>		\$2,648
11	B-2	20	b	674	Employee Pension and Benefits	\$8,636	
	B-2	18	b	670	Office Salaries		\$3,315
	B-2	9	b	630	Employee Labor <i>To adjust for vacation misrecorded in Office Salaries and Employee Labor</i>		5,321

APPENDICES

APPENDIX A—BALANCE SHEETS (AS REPORTED) ⁹

	As of	
	12/31/2018	12/31/2017
ASSETS		
UTILITY PLANT		
Water Plant in Service	\$2,986,067	\$2,938,745
Accumulated Depreciation of Water Plant	(1,551,952)	(1,480,266)
Net Utility Plant	1,434,115	1,458,479
CURRENT AND ACCRUED ASSETS		
Cash	254,336	211,978
Cash-Special Deposits	2,783	2,421
Accounts Receivable – Customers	57,775	56,434
Materials and Supplies	9,500	9,500
Other Current Assets	5,526	20,436
Deferred Chargers	348	7,385
Total Current and Accrued Assets	330,268	308,154
Total Assets ¹⁰	\$1,764,383	\$1,766,633
CAPITALIZATION AND LIABILITIES		
CORPORATE CAPITAL AND SURPLUS		
Common Stocks	\$156,000	\$156,000
Other Paid in Capital	(66,446)	(66,446)
Retained Earnings	1,149,070	1,009,201
Total Corporate Capital and Surplus	1,238,624	1,098,755
LONG TERM DEBT		
Long Term Debt	112,775	166,530
CURRENT AND ACCRUED LIABILITIES		
Accounts Payable	22,511	35,310
Customer Deposits	27,070	14,512
Taxes Accrued	39,255	0
Interest Accrued	564	833
Other Current Liabilities	0	118,079
Total Current and Accrued Liabilities	89,400	168,734
DEFERRED CREDITS		
Advances for Construction	6,854	7,254
Accumulated Deferred Income Tax Liabilities	79,571	76,477
Total Deferred Credits	86,425	83,731
CONTRIBUTIONS IN AID OF CONSTRUCTION		
Contributions in Aid of Construction	361,836	361,836
Accumulated Amortization of Contributions	(124,677)	(112,953)
Net Contributions in Aid of Construction	237,159	248,883
Total Equity and Liabilities ⁹	\$1,764,383	\$1,766,633

⁹ The reported amounts were derived directly from RWC's 2017 and 2018 Annual Reports they do not represent the audited amounts. They are included here for disclosure purposes only.

APPENDIX B—INCOME STATEMENTS (AS REPORTED) ¹¹

	For the Year of	
	2018	2017
OPERATING REVENUES		
Fire Protection Revenue	\$1,582	\$2,193
Irrigation Revenue	24,233	28,874
Metered Water Revenue	851,968	853,655
Other Water Revenue	3,825	3,638
Total Operating Revenue ¹²	881,608	888,360
OPERATING EXPENSES		
Plant Operation and Maintenance Expenses		
Purchased Water	18,800	18,800
Power	108,613	106,645
Other Volume Related Expenses	3,645	2,952
Employee Labor	86,313	83,290
Materials	19,477	21,278
Contract Work	34,257	34,570
Transportation Expenses	16,669	17,794
Other Plant Maintenance Expenses	6,578	13,377
Total Plant Operation and Maintenance Expenses	294,352	298,706
Administrative and General Expenses		
Office Salaries	35,528	31,611
Management Salaries	72,625	212,625
Employee Pensions and Benefits	48,734	47,508
Uncollectible Accounts Expense	2,895	256
Office Services and Rentals	9,146	5,031
Office Supplies and Expenses	39,972	29,623
Professional Services	28,264	25,930
Insurance	19,236	20,140
Regulatory Compliance Expense	14,764	20,883
General Expenses	11,892	13,361
Net Administrative and General Expenses	283,056	406,968
Total Operating Expenses	577,408	705,674
Depreciation Expense	60,997	62,394
Taxes Other Than Income Taxes	32,726	37,972
State Corporate Income Tax Expense	17,169	5,061
Federal Corporate Income Tax Expense	37,180	8,048
Total Operating Revenue Deductions	725,480	819,149
TOTAL UTILITY OPERATING INCOME	156,128	69,211
OTHER INCOME AND DEDUCTIONS		
Non-Utility Income	258	10
Miscellaneous Non-Utility Expense	(5,148)	(11,179)
Interest Expense	(11,369)	(13,898)
Total Other Income and Deductions	(16,259)	(25,067)
NET INCOME	\$139,869	\$44,144

¹¹ The reported amounts were derived directly from RWC's 2017 and 2018 Annual Reports. They do not represent the audited amounts. They are included here for disclosure purposes only.

APPENDIX C—RWC'S RESPONSES



Rogina Water Co., Inc.

P.O. Box 310 • TALMAGE, CALIFORNIA 95481 • (707) 462-4056

Written response by Rogina Water Company Inc. for the Report and Findings:

Finding 1: Internal Control Deficiencies

Response – RWC staff includes the President and a part time bookkeeper. Due to the number of staff, RWC is unable to have an adequate internal control structure for full separation of duties.

RWC officials will implement additional controls to improve the reliability and accuracy of the financial reports. RWC will strengthen its written policies and procedures to include the review of transactions, properly completed timesheets, and ensure income and expenses are properly recorded and reviewed in a timely manner.

RWC will review its Chart of Accounts and implement the Uniform Systems of Accounts as required by the CPUC.

Finding 2: Inadequate Controls over Materials and Supplies

Response –RWC will perform an annual physical inventory of Materials and Supplies. RWC will document the inventory values at year end and update the records for financial statements.

Finding 3: Facilities Fees Reporting Deficiencies

Response –RWC will record Facilities fees collections to Account 132 and account 253 to comply with USOA requirements.

Finding 4: Accumulated Deferred Income Taxes Reporting Deficiencies

Response –RWC will record Deferred Income Tax Liability from accelerated tax depreciation to Account 282 Accumulated Deferred Income Tax Liability – Accelerated Tax Depreciation.

Finding 5: Misclassification of Long-Term Debt

Response –RWC will record the current portion of Long-Term Notes Payable to account 232 Short Term Notes Payable.

Finding 6: CPUC Users Fee Reporting Deficiencies

Response –RWC will record the CPUC User Fees income to Account 480, Other Water Revenue, and Regulatory Compliance Expense to Account 688, Regulatory Compliance Expense.

Finding 7: Ownership Equity Reporting Deficiencies

Response-RWC was incorporated in 1947. RCW will continue research of the historical data to document the changes that occurred to the Ownership Equity accounts over the past 70 years.

Finding 8: Property Tax Prepayment Reporting Deficiency

Response -RWC will record prepaid property taxes to Account 174 Other Current Asset.

Finding 9: Contributions in Aid of Construction - Lack of Supporting Documentation Response

-RWC will continue to research the CIAC balance and document the balance of Account 265 Contributions in Aid of Construction.

Finding 10: Operating Expense Reporting Deficiencies

Response -RWC will report rent expense in Account 678 Rental Expense on the Annual report. Non-Board meeting food purchases will be recorded as Miscellaneous Non-Utility expenses.

Finding 11: Misclassification of Vacation and Sick Pay

Response -RWC will report vacation and sick leave wage expense in Account 674 Employee Pension and Benefits on the Annual report.

Finding 12: Accumulated Depreciation Reporting Deficiencies

Response -RWC will report the calculation of depreciation with their CPA and record the expense as recommended by CPUC.

(RWC representative's name and signature are intentionally removed by UAB for privacy)

APPENDIX D—EVALUATION OF RWC’S RESPONSES

On May 4, 2020, Rogina Water Company (RWC) submitted its comments to Utility Audits Branch’s (UAB) draft report dated April 17, 2020. UAB reviewed and evaluated RWC’s responses and noted that RWC did not object to any of UAB’s findings and recommendations presented in the draft report. UAB appreciates RWC’s willingness to prospectively implement UAB’s recommendations.