

California Public Utilities Commission

Bakman Water Company Balancing Accounts Audit

January 1, 2023 through December 31, 2023

June 2024



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EXECUTIVE SUMMARY

Purpose of the Audit

The California Public Utilities Commission (CPUC or Commission) Utility Audits Branch (UAB) within the Utility Audits, Risk and Compliance Division, engaged Sjoberg Evashenk Consulting, Inc., to conduct an audit of Bakman Water Company's (Bakman) 2023 balancing accounts. The purpose of this balancing account audit was to determine if transactions and activities reported and recorded in Bakman's balancing accounts were for allowable purposes, supported by appropriate documentation, and maintained in compliance with applicable laws and CPUC regulations.

Findings Summary

Bakman Did Not Accrue Interest in Three Balancing Accounts As Required and Used An Incorrect Interest Calculation Methodology in Another

Commission Decision (D.) 94-06-033 states that all regulated water utility balancing accounts are subject to interest accruals except for drought and conservation related accounts. Audit testing determined that Bakman applied interest in only the Purchased Power Balancing Account and not the three other balancing accounts. According to Bakman, not applying interest in these balancing accounts is to the benefit of their ratepayers. Bakman also noted it does not currently recover any amounts in the balancing accounts through surcharges on utility bills to its ratepayers. Using the average account balances and the Federal Reserve's three-month Commercial Paper rate, Bakman should have applied a combined \$22,752 in interest in 2023 to the three balancing accounts. As a result, the combined under-collected balance totaling \$489,423 for the three balancing accounts was slightly understated as of December 31, 2023.

Further, for the Purchased Power Balancing Account, Bakman used the account's accumulated balance as the basis for the interest calculation, resulting in \$35,022 in interest in 2023. However, according to Decision (D.) 94-06-033, the average monthly account balance must be used when calculating interest for water utility balancing accounts, which is the methodology used by energy utilities. According to Bakman, using this alternate interest methodology is to the benefit of the ratepayer as it results in less interest applied to the balancing account. Had Bakman calculated interest using average account balance instead, \$35,464 of interest would have accrued in 2023 – a difference of \$442. As a result, the balancing account's reported under-collected balance of \$814,984 was slightly understated as of December 31, 2023.

Recommendation

To comply with Commission Decision (D.)94-06-033 regarding in the application of interest to balancing accounts, Bakman should apply interest in the Purchase Power, Purchase Water, Water Quality, and California Department of Public Health (CDPH) User Fees Balancing Accounts based on the average account balance using the Federal Reserve's three-month Commercial Paper rate starting with 2023 and going forward.

INTRODUCTION

Audit Authority

This audit was conducted under the general authority outlined in Public Utility (PU) Code sections 314.5, 314.6, 451, 581, 582, 584. Furthermore, PU Code section 792.5 requires the CPUC to review or audit all balancing accounts periodically to ensure that the transactions recorded in the balancing accounts are for allowable purposes and supported by appropriate documentation.

Background

The CPUC has a responsibility to authorize the rates that regulated utilities may charge their customers. Considering that the rates are derived from projected costs and projected consumption of service, the CPUC authorizes regulated utilities to establish balancing accounts to track the actual costs and the related revenues the utilities collect from ratepayers for specified activities. The primary purpose of a balancing account is to ensure that a utility recovers its CPUC-authorized revenue requirement from ratepayers for a given program or function, but not more or less.

Functionally, a balancing account tracks the difference between actual expenditures associated with the account, revenue authorized for recovery by the CPUC (authorized revenue requirement), and the actual revenues collected within customer rates to cover those specific expenditures. Applicable rules for a given balancing account are presented in the account's preliminary statement, which also includes description of the purpose of the account, the types of costs and/or revenues that are to be tracked in the account, and specific accounting procedures that the utility must follow to record transactions for the balancing account. Additionally, unless approved otherwise, a balancing account is required to accumulate monthly interest at a rate equal to one-twelfth of the most recent month's interest rate on three-month Commercial Paper published by the Federal Reserve.

Actual revenues collected by a utility in rates can be more or less than what CPUC had authorized to collect because rates are always forward-looking and based on forecasted sales. Thus, the balance in a balancing account can either be over-or under-collected. If a balancing account is over-or under-collected, the net balance is typically recovered from or refunded to ratepayers on an annual basis through an adjustment in rates.

In 2023, Bakman Water Company (Bakman) was authorized a total of 4 balancing accounts to track actual expenditures associated with the accounts. Bakman reported a total combined under-collected balance of \$1,304,407 in its 4 balancing accounts as of December 31, 2023. During the period reviewed, Bakman did not have any surcharges in place to recover the under-collected

amounts in the balancing accounts. A breakdown of the reported amounts by balancing account is provided in Appendix A.

Bakman is a private company formed in 1948 headquartered in Fresno, California. Bakman is a regulated Class B utility that delivers water to about 3,000 customers the Central Valley.

Objectives

The objectives of the audit were to determine whether Bakman Water Company's transactions and activities reported and recorded in the utilities' balancing accounts were for allowable purposes, supported by appropriate documentation, and complied with all applicable laws and CPUC regulations.

Scope

The audit covered January 1, 2023, through December 31, 2023.

Methodology

To meet the audit objectives, the audit team:

- Reviewed applicable Commission directives and decisions, CPUC's UAB Standard Practice Manual; prior Bakman balancing account audit reports and audited financial statements; and Bakman's internal policies and procedures.
- Interviewed key personnel at Bakman to obtain an understanding of the accounting and billing processes related to balancing accounts.
- Identified and evaluated Bakman internal controls over its balancing accounts.
- Evaluated whether Bakman had taken appropriate corrective action in addressing findings and recommendations from previous CPUC's UAB audits significant to the audit objectives.
- Reconciled ending balances on monthly tracking statements to Bakman accounting records and the Annual Balancing Account and Memorandum Account report submitted to the Commission.
- Performed a risk assessment of the balancing accounts. In assessing significance, evaluated the relative importance of transactions in each balancing account, performed an assessment using qualitative and quantitative factors to identify risks, evaluated the relative importance of the identified risks, including how those risks could impact the accuracy and validity of the transactions and activities reported in the balancing accounts. Of Bakman's 4 balancing accounts, selected two to include in expenditure testing. None of the four balancing accounts receive revenues, thus, testing was limited to selecting a sample of hard copy bills to perform a high level review to determine if rates charged on customer billings complied with CPUC directives and approved tariffs.

- For expenditure testing of the two balancing accounts, judgmentally selected a sample of expenditures recorded in Bakman's accounting records and reviewed supporting documentation to determine whether transactions were accurate, allowable, supported by appropriate source documents, and maintained in compliance with applicable CPUC directives, orders, rules, regulations, and utilities policies and procedures. Selected three transactions in the Purchase Power Balancing Account totaling \$124,800, or 25% of the total account, and two transactions in the Purchase Water Balancing Account totaling \$84,900, or 59% of the total account.
- Based on the results of audit testing, determined impacts on the over- or under-collection amounts reported in the balancing accounts tested.
- Calculated the amount of interest earned in each balancing account and determined if the calculation method used by Bakman complied with applicable rules, such as earning interest monthly at a rate equal to one-twelfth of the most recent month's interest rate on three-month Commercial Paper published by the Federal Reserve.

Statement of Auditing Standards

Sjoberg Evashenk Consulting, Inc. (SEC) conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards require that auditors plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for findings and conclusions based on the audit objectives. SEC believes that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT RESULTS

Finding 1

Bakman Did Not Accrue Interest in Three Balancing Accounts As Required and Used An Incorrect Interest Calculation Methodology in Another

In 2023, Bakman administered the following four balancing accounts:

- Purchased Power—tracks the difference between actual power costs and approved costs.
- Purchased Water—tracks the difference between actual water costs and approved costs.
- Water Quality—Tracks water quality related costs.
- California Department of Public Health (CDPH) User Fees—Tracks Department Health user fees.

Bakman Did Not Accrue Interest in Three Balancing Accounts

Commission Decision (D.)94-06-033 states that all regulated water utility balancing accounts are subject to interest accruals except for drought and conservation related accounts. Therefore, Bakman must apply interest in all four of its balancing accounts. Audit testing determined that Bakman applied interest in only the Purchased Power Balancing Account and not the three other balancing accounts. According to Bakman, not applying interest in these balancing accounts is to the benefit of their ratepayers. Bakman also noted it does not currently recover any amounts in the balancing accounts through surcharges on utility bills to its ratepayers. Nevertheless, Decision (D.)94-06-033 requires the application of interest as accruing interest helps utilities offset expenses and maintain stable rates and Bakman may be able to recover amounts in its balancing accounts in the future.

Using the average account balances and the Federal Reserve’s three-month Commercial Paper rate, Bakman should have applied \$12,451, \$6,390, and \$3,911 in interest in 2023 to the Purchase Water, Water Quality, and CDPH User Fees Balancing Accounts, respectively. As a result, each of the three balancing account’s reported under-collected balances were slightly understated as of December 31, 2023, as shown below:

Balancing Accounts	12/31/2023 Reported Under Collected Balance	Audited December 31, 2023 Under-Collected Balance
Purchase Water	\$289,967	\$302,418
Water Quality	\$124,309	\$130,699
CDPH User Fees	\$75,147	\$79,058

Bakman Used An Incorrect Interest Calculation Methodology to Apply Interest in the Purchased Power Balancing Account

For the Purchased Power Balancing Account, Bakman used the account's accumulated balance as the basis for the interest calculation, resulting in \$35,022 in interest in 2023. However, according to Decision 94-06-033, the average monthly account balance must be used when calculating interest for water utility balancing accounts, which is the methodology used by energy utilities. According to Bakman, using this alternate interest methodology is to the benefit of the ratepayer as it results in less interest applied to the balancing account.

Had Bakman calculated interest using average account balance instead, \$35,464 of interest would have accrued in 2023 – a difference of \$442. As a result, the balancing account's reported under-collected balance of \$814,984 was slightly understated as of December 31, 2023.

Failure to properly accrue or calculate interest as required on a monthly basis can lead to inaccurate recording and reporting of interest in its balancing accounts. Any errors in the calculation or accrual of interest in the balancing accounts can diminish the benefits to ratepayers since balancing accounts accrue interest to be returned to ratepayers if the utility is over-collected or recovered as additional revenue if the utility is under-collected. Furthermore, since any over or under-collected year-end balance, including interest, are carried over from year to year, any potential incorrect interest amount could impact customer rates by being amortized into future rates.

Recommendation

To comply with Commission Decision 94-06-033 regarding in the application of interest to balancing accounts, Bakman should:

1. Apply interest in the Purchase Power, Purchase Water, Water Quality, and CDPH User Fees Balancing Accounts based on the average account balance using the Federal Reserve's three-month Commercial Paper rate starting with 2023 and going forward.

APPENDIX A: BAKMAN'S BALANCING ACCOUNTS

	Balancing Account Name	Purpose of the Balancing Account	Balance at 12/31/2023
1	Purchased Power	Tracks the difference between actual power costs and approved costs.	\$814,984
2	Purchased Water	Tracks the difference between actual water costs and approved costs.	\$289,967
3	Water Quality	Tracks water quality related costs.	\$124,309
4	California Department of Public Health User Fees	Tracks Department Health user fees.	\$75,147
Total Balance			\$1,304,407

APPENDIX B: BAKMAN'S RESPONSE



June 28, 2024

Lynda McCallum
Sjoberg Evashenk Consulting, Inc.
455 Capitol Mall, Suite 700
Sacramento, California 95814

RE: Response to Balancing Account Audit Findings and Recommendations, June 2024

Dear Ms. McCallum:

Bakman Water Company ("BWC") provides the following information in response to the June 2024 Letter (the "Letter") from Sjoberg Evashenk Consulting, Inc ("SEC"). During SEC's Audit of BWC's balancing accounts for the year ended December 31, 2023 (collectively the "Audit"), BWC's balancing account transactions and activities were taken into consideration. The Letter presented the Audit findings and recommendations pertaining to the reported and recorded year end balances in for BWC's management consideration. BWC agrees with and appreciates the constructive direction and recommendations from the Audit process and has served as a supplemental tool towards our goals for improvement.

Audit Finding 1 – Bakman Did Not Accrue Interest in Three Balancing Accounts As Required and Used An Incorrect Interest Calculation Methodology in Another

The Letter states: "Bakman Did Not Accrue Interest in Three Balancing Accounts":

- a. Purchase Water
- b. Water Quality
- c. CDPH User Fees

The Letter recommends that BWC should accrue interest using the average account balances and the Federal Reserve's three-month Commercial Paper rate. This resulted in a slightly understated under-collected balance as of December 31, 2023.

BWC agrees with this finding and will adopt this recommended interest calculation for the three balancing accounts effective January 1st, 2024. This finding is to the benefit of the ratepayers and BWC does not feel that it is necessary to adjust prior periods. Further, as noted in the Audit Results, BWC is not currently recovering any amounts in the balancing accounts through surcharges on utility bills to its ratepayers and hasn't since April 2018, prior to BWC's last general rate increase (effective March 27, 2020). This adoption will improve the accuracy of BWC's balancing account financial reporting as it relates to compliance with Commission Decision (D.)94-06-033.

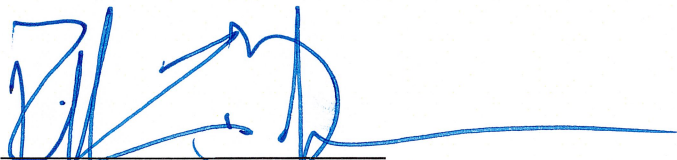
The Letter states: "Bakman Used An Incorrect Interest Calculation Methodology to Apply Interest in the Purchased Power Balancing Account":

BWC agrees with this finding and will adopt this recommended interest calculation for the Purchased Power Balancing Account effective January 1st, 2024. This finding is also to the benefit of the ratepayers and BWC does not feel that it is necessary to adjust prior periods. This adoption will improve the accuracy of BWC's balancing account financial reporting as it relates to compliance with Commission Decision (D.)94-06-033.

All recommendations received from SEC to improve BWC's accuracy of the balancing account financial reporting have been implemented and will contribute to BWC's ongoing efforts to strengthen all areas of business operations.

Should SEC have any questions or concerns regarding this Management Response Letter, please contact BWC at (559) 255-0324.

Best regards,
BAKMAN WATER COMPANY



By: Richard T. Bakman
Its: President



By: R. Shaymus Bakman
Its: Vice President