

# **California Public Utilities Commission**

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## California American Water Company Balancing Accounts Audit

January 1, 2022 through December 31, 2022

August 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 California American Water Company's (CAW) 2022 balancing accounts. The purpose of this balancing account audit was to determine if transactions and activities reported and recorded in CAW's balancing accounts were for allowable purposes, supported by appropriate documentation, and maintained in compliance with applicable laws and CPUC regulations.

## Findings Summary

### **CAW Did Not Follow Commission Directives for Timely Recovery of \$267,507 Related to Wildfire Expenses**

CPUC's Division of Water directed CAW to track revenue losses associated with the 2017 Sonoma wildfires to the Water Revenue Adjustment Mechanism/Modification Cost Balancing Account (WRAM/MCBA), in a "Larkfield" subaccount. In 2019, through Decision (D.) 21-11-018, the Commission approved a settlement agreement authorizing CAW to transfer the amount in the Larkfield subaccount balance to the Consolidated Expense Balancing Account (CEBA) for statewide recovery and to move any additional lost revenues associated with the wildfires to the CEBA for review in the next GRC cycle. However, CAW did not comply with Commission directives to transfer additional lost revenues totaling \$267,507 to the CEBA as instructed, which had yet to be transferred during this audit. As a result, the WRAM/MCBA's under-collected balance of \$16,913,844 as of December 31, 2022, was overstated by \$267,507 and the CEBA's under-collected balance of \$9,159,575 was understated by the same amount. CAW stated that it still intends to address recovering this additional lost revenue in a future GRC proceeding.

### **CAW Did Not Record \$47,625 in Interest to the WRAM/MCBA**

In 2022, CAW recorded \$193,729 in interest to the WRAM/MCBA, but should have recorded a total of \$241,354—a difference of \$47,625. Although CAW eventually noticed the error three months after year end, the account balance remained understated at year-end by \$47,625. As a result, the WRAM/MCBA's under-collected balance of \$16,913,844 as of December 31, 2022, was understated by \$47,625.

### **CAW's Preliminary Statements Did Not Include Fruitridge System Balancing Accounts and Erroneously Included Interest Requirements on Other Balancing Accounts**

CAW acquired the Fruitridge and Hillview systems in February and July 2020, respectively, which included two Fruitridge DWSRF Loan Repayment balancing accounts and Hillview Purchase Power and Hillview Tariffed balancing accounts. However, none of the four balancing accounts were reflected in CAW's 2022 preliminary statements. Additionally, CAW's new 2023 preliminary statements for the two Fruitridge DWSRF balancing accounts and the 2022 preliminary statement for the Hillview DWSRF balancing account included erroneous interest requirements that should be corrected.

## Recommendations

The report provides CAW with four recommendations to better ensure activities recorded in its balancing accounts comply with all applicable CPUC regulations and directives.

# INTRODUCTION

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## **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**

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, 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 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 2022, California American Water Company (CAW) was authorized a total of 20 balancing accounts to track actual expenditures associated with the accounts. CAW reported a total combined under-collected balance of \$80,319,129 in its 20 balancing accounts as of December 31, 2022. A breakdown of the reported amounts by balancing account is provided in

## Appendix A.

CAW, a subsidiary of American Water, is a Class-A utility serving about 675,000 customers across its Northern, Southern, and Central districts in California.

### **Objectives**

The objectives of the audit were to determine whether CAW's transactions and activities reported and recorded in its 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, 2022, through December 31, 2022.

### **Methodology**

To meet the audit objectives, the audit team:

- Reviewed applicable Commission directives and decisions, CPUC's UAB Standard Practice Manual; prior California American Water balancing account audit reports and audited financial statements; and California American Water's internal policies and procedures.
- Interviewed key personnel at California American Water to obtain an understanding of the accounting and billing processes related to balancing accounts.
- Identified and evaluated California American Water internal controls over its balancing accounts.
- Evaluated whether appropriate corrective action had been taken in addressing findings and recommendations from previous CPUC's UAB audits significant to the audit objectives, if any.
- Reconciled ending balances on monthly tracking statements to California American Water 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 CAW's twenty balancing accounts, selected the following accounts to include in revenue and expenditure testing:
  - ✓ Customer Assistance Program (CAP) Balancing Account

- ✓ Water Revenue Adjustment Mechanism/Modification Cost-Balancing Account (WRAM/MCBA)
  - ✓ Consolidated Expense Balancing Account (CEBA)
  - ✓ East Pasadena Pumping Assessment Cost Balancing Account (EPPACBA)
  - ✓ Monterey San Clemente Dam Project (MSCDP) Balancing Account
- For revenue testing of the CAP, CEBA, and MSCDP balancing accounts, compared amounts billed to customers against amounts recorded as collections/recoveries in accounting records. Also, selected a sample of hard copy bills to compare against system billing information to ensure reliability of the system information and to determine if rates charged on customer billings complied with CPUC directives and approved tariffs.
  - For expenditure testing of the WRAM/MCBA and CEBA, judgmentally selected a sample of expenditures recorded in CAW'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 ten transactions across the two balancing accounts:

Balancing Accounts Tested	Total Expenditures	Expenditures Tested	Percentage Tested
WRAM/MCBA	\$10,196,386	\$2,341,884	20%
CEBA	\$1,117,592	\$1,117,592	100%

For the EPPCBA, total cost activity was \$406,559. We reviewed the 2022 activity in the balancing account between the actual cost of pumping assessments and the cost of pumping assessments authorized in the most recent General Rate Case to ensure the amount was authorized and supported with proper documentation.

- Calculated the amount of interest earned in each balancing account and determined if the calculation method used by California American Water 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

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## Finding 1

### **CAW Did Not Follow Commission Directives for Timely Recovery of \$267,507 Related to Wildfire Expenses**

On October 9, 2017, California Governor Jerry Brown declared a state of emergency due to the Atlas and Tubbs wildfires in Sonoma County. CAW's Larkfield District had about 2,400 customers in Sonoma County and the wildfires destroyed 559 structures, including 530 residences and 29 non-residential structures, including schools and businesses. According to CAW, CPUC's Division of Water directed it to track any associated wildfire revenue losses to the Water Revenue Adjustment Mechanism/Modification Cost Balancing Account (WRAM/MCBA), in a "Larkfield" subaccount.

In 2019, CAW filed Application A.19-07-004 to increase revenues in each of its service areas for the years 2021 through 2023 – the Commission approved the application via its 2019 GRC Decision (D.) 21-11-018. Also in D. 21-11-018, the Commission approved a settlement agreement authorizing CAW to transfer \$633,317 of the Larkfield subaccount balance to the Consolidated Expense Balancing Account (CEBA) for statewide recovery via the CEBA surcharge—CAW performed the transfer to CEBA in 2021. The settlement agreement directed that any additional lost revenues associated with the 2017 wildfires be transferred to the CEBA for review in the next GRC cycle.

However, CAW incurred additional lost revenues but did not transfer an additional \$267,507 in lost revenues to CEBA during the following GRC cycle for recovery as directed by the Commission and the amount remained in the Larkfield subaccount in the WRAM/MCBA balancing account as of December 31, 2022. According to CAW, there are no additional lost revenues beyond the \$267,507 balance because all remaining impacts associated with the wildfires were incorporated in the 2019 GRC Application.

According to CAW, although the \$267,507 remained in the WRAM/MCBA balance as of December 31, 2022, the amount was not included in the filing with the Commission when the WRAM/MCBA surcharge was adjusted, which is consistent with CAW's Northern Division Tariff for the surcharge in 2022. While the \$267,507 was mistakenly omitted from CAW's 2022 GRC Application 22-07-001, it still intends to address recovering this lost revenue in a future GRC proceeding.

CAW should have transferred the \$267,507 from WRAM/MCBA to the CEBA for recovery as directed by the Commission. This helps utilities offset expenses,



recover amounts timely, and maintain stable rates. As a result, the WRAM/MCBA's under-collected balance of \$16,913,844 as of December 31, 2022 was overstated by \$267,507 and the CEBA's under-collected balance of \$9,159,575 was understated by the same amount.

## Recommendations

To ensure compliance with Commission directives, CAW should:

1. Review all compliance items, including catastrophic event related items, prior to submission of a general rate case.
2. Move the additional \$267,507 in lost revenues to CEBA during the next GRC cycle to ensure timely recovery.

## Finding 2

### CAW Did Not Record \$47,625 in Interest to the WRAM/MCBA

In 2022, CAW recorded \$193,729 in interest to the WRAM/MCBA, but should have recorded \$241,354—a difference of \$47,625. According to CAW, the interest was incorrectly calculated due to an error occurring in SAP's Web Intelligence billing history reports. Although, CAW noticed the error three months after year-end, the account remained understated and inaccurate at year-end. In March 2023, CAW recorded an interest adjustment in the balancing account in the amount of the error. As a result, the WRAM/MCBA's under-collected balance of \$16,913,844 as of December 31, 2022, was understated by \$47,625.

Failure to properly accrue or calculate interest as required 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.

To ensure accuracy in the application of interest applied to the WRAM/MCBA, CAW should:

## Recommendation

3. Develop a process to minimize the risk that the SAP's Web Intelligence billing system history reports have errors and ensure interest is correctly calculated on all applicable balances prior to year-end.

### Finding 3

#### **CAW's Preliminary Statements Did Not Include Fruitridge System Balancing Accounts and Erroneously Included Interest Requirements on Other Balancing Accounts**

CAW acquired the Fruitridge and Hillview systems in February and July 2020, respectively, which included two Fruitridge DWSRF Loan Repayment balancing accounts, Hillview Purchase Power, and Hillview Tariffed balancing accounts. However, none of the four balancing accounts were reflected on CAW's 2022 preliminary statements. CAW filed an advice letter on September 27, 2023, to add preliminary statements for the two Fruitridge DWSRF balancing accounts and in its GRC filing in 2022, CAW requested to close the Hillview Purchase Power and Tariffed balancing accounts and move the balances to CEBA.

Additionally, CAW's new 2023 preliminary statements for the two Fruitridge DWSRF balancing accounts and the 2022 preliminary statement for the Hillview DWSRF balancing account include an interest requirement. Specifically, the preliminary statements for all three balancing accounts require interest to be applied at a rate equal to one-twelfth of the rate on 90-day Commercial Paper, as reported in the Federal Reserve Statistical Release. However, according to CAW, state revolving fund accounts should only have entries related to loan payments and corresponding surcharge collections. Thus, the three preliminary statements erroneously included an interest requirement and should be corrected.

It is important that utilities reflect all balancing accounts on their preliminary statements to provide transparency to members of the public and/or ratepayers, and other stakeholders by documenting the balancing account's purposes, the applicability of tariff rates, types of costs and/or revenues recorded in the account, accounting procedures, and other provisions that do not appear in tariff rules or rate schedules. Such information, when documented correctly, in the preliminary statement enables stakeholders to validate whether given balancing accounts function within the regulatory framework and prescribed guidelines. Including required information for all balancing accounts in the preliminary statement facilitates accountability and helps ensure that each balancing account follows applicable laws, rules, regulations, and directives so that ratepayers do not pay in applicable rates than necessary.

### **Recommendation**

To provide ensure consistency and transparency in the application of interest in its balancing accounts, CAW should:

4. Work with CPUC's Water Division to correct the interest application in the DWSRF balancing accounts preliminary statements.

## APPENDIX A: CALIFORNIA AMERICAN WATER COMPANY'S BALANCING ACCOUNTS

	Balancing Account Name	Purpose of the Balancing Account	Balance at 12/31/2022
1	Water Revenue Adjustment Mechanism/ Modification Cost Balancing Account	Tracks the difference between recorded and Commission authorized water revenues and differences between recorded and Commission authorized amounts for purchased water, power, and pump taxes. Amounts are subject to revision for Interim Rate True Ups and other ongoing proceedings.	\$16,913,844
2	Customer Assistance Program (CAP) Balancing Account	Track CAP discounts provided, the CAP surcharges collected and to adjust the CAP surcharges on January 1 of each year.	(\$2,153,729)
3	Fruitridge SDWSRF Loan Repayment Balancing Account	Track recovery of the balance on SDWSRF loan D. 06-04-073.	(\$109,859)
4	Fruitridge SDWSRF Loan Repayment Balancing Account	Track recovery of the balance on SDWSRF loan D.10-05-043.	(\$234,790)
5	Garrapata SDWSRF Loan Repayment Balancing Accounts	Track recovery of the balance on SDWSRF loan.	(\$20,596)
6	Hillview SDWSRF Loan Repayment Balancing Account	Track recovery of the balance on SDWSRF loan.	(\$134,395)
7	Hillview Grant Tax Balancing Account	Track recovery of the balance on Hillview Grant Tax loan.	\$46,713
8	Consolidated Expense Balancing Account	The purpose of the Consolidated Expense Balancing Account is to consolidate the amortization of Commission approved balancing and memorandum accounts where appropriate. Some expenses from OPEB, PBA, and Group insurance are moved to CEBA for recovery through a consolidated surcharge.	\$9,159,575
9	Other-Post-Employment Benefits Balancing Account	Other-Post-Employment Benefits Balancing Account, tracks the difference between Commission-authorized OPEB related costs and actual payments. Some expenses are moved to CEBA balancing account for recovery through a consolidated surcharge.	(\$2,635,526)
10	Pension Balancing Account	Tracks the difference between Commission-authorized pensions and actual required ERISA payments-including payments to avoid at risk status. Some expenses are moved to CEBA balancing account for recovery through a consolidated surcharge.	\$223,329
11	Group Insurance	Track the difference between total requested net group insurance costs on a per-employee basis and the actual level of new group insurance costs incurred on a per employee basis. Some expenses are moved to CEBA balancing account for recovery through a consolidated surcharge.	\$386,159
12	Conservation Surcharge Balancing Account	Track conservation-related expenses and surcharges associated with California American Water's conservation efforts.	(\$1,589,365)
13	Monterey San Clemente Dam Project Balancing Account	Tracks authorized costs transferred from the prior memorandum account, actual expenditures for the project, interest at the authorized cost of capital, and any surcharge recoveries collected. The San Clemente Dam balancing account was used to track costs to remove the San Clemente Dam. California American Water is recovering this balance through base rates. The balance is amortized using the authorized revenues included in base rates, offset by the carrying costs associated with the deferred balance. On a monthly basis, the activity in this account will be a debit to amortization expense and a credit to the balancing account.	\$60,557,244
14	Monterey WW Purchased	Tracks differences in purchased power expenses based upon	(\$168,397)

	Power Balancing Account	changes in recorded unit prices versus adopted in the Monterey Waste Water district.	
15	Monterey Seaside Groundwater Basin Balancing Account	Tracks costs associated with Administrative and other payments made to the Seaside Basin Water Master, as well as recovery of such payments from customers in the Monterey County District.	(\$187,956)
16	East Pasadena – Purchased Power Balancing Account	Track differences between the actual cost of power and the cost of power authorized in the most recent GRC.	\$100,572
17	East Pasadena – Purchased Water Balancing Account	Track the differences between actual purchased water costs and purchased water costs authorized in the most recent GRC.	\$0
18	East Pasadena – Pumping Assessment Cost Balancing Account	Track the differences between actual cost of pumping assessments and the cost of pumping assessments authorized in the most recent GRC.	\$156,896
19	Hillview - Purchase Power Balancing Account	This account was carried over from the Hillview Water Company when California American Water acquired the system in July 2020. Through Advice Letter 1299-A, Hillview's tariffs were integrated into California American Water's tariffs.	\$21,930
20	Hillview Tariffed Balancing Account	This account was carried over from the Hillview Water Company when California American Water acquired the system in July 2020. Through Advice Letter 1299-A, Hillview's tariffs were integrated into California American Water's tariffs.	(\$12,520)
<b>Total Balance</b>			<b>\$80,319,129</b>

# APPENDIX B: CALIFORNIA AMERICAN WATER COMPANY'S RESPONSE

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VIA Email Only (Lynda@secteam.com)

August 6, 2024

Lynda McCallum, Partner  
Sjoberg Evashenk Consulting, Inc.  
455 Capitol Mall, Suite 700  
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**Re: California-American Water Company Updated Response to Balancing Accounts Draft Audit**

Dear Lynda:

California-American Water Company ("California American Water") appreciates the efforts undertaken by Sjoberg Evashenk Consulting, Inc.'s ("Sjoberg") to determine (1) whether transactions recorded in California American Water's balancing accounts from January 1, 2022 through December 31, 2022 were for allowable purposes and supported by appropriate documentation; and (2) whether California American Water's balancing accounts were established and maintained as required by applicable CPUC directives, orders, rules, regulations, and California American Water's policies and procedures. California American Water is gratified that based on the July 22, 2024, Draft Balancing Accounts Audit ("Draft Audit") the vast majority of California American Water's balancing accounts from January 1, 2022 through December 31, 2022 met the standards Sjoberg was directed to test. For the three minor issues identified by Sjoberg, California American Water has the following response.

### **1. Recovery of \$267,507 Related to Wildfire Expenses**

Sjoberg's first recommendation regarding the \$267,507 of wildfire expenses inadvertently omitted from California American Water's 2022 general rate case is to "Review all compliance items, including catastrophic even related items, prior to submission of a general rate case."

California American Water takes compliance seriously and has implemented a number of safeguards to ensure that all requirements are met in a timely and responsive manner. The process of regulatory compliance is as follows: (a) record compliance action items issued in regulatory decisions, (b) assign and communicate compliance items to affected parties, (c) monitor and track status of compliance items, and (d) report on status of compliance items to the Commission.

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- Record compliance action items issued in regulatory decisions. The regulatory compliance process is triggered by a Commission decision, resolution, or ruling. The compliance item is recorded into a database housed in Microsoft SharePoint.
- Assign and communicate compliance items to affected parties. Relevant parties are assigned compliance items, upon which an automatic notification is sent via SharePoint. Parties are responsible for entering status updates for each assigned item by the assigned deadline.
- Monitor and track status of compliance items. Items are monitored regularly (at a minimum, annually) as they become due. Items with discrete deadlines, or non-recurring items, are marked as expired once reported as complete before the Commission.
- Report on status of compliance items to the Commission. A comprehensive list of current items is compiled and submitted to the Commission as a part of the general rate case.

As noted above, California American Water undertakes a comprehensive review of all compliance items, including documenting the results and actions taken to ensure that all historical compliance items have been addressed. Thus, we concur with the recommendation to review all catastrophic event related compliance items prior to submission of a general rate case.

California American Water has a robust compliance processes already in place and the \$267,507 was included in California American Water's WRAM filings. The funds simply did not make it into the 2022 general rate case CEBA request. This was a very unique situation – tracking lost revenues due to the decimation of a service area by wildfires – and one we sincerely hope does not occur again.

## **2. Under-collection of \$47,625 in Interest**

The Draft Audit finds that California American Water's \$16,913,844 under-collected WRAM/MCBA balance was understated by just \$47,625 in interest. Sjoberg's recommendation is to "develop a process to minimize the risk that the SAP's Web Intelligence billing system history reports and ensure interest is correctly calculated on all applicable balances prior to year-end." This recommendation is not necessary. The interest calculation error occurred in SAP's Web Intelligence billing history reports and was caught shortly after 2022 year-end in March 2023. The then-existing Web Intelligence report calculations were reviewed and the necessary changes to address the error identified. By April 2023, the interest calculation error was remedied and not expected to reoccur due to the processes developed in April 2023.

### 3. Interest in SRF Balancing Accounts

California American Water agrees it will work with Water Division to remove the interest language from its State Revolving Fund Balancing Accounts.

California American Water also understands it is Sjoberg's position that utilities should reflect all balancing accounts on their preliminary statements, but this is not the standard. The Public Utilities Commission's Standard Practice U-27-W does not require all balancing accounts to be reflected in a utility's preliminary statement. Standard Practice U-27-W states only that authorized memorandum accounts (versus mandated memorandum accounts) are required to be reflected in a utility's preliminary statements.

Again, California American Water thanks Sjoberg for its efforts. Please let me know if you have any questions.

Thank you,

*/s/ Wes Owens*

Stephen (Wes) Owens  
Senior Director Rates and Regulatory

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