

# **Del Oro Water Company**

**Chico, California**

INDEPENDENT ACCOUNTANTS' EXAMINATION REPORT  
OF THE AFFILIATE TRANSACTION RULES FOR THE  
YEARS ENDED DECEMBER 31, 2018 AND 2017

**September 30, 2019**



K · C O E  
I S O M

# Del Oro Water Company

## TABLE OF CONTENTS

December 31, 2018 and 2017

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	<b><u>Page Number</u></b>
Independent Accountants' Examination Report	1
Executive Summary	2
Background	2
Audit Purpose and Objective	3
Audit Scope and Methodology	3
Audit Findings, Conclusions, and Response to Report	3
Appendix A – Audit Methodology, Findings, and Conclusions	4
Rule I – Jurisdiction and Applicability to the Utility Affiliates	4
Rule II – Definitions	6
Rule III – Utility Operations and Service Quality	8
Rule IV – Separation	10
Rule V – Shared Corporate Support	13
Rule VI – Pricing of Goods and Services Between the Utility and its Affiliates	14
Rule VII – Financial Health of the Utility	17
Rule VIII – Regulatory Oversight	19
Rule IX – Confidentiality	22
Rule X – Provision of Non-Tariffed Products and Services (NTP&S)	22

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## INDEPENDENT ACCOUNTANTS' EXAMINATION REPORT

To the Board of Directors  
Del Oro Water Company  
Chico, California

We have examined Del Oro Water Company, Inc.'s (DOWC), compliance with the California Public Utilities Commission's *Standard Rules and Procedures for Water and Sewer Utilities Governing Affiliate Transactions* (the Rules) and the use of *Regulated Assets for Non-Tariffed Utility Services* (Regulated Assets) for the years ended December 31, 2018 and 2017. DOWC's management is responsible for compliance with these Rules and use of Regulated Assets. Our responsibility is to express an opinion on compliance with these Rules and use of Regulated Assets based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the examination to obtain reasonable assurance about whether DOWC is in compliance with the Rules and use of Regulated Assets in all material respects. An examination involves performing procedures to obtain evidence about the Rules and use of Regulated Assets. The nature, timing, and extent of the procedures selected depend on our judgment, including assessment of the risks of material misstatement of the Rules and use of Regulated Assets whether due to fraud or error. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

In our opinion, DOWC complied with the Rules and use of Regulated Assets for the years ended December 31, 2018 and 2017, in all material respects.

This report is intended solely for the information and use of DOWC and the California Public Utilities Commission and is not intended to be, and should not be, used by anyone other than these specified parties.

*KCoe Isom, LLP*

September 30, 2019  
Chico, California

# Del Oro Water Company

## EXECUTIVE SUMMARY

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### Executive Summary

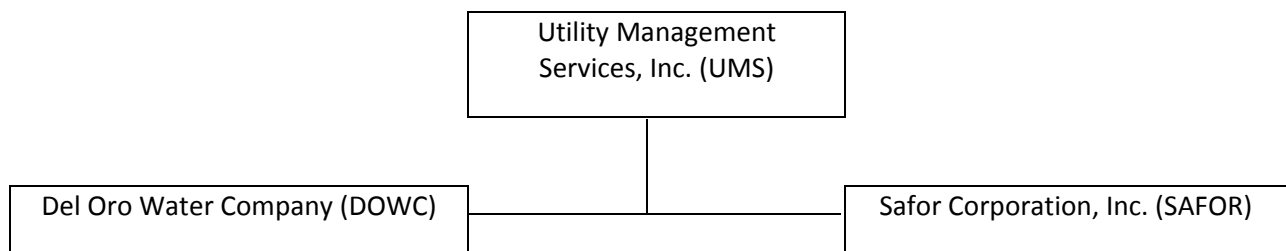
This audit addressed Del Oro Water Company, Inc.'s (DOWC) compliance with the California Public Utilities Commission's (Commission) directives regarding its *Standard Rules and Procedures for Water and Sewer Utilities Regarding Affiliate Transactions* and the use of *Regulated Assets for Non-Tariffed Utility Services (Rules)*. Our examination found that DOWC complied with all Rules. We identified one recommendation to management, which is included in the conclusion of Rule IV.B.

### Background

In October 2010, the Commission adopted Decision (D.) 10-10-019, which provided Class A and B water utilities with a set of rules governing affiliate transactions. Up to that point, some water utilities were operating under Commission affiliate transaction rules designed primarily for the establishment of holding companies. The Commission adopted these affiliate transaction rules to provide "consistent and understandable rules for all subject water and sewer utilities." The Commission further stated in the Decision that "our newly adopted rules address our goals of protecting ratepayers, ensuring the financial health of the utility, and preventing anti-competitive behavior in the competitive marketplace."

Subsequently, D.11-10-034 and D.12-01-042 were issued to modify the Rules. The Rules took effect on June 30, 2011. Also, D.15-06-047 was issued as a settlement to DOWC's July 1, 2011, to December 31, 2012, compliance audit.

DOWC is an affiliate to its parent company, Utilities Management Services, Inc. (UMS), a management company. It is also an affiliate to Safor Corporation, Inc. (SAFOR), a real estate company. DOWC, UMS, and SAFOR all operate exclusively in California, shown as follows:



# **Del Oro Water Company**

## **EXECUTIVE SUMMARY**

(Continued)

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### **Audit Purpose and Objective**

The purpose of this audit is to comply with the audit requirements of Rule VIII.E, which requires each utility to engage an independent auditor biennially to verify compliance with the Rules. The Commission's guidance states that the audits are due by September 30 of the year in which the audit is performed.

### **Audit Scope and Methodology**

The periods covered by this examination are the years ended December 31, 2018 and 2017. The examination fieldwork consisted of interviews, research, data analysis, observations, and sample testing, and was generally conducted at DOWC's headquarters in Chico, California, during the period September 1, 2019, through September 30, 2019. Appendix A describes the methodology used to determine DOWC's compliance with each Rule.

### **Audit Findings and Conclusions**

Appendix A details the findings and conclusions for each Rule, which consists of sub-rules that provide the specific criteria. In compliance to Rule VIII.C, DOWC prepared an annual compliance plan, which describes the procedures in place to ensure compliance with the Rules. We have provided DOWC's responses to the compliance plan for each Rule and sub-rule, followed by KCoe Isom's conclusions and comments.

### **Response to Report**

A preliminary draft examination report was discussed with DOWC's Director of Corporate Accounting and Regulatory Affairs on September 26, 2019. A final draft was submitted to DOWC's Chief Executive Officer and Director of Corporate Accounting and Regulatory Affairs on September 30, 2019. The report was accepted as presented herein and no further comments have been requested to be included.

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

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#### **Rule I. Jurisdiction and Applicability to the Utility Affiliates**

**Rule I.A.** These Rules apply to all Class A and Class B California public utility water and sewer corporations or companies subject to regulation by the California Public Utilities Commission (Commission).

DOWC Compliance Plan: DOWC affirms that as a Class B water utility subject to Commission regulation, these Rules apply to it and its employees.

*KCOE ISOM Conclusion:* Commission directives classify utilities as Class B if the utility serves less than 10,000 customers. DOWC served 6,403 and 8,559 customers in California in 2018 and 2017, respectively.

**Rule I.B.** These Rules apply to transactions between a Commission-regulated utility and another affiliated entity that is engaged in the provision of products that use water or sewer services or the provision of services that relate to the use of water or sewer services, including the utility's parent company, and to the utility's use of regulated assets for non-tariffed utility services, unless specifically modified or exempted by the Commission. Transactions between a Commission-regulated utility and an affiliated utility regulated by a state regulatory commission (whether the utility is located in California or elsewhere) are exempt from these Rules, except for provisions of Rule IV.B and Rule X.

DOWC Compliance Plan: DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule IV.B and Rule X. Further, DOWC affiliates continue to be UMS and SAFOR, as defined in Rule II.E. Within the Plan are descriptions of each affiliate and the applicability of Rules IV.B and X. DOWC reserves the right to reclassify an affiliate as the activities of that affiliate dictate.

*KCOE ISOM Conclusion:* We agree that DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule IV.B and Rule X for their affiliates.

**Rule I.C.** Utilities shall comply with all applicable State and Federal statutes, laws and administrative regulations.

DOWC Compliance Plan: DOWC affirms that it is in compliance with all applicable state and federal statutes, laws and administrative regulations to which it is subject.

*KCOE ISOM Conclusion:* DOWC believes it is complying with existing laws as demonstrated by the fact that they are reviewed by federal and state agencies and engage with KCOE ISOM as an independent accounting and consulting firm with no significant deficiencies reported. We obtained DOWC's consolidated reviewed financial statements for the years ended December 31, 2018 and 2017, and found that DOWC received unmodified review reports. The independent accountants' review report stated, "Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America." Additionally, we reviewed a number of water quality reports, which showed DOWC to be in compliance with federal and state standards. We also reviewed their 2018 and 2017 consolidated tax returns. After reviewing these financial statements, quality reports, and tax returns, we believe that DOWC's statement of compliance for Rule I.C is accurate.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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**Rule I.D.** Existing Commission rules for each utility and its parent company continue to apply except to the extent they conflict with these Rules. In such cases, these Rules supersede prior rules and guidelines, provided that nothing herein shall preclude (1) the Commission from adopting other utility-specific guidelines; or (2) a utility or its parent company from adopting other utility-specific guidelines, with advance Commission approval through Decision or Resolution. In the case of ambiguity regarding whether a conflict exists, there shall be a rebuttable presumption that these Rules apply.

DOWC Compliance Plan: DOWC has no utility-specific Commission rules for the Utility or its affiliates.

*KCOE ISOM Conclusion:* We obtained client representation about the Rule noting no utility-specific rules.

**Rule I.E.** Where these Rules do not address an item currently addressed in a utility's existing rules imposed by this Commission, which govern that utility's transactions with its affiliate(s) or its use of regulated assets for non-tariffed utility services, the existing utility-specific rules continue to apply for that item only.

DOWC Compliance Plan: DOWC has noted this Rule is not applicable at this time as there are no utility-specific rules for DOWC.

*KCOE ISOM Conclusion:* We obtained client representation about the Rule noting no utility-specific rules.

**Rule I.F.** These Rules do not preclude or stay any form of civil relief, or rights or defenses thereto, that may be available under state or federal law.

DOWC Compliance Plan: DOWC affirms that these Rules do not preclude or stay any form of civil relief, or rights or defenses thereto, that may be available under state or federal law.

*KCOE ISOM Conclusion:* DOWC affirms the Rule. Our inquiries and testing did not reveal any instances of non-compliance with this Rule.

**Rule I.G.** A California utility that is also a multi-state utility and subject to the jurisdiction of other state regulatory commissions, may file an application with this Commission, served on all parties to this proceeding and its most recent general rate case, requesting a limited exemption from these Rules or a part thereof, for transactions between the utility solely in its capacity serving its jurisdictional areas wholly outside of California, and its affiliates if such out-of-state operations do not substantially affect the utility's operations and the operating costs inside California. The applicant has the burden of proof.

DOWC Compliance Plan: Rule I.G does not apply to DOWC.

*KCOE ISOM Conclusion:* We agree that Rule I.G does not apply to DOWC since it only operates as a regulated utility within the state of California.

**Rule I.H.** A California utility's affiliates that operate entirely outside of California are exempt from Rule III.B and Rule III.C of these Rules, for transactions between the utility and such affiliates, if the affiliates' operations do not substantially affect the utility's operations and the operating costs inside California.

DOWC Compliance Plan: Rule I.H does not apply to DOWC.

*KCOE ISOM Conclusion:* We agree that Rule I.H does not apply to DOWC since it only operates as a regulated utility within the state of California.

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

(Continued)

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**Rule I.I.** These Rules shall be interpreted broadly, to effectuate the Commission's stated objectives of protecting consumer and ratepayer interests and, as an element thereof, preventing anti-competitive conduct.

DOWC Compliance Plan: DOWC affirms that, for its particular circumstances, application of these Rules, broadly interpreted, will, protect consumer and ratepayer interests and will prevent anti-competitive conduct.

*KCOE ISOM Conclusion:* It is the Commission's view that the Rules, broadly interpreted, should always lean in favor of the ratepayer. During our examination, KCOE ISOM observed DOWC's broad actions protecting the ratepayers. Furthermore, we interviewed DOWC's management and staff who affirmed that they comply with this Rule.

#### **Rule II. Definitions**

**II.A.** "Parent company" or "parent" is the Company, including a holding company or corporation that owns, or has substantial operational control (as defined in Rule II.E) of, the regulated utility.

**II.B.** "Utility" (unless specified as a water utility) refers to all water utilities and sewer utilities regulated by the Commission.

**II.C.** "Water utility" refers to all water utilities regulated by the Commission.

**II.D.** "Sewer utility" refers to all sewer utilities regulated by the Commission.

**II.E.** "Affiliate" means any entity whose outstanding voting securities are more than 10 percent owned, controlled, directly or indirectly, by a utility, by its parent company, or by any subsidiary of either that exerts substantial operational control.

For purposes of these Rules, "substantial operational control" includes, but is not limited to, the possession, directly or indirectly of the authority to direct or cause the direction of the management or policies of a company. A direct or indirect voting interest of more than 10 percent by the utility in an entity's company creates a rebuttable presumption of substantial operational control.

For purposes of these Rules, "affiliate" includes the utility's parent company, or any company that directly or indirectly owns, controls, or holds the power to vote more than 10 percent of the outstanding voting securities of a utility or its parent company.

Regulated subsidiaries of a utility, the revenues and expenses of which are subject to regulation by the Commission and are included by the Commission in establishing rates for the utility, are not included within the definition of affiliate for the purpose of these Rules. However, these Rules apply to all interactions any such regulated subsidiary has with other affiliated unregulated entities covered by these Rules.

For the purposes of this Rule, "affiliate" shall not include a mutual water company, a joint powers authority, other governmental or quasi-governmental agency or authority, a public/private partnership, a watermaster board, a water basin association, or a groundwater management authority in which a utility participates or in which a utility is a member or shareholder.



## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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**II.F.** "Costs" are used in these Rules to refer to the total expenses assigned or allocated to different projects or activities through the utility's and parent company's accounting systems. Cost categories include:

1. *Direct Costs:* Direct costs are costs that can be clearly identified to specific projects or activities because the resource in question, or some measurable portion of that resource, has been dedicated to the project or activity. An example would be the hours of a worker's time spent on the effort, materials purchased and used specifically on that effort, or the proportion of a machine's hours dedicated to the effort.
2. *Direct Overhead Cost:* For organizations that produce multiple outputs, direct overhead costs are the common costs of a subset of the organization, such as supervisors and support staff of a division not assigned or traceable to specific projects, or machinery shared among a subset of the company's projects. Such overhead costs require allocation to specific projects through proxies and methodologies designed to accurately reflect the particular production aspects of each project; e.g., some processes are more capital-intensive than others and need less supervision input. Allocation methodologies for direct overhead costs can make use of several factors, often activity-based and often using "cost causation" as one of the principles in their design.
3. *Indirect Overhead Costs:* Indirect overhead costs are functions that affect the entire organization, such as the headquarters building, the Chief Executive Officer and Chief Financial Officer, General Counsel and associated legal support, personnel departments, security for this building or these offices, shareholder and public relations, insurance, depreciation, advertising, and similar functions. These are real costs of the organization and must be allocated to the ongoing projects and activities to determine the total cost of each. These are also sometimes called "General Overhead Costs."
4. *Fully-Loaded:* (also known as fully-allocated) costs. Fully-loaded (or fully-allocated) costs refer to the total cost of a project or activity, which is the sum of Direct, Direct Overhead, and Indirect Overhead costs as defined in Rule II.F 1,2 and 3.

**II.G.** "Transaction" means any transfer of an item of value such as a good, service, information or money between a utility and one or more of its affiliates.

**II.H.** "Property" refers to any right or asset, tangible or intangible, to which an entity has legal or equitable title.

**II.I.** "Real property" refers to any interest in real estate including leases, easements, and water rights.

**II.J.** "Customer" means any person, firm, association corporation or governmental agency supplied or entitled to be supplied with water, wastewater, or sewer service for compensation by a utility.

**II.K.** "Customer information" means information and data specific to a utility customer which the utility acquired or developed in the course of its provision of utility services.

**II.L.** "Cross-subsidy" means the unauthorized over-allocation of costs to captive ratepayers resulting in under-allocation of costs to a utility affiliate.

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

(Continued)

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DOWC Compliance Plan: DOWC affirms these definitions and applies these definitions in the administration of its procedures, mechanisms, and policies for ensuring compliance with these rules.

*KCOE ISOM Conclusion:* DOWC applies and consistently uses these definitions in their Affiliate Transaction Rules Compliance Plans (dated April 2013, March 2014, and June 2015), Affiliated Company Transactions Procedures (revised 2015), and includes the definitions in their Affiliate Transaction Rules training. We reviewed signed acknowledgements for employees hired during the 2017 and 2018 years, noting Affiliate Compliance Plan, including definitions, was reviewed.

#### **Rule III. Utility Operations and Service Quality**

**Rule III.A.** A utility shall not allow transactions with affiliates to diminish DOWC staffing, resources, or activities in a manner that would result in degradation of the reliability, efficiency, adequacy, or cost of utility service or an adverse impact on customer service. Utility management attention shall not be diverted to such transactions in a way that would result in such degradation. The utility's parent and affiliates shall not acquire utility assets at any price if such transfer of assets would impair the utility's ability to fulfill its obligation to serve or to operate in a prudent and efficient manner.

DOWC Compliance Plan: DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule III.A. Further, DOWC's ongoing compliance with General Order (GO) 103-A precludes the possibility of degradation of the reliability, efficiency, adequacy, or cost of utility service (in particular, Section II of GO 103A, Standards of Service, "requires that each utility shall operate its system so as to deliver reliable, high quality service to its customers at reasonable cost" and that "each water utility shall ensure that it complies with the (California Department of Public Health permit requirements and all applicable drinking water regulations)"). Further, DOWC's compliance with Public Utilities Code Section 851 precludes the acquisition of utility assets in such a manner as to impair the utility's ability to fulfill its obligation to serve or to operate in a prudent and efficient manner.

*KCOE ISOM Conclusion:* We found that, other than shared corporate support, there is no degradation of utility service or impact to customer service related to the affiliates. Additionally, we examined the transactions recorded in the property, plant, and equipment accounts of the general ledger for DOWC and found no transfers of assets from DOWC to its affiliates. We interviewed DOWC management and staff who noted no degradation of utility resources.

**Rule III.B.** Except as otherwise provided by these Rules a utility shall not:

1. Provide leads to its affiliates;
2. Solicit business on behalf of its affiliates;
3. Acquire information on behalf of or to provide to its affiliates;
4. Share market analysis reports or any other types of proprietary or non-publicly available reports, including but not limited to market, forecast, planning or strategic reports, with its affiliates, except that a utility may share such information with a parent under the condition that the parent does not share the information with any other entity;

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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5. Request authorization from its customers to pass on customer information exclusively to its affiliates;
6. Give the appearance that the utility speaks on behalf of its affiliates; or
7. Represent that, as a result of the affiliation with the utility, its affiliates or customers of its affiliates will receive any different treatment by the utility than the treatment the utility provides to other, unaffiliated companies or their customers.
8. Provisions 3, 4 and 5 of Rule III.B shall not apply to utility affiliates that are nonprofit and whose sole purpose is to serve the functions of regulated utilities, the parents of regulated utilities, governmental or non-profit entities, including nonprofit affiliates of regulated utilities.
9. Utilities may file an Advice Letter seeking an exemption to Rule III.B.8 within ninety days of the effective date of the Commission decision adopting these rules, requesting that a non-profit affiliate subject to Rule III.B.8 be allowed to serve the functions of other affiliates, as long as those other affiliates provide no more than five per cent of the annual revenues of the non-profit affiliate.

DOWC Compliance Plan: DOWC affirms that it has adequate procedures, mechanisms, and policies in place to comply with Rules III.B.1., III.B.2., III.B.3., III.B.4., III.B.5., III.B.6., III.B.7., III.B.8., and III.B.9. DOWC policies and the Affiliated Company Transactions Procedures state that employees will not provide any leads to, or solicit business on behalf of, affiliates that fall under the applicability of this Rule. Except as otherwise provided by these Rules, DOWC represents that, as a result of the affiliation with the utility, its affiliates, or customers of its affiliates, will receive any different treatment by the Utility than the treatment the Utility provides to other, unaffiliated companies or their customers. Implementation of this rule is evident with DOWC's Continuing Service Agreements between DOWC and its two affiliates, UMS and SAFOR, amended to address these ATR rules.

*KCOE ISOM Conclusion:* We reviewed the continuing service agreements (amended January 1, 2017, and January 1, 2018), the Affiliated Company Transactions Procedures, and interviewed management and staff to ensure there were no solicitations, leads, or sharing of confidential information with affiliates, or any other activities listed in Rules III.B.1. through III.B.9. We reviewed the DOWC website noting there was no marketing for the affiliates. Separate websites are maintained by DOWC and the affiliates. We agree that DOWC was in compliance with Rule III.B.1 through Rule III.B.9.

**Rule III.C.** Except as provided elsewhere in these rules, if a utility provides customer or utility information, services, or unused capacity or supply to an affiliate, it must offer such customer or utility information, services, or unused capacity or supply to all similarly situated market participants in a non-discriminatory manner, which includes offering on a timely basis.

DOWC Compliance Plan: DOWC affirms that it complies with Rule. III.C.

*KCOE ISOM Conclusion:* We interviewed management and staff and reviewed an excess capacity worksheet derived from DOWC's general ledger and noted minor software, folding machine lease, and rent income for antennas placed on Paradise Pines water tower. We agree that DOWC is in compliance with this Rule.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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#### Rule IV. Separation

**Rule IV.A.** The utility shall maintain accounting records in accordance with Generally Accepted Accounting Principles, the Commission's Uniform System of Accounts, Commission decisions and resolutions, and the Public Utilities Code.

DOWC Compliance Plan: DOWC affirms that it maintains its accounting records in accordance with Generally Accepted Accounting Principles (GAAP), the Commission's Uniform System of Accounts, relevant Commission decisions and resolutions, and that its accounting records are consistent with the provisions in Public Utility Code Sections 314 and 701 (having utility accounting records available for review upon Commission request).

*KCOE ISOM Conclusion:* We examined the reviewed annual financial statements for the years ended December 31, 2018 and 2017, to confirm that they were prepared in accordance with accounting principles generally accepted in the United States of America. We also reviewed the Commission's Uniform System of Accounts and DOWC's chart of accounts to confirm that DOWC was using the Commission's Uniform System of Accounts.

**Rule IV.B.** The utility, its parent and other affiliated companies shall allocate common costs among them in such a manner that the ratepayers of the utility shall not subsidize any parent or other affiliate of the utility.

DOWC Compliance Plan: DOWC affirms that it has adequate procedures, mechanisms, and policies in place to comply with Rule IV.B. DOWC applies Rule II.F's definitions to its compliance with Rule IV.B. DOWC, its parent, UMS, and its other affiliated company, SAFOR, allocate common costs such that DOWC ratepayers do not subsidize UMS or SAFOR. These common costs include payroll and payroll benefits, office space, utilities, equipment and supplies, professional services, technology, and liability insurance. All such costs are reviewed and approved in each of DOWC's general rate cases.

*KCOE ISOM Conclusion:* By reviewing accounting records and Commission guidance for charging common costs to affiliates, we determined that DOWC appropriately included and stated common costs in the 2018 and 2017 Affiliated Transaction Reports. We reviewed DOWC's written policies and procedures and interviewed staff about yearly training related to affiliated transactions. The policies and training ensure affiliates are appropriately charged for services provided and ratepayers do not subsidize any affiliate activity. We selected samples of reported common costs and traced costs to supporting documentation to determine costs were appropriately allocated in accordance with Rules and policies. We believe that DOWC is compliance with Rule IV.B.

*Management Recommendation - Segregation of Duties:* We noted that tracking, training, and reporting of common costs to affiliates is primarily conducted by the Director of Corporate Accounting and Regulatory Affairs, with assistance from one staff accountant. We recommend extending the responsibilities to additional personnel in order to ensure ATR compliance in the event the Director of Corporate Accounting and Regulatory Affairs becomes unavailable. There is a risk associated with compliance responsibilities being dependent upon one individual.

**Rule IV.C.** The utility shall list all shared directors and officers between the utility and its affiliates in its annual report to the Commission. Not later than 30 days following a change to this list, the utility shall notify the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates of the change(s).

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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DOWC Compliance Plan: DOWC affirms that it has adequate procedures, mechanisms, and policies in place to comply with Rule IV.C. DOWC provides a list of all shared directors and officers between the utility and its affiliates in its Annual Report to the Commission and in the supporting documentation for its general rate case applications. DOWC affirms that it will notify the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates no later than 30 days following a change to the list of shared directors and officers.

*KCOE ISOM Conclusion:* We confirmed that DOWC provided the Commission with a listing of shared directors and officers in the 2018 and 2017 Affiliate Transaction Report. There were no changes in the directors or officers during 2018 and 2017.

**Rule IV.D.** Employees transferred or temporarily assigned from the utility to an affiliate shall not use non-public, proprietary utility information gained from the utility in a discriminatory or exclusive fashion to the benefit of the affiliate to the detriment of unaffiliated competitors.

DOWC Compliance Plan: DOWC will provide training to employees transferred or temporarily assigned to affiliates that fall under the applicability of this Rule, specifying that the employees shall not use non-public, proprietary utility information gained from the utility in a discriminatory or exclusive fashion to the benefit of the affiliate or to the detriment of unaffiliated competitors.

*KCOE ISOM Conclusion:* DOWC maintains a shared drive for all employees to access materials related to acceptable practices and required documentation in relation to working for affiliates. DOWC maintains rules and procedures which govern interactions with affiliates and refers employees to DOWC's *Affiliate Compliance Plan* and *Affiliated Company Transaction Procedures*. Training of newly hired employees includes information about not using or sharing non-public, proprietary utility information with affiliates. One employee was hired during the 2017 and 2018 examination period and we obtained the employee's signed acknowledgement form, which emphasized that the employee understood the Rules and the importance of not sharing proprietary information. We interviewed one employee and the Director of Corporate Accounting & Regulatory Affairs about how the training emphasizes that employees shall not use non-public, proprietary utility information to the benefit of affiliates. They affirmed that they do not use such information and have properly trained additional employees.

**Rule IV.E.** All employee movement between a utility and its affiliates, as defined in Rule I.B, shall be consistent with the following provisions:

**Rule IV.E.1** A utility shall track and report to the Commission all employee movement between the utility and affiliates, consistent with Rule VIII.F.

DOWC Compliance Plan: DOWC interprets this Rule as being applicable to permanent movement only, and it affirms that it has adequate procedures, mechanisms, and policies in place to comply with Rule IV.E.1. The utility only shares office employees temporarily; less than 30% of the calendar year. DOWC includes this information in its Affiliate Transaction Report to the Commission, when employee movement occurs. DOWC's Affiliate Transactions Procedures document provides guidance for compliance with this Rule. The current version of the Affiliate Transactions Procedures document is available to the Commission upon request. These procedures may be updated periodically and issued by DOWC's Affiliate Rules Compliance Officer.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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*KCOE ISOM Conclusion:* We reviewed the 2018 and 2017 Affiliate Transaction Report to determine if permanent transfers were included. We noted only common-shared employees, which represented less than 30% of their time during the examination period.

**Rule IV.E.2** When an employee of a utility is transferred, assigned, or otherwise employed by the affiliate, the affiliate shall make a one-time payment to the utility in an amount equivalent to 15% of the employee's base annual compensation. All such fees paid to the utility shall be accounted for in a separate memorandum account to track them for future ratemaking treatment on an annual basis, or as otherwise necessary to ensure that the utility's ratepayers receive the fees. This transfer payment provision does not apply to clerical workers.

DOWC Compliance Plan: DOWC affirms that it has adequate procedures, mechanisms, and policies in place to comply with Rule IV.E.2. DOWC includes this information in its annual Affiliate Transaction Report. DOWC's Affiliate Transactions Procedures document provides guidance for compliance with this Rule. The current version of the Affiliate Transactions Procedures document is available to the Commission upon request. These procedures may be updated periodically and issued by DOWC's Affiliate Rules Compliance Officer. DOWC conducts its affiliate transactions under ATR Rule IV.E.3. DOWC does not transfer its assets or employees (with greater than 30% of the calendar year) and, therefore, this rule is not operative.

*KCOE ISOM Conclusion:* The 2018 and 2017 Affiliate Transaction Report did not report any transfers to SAFOR or UMS. We did not become aware of any transfers among these entities during our examination, and noted that DOWC is aware of the Rule and will appropriately report and make payment if a transfer occurs.

**Rule IV.E.3** Utility employees may be used on a temporary or intermittent basis (less than 30 percent of an employee's chargeable time in any calendar year) by affiliates only if:

- a. All such use is documented, priced and reported in accordance with these Rules and existing Commission reporting requirements, except that when the affiliate obtains the services of a non-executive employee, compensation to the utility shall be priced at a minimum of the greater of fully loaded cost plus 5% of direct labor cost, or fair market values. When the affiliate obtains the services of an executive employee, compensation to the utility shall be priced at a minimum of the greater of fully loaded cost plus 15% of direct labor cost, or fair market value;
- b. Utility needs for utility employees always take priority over any affiliate requests;
- c. No more than 10% of full time equivalent utility employees may be on loan at a given time;
- d. Utility employees agree, in writing, that they will abide by these Rules; and
- e. Affiliate use of utility employees shall be conducted pursuant to a written agreement approved by the appropriate utility and affiliate officers.

DOWC Compliance Plan: DOWC affirms that it has adequate procedures, mechanisms, and policies in place to comply with Rule IV.E.3. DOWC includes this information in its Affiliate Transaction Report. DOWC's Compliance Plan and Affiliate Transactions Procedures provide guidance for compliance with this Rule. The current Compliance Plan is available to the Commission upon request. The procedures may be updated periodically and issued by DOWC's Director of Corporate Accounting and Regulatory Affairs.

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

(Continued)

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*KCOE ISOM Conclusion:* We agree that DOWC has procedures in place to ensure compliance with Rule IV.E.3. We reviewed records showing that employee time is tracked by the minute and applicable rates are applied to fully-loaded costs. We also reviewed written agreements approved by the appropriate officers of DOWC and the affiliates. We found during our examination that DOWC followed Rule IV.E.3.

#### **Rule V. Shared Corporate Support**

**Rule V.A.** A utility, its parent company, or a separate affiliate created solely to perform corporate support services may share with its affiliates, joint corporate oversight, governance, support systems, and personnel as further specified in these Rules. Any shared support shall be priced, reported and conducted in accordance with these Rules as well as other applicable Commission pricing and reporting requirements.

DOWC Compliance Plan: DOWC's Affiliate Transactions Procedures document states that the portion of the fully-loaded costs of shared corporate services that benefits Utility Management Services and other affiliates shall be charged to them. DOWC interprets this rule as permitting allocations pursuant to existing practice, previous General Rate Case (GRC) decisions, etc., to the extent allocations are in compliance with Rule IV.B. Furthermore, DOWC provides shared corporate support to its affiliates UMS and SAFOR. Shared corporate support is allocated in Compliance with Rule IV.B and reviewed during GRCs.

*KCOE ISOM Conclusion:* Based on our review and observations, we noted that shared services allocated by DOWC to UMS and SAFOR are accurately reported and fully reimbursed under Rule IV.B. We selected a sample of corporate support services and traced to supporting documentation noting appropriate tracking and timely reimbursement.

**Rule V.B.** Corporate support shall not be shared in a manner that allows or provides a means for the transfer of confidential information from the utility to the affiliate, creates the opportunity for preferential treatment or unfair competitive advantage, leads to customer confusion, or creates significant opportunities for cross-subsidy of affiliates. The restriction on transfer of confidential information from the utility to the affiliate does not apply to corporate support, shared services and access to capital.

DOWC Compliance Plan: DOWC interprets this Rule such that the restriction on transfer of confidential information from DOWC to an affiliate does not apply to corporate support, shared services, and access to capital. The provision of corporate support services does not provide a means for the transfer of confidential non-public utility information from DOWC to an affiliate that would create the opportunity for preferential treatment or unfair competitive advantage, lead to customer confusion, or create significant opportunities for cross-subsidy of affiliates.

*KCOE ISOM Conclusion:* Based on our review of transactions and inquiries of management and staff, DOWC firmly holds that the restriction on the transfer of confidential information does not apply to shared services. We agree with this conclusion based on D.10-10-019, which states in the conclusion of law (point 23), "It is reasonable to allow water and sewer utilities to share non-public or proprietary information with their affiliates for the limited purposes of shared corporate services, as long as there are sufficient limits on other sharing of nonpublic or proprietary information."

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

(Continued)

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**Rule V.C.** Examples of services that may be shared include: corporate governance and oversight, payroll, taxes, shareholder services, insurance, financial reporting, financial planning and analysis, corporate accounting, corporate security, human resources (compensation, benefits, employment policies), employee records, regulatory affairs, lobbying, legal, and pension management engineering, water or sewage for resale, water storage capacity, and purchasing of water distribution systems.

DOWC Compliance Plan: DOWC affirms that all of the services listed in Rule V.C can be shared between DOWC, UMS and SAFOR.

*KCOE ISOM Conclusion:* Based on our review and observations, we found that DOWC does share several corporate services with UMS and SAFOR, which fit the parameters of Rule V.C which are provided and paid for in accordance with Rules IV.B and V.A. We selected a sample of corporate support services and traced to supporting documentation noting appropriate tracking and timely reimbursement.

**Rule V.D.** Examples of services that may not be shared include: hedging and financial derivatives and arbitrage services, and marketing.

DOWC Compliance Plan: DOWC affirms that all of the services listed in Rule V.D cannot be shared between DOWC, its parent company (if applicable), and all covered affiliates.

*KCOE ISOM Conclusion:* Based on our observations and inquiries of management and staff, KCOE ISOM noted that DOWC's shared corporate services did not include prohibited shared services such as hedging and financial derivatives and arbitrage services, and marketing.

### **Rule VI. Pricing of Goods and Services Between the Utility and Its Affiliate(s)**

To the extent that these Rules do not prohibit the transfer of goods and services between a utility and its affiliates:

**Rule VI.A.** Transfers from the utility to its affiliates of goods and services offered by the utility on the open market will be priced at fair market value.

DOWC Compliance Plan: DOWC does not transfer employees, but does share resources as temporary or intermittent and, therefore, must follow the ATR Rules for such transactions. See Rule IV.E.3 for further discussion.

DOWC represents that staff salaries are in line with market salary rates. Salaries are established upon hiring, after which all staff receive a 5% annual raise representing a cost-of living adjustment (COLA). Salaries are competitive with local regulated utilities such as PG&E and CalWater, which provides water to Chico, directly competing for top staff. DOWC makes use of a local staffing agency to identify candidates and determine market rates. Further, DOWC headquarters are located in Chico and must compete with California State University, Chico (CSU), for staffing. CSU is a state agency and, as such, the salary scale and benefits are at the higher end of the salary range in this semi-rural job market. DOWC claims to pay slightly below CSU rates.

Affiliates reimburse DOWC for their portion of employee salary and benefits based on the percentage of time shared.



## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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The golf course owned by SAFOR was closed in 2014. There are no longer any shared corporate staffing costs related to the management of the course. However, while the golf course has been closed, the land and improvements still belong to SAFOR. SAFOR pays DOWC at tariffed rates for water used for minimal landscaping. Furthermore, the space previously occupied by the club house and pro shop are now leased as a restaurant and office space. As such, SAFOR also pays DOWC for water for these spaces at tariffed rates.

*KCOE ISOM Conclusion:* DOWC complied with this Rule.

**Rule VI.B.** Transfers from an affiliate to the utility of goods and services offered by the affiliate on the open market shall be priced at no more than fair market value.

DOWC Compliance Plan: DOWC pays SAFOR for the cost of utilities provided to its office, and for postage provided. Transfers reflect the direct cost of goods.

DOWC pays rent to SAFOR. DOWC's 2015 Compliance Plan includes a market rate study of rents in Chico where DOWC has offices on the third floor of the Silberstein Building Suites at 426 Broadway.

*KCOE ISOM Conclusion:* We confirmed that rent is shared by DOWC and its affiliates at the settlement established proportion of 80% DOWC, 10% UMS, and 10% SAFOR. Regarding the fair market value of office space:

- The Compliance Plan shows that DOWC's rent is priced at \$1.20/sf/month base rent plus \$0.42/sf/month for common area maintenance (CAM), for a total monthly payment of \$5,532.99. The compliance plan amounts represent fair market value at the time approved and is expected to be adjusted for changes in fair market value each year. In 2016, the rental rate was adjusted to \$1.24/sf/month for base rent plus \$0.46/sf/month for CAM and remained the same through 2017. In 2018, the CAM was reduced to \$0.45/sf/month. The actual average rent paid by DOWC to SAFOR for 2018 and 2017 was \$1.69 and \$1.70/sf/month, respectively, which included base rent and CAM.
- The Compliance Plan shows that SAFOR leases the other units on the third floor of the building at the same rates. Actual charges during 2018 and 2017 reflected the same rates for the third floor of the building.
- The Compliance Plan shows four other properties for lease in Chico in 2015 at base rent rates ranging from \$1.25 to \$2.05/sf/month at an average of \$1.67/sf/month. A fair market value analysis was prepared in November 2016 by the Director of Corporate Accounting and Regulatory Affairs which was used to renew the lease agreement with DOWC. The lease agreement is effective January 1, 2017, through December 31, 2021. The November 2016 fair market value analysis reflects review of six comparable properties for lease in Chico at base rental rates ranging from \$1.25 to \$2.24/sf/month, at an average rate of \$1.52/sf/month.
- DOWC's rent payments to SAFOR in 2017 and 2018 were at a base rate of \$1.24/sf/month, which is below the market rate listed in the Compliance Plan of \$1.67/sf/month and is also below the market rate analysis of \$1.52/sf/month.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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**Rule VI.C.** For goods or services for which the price is regulated by a state agency, that price shall be deemed to be the fair market value, except that in cases where more than one state commission regulates the price of goods or services, this Commission's pricing provisions govern.

This rule is not applicable to DOWC. Water is the only regulated product provided by DOWC.

**Rule VI.D.** Goods and services produced, purchased or developed to be offered on the open market by the utility shall be provided to the utility's affiliates and unaffiliated companies on a nondiscriminatory basis, except as otherwise required or permitted by these Rules or applicable law.

This rule is not applicable to DOWC. Other than water, DOWC produces no goods or services for the open market. Further, services which could potentially be provided on the open market such as billing, accounting, and office support, are either strictly within DOWC or the affiliate, or are considered a shared service. Regarding billing, UMS has dedicated staff for billing processes. DOWC billing services are not shared with its affiliates.

**Rule VI.E.** Transfers from the utility to its affiliates of goods and services not produced, purchased or developed to be offered on the open market by the utility shall be priced at fully allocated cost plus 5% of direct labor cost.

DOWC Compliance Plan: This rule applies to items identified by the DOWC as excess capacity, which includes expenses shared between DOWC and its affiliates. This is important because DOWC's reported costs impact the setting of rates. Billing rates must reflect only DOWC's costs, not those borne by the affiliates. The transfer of such costs includes:

- DOWC's IT assets are recorded as indirect overhead and are depreciated over 10 years. The annual depreciation for both 2018 and 2017 was \$6,009.65. Each affiliate properly reimbursed DOWC \$600.97, representing their 10% share of cost.
- CBSW utility billing software is a direct cost shared with UMS, which began managing two non-DOWC districts in 2014 for the city of Marysville and Ducor Community Services District. The annual sharing of this expense is based on the number of customers served. In 2017, DOWC served 8,559 customers (69%), while UMS served 3,782 customers (31%). In 2018, DOWC served 6,403 customers (63%), while UMS served 3,784 customers (37%). In both 2018 and 2017, license and maintenance costs totaled \$6,109.50, and UMS reimbursed DOWC \$2,269.40 and \$1,872.31 in 2018 and 2017, respectively.
- DOWC and UMS share the use of a leased document folding machine. Cost sharing is based on the annual lease and the total number of pieces folded by each company. In 2018 and 2017, UMS reimbursed DOWC \$3,162.32 and \$2,799.65, respectively. In 2018 and 2017, UMS processed approximately 32% of the total pieces and reimbursed DOWC accordingly.

A 5% surcharge on direct labor was not applied to the above products since their provision did not include any direct labor. Costs related to these products were shared appropriately with DOWC's affiliates.

*KCOE ISOM Conclusion:* DOWC complied with Rule VI.E.

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

(Continued)

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**Rule VI.F.** Transfers from an affiliate to the utility of goods and services not produced, purchased or developed to be offered on the open market by the affiliate shall be priced at the lower of fully loaded cost or fair market value.

DOWC Compliance Plan: DOWC represents during 2018 and 2017 that its affiliates did not transfer to DOWC any goods or services to be offered on the open market.

*KCOE ISOM Conclusion:* DOWC complied with this Rule VI.F.

**Rule VI.G.** The utility shall develop a verifiable and independent appraisal of fair market value for any goods or services that are transferred to any affiliated company at fair market value under these Rules. The Commission's staff shall have access to all supporting documents used in the development of the fair market value. If sufficient support for the appraisal of fair market value does not exist to the reasonable satisfaction of the Commission's staff, the utility shall hire an independent consultant acceptable to the Commission staff to reappraise the fair market value for these transactions.

DOWC Compliance Plan: DOWC represents that they have and will continue to provide Commission staff with access to all supporting documents used in the development of the fair market value.

DOWC developed proxies for fair market value for the goods or services as required under Rule IV.E.3. Other proxies for items transferred to SAFOR and UMS at fair market value per these Rules can also apply in Rule VI. DOWC will be responsible for obtaining an independent consultant acceptable to the Commission staff to reappraise the fair market value for these transactions if the Commission does not find DOWC's calculations of fair market value reasonable.

*KCOE ISOM Conclusion:* DOWC complied with this Rule VI.G.

## **Rule VII. Financial Health of the Utility**

**VII.A.** The parent shall provide the utility with adequate capital to fulfill all of its service obligations prescribed by the Commission.

DOWC Compliance Plan: The parent company, UMS, ensures that DOWC is provided with adequate capital to fulfill all of its service obligations.

There are no plans to create any new affiliates. However, if a new affiliate is ever created, it will be handled in accordance with this Compliance Plan and all applicable ATR Rules.

DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule VII.A. KCOE ISOM discussed capital contributions by UMS and dividend payments by DOWC with the Director of Corporate Accounting and Regulatory Affairs.

As the parent corporation to DOWC and related organization to SAFOR, UMS owns 100% of DOWC stock and is responsible to ensure that DOWC has sufficient capital and resources to carry out its obligations. To do this, UMS makes equity contributions to DOWC which may be considered capital investments. In return, DOWC pays dividends to UMS, at amounts determined by the board, as a return on UMS' investment.

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

(Continued)

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*KCOE ISOM Conclusion:* Based on reviewed financial statements for UMS and DOWC, there is no evidence of inadequate capital during 2018 and 2017. Dividend payments made to UMS seem appropriate and are not subject to fair market valuation. Therefore, DOWC complied with Rule VII.A.

**VII.B.** If the parent is publicly traded, the utility shall notify the Director of the Commission's Division of Water and Audits and the Director of the Division of Ratepayer Advocates in writing within 30 days of any downgrading to the bonds of the parent, another affiliate, and/or the utility, and shall include with such notice the complete report of the issuing bond rating agency.

Rule VII.B Not applicable; UMS is not publicly traded.

**VII.C.** The creation of a new affiliate by the parent or another affiliate shall not adversely impact the utility's operations and provision of service.

Rule VII.C. Not applicable; no new affiliates were created in 2018 and 2017.

**VII.D.** Debt of the utility's parent or other affiliates shall not be issued or guaranteed or secured by the utility.

DOWC Compliance Plan: DOWC maintains appropriate procedures and mechanisms to ensure compliance with the Rule.

*KCOE ISOM Conclusion:* We interviewed the Director of Corporate Accounting and Regulatory Affairs, and reviewed the 2018 and 2017 financial statements of UMS, DOWC, and SAFOR. We examined all relevant debt agreements held by these three entities to determine the guaranty, security, or collateral supporting each loan or line of credit.

We found no instance where the debt of UMS or SAFOR was secured or guaranteed by DOWC. Therefore, DOWC complied with Rule VII.D.

**VII.E.** Financial Separation. Within three months of the effective date of the decision adopting these Rules, each utility with a parent company shall file a Tier III advice letter proposing provisions that are sufficient to prevent the utility from being pulled into the bankruptcy of its parent company. The process specified the Advice Letter Filing shall include a verification that the provisions have been implemented and signed by the utility's senior management (e.g.; the Chief Executive Officer, Chief Financial Officer, and General Counsel).

DOWC Compliance Plan: Pursuant to the conditions stated in the letter from Commission Executive Director, Paul Clanon, to California Water Association Attorney, Jose E. Guzman, Jr., dated December 9, 2010, DOWC filed its Tier III advice letter on March 24, 2011, demonstrating its compliance with Rule VII.E.

*KCOE ISOM Conclusion:* We believe DOWC complied with Rule VII.E. We obtained a copy of Advice Letter No. 281 dated March 24, 2011, filed with the Commission.

**VII.F.** Rules VI, VII, VIII(B) and VIII (C) adopted in Decision 97-12-011 (applicable to California Water Service Company), and Rules 12, 13, 15 and 16 adopted in Decision 98-06-068 (applicable to Golden State Water Company), continue in effect for those companies only.

Rule VII.F is not applicable to DOWC.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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#### Rule VIII. Regulatory Oversight

**Rule VIII.A.** The officers and employees of the utility and its affiliated companies shall be available to appear and testify in any proceeding before the Commission involving the utility. If, in the proper exercise of the Commission staff's duties, the utility cannot supply appropriate personnel to address the staff's reasonable concerns, then the appropriate staff of the relevant utility affiliated companies including, if necessary, its parent company, shall be made available to the Commission staff.

DOWC Compliance Plan: DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule VIII.A. Per our discussions with the Director of Corporate Accounting and Regulatory Affairs, DOWC will continue to make the officers and employees of DOWC and its covered affiliates available to testify before the Commission, as necessary or required.

*KCOE ISOM Conclusion:* After interviewing DOWC management and staff reviewing the compliance procedures, we have no reason to believe that DOWC will not make staff available to appear before Commission proceedings.

**Rule VIII.B.** The utility and its affiliated companies shall provide the Commission; its staff, and its agents with access to the relevant books and records of such entities in connection with the exercise by the Commission of its regulatory responsibilities in examining any of the costs sought to be recovered by the utility in rate proceedings or in connection with a transaction or transactions between the utility and its affiliates. The utility shall continue to maintain its books and records in accordance with all Commission rules. The utility's books and records shall be maintained, housed and available in California.

DOWC Compliance Plan: DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule VIII.B. DOWC will continue to make its books and records available for examination by the Commission and its staff. The DOWC financial records are reviewed annually as part of UMS' reviewed financial statement report.

Books and records for DOWC, UMS, and SAFOR are maintained in compliance with Commission Rule IV.A: "The utility shall maintain accounting records in accordance with GAAP, the Commission's Uniform System of Accounts, Commission decisions and resolutions, and the Public Utilities Code."

*KCOE ISOM Conclusion:* During the course of this audit, DOWC provided all of the requested books and records. These books and records were maintained and stored at DOWC's Chico, California, headquarters. Maintenance of the books in accordance with Commission rules was reported under Rule IV.A.

**Rule VIII.C.** Compliance Plans. Each utility shall include a compliance plan as part of its annual report, starting in 2011 with the 2010 annual report and biennially thereafter. The compliance plan shall include:

1. A list of all affiliates of the utility, as defined in Rule II.E, and for each affiliate a description of its purposes or activities, and whether the utility claims that Rule I.B makes any portion of these Rules applicable to the affiliate;
2. A description of the procedures in place to assure compliance with these Rules; and

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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3. A description of both the specific mechanisms and the procedures that the utility and parent company have in place to assure that the utility is not utilizing the parent company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules in any respect. The description shall address, but shall not be limited to (a) the dissemination of information transferred by the utility to an affiliate covered by these Rules, (b) the provision of services to its affiliates covered by these Rules or (c) the transfer of employees to its affiliates covered by these Rules in contravention of these Rules. A corporate officer from the utility and parent company shall verify the adequacy of these specific mechanisms and procedures to ensure that the utility is not utilizing the parent company or any of its affiliates not covered by these Rules as a conduit to circumvent any of these Rules.

**DOWC Compliance Plan:** DOWC filed its most recent compliance plan with the Commission in 2015. DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule VIII.C. DOWC's Regulatory Affairs Department is responsible for maintaining and updating this compliance plan. If changes are determined to be necessary to ensure compliance, this plan will be revised and updated annually or as needed. DOWC maintains a current list of applicable affiliates of the utility. Further, DOWC affirms that this plan complies with Rule VIII.C., and that the appropriate procedures and mechanisms are detailed in its Affiliate Transactions Procedures document.

**KCOE ISOM Conclusion:** We reviewed the Compliance Plan and determined it contains the information required in items 1 through 3. No attempt to use UMS or SAFOR to circumvent the Rules was discovered.

**Rule VIII.D. New Affiliates.** Upon the creation of a new affiliate, the utility shall immediately notify the Commission of its creation, as well as posting notice of this event on its web site. No later than 60 days after the creation of this affiliate, the utility shall file an information-only filing, as provided for in Rule 6.1 of General Order 96-B, with the Director of the Commission's Division of Water and Audits, with service on the Director of the Division of Ratepayer Advocates. The advice letter shall state the affiliate's purpose or activities and whether the utility claims these Rules are applicable to the new affiliate, and shall include a demonstration to the Commission that there are adequate procedures in place that will assure compliance with these Rules. The advice letter may include a request, including supporting explanation, that the affiliate transaction rules not be applied to the new affiliate. If the utility requests that the affiliate transactions rules not be applied to the new affiliate, in lieu of an information-only filing, the utility shall file a Tier 2 advice letter making such a request, including an explanation of why these Rules should not apply to the new affiliate.

**DOWC Compliance Plan:** DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule VIII.D. DOWC will notify the Commission of the creation of any new affiliate. No later than 60 days after the creation of an applicable affiliate, the utility shall file an information-only filing, as provided for in Rule 6.1 of General Order B, with the Director of the Commission's Division of Water and Audits, with service on the Director of the Division of Ratepayer Advocates, demonstrating how DOWC will implement these Rules with respect to the new affiliate. DOWC notes that it will comply with the definition in Rule II.E of this plan.

**KCOE ISOM Conclusion:** We found no evidence that DOWC created a new affiliate during the period under audit.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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**Rule VIII.E.** Independent Audits. Commencing in 2013, and biennially thereafter, the utility shall have an audit performed by independent auditors if the sum of all unregulated affiliates' revenue during the last two calendar years exceeds 5% of the total revenue of the utility and all of its affiliates during that period. The audits shall cover the last two calendar years which end on December 31, and shall verify that the utility is in compliance with these Rules. The utility shall submit the audit report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates no later than September 30 of the year in which the audit is performed. The Division of Water and Audits shall post the audit reports on the Commission's web site. The audits shall be at shareholder expense.

DOWC Compliance Plan: DOWC will comply with this Rule, as stated, and will cooperate with the Commission's independent auditor, as well as the Division of Water and Audits during the audit.

The combined revenues of UMS and SAFOR exceed 5% of DOWC's revenues. Therefore, DOWC must undertake biennial audits to verify that it is in compliance with these rules.

*KCOE ISOM Conclusion:* This report represents the completion of the required independent audit for the years ended December 31, 2018 and 2017, which is due September 30, 2019. The procedures were completed in accordance with the planned scope and timing.

**Rule VIII.F.** Annual Affiliate Transaction Reports. Each year, by March 31, the utility shall submit a report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates that includes a summary of all transactions between the utility and its affiliated companies for the previous calendar year. The utility shall maintain such information on a monthly basis and make such information available to the Commission's staff upon request. The summary shall include a description of each transaction and an accounting of all costs associated with each transaction although each transaction need not be separately identified where multiple transactions occur in the same account (although supporting documentation for each individual transaction shall be made available to the Commission staff upon request). These transactions shall include the following:

1. Services provided by the utility to the affiliated companies;
2. Services provided by the affiliated companies to the utility;
3. Assets transferred from the utility to the affiliated companies;
4. Assets transferred from the affiliated companies to the utility;
5. Employees transferred from the utility to the-affiliated companies;
6. Employees transferred from the affiliated companies to the utility;
7. The financing arrangements and transactions between the utility and the affiliated companies;
8. Services provided by and/or assets transferred from the parent holding company to affiliate company which may have germane utility regulation impacts; and
9. Services provided by and I or assets transferred from affiliated company to the parent holding company which may have germane utility regulation impacts.

## **Del Oro Water Company**

### **APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS**

(Continued)

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DOWC Compliance Plan: DOWC maintains appropriate procedures and mechanisms to ensure compliance with Rule VIII.F. DOWC affirms that, as part of its Annual Report to the Commission, it will submit an affiliate transactions report to the Director of the Division of Water and Audits and the Director of the Division of Ratepayer Advocates that includes a summary of all transactions between the utility and its affiliated companies for the previous calendar year.

*KCOE ISOM Conclusion:* We reviewed copies of the 2018 and 2017 affiliate transaction reports and determined they include the required summary, monthly breakdown, and transaction descriptions, as well as the information required in items 1 through 9.

#### **Rule IX. Confidentiality**

Any records or other information of a confidential nature furnished to the Commission pursuant to these Rules that are individually marked Confidential are not to be treated as public records and shall be treated in accordance with P.U. Code § 583 and the Commission's General Order 66-C, or their successors.

DOWC Compliance Plan: DOWC affirms compliance with Rule IX: "Del Oro shall take care to submit confidential documents to the Commission individually marked as confidential. Del Oro acknowledges that all documents not so individually marked shall be treated as public records."

*KCOE ISOM Conclusion:* P.U. Code § 583 makes it a misdemeanor for any current or former officer or employee of the Commission to divulge certain confidential information furnished to the commission by a public utility. To confirm that DOWC properly indicates confidential information we:

- Discussed Rule IX with DOWC regulatory affairs personnel.
- Examined DOWC's compliance plan.
- Examined sample documents stored online with DOWC staff; and
- Examined sample documents provided to consultants for proper redaction and indication of confidential information.

DOWC complied with Rule IX by properly indicating that confidential information it submits is to be treated as confidential.

#### **Rule X. Provision of Non-Tariffed Products and Services (NTP&S)**

**X.A.** Except as provided for in these rules, new products and services shall be offered through affiliates.

DOWC Compliance Plan: DOWC has one NTP&S activity - a portion of DOWC land which is rented for the placement of cellular towers. This activity is conducted in accordance with Rule X.B.

*KCOE ISOM Conclusion:* DOWC complied with Rule X.A.



## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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**X.B.** A utility may only offer on the open market the following products and services:

1. Existing products and services offered by the utility pursuant to tariff;
2. New products and services that are offered on a tariffed basis; and
3. Products and services that are offered on a non-tariffed basis (NTP&S) and that meet the following conditions:
  - a) The NTP&S utilizes a portion of the excess or unused capacity of a utility asset or resource;
  - b) Such asset or resource has been acquired for the purpose of and is necessary and useful in providing tariffed utility services;
  - c) The involved portion of such asset or resource may only be used to offer the product or service on a non-tariffed basis without adversely affecting the cost, quality or reliability of tariffed utility products and services;
  - d) The products and services can be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk being incurred by utility ratepayers, and no undue diversion of utility management attention; and
  - e) The utility's offering of the NTP&S does not violate any California law, regulation, or Commission policy regarding anticompetitive practices.

*KCOE ISOM Conclusion:* Based on the work and discussion below, DOWC appears to have complied with Rule X.B.

**X.C. Revenues.** Gross revenue from NTP&S projects shall be shared between the utility's shareholders and its ratepayers. In each general rate case, NTP&S revenues shall be determined and shared as follows:

1. Active NTP&S projects: 90% shareholder and 10% ratepayer.
2. Passive NTP&S projects: 70% shareholder and 30% ratepayer.
3. A utility shall classify all NTP&S as active or passive according to the table below. For a new NTP&S not listed in the table, which requires approval by the Commission by advice letter pursuant to Rule X.G, an "active" project requires a shareholder investment of at least \$125,000. Otherwise the new NTP&S shall be classified as passive. No costs recoverable through rates shall be counted toward the \$125,000 threshold.
4. Revenues received that are specified in a contract as pass-through of costs, without any mark-up, shall be excluded when determining revenue sharing. If an advice letter is required pursuant to Rule X.G, the utility shall specify in the advice letter any items other than postage, power, taxes, and purchased water for which it proposes pass-through treatment and must obtain Commission approval for such treatment.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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5. For those utilities with annual Other Operating Revenue (OOR) of \$100,000 or more, revenue sharing shall occur only for revenues in excess of that amount. All NTP&S revenue below that level shall accrue to the benefit of ratepayers.
6. For those utilities with annual OOR below \$100,000, there shall be no sharing threshold; and ratepayers shall accrue all benefits for non-tariffed products and services.

DOWC Compliance Plan: The cellular tower NTP&S is a passive project as defined by Rule X.C. DOWC collects and retains 100% of the fee for this land rental, and this income is accounted for in GRCs.

*KCOE ISOM Conclusion:* We received and reviewed the Lease agreements with Verizon and American Tower to understand and verify the fluctuating monthly rental payment amounts.

Per discussion with the Director of Corporate Accounting and Regulatory Affairs, as clarified in Decision 15-06-047, DOWC fully accounts for these revenues so as to diminish DOWC's labor costs and thereby diminish the costs to ratepayers. Reduced DOWC labor costs are reflected appropriately in their financial statements and Affiliate Transaction Reports.

DOWC has not completed a GRC since 2014, and expects a new GRC to be submitted in 2019 which will reflect the 5 year average (2014-2018) against the Employee Labor Expense. The five year average is \$36,875.84.

DOWC complied with Rule X.C.

**X.D. Cost Allocation.** All costs, direct and indirect, including all taxes, incurred due to NTP&S projects shall not be recovered through tariffed rates. These costs shall be tracked in separate accounts and any costs to be allocated between tariffed utility services and NTP&S shall be documented and justified in each utility's rate case. More specifically, all incremental investments, costs, and taxes due to non-tariffed utility products and services shall be absorbed by the utility shareholders, i.e., not recovered through tariffed rates.

DOWC Compliance Plan: DOWC does not incur additional costs by providing this NTP&S.

*KCOE ISOM Conclusion:* Per discussion with the Director of Corporate Accounting and Regulatory Affairs, and review of documents associated with the NTP&S, DOWC does not incur additional costs by providing this NTP&S.

**X.E. Annual Report of NTP&S Projects.** Each utility shall include information regarding its NTP&S projects in its Annual Reports, including but not be limited to the following:

1. A detailed description of each NTP&S activity;
2. Whether and why it is classified active or passive;
3. Gross revenue received;
4. Revenue allocated to ratepayers and to shareholders, as established in the company's current general rate case;
5. A complete identification of all regulated assets used in the transaction;

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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6. A complete list of all employees (by position) that participated in providing the non-tariffed service, with amount of time spent on provision of the service;
7. If the NTP&S has been classified as active through advice letter submission, provide the number of the advice letter and the authorizing Resolution; and
8. If the NTP&S did not require approval through advice letter, provide the date notice was given to the Commission.

DOWC Compliance Plan states that NTP&S is reported in Del Oro's Annual Reports.

*KCOE ISOM Conclusion:* We obtained and reviewed copies of DOWC's 2018 and 2017 Affiliate Transaction Reports, Report of Inter-Affiliate Expenses, and also supporting worksheet reports related to excess capacity. NTP&S related to the antenna in Paradise Pines is reflected as a passive project and accurately recorded.

DOWC complied with Rule X.E.

**X.F.** When a utility initiates the offering of NTP&S that are designated as active or passive in the table below, the utility shall provide notice of such activity by letter to the Director of the Division of Water and Audits and the Program Manager of the Division of Ratepayer Advocates-Water Branch, within 30 days of instituting such activity.

DOWC Compliance Plan: There were no new NTP&S initiated during 2018 and 2017.

*KCOE ISOM Conclusion:* Based on our discussions with the Director of Corporate Accounting and Regulatory Affairs, the current NTP&S has been provided for many years, though the accounting for cellular tower revenues changed in 2014 and was subsequently confirmed in Decision 15-06-047. There were no new NTP&S initiated during 2018 and 2017. As such, DOWC has nothing to report under Rule X.F. Based on the above, DOWC appears to have complied with Rule X.F.

**X.G. Provision of New NTP&S.** Any water or sewer utility that proposes to engage in the provision of new NTP&S not included in the table below, using the excess capacity of assets or resources reflected in the utility's revenue requirement, and which are proposed to be classified as active as described herein, shall file a Tier 3 advice letter (see Resolution ALJ-202) with the Director of the Division of Water and Audits seeking Commission approval. The advice letter shall be served on the service list for Rulemaking 09-04-012 and the service list for the utility's current or most recent general rate case. The advice letter shall contain the following:

1. A full description of the proposed NTP&S, including, without limitation, the identity of parties served (if known), revenue and cost forecasts, and the term of any contract to be employed.
2. A description of the accounting method to be used to allocate the incremental costs between tariffed services and caused by the NTP&S.
3. Copies of all operative documents for the proposed service.
4. A detailed description of any items other than postage, power, taxes, and purchased water for which the utility proposes pass-through treatment for purposes of calculating revenue sharing.

## Del Oro Water Company

### APPENDIX A – AUDIT METHODOLOGY, FINDINGS, AND CONCLUSIONS

(Continued)

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5. Complete identification of all utility regulated assets and personnel resources that will be used in the proposed transaction. Identify the particular excess capacity (or capacities) asset or resource to be used to provide the NTP&S.
6. A complete list of all employees that will participate in providing the service, with an estimate of the amount of time each will spend.
7. A showing that the proposed NTP&S may be offered without adversely affecting the cost, quality, or reliability of the utility services.
8. A showing of how the NTP&S will be marketed with minimal or no incremental ratepayer capital, minimal or no new forms of liability or business risk, and no undue diversion of utility management attention.
9. A showing of how the NTP&S does not violate any law, regulation; or Commission policy regarding anti-competitive practices.
10. A justification for classifying the NTP&S as active. The utility shall demonstrate that there is or will be incremental shareholder investments above \$125,000.
11. A statement that all risks incurred through this proposed NTP&S project shall be borne by the utility's shareholders.
12. A description of the market served by the proposed NTP&S project, a list or description of the current incumbents in that market, and an analysis of how the utility's entry into the market will affect the market competitiveness. Include in this analysis a description of how the utility will guard against using anti-competitive pricing in this market.
13. Any other information, opinions, or documentation that might be relevant to the Commission's consideration of the NTP&S.

DOWC Compliance Plan: There were no new NTP&S initiated during 2018 and 2017.

*KCOE ISOM Conclusion:* Based on our discussions with the Director of Corporate Accounting and Regulatory Affairs, the current NTP&S has been provided for many years, though the accounting for cellular tower revenues changed in 2014 and was subsequently confirmed in Decision 15-06-047, as discussed in Rule X.C., there were no new NTP&S initiated during 2018 and 2017. As such, DOWC has nothing to report under Rule X.G. Based on the above, DOWC appears to have complied with Rule X.G.