CALIFORNIA WATER SERVICE GROUP
CALIFORNIA WATER SERVICE COMPANY • CWS UTILITY SERVICES
1720 NORTH FIRST STREET • SAN JOSE, CA 95112-4598 • (408) 367-8200

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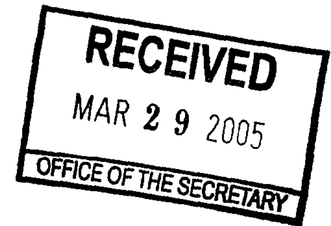

March 28, 2005

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File Number 4-497, Section 404 Sarbanes-Oxley Feedback

Dear Sir:

Cal Water has always been committed to full and proper disclosure for financial reporting. We believe the Sarbanes-Oxley Act of 2002 has helped to restore the confidence of the investing public in America's companies. However, we feel those benefits can still be achieved with reduced costs of compliance by making changes to the standards. The documentation, testing and auditor requirements related to section 404 of Sarbanes-Oxley have caused audit fees to more than double, internal compliance and testing costs to significantly increase by a similar percent and large incremental consulting costs to be incurred to achieve compliance.

We are providing this letter to give the Securities and Exchange Commission feedback regarding our experience implementing the new internal control requirements under Section 404. We are a regulated utility company providing water service through our wholly-owned subsidiaries to two million people in California, Washington, New Mexico, and Hawaii. We recently completed our calendar year-end with revenues of $316 million and an aggregate market capitalization of $689 million as of December 31, 2004. We filed our year-end public report on Form 10-K on March 15, 2005, which contained affirmative attestation reports on internal control over financial reporting and management's assessment of internal control over financial reporting by our outside auditors, KPMG.

Here is a summary of issues we experienced followed by detailed explanations.

Section 404 Implementation Issues:

1. Rules and implementation guidelines were issued without adequate lead time for understanding, planning and execution
2. Key controls inadequately defined and utilized during testing
3. Risk assessment not properly utilized in control testing
4. Documentation requirements
5. Improper assessment of individual controls within control framework
6. "Significant Deficiency" defined too broadly
7. In IT departments, best practices shortfalls were judged to be deficiencies
8. Re-performance of management's tests by external auditors
9. Significantly higher fees by the external auditor

Although some of these issues may be slightly less burdensome in the second year of implementation, we believe serious consideration should be given our recommended changes.

The following is a brief narrative on the above points:

1. **Rules and procedures issued without adequate lead time for understanding, planning and execution.** There was very little guidance issued by either the Public Company Accounting Oversight Board (PCAOB) or the SEC until late in the process. Even though drafts of PCAOB Standard No. 2 were issued in October 2003, this comprehensive Standard was not approved by the SEC until June 2004. As has been noted in publications, this Standard does not scale well to smaller companies. This Standard contained a large number of rules that involved interpretation and judgment in the application for specific company's internal control structure. In the second half of 2004, we were forced to scramble to understand and implement the ever-changing guidance. For example, interpretations related to spreadsheets did not evolve until the second half of 2004, which created huge challenges. New rules of this magnitude should have an effective date of at least one year from the approval date.
2. **Key controls inadequately defined and utilized during testing.** The application of a key control was very judgmental in the process, causing rework, expanded testing and scope expansion as more controls were judged to be key controls during the evaluation process. The concept of key controls needs to be clarified for companies and auditors in their testing.
3. **Risk assessment not properly utilized in control testing.** While the standards and guidance discuss risk assessment in COSO, the risk assessment was not utilized appropriately to limit testing to high risk items. In our opinion, the requirements of the Standard do not properly focus on the risk profile. One item in the Standard involves testing significant locations (those with greater than 5% of consolidated assets, revenues or operating income). For our operations, each of these locations has similar processes and there are Company level controls that exist for these remote locations. Testing by the Company and auditors was performed at 10 of the 24 remote locations, with similar conclusions reached at each location. Management's view was the processes at the remote locations were lower risk than other processes at the corporate office, but the Standard requirements caused significant resources to be allocated to these low risk areas due to defined criteria. Defining specific scope criteria is helpful, but exceptions need to be allowed to fit the risk profile of a specific company.
4. **Documentation Requirements**. Too much time and cost was spent by the Company and our external auditors to meet the SEC/PCAOB exorbitant documentation requirements. These burdensome requirements need to be re-examined for appropriate cost/benefit.

5. **Improper assessment of individual controls within control framework.** Due to the prescriptive nature of the Standard, there was very little allowance in the requirements for companies and auditors to use the "reasonable person" approach in evaluating the effectiveness of controls. Each control either passed or failed on its own merit without an analysis of how that particular control fit into the overall financial reporting process. If 30 transactions were tested and one piece of paper did not have the appropriate approval signature, a deficiency was noted; tests were expanded, severity was assessed, every step was documented, and management's time was spent on items that we believe were clearly inconsequential. There were too many "trees and twigs" examined without an appreciation for the "forest." A process should be assessed as being deficient, not an individual control.
6. **"Significant Deficiency" defined too broadly.** The definition of a "significant" deficiency put forth by the PCAOB as being anything more than inconsequential put almost every transaction into scope and subject to review and interpretation. We understand that many minor items collectively could potentially cause a material error, but some level of risk should be accepted as no internal control system can eliminate all errors. The definition of a significant deficiency needs to be reconsidered.
7. **In IT departments, best practices shortfalls were judged to be deficiencies.** There was no clear dividing line between best practices and deficiencies. This was especially true in the information technology (IT) arena. Items such as disaster recovery and corporate training were thrown into the equation as being part of the section 404 reviews, which increased the scope and the cost to the Company. While IT is clearly part of the reporting processes, testing was not prioritized as to exposure. Almost everything in IT was deemed to be high exposure. The COBIT standard is geared toward best practices and, by applying this standard, a deficiency may be identified as a result of a gap between the Company's practices and the best practice, rather than as a deficiency in internal control.
8. **Re-performance of management's test by external auditors.** There was non-valued time spent by the outside auditors in re-performing management's test as required by the Standard. Review of management's work papers should be sufficient for the auditor to report on management's assessment. Note that the auditors must perform their own independent test, which should determine if management has not tested adequately and if additional deficiencies are determined. The current Standard creates an overkill situation. We would advocate that only one report should be issued by the auditors, the auditor's assessment of internal control.
9. **Significantly higher fees by the external auditor.** As noted in several publications, auditor fees escalated greatly from original estimates for companies involved with section 404. In our situation, the initial estimate of the incremental fee for section 404 was 50% of the regular audit fee, which grew to 70%, then to 100% and finally ended at 140%. Cost-versus-benefit trade-off decisions did not occur. Compliance at any cost appeared to be the theme. The cost was driven by the

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pervasiveness of the Standard, lack of adequate training and planning time, lack of time to add internal staff and ultra conservative interpretations by auditors. Now that actual costs of compliance with section 404 are available, the PCAOB should re-assess the cost-benefit equation and eliminate those requirements that contribute very little to identification of material weaknesses, especially for smaller size companies (under $1 billion market cap).

Recommendations:
1. Provide adequate lead time prior to effective dates of new rules
2. Clarify concept of key controls for testing
3. Allow exceptions to meet risk profiles of specific company
4. Re-examine documentation requirements
5. Deficiencies should be assessed for a process, not an individual control
6. Redefine "significant deficiency"
7. Clearly state that best practice shortfalls in IT are not deficiencies and are out of scope
8. Eliminate re-performance testing by auditors
9. Re-assess cost-benefit

Thank you for soliciting comments concerning this important topic.

Sincerely,

Peter Nelson
President and CEO

Richard Nye
Vice President, CFO and Treasurer

cc: George Vera, Chair of the Audit Committee