

State of Florida



Public Service Commission

-M-E-M-O-R-A-N-D-U-M-

DATE: March 21, 2002
TO: Division of Economic Regulation (Costner)
FROM: Division of Auditing and Safety (Vandiver) *W*
RE: Docket # 011677-WU; Tevalo, Inc. d/b/a McLeod Gardens Water Co.; Audit Purpose: Staff Assisted Rate Case ; Audit Control No. 02-024-2-1

Attached is the final audit report for the utility stated above. I am sending the utility a copy of this memo and the audit report. If the utility desires to file a response to the audit report, it should send the response to the Division of the Commission Clerk and Administrative Services. There are no confidential work papers associated with this audit.

DNV/jcp
Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)
Division of the Commission Clerk and Administrative Services (2)
Division of Competitive Markets and Enforcement (Harvey)
General Counsel
Office of Public Counsel

Mr. James O. Vaughn, President
Tevalo, Inc. d/b/a McLeod Gardens Water Co.
P. O. Box 2898
Winter Haven, FL 33883-2898

DOCUMENT NUMBER DATE

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FPSC-COMMISSION CLERK



FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

TAMPA DISTRICT OFFICE

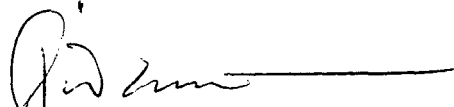
TEVALO, INC. d/b/a MCLEOD GARDENS WATER COMPANY

STAFF-ASSISTED RATE CASE

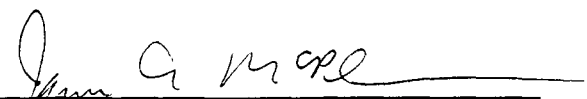
HISTORICAL YEAR ENDED DECEMBER 31, 2001

DOCKET NO. 011677-WU

AUDIT CONTROL NO. 02-024-2-1



Simon O. Ojada, Audit Manager



James A. McPherson, Tampa District Supervisor

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**DIVISION OF AUDITING AND SAFETY
AUDITOR'S REPORT**

FEBRUARY 18, 2002

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to prepare the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure for the historical twelve months period ended December 31, 2001, for McLeod Gardens Water Company. These schedules were prepared by the auditor as part of the utility's petition for a Staff-Assisted Rate Case in Docket No. 0116771-WU. There is no confidential information associated with this audit, and there are no audit staff minority opinions.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this document must not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

SUMMARY OF SIGNIFICANT FINDINGS:

The utility is commingling its utility accounts with the owner's land development business. The company does not utilize the account numbering system delineated by NARUC, and maintains its records on the cash basis. Not included in rate base were the cost of distribution piping and the corresponding contributions in aid of construction.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report:

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Reviewed - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers, and selective analytical review procedures were applied.

Verify - The item was tested for accuracy, and substantiating documentation was examined.

RATE BASE: Compiled account balances for Utility-Plant-in-Service (UPIS). Prepared a schedule of additions from January 1997 through December 2001 from the company general ledger and verified additions to supporting invoices. Reviewed books and records for evidence of contributions-in-aid-of-construction (CIAC). Calculated working capital using one-eighth of the operation and maintenance expenses. Calculated accumulated depreciation. Computed amortization of CIAC using depreciation composite rates.

NET OPERATING INCOME: Compiled utility revenue and operation and maintenance accounts for the period ended December 31, 2001. Reviewed operation and maintenance expenses and examined invoices and supporting documentation. Recalculated depreciation expense for the test year using Commission approved rates. Verified Taxes Other Than Income.

CAPITAL STRUCTURE: Compiled components of the company's capital structure for the fiscal year ended December 31, 2001.

EXCEPTIONS

Exception No. 1

Subject: NARUC Chart of Accounts

Statement of Fact: Rule 25-30.115 Florida Administrative Code states “Water and Wastewater utilities shall, effective January 1, 1998, maintain their accounts and records in conformity with the 1996 NARUC Uniform Systems of Accounts . . .”

The Uniform System of Accounts (USoA) for Class C utilities, Accounting Instruction 2, requires the books of accounts of all water and wastewater be kept by the double entry method, on an accrual basis. It further states that “All books of accounts, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries.”

The utility maintains its records on a cash basis. McLeod Gardens Water Company does not accrue income when earned but records monthly sales revenues when payment is received from the customer. As a result, test year revenues were understated by \$460 due to an excess of sales over receipts.

The utility is commingling its accounting with the owner’s land development business.

Recommendation: The utility should be required to maintain its records in conformity with the NARUC Uniform Systems of Account as prescribed by Rule 25-30.115, F.A.C., regarding record keeping of water and wastewater utilities. Separate utility and non utility general ledgers accounts should be maintained.

Exception No. 2

Subject: Plant in Service

Statement of Fact: Tevalo, Inc. d/b/a McLeod Gardens Water Company does not have separate plant accounts for the various types of utility plant assets listed in its general ledger. Instead, it uses one control account named "Water System - McLeod Gardens" and keeps a depreciation schedule showing the various plant classifications.

The company classified \$50,823 of various utility plant assets purchased in 1996 as pumping equipments in its depreciation schedule. We also determined that \$1,198 in 1997; \$3,403 in 1999; and \$545 in 2000 were classified to wrong plant asset accounts.

Recommendation: Based on a review of the actual invoices for the \$50,823 classified as pumping equipment, only \$7,381 of these costs were actually pumping equipment. Auditors reclassified the \$50,823 originally classified by the utility as pumping equipment in its depreciation schedules as follows:

Pumping Equipment	\$ 7,381	
Well and Springs	3,392	
Supply Mains	7,776	
Water Treatment Plant	895	
Distribution Mains	29,724	
Services	1,655	
Pumping Equipment		\$50,823

The following were also reclassified by the auditor:

Wells and Springs	\$ 1,198	
Distribution Reservoir	1,858	
Meters and Meter Installations	1,545	
Wells & Springs	545	
Other Plant & Misc. Equip.		\$ 3,288
Pumping Equipment		1,858

The utility should be required to open accounts for the various plant account balances.

Exception No. 3

Subject: Land

Statement of Fact: Tevalo, Inc. purchased a total of 70 acres for \$245,000 in 1991 to develop as single family home sites. The company has not allocated any of the land to the utility. Based on a review of the utility site by the staff auditor and engineer, it was determined that approximately two acres should be allocated as utility land.

Recommendation: A separate utility land account should be established with \$7,000 ($\$245,000/70 \times 2$ acres) transferred from the development land account.

Exception No. 4

Subject: Expenses Capitalized

Statement of Fact: McLeod Gardens Water Company purchased a 2" meter including installation for \$662 in the year 2001. This cost was expensed as Operating and Maintenance.

The company also paid \$1,223 to install meters at its customer premises. These installation costs were expensed as contract services.

Recommendation: The utility should increase its plant accounts (Meters and Meters Installations) by a total of \$1,885 (\$662 + 1,223) and reduce its Operating and Maintenance expense by the same amount.

Exception No. 5

Subject: Contributions In Aid of Construction(CIAC) and CIAC Amortization

Statement of Facts: The subdivision is being developed in three phases. Phases I and II are complete and all lots have been sold. The construction work (roads, water mains, service lines and fire hydrants) for Phase III is also complete. Only one lot in Phase III had been sold as of December 31, 2001. The company anticipates selling the remainder during 2002.

We found several invoices relating to the construction of the utility's distribution system that had been misclassified as development costs and included in the company's lot inventory account. The inventory account is then expensed as "cost of sales" as the lots are sold. There was one 1997 invoice relating to Phase I for \$27,590 and one 1998 invoice relating to Phase II for \$13,700. There were also two invoices in 2001 totaling \$55,836 which relate to Phase III.

The utility is authorized to collect a Customer Connect Charge (Tap in Fee) of \$275 from each new customer. The company records these Tap in Fees as revenue in its general ledger. However, the company's accountant maintains a yearly schedule of these fees and calculates yearly amortization to use when preparing the PSC Annual Reports. We reviewed this schedule, and based on actual new customers added each year, found it to be accurate except for a \$300 difference in 1997. The schedule showed CIAC of \$1,350 while the actual amount collected was \$1,650.

Recommendation: The cost of the distribution system should have been included in the utility's Plant in Service accounts. Since these costs have been or are going to be expensed as the lots are sold, they should be treated as CIAC. Therefore, the utility should increase both Plant in Service and CIAC by \$97,126 to reflect the cost of the distribution piping.

The following adjustments should be made to record the cost of the distribution piping and correct the \$300 error made in 1997.

<u>Account</u>	<u>1997</u>	<u>1998</u>	<u>2001</u>	<u>Total</u>
331 Mains	20,824	9,254	34,647	64,725
333 Services	3,222	2,520	16,401	22,143
335 Hydrants	3,544	1,926	4,788	10,258
Retained Earnings	300			300
271 CIAC	(27,890)	(13,700)	(55,836)	(97,426)

Continued on next page.

Exception No. 5 (continued)

We also recalculated the utility's accumulated depreciation (See Ex. 6) and accumulated amortization of CIAC using the annual composite depreciation rates. The following shows adjustments the utility should make to its Accumulated Amortization of CIAC schedule and current year amount. Note: The company had not yet calculated its 2001 amortization.

	Acc. Amort. of CIAC	2001 Amort.
Balance per Utility Schd.	421	0
Balance per Audit	<u>7,522</u>	<u>2,468</u>
Adjustment	7,101	2,468

The utility should be required to establish general ledger accounts for CIAC and Accumulated Amortization of CIAC instead of maintaining separate "off book" schedules.

Exception No. 6

Subject: Accumulated Depreciation and Depreciation Expense.

Statement of Fact: McLeod Gardens Water Company had not recorded depreciation expense for the year 2001. The beginning accumulated depreciation balance per utility was \$14,239.

Recommendation: Auditors recalculated accumulated depreciation and depreciation expense for the period ending December 31, 2001 to be \$18,358 and \$5,278 respectively. The auditor's accumulated depreciation balance reflects all audit adjustments and reclassifications. The company should increase its accumulated depreciation by \$4,119 (18,358-14,239) to reflect the balance of accumulated depreciation for the year ended December 31, 2001.

Exception No. 7

Subject: Taxes Other Than Income.

Statement of Fact: The utility did not accrue taxes for Regulatory Assessment Fees for the year 2001.

Recommendation: FPSC auditors calculated the Regulatory Assessment Fee to be \$560 based on the audited revenue balance of \$12,441 as of December 31, 2001.

Disclosure No. 1

Subject: Proforma Capital Improvements and Increase in Expenses

Statement of Fact: Auditors discussed with utility officials if there were any anticipated capital improvements or large expense increases. The company anticipated an increase in its monthly expenses due to the following: monthly meter readings, billings, and property maintenance. However, there was no mention of any capital improvements or repairs in the near future. According to the utility official, there will be a monthly expense increase of \$650.00 for book keeping, \$65.00 for property maintenance, and \$75.00 for meter reading.

Recommendation: Auditors defer to the analyst and the engineer as to the prudence of the above expenses for rate making purposes.

SCHEDULES FOR STAFF ASSISTED RATE CASE
 MCLEOD GARDENS WATER COMPANY
 DOCKET NO. 011677-WU
 RATE BASE - WATER
 TEST YEAR ENDED 12/31/01

EXHIBIT I

(a) <u>DESCRIPTION</u>	(b) PER COMPANY <u>12/31/00</u>	(c) PER BOOKS <u>12/31/01</u>	(d) AUDIT EXCEP/ <u>DISCL</u>	(e) REFE <u>TO</u>	(f) PER AUDIT <u>12/31/01</u>	(g) AUDIT AVERAGE BALANCE 12/31/01
UTILITY PLANT IN SERVICE	75,345	80,118	1,885 97,126	E-4 E-5	179,129	127,237
LAND	7,000	0	7,000	E-3	7,000	7,000
PLANT HELD FOR FUTURE USE	0	0	0		0	0
CIAC	(12,625)	(15,650)	(97,126) (300)	E-5 E-5	(113,076)	(62,851)
ACCUM. AMORTIZATION OF CIAC	421	421	7,101	E-5	7,522	3,972
ACCUMULATED DEPRECIATION	(14,239)	(14,239)	(4,119)	E-6	(18,358)	(16,299)
WORKING CAPITAL	1,441	0	2,220		2,220	1,830
TOTAL	<u>57,343</u>	<u>50,650</u>	<u>13,787</u>		<u>64,437</u>	<u>60,890</u>

(1). Working Capital Formula: 1/8 Operating and Maintenance Expense.

(2). All amounts rounded to the nearest whole dollar.

SCHEDULES FOR STAFF ASSISTED RATE CASE
 MCLEOD GARDENS WATER COMPANY
 DOCKET NO. 011677-WU
 NET OPERATING INCOME - WATER
 TEST YEAR ENDED 12/31/01

EXHIBIT II

DESCRIPTION	(1) BALANCE PER BOOKS 12/31/01	(2) AUDIT EXCEPTION ADJUST	(3) Refer to	(4) AUDITED BALANCE
OPERATING REVENUES	11,982	460	E-1	12,442
OPERATING EXPENSES				
OPERATION AND MAINTENANCE EXPENSE	19,642	(1,885)	E-4	17,757
DEPRECIATION EXPENSE	0	5,278	E-6	5,278
AMORTIZATION EXPENSE	0	(2,468)	E-5	(2,468)
TAXES OTHER THAN INCOME	297	560	E-7	857
TOTAL OPERATING EXPENSES	19,939	1,485		21,424
NET OPERATING INCOME/LOSS	(7,957)	(1,025)		(8,982)

MCLEOD GARDENS WATER COMPANY
DOCKET 011677-WU
CAPITAL STRUCTURE
AS OF DEC 31, 2001

EXHIBIT III

DESCRIPTION	(a) BALANCE PER T/B @12/31/00	(b) BALANCE PER T/B @12/31/01	(c) SIMPLE AVERAGE PER T/B	(d) AUDIT ADJUST- MENTS	(e) BALANCE PER AUDIT @12/31/01	(f) SIMPLE AVERAGE PER AUDIT	(g) RATIO	(h) COST RATE	(i) WEIGHTED COST OF CAPITAL
COMMON EQUITY	371,117	374,570	372,844	0	374,570	372,844	76.58%	10.24%	7.84%
COMMON STOCK	37,500	37,500	37,500		37,500	37,500			
RETAINED EARN.	35,407	38,860	37,134		38,860	37,134			
	0	0	0	0	0	0			
CAPITAL - J VAUGHN	151,605	151,605	151,605	0	151,605	151,605			
CAPITAL - K.M. GERRAR	146,605	146,605	146,605	0	146,605	146,605			
L/T DEBT- Colonial Bank	75,000	60,000	67,500		60,000	67,500	13.86%	8.75%	1.21%
L/T DEBT- Citrus Highlands	35,000	58,000	46,500	0	58,000	46,500	9.55%	8.30%	0.79%
CUSTOMER DEPOSITS	0	0	0		0	0	0.00%	0.00%	0.00%
OTHER	0	0			0	0	0.00%	0.00%	0.00%
TOTAL	481,117	492,570	486,844	0	492,570	486,844	100.00%		9.85%

Required Footnotes:

- (1) Audit adjustments do not include audit disclosures.
- (2) Equity cost based on FPSC Order No. 01-1226-PAA-WS issued 06/01/01