

State of Florida



Public Service Commission  
-M-E-M-O-R-A-N-D-U-M-

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**DATE:** January 21, 2003  
**TO:** Division of Economic Regulation (Fitch)  
**FROM:** Division of Auditing and Safety (Vandiver) *W*  
**RE:** **Docket No.** 021067-WS; **Company Name:** River Ranch Water Management, LLC; **Audit Purpose:** Staff Assisted Rate Case, prepare schedules of rate base, capital structure and net operating income; **Audit Control No.** 02-318-3-1

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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)  
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**FLORIDA PUBLIC SERVICE COMMISSION**

***DIVISION OF AUDITING AND SAFETY  
BUREAU OF AUDITING***

***TAMPA DISTRICT OFFICE***

**RIVER RANCH WATER MANAGEMENT L.L.C.**

**STAFF ASSISTED RATE CASE**

**FOR THE PROJECTED YEAR ENDED DECEMBER 31, 2002**

**Docket No. 021067-WS**

**AFA Control # 02-318-3-1**

A handwritten signature in black ink, appearing to read "Tomer K.", written over a horizontal line.

***Tomer Kopelovich, Staff Auditor***

A handwritten signature in black ink, appearing to read "James A. McPherson", written over a horizontal line.  
***James A. McPherson, Audit Manager And  
Tampa District Supervisor***

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**DIVISION OF AUDITING AND SAFETY  
AUDIT REPORT**

**JANUARY, 15, 2003**

**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 Net Operating Income and Rate Base for the projected twelve month period ended December 31, 2002, for River Ranch Water Management, LLC. These schedules were prepared as a part of a Staff Assisted Rate Case. 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 report should 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 has not been maintaining its accounts and records in accordance with the NARUC Uniform System of Accounts as required by Rule 25-30.115, Florida Administrative Code. Many utility transactions were and still are being paid for by a related party. The utility has several related party customers which are not billed for water and wastewater services.

## **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.

**NET OPERATING INCOME:** Compiled revenues for the twelve month period. Compiled expenses through October, 2002. Projected Operating and Maintenance (O&M) expenses for the twelve month period based on ten months actual, and utility estimates.

**RATE BASE:** Compiled utility plant in service additions since the utility was acquired by the new owner. An original cost study is being performed on all previously installed plant. We did not determine accumulated depreciation or depreciation expense as these amounts are dependent on the original cost study. We used the one eight of O&M expense method to determine the working capital balance.

## **Disclosure No. 1**

### **Subject: Purchase and Accounting Overview**

**Statement of Facts:** River Ranch Water Management, L.L.C. acquired the utility assets from the previous owner through foreclosure proceedings in November 2001. Very little accounting activity occurred during 2001. The first customer billing was for December 2001, but was not recorded until January 2002 (See Disc. No. 2). Because of the lack of activity during the first two months we have used a test year beginning January 1, 2002 through December 31, 2002. We used actual revenue and expenses recorded through October 31, and projected the remaining two months based on the average ten month amounts.

River Ranch Water Management, L.L.C. is a wholly owned subsidiary of Central Florida Investments, Inc. (CFI), which also owns the River Ranch resort in another subsidiary, Westgate Resorts, Inc. The utility has no accounting records from the previous owner and could not provide any original cost figures for the existing plant. The PSC field engineer is therefore preparing an original cost study to provide this information. The parent company has spent a considerable amount of money on replacing and upgrading both the water and wastewater systems. These new plant items were paid for by CFI and were not recorded on the utility books as of October 31, 2002 (See Disc. No. 2).

All the accounting and customer billing is being handled at the CFI headquarters in Orlando. The company is not using the NARUC Uniform System of Accounts as required by Rule 25-30.115, Florida Administrative Code and is not separating the accounts between the water and wastewater systems.

**Recommendation:** The company should begin using the NARUC Uniform System of Accounts to record utility transactions. All plant assets purchased by the parent company should be transferred to the utility and recorded in the proper plant in service account as shown in Disclosure No. 2.

**Disclosure No. 2**

**Subject: Land and Plant in Service**

**Statement of Facts:** As noted in Disclosure No. 1, there was no plant or land recorded on the utility's books as of October 31, 2002. All major plant additions were paid for by the parent company and were still on the parents books at this time. We were given a list of expenditures totaling \$351,742, paid by the parent company, that was for new utility plant. We examined the supporting invoices and concur with the company that the majority of these expenditures were for new utility plant additions. However, we did remove \$6,633 of expenditures that were either out of period or not utility related and \$2,493 that should have been included in operating expense. We also removed \$14,540 related to using closed circuit TV cameras to aid in the cleaning and leak repair of the utility sewer lines. We believe this is a non recurring expense that should be deferred and amortized over five years. We also found a fire hydrant costing \$5,422 and a rebuilt master lift station pump and motor costing \$8,948 which had been included in the utility's operating expenses. The schedule below shows how we classified all these plant additions totaling \$342,446.

As of October 31, 2002 there was no land recorded on the utility's books. We were given a copy of a quit claim deed dated January 16, 2002, transferring certain property to the utility. We did not have time to determine the location or acreage transferred, but the utility stated it was approximately 34 acres. Based on our tour of the utility we believe the property utilized by the utility encompasses approximately six acres including a four acre percolation pond. We have included the quit claim deed consideration of \$10 as utility land cost.

**Schedule of Plant Additions**

<b>Acct. No. and Description</b>	<b>Amount</b>
301 Organization	\$ 1,500
304 Structures and Improvements	33,512
309 Supply Mains	28,124
310 Power Generation Equip.	14,621
311 Pumping Equipment	17,405
320 Water Treatment Equip.	18,775
335 Fire Hydrants	<u>5,422</u>
Total Water Plant	\$119,359
351 Organization	\$ 1,500
354 Structures and Improvements	209,535
360 Collecting Sewers-Force	8,948
364 Flow Measuring Devices	<u>3,104</u>
Total Wastewater	\$ 223,087

**Recommendation:** The parent company should make the above adjustments and transfer the utility related plant to the utility's books.

**Disclosure No. 3**

**Subject: Revenues**

**Statement of Facts:** The utility is billing its customers on a quarterly basis at flat rates approved by the PSC. However, not all users are being billed. There are several swimming pools, tennis courts and recreation centers associated with the RV and Condo Associations that are not separately accounted for or included in the group bill. There are also several related party entities owned or operated by Westgate Resorts that are not being billed. These include two restaurants, the Hotel with pool, the Saloon, Skeet Range, Rodeo, Stables, Chapel and any common area irrigation using treated water.

Included in the utility revenue was customer billings for December 2001 totaling \$7,203. We have removed this amount from our calculations. Since the utility bills its customers quarterly, it must estimate and accrue revenue on a monthly basis and make any true-ups when the actual bills are determined. We were able to obtain all four of the quarter ended billing registers for 2002 and have adjusted the utility books to the total amount actually billed for the year. The company did not allocate revenue between the water and wastewater systems. We have therefore divided the revenue equally between the systems. The schedule below shows all our adjustments and total 2002 annual revenue.

	<u>Total Amt.</u>	<u>Water</u>	<u>Wastewater</u>
Revenue Per Books at 10/31/02	\$78,629	\$39,315	\$39,314
Remove Dec. 2001 Billing	<u>(7,203)</u>	<u>(3,602)</u>	<u>(3,601)</u>
Audited Amount at 10/31/02	71,426	35,713	35,713
Adjust to Actual Bills at 12/31/02	<u>14,847</u>	<u>7,424</u>	<u>7,424</u>
Total 2002 Revenue	<u>\$86,274</u>	<u>\$43,137</u>	<u>\$43,137</u>

**Recommendation:** The utility should bill all users of water and wastewater services. Additional tariff rates may be needed for some of these commercial customers.



**Disclosure No. 4**

**Subject: Employee Salary and Benefits**

**Statement of Facts:** The utility has no employees. The parent company allocated the salary of one Westgate Resorts employee to the utility. This person, Pete Jaen, was responsible for maintaining all the on-site water and wastewater plant and equipment including supervising any work which is subcontracted out. The company estimated Mr. Jaen's yearly salary and charged equal amounts each month to the utility for salary, benefits and payroll taxes. We adjusted these estimated amounts to the actual amounts paid as of October 31, 2002 and then projected the amounts based on his current rate of pay. The following schedule shows all of our adjustments amounts for the full year.

	<u>Total</u>	<u>Water</u>	<u>Wastewater</u>
Salary Per Books	\$26,866	\$13,433	\$13,433
Adjust to Actual	<u>1,194</u>	<u>597</u>	<u>597</u>
Actual at 10/31/02	28,060	14,031	14,031
To Annualize	<u>5,258</u>	<u>2,629</u>	<u>2,629</u>
Projected 12/31/02	\$33,318	\$16,659	\$16,659
Benefits Per Books	\$ 3,634	\$ 1,817	\$ 1,817
Adjust to Actual	<u>(716)</u>	<u>(358)</u>	<u>(358)</u>
Actual at 10/31/02	2,918	1,459	1,459
To Annualize	<u>530</u>	<u>265</u>	<u>265</u>
Projected 12/31/02	\$ 3,448	\$ 1,724	\$ 1,724
Payroll Taxes Per Books	\$ 1,782	\$ 891	\$ 891
Adjust to Actual	<u>284</u>	<u>142</u>	<u>142</u>
Actual at 10/31/02	2,066	1,033	1,033
To Annualize	<u>356</u>	<u>178</u>	<u>178</u>
Projected 12/31/02	\$ 2,422	\$ 1,211	\$ 1,211

**Recommendation:** Based on discussions and observation, we determined that Mr. Jaen does not spend 100% of his time on utility business. However, there are other Westgate employees that occasionally assist Mr. Jaen at the utility. We believe that allocating one employees salary to a utility of this size is fair and reasonable particularly since the utility will be going to metered rates and will need someone to read and service these.

We have included the above payroll taxes with Taxes Other Than Income (See Disc. No. 8).

**Disclosure No. 5**

**Subject: Purchased Power**

**Statement of Facts:** As of October 31, 2002 the utility had a total of \$20,913 recorded as Purchased Power. We reviewed all of the company's supporting electric bills and compared them to actual on site meters. We determined that the electric bills for December 2001 totaling \$1,966 had been paid and included in the 2002 amounts. We removed these bills from our totals (\$534 Wtr; \$1,432 WWtr). We also removed one Westgate Resort bill of \$706 and one unknown journal entry of \$250 from the company's total.

The meter for one of the monthly bills totaling \$313 through October could not be located. However, there were two lift stations that were not independently metered, and whose usage was not being charged to the utility. The one lift station that was independently metered had a ten month total cost of \$153. We therefore included the unknown meter's cost as approximately that of the two unmetered lift stations. All of the above adjustments are summarized below.

	Water	Wastewater
Amount Per Utility at 10/31/02		
Allocated By Auditor	\$5,495	\$15,418
Remove Dec 2001 Bills	(534)	(1,432)
Remove Westgate Bill		( 706)
Remove Journal Entry		(250)
Remove Double Entry		(15)
Audited Amount as of 10/31/02	<u>\$4,962</u>	<u>\$13,016</u>
To Annualize	<u>992</u>	<u>2,606</u>
Total Projected at 12/31/02	<u>5,954</u>	<u>15,619</u>

**Recommendation:** Use the above amounts for rate setting purposes.

**Disclosure No. 6**

**Subject: Management Fees**

**Statement of Fact:** Currently all accounting, customer billing, tax filings and annual reports are performed by CFI personnel at its Orlando headquarters. No cost has been allocated to the utility for these services. Also, there has not been any cost allocated for any utility Corporate Officer or Directors' pay.

The one utility employee uses a van provided by Westgate Resorts for transportation. No vehicle expense has been allocated to the utility.

**Recommendation:**

Based on the above information, we believe it would be appropriate for CFI to charge the utility for services it is providing. The schedule below is our estimate of these costs.

<u>Description</u>	<u>Monthly Amount</u>
President and Other Officer Mgt	250.00
Office and Office Equipment Rent	300.00
Accounting, Billing and Tax	500.00
Telephones	50.00
Vehical Expense	500.00
Insurance	100.00
	-----
Monthly Amount	1,700.00
Amount as of Oct. 31, 2002	17,000.00
Projected yearly Amount	<u>20,400.00</u>
Split 50/50      Water	<u>10,200.00</u>
Wastewater	<u>10,200.00</u>

**Disclosure No. 7**

**Subject: Operating and Maintenance (O&M) Expense**

**Statement of Facts:** As noted previously, the utility did not allocate its expenses between the water and wastewater systems. At October 31, 2002 there was a total of \$171,584 of O&M expenses recorded on the utility books. We reviewed all invoices associated with these expenses and divided them between the water and wastewater systems (Wtr. \$55,400; WWtr. \$116,184). We found all of the invoices to be utility related, but we did have to make several reclassifications and adjustments as follows. We removed \$5,422 which was the cost of a new fire hydrant and added it to the water plant in service. We also capitalized \$8,948 of costs associated with the rebuilding of the master lift station pump and motor as wastewater plant (See Disc. No. 2). We reclassified \$285 of Chemicals to Contract Services - Testing and \$2,406 of Contract Services - Other to Materials and Supplies. Other adjustments to Salaries, Purchased Power, Professional Services and Management Fees have already been discussed in previous disclosures. Finally, we added \$1,250 to Contract Services-Other which was paid for by CFI and was for the inspection of 25 fire hydrants.

The following is a summarization of all of our adjustments to O&M Expense and the projected annualization of these expenses at December 31, 2002.

	<u>Water</u>	<u>Wastewater</u>
O&M per Books at 10/31/02	\$55,400	\$116,184
Adjust Employee Salaries to Actual	597	597
Adjust Pensions and Benefits to Actual	(358)	(358)
Adjust Purchased Pwr. To Actual	(534)	(2,402)
Add Prof. Services paid by CFI	621	621
Add Contr. Svcs- Other paid by CFI	1,250	
Add Management Fees	8,500	8,500
Remove New Fire Hydrant	(5,422)	
Remove Pump and Motor at Lift Sta.		(8,948)
Net Adjustment	<u>4,654</u>	<u>(1,990)</u>
Total Per Audit at 10/31/02	<u>\$60,054</u>	<u>\$114,194</u>
Projected Y/E 12/31/02	<u>\$71,860</u>	<u>\$136,829</u>

**Recommendation:** The above amounts should be used for setting new utility rates.

**Disclosure No. 8**

**Subject: Taxes Other Than Income**

**Statement of Facts:** The utility had a total of \$7,977 recorded as Taxes Other Than Income as of October 31, 2002. This amount includes \$48 of penalties and interest. The company amounts were accrued monthly, based on the previous year's actual taxes.

**Recommendation:** We allocated the company amount between the water and wastewater systems. We then removed the penalties and interest. Next we adjusted both the regulatory assessment fees and property taxes to current year actuals. We also adjusted payroll taxes to actual as previously discussed in Disclosure No. 4. The following is a summary of our adjustments.

<b>Description</b>	<b>Amount</b>
Regulatory Assessment Fee	\$4,044
Property Taxes	2,103
Payroll Taxes	1,782
Penalties and Interest	<u>48</u>
Total Per Books at 10/31/02	\$7,977

	<u>Water</u>	<u>Wastewater</u>
Auditor Allocated (50/50)	\$3,988	\$3,988
Remove Penalties and Interest	( 24)	( 24)
Adjust RAF To Actual	(415)	(415)
Adjust Prop. Tax to Actual	(963)	801
Adjust P/R Taxes to Actual	<u>142</u>	<u>142</u>
Total Per Audit at 10/31/02	\$2,728	\$4,492

<b>Projected Amounts As of 12/31/02</b>	<u>Water</u>	<u>Wastewater</u>
Regulatory Assessment Fees	1,941	1,941
Payroll Taxes	1,211	1,211
Property Taxes	<u>106</u>	<u>2,224</u>
Total Projected Taxes	<u>3,258</u>	<u>5,376</u>

**Disclosure No. 9**

**Subject: Capital Structure**

**Statement of Facts:** The utility's books did not show any Capital Stock or Paid in Capital amounts. The only amount shown that could be considered in the company's Capital Structure was an intercompany liability of \$180,467 payable to the parent company. We asked the company representative to determine how much of this amount, if any, represented stock or paid in capital, but never received a reply to our document request.

**Recommendation:** Based on the above facts, we have not prepared a Capital Structure Schedule. The utility should formalize its capital accounts and any debt instruments it intends to make before a return on rate base is allowed.

**Disclosure No. 10**

**Subject: Future Plant Additions**

**Statement of Facts:** The utility provided us with a contract cost estimate to install approximately 9,500 feet of Cured-In-Place liner for a portion of its sewer lines. The total cost was estimated to be \$279,700.

The utility also will likely be required to install additional meters for the customers that are not currently being billed and for those customers that do not already have meters. The cost of these meters is not known.

**Recommendation:** The information is provided to assist the analyst in determining an appropriate amount of rate base.

**River Ranch Water Management, LLC**  
**Rate Base 021067-WS**  
**Staff Assisted Rate Case**  
**Projected Year End 12/31/02**

**Exhibit I**

**Water:**

<b><u>Component Title</u></b>	<b>Dollars per <u>Utility</u></b>	<b>Audit <u>Adjustments</u></b>	<b>Ref</b>	<b>Per Audit <u>10/31/02</u></b>	<b>Annualize</b>	<b>Projected as of <u>12/31/02</u></b>
Plant	0	119,359	Disc 2	119,359	0	119,359
Land	0	5	Disc 2	5	0	5
Accum. Depr.	0	0		0	0	0
Working Capital - 1	0	7,507		7,507	1,476	8,983
<b>Net Rate Base</b>	<b>0</b>	<b>126,871</b>		<b>126,871</b>	<b>1,476</b>	<b>128,347</b>
	=====	=====		=====	=====	=====

1) Working Capital was computed using the one-eighth of O&M expense method.



**River Ranch Water Management, LLC**  
**Rate Base 021067-WS**  
**Staff Assisted Rate Case**  
**Projected Year End 12/31/02**

**Exhibit II**

**Wastewater:**

<b><u>Component Title</u></b>	<b>Dollars per <u>Utility</u></b>	<b>Audit <u>Adjustments</u></b>	<b><u>Ref</u></b>	<b>Per Audit <u>10/31/02</u></b>	<b><u>Annualize</u></b>	<b>Projected as of <u>12/31/02</u></b>
Plant	0	223,087	Disc 2	223,087	0	223,087
Land	0	5	Disc 2	5	0	5
Accum. Depr.	0	0		0	0	0
Working Capital - 1	0	0		14,274	2,829	17,104
<b>Net Rate Base</b>	<b>0</b>	<b>223,092</b>		<b>237,366</b>	<b>2,829</b>	<b>240,196</b>
	=====	=====		=====	=====	=====

1) Working Capital was computed using the one-eighth of O&M expense method.

River Ranch Water Management, LLC  
Docket 21067-WS  
Net Operating Income  
Staff Assisted Rate Case  
Projected Year Ended 12/31/02

Exhibit III

<u>Water</u>	Per Books 1/1 - 10/31/02	Audit Adjustments	Ref	Per Audit 10/31/02	Annualize	Projected as of 12/31/02
Operating Revenues	39,315	(3,602)		35,713	7,424	43,137
O&M Expenses	55,400	4,654		60,054	11,808	71,860
Depreciation Expense	-	-		-	-	-
Amortization of Def Asset	-	-		-	-	-
Taxes- Other	3,988	(1,260)		2,728	530	3,258
<b>Total Expenses</b>	<u>59,388</u>	<u>3,394</u>		<u>62,782</u>	<u>12,336</u>	<u>75,118</u>
<b>Profit (Loss)</b>	<u>(20,074)</u>	<u>(6,996)</u>		<u>(27,070)</u>	<u>(4,912)</u>	<u>(31,981)</u>

Note: An original cost study is being performed, therefore depreciation expense and amortization of CIAC were not calculated.

Note: Utility is a Limited Liability Corporation and therefore pays no income tax.

River Ranch Water Management, LLC  
Docket 21067-WS  
Net Operating Income  
Staff Assisted Rate Case  
Projected Year Ended 12/31/02

Exhibit IV

**Wastewater**

	Per Books <u>1/1 - 10/31/02</u>	Audit <u>Adjustments</u>	Ref	Per Audit <u>10/31/02</u>	<u>Annualize</u>	Projected as of <u>12/31/02</u>
Operating Revenues	39,314	(3,601)		35,713	7,424	43,137
O&M Expenses	116,184	(1,990)		114,194	22,635	136,829
Depreciation Expense	-	-		-	-	-
Amortization of Def Asset	0	2,423		2,423	485	2,908
Taxes- Other	3,988	504		4,492	884	5,376
<b>Total Expenses</b>	<u>120,172</u>	<u>938</u>		<u>121,109</u>	<u>24,004</u>	<u>145,113</u>
<b>Profit (Loss)</b>	<u>(80,858)</u>	<u>(4,539)</u>		<u>(85,396)</u>	<u>(16,580)</u>	<u>(101,976)</u>

Note: An original cost study is being performed, therefore depreciation expense and amortization of CIAC were not calculated.

Note: Utility is a Limited Liability Corporation and therefore pays no income tax.