

MEMORANDUM

June 30, 1998

ORIGINAL

TO: DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (VANDIVER) *W*

RE: DOCKET NO. 980445-WU -- MORNINGSIDE UTILITY, INC.
AUDIT REPORT - STAFF-ASSISTED RATE CASE
AUDIT CONTROL NO. 98-131-3-1

The above-referenced audit report is forwarded. Audit exceptions document deviations from the Uniform System of Accounts, Commission rule or order, Staff Accounting Bulletin and generally accepted accounting principles. Audit disclosures show information that may influence the decision process.

The audit was prepared using a micro computer and has been recorded on one diskette. The diskette may be reviewed using IBM compatible equipment and LOTUS 1-2-3 software. There are no confidential working papers associated with this audit.

Please forward a complete copy of this audit report to:

Morningside Utility, Inc.
George De Villers
1106 Monroe Avenue
St. Cloud, FL 34769-6713

DNV/sp

Attachment

cc: Chairman Johnson
Commissioner Clark
Commissioner Deason
Commissioner Garcia
Commissioner Jacobs
Mary Andrews Bane, Deputy Executive Director/Technical
Legal Services
Division of Auditing and Financial Analysis (Devlin/Causseaux/
File Folder)
Division of Water and Wastewater (Galloway)
Orlando District Office (Forbes)

Research and Regulatory Review (Harvey)
Office of Public Counsel

DOCUMENT NUMBER-DATE

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FPSC-RECORDS/REPORTING



ORIGINAL

FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING*

Orlando District Office

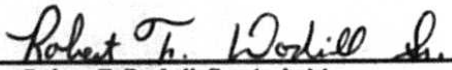
MORNINGSIDE UTILITY, INC.

STAFF-ASSISTED RATE CASE

PERIOD ENDED DECEMBER 31, 1997

DOCKET NO. 980445-WU

AUDIT CONTROL NO. 98-131-3-1



Robert F. Dodrill, Sr., Audit Manager



Ian J. Forbes, Audit Supervisor

TABLE OF CONTENTS

I.	AUDITOR'S REPORT	PAGE
	PURPOSE	1
	DISCLAIM PUBLIC USE	1
	OPINION	1
	SUMMARY OF SIGNIFICANT FINDINGS	2
	SUMMARY OF SIGNIFICANT PROCEDURES	2
II.	EXCEPTIONS	
1.	BOOKS AND RECORDS	3
2.	PLANT ADDITIONS	4
3.	REVENUE OVERSTATED	5
4.	EXPENSES OVERSTATED	6
5.	FAILURE TO BOOK PLANT CAPACITY CHARGES	7
6.	UNRECORDED LONG-TERM DEBT	8
7.	REGULATORY ASSESSMENT FEE	9
III.	DISCLOSURES	
1.	UTILITY ACQUISITION COST AND LAND OWNERSHIP	10
2.	RATE CASE EXPENSE	11
3.	PRO FORMA EXPENSES	12
4.	TORNADO IMPACT	13
IV.	EXHIBITS	
1.	WATER RATE BASE	14
2.	NOI STATEMENT	15
3.	CAPITAL STRUCTURE	16

**DIVISION OF AUDITING AND FINANCIAL ANALYSIS
AUDITOR'S REPORT**

JUNE 18, 1998

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 12-month period ended December 31, 1997, for Morningside Utility, Inc. These schedules were prepared by the auditor as part of the utility's petition for a Staff-Assisted Rate Case in Docket No. 980445-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.

In our opinion, the schedules referred to above, except Rate Base, present fairly, in all material respects, the utility's books and records not maintained in conformity with accounting practices prescribed by the Florida Public Service Commission. The expressed opinion extends only to the scope of work described in this report. The attached findings discuss all differences and other matters which were noted during our examination.

SUMMARY OF SIGNIFICANT FINDINGS

The company did not follow the NARUC Uniform System of Accounts

Original cost records were not available requiring a cost study from the Division of Water and Wastewater's engineering section.

The company omitted the accounts of CIAC and its related amortization from its books and records.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by comparing, on a test basis, certain company accounts and account balances which we believe are significant 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 definition applies when used in this report.

Scanned - The documents or accounts were read quickly looking for obvious errors.

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

Confirmed - Evidential matter supporting an account balance, transaction, or other information was obtained directly from an independent third party.

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

RATE BASE: Compiled the plant additions from invoices and the cash general ledger. Confirmed invoice totals from the plant addition vendor. Compiled the utility's plant capacity charges by year.

OPERATING INCOME: Scanned the cash general ledger for obvious errors in the operations and maintenance account balances. Read invoices and compared to ledger entries to verify correct booking. Selected expense items to verify correct classification.

CAPITAL STRUCTURE: Verified date and interest rate for loan made to utility with the bank document. Verified the vice president's personal advance to the utility from the check registers and expense payments. Compiled amortization schedules for loans to the utility from the bank loan and vice president.

OTHER: Toured utility plant to obtain understanding of plant additions. Read purchase agreements for acquisition adjustment information.

EXCEPTIONS

Exception No. 1

Subject: Books and Records

Statement of Fact: Rule 25-30.115, Florida Administrative Code, requires Florida utilities to maintain their books and records by the NARUC Uniform System of Accounts.

The utility lacked documentation to support costs for its water distribution system. The general ledger beginning balances for buildings and machinery were also unsupported.

The utility also did not maintain a CIAC account for tracking the collection of its hook-up fees, nor did it maintain depreciation detail.

An original cost study was requested from the Division of Water and Wastewater's engineers.

Discussions with the utility during field work emphasized the utility's benefits of using a Uniform System of Accounts. The utility was given the address to purchase the NARUC Uniform System of Accounts.

Recommendation: The Commission should order the utility to convert its books and records to the NARUC System.

Exception No. 2

Subject: Plant Additions

Statement of Fact: The utility charged its plant additions to both asset and expense accounts. Invoice deposits and final payments for the same project were booked to separate accounts.

Recommendation: The following plant additions were compiled during the field work.

<u>ACCOUNT NO.</u>	<u>NAME</u>	<u>AMOUNT</u>
307	WELLS	\$17,054
310	GENERATION	16,058
311	PUMPING EQ	1,548
320	TREATMENT EQ	<u>10,119</u>
	TOTAL	\$44,779

The Commission should make the above additions to the utility plant-in-service account.

Exception No. 3

Subject: Revenue Overstated

Statement of Fact: The utility's accountant credited the revenue account from the monthly bank deposits. These included test year plant capacity charges, returned check redeposits, and personal loans.

The sales account total for the utility, as adjusted for an estimate of personal loans, was used for Florida Public Service Commission reporting and federal income tax returns.

Recommendation: The following reductions were made to the sales account of the utility.

<u>DESCRIPTION</u>	<u>AMOUNT</u>
SALES	\$75,409
HOOK-UPS	(1,200)
REDEPOSITS	(540)
BANK LOAN	(15,000)
PERSONAL LOAN	<u>(6,000)</u>
TOTAL REVENUE	\$52,669

The following is the calculation of the revenue exception.

<u>DESCRIPTION</u>	<u>AMOUNT</u>
REVENUE PER AUDIT	\$52,669
REVENUE PER COMPANY	<u>(75,409)</u>
EXCEPTION	(\$22,740)

Exception No. 4

Subject: General Ledger Expenses Overstated

Statement of Fact: The utility charged plant additions to expense accounts and included one RAF payment for 1996 in a miscellaneous expense account.

Recommendation: The following items should be deducted from the utility's expense accounts.

<u>ACCOUNT</u>	<u>ERROR</u>	<u>AMOUNT</u>
618	PLANT ADDITION	\$660
620	PLANT ADDITION	5,499
630	PLANT ADDITION	2,270
675	1996 RAF PAYMENT	<u>750</u>
	TOTAL	\$9,179

The working capital allowance before pro forma expenses was calculated to be \$4,186.

Exception No. 5

Subject: Failure to Book Plant Capacity Charges

Statement of Fact: The utility did not maintain a CIAC account for tracking the collection of its plant capacity charges (hook-up fees). Neither the owner nor the bookkeeping contractor was familiar with the requirement to accumulate or amortize hook-up fees per the NARUC Uniform System of Accounts. (See Exception No. 1.)

During the life of the water utility, 183 hook-up fees have been collected. None of them were put on the books as CIAC.

Of the 183 hook-up fees, 95 were collected by the previous owner of the utility and 88 have been collected during the Devillers' ownership.

Recommendation: The collection of hook-up fees per year was compiled by the field audit staff, and the amortization was also computed.

The following test year beginning and ending balances were determined.

	<u>BEGIN 1997</u>	<u>END 1997</u>	<u>AVERAGE</u>
CIAC	(\$108,600)	(\$109,800)	(\$109,200)
AMORTIZATION	\$22,373	\$25,103	\$23,738

The above balances of CIAC and amortization should be added to the utility's rate base.

Exception No. 6

Subject: Unrecorded Long-term Debt

Statement of Fact: The vice president provided a loan to the utility with an incomplete amortization schedule which was not booked at year-end.

The utility's bank loan amount was not adjusted monthly to the current year-end balance.

Recommendation: The Commission should recognize the entire corrected debt as part of the utility's capital structure.

<u>DESCRIPTION</u>	<u>AMOUNT</u>
LONG-TERM DEBT PER AUDIT	\$29,549
LONG-TERM DEBT PER LEDGER	<u>(14,646)</u>
ADDITIONAL DEBT	\$14,903

Exception No. 7

Subject: Regulatory Assessment Fee

Statement of Fact: The utility did not calculate and pay its RAF payment until April 17, 1998. The 1996 partial RAF payment of \$750 was booked to operations and maintenance expense and has been removed from that account.

Recommendation: Based on the revised revenue total of \$52,669 and unreported water sales of \$164, the 1997 RAF payment to be added to taxes other is as follows.

	<u>Amount</u>
REVENUE	\$52,669.00
ADDITION	<u>164.00</u>
SUB	52,833.00
RAF RATE	<u>.045</u>
1997 RAF	\$2,377.49

Exception No. 7

Subject: Regulatory Assessment Fee

Statement of Fact: The utility did not calculate and pay its RAF payment until April 17, 1998. The 1997 RAF payment was not booked to the test year expense. A 1996 partial RAF payment of \$750 was booked to operations and maintenance expense and has been removed from that account.

Recommendation: Based on the revised revenue total of \$52,669 and unreported water sales of \$164, the 1997 RAF payment to be added to taxes other is as follows.

	<u>Amount</u>
REVENUE	\$52,669.00
ADDITION	<u>164.00</u>
SUB	52,833.00
RAF RATE	<u>.045</u>
1997 RAF	\$2,377.49

The company payment of its 1997 RAF mentioned above in the amount of \$2,894.98 was an overpayment of \$517.49. (2,894.98 - 2,377.49)

Disclosure No. 1

Subject: Acquisition Costs and Land Ownership

Statement of Fact: George Devillers purchased Morningside Utility, Inc. from Wayne and Clarence Schoolfield who were the original developers of Morningside Acres. Mr. Devillers paid \$100,000 for the stock of the utility and traded two lots in Kissimmee for the utility land. The trade was made under Section 1031 of the Internal Revenue Code and valued by the parties and recorded in Osceola County at \$120,000. Section 1031 recognizes no gain or loss and is for like-kind exchanges.

Osceola County Courthouse land records indicated that the two lots owned by and traded by George Devillers were purchased for \$27,000 in April 1971. The trade for utility land was made September 14, 1988. During this period, which was right after Disney World opened, the land values in Osceola County were increasing rapidly.

The sellers of the utility told Mr. Devillers that the purchase price would be offset by \$55,800 in hook-up fees to be collected.

Recommendation: The Commission should not look on the \$55,800 in hook-up fees to be collected as a reduction in purchase price. The hook-up fees are collections of CIAC and should be accounted for accordingly.

The purchase price from the Commission point of view is reflected below.

	<u>AMOUNT</u>
UTILITY LAND	\$120,000
PURCHASE OF STOCK	<u>100,000</u>
TOTAL	\$220,000

Disclosure No. 2

Subject: Rate Case Expense

Statement of Fact: The utility paid the Florida Public Service Commission an application fee for this rate case of \$1,000. Also included in the rate case expense are professional fees for the utility's accountant who assisted the audit staff in obtaining records and information. This fee consists of current charges of \$787.50 and future implementation fees of \$1,300 for a total accounting fee of \$2,087.50.

Recommendation: The total rate case fee for this proceeding is listed below.

<u>DESCRIPTION</u>	<u>AMOUNT</u>
PSC APPLICATION FEE	\$1,000
PROFESSIONAL FEES	<u>2,088</u>
TOTAL	\$3,088

Using the rule based on the four-year amortization period for rate case expense, the annual amount for this proceeding is \$772. ($\$3,088 / 4$)

Disclosure No. 3

Subject: Pro forma Expenses

Statement of Fact: The current expense structure does not include any compensation for the president of the utility who spends an average of 22.5 hours a week doing utility business. Mr. Devillers stated that he should get at least \$20 an hour.

Mr. Devillers also owns the land the utility occupies and has executed a 99-year lease with the utility at \$300 per month.

The business of the utility is done at the residence of Mr. Devillers, and an office allowance of \$100 per month is proposed by the utility.

Recommendation: The following pro forma expenses are proposed for the utility.

- ANNUAL OFFICER'S SALARY - (\$20/ hour at 22.5 hrs/wk for 52 weeks) or \$ 23,400
- ANNUAL LAND LEASE - (\$300/mo. for 12 months) or \$3,600
- ANNUAL OFFICE ALLOWANCE - (\$100/mo. for 12 months) \$1,200

<u>ACCOUNT</u>	<u>DESCRIPTION</u>	<u>AMOUNT</u>	<u>EXPLANATION</u>
603	OFFICER'S SALARY	\$23,400	COMPENSATION
640	LAND LEASE	3,600	99-YEAR LEASE
675	OFFICE ALLOW.	<u>1,200</u>	BUSINESS OFFICE
	TOTAL	\$28,200	

Audit Disclosure No. 4

Subject: Tornado Impact

Statement of Fact: On February 23, 1998, a tornado blew through Morningside Acres and destroyed 14 of the customers' homes.

This event is less than three months after the test period for this rate proceeding.

Recommendation: Based on the billing analysis data accumulated for this audit, the average consumption of the 14 customers is 6,311 gallons per month.

A correction of the billing analysis appears to be necessary due to this known future event affecting 7.7 percent of the Morningside customers.

EXHIBIT I

MORNINGSIDE UTILITY, INC.
DOCKET NO. 980445-WU
RATE BASE
TEST YEAR ENDED 12-31-97

(a)	(b)	(c)	(d)	(e)
DESCRIPTION	PER COMPANY	AUDIT EXCEPTION (1)	REFER TO (2)	PER AUDIT
UTILITY PLANT-IN-SERVICE	\$0.00	\$44,779.50	AE 2	\$44,779.50
LAND	0.00	0.00		0.00
PLANT HELD FOR FUTURE USE	0.00	0.00		0.00
CIAC	0.00	(109,800.00)	AE 5	(109,800.00)
AMORTIZATION OF CIAC	0.00	25,102.50	AE 5	25,102.50
ACCUMULATED DEPRECIATION	0.00	0.00		0.00
WORKING CAPITAL (3)	0.00	4,186.00	AE 4	4,186.00
TOTAL	\$0.00	(\$35,732.00)		(\$35,732.00)

REQUIRED FOOTNOTES:

- (1) NOTE THIS EXHIBIT NOT COMPLETED PENDING AN ORIGINAL COST STUDY
- (2) Audit adjustments do not include credit disclosures.
- (3) Working Capital was calculated at 1/8 O&M expense per Commission policy.

EXHIBIT II**MORNINGSIDE UTILITY, INC.
DOCKET NO. 980445-WU
NET OPERATING INCOME
TEST YEAR ENDED 12-31-97**

(a)	(b)	(c)	(d)	(e)
DESCRIPTION	PER COMPANY	AUDIT EXCEPTION (1)	REFER TO (2)	PER AUDIT
OPERATING REVENUES	\$75,409.04	(\$22,739.96)	AE 3	\$52,669.08
	-----	-----		-----
OPERATING EXPENSES:				
O&M EXPENSE	42,669.97	(9,178.89)	AE 4	33,491.08
DEPRECIATION EXPENSE (3)	12,845.00	0.00		12,845.00
TAXES OTHER THAN INCOME	2,885.80	2,377.49	AE 7	5,263.29
INCOME TAX EXPENSE	0.00	0.00		0.00
OTHER UTILITY EXPENSE	0.00	0.00		0.00
	-----	-----		-----
TOTAL OPERATING EXPENSE	\$58,400.77	(\$6,801.40)		\$51,599.37
	=====	=====		=====
NET OPERATING INCOME(LOSS)	\$17,008.27	(\$15,938.56)		\$1,069.71

REQUIRED FOOTNOTES:

- (1) *Small differences are due to rounding.*
- (2) *Audit adjustments do not include audit disclosures.*
- (3) NO DEPRECIATION ADJUSTMENT PENDING COST STUDY

EXHIBIT III

**MORNINGSIDE UTILITY, INC.
DOCKET NO. 980445-WU
CAPITAL STRUCTURE (1)
TEST YEAR ENDED 12-31-97**

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
DESCRIPTION	PER COMPANY	AUDIT EXCEPTION (1)	REFER TO	PER AUDIT	RATIO	COST RATE	WEIGHTED COST OF CAPITAL
COMMON EQUITY	\$79,423.16	\$0.00		\$79,423.16	72.88%		0.00%
PREFERRED STOCK	0.00	0.00		0.00	0.00%		0.00%
LONG-TERM DEBT	14,646.00	14,903.00	AE 6	29,549.00	27.12%		0.00%
SHORT-TERM DEBT	0.00	0.00		0.00	0.00%		0.00%
CUSTOMER DEPOSITS	0.00	0.00		0.00	0.00%		0.00%
ITC	0.00	0.00		0.00	0.00%		0.00%
TOTAL	\$94,069.16	\$14,903.00		\$108,972.16	100.00%		0.00%

REQUIRED FOOTNOTES:

(1) Audit adjustments do not include audit disclosures.

STATE OF FLORIDA

Commissioners:
JULIA L. JOHNSON, CHAIRMAN
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.



DIVISION OF RECORDS & REPORTING
BLANCA S. BAYÓ
DIRECTOR
(850) 413-6770

Public Service Commission

July 2, 1998

George De Villers, President
Morningside Utility, Inc.
1106 Monroe Avenue
St. Cloud, Florida 34769-6713

Re: Docket No. 980445 - WU - Morningside Utility, Inc.
Audit Report - Staff-assisted Rate Case
Audit Control # 98-131-3-1

Dear Mr. De Villers:

The enclosed audit report is forwarded for your review. Any company response filed with this office within ten (10) work days of the above case will be forwarded for consideration by the staff analyst in the preparation of a recommendation for this case.

Thank you for your cooperation.

Sincerely,

A handwritten signature in cursive script that reads "Kay Flynn".

Kay Flynn

KF/ABF

Enclosure

cc: Public Counsel
Division of Audit and Financial Analysis