

M E M O R A N D U M

December 31, 1998

TO: DIVISION OF RECORDS AND REPORTING

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

RE: DOCKET NO. 981258-WS -- LAKE WALES UTILITY CO., LTD.
AUDIT REPORT - OVEREARNINGS INVESTIGATION
HISTORICAL YEAR ENDED DECEMBER 31, 1997
AUDIT CONTROL NO. 98-286-2-1

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:

Lake Wales Utility Co., Ltd.
David K. Pearce
P. O. Box 9076
Fedhaven, FL 33854-9076

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 (Quijano)
Tampa District Office (McPherson)

Research and Regulatory Review (Harvey)
Office of Public Counsel

DOCUMENT NUMBER-DATE

00035 JAN-4 88

FPSC-RECORDS/REPORTING



FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING*

TAMPA DISTRICT OFFICE

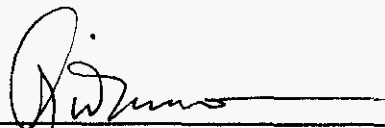
LAKE WALES UTILITY COMPANY, LTD.

OVEREARNING INVESTIGATION

HISTORICAL YEAR ENDED DECEMBER 31, 1997

DOCKET NO. 981258 -WS

AUDIT CONTROL NO. 98-286-2-1



Simon Ojada, Audit Manager



James A. McPherson, Audit Supervisor

DOCUMENT NUMBER - DATE

00035 JAN-4 88

FPSC-RECORDS/REPORTING

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

DECEMBER 15, 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 Lake Wales Utility Company. These schedules were prepared by the auditor as part of the utility overearning investigation in Docket No. 981258 -WS. 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 present fairly, in all material respects, the utility's books and records, 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 utility reported 13 months' revenue in its 1997 annual report. The utility also reduced 1997 operating and maintenance expense by the net effect of 1996 audit adjustments which should have been netted against retained earnings.

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: Prepared a schedule of plant additions from utility general ledger and compiled account balances for Utility-Plant-in-Service (UPIS), Contributions-in-Aid-of-Construction (CIAC), accumulated depreciation, and accumulated amortization of CIAC for the 12 months period ended December 31, 1997. Reconciled rate base balances to the prior audit. Reviewed for CIAC additions. Calculated working capital using one-eighth of the operation and maintenance expenses. Calculated accumulated depreciation. Computed amortization of CIAC using PSC authorized rates.

NET OPERATING INCOME: Compiled utility revenue and operation and maintenance accounts for the period ended December 31, 1997. Chose a judgmental sample of customer bills and recalculated using FPSC approved rates. Reviewed operation and maintenance expenses for supporting documentation. Recalculated depreciation expense. Verified taxes other than income.

CAPITAL STRUCTURE: Compiled components of the capital structures for the period ended December 31, 1997.

DISCLOSURES

Disclosure No. 1

Subject: Plant-in-Service

Statement of Fact: In 1996, FPSC conducted an overearning investigation whereby PSC auditors reconciled Polk County approved Plant in Service balance to the utility books and records. The auditors made recommendations to adjust company books to reconcile with Polk County approved plant balance. Lake Wales Utility Company made all the 1996 auditors' recommended adjustments to Plant in Service.

The utility company entered into a contract with Utility Service Company, Inc. to renovate and maintain its 100,000 gallon water storage tank. The initial amount of the contract was \$26,252 for renovating the tank and \$5,100 for each of the next two years (1998 & 1999) for tank maintenance. The utility has the option of continuing with the contract after the first three years for an annual base fee of \$5,100. The utility was to make payments of \$12,151 per year for three years to pay for these cost.

Recommendation: The utility should be required to capitalize the \$26,252 for the cost of the renovation by making the following journal entry.

Plant in Service (Acct. 330)	26,252	
Water Tank Contract Payable		26,252

This liability will be reduced as payments are made to the contractor. During 1997, Lake Wales Utility paid a total of \$15,188 for this work. This amount was recorded as an expense in account 636, Contract Services-Other. Therefore, the following adjustment also needs to be made.

Accounts Payable	15,188	
Contract Services-Other		15,188

Disclosure No. 2

Subject: Revenue

Statement of Fact: Lake Wales Utility reported 13 months revenues in its 1997 Annual Report. Also, the utility reported miscellaneous water revenue of \$2,174 and non utility revenue of \$5,906

Recommendation: The Company accounting firm that prepared the annual report included \$27,179 for December 1997 meter reading that the company recorded in General Ledger as January 1998 revenue. However, they did not reverse out the December 1996 meter reading that was recorded in the January 1998 General Ledger.

Analysis of the miscellaneous revenue and non utility revenues revealed that \$4,376 should be classified to CIAC (\$1,619 to water and \$2,757 to wastewater), \$3,282 were out of period refunds, and \$422 were miscellaneous refunds which should reduce 1997 expense accounts.

Disclosure No. 3

Subject: Accumulated Depreciation/Expense

Statement of Fact: Rule 25-30.140 FAC establishes the useful life of depreciable assets for Class B utilities effective March 22, 1984. Subsection 4 (b) states "All class B utilities shall maintain depreciation rates and reserve activity data by total depreciable plant, function or account as prescribed by this commission."

Recommendation: The utility did not use the Commission recommended rates in determining the depreciation of its depreciable assets. Depreciation expense and accumulation of depreciation were recomputed by the auditor using the depreciation rates established by Rule 25-30.140 FAC for the test period.

Below is the auditor's recomputed depreciation expense for the test year and the accumulated depreciation.

	Expense		Accum Dep	
	Water	Sewer	Water	Sewer
Balance Per Utility	18,561	20,435	352,483	412,985
Balance Per Audit	<u>13,992</u>	<u>31,008</u>	<u>344,856</u>	<u>423,558</u>
Difference	(4,569)	10,573	7,627	(10,573)

The above calculation includes an adjustment to retained earnings to reflect a reduction of accumulated depreciation for certain class assets that have been over depreciated.

Accum. Depreciation (Acct 304)	820	
Accum. Depreciation (Acct 335)	2,238	
Retained earnings		3,058

Disclosure No. 4

Subject: Contribution in Aid of Construction (CIAC)

Statement of Fact: FPSC auditors established CIAC and Accumulated Amortization of CIAC as of 12-31-96 to be \$218,000 and \$149,331 for water and \$157,439 and \$133,207 for wastewater respectively. These amounts were recorded in the utility books and records.

The utility collected \$4,376 Hook-up fees in 1997 (\$1,619 for water and \$2,757 for wastewater) and recorded it as miscellaneous and non utility revenues.

Recommendation: The auditor started with the balance of CIAC and accumulated amortization of CIAC per the last PSC audit, and applied the annual composite depreciation rate derived from the 1997 depreciation schedules (3.08 percent for water and 4.74 percent for wastewater).

	Expense		Accum Amortz	
	Water	Sewer	Water	Sewer
Balance Per Utility	6,409	6,109	155,740	139,316
Balance Per Audit	<u>6,764</u>	<u>7,593</u>	<u>156,095</u>	<u>140,800</u>
Difference	(355)	(1,484)	355	1,484

The utility should increase water CIAC by \$1,619 and Wastewater CIAC by \$2,757 to record the CIAC collected.

Disclosure No. 5

Subject: Operation and Maintenance Expense

Statement of Fact: The utility recorded a total of \$84,486 for water and \$113,296 for wastewater O&M expense for the 12 months period ended December 31, 1997.

In 1997, the utility paid \$2,280 (\$843 for water and \$1436 for wastewater) to Polk County which was a payment for prior years rate case expense.

The utility reduced O&M expenses by \$15,053 for water and \$9,805 for wastewater, the net effect of all adjustments recommended in a prior PSC audit.

Recommendation: Water O&M expense should be reduced by the \$15,188 payment to Utility Services Company for the renovative contract (see Disclosure No. 1), and \$1,242 for the cost of meters purchased, and \$843 for prior years rate case expense. Wastewater O&M expense should be reduced by \$1,436 for the out of period rate case expense, and \$422 for miscellaneous refunds (See Disclosure No. 2).

The net effect of the prior period adjustment should increase retained earnings, therefore, water O&M expense should be increased by \$15,053, and wastewater O&M expense should be increased by \$9,805. Below is a break down of all audit adjustments to O&M expense.

Water (Balance per book)		84,486
Audit Adjustments		
Out of period rate case expense	(843)	
Payment for item capitalized	(15,188)	
Amount capitalized (Acct 334)	(1,242)	
Net effect of prior audit adjustment	<u>15,053</u>	<u>(2,220)</u>
Balance Per Audit		<u>82,266</u>
Wastewater (Balance per book)		113,296
Audit Adjustments		
Out of period rate case expense	(1,436)	
Miscellaneous refunds	(422)	
Net effect of prior audit adjustment	<u>9,804</u>	<u>7,946</u>
Balance Per Audit		<u>121,242</u>

Utility should be required to increase Acct 334 (Meters and Meter installation by \$1,242) for the capitalized item.

Disclosure No. 6

Subject: Taxes Other Than Income

Statement of Fact: The utility posted 1996 Regulatory Assessment Fee of \$10,605 in 1997 which it also recorded in its 1997 annual report. The 1997 Regulatory Assessment Fee payment of \$14,944 (\$15,999 less \$1,055 credit) is recorded in 1998.

The utility recorded out of period Real Estate Tax of \$705 in 1997.

Recommendation: The Regulatory Assessment Fee for 1997 was based on \$140,740 revenue for water and \$214,793 for wastewater. However, the audited water revenue for 1997 is \$128,510 and \$197,670 for wastewater. Therefore, the Regulatory Assessment Fee for water should be \$5,783 ($\$140,740 \times 0.045$) and \$8,895 ($\$197,670 \times 0.045$) for wastewater.

<u>Regulatory Assess Fee</u>	<u>Water</u>	<u>Wastewater</u>
Amount per audit	5,783	8,895
Amount per book	3,924	6,681
Audit adjustments	<u>1,859</u>	<u>2,214</u>

Regulatory Assessment Fee should be increased by \$1,859 for water and \$2,214 for wastewater.

Real estate tax should be reduced by \$705 (\$261 for water and \$444 for wastewater).

Disclosure No. 7

Subject: Proposed Plant Improvements.

Statement of Fact: Lake Wales Utility Company submitted an estimated total cost of capital improvements of \$909,850 for the years 1999 through 2003.

Recommendation: Staff defers to the Division of Water and Wastewater as to the cost of the improvement.

SCHEDULES OF RATE BASE
LAKE WALES UTILITY CO., LTD
DOCKET NO. 981258-WS
RATE BASE - WATER
TEST YEAR ENDED 12/31/97

EXHIBIT I

(a) DESCRIPTION	(b) PER BOOKS 12/31/96	(c) PER BOOKS 12/31/97	(d) AUDIT ADJUST	(e) REFER TO	(f) PER AUDIT 12/31/97	(g) AVERAGE BAL PER AUDIT
UTILITY PLANT IN SERVICE	429,256	429,973	26,252 1,242	D1 D5	457,467	443,362
LAND	14,473	14,473	0		14,473	14,473
PLANT HELD FOR FUTURE USE	0	0	0		0	0
CIAC	(218,000)	(218,000)	(1,619)	D4	(219,619)	(218,810)
AMORTIZATION OF CIAC	149,331	155,740	443	D4	156,183	152,757
ACCUMULATED DEPRECIATION	(333,922)	(352,483)	4,569 3,058	D3 D3	(344,856)	(339,389)
WORKING CAPITAL	7,488	0	10,283		10,283	8,886
TOTAL	48,626	29,703	44,228		73,931	61,279

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

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

SCHEDULES OF RATE BASE
 LAKE WALES UTILITY CO., LTD
 DOCKET NO. 981258-WS
 RATE BASE - SEWER
 TEST YEAR ENDED 12/31/97

EXHIBIT II

(a) DESCRIPTION	(b) PER BOOKS <u>12/31/96</u>	(c) PER BOOKS <u>12/31/97</u>	(d) AUDIT ADJUST	(e) REFER TO	(f) PER AUDIT <u>12/31/97</u>	(g) AVERAGE BAL PER AUDIT
UTILITY PLANT IN SERVICE	653,619	654,840	0		654,840	654,230
LAND	34,247	34,247	0		34,247	34,247
PLANT HELD FOR FUTURE USE	0	0	0		0	0
CIAC	(157,439)	(157,439)	(2,757)	D4	(160,196)	(158,818)
AMORTIZATION OF CIAC	133,207	139,316	1,484	D4	140,800	137,004
ACCUMULATED DEPRECIATION	(392,550)	(412,985)	(10,573)	D5	(423,558)	(408,054)
WORKING CAPITAL	14,999	0	15,155		15,155	15,077
TOTAL	<u>286,083</u>	<u>257,979</u>	<u>3,309</u>		<u>261,288</u>	<u>273,686</u>

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

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

SCHEDULES OF RATE BASE
LAKE WALES UTILITY CO., LTD
DOCKET NO. 981258-WS
NET OPERATING INCOME - WATER
TEST YEAR ENDED 12/31/97

EXHIBIT III

DESCRIPTION	(1) BALANCE PER BOOKS 12/31/97	(2) AUDIT ADJUST MENT	(3) Refer to	(4) AUDITED BALANCE
OPERATING REVENUES	130,684	(2,174)		128,510
<hr/>				
OPERATING EXPENSES				
OPERATION AND MAINTENANCE EXPENSE	84,486	(843)	D5	82,266
		(15,188)	D5	
		(1,242)	D5	
		15,053	D5	
DEPRECIATION EXPENSE	18,561	(4,569)	D3	13,992
AMORTIZATION EXPENSE	(6,409)	(355)	D4	(6,764)
TAXES OTHER THAN INCOME	7,861	1,859	D6	9,459
		(261)	D6	
TOTAL OPERATING EXPENSES	104,499	(5,546)		98,953
NET OPERATING INCOME/LOSS	26,185	3,372		29,557

SCHEDULES OF RATE BASE
LAKE WALES UTILITY CO., LTD
DOCKET NO. 981258-WS
NET OPERATING INCOME - SEWER
TEST YEAR ENDED 12/31/97

EXHIBIT IV

DESCRIPTION	(1) BALANCE PER BOOKS 12/31/97	(2) AUDIT ADJUST- MENT	(3) Refer to	(4) AUDITED BALANCE
OPERATING REVENUES	197,670	0		197,670
OPERATING EXPENSES				
OPERATION AND MAINTENANCE EXPENSE	113,296	(1,436) (422) 9,804	D5 D5 D5	121,242
DEPRECIATION EXPENSE	20,435	10,573	D3	31,008
AMORTIZATION EXPENSE	(6,109)	(1,484)	D4	(7,593)
TAXES OTHER THAN INCOME	13,384	2,214 (444)	D6 D6	15,154
TOTAL OPERATING EXPENSES	141,006	18,805		159,811
NET OPERATING INCOME/LOSS	56,664	(18,805)		37,859

LAKE WALES UTILITY CO. LTD
DOCKET 981258-WS
CAPITAL STRUCTURE
AS OF DECEMBER 31, 1997

EXHIBIT V

DESCRIPTION	(a) BALANCE PER T/B @12/31/96	(b) BALANCE PER T/B @12/31/97	(c) AUDIT ADJUST- MENTS	(d) SIMPLE AVERAGE PER T/B	(e) BALANCE PER AUDIT @12/31/97	(f) SIMPLE AVERAGE PER AUDIT	(g) RATIO	(h) COST RATE	(i) WEIGHTED COST OF CAPITAL
COMMON EQUITY	130,427	208,437	31,732	185,298	240,169	185,298	52.96%	10.70%	5.67%
PARTNER'S CAPITAL	130,427	208,437	31,732	185,298	240,169	185,298			
L/T DEBT- MORT PAYABLE	109,254	54,945		82,100	137,045	123,149	35.20%	9.50%	3.34%
L/T DEBT- MORTG PAYABLE-WELL	21,144	1,729	0	11,437	13,166	17,155	4.90%	9.50%	0.47%
L/T DEBT- JOHN DEERE	21,890	10,456		16,173	26,629	24,260	6.93%	8.50%	0.59%
CUSTOMER DEPOSITS	0	0		0	0	0	0.00%	0.00%	0.00%
OTHER					0	0	0.00%	0.00%	0.00%
TOTAL	282,715	275,567	31,732	295,007	417,008	349,862	100.00%		10.07%

Required Footnotes:

(1) Equity cost based on Polk county order