

State of Florida



Public Service Commission

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

DATE: January 12, 1999

TO: Division of Auditing and Financial Analysis (Vandiver)

FROM: Division of Water and Wastewater (Walker) *NW Walker*

RE: Docket No. 980307-WS - Application for Certificate to Provide Water and Wastewater Service in Orange County by Zellwood Station Co-op, Inc.

An Audit Critique and Evaluation Form (ACE) for the above referenced docket is attached. A copy of Zellwood response to the audit report is also attached. Zellwood basically agreed that an original cost study is needed to support the rate base determination and that its operating expenses require further explanation. The audit report clearly revealed that Zellwood's supporting documents were inadequate.

A December 16, 1998 hearing date was scheduled after Zellwood's customers protested the proposed rates. However, on September 4, 1998, Zellwood and its customers asked the Commission to approve a stipulation. By Proposed Agency Action Order No. PSC-98-1572-FOF-WS, issued on November 23, 1998, the stipulation was approved and the hearing was canceled.

cc: Division of Records and Reporting
Division of Legal Services (Ferguson)

- ACK _____
- AFA _____
- APP _____
- CAF _____
- CMU _____
- CTR _____
- EAG _____
- LEG _____
- LIN _____
- OPC _____
- RCH _____
- SEC 1
- WAS _____
- OTH _____

DOCUMENT NUMBER-DATE
00489 JAN 13 99
FPSC-RECORDS/REPORTING

AUDIT CRITIQUE AND EVALUATION (ACE) FORM
DIVISION OF AUDITING AND FINANCIAL ANALYSIS ♦ BUREAU OF AUDITING
RETURN TO AFA BEFORE: Sept. 21, 1998

RECEIVED
JUL 27 1998
 Florida Public Service Commission
 Division of Water and Wastewater

Company Name: Zellwood Station Co-op

Docket No.: 980307-WS

Audit Control No.: 98-095-3-1

Analyst Assigned: N.D.Walker

| AUDIT REPORT | Excellent | Satisfactory | Unsatisfactory | Not Applicable |
|--|-----------|--------------|----------------|----------------|
| | 3 | 2 | 1 | 0 |
| <i>Accuracy of the report</i> | 3 | 2 | 1 | 0 |
| <i>Clarity of the report</i> | 3 | 2 | 1 | 0 |
| <i>Usefulness of information in report</i> | 3 | 2 | 1 | 0 |
| <i>Conclusions in report are supported</i> | 3 | 2 | 1 | 0 |

This audit report included unique features that I would like to see in future audit reports. These features were as follows:

N/A

I would have liked to have seen the following in the audit report:

N/A

| AUDIT WORK PAPERS | Excellent | Satisfactory | Unsatisfactory | Not Applicable |
|--|-----------|--------------|----------------|----------------|
| | 3 | 2 | 1 | 0 |
| <i>The work papers supported the audit conclusions</i> | 3 | 2 | 1 | 0 |
| <i>The work papers included accurate information</i> | 3 | 2 | 1 | 0 |
| <i>Cross references allowed tracing of audit work</i> | 3 | 2 | 1 | 0 |
| <i>Indexing assisted in locating information</i> | 3 | 2 | 1 | 0 |

These audit work papers included unique features that I would like to see in future work papers. These features were as follows:

N/A

In support of items in the Audit Service Request and the Audit Manual audit guide, I would have liked to have seen the following in the audit work papers:

N/A

AUDIT CRITIQUE AND EVALUATION (ACE) FORM
DIVISION OF AUDITING AND FINANCIAL ANALYSIS ♦ BUREAU OF AUDITING
RETURN TO AFA BEFORE: Sept. 21, 1998

Company Name: Zellwood Station Co-op

Docket No.: 980307-WS

Audit Control No.: 98-095-3-1

Analyst Assigned: N.D.Walker

| Excellent | Satisfactory | Unsatisfactory | Poor |
|-----------|--------------|----------------|------|
| 3 | 2 | 1 | 0 |

COMMUNICATION AND CONDUCT

I was satisfied with how often the auditor communicated with me.

| | | | |
|---|---|---|---|
| 3 | 2 | 1 | 0 |
|---|---|---|---|

The information provided by the auditor during the audit process was useful.

| | | | |
|---|---|---|---|
| 3 | 2 | 1 | 0 |
|---|---|---|---|

Conduct & general helpfulness of auditor(s)

| | | | |
|---|---|---|---|
| 3 | 2 | 1 | 0 |
|---|---|---|---|

I appreciated the auditor(s) letting me know the following before the audit was complete:

N/A

While reviewing the audit work papers, I discovered the following information which I would have liked to have known about earlier:

N/A

OVERALL AUDIT PROCESS

Extent to which this audit met my needs

| | | | |
|---|---|---|---|
| 3 | 2 | 1 | 0 |
|---|---|---|---|

Fulfillment of scope and objectives

| | | | |
|---|---|---|---|
| 3 | 2 | 1 | 0 |
|---|---|---|---|

OTHER COMMENTS BENEFICIAL TO IMPROVING FUTURE AUDITS OR AUDITOR PERFORMANCE:

Please comment specifically on any unsatisfactory work indicated above.

N/A

HARTMAN & ASSOCIATES, INC.

engineers, hydrogeologists, surveyors & management consultants

PRINCIPALS

James E. Christopher, P.E.
Charles W. Drake, P.G.
Gerald C. Hartman, P.E.
Mark I. Luke, P.S.M.
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Andrew T. Woodcock, P.E.

August 5, 1998

HAI#96-459.01

RECEIVED

AUG 11 1998

Florida Public Service Commission
Division of Water and Wastewater

Ms. Blanca S. Bayo
Division of Records & Reporting
Florida Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

**Subject: Docket No. 980307 - WS - Zellwood Station Co-Op, Inc.
Audit Report - Establish Rate Base - Period Ended December 31, 1998
Audit Control # 98-095-3-1**

Dear Ms. Bayo:

The following are responses and/or clarifications as to the eight (8) Audit Exception's and four (4) Disclosures included in Mr. Brown's report.

**Audit Exception No. 1
Subject: Utility Plant**

Facts: The utility could not provide documents (invoices and checks) supporting the transfer of \$210,781.00 and \$1,989,822.00 of respective water and wastewater plant-in-service.

Zellwood Station Co-Op, Inc. purchased the utility along with the mobile home park on October 1, 1993, from Zellwood Station, LTD., for \$13,600,000.

The \$2,200,603 allocated to the utility was based on a physical improvement inspection report conducted by a public engineer on February 25, 1994. The total amount did not include general plant and was not an original cost study. The allocations in the rate case filing of \$1,156,768 for water and \$1,736,274 for wastewater reflected general and common plant and HAI's best estimate of the original cost of both systems without performing an original cost study.

Opinion/Recommendation: Water and wastewater plant-in-service should be reduced by \$1,097,725.84 and \$1,721,884.97, respectively. Field staff defers to the FPSC engineer and analyst for disposition of the plant valuation at transfer.

DOCUMENT NUMBER-DATE

201 EAST PINE STREET • SUITE 1000 • ORLANDO, FL 32801
TELEPHONE (407) 839-3955 • FAX (407) 839-3790 • www.consulthai.com

08468 AUG 10 98

ORLANDO FORT MYERS PLANTATION JACKSONVILLE FPSC-RECORDS/REPORTING

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August 5, 1998
Page 2

Company Response: The Company feels that in absence of the supporting documents from the previous two owners, it may well be in the best interest of all parties to agree to performing an "original cost study" as part of a supplemental rate filing which would also include metered rates within the next three years, with the requested rates put in place during the interim period.

Audit Exception No. 2

Subject: Depreciation and related Reserve

Facts: The water and wastewater reserve at December 31, 1996, along with test year depreciation, was recalculated per F. A. C. 25-30.140. Accumulated depreciation on the unsupported transferable plant along with associated depreciation expense (Exception No. 1) was excluded from the respective balances at December 31, 1996.

Opinion/Recommendation: It is recommended that accumulated depreciation at December 31, 1996, and water depreciation expense for the test year ended at the same date be reduced by \$239,519.12 and \$81,430.40, respectively; and that wastewater accumulated depreciation and depreciation expense for the same period be reduced by \$294,738.54 and \$88,552.04, respectively.

Company Response: The Company agrees that all water and wastewater assets should be recalculated per F. A. C. 25-30.140 for the test year versus the original depreciation rates and lives that are on the Company's books and records. The depreciation expense is predicated upon the plant in service which is at issue. The depreciation "fall-out" from expense and accumulated depreciation balances will be a by-product of the original cost study proposal to be conducted within the next 3 years.

Audit Exception No. 3

Subject: CIAC and Amortization

Facts: The utility reflected \$250,000 of contributions -in-aid-of-construction (CIAC) at December 31, 1996, via its Commission -submitted rate filing.

A review of the company's records did not support the existence of CIAC. Utility representative informed staff that it has never collected monies from customers for anything other than monthly water and wastewater charges of \$17.50 per customer.

Opinion/Recommendation: It appears that the utility's consultants imputed the CIAC. It is recommended that CIAC be reduced until the Tallahassee analyst and engineer evaluate the transferable plant per Exception No. 1 and determine the associated components. The related accumulated amortization of \$12,513 should be reduced in total.

Company Response: At the time of this filing, the Company has petitioned the St. Johns River Water Management District for grant money to assist in metering the system. The Company hopes to receive up to \$125,000 in matching grant money. At its August 11 monthly meeting, the SJRMD is expected to consummate a \$50,000 grant agreement. Therefore, the Company believes that a minimum \$50,000 in CIAC from The SJRWMD is appropriate and the fallout adjustments associated therewith.

Audit Exception No. 4

Subject: Utility Pro Forma Adjustments

Facts: The utility was unable to provide field staff with schedules or documentation supporting \$68,111.11 and \$77,369.00 of 1996 water and wastewater proforma's, respectively. Water and wastewater operating and maintenance expenses (O&M), including proforma's, were \$169,841.07 and \$167,421.93, respectively, for the test year ended December 31, 1996.

The 1997 unaudited water and wastewater O&M expenses per the utility's general ledger were \$125,197.07 and 156,770.82, respectively.

Opinion/Recommendation: Staff recommends that 1996 water and wastewater operating expenses be reduced by \$68,111.11 and \$77,369.00 and net operating income be increased by the same.

Company Response: The Company respectfully apologizes to staff for not providing the support schedules and documentation apparently needed (please see Attachment No. 1). The Company has projected the additional operations and maintenance (including administrative & general) expense increases associated from transcending the utility from a non regulated mom and pop operation to a highly disciplined regulated water and wastewater utility. The Company is in a "catch 22" where as it is in dire need of rate relief before it can actually implement the requested pro forma expense request because of its financial condition.

Audit Exception No. 5

Subject: Filing/Per Books Reconciliation

Facts: The following differences in O&M accounts were noted between the utility's Commission rate filing and its books (general ledger).

Opinion/Recommendation: Staff recommends that water operating and maintenance expense be reduced by \$2,323.27 and wastewater be increased by \$14,712.48.

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Company Response: The Company agrees with staff, except that the dollars associated with accounts 631, 633 and 731 were pulled out of O&M and reassigned to rate case expense. The majority of the other differences occurred because of account classification differences. A/C 601 was a transposition error and A/C 711 test year number was in the pro forma column.

Audit Exception No. 6
Subject: Consumptive Use Permit

Facts: The utility charged Account 631, Contractual Services-Engineering for \$3,564.80 during the test year ended December 31, 1996.

The \$3,564.80 billed to Zellwood Station Co-Op, Inc. by Excel Engineering Consultants was for services provided in processing the utility's application for its consumptive use permit (CUP).

The permit issuer, St. Johns River Water Management District, establish a five-year CUP life.

Opinion/Recommendation: Field staff recommends that the \$3,564.80 charged to Contractual Services-Engineering be reduced to \$2,851.84 to reflect a five-year amortization period.

Company Response: The Company has reflected this expense as a part of its rate case expense using a four-year amortization. The company agrees that this expense should carry a amortization period that parallels the CUP life.

Audit Exception No. 7
Subject: Utility Expensed Plant Additions

Facts: The following capital expenditures were charged to operations during the test year ended December 31, 1996.

Opinion/Recommendation: Staff makes the following recommendations: that water and wastewater operating expenses be reduced by respective \$175.92 and 587.57; that water and wastewater utility plant be increased by the same; and that water and wastewater test year depreciation expense and the associated reserve at December 31, 1996, be increased by \$7.33 and \$16.43.

Company Response: The Company agrees.

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Audit Exception No. 8
Subject: Capital Structure

Facts: The utility purchased the mobile home park along with the utility for \$13,600,000 on October 1, 1993.

The seller, Zellwood Station, LTD., agreed to finance \$1,500,000 of the purchase price at 7 percent and received the balance in cash.

The utility reflected a 7.95 percent cost rate via its submitted filing applicable to the financing of the said loan.

Opinion/Recommendation: Long-term debt for the utility should be reflected at a 7 percent rate and the remaining investment equity.

Company Response: The Company agrees.

Audit Exception No. 9
Subject: Working Capital Allowance

Facts: The working capital allowance has been computed based on the 1/8 formula method to comply with Commission rule 25-30.433(2), Florida Administrative Code.

The respective water and wastewater working capital allowance was computed as \$12,047.37 and \$213,022.23 based upon staff adjusted operation and maintenance expenses of \$96,378.93 and \$104,177.84.

Opinion/Recommendation: Staff recommends that water and wastewater rate base be increased by \$12,047.37 and \$13,022.23, respectively.

Company Response: The Company agrees that the working capital method per Commission rule 25.30.433(2) is the 1/8 O&M method. It does not agree with the staff's level of adjusted water and wastewater O&M expenses.

Disclosure No. 1
Subject : Pro Forma Plant

Facts: The utility reflected a pro forma adjustment of \$234,678 for meters during 1997, via its submitted Commission rate filing.

The utility acquired \$98,383.39 and \$49,448.11 of respective water and wastewater additions from the end of the test year at December 31, 1996 through May 31, 1998.

Meters and associated costs represented \$59,682.54 of the \$147,832.00 plant additions obtained since December 31, 1996.

Opinion/Recommendation: Staff reflected rate base as of December 31, 1996, exclusive of the meter pro forma. Staff traced \$96,959.27 of the \$147,932.00 to supporting documentation. Staff defers to Tallahassee analyst for disposition of this matter.

Company Response: The Company feels strongly that the \$234,678 is an accurate estimate of the cost of purchasing and installing the meters for existing customers. It was originally thought that SJRWMD would reimburse the Company approximately \$250,000 through a grant, but the grant will be in an amount no less than \$50,000 and no more than \$125,000. It is critical that all meter installation expenditures are reflected in the proposed water rates.

Disclosure No. 2
Subject: Nonrecurring Expenses

Facts: The utility charged Account 633, Contractual Services-Legal for \$24,306.30 during the test year ended December 31, 1996.

The \$24,306.30 represents legal services provided by Gray, Harris & Robinson for utility-related matters.

Field staff was unable to categorize legal expense as some were inadequately descriptive. However, all costs appear to be specifically related to the FPSC rate filing, processing of the consumptive use permit, and the purchase of the utility.

Opinion/Recommendation: The legal costs should be amortized over a period as deemed reasonable by the FPSC analyst. A copy of the invoices totaling \$24,306.30 has been included in the audit work papers to assist the analyst in disposition of this matter.

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Page 7

Company Response: The Company has included these legal expenses as a part of its requested rate case expense, of which it is requesting a four-year amortization. The Company will assist the FPSC analyst in any way it can as it pertains to rate case expense documentation. The \$24,306.30 of legal expenses does not reflect any cost associated with processing of the consumptive use permit, and the purchase of the utility. It pertains to the original certificate application only.

Disclosure No. 3
Subject: Water Conservation

Facts: The St. Johns River Water Management District's issuance of Zellwood Station Co-Op, Inc.'s consumptive use permit was conditional upon the utility implementing certain water conservation measures. One condition was requiring water meters on all new construction and retrofitting such on existing residences. The retrofit program is required to be completed by the end of 1998.

Opinion/Recommendation: As of May 31, 1998, 690 of the 995 developed lots have been metered. In order to comply with the conditions, the remaining 305 need to be installed by December 31, 1998.

Company Response: The Company will, in good faith, attempt to meet this deadline. As of July 31, 1998, it has 730 meters installed.

Disclosure No. 4
Subject: Allocations

Facts: Operating expenses with the exception of salaries and wages, were distributed equally between water and wastewater, if not specifically identifiable with either operation.

Opinion/Recommendation: Utility representative informed staff that the allocation methodology was based on revenue at a flat rate of \$8.75 for water and \$8.75 for wastewater.

Company Response: The Company believes this is the correct allocation methodology because of the flat rates (revenues). In addition, there are an equal amount of water and wastewater customers.

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This filing contains an original and four copies of the service availability policy tariff sheets, and an original and five copies of the remaining information that you requested. Please feel free to call Mr. Chuck Lewis at (407) 839-3955 ext. 203 if you have any questions.

Very truly yours,

Zellwood Station Co-Op, Inc.



W. A. Restall
Utilities Director

cc: Irving Perkins
T. A. Cloud
G. C. Hartman
Julian Coto
Chuck Lewis

CKL/tm/96-459.01/corresp/bayo.ckl

Zellwood Station: W-WWTF Feasibility Study
 Docket No. 980307-WS
 Pro Forma Reconciliation
 Audit Report

| Item | Description | Hourly Rate (1) | Overhead Factor (2) | Factored Rate | Annual Hours | Annual Salary |
|---|------------------|-----------------|---------------------|---------------|--------------|-------------------------------------|
| 1 | Manager/Operator | \$22.00 | 130.00% | \$28.60 | 2,080 | \$59,488.00 |
| 2 | Labor/Operator | \$10.00 | 130.00% | \$13.00 | 2,080 | \$27,040.00 |
| 3 | Labor | \$8.00 | 130.00% | \$10.40 | 2,080 | \$21,632.00 |
| 4 | Clerical | \$10.00 | 130.00% | \$13.00 | 2,080 | \$27,040.00 |
| | | | | | | <u>\$135,200.00</u> |
| Water Allocation | | | | | | \$67,600.00 |
| Less 1996 Booked Water Wages & Salaries | | | | | | \$44,395.17 Incorrect Booked Number |
| Pro Forma | | | | | | <u>\$23,204.83 A/C 601</u> |
| Water Allocation | | | | | | \$67,600.00 A/C 601 |
| Less 1996 Booked Water Wages & Salaries | | | | | | \$14,395.17 A/C 601 |
| Pro Forma | | | | | | <u>\$53,204.83 A/C 601</u> |
| Wastewater Allocation | | | | | | \$67,600.00 A/C 701 |
| Less 1996 Booked Water Wages & Salaries | | | | | | \$43,187.11 A/C 701 |
| Pro Forma | | | | | | <u>\$24,412.89 A/C 701</u> |

| Water Expense | Pro Forma | Account | Allocation |
|-------------------------|--------------------|---------|-------------|
| Chemicals (3) | \$5,450.00 | A/C 618 | |
| Inspections (4) | \$0.00 | A/C 635 | |
| Laboratory Testing (5) | \$3,250.00 | A/C 635 | 50/50 Split |
| Supplies & Cleaning (6) | \$1,500.00 | A/C 620 | 50/50 Split |
| | <u>\$10,200.00</u> | | |

| Sewer Expense | Pro Forma | Account | Allocation |
|--------------------------|--------------------|---------|-------------|
| Chemicals (7) | \$0.00 | A/C 718 | |
| Inspections (8) | \$500.00 | A/C 735 | |
| Laboratory Testing (9) | \$3,250.00 | A/C 735 | 50/50 Split |
| Sludge Removal (10) | \$13,500.00 | A/C 711 | |
| Supplies & Cleaning (11) | \$1,500.00 | A/C 720 | 50/50 Split |
| | <u>\$18,750.00</u> | | |

Zellwood Station: W-WWTF Feasibility Study
 Docket No. 980307-WIS
 Pro Forma Reconciliation
 Audit Report

| General Expenses | | | |
|-----------------------------|--------------------|---------|------------|
| Water and Sewer | Pro Forma | Account | Allocation |
| General Administration (12) | \$3,000.00 | A/C 620 | 50/50 Spk |
| Regulatory Licenses (13) | \$500.00 | A/C 675 | 50/50 Spk |
| Repair of Equipment (14) | \$7,500.00 | A/C 620 | 50/50 Spk |
| State & County Permits (15) | \$0.00 | N/A | 50/50 Spk |
| Utility (16) | \$0.00 | N/A | 50/50 Spk |
| Misc. Expenses (17) | \$1,200.00 | A/C 675 | 50/50 Spk |
| | <u>\$12,200.00</u> | | |

| Office Expenses | | | |
|---------------------|--------------------|---------|------------|
| Water and Sewer | Pro Forma | Account | Allocation |
| Office Trailer (18) | \$4,500.00 | A/C 641 | 50/50 Spk |
| Supplies (19) | \$1,000.00 | A/C 620 | 50/50 Spk |
| Electricity (20) | \$2,500.00 | A/C 515 | 50/50 Spk |
| Computer (21) | \$1,500.00 | A/C 642 | 50/50 Spk |
| Software (22) | \$2,500.00 | A/C 642 | 50/50 Spk |
| Telephone (23) | \$600.00 | A/C 620 | 50/50 Spk |
| Travel (24) | \$3,000.00 | A/C 620 | 50/50 Spk |
| | <u>\$18,500.00</u> | | |

Footnotes:

- (1) - These are the applicable hourly rates for the various labor categories in the Orlando Area.
- (2) - This factor includes Zellwood Station Coop, Inc. applicable local, state and federal payroll taxes and fringe benefits
- (3) - Higher chemical costs are anticipated in the test year because of market conditions along this is estimated to be approximately equal to a compounded inflation allowance of 7% between the test year 1995 and the rate year 1999.
- (4) - N/A
- (5) - This item includes water quality testing required by the FDEP. It should be noted that water quality testing is performed over a 3 year cycle. Therefore, the costs for each year is not homogeneous and varies significantly between one year and the next. During the cycle year where volatile organics and radionuclides are tested the analytical expenses can be greater than \$3,000 for these parameters. Staff found test year amount to be 1,230.00.
- (6) - Supplies and cleaning includes miscellaneous chemical and cleaning supplies used to maintain the operations of the water facilities. There was no accounting entry for this expense in the test year.
- (7) - N/A
- (8) - The wastewater treatment facility is inspected 4 times per year by Orange County. The County charges Zellwood \$250.00 per inspection. Orange County also takes additional effluent water quality samples and charges the utility for these as well. The additional water quality Analysis are included in Laboratory testing.
- (9) - This item includes influent and effluent water quality testing required by the FDEP and Orange County. It should be noted that the new wwft operating