

STATE OF FLORIDA

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Public Service Commission

May 27, 1999

Mr. Robert L. Chapman
Southlake Utilities, Inc.
P. O. Box 6209
Tallahassee, FL 32314-6209

**Re: Docket No. 981609-WS; Southlake Utilities, Inc.
Audit Report - Investigation of Rate Base, AFPI, and Revenues
Audit Control No. 98-343-3-1**

Mr. Chapman:

The enclosed audit report is forwarded for your review. If you desire to file a response to the audit, please file one with the Division of Records and Reporting so it may be forwarded for consideration by the staff analysts in their review of the audit.

Sincerely,

Denise N. Vandiver
Bureau Chief - Auditing Services

DNV/sp

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- Division of Water and Wastewater (Fletcher)
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FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING SERVICES

Tallahassee District Office

Southlake Utilities, Inc.

Investigation of Rate Base, AFPI, and Revenues

January 1, 1993 through December 31, 1998

DOCKET NO. 981609-WS
AUDIT CONTROL NO. 98-343-3-1

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

May 20, 1999

**TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED
PARTIES**

We have applied the procedures described later in this report to audit the Allowance for Funds Prudently Invested (AFPI), Revenues, and Rate Base for the period 1993-1998 for Southlake Utilities, Inc. 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.

In our opinion, the utility's books and records (as of May 7, 1999 prior to the utility's year-end close for 1998 and prior to the preparation of its 1998 Annual Report) reflect the balances of AFPI, Revenues, and Rate Base in all material respects as maintained in general conformity with the accounting practices prescribed by the Florida Public Service Commission. The attached findings discuss all differences and other matters which were noted during our examination.

SUMMARY OF SIGNIFICANT FINDINGS

Utility calculations for depreciation expense, accumulated depreciation, and CIAC amortization differ from FPSC procedures. In addition, as of May 12, 1999, the utility had not closed its books and records for the 1998 year. As of May 13, 1999, the utility had not yet started its Annual Report for 1998 and will not have that completed until the end of May, 1999.

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:

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.

RATE BASE: Traced balances in plant accounts from the filed Annual Reports to the General Ledger. Selected on a judgement basis transactions for each year (1993-1998) within the plant accounts for water and for wastewater. Researched the selected transactions to determine the accuracy of the utility's accounting entries for plant accounts based upon the existence of obtained utility documentation. Researched the methodology used by the utility for its calculations of depreciation expense and allowance for depreciation. Selected on a judgement basis CIAC data to be researched. Traced CIAC data to trial balance, General Ledger, Cash Receipts Journal, to bank statements, to deposit slips, and to Developers' Agreements. Researched the methodology used by the utility for its calculations of amortization of CIAC.

AFPI: For the years 1993-1998, defined the accounts in which original AFPI related transactions occurred. Traced original AFPI amounts paid by Customers/Developers to the General Ledger, Cash Receipts Journal and/or Edit Journal, Developers' Agreements, and original FPSC tariff tables. Categorized the AFPI data in the General Ledger by Developer/Customer to determine appropriate AFPI balances. Researched the calculations of AFPI to be refunded per Developer/Customer. Traced the re-tariffed/allowed AFPI for each Developer/Customer to the FPSC revised tariff table. Traced the AFPI refunds from the Developer/Customer AFPI account balances to utility records. Selected on a judgement basis a set of AFPI transactions in the post-refund period to test for application of correct tariff rates.

OPERATING REVENUES: Prepared a schedule of Operating Revenues for 1998 based upon General Ledger data. Traced it to Billing Register for all primary revenue accounts. Researched billing calculations made for selected customer accounts.

Exception No. 1

Subject: Capitalized Labor

Statement of Facts: In October 1996, Southlake Utilities Inc., capitalized salary expenses for the current year and prior years. These transactions resulted in a debit to water and wastewater plant accounts. FPSC Rule 25-30.115, F.A.C. 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 (USOA) adopted by the National Association of Regulatory Utility Commissioners." USOA Accounts 603 (water) and 703 (wastewater) shall include the compensation (salaries, bonuses and other consideration for services) paid or accrued to officers, directors, or majority stockholders of the utility company.

Recommendation: The utility should make the following adjustments to its books and records:

WATER

Acct. No.	Account Name	Debit	Credit
603	Salaries & Wages- Officers, Directors, and Majority Stockholders	11,971.91	
301	Organization		1,986.43
304	Structures & Improvements		504.06
307	Wells & Springs		3,979.60
310	Power Generation Equipment		860.22
311	Pumping Equipment		2,288.30
320	Water Treatment Equipment		19.67
330	Distribution Reservoirs		1,453.29
333	Services		36.86
334	Meters & Installations		487.10
339	Other Plant & Misc. Equipment		345.48
345	Power Operated Equipment		10.90

WASTEWATER

Acct. No.	Account Name	Debit	Credit
703	Salaries & Wages- Officers, Directors, and Majority Stockholders	45,624.73	
351	Organization		1,444.12
354	Structures & Improvements		793.53
380	Treatment & Disposal Equipment		43,367.53
389	Other Plant & Misc. Equipment		8.65
395	Power Operated Equipment		10.90

The utility should remove the depreciation expense and amortization associated with the above accounts, the adjustment should be as follows:

WATER

Acct. No.	Account Name	Debit	Credit
108	Accumulated Depreciation and Amortization of UPIS	175.20	
407	Amortization Expense		175.20
108	Accumulated Depreciation and Amortization of UPIS	878.61	
403	Depreciation Expense		878.61

WASTEWATER

Acct. No.	Account Name	Debit	Credit
108	Accumulated Depreciation and Amortization of UPIS	127.37	
407	Amortization Expense		127.37
108	Accumulated Depreciation and Amortization of UPIS	3,141.44	
403	Depreciation Expense		3,141.44

Disclosure No. 1

Subject: 1995 Annual Report Beginning Balance

Statement of Facts: The 1994 annual report reflects an ending balance of \$40,950 in Account 301, Organization (water). The 1995 annual report beginning balance in Account 301 is \$38,606. The correct beginning balance for Account 301 is \$40,950. The 1994 annual report reflects an ending balance of \$29,770 in Account 351, Organization (wastewater). The 1995 annual report beginning balance in Account 351 is \$27,427. The correct beginning balance for Account 351 is \$29,770.

Recommendation: The utility should create annual reports that reflect the correct beginning and ending balances in all accounts.

Disclosure No. 2

Subject: Summer Bay Force and Water Main

Statement of Facts: For the year ending December 31, 1995, Southlake Utilities recorded a debit entry to accounts 331 and 360 in the amount of \$41,352 and \$18,648, respectively. The audit staff attempted to review the Company's support for the entries (invoices and canceled checks). However, no canceled checks were provided and the invoice that was provided did not contain company letterhead, a date, or any other identifying factors. This did not qualify as sufficient support for the total amount of \$60,000.

Recommendation: The utility should remove \$41,352 and \$18,648 from both water and wastewater plant accounts 331 and 360 and the associated depreciation expense because of its failure to provide sufficient support for the expenditures. The adjustment for plant and depreciation should be as follows:

Acct. No.	Account Name	Debit	Credit
108	Accumulated Depreciation (water)	2,007.30	
108	Accumulated Depreciation (wastewater)	1,914.68	
215	Retained Earnings (water)	41,352.00	
215	Retained Earnings (wastewater)	18,648.00	
403	Depreciation Expense (water)		2,007.30
403	Depreciation Expense (wastewater)		1,914.68
331	Transmission and Distribution Mains		41,352.00
360	Collections wastewaters - force		18,648.00

Disclosure No. 3**Subject: Accumulated Depreciation**

Statement of Facts: The Utility's 1998 year-to-date general ledger reflects \$47,139 in accumulated depreciation (water) and \$253,418 in accumulated depreciation (wastewater) for the year ending 1998. The audit staff recalculated depreciation based on beginning plant balances, additions, and retirements and has determined accumulated depreciation (water) to be \$53,927 and accumulated depreciation (wastewater) to be \$288,612. The utility calculates depreciation on a month to month basis and uses depreciation rates for Class B utilities. The audit staff calculated depreciation based on the half-year convention. Southlake Utilities, Inc. is a Class C company, therefore the audit staff used depreciation rates designed for Class C utilities. The audit difference of \$6,789 (water) and \$35,194 (wastewater) is due to the use of different depreciation methods, different rates, and immaterial errors.

Recommendation: The utility should use depreciation rates that are designed for Class C companies.

Disclosure No. 4

Subject: Depreciation Expense

Statement of Facts: For the year ended December 31, 1998, Southlake Utilities, Inc. overstated Account 01403, Depreciation Expense-Water, by \$9,554. During the same period, the company understated Account 02403, Depreciation Expense-Wastewater, by \$9,554.

Recommendation: Although the net effect is zero, a reversed entry is necessary. The utility should make the following adjustment to the general ledger:

Account No.	Account Name	Debit	Credit
02403	Depreciation Expense-Wastewater	\$9,554	
01403	Depreciation Expense-Water		\$9,554

Disclosure No. 5

Subject: Office Furniture and Equipment

Statement of Facts: The 1994 year to date general ledger includes an adjustment of \$1,500 to Account 340, Office Furniture and Equipment (water) and \$1,500 to Account 390, Office Furniture and Equipment (wastewater). The audit staff requested the utility to provide supporting documentation for each adjustment. As of May 6, 1999, the utility has not provided any support for the above entries.

Recommendation: The utility should provide documentation for the adjustments before they are included in plant accounts.

Disclosure No. 6

Subject: Amortization of Contribution in Aid of Construction (CIAC)

Statement of Fact: The utility calculated CIAC Amortization based on service lives by certain categories of plant from 1994 through 1998, and used individual rates for each category of account. The Water and Wastewater analyst requested the calculation of amortization of CIAC on a composite rate basis.

The amount that the utility calculated for amortization of CIAC was \$62,707 for Water and \$174,956 for Wastewater. Auditors calculated amortization based on a composite depreciation rate for each year for the period 1994 through 1998. The total amortization for Water and Wastewater for the period was \$85,574 and \$205,566, respectively.

Recommendation: This Disclosure is provided for the information of the Water & Wastewater analyst.

Disclosure No. 7

Subject: Water and Wastewater Tariff

Statement of Fact: Southlake Utility filed two tariffs with the Commission dated December, 1991. These tariffs were Developer's agreements made between the Utility and Southlake Community Partnership.

In the body of the Water agreement, the Utility stated that the plant capacity charge as calculated in Exhibit "B" was \$180,785. In reviewing the calculation on Exhibit "B", the amount reported was \$130,200. The Utility could not explain the difference. The Company recorded \$130,200 in the books and records.

In the body of the Wastewater agreement, the Utility reported plant capacity charge as being \$296,479 as calculated in Exhibit "B". Exhibit "B" shows an amount of \$225,835. The Utility could not explain this difference. The Utility recorded \$225,835 in the books and records.

Recommendation: The Utility should explain the different amounts.

Disclosure No. 8

Subject: Company CIAC Worksheets compared to the General Ledger

Statement of Fact: The Utility calculated amortization based on the additions to CIAC and recorded the amortization the following month. Staff followed the same procedure; however, at the close of 1998, it was noted that the additions per the company worksheets at the end of 1998 for Water and Wastewater did not tie to the General Ledger.

The Utility's CIAC worksheet totals were \$863,237 for Water and \$1,340,827 for Wastewater. The General Ledger amounts were \$783,533 for Water and \$1,155,159 for Wastewater. As of May 7, 1999 the Utility had not closed its books and records for 1998, and no Annual Report existed to compare the CIAC amounts to.

Recommendation: The company should reconcile the differences. In addition, the worksheets used by the Utility should tie to the General Ledger.

Disclosure No. 9

Subject: ERC Data

Statement of Fact: On March 16, 1999 the audit staff requested data necessary to determine if AFPI Revenues had occurred after the utility had reached its maximum ERC collection allowance. The utility responded on March 29, 1999 "We can not provide the requested information until we have the general ledger updated and adjusted through December 31, 1998. We plan to have this information available by April 30, 1999, our deadline for filing the 1998 Annual Report."

On Friday May 7, 1999 the utility responded by faxed documents. However, the response was not complete because it did not fully provide the items requested by the audit staff.

As of May 12, 1999 3:30 p.m., the utility had not closed its books and records for the 1998 year. The utility expects to complete its 1998 Annual Report by the end of May 1999.

On May 18, 1999 additional ERC data was provided by the utility. However, this data could not be fully reviewed by the audit staff because field-work had ended and the audit report was being finalized.

Recommendation: Additional analysis of the company's ERC Data should be completed by the industry analyst.