State of Florida

Public Service Commission

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

DATE: May 16, 2000

TO: Division of Water and Wastewater (Barry Davis)

FROM: Division of Auditing and Financial Analysis (Vandiver)

RE: Docket No. 991902-SU; Commercial Utilities, A Division of Grace & Company
Audit Report - Earnings Investigation
Audit Control No. 00-033-1-1

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, they should send it to the Division of Records and Reporting. There are no confidential work papers associated with this audit.

DNV/sp

Attachment

cc: Division of Auditing and Financial Analysis (Devlin/Causseaux/Harvey/File Folder)
Tallahassee District Office (Hicks)
Division of Records and Reporting
Division of Legal Services

Commercial Utilities
A Division of Grace & Company, Inc.
865 South Lane Avenue
Jacksonville, FL 32205-4420

FA
PP
AF
MU
TR
AG
EG
AS
PC
RR
EC
WAW
TH

FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING SERVICES

Tallahassee District Office

Commercial Utilities, A Division of Grace & Company, Inc.

Earnings Investigation Audit

Historical Year Ended December 31, 1999

Docket No. 991902-SU
Audit Control No. 00-033-1-1

Edward Bass, Audit Staff

Mike Buckley, Audit Staff

Demetrius Lockwood, Audit Staff

Robert Moore, Audit Staff

Christine Vendetti, Audit Staff

Rhonda Hicks, Audit Supervisor

TABLE OF CONTENTS

DIVISION OF AUDITING AND FINANCIAL ANALYSIS
AUDITOR'S REPORT

May 3, 2000

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the financial and operating records for the historical 12-month period ended December 31, 1999, for Commercial Utilities, A Division of Grace & Company, Inc. The attached schedules were prepared by the audit staff as part of our work in Docket No. 991902-SU.

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 does not use accrual accounting; Accumulated depreciation is based on federal income tax rates; Intangible plant and related amortization are not reflected on the books; Utility does not maintain regulated books and records; Amortization of CIAC is incorrect; Test year revenues are understated; Test year expenses are overstated; Plant in Service is incorrect.

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.

Examined - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers. Selective analytical review procedures were applied, and accounts balances were tested to the extent further described.

Verify - The item was tested for accuracy and compared to the substantiating documentation.

RATE BASE: Plant in Service - Obtained and reviewed copies of all plant invoices for the period June 30, 1992 through December 31, 1999; Examined each plant account; Recalculated plant in service; Verified all additions and retirements. Accumulated Depreciation - Reviewed depreciation accounts in the general ledger; Recalculated accumulated depreciation using Class C depreciation rates. Contributions-In-Aid-of-Construction (CIAC) - Compiled and recalculated CIAC and accumulated amortization of CIAC in accordance with Commission Order No. PSC-93-0233-FOF-WS. Working Capital - Calculated working capital using one-eight of O&M expenses.

NET OPERATING INCOME: Compiled revenues and traced to the general ledger; Prepared worksheet for all billings in 1999 using cubic feet of water usage; Verified sample of billings; Reviewed and scheduled all cash receipts; Examined all O&M expenses; Scheduled all invoices included in 1999 expenses; Traced all invoice amounts to the general ledger.

CAPITAL STRUCTURE: Verified cost rates being used in computation of the cost of capital; Reconciled cost of debt, related interest expense and common equity amounts to the general ledger; Recalculated the weighted cost rates and the cost rate for common equity using the modified leverage formula per Docket No. 990006-WS.

OTHER: Reviewed intangible plant adjustment ordered in PSC-93-0233-FOF-WS; Obtained documentation from the utility; Reviewed canceled checks; Determined appropriate balance to transfer to intangible plant.

EXCEPTIONS

Exception No. 1

Subject: Accrual Accounting

Statement of Fact: Accounting Instruction 2A of the National Association of Regulatory Utility Commissioners - Uniform System of Accounts (USoA) for Class C Utilities states, "The books of accounts for all wastewater utilities shall be kept by the double entry method, on an accrual basis. Each utility shall keep its accounts monthly and shall close its books at the end of each calendar year."

The Company does not keep its accounts on a monthly basis. In addition, the Company maintains its books and records using cash basis accounting.

Recommendation: The Company should be required to keep its books on a monthly basis and use accrual accounting.

Exception No. 2

Subject: Accumulated Depreciation - Plant in Service

Statement of Fact: Commission Rule 25-30.140 (4) (a), F.A.C. states, "All Class A and B utilities shall maintain depreciation rates and reserve activity by account as prescribed by this Commission." Commission Rule 25-30.140 (4) (b), F.A.C. states, "All Class C utilities shall maintain depreciation rates and reserve activity data by total depreciable plant, function or account as prescribed by this Commission." At the time of the utility's last rate proceeding, Commercial Utilities was a Class C utility. The utility is maintaining its depreciation records using accelerated federal income tax depreciation rates.

At December 31, 1999, the utility's general ledger reflects an accumulated depreciation balance of $135,052.

The utility's annual reports filed with the Commission reflect Class C depreciation rates.

Recommendation: The audit staff recalculated depreciation using Class C depreciation rates as prescribed by Commission Rule 25-30.140 (4) (b), F.A.C., and as of December 31, 1999, we determined that the appropriate amount of depreciation is $128,479. Staff's calculation yields a difference of $6,573 ($135,052 - $128,479). Of this difference, $1,577 relates to 1999 depreciation expense. The utility should make the following adjustment to accumulated depreciation to reflect the depreciation rates prescribed by Commission Rule 25-30.140 (4) (b), F.A.C.

Account/Name	Debit	Credit
108 Accumulated Depreciation - Plant in Service	$6,573	
403 Depreciation Expense		$6,573

Exception No. 3

Subject: Intangible Plant

Statement of Fact: In the utility's last rate case, the Commission ordered Commercial Utilities to transfer specific plant costs to intangible plant. Commission Order No. PSC-93-0233-FOF-WS, page 6, issued February 12, 1993 states,

> We transferred into this category all costs related to the wastewater interconnection that cannot be considered tangible plant, but do represent investment by the utility. This includes: a $50,000 fee to hook into the City's lift station; a $287,204 impact fee charged by the City at the time of the interconnection; and $5,876 in street repairs associated with construction of the force main.

The Order also provided that the costs associated with the wastewater interconnection be amortized over 27 years, which is the estimated life of the force main. The utility's books and records do not reflect the ordered transfer of the hook up fees and street repairs until the end of 1999. However, the impact fee was never recorded on the company's books. In addition, no amortization related to the transfer was ever recorded on the books and records. All of the information obtained during the audit of the utility's books is presented below.

Beginning September 1992, the utility submitted monthly payments of $4,120.54 to the City of Jacksonville. On June 22, 1993, the City of Jacksonville sent a letter asking the utility to review and sign an agreement for the deferred payment of the impact fee. This letter also acknowledges prior payments by the utility. According to the agreement, the utility would pay $4,120.54 a month, over 120 months, at an annual interest rate of 12 percent. Although the utility failed to record the impact fee, and sign the agreement with the City, it did make monthly payments through August 1997. In all, sixty payments totaling $247,232.40 were submitted to the City of Jacksonville. According to an amortization schedule attached to the unsigned agreement, a principal balance of $185,239.42 remains due after the sixtieth payment. Therefore, of the $247,232.40 paid by the utility, $101,964.58 was applied to the principal balance, while the remaining $145,267.82 was applied to interest.

Recommendation: Commercial Utilities never acknowledged a debt relating to the impact fee on its books and records, and it does not presently recognize any impact fees due. The utility did make payments relating to the impact fee for a limited period of time, and these payments should be recognized. However, the audit staff is unsure as to how these payments should be treated for regulatory purposes. As a result, two alternatives are being recommended by the auditor.

The first alternative is to place the total payments of $247,232, made by the utility, in an intangible account. This intangible account should also include the $50,000 hook up fee and the $5,876 in street repairs that were initially ordered to be placed in this account. The schedule below reflects the audit staff's determination of intangible plant.

Account No.	Description	Intangible Plant
389	Hook Up Fee	$50,000
	Impact Fee	$247,232
	Street Repairs	$5,876
	Total	$303,108

As previously ordered, the intangible plant account should be amortized over 27 years, which is the estimated life of the force main. Annual amortization expense of $11,224 related to the hook up fee, impact and street repairs would be retroactively applied from the date the force main was placed in service. The schedule below reflects audit staff's determination of annual amortization expense.

Account No.	Description	Annual Amortization
407	Hook Up Fee	$1,850
	Impact Fee	$9,157
	Street Repairs	$217
	Total	$11,224

The audit staff recommends this alternative be used in the determination of earnings because the Company never signed the agreement with the City of Jacksonville to pay the $287,204 impact fee at 12% interest. Because the agreement was never signed, the 60 payments for impact fees totaling $247,232, should be included in the intangible plant account and amortized along with the hook up fees and street repairs of $50,000 and $5,876, respectively. This recommendation is incorporated in audit staff's schedules.

The second alternative takes the unsigned agreement into consideration. Based on the agreement, the Company has a principal balance due of $185,239.42 after its 60 payments. The amortization schedule attached to the agreement indicates that of the $247,232 in total payments made by the Company, approximately $101,964 was applied to the principal balance while $145,268 was applied to interest. Therefore, the second alternative includes only the principal payments in an intangible account along with the hook up fees of $50,000 and street repairs of $5,876 to amortize over 27 years. The problem with this alternative is that the application of the payments to principal and interest is disproportionate. That is, the payment of the debt was calculated over 120 months while the Company stopped payment after 60 months. Following this alternative would create an intangible plant balance of $157,841 and an annual amortization expense of $5,843. As in the first alternative, annual amortization would accumulate retroactively from the date the force main was placed in service.

Exception No. 4

Subject: Amortization of Intangible Plant

Statement of Fact: In the utility's last rate case, the Commission ordered Commercial Utilities to transfer specific plant costs of $343,080 to intangible plant. The Order also required that the utility amortize these plant costs over 27 years. As of December 31, 1999, the utility's general ledger does not reflect any amortization related to this intangible plant.

Recommendation: The utility should be required to amortize all approved costs associated with the intangible plant over 27 years as required by Order No. PSC-93-0233-FOF-WS.

DISCLOSURES

Disclosure No. 1

Subject: Books and Records

Statement of Fact: The utility has an outside Certified Public Accountant (CPA) who prepares its financial statements and maintains the general ledger. An outside consultant prepares the annual reports.

Recommendation: The audit staff examined the books and records of Commercial Utilities. Annual Reports were also examined. During the audit, it was discovered that the CPA made no adjustments to the utility's rate base accounts in the general ledger unless he received instruction from the consultant. The consultant, in many instances, made adjustments to the annual reports but failed to notify the CPA in a timely manner to adjust the general ledger. The lack of coordination of efforts presented some problems for the audit staff. The CPA was unable to provide any information regarding discrepancies the audit staff noted in the general ledger.

Order No. PSC-93-0233-FOF-WS required the utility to make several adjustments to its books and records. Although some of the adjustments were made in the Annual Reports, none of them were made to the general ledger until the consultant provided the adjustments to the CPA. These adjustments were provided to the CPA at the end of 1999, and he adjusted the general ledger in February 2000. As a result the utility's books and records did not reflect any of the required Commission adjustments until seven years after they were ordered.

The consultant and CPA should work together to ensure that required adjustments are completed in a timely manner.

Disclosure No. 2

Subject: Accumulated Amortization - CIAC

Statement of Fact: Commission Order No. PSC-93-0233-FOF-WS, issued February 12, 1993, ordered Commercial Utilities, Inc. to amortize $15,440 of CIAC over a period of 27 years. At December 31, 1999, the utility's general ledger reflects a debit balance of $3,997 in Account 424, Accumulated Amortization - CIAC.

Recommendation: At December 31, 1999, Account 424, Accumulated Amortization - CIAC should reflect a debit balance of $4,854. Commission Order No. PSC-93-0233-FOF-WS, issued February 12, 1993, ordered Commercial Utilities, Inc. to adjust Accumulated Amortization - CIAC to reflect a debit balance of $571. This represents one year of amortization for the period of June 30, 1991 to June 30, 1992. Amortization for the period of June 30, 1992 to December 31, 1992 should be $286. Amortization is then recognized at $571 each year following. The following schedule reflects the calculation of Accumulated Amortization- CIAC.

	Period	Per Audit	Per Books	Adjust.
Order PSC-93-0233-FOF-WS	06/30/91 - 06/30/92	$571	0	$571
One half year Amortization	06/30/92 - 12/31/92	286	67,035	(66,749)
One year Amortization	01/01/93 - 12/31/93	571	3,705	(3,134)
One year Amortization	01/01/94 - 12/31/94	571	3,705	(3,134)
One year Amortization	01/01/95 - 12/31/95	571	3,705	(3,134)
One year Amortization	01/01/96 - 12/31/96	571	3,705	(3,134)
One year Amortization	01/01/97 - 12/31/97	571	0	571
One year Amortization	01/01/98 - 12/31/98	571	0	571
One year Amortization	01/01/99 - 12/31/99	571	(77,859)	78,430
Accumulated Amortization - CIAC	**12/31/99 Balance**	**$4,854**	**$3,997**	**$857**

The annual differences are due to the consultant failing to forward the adjustments to the utility's CPA on a timely basis. While the amortization should have started with the ordered amount in 1992, the utility amortized some other unexplained amount until 1999. At this time, the consultant provided the CPA with a series of adjustments to correct the balance in this account.

The utility should make the following adjustment to Account 424, Accumulated Amortization - CIAC and Account 421, Retained Earnings:

Account/Name	Debit	Credit
424 Accumulated Amortization - CIAC	$857	
421 Retained Earnings		$857

Disclosure No. 3

Subject: Understated Revenues

Statement of Fact: The company operates on a cash basis and reports its revenues based on cash receipts of $278,498.65. However, actual billed revenues were $282,076.24.

Recommendation: The company's revenues are understated. Although the company has not received all of its billings, this money is owed to the utility. The difference between billings and cash received from billings should be placed in a receivable account. The following adjustment should be made.

Account/Name	Debit	Credit
141 Customer Accounts Receivable	$3,577.59	
522 Revenues		$3,577.59

Disclosure No. 4

Subject: Regulatory Commission Expense

Statement of Fact: The Regulatory Assessment Fee (RAF) for 1998 was $15,878.90, and the RAF for 1999 was $12,546.36. The utility's 1999 expenses include the 1998 RAF payment.

Recommendation: The 1999 expenses are overstated. The Regulatory Assessment Fee for 1998 should be reversed. The following entry should be made.

Account/Name	Debit	Credit
236 Accrued Taxes	$15,878.90	
765 Regulatory Commission Expense		$15,878.90

Disclosure No. 5

Subject: Expense Revisions

Statement of Fact: Commission Order No. PSC-93-0233-FOF-WS allowed allocated salaries of \$34,002.16 and allocated overhead expenses of \$8,007.24. Commercial Utilities increased the salaries and overhead allocation in 1997.

Recommendation: Until 1997, the utility included the approved salaries and overhead allocation in its expenses. Each year, the allocation was increased by the Price Index Factor. Beginning 1997, salaries were increased by \$6,967.98 and overhead was increased by \$6,991.99. These increases were in addition to the Price Index Factor.

Salaries were increased to include 15% of the cost of employee benefits which were not originally included in the operating expenses during the last rate proceeding. This was done without Commission approval. Overhead expenses were increased to reflect the market price of rental property in the area and to include the rental of various types of office equipment.

Disclosure No. 6

Subject: Plant in Service

Statement of Fact: The utility's general ledger plant balances, by primary account, as of December 31, 1999, are reflected in the following table:

Account/Name	Per General Ledger
360 Collection Sewers - Force	$321,654
361 Collection Sewers - Gravity	9,458
363 Services to Customers	2,492
370 Receiving Wells	54,246
371 Construction Work	17,449
389 Other Plant - Misc. (Intangible)	153,492
Totals	$558,791

Recommendation: The following table compares the general ledger plant balances to the audit staff's calculation of plant balances, by primary account, as of December 31, 1999:

Account/Name	Per General Ledger	Per Audit	Difference
360 Collection Sewers - Force	$321,654	$255,659	($65,995)
361 Collection Sewers - Gravity	9,458	12,226	2,768
363 Services to Customers	2,492	2,492	0
370 Receiving Wells	54,246	54,246	0
371 Construction Work	17,449	0	(17,449)
389 Other Plant - Misc. (Intangible)	153,492	303,108	149,616
Totals	$558,791	$627,731	$68,940

The difference can be attributed to the following:
Account 360 & 361- Collection Sewers- Force and Gravity. The utility's documentation supported the audit balances.

Account 371- Construction Work- The balance in this account represents engineering work on a project that is no longer scheduled to take place. The balance in this account should be transferred to Account 426- Miscellaneous Non-Utility expense.

Account 389, Other Plant - Miscellaneous - This account consists of the costs related to the wastewater interconnection with the City of Jacksonville, which was classified as intangible plant per Commission Order PSC-93-0233-FOF-WS. Exception No. 3 provides additional information related to the interconnection project.

The utility should make the following adjustments to Account 360, Collection Sewers - Force; Account 361, Collection Sewers - Gravity; and Account 371, Construction Work to reflect the audited amounts.

Account/Name	Debit	Credit
215 Retained Earnings	$65,995	
361 Collection Sewers - Gravity	2,768	
426 Miscellaneous Non-utility Expense	17,449	
360 Collection Sewers - Force		$65,995
371 Construction Work		17,449
730 Contractual Services		2,768

Disclosure No. 7

Subject: Income Tax Expense

Statement of Fact: In the last rate case, the utility was allowed income tax expense. However, the utility's general ledger does not reflect any income tax expense.

Recommendation: The utility files income taxes as part of its parent company's consolidated tax return. During the test year, the parent company paid income taxes. As a result, it may be appropriate to include income tax expense in the utility's determination of earnings. Because of time constraints, the audit staff was unable to calculate this amount.

Commercial Utilities, Inc. **Rate Base Exhibit**

Schedule of Wastewater Rate Base

Test Year Ended December 31, 1999

	Test Year Per Utility	Audit Adjustments	Refer to	Balance Per Audit
Utility Plant in Service	$558,791	$68,940	D-6	$627,731
Accumulated Depreciation	(135,052)	6,573	E-2	(128,479)
Accumulated Amort of Intangible Plant	0	(95,402)	E-4	(95,402)
Contributions in Aid of Construction	(15,440)	0		(15,440)
Accumulated Amortization of CIAC	3,997	857	D-2	4,854
Construction Work in Progress	17,449	(17,449)	D-6	0
Working Capital	0	25,016	(1)	25,016
Total Wastewater Rate Base	$687,837	($11,465)		$676,372

(1) Working Capital was calculated based on one-eighth of operation and maintenance expenses.

	Test Year Per Utility	Audit Adjustments	Refer to	Balance Per Audit
Operating Revenues	$278,498	$3,578	D-3	$282,076
Operating Expenses:				
Operation and Maintenance	$200,465	($334)		$200,131
Depreciation	13,012	(1,577)	E-2	11,435
Amortization of Intangible Plant	0	11,224	E-3	11,224
Amortization of CIAC	(3,705)	3,134	D-2	(571)
Taxes Other Than Income	10,593	(9,859)	D-4	734
Income Tax Expense	0	0	D-7	0
Net Operating Income (Loss)	$58,133	$990		$59,123

Commercial Utilities, Inc.
Schedule of Capital Structure
Test Year Ended December 31, 1999

Capital Structure Exhibit

	Test Year Per Utility	Pro Rata Adjustments	Balance Per Audit	Percent of Total	Cost (%)	Weighted Cost (%)
Common Equity	$1,581,732	$1,002,574	$579,158	0.8563	9.06	7.76
Short-Term Debt	265,500	168,286	97,214	0.1437	9.00	1.29
TOTAL	$1,847,232	$1,170,860	$676,372	1.0000		9.05%