

State of Florida



Public Service Commission  
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**DATE:** October 31, 2002  
**TO:** Division of Economic Regulation (Brady)  
**FROM:** Division of Auditing and Safety (Vandiver)  
**RE:** **Docket No.** 020484-WS; **Company Name:** Labrador Utilities, Inc.; **Audit Purpose:** Establish rate base for transfer purposes as of May 31, 2002; **Audit Control No.** 02-196-2-1

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, it should send the response to the Division of the Commission Clerk and Administrative Services. There are confidential work papers associated with this audit.

DNV/jcp  
Attachment

cc: Division of Auditing and Safety (Hoppe, District Offices, File Folder)  
Division of the Commission Clerk and Administrative Services (2)  
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DOCUMENT NUMBER- DATE

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# FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY  
BUREAU OF AUDITING*

*Tampa District Office*


**LABRADOR UTILITIES, INC.**

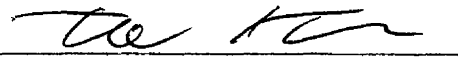
**CERTIFICATE TRANSFER AUDIT**

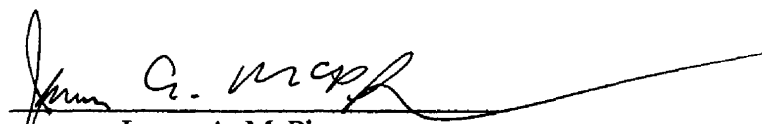
**AS OF MAY 31, 2002**

**Docket Number 020484-WS**

**Audit Control Number 02-196-2-1**

  
Thomas E. Stambaugh, Audit Manager

  
Tomer Kopelovich, Audit Staff

  
James A. McPherson  
Tampa District Supervisor

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**DIVISION OF AUDITING AND SAFETY  
AUDIT REPORT**

**October 25, 2002**

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

We have applied the procedures described later in this report to audit the books and records of Labrador Utilities, Inc., (Labrador) a wholly-owned subsidiary of Utilities, Inc., as of May 31, 2002. Schedules of rate base and its components were prepared by the audit staff from utility records in support of a certificate transfer audit, Docket No. 020484-WS. No confidential information is associated with this audit.

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:**

Very little documentation is available to verify \$166,393 in the water system and \$410,573 in the wastewater system. Original cost studies may need to be undertaken to verify the value of undocumented assets.

## **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.

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

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**RATE BASE :** Compiled the components of rate base to include Utility Plant in Service (UPIS) and Accumulated Depreciation (A/D). A schedule of working capital was not requested by the analyst.

**PLANT IN SERVICE:** Compiled UPIS for both the water and wastewater systems. Found invoice support for \$949,038 of plant additions out of a total of \$1,526,004 (62.2%) from inception to the present.

**ACCUMULATED DEPRECIATION:** Recalculated the balance of A/D as stated by Utility. Adjusted the balance of A/D associated with adjustments to UPIS.

## **Audit Disclosure No. 1**

### **Subject: Valuation of Rate Base To Arrive at the Sale Price**

**Statement Of Fact:** Utilities, Inc. has agreed to purchase Labrador Utilities, Inc., from the estate of Henri Viau as of May 31, 2002. The actual purchase price will be based on the FPSC's determination of rate base as follows: A \$425,000 minimum purchase price is to be paid for a \$425,000 minimum net rate base. As rate base increases, the purchase price would increase dollar for dollar up to a net rate base of \$750,000. For each dollar of rate base increase beyond \$750,000, the purchase price would increase by fifty cents per dollar up to a maximum price of \$800,000.

The total net rate base as of May 31, 2002 from the Utility's records and our adjustments to plant and depreciation, equals \$1,135,917. Compared to the purchase price of \$800,000, a negative acquisition adjustment of \$335,917 would exist.

**Recommendation:** Presented for information only.

## Audit Disclosure No. 2

### Subject: Valuation of Water and Wastewater Plant Accounts

**Statement Of Fact:** Forest Lake Estates (the utility's first owner) sold all of the utility assets to Labrador Utilities, Inc., in 1999. Based on its 1999 Federal income tax return, Utility assets totaled \$1,788,793 at the time of transfer. Regulatory Consultants, Inc.(RCI) was hired by Utilities, Inc., to determine the cost basis of the various components of the utility's rate base as of May 31, 2002, the effective date of Utilities Inc's purchase of Labrador Utilities from the estate of Henry Viau. RCI based its work on some actual invoices and construction documents supplied by the utility, and the 1999 Federal income tax return. The tax return included a depreciation schedule which listed yearly utility additions separately from non-utility plant.

The plant additions for which no invoices were available, but which were listed in the tax return were imputed between systems by RCI based on the allocation of those construction phases for which actual invoices and construction documents were available. Other plant items for which no invoices were available were valued based on the consultant's experience. In total, all additions by year reconciled to the tax return for the same year.

**Audit Opinion:** The audit staff examined water system invoices which totaled \$198,164 and wastewater system invoices which totaled \$750,874. The 2000 annual report showed \$15,866 for franchise fees (\$7,933 per system) which were not supported by invoices and were not shown as plant additions in the 2000 tax return. These amounts were removed from each system.

The auditor recalculated the amounts of plant additions which were based only on the tax return. By use of the RCI methodology, the auditor arrived at substantially the same totals as did Regulatory Consultants, Inc., except for the adjustments noted above. Those estimates which were based on the consultant's experience could not be objectively verified.

Dollars of documented and undocumented plant, and other assets were identified as follows:

<u>Basis</u>	<u>Water</u>	<u>Wastewater</u>	<u>Total</u>
Documented	\$198,164	\$750,874	\$949,038
Undocumented	166,393	410,573	576,966
Utility Total	<u>\$364,557</u>	<u>\$1,161,447</u>	<u>\$1,526,004</u>
Audit Adjustments	7,933	7,933	15,866
Adjusted Total	<u><u>\$356,624</u></u>	<u><u>\$1,153,514</u></u>	<u><u>\$1,510,138</u></u>

Audit staff defers to the judgement of the staff analyst regarding the sufficiency of tax return support for the undocumented plant, or whether original cost studies are required. A listing of these plant additions follows in Audit Disclosure No. 3.

### Audit Disclosure No. 3

#### Subject: Cost Studies of Undocumented Plant

**Statement Of Fact:** Since its inception in 1987, Labrador accumulated \$364,557 in its water plant and \$1,161,447 in its wastewater plant for a total of \$1,526,004. As noted in the previous disclosure, we were able to verify \$198,164 of water plant additions and \$750,874 of wastewater plant additions by examining supporting invoices. The remainder, listed in detail below, is a description of plant additions for which no invoice support was available and the method used by the consultant to determine its value.

<b>Water:</b>	<b>Description and Method of Calculation</b>	<b>Amount</b>
1987	Lines-Phase 1-109 Lots-Estimated from actual: \$200 per lot.	\$21,800
1989	Well - Consultant Experience	10,000
1989	Lines-Phase 2-111 Lots-Estimated from actual: \$260 per lot	28,860
1989	High Service Pump - Consultant Experience	5,000
1989	Lines - Phase 3 - 125 Lots-Estimated from actual: \$260 per lot	32,500
1994	Lines - Phases 6 & 7 - 201 Lots-Est. from actual: \$330 per lot	60,300
2000	Franchise Certificate Costs - Expensed on tax return	<u>7,933</u>
Water System Total		\$166,393
<b>Wastewater:</b>		
1987	Lines - Phase 1 - 109 Lots-Estimated from actual: \$350 per lot	\$38,150
1987	Master Pump Station-Consultant Experience	20,000
1987	Original WWTP-Consultant Experience	20,000
1989	Lines - Phase 2 - 111 Lots-Estimated from actual: \$350 per lot	38,850
1989	Lines - Phase 3 - 125 Lots-Estimated from actual: \$350 per lot	43,750
1989	Rec. Vehicle Lift Station and Force Mains-Consultant Experience	12,000
1994	Lines - Phases 6 & 7 - 201 Lots-Est. from actual: \$480 per lot	96,480
1995	Expand Sprayfield-Per Tax Return	108,410
1998	Automatic Filter - Per Tax Return	25,000
2000	Franchise Certificate Costs - Expensed on tax return	<u>7,933</u>
Wastewater System Total		<u>410,573</u>
Utility Total		<u>\$576,966</u>



## **Audit Disclosure No. 4**

### **Subject: Accumulated Depreciation**

**Statement Of Fact:** According to the 2001 annual report, accumulated depreciation was stated as \$91,599 for water and \$266,722 for wastewater. These amounts were based on the use of the forty year service life (2.5%) for all assets except Office Furniture and Equipment, and Tools, Shop and Garage Equipment. These accounts were depreciated over sixteen years (6.25%).

**Audit Opinion:** The Utility has not filed for a rate case during its life. Therefore, guideline rates were never mandated as a means to calculate depreciation. Audit staff recalculated accumulated depreciation by use of the Utility's rates. The audit staff arrived at the same balances of accumulated depreciation as the Utility did, up to December 31, 2001. Auditors then extended accumulated depreciation to the date of sale, May 31, 2002, to arrive at a net rate base for certificate transfer purposes. Balances of accumulated depreciation according to the audit are \$95,563 for water and \$279,054 for wastewater as of May 31, 2002.

The audit staff identified additions to plant in service which were not supported by invoices. Adjustments to the water and wastewater systems totaled \$7,933 for each system.

The effect on accumulated depreciation for the water system was a reduction in the balance from \$95,563 by \$198 to \$95,365. The effect on accumulated depreciation for the wastewater system was a reduction in the balance from \$279,054 by \$198 to \$278,856.

**Recommendation:** The audited balances of accumulated depreciation stated above should be used as the beginning balances of accumulated depreciation for Labrador Utilities under the ownership of Utilities, Inc. On a going forward basis, beginning June 1, 2002, the new owner should depreciate utility plant using the guideline rates prescribed in Rule 25-30.140, FAC.

Labrador Utilities, Inc.  
Docket 020484-WS: Certificate Transfer Audit  
Audited Rate Base  
As of May 31, 2002

Water:

<u>Component Title</u>	<u>Ref.</u>	<u>Dollars per Utility</u>	<u>Audit Adjustments</u>	<u>Dollars per Audit</u>
Plant	16	364,557	(7,933)	356,624
Land	17	0	0	0
Accum. Depr.	22	<u>(95,563)</u>	<u>198</u>	<u>(95,365)</u>
Net Rate Base		<u>268,994</u>	<u>(7,735)</u>	<u>261,259</u>

Wastewater:

<u>Component Title</u>	<u>Ref.</u>	<u>Dollars per Utility</u>	<u>Audit Adjustments</u>	<u>Dollars per Audit</u>
Plant	16	1,161,447	(7,933)	1,153,514
Land	17	0	0	0
Accum. Depr.	22	<u>(279,054)</u>	<u>198</u>	<u>(278,856)</u>
Net Rate Base		<u>882,393</u>	<u>(7,735)</u>	<u>874,658</u>
<u>Total System:</u>		<u>1,151,387</u>	<u>(15,470)</u>	<u>1,135,917</u>