

State of Florida



Public Service Commission
-M-E-M-O-R-A-N-D-U-M-

DATE: February 20, 2003
TO: Division of Economic Regulation (Biggins)
FROM: Division of Auditing and Safety (Vandiver)
RE: **Docket No.** 021192-WS; **Company Name:** Damon Utilities, Inc.; **Audit Purpose:** Staff Assisted Rate Case; **Audit Control No.** 02-357-3-1

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 no 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)
Division of Competitive Markets and Enforcement (Harvey)
General Counsel
Office of Public Counsel

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DOCUMENT NUMBER DATE

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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

Orlando District Office

**DAMON UTILITIES, INCORPORATED
STAFF-ASSISTED RATE CASE**

HISTORICAL PERIOD ENDED DECEMBER 31, 2002

**DOCKET NO. 021192-WS
AUDIT CONTROL NO. 02-357-3-1**

Intesar Terkawi

Intesar Terkawi, Audit Manager

Charleston J. Winston

Charleston J. Winston, District Audit Supervisor

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**DIVISION OF AUDITING AND SAFETY
AUDITOR'S REPORT**

February 8, 2003

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to audit the accompanying schedules of Rate Base, Net Operating Income, and Capital Structure for the historical 12-month period ended December 31, 2002, for Damon Utilities, Inc. The attached schedules were assembled by the audit staff as part of the utility's application for a Staff-Assisted Rate Case in Docket No. 021192-WS.

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's water plant is overstated by \$164. The utility's wastewater plant is understated by \$400.

The utility's wastewater accumulated depreciation balance is understated by \$9,634, as of December 31, 2002. Wastewater depreciation expense is understated by \$2,419 for the 12-month period ended December 31, 2002.

The water accumulated amortization is overstated by \$812. The wastewater accumulated amortization is understated by \$2,893, as of December 31, 2002. The utility's water amortization expense is understated by \$78. The wastewater amortization expense is understated by \$763, as of December 31, 2002.

The utility's water operating and maintenance expenses are overstated by \$8. The utility's wastewater operating and maintenance expenses are understated by \$291 for the 12-month period ended December 31, 2002. Working capital balances were calculated to be \$3,525 and \$2,623 for water and wastewater, respectively.

The utility's water taxes other than income balance is overstated by \$787. The utility's wastewater taxes other than income are understated by \$1,327 for the 12-month period ended December 31, 2002.

The utility's capital structure is composed entirely of debt of \$71,286 with a weighted average cost rate of 8.04 percent.

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.

Verified - The items were tested for accuracy, and compared to the substantiating documentation

Assembled - Presented in Commission-required format financial information that was provided to the audit staff and is the representation of utility management.

Compiled - The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

RATE BASE: Scanned and verified 100 percent of utility-provided documents used to assemble water and wastewater account balances for utility-plant-in-service (UPIS), land and land rights, contributions-in-aid-of-construction (CIAC), accumulated depreciation, accumulated amortization of CIAC, and working capital as of December 31, 2002. Reconciled rate base balances authorized in Commission Order No. 99-1223-PAA-WS, issued on June 21, 1999, to the June 30, 1998 general ledger balance.

NET OPERATING INCOME: Scanned and verified 100 percent of utility-provided documents used to assemble water and wastewater account balances for the utility revenues, operating and maintenance expenses, depreciation expenses, amortization expenses, and taxes other than income for the year ended December 31, 2002. Recomputed an audit-determined sample of utility billing records to verify the existing rates, miscellaneous service charges, and service availability charges charged by the utility.

CAPITAL STRUCTURE: Scanned and verified 100 percent of utility-provided documents used to assemble its capital structure as of December 31, 2002. Agreed interest expense to the terms of the debt obligations.

OTHER: Audited the utility's 2001 Regulatory Assessment Fee return filed with the Commission.

Exception No. 1

Subject: Utility-Plant-In-Service (UPIS) and Associated Accumulated Depreciation of UPIS

Statement of Fact: Commission Order No. PSC-99-1223-PAA-WS, issued June 21, 1999, established the beginning plant balances of \$122,906 and \$215,776 for water and wastewater, respectively.

In the above Order wastewater depreciation rates were established as 6.67 percent and 16.67 percent for Accounts Nos. 380 and 390, respectively.

Recommendation: The utility did not make the required plant adjustments per the above Order. The audit staff recommends that the Commission should require the utility to decrease the water plant by \$164 (\$122,906-\$123,070) and increase the wastewater plant by \$400 (\$215,776-\$215,376).

During the period from July 1, 1998 through December 31, 2002, the audit staff determined that the utility used 4.00 percent and 6.67 percent for Accounts Nos. 380 and 390, respectively. The Commission should require the utility to increase wastewater accumulated depreciation by \$9,634, as of December 31, 2002.

Due to the above adjustments, wastewater depreciation expense should be increased by \$2,419 for the 12-month period ended December 31, 2002.

Exception No. 2

Subject: Contributions-in-Aid-of Construction (CIAC) and Accumulated Amortization (AA)

Statement of Fact: Commission Order No. PSC-99-1223-PAA-WS, issued June 21, 1999, established the beginning accumulated amortization balances of \$17,247 and \$13,690 for water and wastewater, respectively.

The above-mentioned Order required the utility to use composite plant amortization rates for calculating water and wastewater CIAC amortization expenses.

Recommendation: The utility did not make the required adjustments per the above Order. The utility should decrease the CIAC water accumulated amortization by \$431 (\$17,247-\$17,678) and increase the wastewater CIAC accumulated amortization by \$386 (\$13,690-\$13,304).

The utility did not use the correct composite plant rates required in the above-mentioned Order. A recalculation results in a decrease to the water CIAC accumulated amortization by \$381 and an increase to the wastewater CIAC accumulated amortization by \$2,507, as of December 31, 2002.

The Commission should require the utility to decrease the water CIAC accumulated amortization by \$812 (\$381+ \$431) and increase wastewater CIAC accumulated amortization by \$2,893 (\$2,507+ 386), as of December 31, 2002.

The associated adjustment to amortization expense is an increase of \$78 and \$763 for water and wastewater, respectively, for the period ended December 31, 2002.

Exception No. 3

Subject: Operating and Maintenance (O&M) Expense

Statement of Fact: The utility reported operating and maintenance expense balances of \$28,209 and \$20,697 for water and wastewater, respectively, for the 12-month period ended December 31, 2002.

The utility included the \$300 in taxes paid to the Board of County Commissioners, Highlands County, Florida, \$150 in taxes paid to the Florida Department of State, and \$90 in taxes paid to the Highlands County Tax Collector for the total of \$540 charged to Account No. 675, Miscellaneous Expenses.

Order No. PSC-99-1223-PAA required the utility to allocate 5 percent of the common expenses to the utility, then split 90 and 10 percent between water and wastewater, respectively. Test year common expenses were \$12,812.

Order No. PSC-99-1223-PAA required the utility to charge \$292 (\$1,461/5) to Account No. 736, Contractual Services-Other for major repairs to the equipment associated with a lift station over a five-year period (1998 through 2002).

The utility included \$110 in the Account No. 675, Miscellaneous Expenses, for donations to Special Olympics Florida. Per NARUC Account No.426, Miscellaneous Nonutility Expenses should include "Donations for charitable, social or community welfare purposes."

Recommendation: The audit staff calculated working capital balances using 1/8 of O&M of \$3,525 and \$2,623 for water and wastewater, respectively, as of December 31, 2002.

<u>Account</u>	<u>Per Company</u>	<u>Per Audit</u>	<u>Adjustment</u>	<u>Description</u>
615	\$1,933	\$2,509	\$577	5% allocation of office power 90/10 alloc.(1)
675	1,385	800	(585)	\$486 removed to TOTI, \$99 removed to Account 426 below the line(2)
Total	\$3,318	\$3,309	(\$8)	
715	\$2,123	\$2,187	\$64	5% allocation of office power 90/10 alloc.(3)
720	1,094	1,083	(11)	Moving donation expense from Account 426 below the line (4)
736	289	581	292	Amortization of 1/5 of non-recurring exp. from the last audit (5)
775	54	0	(54)	Moving taxes to taxes other than income account(6)
Total	\$3,560	\$3,851	\$291	

Note:

- 1) \$641 (\$12,812 x 5%) electricity allocation for utility's office, 90% water allocation
- 2) \$486 (\$540 x90% water allocation). + \$99(\$110 x90%)
- 3) \$641 (\$12,812 x5%) electricity allocation for utility's office, 10% sewer allocation
- 4) \$11 (\$110 x 10% sewer allocation)
- 5) \$292 (\$1,461/5) cost of repairs amortized into 5 years from the prior audit
- 6) \$54 (\$540 x 10% sewer allocation)

Exception No. 4

Subject: Taxes Other Than Income (TOTI)

Statement of Fact: The utility recorded \$1,637 and \$182 for tangible personal property taxes for water and wastewater, respectively.

Order No. 99-1223-PAA-WS, issued June 21, 1999, included a 20/80 allocation between water and wastewater, respectively, for the tangible personal property taxes.

The utility included the \$300 taxes paid to the Board of County Commissioners, Highlands County, Florida, \$150 taxes paid to the Florida Department of State, and \$90 in taxes paid to Highland County Tax Collector for the total of \$540 charged to Account No. 675, Miscellaneous Expenses. These should be split 90/10 as described in Exception No.3.

Recommendation: The utility did not use the proper allocation 20/80 for the tangible personal property taxes recommended in the above-mentioned Order. The audit staff used the proper allocation and calculated \$364 and \$1,455 ($\$1,637 + \$182 = \$1,819 \times 20/80$ percent) for water and wastewater, respectively for miscellaneous taxes.

The TOTI balances for water and wastewater should be increased by \$486 ($\$540 \times 90\%$) and \$54 ($\$540 \times 10\%$) for water and wastewater, respectively.

The Commission should require the utility to decrease its water TOTI balance by \$787 ($\$1,273 (\$1,637 - 364) - \486) and to increase its wastewater TOTI balance by \$1327 ($\$1,273 (\$1,455 - \$182) + \54) for the 12-month period ended December 31, 2002.

Exception No. 5

Subject: Capital Structure

Statement of Fact: The utility recorded a negative shareholder equity of \$62,867, as of December 31, 2002.

The utility recorded long-term debts of \$78,487.15, as of December 31, 2002. The long-term debts include the following:

Highlands Independent Bank	\$71,287.15
Loan/ Rodney Davis	4,100.00
Loan/ Jeff Harstine	<u>3,100.00</u>
Total long-term debt	\$78,487.15

Recommendation: The utility's shareholder equity should be restated to zero because of its negative balance.

The long-term debts should be reduced by \$7,200 (\$4,100+\$3,100) for the two shareholder loans and be transferred to equity. This is in accordance with Order No. PSC-00-1165-PAA-WS, issued December 31, 2002, since no cost is assigned to the debt, and no debt instrument was available.

Disclosure No. 1

Subject: Projected Increases and Reserve for Emergency Repairs

Statement of Fact: The utility submitted a letter dated January 28, 2003, to the audit staff requesting an increase for the office labor rate from the prior rate of \$7,207 per year to \$10,400 per year. The letter also requests an increase of the rent for the office space from \$120 per month to \$200 per month. The office rent increase will include water, sewer and electric expenses. The prior office rent did not include water, sewer, nor electricity.

The letter also requests placing \$250 per month in reserve for emergency repairs.

Recommendation: The audit staff forwards this information to the analyst in this rate proceeding for consideration.

EXHIBIT I

**DAMON UTILITIES, INC.
WATER RATE BASE
DOCKET NO. 021192-WS
STAFF-ASSISTED RATE CASE
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO	PER AUDIT(1)
UTILITY PLANT-IN-SERVICE	\$128,927	(\$164)	E1	\$128,763
LAND & LAND RIGHTS	0	0		0
CONTRIBUTIONS-IN-AID- OF- CONSTRUCTION (CIAC)	(55,955)	0		(55,955)
ACCUMULATED DEPRECIATION	(63,632)	0		(63,632)
ACCUMULATED AMORTIZATION OF CIAC	27,170	(812)	E2	26,358
WORKING CAPITAL(2)	<u>0</u>	<u>3,525</u>	E3	<u>3,525</u>
TOTAL	\$36,510	\$2,549		\$39,059

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.
- 2) Working Capital is calculated as 1/8 of O&M Expenses.

EXHIBIT II**DAMON UTILITIES, INC.
WASTEWATER RATE BASE
DOCKET NO. 021192-WS
STAFF-ASSISTED RATE CASE
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO	PER AUDIT(1)
UTILITY PLANT-IN-SERVICE	\$223,171	\$400	E1	\$223,571
LAND & LAND RIGHTS	0	0		0
CONTRIBUTIONS-IN-AID- OF- CONSTRUCTION (CIAC)	(63,796)	0		(63,796)
ACCUMULATED DEPRECIATION	(141,501)	(9,634)	E1	(151,135)
ACCUMULATED AMORTIZATION OF CIAC	22,369	2,893	E2	25,262
WORKING CAPITAL(2)	<u>0</u>	<u>2,623</u>	E3	<u>2,623</u>
TOTAL	\$40,243	(\$3,718)		\$36,525

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.
- 2) Working Capital is calculated as 1/8 of O&M Expenses.

EXHIBIT III

**DAMON UTILITIES, INC.
WATER NET OPERATING INCOME
DOCKET NO. 021192-WS
STAFF-ASSISTED RATE CASE
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO	PER AUDIT(1)
REVENUES:				
OPERATING REVENUES	\$42,275	\$0		\$42,275
EXPENSES:				
O&M EXPENSE	28,209	(8)	E3	28,201
DEPRECIATION EXPENSE	5,372	0		5,372
AMORTIZATION EXPENSE	(2,295)	(78)	E2	(2,373)
TAXES OTHER THAN INCOME	3,539	(787)	E4	2,752
TOTAL	\$34,825	(\$873)		\$33,952
NET OPERATING INCOME	\$7,450	\$873		\$8,323

FOOTNOTES:

1) Small differences can be attributed to rounding errors.

EXHIBIT IV

**DAMON UTILITIES, INC.
WASTEWATER OPERATING INCOME
DOCKET NO. 021192-WS
STAFF-ASSISTED RATE CASE
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO	PER AUDIT(1)
REVENUES:				
GROSS REVENUES	\$29,448	\$0		\$29,448
EXPENSES:				
O&M EXPENSE	20,697	291	E3	20,988
DEPRECIATION EXPENSE	7,804	2,419	E1	10,223
AMORTIZATION EXPENSE	(2,212)	(763)	E2	(2,975)
TAXES OTHER THAN INCOME	1,507	1,327	E4	2,834
TOTAL	\$27,796	\$3,274		\$31,070
NET OPERATING INCOME	\$1,652	(\$3,274)		(\$1,622)

FOOTNOTES:

- 1) Small differences can be attributed to rounding errors.

EXHIBIT V

**DAMON UTILITIES, INC.
DOCKET NO. 021192-WS
CAPITAL STRUCTURE
STAFF-ASSISTED RATE CASE
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER COMPANY @12/31/02	AUDIT EXCEPTION	REFER TO	PER AUDIT @12/31/02	RATIO	COST RATE	WEIGHTED COST OF CAPITAL
COMMON EQUITY	(\$62,867)	\$62,867	E5	\$0	0.00%	10.23%	0.000%
PREFERRED STOCK	0	0		0	0.00%	0.00%	0.000%
LONG-TERM DEBT	78,487	(7,201)	E5	71,286	100.00%	8.04%	8.040%
SHORT-TERM DEBT	0	0		0	0.00%	0.00%	0.000%
CUSTOMER DEPOSITS	0	0			0.00%	0.00%	0.000%
ITC	0	0		0			0.000%
TOTAL	\$15,620	\$55,666		\$71,286	100.00%		8.040%

REQUIRED FOOTNOTES:

- 1) Audit adjustments do not include audit disclosures.
- 2) The company does not collect a customer deposit for service connections.
- 3) Cost rate for common equity established in Order No.PSC-02-0898-PAA-WS, issued 7/05/02.
- 4) Common equity is zero because of negative balance.