



Public Service Commission

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

DATE: August 19, 2003
TO: Division of Economic Regulation (Merta)
FROM: Division of Auditing and Safety (Vandiver) *W*
RE: **Docket No.** 030423-WU; **Company Name:** Residential Water Systems, Inc.;
Audit Purpose: Investigation of 2002 Earnings; **Audit Control No.** 03-132-3-1

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

Mr. Charles deMenzes, President
Residential Water Systems, Inc.
1410 NE Eighth Avenue
Ocala, FL 34470-4250

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FLORIDA PUBLIC SERVICE COMMISSION

*DIVISION OF AUDITING AND SAFETY
BUREAU OF AUDITING*

Orlando District Office

RESIDENTIAL WATER SYSTEMS, INC.

INVESTIGATION OF 2002 EARNINGS

HISTORICAL PERIOD ENDED DECEMBER 31, 2002

**DOCKET NO. 030423-WU
AUDIT CONTROL NO. 03-132-3-1**

A handwritten signature in black ink, appearing to read "Inesar Terkawi".

Inesar Terkawi, Audit Manager

A large, stylized handwritten signature in black ink, appearing to read "Charleston J. Winston".

Charleston J. Winston, Audit Staff

A handwritten signature in black ink, appearing to read "Jeffery A. Spall".

Jeffery A. Spall, Professional Accountant Specialist

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

August 12, 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 Residential Water Systems, Inc. The attached schedules were prepared by the audit staff as part of our work in the utility's Investigation of 2002 Earnings, Docket No. 030423-WU.

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 books and records of the utility are not in compliance with NARUC.

The utility-plant-in-service should be decreased by \$194,437, accumulated depreciation should be decreased by \$153,925, and depreciation expense should be decreased by \$7,149.

The value of the utility's land was established as \$7,704.

The utility's contributions-in-aid-of-construction (CIAC) should be increased by \$81,849, accumulated amortization of CIAC should be decreased by \$68,615, and CIAC amortization expense should be increased by \$2,066.

The utility's water revenue is understated by \$3,221 for the 12-month period ended December 31, 2002.

The utility's water operating and maintenance expenses (O&M) are understated by \$709 for the 12-month period ended December 31, 2002. The working capital balance was calculated to be \$19,963.

The utility's water taxes other than income balance is understated by \$7,295.

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 substantiating documentation was examined.

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

RATE BASE: Compiled and verified utility plant-in-service (UPIS) and accumulated depreciation (AD) additions as of December 31, 2002. Compiled and verified contributions-in-aid-of-construction (CIAC) and accumulated amortization (AA) additions as of December 31, 2002. Scanned the utility's records for CIAC additions. Calculated a working capital allowance as of December 31, 2002, using one-eighth of operation and maintenance expenses. Prepared the rate base exhibit as of December 31, 2002.

NET OPERATING INCOME: Scanned and verified samples of the utility-provided documents used to prepare water account balances for the utility revenues, operating and maintenance expenses, depreciation 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 fees charged by the utility.

CAPITAL STRUCTURE: Compiled and verified the components of the utility's capital structure as of December 31, 2002. Agreed interest rates to the terms of the notes. Prepared the capital structure exhibit as of December 31, 2002.

OTHER: Scanned the utility's income tax returns from 1994 to 2002 for items pertinent to this rate case.

Exception No. 1

Subject: Books and Records

Statement of Fact: The books and records of Residential Water Systems, Inc. were not maintained in compliance with NARUC Uniform System of Accounts (USOA).

Per Water and Wastewater Class "C" Accounting Instruction 2.A., which states as follows:

The books of accounts of all water 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.

Per Water and Wastewater Class "C" Accounting Instruction 2.B., which states as follows:

All books of accounts, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, invoices, memoranda and information useful in determining the facts regarding a transaction.

Recommendation: Part of the books and records of Residential Water Systems, Inc. are mixed with the books and records of the management company, Mira International, Inc. Both companies have the same owner. The utility should maintain a separate record of its books where the invoices and cancelled checks can be traced to the original sources.

The utility could not provide support documentation for some of its plant additions.

There are discrepancies in the amounts of revenue, and RAF taxes reported in the General Ledger (G/L), and the Regulatory Assessment Fee (RAF) return filed with the Commission. The utility related these discrepancies to the accounting system it operates. The utility accounting system does not allow the accountant to enter closing entries or make any adjustment to the G/L at the end of the year. Therefore, the adjusting journal entries as of December 31, 2002, were not posted to the G/L. The utility reported the correct adjusted figures of revenue and RAF in the RAF return filed with the Commission.

The Commission should require the utility to maintain its books and records in compliance with NARUC.

Exception No. 2

Subject: Utility-Plant-in-Service and Accumulated Depreciation

Statement of Fact: Per the utility's general ledger, the amount of plant-in-service is \$701,940 and accumulated depreciation is \$185,669 as of December 31, 2002. The amount for depreciation expense was \$23,634 for the period ended December 31, 2002.

Per NARUC Water and Wastewater Class "C" Accounting Instruction 2.B., which states as follows:

All books of accounts, together with records and memoranda supporting the entries therein, shall be kept in such a manner as to support fully the facts pertaining to such entries. The books and records referred to herein include not only the accounting records in a limited technical sense, but also all other records, reports, correspondence, invoices, memoranda and information useful in determining the facts regarding a transaction.

Recommendation: The utility could not provide supporting documentation for some of its plant additions. The company does not maintain continuing property records (CPRs) for its plant in service. Properly maintained CPRs should show the following items.

NARUC Account No., - Asset Description, - Date in Service, - Model No., - Serial No., - Location, - Vendor, - Invoice No., - Asset Cost, - Date Retired, - Cost of Removal, - Salvage Value, etc.

The audit staff determined plant-in-service to be \$507,503 as of December 31, 2002. The Commission should reduce the utility's plant-in-service by \$194,437 (\$701,940 - \$507,503). See attached Schedules A and B for further details.

The audit staff determined the associated accumulated depreciation of \$31,744 as December 31, 2002. The utility should be required to decrease the accumulated depreciation by \$153,925 (\$185,669 - \$31,744). The substantial difference is due to the utility not properly recording its retirements, some early retirements, not adjusting its books per the prior audit and not using the proper rates.

The audit staff determined depreciation expense to be \$16,485. The utility should be required to decrease its depreciation expense by \$7,149 (\$23,634 - \$16,485).

Per Commission Order No. 13688, issued September 19, 1984, an annual rate of 2.5 percent was used for years 1996 through 2001. For 2002, the depreciation rates prescribed in Commission Rule 25-30.140, Florida Administrative Code (F.A.C.) were used.

The Commission should require the utility to record the above adjustments.

Schedule A - Exception No. 2

Date	Per Co.	Diff.	Per Audit	Explanation
11/30/96	\$ 200,185	\$ (140,826)	\$ 59,359	Beginning balance per prior audit, DKT 961310-WU, AC# 96-326-3-1
	Per Co.		Per Audit	
12/1996 Additions	4,216	(3,989)	227	\$3,729 (Schedule B) + \$260, Acct. 181, Unamort. Debt Discount that was disallowed in the prior audit.
1997 Additions	39,915	(4,208)	35,707	\$1,494, Acct 181, + \$114, Acct. 301, Franchise disallowed in prior audit +\$2,600 (Schedule B)
1997 Retirements	(12,527)	973	(11,554)	\$11,554 was the amount recorded in the prior audit for the retired generator.
1998 Additions	280	0	280	
1998 Retirements	(8,876)	8,876		The removal of Acct 181, Unamort. Debt Discount, from plant-in-service. Disallowed in prior audit.
1999 Additions	11,237	(5,845)	5,392	See Note A.
1999 Retirements	(114)	114	0	Franchise that was removed in the prior audit but not removed by the utility. The utility is removing it here.
2000 Additions	352,357	(46,360)	305,997	\$25,085 (Schedule B) + \$21,275 the utility recorded in 2000 and removed in 2001.
2000 Retirements	(5,000)	(1,869)	(6,869)	Retirement of old water tank. The \$6,869 addition was recorded in the prior audit. (Schedule B) and Note A.
2001 Additions	63,893	7,739	71,632	\$21,275 added in 2000 removed in 2001 + \$12,929 retirement for a generator included in the 1997 per audit amount - \$26,464 (Schedule B).
2001 Retirements	0	0	0	
2002 Additions	56,374	(9,042)	47,332	See Schedule B
Total:	\$ 701,940	\$ (194,437)	\$ 507,503	

A. \$4,128 (Schedule B) - \$3,284, Acct 340, Office Furn., disallowed in the prior audit - \$5,000 recorded for a generator added on 12/10/1999 and retired on 01/01/2000. To record this item and retire it in less than a month would distort the financial statements. Therefore, the audit staff did not record this item.

Schedule B - Exception No. 2, continued

DATE	ACCT #	DESCRIPTION	PER BOOKS	VENDOR	AUDIT ADJ.	AMOUNT PER AUDIT	CK #	Comments
12/10/1996	310		1,175.36	Mira International	(1,175.36)	0.00	3962	Check/No Invoice
12/02/1996	311		1,518.48	Mira International	(1,518.48)	0.00	3962	Check/No Invoice
12/03/1996	330	Tank Installation	1,035.09	Davis Water&Waste	(1,035.09)	0.00		Included in Prior Audit
Total 1996			3,728.93		(3,728.93)	0.00		
02/14/1997	304	Fence	2,350.00	Binks Link Fence	0.00	2,350.00	4001	
01/02/1997	311	Pumping/Tank System	100.00	Gray Well Drilling	0.00	100.00	3976	
01/16/1997	330	Tanks	26,017.02	Dixie Tanks		26,017.02	4040	
01/16/1997	330	Capitalized Management Fee	2,600.00	Mira International	(2,600.00)	0.00	3984	Check/No Invoice
02/05/1997	330	Tank Installation	319.11	Tnemec Co.		319.11	3991	
02/07/1997	330	Painting for Tank Installation	500.00	Jeff Roderick		500.00	3994	
02/07/1997	330	Crane Service Tank Installation	285.00	Kalfs Crane Service		285.00	3995	
02/07/1997	330	Misce. Parts for Tank Install	956.01	Florida Pump, Inc.		956.01	3993	
02/19/1997	330	Misce. Parts for Tank Install	1,193.08	U.S. Filter		1,193.08	4003	
02/26/1997	330	Pumps for Tank Installation	536.00	All Phase Electric		536.00	4009	
02/26/1997	330	Air Compressor Pressure Relief	1,843.62	Cray Well Drilling		1,843.62	4008	
03/06/1997	330	Tank Installation	261.61			261.61	4012	
04/11/1997	330	Paint for Tank Installation	79.91	Sherwin Williams		79.91	4036	
05/12/1997	330	Paint for Tank Installation	77.57	Sherwin Williams		77.57	4045	
Total 330			34,668.93		(2,600.00)	32,068.93		
Total 1997			37,118.93		(2,600.00)	34,518.93		

Schedule B - Exception No. 2, continued

DATE	ACCT #	DESCRIPTION	PER BOOKS	VENDOR	AUDIT ADJ.	AMOUNT PER AUDIT	CK #	Comments
01/01/1999	304	Tank Installation	114.44	Prior Period	(114.44)	0.00		See Note 1
01/01/1999	310	Generator Equipment	574.78	Prior Period	(574.78)	0.00		See Note 1
07/13/1999	310	Generator	500.00	Marion Landing	(500.00)	0.00		Retired 01/01/00
12/10/1999	310	Generator	4,500.00	Marion Landing	(4,500.00)	0.00	1210	Retired 01/01/00
Total 310			5,574.78		(5,574.78)	5,000.00		
01/01/1999	311	Pumps	749.51	Prior Period	(749.51)	0.00		See Note 1
09/16/1999	311	Well Upgrade	2,288.97	Florida Pump, Inc.		2,288.97	1336	
09/20/1999	311	Pump	1,350.00	Cray Pump Service		1,350.00		
12/16/1999	311		1,013.41	Florida Pump	(1,013.41)	0.00	1216	No Support
Total 311			5,401.89		(1,762.92)	3,638.97		
01/01/1999	330	Tank Installation	1,676.15	Prior Period	(1,676.15)	0.00		See Note 1
11/05/1999	334	Meters & Installation	1,537.00	Mira International		1,537.00	1353	
Total 1999			14,304.26		(4,128.29)	10,175.97		
06/06/2000	310	Tank/Generator Installations	16,500.00	Hamlet Construction	(6,600.00)	9,900.00	1443	Tank Relass to 330
07/28/2000	310	Electrical System for Generator	18,095.81	Crandon Electric Co.		18,095.81		
07/28/2000	310	Transfer from CIP	5,000.00		(5,000.00)	0.00	728	Check/No Invoice
Total 310			39,595.81		(11,600.00)	27,995.81		
02/18/2000	311	Pumping/Well Upgrades	9,151.00	Hamlet Construction		9,151.00	1392	
05/18/2000	311	Pumping/Well Upgrades	707.71	Earls Well Drilling		707.71	1432	
07/07/2000	311	Pumping/Well Upgrades	707.71	Earls Well Drilling		707.71	1457	
Total 311			10,566.42		0.00	10,566.42		
06/01/2000	330	Tank Installations	84,000.00	Hamlet Construction		84,000.00	1441	
07/01/2000	330	Tanks Installation	10,897.13	Hughes Supply		10,897.13		
06/06/2000	330	Tank/Generator Installations	0.00	Hamlet Construction	6,600.00	6,600.00	1443	Tank Relass fr 310
08/30/2000	330	Tank Retirement	0.00		(6,868.83)	(6,868.83)		Retire Old Tank
07/20/2000	330	Tanks Installation	7,694.00	Aqua Pure		7,694.00	1462	

Schedule B - Exception No. 2, continued

DATE	ACCT #	DESCRIPTION	PER BOOKS	VENDOR	AUDIT ADJ.	AMOUNT PER AUDIT	CK #	Comments
07/28/2000	330	Transfer from CIP	2,000.00		(2,000.00)	0.00	728	Check/No Invoice
07/28/2000	330	Transfer from CIP	180.00		(180.00)	0.00	728	Check/No Invoice
07/28/2000	330	Transfer from CIP	167.23		(167.23)	0.00	728	Check/No Invoice
07/28/2000	330	Transfer from CIP	10,393.57		(10,393.57)	0.00	728	Check/No Invoice
10/17/2000	330	Crane Service Tank Install	365.00	R. W. Josephson.		365.00	1499	
Total 330			115,696.93		(13,009.63)	102,687.30		
11/09/2000	331	Mains Lines Installation	132,713.60	Dalton Woods Sub.	0.00	132,713.60	1109	Donated Property
03/09/2000	333	Water Service Installation	24,136.00	Hamlet Cons., Co.		24,136.00		
04/10/2000	333	Water Service Installation	250.00	Kinsey Underground		250.00	1418	
Total 333			24,386.00		0.00	24,386.00		
01/01/2000	334	A/P Trade 99	795.00		(795.00)	0.00	101	Check/No Invoice
08/15/2000	335	Hydrants	4,500.00	Hamlet Cons.	320.00	4,820.00	1541	Per Invoice
Total 2000			328,253.76		(25,084.63)	303,169.13		
01/01/2001	311	CPA EOY ADJ	9,005.71		(9,005.71)	0.00	101	Check/No Invoice
01/01/2001	330	CPA EOY ADJ	15,659.34		(15,659.34)	0.00	101	Check/No Invoice
06/21/2001	331	Mains Lines Installation	64,658.36	Dalton Woods Contri	0.00	64,658.36	621	Donated Property
01/01/2001	333	CPA EOY ADJ	1,729.12		(1,729.12)	0.00	101	Check/No Invoice
01/01/2001	334	CPA EOY ADJ	70.00		(70.00)	0.00	101	Check/No Invoice
09/28/2001	334	Meters & Installation	3,232.50	Mira International		3,232.50	2824	
11/09/2001	334	Meters & Installation	577.50	Mira International		577.50	2842	
12/04/2001	334	Meters & Installation	1,050.00	Mira International		1,050.00	2850	
Total 334			4,930.00		(70.00)	4,860.00		
Total 2001			95,982.53		(26,464.17)	69,518.36		

Schedule B - Exception No. 2, continued

DATE	ACCT #	DESCRIPTION	PER BOOKS	VENDOR	AUDIT ADJ.	AMOUNT PER AUDIT	CK #	Comments
07/31/2002	304	Building Addition	5,000.00	J.H. Fannon Const.	0.00	5,000.00	2952	
01/17/2002	310	New Surge	570.00	Crandon Electric	0.00	570.00	2870	
01/01/2002	334	CPA ADJ EOY	7,065.00		(7,065.00)	0.00	101	Check/No Invoice
01/14/2002	334	Meters & Installation	385.00	Mira International		385.00	2869	
03/25/2002	334	Meters & Installation	648.00	Mira International		648.00	2894	
04/12/2002	334	Meters & Installation	875.00	Mira International		875.00	2900	
07/01/2002	334	Meters & Installation	2,250.00	Mira International		2,250.00	2934	
07/30/2002	334	Meters & Installation	2,039.50	Mira International		2,039.50	2951	
08/31/2002	334	Meters & Installation	3,313.75	Mira International		3,313.75		
09/03/2002	334	Meters & Installation	1,870.00	Mira International		1,870.00	2966	
09/30/2002	334	Meters & Installation	1,252.50	Mira International		1,252.50		
10/31/2002	334	Meters & Installation	1,975.00	Mira International		1,975.00		
12/31/2002	334	Meters & Installation	1,950.00	Mira International		1,950.00		
Total 334			23,623.75		(7,065.00)	16,558.75		
08/27/2002	340	Bobcat Loader Backhoe	1,000.00	Bobcat & Kubota	(1,000.00)	0.00		Reclassified to 345
08/27/2002	340	Bobcat Loader Backhoe	21,926.16	Bobcat & Kubota	(21,926.16)	0.00		Reclassified to 345
09/19/2002	340	Bobcat Payment	494.09	Bobcat/Fin Svc	(494.09)	0.00	3003	Debt Payment
11/01/2002	340	Bobcat Payment	494.09	Bobcat/Fin. Svc	(494.09)	0.00	2993	Debt Payment
11/19/2002	340	Bobcat Payment	988.18	Bobcat/Fin. Svc	(988.18)	0.00	2971	Debt Payment
Total 340			24,902.52		(24,902.52)	0.00		
08/27/2002	345	Bobcat Loader Backhoe		Bobcat & Kubota	1,000.00	1,000.00		Reclassified from 340
08/27/2002	345	Bobcat Loader Backhoe		Bobcat & Kubota	21,926.16	21,926.16		Reclassified from 340
Total 345			0.00		22,926.16	22,926.16		
Total 2002			54,096.27		(9,041.36)	45,054.91		

1. The majority of these items were audited in the prior audit. The totaled of these items are \$3,115

ADOPTED FROM PRIOR AUDIT REPORT, DOCKET NO. 961310-WU, AUDIT CONTROL NO. 96-326-3-1, Audit Exception No. 3, PAGE 6.

Audit Exception No. 3

Subject: Utility Land

Statements of Facts: The utility has not recorded any amount in Account No. 303 - Land and Land Rights.

The Uniform System of Accounts (USOA) requires Account No. 303 to reflect the costs of land used in water operations.

Opinion/Recommendation: Field audit staff used the records at the Marion County Courthouse to determine the original cost of utility land.

Tract "A" in High Pointe subdivision costs the utility \$4,502.74 per acre. Utility land is .67 acre, thus a cost of \$3,016.84 ($4,502.74 \times .67$).

Tract "A" in Suntime subdivision costs the utility \$6,250.16 per acre. Utility land is .75 acre, thus a cost of \$4,687.62 ($6,250.16 \times .75$).

Total original cost of utility land as determined by staff is \$7,704.46 ($3,016.84 + 4,687.62$).

Staff recommends that the Commission directs the utility to adjust its books to the amount determined by the field audit staff.

Exception No. 4

Subject: Revenues

Statement of Fact: The utility recorded total utility revenue of \$194,937 in the General Ledger. This amount includes residential water revenue of \$186,902 and other water revenue of \$8,035. The utility calculated the revenues based on the billing date.

Recommendation: The audit staff calculated the revenue based on the meter reading date and determined that the residential water revenue should be increased by \$3,221. The total utility revenue should be \$198,158 (\$194,937 + \$3,221).

The utility adjusted the revenue based on the meter reading date and reported the revenue of \$198,018 and the RAF of \$8,911 on the RAF return filed with the Commission.

Exception No. 5

Subject: Operation and Maintenance (O&M) Expense

Statement of Fact: The utility reported an operation and maintenance expense balance of \$158,999 for the 12-month period ended December 31, 2002.

Recommendation: The audit staff recommends that the Commission should require the utility to increase its operation and maintenance expense by \$709. The total operation and maintenance expense per audit is \$159,707 for the period ended December 31, 2002.

The audit staff calculated the water working capital balances using one-eighth of O&M of \$19,963 ($\$159,707 \times 1/8$), as of December 31, 2002.

See Schedule on the following page for more details.

Schedule of Exception No. 5

Account No.	Per Company	Adjustment	Per Audit
601 - Salaries & Wages-Employees (1)	\$41,800	\$9,600	\$51,400
603 - Salaries & Wages-Officers	59,800	0	59,800
604 - Employee Pension and Benefits (2)	1,324	10,705	12,029
615 - Purchased Power	6,273	0	6,273
618 - Chemicals (3)	712	(50)	662
631 - Contractual Services - Professional	1,510	0	1,510
635 - Contractual Services - Testing	400	0	400
636000 - Contractual Services - Other (4)	14,831	(4,785)	10,046
636001 - Contractual Services - Other (5)	4,514	2,638	7,152
640 - Rents	5,350	0	5,350
650 - Transportation Expenses	4,408	0	4,408
655 - Insurance Expense (6)	6,598	(5,920)	678
675 - Miscellaneous Expenses (7)	1,779	(1,779)	
675002 - Bank Service Charges (8)	1,741	(1,741)	0
675005 - Maintenance Expense (9)	859	(859)	0
675009 - Misc. Expense (10)	109	(109)	0
676 - Payroll Taxes (11)	6,991	(6,991)	0
Total	\$158,999	\$709	\$159,708

See below for details of the above-mentioned adjustments.

Notes:

- (1) The utility underestimated the amount of the annual salary of the vice president on the G/L by \$9,600.
- (2) Account 604, Employee Pension and Benefits, should be increased by \$10,705 (\$5,920 + \$4,785). The amount of \$5,920 represents the utility's share of the utility owner's life insurance expense, included in the Account 655, Insurance Expense. The amount of \$4,785, included in the Account 636001, Contractual Services-Other, represents part of the hospitalization expense of the vice president.
- (3) The amount of \$50 should be removed from Account 618, Chemicals, as it belongs to 2001.
- (4) See Note No. 2.
- (5) Account 636001, Contractual Services-Other, should be increased by \$2,638 (\$1,779 + \$859). The amounts of \$1,779 from Account 675, Miscellaneous Expense, and \$859 from Account 675002, Maintenance Expense, represent contractual services.
- (6) See Note No.2.
- (7) See Note No. 5.
- (8) The amount of \$1,741 should be transferred to Account 427, Interest Expense.
- (9) See Note No. 5.
- (10) The amount of \$109 should be increased by \$50 and transferred to Account 408, Taxes Other Than Income, as it represents the Florida Secretary of State tax expense.
- (11) The amount of \$6,991, Payroll Taxes, should be transferred to Account 408, Taxes Other Than Income.

Exception No. 6

Subject: Taxes Other Than Income (TOTI)

Statement of Fact: The utility recorded taxes other than income of \$2,677 for the 12-month period ended December 31, 2002. These balances included \$413 for real estate taxes and \$2,264 for tangible personal property taxes. The utility reported RAF of \$8,772, separate from Taxes Other Than Income in the G/L for the period ended December 31, 2002.

Recommendation: The taxes other than income balance should be increased by \$7,295 according to the following schedule:

Description	Balance Per Company	Audit Adjustments	Balance Per Audit
Payroll Taxes (1)	\$0	\$6,991	\$6,991
Florida Secretary of State (2)	0	159	159
RAF(3)	8,772	145	8,917
Real Estate Taxes	413	0	413
Tangible Personal Property Taxes	2,264	0	2,264
Total	\$11,449	\$7,295	\$18,744

- (1) See Exception No.5, Note No. 11.
- (2) See Exception No.5, Note No. 10.
- (3) The revenue per audit is $\$198,157 \times 4.5\% = \$8,917$

Exception No. 7

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

Statement of Facts: The utility recorded \$508,358 for CIAC and \$198,326 for accumulated amortization as of December 31, 2002. Amortization expense was recorded for \$17,116 for the period ended December 31, 2002.

The utility had recorded \$66,470 in Account No. 271002, titled CIAC Repaid. On December 31, 1996, the utility removed this amount from Account No. 271002 and charged it against (decreasing) Account 271001, CIAC.

An agreement between the utility and Suntree Subdivision development, dated August 8, 1984, states,

As of the date of this agreement, said central water system serving Suntree Subdivision shall become the sole property of Residential Water Systems, Inc. and that Residential Water Systems, Inc. shall pay to Suntree Ocala, Inc. the sum of Two Hundred Dollars (\$200.00) for each and every lot sold in the Suntree Subdivision by Suntree Ocala, Inc., for installation of said central water system serving Suntree Subdivision for Residentail Water Systems, Inc.

In the prior audit, Docket No. 961310-WU, Audit Control No. 96-326-3-1, page 14, the audit staff increased CIAC by \$15,379.

Commission Order No. 13688, issued September 19, 1984, Docket No. 830455-W, states, "In establishing initial service rates, the Commission has assumed the useful life of plant to be 40 years and, therefore, a depreciation rate of 2.5%."

Recommendation: On page 18 is Exception No. 6 of the prior audit, concerning the \$66,470 Repaid CIAC. The \$66,470 should not be removed from CIAC. There are no provisions in Commission Order No. PSC-98-1152-FOF-WU, issued August 25, 1998, and the utility's tariff for the return of CIAC.

The utility did not increase CIAC per the prior audit of \$15,379.

The utility should be required to increase CIAC by \$81,849 (\$66,470 + \$15,379). See attached schedule on page 19 for more details.

The audit staff determined the associated accumulated amortization of CIAC to be \$129,711. The utility should be required to decrease the accumulated amortization of CIAC by \$68,615 (\$198,326 - \$129,711).

The audit staff determined accumulated amortization of CIAC expense to be \$19,182. The utility should be required to increase the accumulated amortization of CIAC expense by \$2,066 (\$19,182 - \$17,116).

Exception No. 7, continued

Per Commission Order No. 13688, issued September 19, 1984, an annual rate of 2.5 percent was used for years 1996 through 2001. For 2002, a composite rate of 3.25 percent was used to conform with the depreciation rates prescribed in Commission Rule 25-30.140, Florida Administrative Code (F.A.C.)

Exception No. 7, continued

ADOPTED FROM PRIOR AUDIT REPORT, DOCKET NO. 961310-WU, AUDIT CONTROL NO. 96-326-3-1, Audit Exception No. 6, PAGE 12.

Subject: Purchase Agreements

Statements of Facts: The utility has recorded \$66,470 in an account titled "CIAC Repaid."

The utility's representative has orally represented that the amounts in this account are payments to developers for the purchase of the water distribution systems installed by said developers in the subdivisions served by the utility.

The utility paid each developer \$200 per lot sold.

The utility lacked support for the entire amount of \$66,470.

Opinion/Recommendation: The utility provided partial copies of two agreements in which the utility paid the developers \$200 for each lot the developers sold, in return the utility became the owner of the water system which the developers had installed in the different subdivisions.

The utility usually paid the \$200 after it has collected the tariff authorized connection fee of \$570 from each lot owner.

Field audit staff believes that the agreements are purchase agreements and should be treated as such. The \$66,470 is for plant additions that are already included in the utility's plant in service balance of \$200,185.30.

The utility provided support for \$21,800 of the \$66,470 recorded as CIAC Repaid.

It is recommended that the Commission orders the utility to treat the \$66,470 as purchasing the water distribution systems in the different subdivisions, and that the utility eliminates its Account No. 271002 - CIAC Repaid.

Schedule - Exception No. 7

Date	Add	Subtract	Per Company	Audit Adjustment	Per Audit	
@11/30/96			282,731.00	15,379.00	298,110.00	Prior audit adjustment
12/01/96 to 12/31/96		(66,470.00)	216,261.00	66,470.00	298,110.00	Repaid CIAC included
1997	570.00		216,831.00		298,680.00	
1998	3,420.00		220,251.00		302,100.00	
1999	570.00		220,821.00		302,670.00	
2000	162,283.60		383,104.60		464,953.60	
2001	117,408.36		500,512.96		582,361.96	
2002	7845.00		508,357.96		590,206.96	
Total	292,096.96			81,849.00		

Exception No. 8

Subject: Capital Structure

Statement of Fact: The utility recorded \$21,926 in its general ledger for one of its long-term debts owed to Bobcat & Kubota of Ocala as of December 31, 2002. The amount recorded in the Annual Report filed with the Commission was \$20,226 as of December 31, 2002.

The Utility recorded Retained Earnings of (\$46,002) in its general ledger as of December 31, 2002. The amount recorded in the Annual Report was (\$43,246) as of December 31, 2002.

Recommendation: The utility should adjust its general ledger to the correct amount per its Annual Report. The utility does not adjust its general ledger at year-end for closing adjusting journal entries. However, the Annual Report is adjusted.

The general ledger amount should be reduced by \$1,700 ($\$21,926 - 20,226$) to agree with the Annual Report and the debt agreement amortization schedule.

The general ledger retained earnings amount should be increased by \$2,756 ($(\$46,002) - (\$43,246)$) to agree with its Annual Report as of December 31, 2002.

Disclosure No. 1

Subject: Transportation Expense

Statement of Fact: The utility included \$4,234 in its operating and maintenance expense account as an expense for a 2002 Lincoln Navigator, leased from Ocala Lincoln-Mercury Company. The monthly lease payment is \$529. The lease payments for the vehicle began May 31, 2002. The vice president uses the car to run errands to the bank, post office, and other offices.

Recommendation: The audit staff forwards this information to the Commission for consideration in this case.

Disclosure No. 2

Subject: Salaries

Statement of Fact: The utility has two employees on its payroll, the president and the vice president. The president owns three businesses including Residential Water Systems Inc., Mira International Inc., and Tradewinds Utilities, Inc. He devotes 35 hours a week to managing the utility, Residential Water Systems Inc. The president earns \$59,800 annually. The vice president works 40 hours a week and earns \$51,400 annually. Her duties involve accounting and administrative matters.

Recommendation: The audit staff forwards the information to the Commission for consideration in this case.

Disclosure No. 3

Subject: Hourly Charges

Statement of Fact: The president of the utility, who earns \$59,800 annually, charges the utility \$35 an hour per leakage repair through Mira International, Inc. The total repair expense for 2002 is \$1,603. The owner of Residential Water Systems, Inc. is also the owner of Mira International Inc.

Recommendation: The audit staff forwards the information to the Commission to consider in this case.

Disclosure No. 4

Subject: 2002 Revenues

Statement of Fact: The president of the utility provided the audit staff with a letter dated June 26, 2003, explaining that the revenues earned in 2002 were high because of the construction that took place in the area. A copy of the letter is on the following page of this report.

Recommendation: The audit staff forwards the information to the Commission to consider in this case.

Residential Water Systems, Inc.

P.O. Box 5220
Ocala, FL 34478

June 26, 2003

To Whom It May Concern:

In 1999 Residential Water Systems, Inc. applied to the Florida PSC for an extension of its franchised area, which was approved in Order No. PSC-99-2248-FOF-WU as of 11/15/1999. The new development known as Dalton Woods, with all $\frac{3}{4}$ acre lots, was originally projected to build out in 5 to 7 years as the majority of medium to high priced subdivisions have in the past.

What was not expected was a complete sellout of the subdivision in less than 120 days. Construction began in late 2000 with four (4) homes, then in 2001 fifty-three (53) homes and in 2002 forty (40)-homes for a total of 97 homes in two (2) years.

During this construction we were in the midst of upgrading our water plant to handle the projected water demand from the new subdivision as well as bringing the plant up to current capacity code regarding fire flow.

Contractors in the meantime were building furiously and upon completion of each home, they were irrigating the $\frac{3}{4}$ acre lots in an attempt to complete landscaping and grass (St. Augustine) for marketing purposes.

As a result of the new construction and construction irrigation we experienced a tremendous water demand and unusual income. The average contractor would use 100,000 to 150,000 gallons of water per month once the landscaping was installed. Once the vegetation took hold, the contractor would reduce usage accordingly. Our water demand this year has reduced significantly now that homeowners are maintaining their own property as our monthly accounting reports for 2003 currently reflex.

Please take this into consideration in calculating future income and expense levels. Sincerely,

Charles deMenzes
President

Disclosure No. 5

Subject: Life Insurance

Statement of Fact: The sales contract between the buyer and the seller of the utility, Term No. 9 states:

Buyer agrees to obtain Term Life insurance, with the sellers as beneficiary, in an amount of at least 50% of outstanding debt.

The total amount of the life insurance that is allocated to the utility is \$5,920 for the period ended December 31, 2002.

The owner allocated \$1,480 of the life insurance policy expense per quarter to the utility. There is no certain form of allocation but the owner's estimate of the utility's share of the life insurance policy expense.

Recommendation: The audit staff forwards the information to the Commission to consider in this case.

Disclosure No. 6

Subject: Pro Forma Plant

Statement of Fact: The utility is presently upgrading its water distribution system and adding a new storage building to the water plant. The utility is requesting a pro forma plant adjustment of \$153,100 for the above items. The following breakdown is provided:

Building	\$59,000
Distribution System	120,000
Less expended in 2002	<u>(25,900)</u>
Total	\$153,100

The work has already started and is scheduled to be completed in 2004.

Disclosure No. 7

Subject: Rate Base at Transfer

Statement of Fact: The utility was transferred to the present owners on November 26, 1996. An audit was done to established rate base at the time of transfer. The following is rate base taken from that audit as of November 30, 1996.

**RESIDENTIAL WATER SYSTEM, INC.
WATER RATE BASE
DOCKET NO. 961310-WU
RATE BASE
AS OF NOVEMBER 30, 1996**

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	PRIOR AUDIT REFER TO	PER AUDIT
UTILITY PLANT-IN-SERVICE	\$200,185	(\$140,826)	E2	\$59,359
LAND	\$0	\$7,704	E3	\$7,704
ACCUMULATED DEPRECIATION	(\$166,475)	\$157,333	E4	(\$9,142)
CONTRIBUTIONS-IN-AID-OF- CONSTRUCTION (CIAC)	(\$282,731)	(\$15,379)	E5	(\$298,110)
ACCUMULATED AMORTIZATION OF CIAC	\$157,045	(\$95,906)	E5	\$61,139
WORKING CAPITAL ALLOWANCE		\$0		\$0
TOTAL	(\$91,976)	(\$87,074)		(\$179,050)

EXHIBIT I

**RESIDENTIAL WATER SYSTEM, INC.
WATER RATE BASE
DOCKET NO. 030423-WU
RATE BASE
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY	AUDIT EXCEPTION	REFER TO	PER AUDIT
UTILITY PLANT-IN-SERVICE	\$701,940	(\$194,436)	E2	\$507,504
LAND	\$0	\$7,704	E3	\$7,704
ACCUMULATED DEPRECIATION	(\$185,669)	\$153,925	E2	(\$31,744)
CONTRIBUTIONS-IN-AID-OF- CONSTRUCTION (CIAC)	(\$508,358)	(\$81,849)	E7	(\$590,207)
ACCUMULATED AMORTIZATION OF CIAC	\$198,326	(\$68,615)	E7	\$129,711
WORKING CAPITAL ALLOWANCE		\$19,963	E5	\$19,963
TOTAL	\$206,239	(\$163,308)		\$42,931

EXHIBIT II

**RESIDENTIAL WATER SYSTEMS, INC.
WATER NET OPERATING INCOME
DOCKET NO. 030423-WU
INVESTIGATION OF 2002 EARNINGS
HISTORICAL PERIOD ENDED DECEMBER 31, 2002**

DESCRIPTION	PER UTILITY(1)	AUDIT EXCEPTION(1)	REFER TO	PER AUDIT(1)
REVENUES:				
OPERATING REVENUES	\$194,937	\$3,220	E4	\$198,157
EXPENSES:				
O&M EXPENSE	158,999	708	E5	159,707
DEPRECIATION EXPENSE	23,634	(7,149)	E2	16,485
AMORTIZATION EXPENSE	(17,116)	(2,066)	E7	(19,182)
TAXES OTHER THAN INCOME	11,449	7,295	E6	18,744
TOTAL	\$176,966	(\$1,212)		\$175,754
NET OPERATING INCOME	\$17,971	\$4,432		\$22,403

FOOTNOTES:

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

EXHIBIT III**RESIDENTIAL WATER SYSTEM, INC.
DOCKETED NO. 030423-WU
CAPITAL STRUCTURE
AS OF DECEMBER 31, 2002**

DESCRIPTION	PER COMPANY	AUDIT EXCEPTION	REFER TO(1)	PER AUDIT	RATIO	COST RATE(2)	WEIGHTED COST OF CAPITAL
COMMON EQUITY	\$100	\$0		\$100	0.04%	11.96%	0.005%
PAID IN CAPITAL	\$400	\$0		\$400	0.16%	11.96%	0.019%
RETAINED EARNINGS	(\$46,002)	\$2,756		(\$43,246)	(17.22)%	11.96%	(2.060)%
LONG-TERM DEBT (KUBOTA)	\$21,926	(\$1,700)		\$20,226	8.05%	3.90%	0.314%
LONG-TERM DEBT (WACHOVIA)	\$84,065	\$0		\$84,065	33.46%	8.75%	2.930%
LONG-TERM DEBT (FLORIDA)	\$186,648	\$0		\$186,648	74.30%	3.55%	2.640%
CUSTOMER DEPOSITS	\$3,015	\$0		\$3,015	1.20%	6.00%	0.072%
TOTAL	\$250,152	\$1,056		\$251,208	100.00%		3.920%

REQUIRED FOOTNOTES:

- 1) Audit adjustments do not include audit disclosures.
- 2) Cost rate for common equity established in Order No. PSC-03-0799-CO-WS, issued July 8, 2003.