

State of Florida



Public Service Commission

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DATE: April 4, 2011
TO: Shannon Hudson, Regulatory Analyst IV, Division of Economic Regulation
FROM: Clarence J. Prestwood, Chief of Auditing, Office of Auditing and Performance Analysis
RE: Docket No.: 100472-WS
Company Name: Heather Hills Estates Utilities, LLC
Company Code: WS925
Audit Purpose: Staff Assisted Rate Case
Audit Control No: 11-024-2-3

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 a response to the Office of Commission Clerk. There were no confidential work papers associated with this audit.

CJP/ir

Attachment: Audit Report

cc: (With Attachment)
Office of Auditing and Performance Analysis
Office of Commission Clerk
Office of the General Counsel
Dale Mailhot, Office of Auditing and Performance Analysis
Clarence Prestwood, Office of Auditing Performance Analysis
Lisa Harvey, Office of Auditing and Performance Analysis
Lynn Deamer, Office of Auditing and Performance Analysis
Linda Hill-Slaughter, Office of Auditing and Performance Analysis

DOCUMENT NUMBER-DATE

02234 APR -4 =

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State of Florida



Public Service Commission

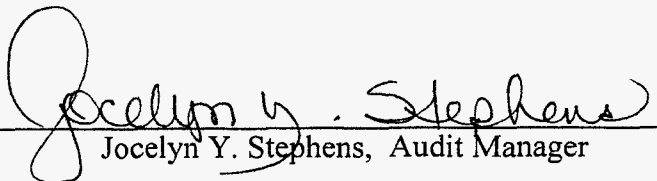
Office of Auditing and Performance Analysis
Bureau of Auditing
Tampa District Office

Auditor's Report

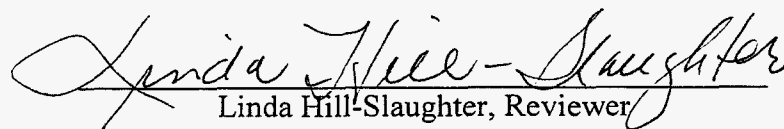
Heather Hills Estates Utilities, LLC
Staff Assisted Rate Case Audit

Twelve Months Ended December 31, 2010

Docket No. 100472-WS
Audit Control No. 11-024-2-3
March 29, 2011



Jocelyn Y. Stephens, Audit Manager



Linda Hill-Slaughter, Reviewer

DOCUMENT NUMBER-DATE

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Table of Contents

	Page
Purpose.....	1
Objectives and Procedures	2
Audit Findings	
1 ProForma Plant	9
2 Calculation of the Retirement Cost of Valves	10
3 Staff Adjustments to Utility’s Books	11
4 Bad Debt Expense	13
5 Staff Calculation of Accumulated Depreciation	14
6 2009 O&M Expenses that Should be Capitalized.....	16
7 Posting Revenues to General Ledger	17
8 ProForma Expense – Customer Billing	18
9 Purchase of Van	20
10 Condition of Books and Records	21
11 Management Fee	22
12 Plant Acquisition Adjustment	23
13 Utility Expense not Recorded on Utility Books	24
Exhibits	
1 Rate Base Water.....	25
2 Rate Base Wastewater.....	26
3 Water Net Operating Income	27
4 Wastewater Net Operating Income	28
5 Capital Structure	29

Purpose

To: Florida Public Service Commission

We have performed the procedures described later in this report to meet the agreed upon objectives set forth by the Division of Economic Regulation in its audit service request dated January 25, 2011. We have applied these procedures to the attached exhibits prepared by the audit staff in support of Heather Hills Estates Utilities, LLC's request for a Staff Assisted Rate Case in Docket No.100472-WS.

This audit was performed following general standards and fieldwork standards found in the AICPA statements on standards for Attestation Engagements. Our report is based on agreed upon procedures. The report is intended only for internal Commission use.

Objectives and Procedures

General

Utility Information

Heather Hills Estates Utilities, LLC is a Class C utility that provides utility services to approximately 354 water and wastewater customers in Manatee County, Florida. The Utility is owned and managed by Mr. Richard Stephens and Mrs. Christina Stephens.

Definition

The term "Utility" used within this report refers to Heather Hills Estates Utilities, LLC.

Historical Record

We determined that the Utility has had a prior rate case which established rate base. We also determined that the Commission has established dockets pertaining to the following actions.

<u>Docket No.</u>	<u>Order No.</u>	<u>Purpose</u>
951533-WS	PSC-96-0434-FOF-WS	Application for certificates to provide water and wastewater in service in Manatee County by Keith & Clara Starkey d/b/a Heather Hills Estates.
960814-WS	PSC-96-1126-FOF-WS	Investigation into possible overearnings in Manatee County by Keith & Clara Starkey d/b/a Heather Hills Estates.
090500-WS	PSC-10-0014-TRF-WS	Request for approval of late payment charge by Heather Hills Estates Utilities, LLC in Manatee County.
090093-WS	PSC-10-0519-FOF-WS	Application for approval of transfer of Keith & Clara Starkey d/b/a Heather Hills Estates' water and wastewater Utility...to Heather Hills Estates Utilities, LLC in Manatee County.

Utility Books and Records

Objectives:

Our objectives were to:

- 1) Reconcile the Utility's books with the Utility's annual report or tax return and have the Utility reconcile differences.
- 2) Review any outside auditors report or workpapers.

- 3) Determine that the Utility maintains its accounts and records in conformity with the National Association of Regulatory Utility Commissioners Uniform System of Accounts.

Procedures: We reviewed the Utility's accounting systems and annual reports for the years 2000 through 2010. We also reviewed outside accountant's adjusting journal entries (AJE) and reclassifying journal entries (RJE) for the years 2008, 2009 and 2010.

Audit Findings 3, 7 and 10 discuss our findings and recommendations for the Utility's books and records.

Rate Base

Land

Objectives:

Our objectives were to:

- 1) Determine that utility land is recorded at original cost and is own or secured under a long-term lease.
- 2) Verify that the adjustments to land in the Utility's last rate proceeding were recorded in its general ledger.
- 3) Review the warranty deed or other evidence of the Utility's land ownership for any purchase, sale, or transactions which may have occurred since the last rate case.

Procedures: In Docket No. 090093, Order No. PSC-10-0519-FOF-WS, it was established that since the Utility purchases water and wastewater treatment services from Manatee County, it is not required to provide proof of ownership of the land under the treatment facilities, pursuant to Rule 25-30.037(2)(q), Florida Administrative Code (F.A.C.). Additionally, the Order states that the application contains a copy of the Asset Purchase Agreement with an attached easement agreement which allows access to the distribution and collection systems. Lastly, we noted that the value of land, as reported in its Annual Reports for the years 2000 through 2010 is minimal and has not changed. As such, we did not obtain or review the warranty deed or other evidence of land ownership.

Utility Plant In Service

Objectives:

Our objectives were to:

- 1) Test additions and retirements to plant.
- 2) Describe major additions, retirements or adjustments.
- 3) Prepare a schedule of UPIS, by account, from the last order with year to year additions and retirements.
- 4) Review appropriate documentation to ensure that the Utility owns all assets associated with the provision of service to its customers.
- 5) Review the allocation methodology for plant used by the Utility. Determine whether the original amounts to be allocated and the methodology used were properly calculated.

Procedures: Using the Utility Plant in Service (UPIS) from Commission Order No. PSC-96-1126-FOF-WS in Docket 960814-WS and the Utility's annual reports, we scheduled additions to UPIS for the period December 31, 1995, through December 31, 2010.

For 2008 through 2010 additions, we examined supporting documentation and made adjustments as necessary.

Audit Findings 1, 2, 6, 9 and 12 discuss our findings and recommendations for the Utility's plant in service.

Accumulated Depreciation and Depreciation Expense

Objectives:

Our objectives were to:

- 1) Test the annual accruals to accumulated depreciation based on adjusted plant, using the last authorized depreciation rates up to the beginning of the test year and the rates prescribed by Rule 25-30.140, F.A.C. for the test year.
- 2) Prepare a schedule of accumulated depreciation balances by plant account from the last order with year to year additions and retirements.

Procedures:

Using the depreciation rates prescribed in Commission Rule 25-30.140, F.A.C. we calculated depreciation expense beginning in 1996. Our schedule of UPIS reflects both plant balances and accumulated balances for the annual 12-month periods ending December 31 for the years 1996 through 2010.

Audit Finding No. 5 discusses our findings and recommendations for accumulated depreciation and depreciation expense.

Contributions in Aid of Construction (CIAC)

Objectives:

Our objectives were to:

- 1) Test CIAC additions and adjustments since inception. Test by estimation using the service availability policy in effect during the period and number of customers.
- 2) Test the annual accruals to accumulated amortization of CIAC applying the annual composite depreciation rate.
- 3) Test to determine whether the appropriate test year depreciation and amortization rates have been used for test year expense.

Procedures: We noted that Contributions in Aid of Construction (CIAC) was recorded on the books of the Utility in the amount of \$26,625. This amount was imputed by the Commission's staff in a prior rate case proceeding (Docket 960814-WS, Order No.PSC-96-1126-FOF-WS). CIAC was fully amortized as of December 31, 1999.

NET OPERATING INCOME

Operating and Service Revenues

Objectives:

Our objectives were to:

- 1) Test revenue transactions using the tariff rates and perform simple calculation estimation to determine what test year revenues should be.
- 2) Perform billing analysis for the test year.
- 3) Examine and list the dollar amount, type and frequency of miscellaneous service charges in the test year.

Procedures: We obtained copies of Commission approved test year tariff sheets. We obtained access to customer quarterly bills. On a random basis, we verified that customers are billed according to the water tariff rates for residential and general customers.

We recalculated water and wastewater revenues using total gallons billed by the Commission approved tariff rates. Except for rounding, there were no differences between company recorded revenues and staff calculated revenues.

We also performed a billing analysis which included all quarterly bills for all Utility customers using actual customer usage.

Lastly, we performed an analysis of miscellaneous service revenues. Miscellaneous Revenues were the result of late payment fees and turn on/off fees either for non payment or at a customer's request. Miscellaneous fees were also assessed to a customer to recover the cost of fees charged by the bank for returned checks.

Audit Findings 4 and 10 discuss our findings and recommendations for the Utility's operating and service revenues.

Operation and Maintenance Expenses

Objectives:

Our objectives were to:

- 1) Sample test year operation and maintenance expense accounts.
 - a. Examine the expense for
 - i. Proper Period
 - ii. Amount
 - iii. Classification
 - iv. Support documentation
 - v. Whether non-utility related
 - vi. Whether non-recurring
 - vii. Unreasonable or imprudent
- 2) Review the allocation methodology for O&M expenses used by the Utility.
 - a. Determine whether the original amounts to be allocated and the methodology used were calculated properly.
 - b. Check the basis for accuracy and consistent application.

- 3) For the test year, prepare or obtain the Utility's schedule of contracted services.
 - a. Separate services by:
 - i. Engineering
 - ii. Accounting
 - iii. Legal
 - iv. Billing
 - v. Testing
 - vi. Operating
 - vii. Management
 - b. Test documentation for amounts paid, period of service, and that the service was related to utility operations.
- 4) Provide the number of hours per month, employees and/or contracted vendors spend on operating, billing, testing, maintenance, and general management activities.
- 5) Note expense areas where the Utility has no costs assigned, but where benefits to utility operations are evident.

Procedures: For non-related third party expenses incurred by the Utility, we verified third party supporting documentation. These included purchased water, professional fees (accounting, legal), water testing, office supplies and expenses, transportation expense, materials and supplies and repairs. We prepared schedules summarizing the costs incurred.

For costs incurred by the Utility for contract labor, we examined the work orders and noted the hours, description of the work performed and the copy of the check used to make payment for the labor. Also, we prepared a schedule of contractual labor costs and segregated cost among capitalized labor, meter reading, repairs, and miscellaneous other.

All expenses were analyzed for being recorded in the proper period, proper amount and for proper classification. Expenses were also analyzed to determine if they were non-utility related, non-recurring, unreasonable or imprudent.

All non-specific and general expenses were allocated between water and wastewater at 50% based upon customers. All customers receive both water and wastewater services.

The Utility has an agreement with Heather Hills Estates to rent office space. The monthly charge is \$400 and includes use of office equipment, electric, water, telephone service, use of office furniture and miscellaneous office supplies.

Audit Findings No. 3, 11 and 13 discuss our findings and recommendations for the Utility's operation and maintenance expenses.

Federal Income Tax Returns

Objectives:

Our objectives were to:

- 1) Request copies of all the Utility's tax returns for each year covered by the audit review.
- 2) Verify the Utility filing status

Procedures:

We received a 2009 Form 1065 – U.S. Return for Partnership Income.

The IRS does not recognize the limited liability company, or LLC, as a distinct form of business organization for tax purposes. Instead, an LLC is generally treated as a partnership for tax purposes. For this reason, an LLC must file Form 1065 and Schedule K-1 as if it were a partnership.

Form 1065 requires detailed financial information about the partnership, including income, profits and losses.

We used the Form 1065 and compared the recorded amounts to those in the 2009 Annual Report. We were not able to reconcile differences.

Objectives:

Our objectives were to:

- 1) Note all related party relationships and transactions.
- 2) Determine that related party transactions appear prudent and competitive with non-affiliated transactions and that any contractual agreements have been negotiated with terms similar to arms length transactions.

Procedures: We reviewed all Utility transactions and noted that the Management Fee and Rent are related party transactions. The nature and amount of these transactions appear to be prudent and competitive.

CAPITAL STRUCTURE

Objectives:

Our objectives were to:

- 1) Determine the equity balance, transactions and adjustments from the previous audited period forward are in compliance with Commission Rules and the USofA
- 2) Determine that notes payable, long-term debt, and debt equivalents are authorized and properly classified in compliance with the USofA and presented in the capital structure exhibits in compliance with Commission Rules.
- 3) Determine that related interest expense, including amortization of debt discount, premium, and issuance expense, has been properly recognized and accounted for in compliance with the USofA.

- 4) Determine if deferred income taxes represent the effect of timing differences and are accounted for according to the USofA.

Procedures:

We substantiated the amount and cost of long term debt. We analyzed the detail of the owners equity and retained earnings transactions. We determined that the Utility has no customer deposits. We prepared a Capital Structure which is shown on Exhibit 5.

Audit Findings

Finding 1

Subject: Proforma Plant

Audit Analysis:

Beginning in 2008, the previous owners of the Utility took on a commitment to install new water valves and replace existing meters. The current owners of the Utility have proceeded with this project and in 2011 have begun the final phase of the project.

On February 17, 2011, the Utility entered into an agreement for gate valve replacements at a cost of \$11,635. Work began on this project in March 2011. Additional related costs totaling \$659 have been incurred. Total capitalized costs incurred subsequent to the test period equal \$12,294.

Effect on the General Ledger: N/A

Effect on the Filing: For informational purposes only.

Finding 2

Subject: Calculation of the Retirement Cost of Valves and Office Equipment

Audit Analysis:

In 2008, the Utility incurred capital costs of \$23,000 for the replacement of 16 – 2” isolation valves recorded in A/C 331 Transmission and Distribution Mains. No plant records exist to document the original costs of the valves.

To approximate an original cost for the valves, the Utility used an inflation calculator and discounted the \$23,000 back to 1967 dollars. This resulted in an original cost calculation of \$3,616. The net plant adjustment per the Utility is an increase of \$19,384 (\$23,000 - \$3,616).

In previous dockets before the Commission, utilities have been permitted to retire 75% of the capital assets’ purchase price when the original cost cannot be determined. The retirement is made by crediting plant and debiting accumulated depreciation.¹

We calculated an original cost of the retired valves at \$17,250 (75% of \$23,000). The net plant adjustment, per staff, is an increase of \$5,750 (\$23,000 - \$17,250).

The difference between the staff calculation and the Utility calculation for Transmission and Distribution Mains is \$13,634.

Also, we noted that the Utility recorded costs for the purchase of a computer in 2003 and a computer monitor in 2009 for \$744 and \$100, respectively. This cost was included at 50/50 in A/C’s 341 - Office Furniture and Equipment (water) and 391 – Office Furniture and Equipment (sewer). In 2010, the Utility replaced these items with the purchase of a new Apple computer with its own monitor but did not retire the costs of the original computer and monitor.

Staff made an adjustment for 2009 of \$33 to remove the non-utility portion of the monitor (See Finding 6). No adjustment was for made for the non-utility portion of the computer because it was fully depreciated. We calculated that the remaining cost of the original computer and monitor to be retired was \$810 (\$405 – water and \$405 – wastewater).

Effect on the General Ledger: For 2008, cost recorded in general ledger for Account 331 - Transmission and Distribution Mains and the associated accumulated depreciation should be reduced by \$13,634 in addition to \$3,616 recorded by the Utility. The resulting adjustments for depreciation expense and accumulated depreciation for 2009 and 2010 are incorporated in staff’s recalculation of depreciation.

For 2010, adjustments to the general ledger are included in Finding 3.

Effect on the Filing: N/A

¹ Order No. PSC-07-0505-SC-WS, Docket No. 060253-WS, page 13 – Issued 6/13/2007.

Finding 3

Subject: Staff Adjustments to Utility's Books

Audit Analysis: During the audit of the books and records of the Utility, many instances were found where the Utility posted accounting entries to the wrong account. We noted that at year-end the Utility sends its general ledger to its outside accountant. The accountant prepares adjusting journal entries to correct erroneous entries posted in the general ledger. The accountant also prepares reclassifying journal entries to segregate water and wastewater amounts. We noted that the accountant allocated costs for Office Furniture and Equipment (computer) 50/50 between water and wastewater for the years 2003 to 2010. The accountant uses the adjusted general ledger balances to prepare the annual report.

After a thorough inspection of available supporting documentation, we found it necessary to make additional adjusting entries to reclassify dollars into the proper NARUC account, as well as make correcting entries for various non-recurring items, non-utility items, and items outside of the period as well as O&M expense to be capitalized.

See the Table below.

Effect on the General Ledger: See attached schedule

Effect on the Filing: N/A

Summary of Audit Adjustments

<u>Account Description</u>	<u>Debit</u>	<u>Credit</u>
Accumulated Depreciation	\$ 14,444.00	
Bad Debt Expense	661.00	
Collecting Sewers - Gravity	250.00	
Insurance Expense	763.00	
Management Fee	3,500.00	
Meter and Meter Installation	190.00	
Meter Reading	480.00	
Misc - Other	785.04	
Non Utility Expense	2,915.45	
Miscellaneous Expense	108.84	
Office Expense	1,523.74	
Office Furniture and Equipment	1,447.58	
Office Furniture and Equipment (Non-Utility)	723.79	
Purchased Water	82.73	
Rent	2,800.00	
Repairs	1,293.90	
Retained Earnings	1,360.45	
T&D Mains	10,606.21	
Transportation - Water	3,000.00	
Transportation expense	699.90	
Water Testing	1,130.00	
A/P - HOA		\$ 15.00
A/R Uncollectible		661.00
Accounts Payable		7,475.65
Accounts Payable (Non-Utility Repair)		125.00
Building Repairs		99.00
Cash		108.84
Cash A/P		89.01
Computer Repairs		750.00
Equipment Repairs		148.18
Filing Fees		172.00
Meter and Meter Installation		8,036.61
Misc Expense		2,670.15
Office Equipment (W) - Computer		810.00
Office Expense		3,891.02
Professional Fees other		834.00
Purchased Water		2,043.69
Retained Earnings		3,500.00
Revenue		25.00
Taxes Other Than Income		127.00
Transmission & Distribution		13,634.00
Transportation Expense		727.97
Undeposited Funds		57.73
Water Lines Repaired		2,764.78
	48,765.63	48,765.63

Finding 4

Subject: Bad Debt Expense

Audit Analysis: The Utility entered into an agreement with Manatee County to provide treated water to the subdivision and to also treat its wastewater. This agreement was entered into on February 14, 1976, and requires the subdivision to pay both a base and a usage charge for both water and wastewater for each unit in the subdivision. The agreement contains no wastewater allowance for irrigation.

Because the Utility is required to pay Manatee County a base charge for each lot in the subdivision, the Utility is required to assess the Commission approved tariff water and wastewater base rates to each unit in the subdivision.

During the test period, staff noted that three units in the subdivision are in the process of foreclosure. Even though the residents have moved out, the county continues to bill the Utility for the water and wastewater base rate. Additionally, there was water usage at these locations for which the Utility is responsible for payment to the County. However, the Utility has not received payment from the residents.

The Utility owner stated that they believe they will be able to recoup the billed cost of water and wastewater when the bank or mortgage holder sells the property at some date in the future.

There is no guarantee that the Utility will ever recover these revenues and as such, we calculated the remaining outstanding balance on these three units and charged \$661 to bad debt expense.

The Utility should be required to contact the County and inform them that there are no residents at these units and request that the base charge be waived.

The analyst may want to consider whether the \$661 is the proper amount of bad debt expense for ratemaking purposes.

Also, the Utility did not record the bank charge for the return check nor did it record the offsetting funds collected from a customer to cover the bank charge for the returned check.

Effect on the General Ledger: Record an amount for bad debt expense for \$661.00

Effect on the Filing: N/A

Finding 5

Subject: Staff Calculation of Accumulated Depreciation

Audit Analysis:

Staff performed an analysis of Accumulated Depreciation, as recorded in the Annual Reports, for the purpose of verifying that (1) the depreciation rates applied by the Utility comply with the rates from Rule 25-30.140 F.A.C. and, (2) that the correct Utility plant in service balances were used for the depreciation computation.

In Docket No. 960814-WS, Order No. PSC-96-1126-FOF-WS, the Commission established rate base at December 31, 1995. The analyst used a 2 1/2% depreciation rate starting with the original cost study in 1967 through March of 1984 when the NARUC system of accounts was initiated. Accumulated depreciation from that date forward was calculated using the prescribed rates described in Rule 25-30.140, Florida Administrative Code.

Using the Utility filed annual reports and depreciation schedules provided by the Utility's outside accountants, we observed that the Utility used the following depreciation rates when calculating depreciation expense.

	Annual Report (Prior to 2003)	Annual Report (Eff. 2003)	PSC Rule
A/C 309 - Supply Mains*	1.764%		3.125%
A/C 331 - T & D Mains		2.50%	2.632%
A/C 334 - Meter & Meter Installation		2.50%	5.888%
A/C 340 (390) - Computer		16.67%	16.67%
A/C 341 (391) - Transportation			16.67%
A/C 361 - Collecting Sewers - Gravity		2.50%	2.50%

*Reclassified to A/C 331 in 2003

We reviewed the Utility's calculation of Depreciation. We observed that the annual reports used depreciation rates of 1.764% (56 years) for Account 309 and 2.5% (40 years) for Account 331, which were not the prescribed rates.

We also noted that the annual report balances reflect that Account 309/331 - Transmission and Distribution Plant (Water) was fully depreciated as of December 31, 2002. Collection Wastewater -Gravity (Wastewater) (Account 361) was fully depreciated as of December 31, 2004. Fully depreciated indicates that the cost of plant equaled accumulated depreciation.

The beginning plant balances used for depreciation purposes, were not correct. The Utility used the average plant balances, per Commission Order PSC-96-1126-FOF-WS instead of the actual plant balances as of December 31, 1995.

Staff adjusted the amount recorded by the Utility for the retirement of valves in 2008, adjusted plant additions for all plant accounts for the years 2009 and 2010, and posted plant not previously recorded in the general ledger for 2009.

Because both incorrect depreciation rates and beginning plant balances were used by the Utility in calculating accumulated depreciation, as well as other adjustments being made to plant balances by the staff, we have prepared an adjustment to the amount recorded in the Utility's annual report for the difference in accumulated depreciation and depreciation expense.

	<u>Water</u>	<u>Wastewater</u>
Accumulated Depreciation - Utility	\$ 45,989	\$ 72,836
Accumulated Depreciation - Staff	33,450	72,946
Difference	\$ (12,539)	\$ 110
Depreciation Expense - Utility	\$ 2,176	\$ 198
Depreciation Expense - Staff	2,408	277
Difference	\$ 232	\$ 79

Effect on the General Ledger: Decrease the accumulated depreciation balance at December 31, 2010 by \$12,539 for water and increase the accumulated depreciation balance by \$110 for wastewater. Increase Depreciation Expense for 2010 by \$232 for water and \$79 for wastewater.

Effect on the Filing: N/A

Finding 6

Subject: 2009 O&M Expenses that should be Capitalized

Audit Analysis:

In the analysis of Operation and Maintenance Expense (O&M) for 2010 (See Audit Finding 3), we noted dollars charged to expense that would be accurately reported as Capital amounts. As a result of this finding, staff also reviewed 2009 O&M expenses and determined that a portion of these dollars should also be recorded as capital costs.

The table shown below summarizes those costs that staff has removed from Retained Earnings (2009) and recorded as capital costs for 2009.

A/C 334 - Meters and Meter Installation	290	
A/C 331 - Transmission and Distribution Mains (Valves)	75	
A/C 339 - Office Furniture and Equipment		33
A/C 215 - Retained Earnings		332

To adjust 2009 capital improvements

Effect on the General Ledger: Increase Plant in Service by \$332. Increase Retained Earnings by \$332

Effect on the Filing: N/A

Finding 7

Subject: Posting Revenues to General Ledger

Audit Analysis: In the analysis of revenues, staff noted that the Utility made several incorrect postings to its general ledger for residential and commercial revenues and for revenues derived from meter turn-ons and turn-offs.

Staff advised the Utility of these postings and explained how to properly post these entries.

The outside accountant made adjusting and reclassifying journal entries to adjust these incorrect postings.

We noted that the Commission approved tariff for wastewater customers require the Utility to bill its wastewater customers at 85% of water use. The billing system used by the Utility does not allow for the calculation of a percentage of water use. In order to bill at 85% of water use, the Utility would have to manually recalculate the water use and then input that data into the system. This method would allow for possible errors in calculation and application to the customer bill. The Utility has instead reduced the Commission approved tariff rate by 85% and then applied that resulting rate to 100% of the water use. This methodology produces the same billed amount as applying the tariff rate to 85% water use.

Effect on the General Ledger: Provided for informational purposes only.

Effect on the Filing: N/A

Finding 8

Subject: Proforma Expense – Customer Billing

Audit Analysis:

In the analysis of revenues, the Utility owner stated that meter reading may increase from a quarterly basis to a monthly basis. In preparation for this, the Utility is looking into the possibility of outsourcing its billing. Three proposals have been received by the Utility but no action has been taken.

We prepared an analysis of these proposals detailing the cost, term, services provided and Utility's continuing responsibilities. (See Table below).

Additionally, if meter reading changes from a quarterly billing to a monthly billing several other expense items would also change.

Annual meter reading costs would increase from \$120 every quarter (\$480) to every month (\$1,440).

The Utility owner also stated that a change in the frequency of customer billings would result in an increase to the management fee charged to the Utility. Currently, the monthly management fee is \$1500 per month or \$18,000 annually. If the billing changes from quarterly to monthly, the management fee would be \$550 weekly or \$28,600 annually.

Effect on the General Ledger: Provided for informational purposes only.

Effect on the Filing: N/A

Proposals received for Monthly Billing Services of Water and Sewer Services

<u>Proposal Date</u>	<u>Vendor</u>	<u>Costs</u>	<u>Services to be performed by Vendor</u>	<u>Services to be performed by Heather Hills</u>	<u>Contract Term</u>
2/21/2011	Vengroff Williams	\$2.50, per occurrence, for water and wastewater combined for up to 354 units No set-up fee No charge for postage or materials	Monthly Water Billing by 1st of each month Cash Application Support customer service & collections Will supply all materials and labor Will require full access to HHE systems Billing for services on monthly basis Provide billing detail to HHE by 26th of month Provide updated list of service shut-offs (within 3 days)	Meter Reading	2 years w/auto 1 yr renewal option by HHE
2/10/2011	eWaterbilling.com	Base charge \$2.50 per for billing only Postage \$0.28 per Card Stock \$0.07 per for 354 customers Total monthly Cost = \$1,008.90	Produce postcard or email billing Mgmt of delinquent accounts-Monitoring, Collection and Shut-off Customer Service A/R - Tracking of Payment Tracking of customer charges/fees Process Payment Water Usage and Loss Analysis Maintain communicatio with Systems Operator/Meter Reader Process Meter readings via meter reader sheet or PDA uploads Revenue, Delinquent Accounts and Water Usage Reporting 1800 number available for customers Quickwater Rural: bills water, wastewater and misc charges. Quickbooks cash transfer includes four hours of telephone/internet support	Meter Reading Accept payment on site Handle all late notices Resolve issues with resident's bill Review Report Turn water on and off	2 years
	eWaterbilling.com	Set-up Cost \$629.00 17 hrs x \$37(\$52.42/mo) (1st year only) \$2.00 per customer for any collection activity Electronic meter interface @ \$1,495. Add PDA for additional \$500			
None	Champion Utility Billing Services	Set-Up \$4.00 per Billing \$4.25 - (Postage pd by Resident) Activation Fee \$8.00 (New move-in Residents) Returned Chk Chg \$35.00 (Paid by resident)	<u>Water metered with manual reads for 100% capture</u> (Read, Bill and Remittance services) Complete web based services for managers Complete web based services for residents -Monthly preliminary & Final Reports -Resident on-line payment ability with daily updates -Monthly equipment exception reports (Showing zero and high reads)	The billing company will reconcile the difference in fees The residents will be billed for postage The Utility will resolve issues with residents bills, review reports, collect payments on site, update quickbooks when payments are received The Utility will pay for materials charge. The Utility will handle all late notices and water turn off and on.	2 yrs- may cancel w/cause up to 60 days
None	Champion Utility Billing Services	Set-Up \$4.00 per Billing \$3.75 - (Postage pd by Resident) Activation Fee \$8.00 (New move-in Residents)	<u>Water metered with manual reads for 100% capture</u> (Read, Bill and Remittance services) - Complete web based services for managers - Complete web based services for residents -Monthly preliminary & Final Reports -Resident on-line payment ability with daily updates -Monthly equipment exception reports (Showing zero and high reads) -Customer service 9:00a-5:00p (Mon-Fri)		

Finding 9

Subject: Purchase of Van

Audit Analysis: On April 1, 2009, the Utility purchased a vehicle from Keith Starkey. This vehicle was a 2003 Ford Econoline van. Purchase price was \$3,000.00. This vehicle has not previously been recorded on the books of the Utility.

Effect on the General Ledger: Increase plant in service by \$3,000 (Water - \$1,500; Wastewater - \$1,500). Record test year depreciation expense for water and wastewater at \$250 each. Increase Accumulated Depreciation (water, wastewater) by \$750.

Effect on the Filing: N/A

Finding 10

Subject: Condition of Books and Records

Audit Analysis:

As part of the audit of Heather Hill Estates Utilities, LLC, we examined the detail posted to the general ledger, trial balances, account set-up, account numbering, year end adjusting journal entries and supporting documentation of expenditures incurred and posted in the general ledger and cancelled checks.

We noted also that the Utility uses Quick Books for its bookkeeping program.

We observed numerous instances of items posted to incorrect accounts, items not being posted consistently to accounts, entries posted to redundant accounts, memo entries not coinciding with either the source documentation or the check memo notation. We also determined that the Utility was not posting the year-end adjusting (AJE) and reclassifying entries (RJE) prepared by its outside accountant. A second outside accountant who prepares the tax return was not aware that an accountant was making adjusting journal entries to the amounts recorded in the general ledger and therefore made different adjusting entries for tax purposes.

As a result, staff used source documents and cancelled checks to build account activity for the test period and then applied the entries posted in the general ledger to either verify, reclassify or correct entries posted in the general ledger. Additionally, the accountant's AJE and RJE's were evaluated to determine whether the correction or reclassification had already been adjusted by staff.

To ensure the accurate measure of test year activity, staff used the annual reports that are prepared by the outside accountant as per book amounts.

The Utility, with the help of a CPA, has begun the process of establishing correct book balances in its general ledger as of January 1, 2011, as well as fine-tuning accounts to be used and procedures to be followed.

Staff recommends that the Commission Order require the Utility to improve the integrity of its general ledger balances so that amounts can be verified at any point in time other than just at year-end.

Effect on the General Ledger: Presented for informational purposes.

Effect on the Filing: N/A

Finding 11

Subject: Management Fee

Audit Analysis:

Staff noted that the Utility is charged a management fee by the owners of the Utility. The current amount charged for the management fee is \$1,500 per month or \$18,000 annually.

We received a detail explanation of the responsibilities/duties of both of the owners, which is shown below.

The management fee covers the following items:

<u>Rick Stephens</u>	<u>Time Required</u>
- Works with contract labor hired for repairing water lines.	Daily - as needed
- Does meter shut-offs and turn-ons for resident plumbing repairs.	Daily – as needed
- In 2010 had added responsibility for overseeing valve and water meter replacement.	
- Oversees meter reader and assist when necessary.	Approx. 3 hrs Qtrly
- Places all notices, including late notices, concerning water and wastewater on customer premises.	Approx. 2 hrs Qtrly
- Responds to all customer questions/complaints/concerns for water/wastewater.	
- Does water testing. Transports samples to test lab.	Approx. 3 hours mo
- On call 7 days a week, 24 hours a day for any emergencies for 354 connections.	
 <u>Chris Stephens</u>	
-Handles all complaints by water/wastewater customers, by phone, in person, thru e-mail.	Daily – as needed
- Liaison between Utility and all regulatory agencies	As needed
- Performs all accounting/bookkeeping functions for the Utility.	Daily – as needed
- Prepares customer billing (using input from meter reading, mails out customer bills.	Approx 40 hrs Qtrly
- Receives payment of funds, prepares and makes deposits to bank.	Daily, as required
- Prepares late billing notices.	Approx 5 hrs Qtrly

Effect on the General Ledger: Presented for informational purposes only.

Effect on the Filing N/A

Finding 12

Subject: Plant Acquisition Adjustment

Audit Analysis:

In 2010, the Utility recorded a plant acquisition adjustment of \$99,587. The adjustment was made to record the financing of a note payable for the purchase of the utility system by its new owners. This amount was derived from the difference between the purchase price of the \$123,123 (AJE #12) and the net book value of the Utility's assets of \$23,536 (AJE #15) at December 31, 2008. Water net assets were \$23,147. Wastewater net assets were \$389.

Per Order No. PSC-10-0519-FOF-WS, which established rate base at no acquisition adjustment shall be made pursuant to Rule 25-30.0371.

F.A.C. 25-30.0371 Acquisition Adjustments.

(1) Definition. For the purpose of this rule, an acquisition adjustment is defined as the difference between the purchase price of system assets to an acquiring and the net book value of the assets. A positive acquisition adjustment exists when the purchase price is greater than the net book value. A negative acquisition adjustment exists when the purchase price is less than the net book value.

(2) Positive Acquisition Adjustments. A positive acquisition adjustment shall not be included in rate base absent proof of extraordinary circumstances. Any entity that believes a full or partial positive acquisition adjustment should be made has the burden to prove the existence of extraordinary circumstances. In determining whether extraordinary circumstances have been demonstrated, the Commission shall consider evidence provided to the Commission such as anticipated improvements in quality of service, anticipated improvements in compliance with regulatory mandates, anticipated rate reductions or rate stability over a long-term period, anticipated cost efficiencies, and whether the purchase was made as part of an arms-length transaction. Amortization of a positive acquisition adjustment shall be pursuant to paragraph (4)(a).

We did not include this line item for rate base purposes.

Effect on the General Ledger: Presented for informational purposes only.

Effect on the Filing N/A

Finding 13

Subject: Utility Expense not Recorded on Company Books

Audit Analysis: In March, 2009, the Utility purchased a 2003 Ford Econoline Van from Keith Starkey, the prior owner of the Utility. The van was not recorded on the books of the Utility. The purchase of the vehicle was \$3,000 which we allocated 50/50 between water and wastewater.

During 2010 the Utility incurred and recorded costs related to the vehicle for repairs, maintenance, tag and tires. However, we did not observe any vehicle liability insurance recorded for the vehicle.

The Utility provided us with a copy of the insurance premium for the policy period January 10, 2011, to January 10, 2012. The policy is in the name of the Utility owner. The policy includes coverage for the van. Total premium cost for the van is \$763.00

We have added the cost of vehicle to rate base effective 2009. We have also added the cost of insurance to test year expenses.

Effect on the General Ledger: Increases Insurance Expense by \$763.00

Effect on the Filing N/A

Exhibit 1

**Heather Hills Estates Utilities, LLC
Average Rate Base - Water
12 Months Ended December 31, 2010**

<u>Water</u>	Balance Per <u>Utility</u>	Staff Adjustments for Audit		Balance Per <u>Audit</u>
		<u>Dr</u>	<u>Cr</u>	
Utility Plant in Service	90,715		(20,857)	69,858
Land and Land Rights	389			389
Accumulated Depreciation	(45,989)	13,915		(32,074)
CIAC	(26,625)			(26,625)
Accumulated Amortization - CIAC	26,625			26,625
Plant Acquisition Adjustment	99,587		(99,587)	-
Working Capital Allowance			5,669	5,669
Water Rate Base	144,702	13,915	(114,775)	43,842

Exhibit 2

**Heather Hills Estates Utilities, LLC
Average Rate Base - Wastewater
12 Months Ended December 31, 2010**

<u>Wastewater</u>	Balance Per <u>Utility</u>	Staff Adjustments for Audit		Balance Per <u>Audit</u>
		<u>Dr</u>	<u>Cr</u>	
Utility Plant in Service	74,897	69		74,966
Land and Land Rights	389			389
Accumulated Depreciation	(72,836)	(1,382)		(74,218)
CIAC	-			-
Accumulated Amortization - CIAC	-			-
Plant Acquisition Adjustment	-			-
Working Capital Allowance			9,656	9,656
Wastewater Rate Base	2,450	(1,313)	9,656	10,793

Exhibit 3

**Heather Hills Estates Utilities, LLC
Net Operating Income - Water
12 Months Ended December 31, 2010**

	Test Year per Utility	Audit Adjustments	Audit Adjusted Test Year
Operating Revenues	<u>47,545</u>		<u>47,545</u>
Operating Expenses			
Operating and Maintenance	44,797	551	45,348
Depreciation	2,176	232	2,408
Amortization			-
Taxes Other Than Income	2,140		2,140
Income Taxes			-
Total Operating Expenses	<u>49,113</u>	<u>783</u>	<u>49,896</u>
Operating Income (Loss)	<u>(1,568)</u>	<u>783</u>	<u>(2,351)</u>
Rate Base	144,702		43,842
Rate of Return	-1.08%		-5.36%

Exhibit 4

**Heather Hills Estates Utilities, LLC
Net Operating Income - Wastewater
12 Months Ended December 31, 2010**

	Test Year per Utility	Audit Adjustments	Audit Adjusted Test Year
Operating Revenues	<u>71,929</u>		<u>71,929</u>
Operating Expenses			-
Operating and Maintenance	73,803	3,442	77,245
Depreciation	198	79	277
Amortization			-
Taxes Other Than Income	3,237	-	3,237
Income Taxes			-
Total Operating Expenses	<u>77,238</u>	<u>3,521</u>	<u>80,759</u>
Operating Income (Loss)	<u>(5,309)</u>	<u>3,521</u>	<u>(8,830)</u>
Rate Base	2,450		(10,793)
Rate of Return	-216.69%		81.81%

Exhibit 5

**Heather Hills Estates Utilities, Inc
Average Capital Structure
12 Months Ended December 31, 2010**

	<u>Average Capital Structure</u>	<u>Audit Adjusted Average Capital Structure</u>	<u>Ratio</u>	<u>Avg Capital Structure Reconciled to Avg Rate Base</u>	<u>Cost Rate</u>
Proprietary Capital	9,695	-		-	10.85% (a)
Notes Payable - Starkey	(57,632)	(57,632)	100.00%	54,634	3.52%
	<u>(47,937)</u>			<u>54,634</u>	

(a) Per Order PSC-10-041-PAA-WS