

State of Florida



Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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

DATE: February 3, 2020

TO: Office of Commission Clerk

FROM: Lynn M. Deamer, Chief of Auditing, Office of Auditing and Performance Analysis

RE: Docket No.: 20190166-WS
Company Name: HC Waterworks, Inc.
Company Code: WS968
Audit Purpose: A1f: File & Suspend Rate Case (PAA)
Audit Control No.: 2019-329-1-1

Attached is the final audit report for the Utility stated above. I am sending the Utility a copy of this memo and the audit report. If the Utility desires to file a response to the audit report, it should send a response to the Office of Commission Clerk. There are no confidential work papers associated with this audit.

LMD/cmm

Attachment: Audit Report

cc: Office of Auditing and Performance Analysis File.

State of Florida



Public Service Commission

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

Auditor's Report

HC Waterworks, Inc.
Rate Case (PAA)

Twelve Months Ended June 30, 2019

Docket No. 20190166-WS
Audit Control No. 2019-329-1-1
January 28, 2020


Thomas Wolff
Audit Manager



Marisa N. Glover
Reviewer

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Purpose

To: Florida Public Service Commission

We have performed the procedures described later in this report to meet the objectives set forth by the Division of Accounting and Finance in its audit service request dated November 25, 2019. We have applied these procedures to the attached schedules prepared by HC Waterworks, Inc. in support of its filing for rate relief in Docket No. 20190166-WS.

The report is intended only for internal Commission use.

Objectives and Procedures

General

Definitions

Utility refers to HC Waterworks, Inc.

Test year refers to the twelve months ended June 30, 2019.

NARUC refers to the National Association of Regulatory Utility Commissioners.

USOA refers to the NARUC Uniform System of Accounts as adopted by Rule 25-30.115 – Uniform Systems of Accounts for Water and Wastewater Utilities, Florida Administrative Code (F.A.C.)

Background

HC Waterworks is a Class B utility serving approximately 940 water customers and 296 wastewater customers in Highlands County. Rate base was last established as of June 30, 2014 for the Utility by Order No. PSC-2015-0282-PAA-WU, issued July 8, 2015, in Docket No. 20140158-WS. Rate base was audited from June 30, 2014 through June 30, 2019. Audit staff used the original MFRs filed with the Commission on October 15, 2019.

Audit staff was asked to audit the Utility's water rate base, capital structure, and net income for the test year ended June 30, 2019.

Rate Base

Utility Plant in Service

Objectives: The objectives were to determine whether utility plant in service (UPIS): 1) Consists of property that exists and is owned by the Utility, 2) Additions are authentic, recorded at original cost, and properly classified as a capital item in compliance with Commission rules and the NARUC USOA, 3) Retirements are made when a replacement item is put into service, and 4) Adjustments required in the Utility's last rate case proceeding were recorded in its books and records.

Procedures: We reconciled the UPIS accounts in the filing to the general ledger. We determined the beginning balance for each account that was established by Order No. PSC-2015-0282-PAA-WU. We verified that the Commission ordered adjustments in the prior order were posted to the general ledger. We scheduled utility additions and retirements since rate base was last established to determine the UPIS balance as of June 30, 2019. We traced additions and retirements to source documents and verified that additions were recorded at original cost and that retirements were properly posted. We determined the year end and simple average balance as of June 30, 2019. Our recommended adjustments to water plant in service are discussed in Finding 1.

Land & Land Rights

Objectives: The objectives were to determine whether utility land is recorded at original cost, is used for utility operation, and is owned or secured under a long-term lease.

Procedures: We determined the beginning balance for each account that was established by Order No. PSC-2015-0282-PAA-WU. We determined the land balance as of June 30, 2019. We searched the property records of the County Clerk's Office in Highlands County, Florida for utility related activity. We inquired whether the utility had any changes in land or land use. We noted that there were no changes to land since rate base was last established.

Contributions in Aid of Construction

Objectives: The objectives were to determine whether utility contributions in aid of construction (CIAC) balances are properly stated, are reflective of the service availability charges authorized in the Utility's Commission approved tariffs, and the adjustments required in the Utility's last rate proceeding were recorded in its books and records.

Procedures: We reconciled the CIAC accounts presented in the filing to the general ledger. We determined the beginning balance for each account that was established by Order No. PSC-2015-0282-PAA-WU. We verified that the Commission ordered adjustments in the prior order were posted to the general ledger. We scheduled utility additions and retirements since rate base was last established to determine the CIAC balances as of June 30, 2019. We traced the additions and retirements to source documents and traced the service availability charges to the Utility's approved tariffs. We reviewed CIAC agreements, and inquired about new special agreements, developer agreements, and donated property. We recalculated the simple average balance for the filing. No exceptions were noted.

Accumulated Depreciation

Objectives: The objectives were to determine whether: 1) Accruals to accumulated depreciation are properly recorded in compliance with Commission rules and the NARUC USOA, 2) Depreciation accruals are calculated using the Commission's authorized rates and that retirements are properly recorded, and 3) Adjustments required in the Utility's last rate case proceeding were recorded in its books and records.

Procedures: We reconciled the accumulated depreciation accounts presented in the filing to the general ledger. We determined the beginning balance for each account that was established in Order No. PSC-2015-0282-PAA-WU. We verified that the Commission ordered adjustments in the prior order were posted to the general ledger. We scheduled utility accruals and retirements since the last rate proceeding to determine the accumulated depreciation balance as of June 30, 2019. We calculated accumulated depreciation accruals using the rates authorized in Rule 25-30.140 – Depreciation, Florida Administrative Code (F.A.C.) and compared our balance to the balances in the general ledger and the filing. We recalculated the simple average balance for the filing. Our recommended adjustments to water accumulated depreciation are discussed in Finding 1.

Accumulated Amortization of CIAC

Objectives: The objectives were to determine whether accumulated amortization of CIAC balances were properly stated, that annual accruals were reflective of the depreciation rates and were in compliance with Commission rules and orders, and that the adjustments required in the Utility's last rate case proceeding were recorded in its books and records.

Procedures: We reconciled the accumulated amortization of CIAC accounts presented in the filing to the general ledger. We determined the beginning balance for each account that was established by Order No. PSC-2015-0282-PAA-WU. We verified whether the Utility included the Commission adjustments from the order. We calculated accumulated amortization of CIAC accruals using the rates authorized in Rule 25-30.140, F.A.C. We scheduled the accruals since rate base was last established to determine the accumulated amortization of CIAC balances as of June 30, 2019. We recalculated the simple average balance for the filing. No exceptions were noted.

Working Capital

Objectives: The objective was to determine whether the Utility's working capital balance is properly calculated in compliance with Commission rules.

Procedures: We verified the Utility's calculation of working capital as of June 30, 2019 using one-eighth of operation and maintenance (O&M) expense as required by Commission Rule 30.433(2), F.A.C. No exceptions were noted.

Capital Structure

Objectives: The objectives were to determine whether the components of the Utility's capital structure and the respective cost rates used to arrive at the overall weighted cost of capital were properly recorded in compliance with Commission rules and that it accurately represented the ongoing utility operations.

Procedures: Audit staff reconciled the components of the Utility's capital structure presented in the filing to the general ledger. We obtained a reconciliation of the adjustments to the capital structure and traced these to the MFRs and the general ledger. No exceptions were noted.

Net Operating Income

Operating Revenue

Objectives: The objectives were to determine whether: 1) Utility charges were those approved by the Commission in the Utility's current authorized tariff for both water and wastewater, and 2) Revenue earned from utility property during the test year was recorded and properly classified in compliance with Commission rules and the NARUC USOA.

Procedures: We reconciled the water revenue accounts presented in the billing register to the general ledger. We reviewed all customer accounts from the billing register for proper customer classification, use of approved tariffs, and miscellaneous service charges. We verified the Utility's revenue by multiplying the average consumption by the tariff rate for each customer

class in the billing register. We reconciled gallons sold and customer bill counts presented in the filing to the billing register. We reconciled the MFR schedule E-2 to the billing register and determined that the E-2 schedule used an incorrect tariff rate for residential class using ¾” meters. Technical staff needs to ensure the Utility provide staff with a corrected E-2 schedule for ratemaking purposes. No further work performed.

Operation and Maintenance Expense

Objectives: The objectives were to determine whether operation and maintenance (O&M) expenses were properly recorded in compliance with Commission rules, and were reasonable and prudent for ongoing utility operations.

Procedures: We reconciled the O&M expense accounts presented in the filing to the general ledger. We reviewed all of the O&M expense invoices for proper amount, period, classification, recurring nature, and whether the expense was utility related during the test year. No exceptions were noted.

Depreciation and Amortization

Objectives: The objective was to determine whether depreciation and amortization was properly recorded in compliance with Commission rules and that it accurately represented the depreciation of UPIS assets and the amortization of utility CIAC assets for ongoing utility operations.

Procedures: We reconciled the depreciation and amortization expense accounts presented in the filing to the general ledger. We calculated depreciation and amortization expense for the test year using the rates prescribed in Rule 25-30.140, F.A.C. and compared our amounts to the amounts reflected in the filing. Our recommended adjustments to water depreciation and amortization expense are discussed in Findings 1.

Taxes Other than Income

Objectives: The objective was to determine the appropriate amounts for taxes other than income tax (TOTI) for the test year ended June 30, 2019.

Procedures: We reconciled the components of the TOTI tax expense accounts presented in the filing to the general ledger. We recalculated regulatory assessment fees (RAF) based on audited revenues. We traced real estate and tangible property taxes to source documents, and verified that these taxes included the maximum discount and are only for utility property. No exceptions were noted.

Audit Findings

Finding 1: Utility Plant in Service- Water

Audit Analysis: In the MFR Schedules A-5 and A-1 filed with the Commission on October 15, 2019, the Utility had balance of \$4,902,306 and simple average balance of \$4,654,511 as of June 30, 2019. Audit staff traced all plant additions and retirements to its source documentation, and noted the Commission Ordered adjustments established by Order No. PSC-2015-0282-PAA-WS have not been recorded correctly as shown in Table 1-1.

Table 1-1

Water		Date in	FPSC	Years in	AD	Years in	AD	AD	Current	
Account	Description	Service	Cost	Rule Rate	Service	6/30/2018	Service	6/30/2019	Simple Avg	Depreciation Expense
301 Organization	Transfer balance recorded in wrong acct	3/28/2013	(298)	0.0250	5.3	(39)	6.3	(47)	(43)	(7)
302 Franchises	Transfer balance recorded in correct acct	3/28/2013	298	0.0250	5.3	39	6.3	47	43	7
307 Wells & Springs	proforma adjustment	1/29/2015	(6,527)	0.0333	3.4	(744)	4.4	(961)	(853)	(218)
310 Power Generation Equip.	proforma adjustment	1/29/2015	(856)	0.0500	3.4	(146)	4.4	(189)	(168)	(43)
		Totals	\$ (7,383)			\$ (890)		\$ (1,151)	\$ (1,020)	\$ (260)

The following adjustments were determined by audit staff:

1. Account 301 Organization- We decreased by \$298 according to the Commission Order adjustment in Order PSC-2015-0282-PAA-WS.
2. Account 302 Franchises- We increased by \$298 according to the Commission Order adjustment in Order PSC-2015-0282-PAA-WS.
3. Account 307 Wells & Springs- We decreased by \$6,527 according to the Commission Order adjustment in Order PSC-2015-0282-PAA-WS. This is related to a proforma adjustment invoice in the amount of \$8,703 x .75% retirement rate with a difference of \$6,527.
4. Account 310 Power Generation Equipment- We decreased by \$856 according to the Commission Order adjustment in Order PSC-2015-0282-PAA-WS. This is related to proforma adjustment invoice in the amount of \$1,140 x.75% retirement rate with a difference of \$855.

Effect on the General Ledger: The Utility should determine the effect on the general ledger.

Effect on the Filing: The Account 101 – Water Plant in Service simple average balance should be decreased by \$7,383, Account 108 – Water Accumulated Depreciation simple average balance should be decreased by \$1,020, and Account 403 – Water Depreciation Expense should be decreased by \$260.

Exhibits

Exhibit 1: Rate Base

Schedule of Water Rate Base

Florida Public Service Commission

HC Waterworks, Inc.
Docket No. 20190166-WS
Historical Test Year Ending June 30, 2019
Historical & Pro Forma

Schedule: A-1
Page: 1 of 1
Preparer: W T Rendell

Explanation: Provide the calculation of the average Water rate base for the test year, showing all adjustments. All non-used and useful items should be reported as Plant Held For Future Use.

Line No.	Description	(1)	Historical Test Year		(4)	(5)
			Average Balance Per Books	Adjustments	Adjusted Average Balance	Supporting Schedules
1	Utility Plant In Service		4,654,511	525,970	5,180,481	A-5
2	Utility Land & Land Rights		25,450	0	25,450	A-5
3	Less: Non-Used & Useful Components		0	(107,752)	(107,752)	A-7
4	Construction Work in Progress		0	0	0	
5	Less: Accumulated Depreciation		(1,358,277)	(11,449)	(1,369,726)	A-9
6	Less: CIAC		(904,320)	0	(904,320)	A-12
7	Accumulated Amortization of CIAC		623,602	0	623,602	A-14
8	Acquisition Adjustments		(809,041)	0	(809,041)	
9	Less: Accum. Amort. of Acq. Adjustments		334,500	0	334,500	
10	Less: Advances For Construction		0	0	0	A-16
11	Working Capital Allowance		0	48,299	48,299	A-17
12	Total Rate Base		2,568,425	455,067	3,021,492	

Exhibit 2: Capital Structure

Schedule of Water Net Operating Income

Florida Public Service Commission

HC Waterworks, Inc.
 Docket No. 20190166-WS
 Historical Test Year Ending June 30, 2019
 Historical & Pro Forma

Schedule: B-1
 Page: 1 of 1
 Preparer: WT Rendell

Explanation: Provide the calculation of net operating income for the test year. If amortization (Line 4) is related to any amount other than an acquisition adjustment, submit an additional schedule showing a description and calculation of charge.

Line No.	(1) Description	(2) Per Books Test Year	(3) Utility Test Year Adjustment	(4) Adjusted Test Year	(5) Requested Revenue Adjustment	(6) Requested Annual Revenues	(7) Supporting Schedules
1	OPERATING REVENUES	574,165	(4,454)	569,711	175,171	744,882	B-4, E-2
2	Operation & Maintenance	376,618	9,770	386,388	3,432	389,820	B-5, B-3
3	Depreciation, net of CIAC Amort., U&U	129,717	4,835	134,552	0	134,552	B-13, B-3
4	Amortization	(74,935)	0	(74,935)	0	(74,935)	B-3
5	Taxes Other Than Income	55,559	8,810	64,369	7,883	72,252	B-15, B-3
6	Provision for Income Taxes	0	0	0	0	0	C-1, B-3
7	OPERATING EXPENSES	488,959	23,415	510,374	11,314	521,688	
8	NET OPERATING INCOME	87,206	(27,869)	59,336	163,857	223,193	
9	RATE BASE	2,566,425	455,067	3,021,492		3,021,492	A-1
10	RATE OF RETURN	3.40%		1.96%		7.39%	

Exhibit 3: Net Operating Income

Schedule of Requested Cost of Capital
 13 Month Average balance
 HC Waterworks, Inc.
 Docket No. 20190186-WS
 Historical Test Year Ending June 30, 2019
 Historical [X] Projected []

Florida Public Service Commission

Schedule: D-1
 Page: 1 of 2
 Preparer: W T Rendell

Explanation: Provide a schedule which calculates the requested Cost of Capital on a 13-month average basis.
 If a year-end basis is used submit an additional schedule reflecting year-end calculations.

Line No.	(1) Class of Capital	(2) Reconciled To Test Yr Rate Base	(3) Ratio	(4) Cost Rate	(5) Weighted Cost Rate	(6) Cost	(7) Supporting Schedules
COMPOSITE WATER & SEWER							
1	Long-Term Debt	1,500,127	49.65%	5.25%	2.61%		D-2, D-5
2	Short-Term Debt	0	0.00%	0.00%	0.00%		D-2
3	Preferred Stock	0	0.00%	0.00%	0.00%		D-2
4	Common Equity	1,487,414	49.23%	9.67%	4.76%		D-2
5	Customer Deposits	33,951	1.12%	2.00%	0.02%		D-2
6	Accumulated Deferred Income Taxes	0	0.00%	0.00%	0.00%		D-2
7							
8	Total	<u>3,021,492</u>	<u>100.00%</u>		<u>7.39%</u>		