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# Public Service Commission

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

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**DATE:** April 8, 2009  
**TO:** John E. Mann, Professional Accountant Specialist, Division of Regulatory Compliance  
**FROM:** Denise N. Vandiver, Chief of Auditing, Division of Regulatory Compliance *a*  
**RE:** Docket No: 080597-WU; Company Name: Southlake Utilities;  
Audit Purpose: Rate Case; Company Code: WS638;  
Audit Control No: 09-021-2-1;

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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 the Commission Clerk. There are confidential work papers associated with this audit.

DNV/tbm

Attachment: Audit Report

CC: Division of Regulatory Compliance (Salak, Mailhot, Harvey,  
District Offices, File Folder)  
Office of Commission Clerk (2)  
General Counsel  
Office of Public Counsel

Mr. William J. Deas  
Southlake Utilities, Inc.  
2215 River Boulevard  
Jacksonville, FL 32204-4647

Mr. James L. Ade  
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**FLORIDA PUBLIC SERVICE COMMISSION**

*DIVISION OF REGULATORY COMPLIANCE  
BUREAU OF AUDITING*

*TAMPA DISTRICT OFFICE*

**SOUTHLAKE UTILITIES, INC**

**FILE AND SUSPEND RATE CASE AUDIT**

**HISTORICAL YEAR ENDED DECEMBER 31, 2008**

**DOCKET NO. 080597-WS**

**AUDIT CONTROL NO. 09-021-2-1**

*Ron Mavrides*  
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DOCUMENT NUMBER-DATE

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**DIVISION OF REGULATORY COMPLIANCE  
AUDITOR'S REPORT**

**MARCH 20, 2009**

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

We have performed the procedures enumerated later in this report to meet the agreed upon objectives set forth by the Division of Regulatory Compliance in its audit service request dated January 20, 2009. We have applied these procedures to the attached schedules prepared by Southlake Utilities Inc. in support of its filing for rate relief in Docket No. 080597-WS.

This audit was performed following general standards and field work standards found in the AICPA Statements on Standards for Attestation Engagements. This report is based on agreed upon procedures and therefore is intended only for internal Commission use.

## OBJECTIVES AND PROCEDURES

### RATE BASE

#### General

*Objective:* To determine that the utility's filing represents its recorded results from continuing operations.

*Procedures:* For this rate case proceeding, the historical test period prescribed by the audit services request was the 12-month period ending December 31, 2008. In the utility's filing, amounts for this time period were projected. For audit purposes, the staff used the actual general ledger amounts subject to audit adjustments. Staff then prepared adjustments for any differences between the projected amounts in the filing and general ledger audited amounts. All rate base items will be addressed by: an analysis of company adjustments used to derive projected amounts recorded in the Minimum Filing Requirements (filing); preparation of audit adjustments to the general ledger balances; and, a comparison of the differences between the projected filing and staff calculated amounts.

#### Utility-Plant-in-Service (UPIS)

*Objective:* To determine that property exists, is being used in utility operations and is owned by the utility. To determine that additions to UPIS are authentic, recorded at original cost, and properly classified in compliance with Commission rules and the NARUC Uniform System of Accounts. To verify that the proper retirements of UPIS were made when a replacement item was put in service. To determine that encumbrances and liens on utility plant assets are identified and adequately disclosed.

*Procedures:* For the calendar years 1999 through 2002, we selected and tested direct charges to plant accounts. For the years, 2003 through 2008, we determined that the majority of plant additions were transfers from Construction Work in Progress (CWIP) and Contributions in Aid of Construction (CIAC). As a result, all additions to plant subsequent to 2002 were tested in the CWIP accounts. For plant testing, we selected additions greater than \$75,000. This resulted in the testing of 87% of water plant additions and 95% of wastewater plant additions. We verified that the utility properly recorded retirements to UPIS when a capital item was removed or replaced. We toured the utility plant sites to observe whether selected plant additions were in existence. We requested supporting documentation for selected construction project additions. Audit Finding No. 3 provides information on CWIP additions on which the staff made adjustments. Audit Finding No. 1 provides information on plant additions on which the staff made adjustments. Adjustments were the result of reclassifications to expense, duplicate amounts recorded in the general ledger, transfers to/from water and wastewater, and adequate supporting documentation not being provided by the utility. We compared projected balances for plant in service to balances calculated by staff from the audit analysis.

#### Land and Land Rights

*Objective:* To determine that land is recorded at original cost, is being used in utility operations and is owned by the utility or that the utility has a long-term written agreement for use of the land.

*Procedures:* Verified that the company entered into a capital lease with Southlake Development, Ltd. for the utility land. Verified that the company has not adjusted the book value of land to the amount required by Commission Order No. PSC-00-0917-SC-WS. Noted that the utility removed the capital lease obligation and the cost of land from the general ledger in September 2008. Audit Finding No. 2 provides information on the land balances.

#### Contributions-in-Aid-of-Construction (CIAC)

*Objective:* To determine that additions to CIAC are properly stated and are reflective of service availability charges authorized in the utility's approved Commission tariff. To verify that all donated property is properly accounted for and recorded as CIAC and UPIS.

*Procedures:* We began the analysis of CIAC using the ending balances recorded in the prior audit workpapers which were established by Commission Order No. PSC-00-0917-SC-WS, Dockets 981609-WS and 980992-WS. We traced cash contributions from a company prepared Contract Summary schedule for the years 2002 through 2008 to the general ledger. We reviewed the developer agreements and traced amounts from the agreements to the Summary schedule. The company could not provide documentation for the years 1999-2001. However, a review of the general ledger entries for CIAC specifies developer names and amounts. We also verified plant contributions in 2000 and agreed amounts to those recorded in the plant in service accounts. We determined that cash contributions were billed and recorded in compliance with authorized tariff rates. We toured the utility's authorized service territory for evidence of new developments. We compared projected balances for CIAC to balances calculated by staff from the audit analysis. Audit Finding No. 4 provides information on the CIAC balances.

#### Accumulated Depreciation

*Objective:* To determine that the company's accumulated depreciation balances are properly stated and are in compliance with Commission Rules and the NARUC Uniform System of Accounts. To verify that annual accruals are calculated using Commission authorized depreciation rates and that retirements are properly computed.

*Procedures:* We requested that the company provide its schedules for the calculation of depreciation expense and accumulated depreciation for the years 1999 through 2008. Company provided water and wastewater plant schedules for the years 2002-2008. We reviewed the company's calculation of accumulated depreciation and determined that it used the prescribed rates in Commission Rule 25-30.140, F.A.C. We recalculated accumulated depreciation for selected months. We adjusted accumulated depreciation for plant adjustments made by audit staff. We compared projected balances for accumulated depreciation to balances calculated by staff from the audit analysis.

#### Accumulated Amortization of CIAC

*Objective:* To determine that accruals to accumulated amortization of CIAC are properly recorded in compliance with Commission Rules and the NARUC Uniform System of Accounts. To verify that CIAC amortization expense accruals are properly recorded and calculated based on the rates and method used in the utility's last rate proceeding.

*Procedures:* As the beginning balances of accumulated amortization, we used the ending balances recorded in the prior audit workpapers which were adopted in Commission Order No. PSC-00-0917-SC-WS, Dockets 981609-WS and 980992-WS. For the years 1999 through

2001, we calculated annual amortization using average CIAC balances multiplied by the composite depreciation rate. For the years 2002 through 2008, we calculated annual amortization using the same rate that the related contributed plant is depreciated. We compared the general ledger balances to the staff's calculation for amortization of CIAC and we also compared projected balances for accumulated amortization of CIAC from the filing to balances calculated by staff.

#### Working Capital

*Objectives:* To determine that the utility's working capital balance is properly calculated in compliance with Commission Rule 25-30.433(2), Florida Administrative Code.

*Procedures:* We calculated the utility's working capital balance as of December 31, 2008 using one-eighth of O&M expense as required by Commission Rule.

### **NET OPERATING INCOME**

#### General

*Objective:* To determine that the utility's filing represents its results from continuing operations.

*Procedures:* We reconciled the following individual component net operating income balances to the utility's general ledger for the 12-month period ended December 31, 2008.

#### Revenues

*Objective:* To determine that revenues are properly recorded in compliance with Commission rules and are based on the utility's Commission approved tariff rates.

*Procedures:* We scanned the billing registers during the test year for unusual entries and tested customer bills. We traced revenues from the Regulatory Assessment Fee Form to revenues per the general ledger. Performed a reasonableness check on revenues recorded in the general ledger compared to revenues billed to customers. Prepared an adjustment for the difference between the adjusted general ledger balance and the utility filing. Audit Finding No. 5 discusses our findings and recommended balance for Revenues for the 12-month period ended December 31, 2008.

#### Operation and Maintenance Expenses (O&M)

*Objective:* To determine that operation and maintenance expenses are properly recorded in compliance with Commission rules and were reasonable and prudent for ongoing utility operations.

*Procedures:* We analyzed selected O&M expense accounts. We reviewed a sample of invoices for proper amount, period, classification, NARUC account and recurring nature. We prepared an adjustment for differences between the filing and the utility general ledger. Audit Finding No. 6 discusses our findings and recommended balance for O&M expenses for the 12-month period ended December 31, 2008.

### Taxes Other Than Income (TOTI)

*Objective:* To determine that taxes other than income tax expense is properly recorded in compliance with Commission rules and was reasonable and prudent for ongoing utility operations.

*Procedures:* We performed an analysis of TOTI as recorded in the general ledger for the 12-month period ending December 31, 2008. We reviewed the calculations of payroll tax, property tax and regulatory assessment fee for proper amount, period, classification, NARUC account and recurring nature. We prepared an adjustment for differences between the projected balance in the filing and the audit adjusted balance from the general ledger. Finding No. 7 discusses our findings and recommended balance for Taxes Other than Income for the 12-month period ended December 31, 2008.

### Depreciation Expense

*Objective:* To determine that depreciation expense is properly recorded in compliance with Commission rules and that it accurately represents the depreciation of UPIS assets and amortization of CIAC assets for ongoing utility operations.

*Procedures:* We recalculated depreciation expense and CIAC amortization expense using audit adjusted balances for plant and CIAC and applying Commission approved rates and composite depreciation rates respectively.

## **CAPITAL STRUCTURE**

### General

*Objective:* To determine the components of the utility's capital structure and the respective cost rates used to arrive at the overall weighted cost of capital are properly recorded in compliance with Commission rules and that they accurately represent the ongoing utility operations.

*Procedures:* We verified the amounts included in the capital structure for equity accounts and for customer deposits. There were no other sources of capital.



**AUDIT FINDING NO. 1**

**SUBJECT: PLANT IN SERVICE (UPIS)**

**AUDIT ANALYSIS:**

We performed an analysis of UPIS for the calendar years 1999 through 2008. In the analysis we determined that plant additions for 1999 through 2002 were the result of direct charges made to plant accounts. For the years 2003 through 2008, the majority of the plant additions were the result of transfers from Construction Work in Progress (CWIP) and Contributions in Aid of Construction (CIAC). (See Audit Finding No. 3 for a more detailed discussion).

For the analysis of water plant additions, we selected calendar years 2000 and 2002. For the analysis of wastewater plant additions, we selected calendar years 2000, 2001 and 2002.

We determined that for 2000 95% of water plant additions were the result of contributions. For 2002 we selected 78% of water plant additions for further analysis. We noted that the company recorded entries for water plant - Structures and Improvements of \$142,789. The offsetting journal entry was for Paid in Capital. The company did not provide supporting documentation for this plant. We recommend an adjustment to remove this amount and the related accumulated depreciation.

For wastewater plant additions in 2000 we determined that 98% of additions were the result of contributions. For 2001 and 2002 we selected 78% and 96% of additions, respectively, for further analysis. We noted that for 2002 the company recorded entries for wastewater plant - Structures and Improvements of \$176,812. The offsetting entries were for Paid in Capital of \$142,789 (General Journal), Cash of \$25,720 (Cash Disbursement Journal) and Cash of \$8,302 (Purchase Journal). The company did not provide supporting documentation for this plant. We recommend an adjustment to remove this amount and the related accumulated depreciation.

We calculated depreciation associated for these plant items, using the 3.13% depreciation rate and methodology used by the company in the depreciation schedule provided to staff.

**EFFECT UPON GENERAL LEDGER:**

Dr	Paid in Capital	\$ 319,601	
Dr	Accumulated Depreciation-Water	29,050	
Dr	Accumulated Depreciation-Wastewater	35,972	
Dr	Net Operating Income	10,003	
	Cr	Plant In Service-Water	\$142,789
	Cr	Plant in Service-Wastewater	176,812
	Cr	Depreciation Expense	10,003
	Cr	Retained Earning	65,022

**EFFECT UPON FILING:**

Dr	Paid in Capital	\$ 319,601
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Dr	Accumulated Depreciation-Water	29,050	
Dr	Accumulated Depreciation-Wastewater	35,972	
Dr	Net Operating Income	10,003	
	Cr	Plant In Service-Water	\$142,789
	Cr	Plant in Service-Wastewater	176,812
	Cr	Depreciation Expense	10,003
	Cr	Retained Earning	65,022

**AUDIT FINDING NO. 2**

**SUBJECT: LAND**

**AUDIT ANALYSIS:**

In Commission Order No. PSC-00-0917-SC-WS, the Commission determined that Southlake Utilities, Inc (utility) and Southlake Development, Ltd entered into a capital lease on December 23, 1998. This lease pertained to 10 acres of land to be used for the wastewater treatment plant; 2.528 acres for the water treatment plant; and .0023 acres for "Well A". The cost of land recorded on the utility's books at December 31, 1998, was \$1,003,224. (\$201,083 – Water; \$802,141 – wastewater). Documentation provided by the utility showed that the above amounts were calculated as follows:

		<u>Water</u>	<u>Wastewater</u>	<u>Total</u>
1996 Land Addition	1996	\$ 11,411	\$ 11,411	\$ 22,822
Cost of Lease	1998	153,608	607,147	760,755
Bargain Purchase Option	1998	29,278	115,722	145,000
Legal Services & Overheads	1998	6,786	67,861	74,647
Cost on Books	12/31/1998	<u>\$ 201,083</u>	<u>\$ 802,141</u>	<u>\$ 1,003,224</u>
FPSC Adjustments		<u>(105,183)</u>	<u>(502,141)</u>	<u>(607,324)</u>
Commission Approved Bal		<u>\$ 95,900</u>	<u>\$ 300,000</u>	<u>\$ 395,900</u>

Commission Order No. PSC-00-0917-SC-WS ordered adjustments to reduce the cost of Land to \$95,900 (Water) and \$300,000 (Wastewater). The Commission's adjustment was based upon staff's calculation of land value in 1990 when it was first devoted for public utility use.

The utility has made subsequent adjustments to the cost of land, but has not reduced costs to the level ordered by the Commission. The company adjustments are listed below.

	<u>Date</u>	<u>Water</u>	<u>Wastewater</u>
Per Utility G/L	Dec-98	\$ 201,083	\$ 802,141
Revalue Land Per Appraisal (Ref GA-T, GENJ)	Dec-00	<u>(44,975)</u>	<u>(294,280)</u>
	12/31/2000	156,108	507,861
Land Sale	7/30/2004	(22,822) (a)	
Land Addition	12/31/2005		50,585
Per Utility Filing	12/31/2007	<u>\$ 133,286</u>	<u>\$ 558,446</u>

(a) In 2004, the utility sold land with a book value of \$22,822. The land was originally recorded on the books of the utility in 1996. The land was sold for \$140,000 to Mr. Charles Hwang. The analyst should consider whether this gain on sale of land should be amortized over future periods.

Because the value of land for water and wastewater do not conform to the balances established by the Commission order, the audit staff has prepared the following adjustment.

	<u>Date</u>	<u>Water</u>	<u>Wastewater</u>
Per Order	12/31/1998	95,900	300,000
Land Sale - 2004		(22,822)	
Order Value after Sale		73,078	300,000
Additions - 2005			50,585
Per Books	12/31/2007	(133,286)	(558,446)
Staff Adjustment	12/31/2008	(60,208)	(207,861)

Also, during the analysis of land, staff noted that the utility removed all costs of land as well as the land lease obligation from its general ledger by a general journal entry made at September 30, 2008.

Lastly, the utility consultant, John Guastella, stated that Southlake Development Ltd will be transferring ownership of land to the utility. This entry will be included in the year-end adjusting journal entries for the 12-month period ending December 31, 2008. Per the utility accountant, the year-end adjusting journal will be prepared as of April 30, 2009.

**EFFECT UPON GENERAL LEDGER:**

Dr	A/C 01101303 Land (Water)	\$ 133,286	
Dr	A/C 01414 (Gain-Water))	12,398	
Dr	A/C 02101353	558,446	
Dr	A/C 02414 (Gain-Wastewater)	51,939	
Cr	A/C 224.04 Land Lease Obligation		\$756,069

(To reverse Journal Entry removing the cost of Land from the General Ledger at 9/2008)

Dr	Retained Earning	\$ 268,069	
Cr	A/C 01101303 Land (Water)		\$ 60,208
Cr	A/C 02101353 Land (Wastewater)		207,861

(To adjust the value of Land as determined by Commission Order PSC-00-0917-SC-WS)

**EFFECT UPON FILING:**

Dr	Retained Earning	\$ 268,069	
Cr	A/C 01101303 Land (Water)		\$ 60,208
Cr	A/C 02101353 Land (Wastewater)		207,861

(To adjust the value of Land as determined by Commission Order PSC-00-0917-SC-WS)

**AUDIT FINDING NO. 3**

**SUBJECT: CONSTRUCTION WORK IN PROGRESS (CWIP)**

**AUDIT ANALYSIS:**

Because the majority of plant additions posted in the general ledger Plant in Service accounts are transferred from Construction Work In Progress (CWIP), staff performed an analysis of CWIP. The analysis consisted of: compiling all activity in each CWIP account for water subsequent to December 31, 1997 and wastewater subsequent to December 31, 1995 (population); selecting lines items from this population that exceeded a selected threshold (sample); requesting documentation which supports the selected line items; and determining that the documentation received is adequate and supports the sample items.

Rule 25-30.110(1) (a), F.A.C. states "Each utility shall preserve its records in accordance with the 'Regulations to Govern the Preservation of Records of Electric, Gas and Water Utilities' as issued by the National Association of Regulatory Utility Commissions, as revised May 1985." According to the above "Regulations..." -- General Instructions J: "...records related to plant shall be retained a minimum of 25 years unless accounting adjustments resulting from reclassification and original cost studies have been approved by the regulatory Commission having jurisdiction and either continuing plant inventory records are maintained or unitization of construction costs appear in work orders except that records related to the construction of licensed projects, or additions or betterments thereto, for which the Commission has not determined the actual legitimate original cost shall be retained until such cost has been determined and records affecting the determination of amortization reserves related to licensed projects shall be retained until Commission determination and final adjudication is made."

Also, according to PSC Order No. PSC-00-0917-SC-WS, "...Without invoices supporting these checks, we are unable to determine whether these checks are for utility or non-utility related costs. It is the utility's burden to prove that its costs are reasonable."

Total dollars analyzed and tested for water and wastewater were \$5,550,619 and \$3,346,265, respectively. Staff is proposing an adjustment for water totaling (\$232,451) and an adjustment for sewer totaling (\$340,334). Detail of the adjustments is listed below:

	<u>Water</u>	<u>Wastewater</u>
Insufficient or no documentation	\$ (173,557)	\$ (102,466)
Transfer from water to wastewater	(50,048)	\$ 50,048
Transfer from wastewater to water	222,868	(222,868)
Items to be Expensed	(8,847)	
Duplicate Amount		(15,000)
Total	<u>\$ (9,583)</u>	<u>\$ (290,286)</u>
Accumulated Depreciation	<u>(5,727)</u>	<u>(30,794)</u>

**EFFECT UPON GENERAL LEDGER:**

	<u>Debit</u>	<u>Credit</u>
Adjust Plant in Service		
Water		\$9,583
Wastewater		\$290,283
Adjust Accumulated Depreciation		
Water	\$5,727	
Wastewater	\$30,794	
Adjust Retained Earnings		
Water	\$3,856	
Wastewater	\$259,489	

**EFFECT UPON FILING:**

	<u>Debit</u>	<u>Credit</u>
Adjust Plant in Service		
Water		\$9,583
Wastewater		\$290,283
Adjust Accumulated Depreciation		
Water	\$5,727	
Wastewater	\$30,794	
Adjust Retained Earnings		
Water	\$3,856	
Wastewater	\$259,489	

**AUDIT FINDING NO. 4**

**SUBJECT: CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC)**

**AUDIT ANALYSIS:**

We performed an analysis of CIAC for the years 1999 through 2008. The purpose of this analysis was to verify additions to CIAC for water and wastewater and to determine the difference between the average CIAC balance per staff analysis and the projected average CIAC in the filing at December 31, 2008.

We determined that the average CIAC-water per the staff calculation is \$8,958 greater than the average CIAC-water per the filing. For wastewater, we determined that the average CIAC per the staff calculation is \$7,525 greater than the average CIAC per the filing. We recommend an adjustment for this difference.

<u>CIAC</u>		Balance Per Filing	General Ledger 2008	Staff Adjustment	13-mo Avg Adjustment	Adjusted G/L 2008	Adjustment to Filing
	WATER	3,946,235	3,969,021	-	(13,828)	3,955,193	8,958
	WASTEWATER	5,352,949	5,380,140	-	(19,666)	5,360,474	7,525

We analyzed the Accumulated Amortization associated with the adjusted CIAC and determined that Accumulated Amortization should per the filing is \$271 and \$168 dollars less than the amount included in the filing for water and wastewater, respectively.

<b>Accumulated Amortization of CIAC</b>							
		Balance Per Filing	General Ledger 2008	Staff Adjustment	13-mo Avg Adjustment	Adjusted G/L 2008	Adjustment to Filing
	WATER	890,606	953,187	-	(62,852)	890,335	(271)
	WASTEWATER	1,564,285	1,677,907	-	(113,790)	1,564,117	(168)

**EFFECT UPON GENERAL LEDGER**

None

**EFFECT UPON FILING**

Dr	CIAC - Water	\$8,958	
Dr	CIAC - Wastewater	7,525	
	Cr- Retained Earnings		16,044
	Accumulated Amortization – Water		271
	Accumulated Amortization – Wastewater		168

**AUDIT FINDING NO. 5**

**SUBJECT: REVENUES**

**AUDIT ANALYSIS:**

We performed an analysis of revenue for the 12 month period ended December 31, 2008. The purpose of this analysis was to determine the amount of water and wastewater revenues for the test period and the difference between the actual revenues per the general ledger and the projected revenues in the filing. It was determined that the water revenues per the general ledger are \$110,257 less than the revenues per the filing. For wastewater, the revenues per the general ledger are \$109,326 less than in the filing.

	<u>Per G/L</u>	<u>Per Filing</u>	<u>Difference</u>
<b><u>Water</u></b>			
Residential	\$ (394,343)		
Fire Protection	\$ (54,041)		
Miscellaneous	\$ (14,145)		
Commercial	\$ (427,688)		
	<u>\$ (890,217)</u>	<u>\$ (1,000,474)</u>	<u>\$ (110,257)</u>
<b><u>Wastewater</u></b>			
Residential	\$ (310,748)		
Commercial	\$ (385,223)		
	<u>\$ (695,972)</u>	<u>\$ (805,298)</u>	<u>\$ (109,326)</u>

**EFFECT UPON GENERAL LEDGER:**

None

**EFFECT UPON THE FILING:**

Decrease Revenues by \$110,257 for water.

Decrease Revenues by \$109,326 for wastewater.



## **AUDIT FINDING NO. 6**

### **SUBJECT: OPERATION & MAINTENANCE EXPENSES (O&M)**

#### **AUDIT ANALYSIS:**

We performed an analysis of O&M expenses for water and wastewater to determine if the amounts recorded in the general ledger were accurately stated and to determine if a difference exists between O&M expenses reported in the general ledger and projected O&M expenses reported in the filing. Balances at December 31, 2008 per the general ledger are \$568,088 for water and \$688,088 for wastewater.

Based upon our analysis, we are recommending that the following adjustments be made to the company's general ledger balances and filing at December 31, 2008.

#### Land Lease Rental Expense

For the 12-month test period ended December 31, 2008, the company had a capital lease agreement with Southlake Development, Ltd. A capital lease requires a company to record the plant asset on its books and records and payments made to the lessor used to reduce the cost of land lease obligation. The utility recorded the payments to expense accounts 641 and 741 (Rental of Building - Real Property) in the amounts of \$11,778 and \$45,297, respectively. These costs should be removed from O&M expenses as recorded in the general ledger.

#### Consumptive Use Permit (CUP)

In 2008, the company began preparation of a consumptive use permit required by the St. John's River Water Management District. Anticipated costs, as calculated by the company, total \$103,950. Costs incurred and expensed during the test period equal \$11,389. The company prepared an adjustment to projected O&M to record amortization of the CUP renewal expense of \$33,333. Based upon a recommendation from the FPSC engineering staff, we used a seven (7) year period for amortization of this permit with annual amortization of \$14,850. We recommend that the company establish a deferred account for \$89,100 for CUP costs and increase O&M expenses for the CUP renewal expense of \$3,461.

In the projected rate base calculation for water, the company included an amount equal to the average balance of the anticipated CUP costs of \$50,000. This amount was recorded as Avg Unamortized (non-annual) Project Cost to be amortized over a three year period. We recommend an adjustment to rate base of \$50,000 for CUP cost.

#### Rate Case Expense

In 2008, the utility incurred rate case expense, which was charged to various water and wastewater accounts in the amount of \$68,307 (water) and \$67,307 (wastewater). These costs were not included in the filing. However, the company prepared an adjustment to projected O&M expense to include rate case expense amortization of \$33,544 for both water and wastewater. At the end of fieldwork, the company had not recorded any year-end adjusting journal entries to the general ledger. We are recommending that rate case expense be removed from O&M expenses until such time as the Commission has determined the authorized amount and amortization period.

In the projected rate base calculation for water and wastewater, the company included amounts equal to the average balance of the anticipated rate case costs of \$67,088. This amount was recorded as Avg Unamortized (non-annual) Project Cost to be amortized over a four year period. We recommend an adjustment to rate base of \$67,088 for water and wastewater for rate case expense.

Out of Period Amounts

We noted that some O&M accounts in the general ledger included amounts for expenses which incurred outside the 12-month test period ending December 31, 2008. We scanned invoices paid during January 2009 and noted that several of these invoices were dated for the test period. We recommend an adjustment to true-up the test period to include only expenses which occurred during the test period. The true-up for water and wastewater is (\$3,500) and (\$6,703) respectively.

Unsupported Expenses

As stated in Audit Finding No. 3 above, the company bears the responsibility of maintaining documentation which supports its general ledger. During the course of our analysis of O&M expenses, the company could not provide supporting documentation for some of the expenses recorded in the general ledger. Unsupported Water expenses totaled \$20,315 and wastewater expenses totaled \$38,615. We recommend adjustments for these amounts.

Capital Costs

We determined that the utility expensed costs that should be recorded as capital expenditures and charged to the water and wastewater treatment systems. These costs were for

	<u>Water</u>	<u>Wastewater</u>
Mapping	34,476	34,477
Sanitary Lateral Connection		5,700
Lift Station Construction		17,259
	<u>34,476</u>	<u>57,436</u>

The calculation for depreciation expense and accumulated depreciation for these reclassifications from O&M to capital expenditures is \$431 for water and \$899 for wastewater.

We recommend an adjustment to O&M expense for \$34,476 water and \$57,436 wastewater and to depreciation expense for \$431 water and \$899 wastewater. We recommend these corresponding adjustments to rate base for plant in service and accumulated depreciation.

A summary of the recommended adjustments to the general ledger is shown below:

<u>Audit Adjustments</u>							
	<u>Land</u>		<u>Rate Case</u>	<u>YE Test</u>	<u>Reclass to</u>	<u>Undocumented</u>	<u>Total</u>
	<u>Lease</u>	<u>CUP</u>	<u>Expense</u>	<u>Period Adj</u>	<u>Capital</u>	<u>Costs</u>	<u>Adjustments</u>
Water	(11,778)	3,461	(68,307)	(3,500)	(34,476)	(20,315)	(134,915)
Wastewater	(45,297)		(67,307)	(6,703)	(57,435)	(38,615)	(215,357)

### Projected O&M Balances

The company filing includes O&M expenses based upon projections for the calendar year 2008. Total projected O&M expenses for Water are \$624,964 and for Wastewater \$927,017. Adjusted general ledger balances for O&M water and wastewater expenses are \$450,640 and \$714,573 respectively. We recommend an adjustment be made to the filing for the difference between projected amounts and adjusted general ledger amounts of (\$174,324) for water and (\$212,444) for wastewater.

	Balance Per Filing	Balance Per G/L	Total Adjustments	Adjusted General Ledger	Adjustment to Filing
Water	<u>624,964</u>	<u>589,016</u>	(138,376)	<u>450,640</u>	<u>(174,324)</u>
Wastewater	<u>927,017</u>	<u>929,931</u>	(215,357)	<u>714,573</u>	<u>(212,444)</u>

### **EFFECT UPON GENERAL LEDGER**

Dr	Net Operating Income	\$353,733	
Dr	Depreciation Expense - Water	431	
Dr	Depreciation Expense - Wastewater	899	
	Cr	O&M expenses - Water	\$ 138,376
	Cr	O&M expense - Wastewater	215,357
	Cr	Accumulated Depreciation - Water	431
	Cr	Accumulated Depreciation - Wastewater	899

### **EFFECT UPON FILING**

Dr	Net Operating Income	\$386,768	
Dr	Depreciation Expense - Water	431	
Dr	Depreciation Expense - Wastewater	899	
	Cr	O&M expenses - Water	\$ 174,324
	Cr	O&M expense - Wastewater	212,444
	Cr	Accumulated Depreciation - Water	431
	Cr	Accumulated Depreciation - Wastewater	899

**AUDIT FINDING NO. 7**

**SUBJECT: TAXES OTHER THAN INCOME (TOTI)**

**AUDIT ANALYSIS:**

We performed an analysis of taxes other than income for the test year 2008. The purpose of this analysis was to determine that the taxes other than income are calculated properly and are represented accurately in the general ledger for payroll, regulatory assessment and property taxes.

We determined that the payroll tax was understated in the general ledger by \$939 for water and overstated by \$1,061 for wastewater. The filing overstates the adjusted general ledger by \$134 and \$104, respectively, for water and wastewater.

We determined that the filing overstates regulatory assessment fees recorded in the general ledger by \$4,961 for water and \$4,919 for wastewater.

We determined that the property tax expense for water is understated in the general ledger by \$3,926 for water and \$4,135 for wastewater. The filing understates the adjusted general ledger balance by \$17,979 and \$22,137 for water and wastewater, respectively.

Taxes Other Than Income - Water

ACCT#		Balance per Filing Pro-Forma	G/L Amount	Adjustments to G/L	Adjusted G/L Amount	Difference Adjustment to Filing
1408.3	Payroll Tax	\$ 8,152	\$ 7,079	\$ 939	\$ 8,018	\$ (134)
1408.2	Property Tax	44,947	59,000	3,926	62,926	17,979
1408.1	RAF Tax	45,021	40,060	-	40,060	(4,961)
	<u>Totals</u>	<u>\$ 98,120</u>	<u>\$ 106,139</u>	<u>\$ 4,865</u>	<u>\$ 111,004</u>	<u>\$ 12,884</u>

Taxes Other Than Income - Wastewater

ACCT#	Tax Authority	Balance per Filing Pro-Forma	G/L Amount	Adjustments to G/L	Adjusted G/L Amount	Difference Adjustment to Filing
2408.3	Payroll Tax	\$ 6,122	\$ 7,079	\$ (1,061)	\$ 6,018	\$ (104)
2408.2	Property Tax	40,998	59,000	4,135	63,135	22,137
2408.1	RAF Tax	36,238	31,319	-	31,319	(4,919)
	<u>Totals</u>	<u>\$ 83,358</u>	<u>\$ 97,398</u>	<u>\$ 3,074</u>	<u>\$ 100,472</u>	<u>\$ 17,114</u>

**EFFECT ON GENERAL LEDGER:**

Increase TOTI – Water by \$4,865 and Wastewater by \$3,074. Decrease Net Operating Income- Water by \$4,865 and Wastewater by \$3,074.

**EFFECT ON THE FILING:**

Increase TOTI – Water by \$12,884 and Wastewater by \$17,114. Decrease Net Operating Income by \$29,998.

**Schedule of Water Rate Base**

**Florida Public Service Commission**

**Southlake Utilities, Inc.**  
 Docket No. 080597-WS  
 Test Year Ending 12/31/08  
 Interim [ ] Final [X]  
 Historical [ ] Projected [X]

Schedule: A-1  
 Page: 1 of 2  
 Preparer: Guastella Associates

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

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Line No.	Description	Adjusted Balance 12/31/2007	Utility Adjustments	Adjusted Balance 12/31/2008	Utility Adjustments	Average Balance 12/31/2008	Supporting Schedule(s)
1	Utility Plant in Service	\$7,011,442	\$66,850	\$7,078,292	(\$33,425)	\$7,044,867	A-5
2	Utility Land & Land Rights	133,286	0	133,286	0	133,286	A-5
3	Less: Non-Used & Useful Plant	0	0	0	0	0	A-7
4	Construction Work in Progress	778,064	0	778,064	0	778,064	
5	Less: Accumulated Depreciation	(870,163)	(201,627)	(1,071,790)	100,814	(970,976)	A-9
6	Less: CIAC	(3,939,479)	(13,512)	(3,952,991)	6,756	(3,946,235)	A-12
7	Accumulated Amortization of CIAC	827,836	125,541	953,376	(62,770)	890,606	A-14
8	Acquisition Adjustments	0	0	0	0	0	
9	Accum. Amort. Of Acq. Adjustments	0	0	0	0	0	
10	Advances For Construction (prepaid CIAC)	(123,121)	0	(123,121)	0	(123,121)	A-16
11	Avg Unamortized (non-annual) Project Cos	0	117,088	117,088	0	117,088	
12	Working Capital Allowance	68,090	1,671	69,761	0	69,761	A-17
13	<b>Total Rate Base</b>	<b>\$3,885,954</b>	<b>\$96,010</b>	<b>\$3,981,964</b>	<b>\$11,375</b>	<b>\$3,993,339</b>	

**Schedule of Sewer Rate Base**

**Florida Public Service Commission**

Southlake Utilities, Inc.  
 Docket No. 080597-WS  
 Test Year Ending 12/31/08  
 Interim [ ] Final [X]  
 Historical [ ] Projected [X]

Schedule: A-2  
 Page: 1 of 2  
 Preparer: Guastella Associates

Description: Provide the calculation of the 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.	(1) Description	(2)	(3)	(4)	(5)	(6)	(7)
		Adjusted Balance 12/31/2007	Utility Adjustments	Adjusted Balance 12/31/2008	Utility Adjustments	Average Balance 12/31/2008	Supporting Schedule(s)
1	Utility Plant in Service	\$7,287,302	\$54,997	\$7,342,299	(\$27,498)	\$7,314,800	A-6
2	Utility Land & Land Rights	558,446	0	558,446	0	558,446	A-6
3	Less: Non-Used & Useful Plant	0	0	0	0	0	A-7
4	Construction Work in Progress	0	0	0	0	0	
5	Less: Accumulated Depreciation	(1,458,018)	(263,580)	(1,721,598)	131,790	(1,589,808)	A-10
6	Less: CIAC	(5,341,309)	(23,280)	(5,364,589)	11,640	(5,352,949)	A-12
7	Accumulated Amortization of CIAC	1,450,736	227,098	1,677,834	(113,549)	1,564,285	A-14
8	Acquisition Adjustments	0	0	0	0	0	
9	Accum. Amort. Of Acq. Adjustments	0	0	0	0	0	
10	Advances For Construction (prepaid CIAC)	(295,893)	0	(295,893)	0	(295,893)	A-16
11	Avg Unamortized (non-annual) Project Cost	0	67,088	67,088	0	67,088	
12	Working Capital Allowance	104,103	7,581	111,684	0	111,684	A-17
13	<b>Total Rate Base</b>	<b>\$2,305,367</b>	<b>\$69,903</b>	<b>\$2,375,270</b>	<b>\$2,383</b>	<b>\$2,377,653</b>	

**Schedule of Water Net Operating Income**

**Florida Public Service Commission**

**Southlake Utilities, Inc.**  
 Docket No. 080597-WS  
 Test Year Ending 12/31/08  
 Interim [ ] Final [X]  
 Historical [ ] Projected [X]

Schedule: B-1  
 Page: 1 of 2  
 Preparer: Guastella Associates

Description: 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) Proforma Existing Rates	(3) Utility Test Year Adjustments	(4) Utility Adjusted Test Year	(5) Requested Revenue Adjustment	(6) Requested Annual Revenues	(7) Supporting Schedule(s)
1	OPERATING REVENUES	\$1,000,474	\$0	\$1,000,474	\$183,853	\$1,184,327	B-4,E-12
2	Operation & Maintenance	546,540	78,424	624,964		624,964	B-5
3	Depreciation, net of CIAC Amort.	76,086	0	76,086		76,086	B-13
4	Amortization			0		0	
5	Taxes Other Than Income	91,181	6,940	98,121	8,273	106,394	B-15
6	Provision for Income Taxes			0	0	0	C-1
7	OPERATING EXPENSES	<u>713,807</u>	<u>85,364</u>	<u>799,171</u>		<u>807,445</u>	
8	NET OPERATING INCOME	<u>\$286,667</u>	<u>(\$85,364)</u>	<u>\$201,303</u>		<u>\$376,883</u>	
9	RATE BASE	<u>\$3,993,339</u>		<u>\$3,993,339</u>		<u>\$3,993,339</u>	
10	RATE OF RETURN	<u>7.18%</u>		<u>5.04%</u>		<u>9.44%</u>	

**Schedule of Sewer Net Operating Income**

**Florida Public Service Commission**

Southlake Utilities, Inc.  
 Docket No. 080597-WS  
 Test Year Ending 12/31/08  
 Interim [ ] Final [X]  
 Historical [ ] Projected [X]

Schedule: B-2  
 Page: 1 of 2  
 Preparer: Guastella Associates

Description: 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) Proforma Existing Rates	(3) Utility Test Year Adjustments	(4) Utility Adjusted Test Year	(5) Requested Revenue Adjustment	(6) Requested Annual Revenues	(7) Supporting Schedule(s)
1	OPERATING REVENUES	\$805,299	\$0	\$805,299	\$487,912	\$1,293,211	B-4,E-12
2	Operation & Maintenance	834,446	92,571	927,017		927,017	B-6
3	Depreciation, net of CIAC Amort.	36,482	0	36,482		36,482	B-14
4	Amortization			0		0	
5	Taxes Other Than Income	80,427	2,932	83,359	21,956	105,315	B-15
6	Provision for Income Taxes			0	0	0	C-1
7	OPERATING EXPENSES	951,354	95,503	1,046,857		1,068,813	
8	NET OPERATING INCOME	<u>(\$146,055)</u>	<u>(\$95,503)</u>	<u>(\$241,558)</u>		<u>\$224,398</u>	
9	RATE BASE	<u>\$2,377,653</u>		<u>\$2,377,653</u>		<u>\$2,377,653</u>	
10	RATE OF RETURN	<u>-6.14%</u>		<u>-10.16%</u>		<u>9.44%</u>	



**Schedule of Requested Cost of Capital**

**Florida Public Service Commission**

**Southlake Utilities, Inc.**

Docket No. 080597-WS

Test Year Ending 12/31/08

Historical [ ] Projected [X]

**Average Balance Test Year**

Schedule: D-1

Page: 1 of 4

Preparer: Guastella Associates

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

Line No.	Class of Capital	(1) Reconciled To Requested Rate Base	(2) Ratio	(3) Cost Rate	(4) Weighted Cost
1	Long-Term Debt	\$0	0.00%		0.00%
2	Short-Term Debt	0	0.00%		
3	Preferred Stock	0	0.00%		
4	Common Stock	7,500	0.12%	9.56%	0.01%
5	Customer Deposits	211,614	3.32%	6.00%	0.20%
6	Tax Credits - Zero Cost	0	0.00%		
7	Tax Credits - Weighted Cost	0	0.00%		
8	Accumulated Deferred Income Taxes	0	0.00%		
9	Other-Retained Earnings	6,151,877	96.56%	9.56%	9.23%
10	Total	<u>6,370,992</u>	<u>100.00%</u>		<u>9.44%</u>

Leverage Graph = 7.36 + 2.123 / 0.9668  
 Equity Cost Rate = 9.56%  
 Equity Cost Rate Cap = 12.01%