

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: August 12, 2016
TO: Office of Commission Clerk
FROM: Lynn M. Deamer, Chief of Auditing, Office of Auditing and Performance Analysis
RE: Docket No.: 160030-WS
Company Name: Ni Pacolet Milliken Utilities, LLC
Company Code: WU920/SU915
Audit Purpose: A1f - Affiliated Transactions Audit
Audit Control No.: 16-130-4-2

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 confidential work papers associated with this audit.

LMD/cm

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

Ni Pacolet Milliken Utilities, LLC
Audit of Affiliate Transactions

Twelve Months Ended December 31, 2015

Docket No. 160030-WS
Audit Control No. 16-130-4-2
August 1, 2016

A handwritten signature in blue ink, appearing to read "Donna Brown", written over a horizontal line.

Donna Brown
Audit Manager

A handwritten signature in blue ink, appearing to read "Joan Hudson", written over a horizontal line.

Joan Hudson
Audit Staff

A handwritten signature in blue ink, appearing to read "Marisa Glover", written over a horizontal line.

Marisa Glover
Reviewer

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Purpose

To: Florida Public Service Commission

We have performed the procedures described later in this report set forth by the Division of Accounting and Finance in its audit service request dated May 9, 2016. We have applied these procedures to the allocated costs included in schedules prepared by Ni Pacolet Milliken Utilities, LLC in support of its filing for rate relief in Docket No. 160030-WS.

This audit was performed following General Standards and Fieldwork Standards found in the AICPA Statements on Standards for Attestation Engagements. The report is intended only for internal Commission use.

Objectives and Procedures

General

Definitions

The term “Company” and “Parent” refer to Ni Pacolet Milliken Utilities, LLC, the parent of Ni Florida, LLC.

Subsidiary refers to Ni Florida, LLC.

Utilities refer to Tamiami Village Water Company and Hudson Utilities.

Prior rate case refers to prior Ni Florida, LLC rate cases.

ERC refers to Equivalent Residential Connections as defined by Commission Rule 25-30.055, Florida Administrative Code (F.A.C.).

NARUC refers to National Association of Regulatory Utility Commissioners.

USOA refers to the NARUC Uniform System of Accounts as adopted by Commission Rule 25-30.115 – Uniform System of Accounts for Water and Wastewater Utilities, F.A.C.

Background

This audit pertains only to allocated costs. All direct costs were audited in the rate case audit, Docket No. 160030-WS, Audit Control No. 16-140-1-1 (ACN).

The Company’s allocated costs were last audited in Docket No. 130010-WS. This audit addresses the costs allocated from the Company to the respective Utilities that are currently under review before the Commission. Tamiami Village Water Company and Hudson Utilities used the test year ended December 31, 2015 in their applications for rate relief in Docket No. 160030-WS. On April 3, 2015, Ni Florida, LLC filed a joint application for transfer of majority organizational control of Ni Florida, LLC to Ni Pacolet Milliken Utilities, LLC. The transfer was approved effective July 21, 2015 by the Florida Public Service Commission per Commission Order No. PSC-15-0315-FOF-WS, issued August 5, 2015.

The Company allocates its costs to each of its utility subsidiaries based on direct assignment of costs and ERCs. Each subsidiary receives costs based on the ratio of its ERC per system to the total ERCs at the corporate level for Ni Pacolet Milliken Utilities, LLC. In prior rate cases, the company allocated costs using the same method for its Tamiami and Hudson Utilities based on the total ERCs for the company.

Rate Base

All rate base components are direct costs. Therefore, these items were audited under ACN 16-130-4-1 of Docket No. 160030-WS.

Net Operating Income

Operation Maintenance and Expenses

Objectives: The objectives were to determine whether Operation and Maintenance expenses that were allocated to subsidiaries were properly recorded in compliance with NARUC USOA and Commission rules and that expenses recorded were representative of the Subsidiary's ongoing utility operations.

Procedures: Audit staff verified Operation and Maintenance expense accounts allocated for the 12-months ended December 31, 2015 by tracing a sample of invoices to the original source documentation. We reviewed source documents for proper amount, period classification, NARUC account, and recurring nature. We reconciled the ledger to the Subsidiary's allocation worksheets.

Salaries, benefits, and transportation expenses from the corporate office and the subsidiary office were recalculated and reconciled to Company and Subsidiary provided salary and benefits worksheets. The allocation factors were reviewed for applicability of the type of job. Findings 1 and 2 discuss Operation and Maintenance expenses.

Allocated Depreciation Expense

Objectives: The objectives were to determine whether the depreciation expense allocated is properly recorded in compliance with Commission rules and that they accurately represent the depreciation of the Utility's asset used to manage ongoing utility operations.

Procedures: Audit staff noted the allocated expenses included depreciation expense for computer & office equipment, furniture & fixtures, software, and utility plant in service. We also noted that the depreciation is related to Account 101 – Utility Plant in Service and Account 121 – Non-Utility Property. We reviewed the 2012 rate case, ACN 13-071-4-2 in Docket No. 130010-WS and noted that depreciation expenses were not allocated in the prior rate case. Finding 3 discusses allocated depreciation expense.

Taxes Other Than Income

Objectives: The objectives were to determine whether the Company's allocation of taxes represented the actual taxes recorded in the ledger, and that they were allocated using the appropriate ERC factors.

Procedures: Audit staff noted that the filed Minimum Filing Requirement (MFR) does not include payroll taxes in the Taxes Other Than Income (TOTI) section. Regulatory Assessment Fees (RAFs), Real Estate & Personal Property, and "Other" taxes other than income, were tested under ACN 16-130-4-1 in Docket No. 160030-WS. No exceptions were noted.

Capital Structure

Objectives: The objectives were to determine whether the equity and debt components of the Company's capital structure and their respective cost rates used to arrive at the overall weighted cost of capital are based on the weighted percent of the Company's audited financial statements and Commission's authorized rate of return.

Procedures: Audit staff determined the Company's long-term debt, short-term debt, and common equity. We reconciled the components to the audited financial statements and the general ledger and traced amounts to debt worksheets, invoices, and credit agreements. The equity rate filed was compared to Order No. PSC-16-0254-PAA-WS. Finding 4 discusses capital structure, specifically the allocated long-term debt of the Parent.

Audit Findings

Finding 1: Allocated Expenses by Detailed Account

Audit Analysis: Audit staff selected a judgmental sample to test the allocated operating and maintenance expenses from Ni Pacolet Milliken Utilities, LLC. We requested invoices and contracts, and then reviewed the amounts, period, and classification of the expenses to determine if they are proper.

We noted that there were several transactions in which we recommend adjustments. These adjustments consist of disallowances and reclassifications. We noted non-utility expense adjustments, allocated down, in the amount of \$717.37 for Hudson and \$186.93 for Tamiami. These adjustments consisted of late payment fees, country club membership fees, non-utility office expenses, non-supported expenses, and outside the test year expenses.

In addition, we noted several transactions, in which costs were recorded on Ni America Operating, LLC's books, instead of being directly booked to Hudson Utilities and Tamiami Village Water Company. We recommend the reclassification of \$13,195.90 to Hudson and \$390.00 to Tamiami. The Hudson adjustment consists of \$3,900.00 for legal expenses and \$9,295.90 for transportation expenses. The Tamiami adjustment consists of \$390.00 for legal expenses. Audit staff was unable to determine legal expenses for prior years, therefore we recommend the analyst further review the legal expense amounts to determine if they are reasonable and recurring.

We also noted additional transactions in which we recommend adjustments. These adjustments consist of Director and Officer Liability (DOL) Insurance. Audit staff noted a total annualized cost of \$19,478.66 (\$14,568.00 + \$4,910.67). This amount consisted of a six-year coverage in the amount of \$4,910.67 (\$29,464/6) and \$14,568.00. As of August 9, 2016, audit staff has not received the DOL Insurance Policy associated with the \$14,568.00.

Commission Order No. PSC-13-0611-PAA-WS, issued November 19, 2013, states that the cost of DOL insurance benefits both the ratepayer and the shareholder, and should be shared equally between both of them. Therefore, audit staff reduced the insurance costs prior to the allocation by half ($\$19,478.67/2 = \$9,739.33$). We then multiplied the remaining costs by the allocation percentage for Hudson and Tamiami. We recommend an adjustment in the amount of \$2,340.43 ($\$3,005.62 - \665.20) for Hudson and \$609.84 ($\$783.20 - \173.36) for Tamiami to adjust the six-year coverage insurance and to reflect the removal of the costs associated with the shareholder. However, since the last rate case, this Company was purchased by Pacolet Milliken Enterprises, Inc., which is a privately traded investment company. Therefore we defer this issue to the analyst to determine whether the DOL insurance is allocable.

Tables 1-1 to 1-4 summarizes the accounts, amounts, and reasons for adjustments for the allocated expenses.

Table 1-1

	Date	Name	Amount	Hudson 6.83%	Tamiami 1.78%
650.205 · Mike Ashfield - Other	01/26/2015	Westin Hotel and Resort	\$ 174.33	\$ 11.90	\$ 3.10
650.205 · Mike Ashfield - Other	12/18/2015	Ashfield, Mike (vendor)	\$ 271.98	\$ 11.50	\$ 3.00
650.230 · Lauren Burgess	05/18/2015	Bank of America	\$ 633.10	\$ 43.22	\$ 11.26
650.231 · Mark Daday - Other	09/29/2015	Daday, Mark (vendor)	\$ 698.88	\$ 24.39	\$ 6.36
650.240 · April Braswell	08/18/2015	August 2015 Visa - April (Corporate Travel to Houston)	\$ 2,397.21	\$ 163.63	\$ 42.64
650.2 · Travel Expense Corporate	04/18/2015	April 2015 Visa - Carey (Limo Service for Pacolet Group)	\$ 255.00	\$ 17.41	\$ 4.54
675.1 · Telephone Expense	03/18/2015	Free Conferencing Corp	\$ 70.23	\$ 4.79	\$ 1.25
675.1 · Telephone Expense	09/08/2015	Verizon Wireless	\$ 3,497.46	\$ 2.76	\$ 0.72
675.1 · Telephone Expense	09/09/2015	Verizon Wireless	\$ 3,660.80	\$ 3.38	\$ 0.88
675.1 · Telephone Expense	09/19/2015	AT&T (Fax/Alarm)	\$ 299.97	\$ 1.44	\$ 0.37
675.4 · Dues, Subscrip. & Prof. Org	06/18/2015	Bank of America	\$ 965.04	\$ 44.72	\$ 11.65
675.4 · Dues, Subscrip. & Prof. Org	09/10/2015	Bank of America	\$ 70.00	\$ 1.30	\$ 0.34
675.4 · Dues, Subscrip. & Prof. Org	09/18/2015	The Members Club at Woodcreek and Wildewood, TSCPA, WebTimeClock.com, TexasNotary.com	\$ 1,045.67	\$ 36.85	\$ 9.60
675.4 · Dues, Subscrip. & Prof. Org	11/18/2015	WebTimeClock.com fees, Membership Dues, CPA Membership fees	\$ 1,298.38	\$ 47.14	\$ 12.28
675.5 · Computer and Internet Exp.	09/07/2015	Logix Communications	\$ 1,294.81	\$ 2.22	\$ 0.58
675.5 · Computer and Internet Exp.	09/18/2015	Business Card	\$ 36.18	\$ 2.47	\$ 0.64
675.7 · Office Supplies	04/18/2015	April 2015 Visa - Carey (Snacks and Drinks for Office)	\$ 69.86	\$ 4.77	\$ 1.24
675.7 · Office Supplies	04/21/2015	Rotermund, Nicia (exp)	\$ 224.86	\$ 15.35	\$ 4.00
675.8 · Postage, Freight, and Overnight	08/01/2015	Pitney Bowes Global Financial Svcs.	\$ 296.64	\$ 2.73	\$ 0.71
675.8 · Postage, Freight, and Overnight	08/01/2015	Pitney Bowes Global Financial Svcs.	\$ 310.20	\$ 2.18	\$ 0.57
675.8 · Postage, Freight, and Overnight	08/18/2015	Visa - Elgin Post Office - Certified Mail Postage for Gross Receipts Reports to SC PSC	\$ 8.77	\$ 0.60	\$ 0.16
675.9 · Other	06/18/2015	U-Haul	\$ 1,206.37	\$ 82.35	\$ 21.46
675.9 · Other	07/01/2015	Delta Airlines, U-Haul, Discount Hitch & Truck	\$ 2,787.60	\$ 190.28	\$ 49.58
Total				\$ 717.37	\$ 186.93

Table 1-2

	Date	Name	Amount	Hudson 6.83%	Tamiami 1.78%	Audit Staff Adjustment
633.2 · Hudson Utilities	03/01/2015	Rutledge Ecenia	\$ 3,900.00	\$ 266.37	\$ -	\$ 3,633.63
633.3 · Tamiami Village	03/01/2015	Rutledge Ecenia	\$ 390.00	\$ -	\$ 6.94	\$ 383.06
650.202.2 · Hudson Utilities	05/18/2015	E.Wallace - Travel	\$ 1,639.65	\$ 111.99	\$ -	\$ 1,527.66
650.202.2 · Hudson Utilities	09/18/2015	E.Wallace - Travel	\$ 699.49	\$ 47.78	\$ -	\$ 651.71
650.202.2 · Hudson Utilities	10/18/2015	E.Wallace - Travel	\$ 2,514.00	\$ 171.71	\$ -	\$ 2,342.29
650.208.2 · Hudson Utilities	04/08/2015	A. Thomas - Travel	\$ 486.12	\$ 33.20	\$ -	\$ 452.92
650.208.2 · Hudson Utilities	04/18/2015	A. Thomas - Travel	\$ 1,499.05	\$ 102.39	\$ -	\$ 1,396.66
650.208.2 · Hudson Utilities	05/18/2015	A. Thomas - Travel	\$ 1,058.63	\$ 72.30	\$ -	\$ 986.33
650.208.2 · Hudson Utilities	07/18/2015	A. Thomas - Travel	\$ 1,161.54	\$ 79.33	\$ -	\$ 1,082.21
650.208.2 · Hudson Utilities	10/18/2015	A. Thomas - Travel	\$ 237.42	\$ 16.22	\$ -	\$ 221.20
Total				\$ 901.28	\$ 6.94	\$ 12,677.68

Hudson \$ 12,294.62
 Tamiami \$ 383.06

Table 1-3

ORIGINAL ALLOCATION					
	Insurance		Hudson		Tamiami
	Amount		6.83%		1.78%
	\$ 29,464.00	\$	2,011.21	\$	524.08
	\$ 14,568.00	\$	994.41	\$	259.12
		\$	3,005.62	\$	783.20
 CALCULATION FOR 6-YEAR INSURANCE					
	\$ 29,464.00				
	6	years			
	\$ 4,910.67	per year of	409.22	per month	
 PROPER ALLOCATION AFTER RECALCULATING 6-YEAR INSURANCE AND DIVIDING BOTH BY 2					
	Insurance		Hudson		Tamiami
	Amount		6.83%		1.78%
	\$ 2,455.33	\$	167.70	\$	43.70
	\$ 7,284.00	\$	497.50	\$	129.66
	\$ 9,739.33	\$	665.20	\$	173.36
 ORIGINAL ALLOCATION MINUS THE PROPER ALLOCATION					
	Hudson	\$	3,005.62	\$ (665.20)	= \$ 2,340.43
	Tamiami	\$	783.20	\$ (173.36)	= \$ 609.84

Table 1-4

	Disallowances	Reclass to Direct	DOL Insurance	Total Adjustments
Hudson	\$ (717.37)	\$ 12,294.62	\$ (2,340.43)	\$ 9,236.82
Tamiami	\$ (186.93)	\$ 383.06	\$ (609.84)	\$ (413.71)
				<u>\$ 8,823.11</u>

Effect on the General Ledger: There is no effect on the general ledger.

Effect on the Filing: Audit staff recommends an adjustment of \$9,236.82 to increase expenses for Hudson and an adjustment of \$413.71 to decrease expenses for Tamiami. Additionally, audit staff recommends further review of legal and DOL insurance.

Finding 2: Salaries and Benefits

Audit Analysis: The Parent and the Subsidiary provided schedules that noted the most current annualized salary and the allocated salary and benefits using the appropriate ERC allocation. The Parent and the Subsidiary submitted a description of duties and responsibilities for each employee whose salaries and benefits were allocated to the Utilities. We also reviewed the employees' W-2s and reconciled the amounts to the payroll reports and general ledger.

We reviewed the duties and responsibilities description provided by the Subsidiary, and noted several employees who work only in South Carolina or Texas. Any cost that can be directly attributed to a specific utility should be charged to that utility. The total salaries and benefits for employees that specifically worked in South Carolina or Texas Utilities according to their job descriptions was \$459,460.95. This amount consisted of \$382,799.32 for salaries and \$76,661.63 for benefits. The percentage applied to Hudson and Tamiami is 6.83 percent and 1.78 percent, respectively. We recommend an adjustment of \$26,145.19 ($\$382,799.32 * 0.0683$) and \$5,235.99 ($\$76,661.63 * 0.0683$) for Hudson Salaries and Benefits. We also recommend an adjustment of \$6,813.83 ($\$382,799.32 * 0.0178$) and \$1,364.58 ($\$76,661.63 * 0.0178$) for Tamiami.

In addition, 5% of one employee's salary was allocated to due diligence, which was disallowed in Commission Order PSC-11-0199-PAA-WU. We removed the amount included in this rate case, as shown below.

We determined salaries and benefits to be overstated by \$40,348.94, as shown in Table 2-1.

Table 2-1

	Salaries	Benefits	Due Diligence	Total
Hudson	\$ 26,145.19	\$ 5,235.99	\$ 626.17	\$ 32,007.35
Tamiami	\$ 6,813.83	\$ 1,364.58	\$ 163.17	\$ 8,341.57
				<u>\$ 40,348.94</u>

Effect on the General Ledger: There is no effect on the general ledger.

Effect on the Filing: Audit staff recommends salaries and benefits be reduced by \$40,349.

Finding 3: Depreciation Expense

Audit Analysis: For the 2015 test year, depreciation expense is allocated. We inquired from the Subsidiary representative what assets the depreciation expenses are related to, and found that they are assets, which are not allocated to the Florida Utilities.

The Utility requested depreciation expense in the prior docket and was disallowed by Commission Order. Therefore, audit staff recommends a decrease in the amount of \$1,974.86 (\$1,566.58 + \$408.28) be made to depreciation expense.

Table 3-1 summarizes the depreciation expense amounts allocated to the water and wastewater utilities.

Table 3-1

	Total	Allocated	Hudson (6.83%)	Tamiami (1.78%)
403 · Depreciation Expense				
403.1 · Furniture and Fixtures	\$ 4,288.20	\$ 4,288.20	\$ 292.88	\$ 76.33
403.2 · Computer and Office Equipment	\$ 17,224.76	\$ 17,224.76	\$ 1,176.45	\$ 306.60
403.5 · Software	\$ 76.38	\$ 76.38	\$ 5.22	\$ 1.36
403.6 · Utility Plant in Service	\$ 1,347.48	\$ 1,347.48	\$ 92.03	\$ 23.99
Total	\$ 22,936.82	\$ 22,936.82	\$ 1,566.58	\$ 408.28

Effect on the General Ledger: There is no effect on the general ledger.

Effect on the Filing: Audit staff recommends that depreciation expense be reduced by \$408.28 for water and be reduced by \$1,566.58 for wastewater. The Utility did not adjust accumulated depreciation in the MFR, therefore no adjustment is necessary.

Finding 4: Cost of Capital

Audit Analysis: The Subsidiary provided general ledgers and audited financial statements that were used to calculate the Cost of Capital. We reconciled Long-Term Debt amounts to the general ledgers. In MFR Schedule D-2, audit staff found that the Subsidiary included long-term debts that were paid off during the test year in their calculation of Cost of Capital.

The Subsidiary's filed MFR Schedule D-2, page 1, included two long-term debt instruments, which were paid off. The first long-term debt on Schedule D-2 has a 13-month average balance amount of \$125,590.00, which was paid off in May 2015. The second long-term debt on Schedule D-2 has a 13-month average balance amount of \$2,318,685.00. This included debt with a 13-month average balance of \$780,224.00, which was paid off in March 2015. The long-term debts above were paid off during the test year and should not be included in the MFR's Cost of Capital calculations. However, we also noted on Schedule A-18, page 5, the debt is zero from March 2015 to August 2015.

Starting in September 2015, the Parent Company allocated a portion of its debt to Ni Florida, LLC in the amount \$4,736,843 for September, October, and November. This amount increased to \$5,000,000.00 in December 2015.

Effect on the General Ledger: There is no effect on the general ledger

Effect on the Filing: The analyst needs to determine the appropriate amount of debt and the cost rate for debt to include in Cost of Capital for ratemaking purposes.