

M E M O R A N D U M

March 3, 1998

TO: DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF AUDITING AND FINANCIAL ANALYSIS (VANDIVER) *CV*

RE: DOCKET NO. 971186-SU -- SANLANDO UTILITIES CORPORATION
AUDIT REPORT - LIMITED SCOPE AUDIT OF ACCOUNTS
AUDIT CONTROL NO. 98-029-3-1

The above-referenced audit report is forwarded. Audit exceptions document deviations from the Uniform System of Accounts, Commission rule or order, Staff Accounting Bulletin and generally accepted accounting principles. Audit disclosures show information that may influence the decision process.

The audit was prepared using a micro computer and has been recorded on one diskette. The diskette may be reviewed using IBM compatible equipment and LOTUS 1-2-3 software. There are no confidential working papers associated with this audit.

Please forward a complete copy of this audit report to:

Sanlando Utilities Corporation
Hampton P. Conley
P. O. Box 3884
Longwood, FL 32791-0884

DNV/sp

Attachment

cc: Chairman Johnson
Commissioner Clark
Commissioner Deason
Commissioner Garcia
Commissioner Jacobs
Mary Andrews Bane, Deputy Executive Director/Technical
Legal Services
Division of Auditing and Financial Analysis (Devlin/Causseaux/
File Folder)
Division of Water and Wastewater (Casey)
Orlando District Office (Forbes)

Research and Regulatory Review (Harvey)
Office of Public Counsel

DOCUMENT NUMBER-DATE

02822 MAR-3 88

FPSC-RECORDS/REPORTING



FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF AUDITING AND FINANCIAL ANALYSIS
BUREAU OF AUDITING

Orlando District Office

SANLANDO UTILITIES CORPORATION

LIMITED SCOPE AUDIT OF ACCOUNTS

PERIOD ENDED DECEMBER 31, 1996

DOCKET NO. 971186-SU

AUDIT CONTROL NO. 98-029-3-1

Robert F. Dodrill, Sr., Audit Manager

Richard F. Brown, Audit Staff

Elbert E. Phillips, Audit Staff

Ian J. Forbes, Audit Supervisor

DOCUMENT NUMBER-DATE

02822 MAR-3 88

FPSD-RECORDS/REPORTING

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**DIVISION OF AUDITING AND FINANCIAL ANALYSIS
AUDITOR'S REPORT**

FEBRUARY 20, 1998

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described later in this report to perform a limited scope audit of the 1996 Annual Report of Sanlando Utilities Corporation. (Sanlando) There is no confidential information associated with this audit, and there are no audit staff minority opinions.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this document must not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

In our opinion, with the following exceptions, the audited water conservation program, specified operating expenses, profit-sharing plan, and miscellaneous liabilities of Sanlando are being maintained in compliance with the accounting practices prescribed by the Florida Public Service Commission.

SUMMARY OF SIGNIFICANT FINDINGS

The company charged legal retainer fees totaling \$36,000 (\$19,080 and \$16,920 to Water and Sewer respectively) to utility operations

The company charged \$20,000 in non-recurring lake cleanup expenses to account No. 735 Contractual Services - Other

The company paid office rent in excess of market rates to an affiliate in amount of \$79,053 (\$42,260 and \$36,793 for water and sewer respectively).

The company capitalized \$77,600 of legal fees in its Water Conservation Program.

The company charged \$81,600 to the water and sewer utilities (\$40,800 and \$40,800 respectively) for management fees paid to affiliates based on estimates

The company charged a \$28,095 non-recurring engineering study to contractual services - engineering entirely in 1996.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by comparing, on a test basis, certain company accounts and account balances which we believe are significant to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definition applies when used in this report.

Scanned - The documents or accounts were read quickly looking for obvious errors.

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

Reviewed - The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers, and selective analytical review procedures were applied.

Confirmed - Evidential matter supporting an account balance, transaction, or other information was obtained directly from an independent third party.

Verify - The item was tested for accuracy, and substantiating documentation was examined.

WATER CONSERVATION PROGRAM: Compiled the Water Conservation Program expenses from the filing and documented major components. Scheduled and scanned the legal costs charged to the program.

OFFICE RENT: Confirmed the market rate for business offices in the utility neighborhood and verified the utility payments of major leasehold expenses. Reviewed neighborhood rental rates to vouch for third party representation.

MANAGEMENT AND CONSULTING SERVICES: Traced and tested the \$81,600 related party management fee for proper support

LEGAL SERVICES: Compiled line item descriptions from the legal retainer invoices and scanned the balance of the legal invoices which were expensed.

TRANSPORTATION EXPENSE: Traced \$57,943 transportation expense and tested 31% of the amount for prudence, proper classification and correct amount

CONTRACTUAL SERVICES-OTHER: Verified approximately 95% of the balances in the Water and Wastewater accounts to supporting documentation.

CONTRACTUAL SERVICES - ENGINEERING:OTHER: Verified approximately 95% of the balances in the Water and Wastewater accounts to supporting documentation.

PROFIT SHARING: Traced the \$120,000 amount of profit sharing to the company's general ledger. Obtained a description of the plan from the Note No. 1. to the 1996 unaudited financial statement and tested this amount for prudence.

MISCELLANEOUS LIABILITIES: Verified approximately 50% of the December 31, 1996 balance in account #252 (Miscellaneous Liabilities) to supporting documentation.

EXCEPTIONS

Exception No. 1

Subject: Legal Retainer Fee

Statement of Fact: The Sanlando 1996 Annual Report indicated that the utility incurred \$77,357 in legal fees for the year. (\$35,873 and \$41,484 for water and sewer, respectively.)

Included in this amount was \$36,000 for a retainer fee for John F. Lowndes. This utility attorney is a shareholder of the utility, a director, and also trustee of the utility's pension and retirement fund. This \$36,000 was charged to Sanlando at \$3,000 per month split between the water and sewer utilities. (\$19,080 and \$16,920 respectively) The invoices for the retainer fees of \$3,000 per month were referenced General Matters. Over seventy percent (72.9%) of the 59 line items described on these retainer invoices were "Conferring with Lester and Bob Mandell." or others with no subject matter noted. No hours or hourly rates were documented on the invoices provided. (Lester and Bob Mandell are officers and directors of the utility.)

The October and the November bills read only "MONTHLY RETAINER"\$3,000.

The NARUC Class "A" Accounting Instruction No. 2, General Records, states in part:

Each entry shall be supported by such detailed information as will permit a ready identification, analysis and verification of all facts relevant thereto

Of the other 16 line items, six discuss cafeteria plans, Guastella and Associates, profit-sharing plans, bookkeeping, and legislation concerning CIAC.

Four line items mention Mr. Lowndes conferring with utility officials and Bill Sundstrom who is associated with United Water Resource. All other non-retainer legal invoices referring to Bill Sundstrom were charged to Account No. 426.1 Nonutility expense. When asked about these other invoices, the utility responded by saying, "The charges pertained to a potential sale of the utility. The expenses were charged this way because the sale would have benefited the owners and not the ratepayers."

The only ongoing legal action listed was the Montgomery Road Condemnation. (one line item)

PSC Order No. 23809 Dated November 27, 1990 stated "In its response to the audit report, the utility listed many general areas of service provided by the attorney." The order went on to state in part:

We are not persuaded by the utility's audit response. We were not provided with sufficient description of legal work performed, legal

proceedings or any detail supporting the benefit derived by the utility. All utilities are held to the same requirement that expenses recovered through rates must be justified as reasonable and prudently incurred. Just because the utility incurred these amounts does not lend any support to the reasonableness or prudence thereof. The fact that the attorney is a related party requires an even greater degree of scrutiny to assure that expenses are incurred on an arm's-length basis.

The utility was given the opportunity to support and justify these expenses and its attempt was unsatisfactory. Therefore, we will only allow base year legal expenses of \$40,000, which would be a reasonable level if the utility employed in-house counsel.

The order finishes the subject by stating:

The utility is placed on notice that in future rate proceedings it must provide greater detail to justify contract or outside legal services.

Recommendation: Because of the lack of documentation of utility benefits, and the Board of Director nature of other business subjects discussed (cafeteria, profit-sharing, consultants, and, bookkeeping etc.), and the non-utility nature of the Bill Sundstrom conferences (the potential buyer of Sanlando), the \$36,000 retainer (\$19,080 and \$16,920 for Water and Sewer respectively) should be disallowed.. This would leave \$41,357 (\$77,357-\$36,000) in the legal accounts. \$40,000 per year was left in the legal accounts by the PSC Sanlando order No. 23809 as stated above.

Exception No. 2

Subject: Annual Maintenance Fee

Statement of Fact: Sanlando Utilities Corporation and Sweetwater Oaks Homeowners Association, Inc. entered into an agreement termed the "Cove Lake System Restoration Agreement" that was executed on November 8, 1991.

Treated effluent from the utility's wastewater treatment plant is discharged via the Sweetwater Creek into and through a body of surface water known as the Sweetwater Cove Lake System.

The agreement referred to as a "one-time clean up operation" was for the purpose of improving and maintaining the water and aesthetic quality of the Cove Lake System.

The association was provided the following monies from the utility for maintaining the system in accordance with the agreement:

April 1, 1993	\$27,500
April 1, 1994	25,000
April 1, 1995	22,500
April 1, 1996	20,000

The last payment of \$20,000, per the agreement, was remitted by the utility on April 19, 1996, via Check 15202. The amount was charged to wastewater operating Account 735, Contractual Services-Other.

No further payments, per this agreement, have been made by the utility between April 20, 1996 and January 1, 1998.

Recommendation: Staff recommends, for rate purposes, that Account 735 be reduced by \$20,000 and wastewater net operating income be increased by the same based on the non-recurring nature of the charge that was absent during 1997 operations.

Exception No. 3

Subject: Contractual Services - Other

Facts: The utility charged consulting fees of \$2,943 and \$2,507 to respective water and wastewater operating Accounts 635 and 735, during the test year ended December 31, 1996.

Mr. George Billings, the former Chief Financial Officer for the affiliated Greater Construction Corporation and Assistant Treasurer of Sanlando Utilities, billed the above fees for his work in connection with his review of the 1995 PSC Annual Report and other miscellaneous utility-related matters.

In response to staff's inquiry regarding this matter, the utility's representative stated as follows:

George Billings served as Chief Financial Officer for the Greater Construction Corporation and as Assistant Treasurer for Sanlando Utilities from 1981 until he left the firm in 1996. His duties in those positions included all aspects of preparation and review of the annual PSC reports. We retained Mr. Billings on a one-time basis to assist in preparation and review of the 1995 PSC annual report submittal.

Recommendation: Staff has concluded that the consulting fees are out-of-period and non-recurring and for rate purposes should be excluded from 1996 test year operating expenses. Staff recommends that Accounts 635 and 735 be reduced by \$2,943 and \$2,507, respectively, and that water and wastewater net operating income be increased by the same amounts.

Exception No. 4

Subject: Rate Case Expense

Facts: The utility charged rate filing fees of \$2,830.59 and \$2,510.14 to respective water and wastewater operating Accounts 635 and 735, during the test year ended December 31, 1996.

Guastella Associates, Inc. billed the utility on July 1, 1996, the above charges for its work-in-progress applicable to the utility's application for approval of a reuse project plan and increase in wastewater rates.

Recommendation: In accordance with F. S. 367.0816, rate case expense shall be apportioned for recovery over a four-year period. Staff recommends that water and wastewater Accounts 635 and 735, Contractual Services-Other, be reduced by \$2,476.76 ($\$2,830.59 - (\$2,830.59/4/2)$) and \$2,196 ($\$2,510.14 - (\$2,510.14/4/2)$), respectively, to comply with said statute.

Disclosure No. 1

Subject: Office Building Rent

Statement of Fact: The Sanlando 1996 Annual Report indicated that the utility incurred \$149,381 in office rental expense for the year. (\$79,816 and \$69,565 for water and wastewater, respectively) The utility states that there are 5,774 square feet of rented area which yields an annual per square foot rental of \$25.87. ($\$149,381 / 5,774$)

The office rental payments were made to Kensington Park Limited which is a related business entity as noted in Sanlando Utilities' 1996 PSC Annual Report.

The previous Sanlando Utilities' rate order stated that "This commission closely scrutinizes related - party transactions." (In order to verify that they are conducted at arms-length)

Recommendation: The Orlando area real estate brokerage firm of Cushman & Wakefield (C&W) provided a study which indicated that the net market rate for comparable commercial office rental in the Sanlando area was \$13.59 per square foot. This is a base overall rental rate net of property taxes, property insurance and maintenance expenses. In other words, with this rate, the tenant pays all property related expenses such as property tax, property insurance and maintenance . This rate is opposed to a gross full service rate where the landlord pays all of the property expenses.

Interviews with property managers and tenants in neighboring "Class A" (based on location) office buildings provided corroboration of the Cushman & Wakefield (C&W) current market rate of \$13.59. The C&W analyst stated that the difference between the base overall rate and the gross full service rate is a gross up factor of \$4.64 for the Longwood/Lake Mary market. The analyst also said that this gross up factor has remained constant from 1996 and 1997.

The C&W study indicated that the "Weighted Average Class A Rental Rate" for the 4th Quarter 1996 for the Longwood/Lake Mary market was \$16.82. Reducing this by the gross up factor of \$4.64 mentioned above, yields a 1996 overall net rental rate of \$12.18. ($16.82 - 4.64$)

In recomputing the Sanlando 1996 rental expense at market rates, the overall net rate should be used. This is required because Sanlando Utilities pays its share of the property related expenses. In response to a document/information request #2-3 concerning property taxes Sanlando indicated that it paid 48% of the office building property taxes. In response to document/information request #2-4 concerning other property related expenses, the utility states "Sanlando pays 48% of the landscaping fees and 50% of the electric bill. Sanlando does not pay any insurance on the building, we carry liability to protect against someone getting injured and we insure the contents."

Staff recomputed the rent on 5,774 sq ft at the net overall rate of \$12.18 or \$70,327 and it recommends reducing Sanlando's office rental by \$79,053. (\$149,381- 70,327) for the water and sewer utilities respectively at \$42,260 and \$36,793)

Disclosure No. 2

Subject: Water Conservation Program

Statement of Fact: Since 1993, Sanlando has charged \$91,097 or 84.3% of its water conservation program expenses to construction work-in-progress. These included \$77,600 in legal fees for protest of the reuse order, \$5,600 for the reuse system engineering, \$4,500 for two trips to Tallahassee by way of charter aircraft for Sanlando employees and guests, and \$3,000 for public meetings.

The legal expense charged to the conservation program were for appealing a Florida PSC reuse order, a failed attempt to obtain an IRS letter approving the collection of tax free CIAC and, golf course reuse.

Recommendation: The analyst should review the legal invoices in question and make a final determination about whether they are appropriate expenses for Sanlando's Water Conservation Program.

Disclosure No. 3

Subject: Management Fees

Statement of Fact: The company recorded \$81,600 in management fees for the period ending December 31, 1996. These services have been purchased from a related party, Greater Construction, Incorporated.

The company maintains that the basis for these costs are estimations made by management.

Recommendation: The basis for these costs billed by Greater Construction were estimations that were not supported by independent data such as employee time sheets.

The audit staff defers to the analyst assigned to this limited proceeding as to the proper treatment for these costs.

Audit Disclosure No. 4

Subject: Cove Lake Engineering Study

Facts: The utility retained the engineering firm of Post, Buckley, and Schuh & Jernigan, Inc. to determine the feasibility of routing water from Lake Brantley to the Cove Lake System.

The firm concluded that the project was too environmentally sensitive to implement, at which time the utility expensed the \$28,094.57 cost of the study via wastewater operating Account 731, Contractual Services-Engineering. The total consists of the following itemized charges.

<u>Description</u>	<u>Source/Date</u>	<u>Amount</u>
Technical consultation on water quality & improvements	INV.23761	
	CK. 16097	
	10-25-96	\$ 6,941.51
	INV.24185	
	CK. 16297	
	12/6/96	2,397.20
	INV.24463	
	11/30/96	464.92
	Cove Lake Feasibility Study	
	INV.24499	
	11/30/96	2,355.00
	INV.24756	
	12/31/96	<u>15,935.94</u>
		<u>\$28,094.57</u>

Recommendation: Staff is of the opinion that the total costs of the project be amortized over a reasonable period of time so as not to distort the operating results from the test year ended December 31, 1996.

Staff defers to FPSC Analyst for disposition of this matter.

EXHIBIT I

**SANLANDO UTILITIES CORPORATION
DOCKET NO. 971186-SU
WATER CONSERVATION PROGRAM
PERIOD ENDED DECEMBER 31, 1996**

DESCRIPTION	PER COMPANY	AUDIT EXCEPTION ⁽¹⁾	REFER TO ⁽²⁾	PER AUDIT
OPERATING REVENUES	\$100,032	\$0		\$100,032
	-----	-----		-----
OPERATING EXPENSES:				
PROTEST EXPENSE	\$68,460	\$0		\$68,460
LEGAL EXPENSE	\$10,746	\$0		\$10,746
WATER PROGRAM EXPENSE	\$7,667	\$0		\$7,667
REUSE ENGINEERING EXPENSE	\$5,605	\$0		\$5,605
TRAVEL EXPENSE	\$4,506	\$0		\$4,506
PUBLIC MEETING EXPENSE	\$3,030	\$348		\$3,378
MISCELLANEOUS EXPENSE	\$8,036	\$0		\$8,036
	-----	-----		-----
TOTAL OPERATING EXPENSE	\$108,050	\$348		\$108,398
	=====	=====		=====
NET OPERATING INCOME(LOSS)	(\$8,018)	(\$348)		(\$8,366)

REQUIRED FOOTNOTES:

- (1) Small differences are due to rounding.
- (2) Audit adjustments do not include audit disclosures.

EXHIBIT II

**SANLANDO UTILITIES CORPORATION
DOCKET NO. 971186-SU
OPERATING EXPENSES
PERIOD ENDED DECEMBER 31, 1996**

WATER OPERATIONS

DESCRIPTION	PER COMPANY	AUDIT (1) EXCEPTION	REFER TO(2)	PER AUDIT
OFFICE RENT EXPENSE	\$74,690	\$0		\$74,690
TRANSPORTATION EXPENSE	\$28,981	\$0		\$28,981
CONTRACTUAL EXPENSES:				
MANAGEMENT & CONSULTING	\$115,888	\$0		\$115,888
LEGAL	\$35,873	(\$19,080)	E-1	\$16,793
ENGINEERING	\$24,981	\$0		\$24,981
OTHER	<u>\$12,644</u>	<u>(\$5,420)</u>	E-3, E-4	<u>\$7,224</u>
TOTAL OPERATING EXPENSE	\$293,057	(\$24,500)		\$268,557

WASTEWATER OPERATIONS

DESCRIPTION	PER COMPANY	AUDIT (1) EXCEPTION	REFER TO(2)	PER AUDIT
OFFICE RENT EXPENSE	\$74,690	\$0		\$74,690
TRANSPORTATION EXPENSE	\$28,981	\$0		\$28,981
CONTRACTUAL EXPENSES:				
MANAGEMENT & CONSULTING	\$115,889	\$0		\$115,889
LEGAL	\$41,484	(\$16,920)	E-1	\$24,564
ENGINEERING	\$24,981	\$0		\$24,981
OTHER	<u>\$38,125</u>	<u>(\$24,703)</u>	E-2, E-3, E-4	<u>\$13,422</u>
TOTAL OPERATING EXPENSE	\$324,150	(\$41,623)		\$282,527

REQUIRED FOOTNOTES:

- (1) Small differences are due to rounding.
(2) Audit adjustments do not include audit disclosures.

EXHIBIT III

**SANLANDO UTILITIES CORPORATION
DOCKET NO. 971186-SU
PROFIT SHARING & MISCELLANEOUS LIABILITIES
PERIOD ENDED DECEMBER 31, 1996**

DESCRIPTION	PER COMPANY	AUDIT (1) EXCEPTION	REFER TO(2)	PER AUDIT
ACCRUED PROFIT SHARING	\$120,000	\$0		\$120,000
MISCELLANEOUS LIABILITIES	\$252,832	\$0		\$252,832
	-----	-----		-----
TOTAL LIABILITIES	\$372,832	\$0		\$372,832

REQUIRED FOOTNOTES:

- (1) Small differences are due to rounding.
- (2) Audit adjustments do not include audit disclosures.

STATE OF FLORIDA

Commissioners:
JULIA L. JOHNSON, CHAIRMAN
J. TERRY DEASON
SUSAN F. CLARK
JOE GARCIA
E. LEON JACOBS, JR.



DIVISION OF RECORDS & REPORTING
BLANCA S. BAYÓ
DIRECTOR
(850) 413-6770

Public Service Commission

March 4, 1998

Sanlando Utilities Corporation
Mr. Hampton P. Conley
Post Office Box 3884
Longwood, Florida 32791-0884

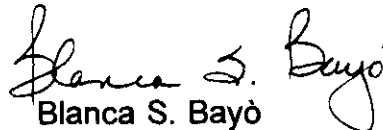
Re: Docket No. 97-1186 - SU - Sanlando Utilities Corporation
Audit Report - Limited Scope Audit of Accounts
Audit Control # 98-029-3-1

Dear Mr. Conley:

The enclosed audit report is forwarded for your review. Any company response filed with this office within ten (10) work days of the above date will be forwarded for consideration by the staff analyst in the preparation of a recommendation for this case.

Thank you for your cooperation.

Sincerely,


Blanca S. Bayó

BSB/cl
Enclosure
cc: Public Counsel
Division of Auditing and Financial Analysis
Lowndes Law Firm